

Chapter 20

Individual Health Insurance Coverages

■ Overview

In this chapter we examine individual health insurance coverage. After a discussion of major problems with the present health care system, the various forms of individual health insurance are examined. The most important individual health coverages include: major medical insurance, health savings accounts, long-term care insurance, and disability-income insurance. Next, important policy provisions found in individual health insurance coverage are examined. Finally, a number of important guidelines are discussed for purchasing individual health insurance coverage.

■ Learning Objectives

After studying this chapter, you should be able to:

- Explain the major health-care problems in the United States.
- Describe the basic characteristics of individual major medical insurance.
- Identify the basic characteristics of health savings accounts (HSAs).
- Describe the key characteristics of long-term care insurance.
- Describe the major characteristics of disability-income insurance contracts.
- List the guidelines to follow when purchasing individual health insurance.
- Define the following:

Accident-only policy
Activities of daily living (ADLs)
Benefit triggers
Calendar-year deductible
Coinsurance provision
Common-accident provision
Copayment
Disability-income insurance
Elimination period
Grace period
Guaranteed renewable policy
Health savings accounts (HSA)
Hospital confinement indemnity policy
Internal limits
Limited policy

Long-term care insurance
Major medical insurance
Noncancellable policy
Nonrenewable for stated reasons only
Optionally renewable policy
Out-of-pocket limit (stop-loss limit)
Partial disability
Preexisting-conditions clause
Preferred provider
Reasonable and customary charges
Reinstatement provision
Residual disability
Specified (dread) disease policy
Time limit on certain defenses
Total disability
Waiver of premium provision

■ Outline

I. Health-Care Problems in the United States

- A. Rising Health-Care Expenditures
- B. Large Number of Uninsured Persons in the Population
- C. Uneven Quality of Medical Care
- D. Waste and Inefficiency
- E. Health-Care Reform

II. Individual Health Insurance Coverages

- A. Major Medical Insurance
 - 1. High Lifetime Limits
 - 2. Broad Range of Benefits
 - 3. Deductible
 - 4. Coinsurance
 - 5. Out-of-Pocket Limit
 - 6. Exclusions
 - 7. Internal Limits
 - 8. Major Medical Insurance and Managed Care
- B. Health Savings Accounts
 - 1. Eligibility Requirements
 - 2. High-Deductible Health Plan
 - 3. Contribution Limits
 - 4. Favorable Tax Treatment
 - 5. Rationale for HSAs
- C. Long-Term Care Insurance
 - 1. Chance of Entering a Nursing Home
 - 2. Basic Characteristics
- D. Disability-Income Insurance
 - 1. Meaning of Total Disability
 - 2. Benefit Period
 - 3. Elimination Period
 - 4. Waiver of Premium
 - 5. Rehabilitation Provision
 - 6. Accidental Death, Dismemberment, and Loss-of-Sight Benefits
 - 7. Optional Disability-Income Benefits

III. Individual Medical Expense Contractual Provisions

- A. Renewal Provisions
- B. Preexisting-Conditions Clause
- C. Notice of 10-Day Right to Examine Policy

9. What is a renewal provision and why is the renewal provision important?
10. Carla purchased a major medical health insurance policy. A number of questions have developed with regard to the coverage. Which policy provision should Carla review for clarification?
- (a) Her insurer denied a claim because Carla lied on the application. Carla does not believe the insurer has the right to deny the claim.
 - (b) Carla was treated for high blood pressure three months before purchasing the coverage. Her insurer denied a claim for treatment of high blood pressure two months after Carla purchased the policy.
 - (c) Carla received a notice from her health insurer that her premium would increase and that if she did not pay the higher premium, the coverage would not be renewed. Carla does not believe the insurer has the right to raise premiums or not renew her coverage.
 - (d) Carla forgot to pay the premium that was due last week. She wonders if she can still pay the premium and have coverage in force.

11. What suggestions do consumer experts offer when shopping for individual health insurance?

■ Multiple Choice Questions

Circle the letter that corresponds to the BEST answer.

1. How are surgeons and physicians commonly reimbursed under individual major medical health policies?
 - (a) based on a fee schedule
 - (b) at the physician or surgeon's discretion
 - (c) based on reasonable and customary charges
 - (d) using a flat hourly rate regardless of the service delivered

2. Which statement is true with regard to individual major medical insurance?
 - I. The coverage provided is broad in scope.
 - II. Major medical insurance plans emphasize first-dollar coverage by the insurer.
 - (a) I only
 - (b) II only
 - (c) both I and II
 - (d) neither I nor II

3. Susan's health insurance coverage cannot be canceled, is guaranteed renewable to age 65, and under no circumstances can her premium be increased. What type of renewal provision is found in Susan's health insurance coverage?
 - (a) renewable at the insurer's option
 - (b) conditionally renewable
 - (c) guaranteed renewable
 - (d) noncancellable

4. All of the following are major problems with the health care system in the United States EXCEPT:
- (a) rising health care expenditures
 - (b) waste and inefficiency
 - (c) uneven quality of medical care
 - (d) too many people covered under the present system
5. Ted's health insurance lapsed because he didn't pay the premium on time. Ted wants the coverage back in force. Which policy provision explains the requirements he must satisfy to place the coverage back in force?
- (a) time limit on certain defenses
 - (b) renewal provision
 - (c) reinstatement provision
 - (d) claims provision
6. All of the following are characteristics of health savings accounts (HSAs) EXCEPT:
- (a) Contributions to a qualified HSA are income tax deductible.
 - (b) There is no annual contribution limit to an HSA.
 - (c) HSAs are used in conjunction with a high deductible health plan.
 - (d) HSA investment income accumulates income tax-free and distributions are tax-free if used to pay qualified medical expenses.
7. Which statement is true with regard to long-term care insurance?
- I. This coverage is not needed if you are covered under Medicare.
 - II. Coverage is typically provided for skilled nursing care and custodial care.
- (a) I only
 - (b) II only
 - (c) both I and II
 - (d) neither I nor II
8. Health insurance typically includes a two-year discovery period after which the insurer can't void coverage or deny a claim because of concealment or misrepresentation by the applicant. This provision is called:
- (a) the time limit on certain defenses provision
 - (b) the recurrent disability provision
 - (c) the renewal provision
 - (d) the reinstatement provision
9. All of the following are characteristics of major medical insurance EXCEPT:
- (a) coinsurance (percentage participation)
 - (b) deductibles
 - (c) high limits
 - (d) no exclusions

10. All of the following are characteristics of long-term care insurance EXCEPT:
- benefit triggers used to determine eligibility for benefits
 - inflation protection
 - elimination (waiting) periods
 - unlimited benefits
11. Which statement is true with regard to disability-income insurance?
- An increase in the elimination period will decrease the premium.
 - Disability can be defined in a number of ways.
- I only
 - II only
 - both I and II
 - neither I nor II
12. Tina's health insurance coverage includes a provision that excludes from coverage physical or mental conditions that existed prior to issuance of the policy and were not disclosed on the application. This provision is the:
- preexisting conditions clause
 - second injury clause
 - recurrent disability clause
 - renewal provision

■ True/False

Circle the T if the statement is true, the F if the statement is false. Explain to yourself why a statement is false.

- T F 1. Major medical insurance policies typically cover the daily cost of a semi-private hospital room.
- T F 2. The economic loss from long-term total disability can be greater than the economic loss that results from premature death.
- T F 3. The guaranteed renewable renewal provision provides the greatest security to a health insurance purchaser.
- T F 4. Long-term care insurance is expensive.
- T F 5. Although the United States spends a significant percentage of gross domestic product on health care, not everyone has health insurance coverage.
- T F 6. Disability income insurance usually replaces all of a disabled person's lost income.
- T F 7. Consumer experts agree that dread disease policies are a wise purchase.
- T F 8. Under a common accident provision in major medical insurance, only one deductible must be paid if two family members are injured in the same accident.
- T F 9. Residual disability refers to whether a second disability is considered a continuation of a prior disability or considered a new disability.

- T F 10. Contributions to health savings accounts (HSAs) are tax deductible.
- T F 11. A single, uniform, definition of disability is used in all disability income policies.
- T F 12. High deductible health savings account plans limit annual out-of-pocket expenses.

■ Case Applications

Case 1

Sarah purchased a major medical insurance policy that included a \$250 deductible and an 80-20 coinsurance (percentage participation) provision. She required medical care and the cost of the care provided was \$40,750. How much of this amount must Sarah pay and how much will her insurer pay? How would your answer change if Sarah's policy included a \$3000 out-of-pocket (stop-loss) limit that applied to coinsurance payments?

Case 2

Mark works for a company that does not provide any group health insurance benefits to its employees. Mark is the treasurer and earns \$160,000 per year. Although covered by workers' compensation and Social Security, Mark is considering the purchase of a private disability income policy. A number of questions have arisen regarding the coverage. How would you respond to the following questions/concerns?

- a. Mark wonders if the coverage is really necessary because he is covered by workers' compensation and Social Security.

- b. Mark asked an agent to quote the premium for complete replacement of his work earnings as soon as Mark is disabled. The premium was much higher than Mark anticipated. How can he reduce the premium?
- c. Mark wonders how sick or badly injured he must be in order to collect benefits under a disability income insurance policy. He is convinced that if he is sick or injured, regardless of the severity of the impairment, the insurer will say that he is not eligible to collect benefits.

■ Solutions to Chapter 20

Short Answer Questions

1. There are many problems associated with the present health care system in the United States. The major problems include: rising health care expenditures, large number of uninsured people, uneven quality of medical care, and considerable waste and inefficiency.
2. About nine out of ten people under age 65 who are covered by health insurance are covered by a group health plan.

The most important types of individual health insurance are: major medical insurance, health savings accounts, long-term care insurance, and disability income insurance.

3. A typical individual major medical insurance policy has the following characteristics: high lifetime limits, broad range of benefits, deductibles, coinsurance, out-of-pocket limit, exclusions, and internal policy limits.
4. The coinsurance provision in major medical insurance is simply the cost sharing percentages after the deductible has been met. If the major medical plan includes an 80-20 coinsurance provision, the insurer pays 80 percent of covered medical expenses after the deductible has been satisfied and the insured pays the other 20 percent. Case 1 illustrates a major medical coinsurance settlement.
5. Managed care plans are health benefit plans that provide benefits to insureds in a cost-effective manner. There is a heavy emphasis on controlling costs and providing benefits to insureds in a cost-effective manner.

A preferred provider organization (PPO) contracts with physicians, hospitals, and other health care providers to deliver medical services to members at discounted fees. Insureds have a strong financial incentive to receive care from preferred providers because of lower deductibles and coinsurance charges. Care received outside the network is covered, but deductibles and copays are higher.

6. A health savings account (HSA) is a tax exempt or custodial account established exclusively for the purpose of paying qualified medical expenses of the account beneficiary who is covered under a high-deductible health insurance plan. Certain requirements must be met to be eligible to establish an HSA. First, you must be covered by a high deductible health plan and no other comprehensive plan that is not a high deductible plan. Second, you must not be eligible for Medicare benefits. Finally, you must not be claimed as a dependent on someone else's tax return.
7. The basic characteristics of long-term care insurance include: coverage for skilled nursing, intermediate nursing care, and custodial care; choice of benefits; an elimination period; a benefits trigger tied to activities of daily living and cognitive impairment, inflation protection, the coverage is guaranteed renewable, the coverage is expensive, and long-term care insurance receives favorable income tax treatment.
8. Insurers limit the replacement of income under disability income policies to prevent overinsurance and to reduce moral hazard and malingering. In addition, some work-related expenses do not continue in the case of disability.

Total disability can be defined in several ways. Common definitions include: inability to perform all duties of your job or occupation, inability to perform duties of any occupation for which you are reasonably suited by education and experience, inability to perform duties of gainful employment, and some insurers define total disability in term of the loss of income after the illness or injury.

9. A renewal provision specifies under what conditions the coverage can be renewed and if the insurer can raise the premium for the coverage. A number of different renewal provisions are found in individual health insurance plans. As this provision specifies the conditions for coverage continuation and the cost of coverage, it is a critical issue.
10.
 - (a) Carla should review the time limit on the certain defenses provision. Under this provision, the insurer can deny claims based on concealment and misrepresentation during the first two years of coverage.
 - (b) Carla should review the preexisting conditions clause in the policy. Through this clause, the insurer can avoid liability for conditions present when the coverage went into effect.
 - (c) Carla should review the renewal provision included in her health insurance policy. Depending on the provision, the insurer may be well within its rights to increase the premium and to not renew her policy.
 - (d) As the premium was due last week, Carla is protected through the grace period provision. This mandatory provision typically extends coverage for up to 31 days if the premium payment is late.
11. Consumer experts offer the following suggestions when shopping for individual health insurance coverage:
 - Insure for the catastrophic loss.
 - Consider group health insurance first.
 - Purchase a policy that has a preferred provider network.
 - Don't ignore disability-income insurance.
 - Avoid limited policies.
 - Watch out for restrictive policy provisions and exclusions.
 - Use deductibles and elimination periods to reduce premiums.

Multiple Choice Questions

1. (c) Surgeons and other physicians are commonly reimbursed on the basis of reasonable and customary charges which vary by insurer.
2. (a) Only the first statement is true. Major medical coverage is broad in scope. Major medical insurance does not emphasize first-dollar coverage. Indeed, there are several types of deductibles used in major medical plans.
3. (d) Susan's health insurance policy contains the most favorable and most expensive renewal provision. This type of renewal provision is called "noncancellable."
4. (d) Lack of coverage, rather than "too many people covered," is a major problem. Millions of Americans have no health insurance coverage.
5. (c) An explanation of how to put lapsed coverage back in force is provided in the reinstatement provision.

6. (b) There are annual contribution limits to HSAs. The limits apply to individuals and to family coverage plans. The limits are indexed each year for inflation.
7. (b) Only the second statement is true. Medicare only covers skilled care for a limited time per benefit period and custodial care is excluded. Private long-term care plans typically cover skilled care, intermediate nursing care, and custodial care.
8. (a) The time limit on certain defenses provision provides for a two-year discovery period. This provision is similar to the incontestable clause in life insurance.
9. (d) Major medical insurance policies contain a number of common exclusions. Major medical plans typically have the other characteristics listed (coinsurance, deductibles, and high limits).
10. (d) Benefits are limited under most long-term care policies. There are daily limits, such as \$100 or \$120 per day; and a limit placed on benefits paid over the insured's lifetime, such as \$250,000 or \$500,000.
11. (c) Both statements are true. If you increase the elimination period, it increases the time period you must wait to receive benefits. This change is analogous to increasing the size of a deductible. There are several definitions of disability used in private disability insurance coverages.
12. (a) Such a provision is called a preexisting conditions clause.

True/False

1. **T**
2. **T**
3. **F** Although the coverage is guaranteed renewable, the insurer can increase premiums for the entire underwriting class. The noncancellable renewal provision provides coverage that is guaranteed renewable until a specified age and also specifies that the premium cannot be increased.
4. **T**
5. **T**
6. **F** Disability-income insurance typically replaces less than all of the disabled person's lost income. Most insurers limit the amount of income replaced to no more than 60 to 80 percent of the person's gross earnings. Replacing less than the full amount of lost income reduces moral hazard and provides an incentive to recover and to return to work.
7. **F** Dread disease policies (e.g., cancer insurance) are not recommended by consumer experts. These policies are narrow, providing benefits only if you have the "correct" illness.
8. **T**
9. **F** Residual disability refers to a reduction in earnings because of the accident or sickness once the worker is able to return to the work force.

10. **T**
11. **F** There are variations in the definition of disability. That is why it is important to review the definition of disability before you purchase coverage.
12. **T**

Case Applications

Case 1

With the deductible, Sarah is responsible for the first \$250 of covered medical expenses. Then the remaining expenses are shared on an 80 percent/20 percent basis:

Eligible medical expenses	\$40,750	
Deductible (Sarah pays)	<u>-250</u>	
Expenses to be shared	\$40,500	
	The insurer pays 80% of this amount \$32,400.	Sarah pay 20% of this amount, \$8,100.

So Sarah would pay a total of \$8350 (\$8100 + \$250), and the insurer would pay \$32,400.

As \$8350 is a large out-of-pocket expense, many major medical insurance policies contain an out-of-pocket limit (stop-loss limit). This provision caps out-of-pocket expenses of the insured at a specified amount after the deductible is satisfied. If the policy included a \$3000 stop-loss limit that applies to coinsurance, Sarah would pay only \$3250 (\$3000 plus the deductible), and the insurer would pay the balance.

Case 2

- Private disability income insurance is a necessary coverage. It provides benefits in case of nonoccupational disability. Workers' compensation will pay for work-related illness and injury only. Social Security uses a harsh definition of disability and requires serving a 5-month waiting period before benefits are paid. An individual disability income policy would be a wise purchase for Mark.
- Mark can get a lower premium by reducing the level of income replaced, for example, 75 percent or 80 percent income replacement. He can also include an elimination (waiting) period in the contract. The elimination period is a period of time after the disability occurs during which no benefits are paid. The longer the elimination period, the lower the premium.
- Whether Mark will be able to collect benefits under the disability income policy will be determined by his condition and the definition of disability stated in the policy. If Mark satisfies the definition of disability stated in the policy, he should be able to collect disability income benefits. Several different definitions of disability are used. For example, disability may be defined in terms your current job, any job you could perform based on your training and experience, etc.