Health Insurer's Premium Practices Add to Profit Surge, Roil Customers
Chad Terhune, WSJ 4-9-02 *summary slides and articles follow*

American Medical

Price Customization – Fixing the Losers

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- American Medical reviews customers' health and "reunderwrites" premiums at each annual renewal: if they have developed a chronic disease in the past 12 months or filed claims that seem to foretell more claims to come, it raises their premiums.
- While minimizing price increases for healthy customers who file few claims, American Medical, slaps those who are less healthy with double-digit increases year after year.
- American Medical recorded a 56% earnings increase last year, which its chief executive attributed partly to "aggressive rate action."
- American Medical's stock recently hit a 52-week high.

Price Customization
Health Insurance

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Each year when people's individual health insurance comes up for renewal, American Medical Security sorts them by health and claims filed, and raises their rates accordingly.

Category	Preferred	Manual	Sub-standard
Description	Healthiest	Less Healthy	Least Healthy
Claims	Fewest	Some	Most
Renewal Rate	40%	40%	20%
Rate Increase	ATB*	ATB* + 5%	ATB* + 37%
Loss Ratio	$0.21	$0.48	$1.71
**Across-the-board*			

Health Insurer's Premium Practices Add to Profit Surge, Roil Customers

Chad Terhune, WSJ 4-9-02 **Note: Follow-up article follows**

Shaneen and Tom Wahl were paying $417 a month for health insurance when Mrs. Wahl was diagnosed with breast cancer in 1996. Their premiums began rising steadily, and by August 2000, the Wahls were told their new rate would be $1,881 a month.

Mrs. Wahl, whose cancer was in remission, tried to find out why. Unsatisfied with answers they got on the phone, the Port Charlotte, Fla., couple visited the Wisconsin offices of the insurer, American Medical Security Group Inc. There, Mrs. Wahl says, an executive explained why her premium was soaring: "because of your dread disease."

It's called reunderwriting. Normally, companies that sell health insurance to individuals evaluate their medical history just once, at the outset. American Medical reviews customers' health at each annual renewal. If they have developed a chronic disease in the past 12 months or filed claims that seem to foretell more claims to come, it raises their premiums.

This isn't unusual in some types of insurance, such as auto and homeowners' coverage. Drivers who have accidents or get speeding tickets can expect to see their premiums rise. But reunderwriting of individual health insurance faded away in the 1950s, in part because of regulatory pressure. Now, the practice is making a quiet comeback -- a sign of how soaring health-care costs are driving some insurers to aggressive practices that can have severe consequences for consumers.

American Medical, while minimizing price increases for healthy customers who file few claims, slaps those who are less healthy with double-digit increases year after year. To pay, some squeeze their budgets, cutting out restaurant meals and tuition savings for their children. One Florida woman took out a second mortgage. Others boost their deductible to limit the rate increase, leaving themselves on the hook for more medical expenses. The Wahls raised their deductible to $2,500 from $500, bringing the threatened $1,881 monthly rate down to $887.

Once family members become sick, their American Medical policy is often the only option, apart from finding a job that offers insurance. Other companies usually won't insure an applicant who has a serious medical condition, or will offer only a policy that excludes that condition.

'I Try to Ignore the Pains'

Policyholders who become aware of reunderwriting say they sometimes hesitate to see a doctor for fear of giving the company reason to raise its rates. Ed Bonsignore, a 58-year-old who had a heart attack four years ago, was notified of a 60% rate increase at his last renewal date. He says that although his doctor has told him to go to a hospital if he feels chest pains, he just takes a nitroglycerin tablet and tries to relax. "They make you scared to use your insurance because they just keep jacking up your rates," he says. "I try to ignore the pains. Either I drop dead or it blows over."

He and his wife, Marie, retired restaurateurs in Palm Beach Gardens, avoided their most recent increase by raising their deductibles to a steep $9,000 apiece.

American Medical's tactics have helped its performance during a tough time for the industry. Rising drug costs, advances in medical technology, an aging population and the retreat from tightly managed care are increasingly pressuring insurers' profits. But American Medical recorded a 56% earnings increase last year, which its chief executive attributed partly to "aggressive rate action." Its stock has just hit a 52-week high.

Glimpse of the Future?

Although the company, with under $1 billion in annual revenue, is far from a health-insurance giant, its moves could herald a new strategy for a beleaguered industry. A competitor, American Republic Insurance Co., recently adopted a form of reunderwriting.

"People in good health are demanding some kind of discount for not using their coverage," says Rod Turner, a vice president of the Des Moines, Iowa, company. And "if someone gets a discount for no claims, then someone has to get higher premiums for having claims. The industry is moving in that direction."

This fall, an insurance-industry work group plans to ask state regulators to be more open to individual reunderwriting. "If regulators can overcome their emotional reaction and allow it to happen, I think it could be a useful tool in managing health-care costs," says Bill Bluhm, chairman of an American Academy of Actuaries task force on rates.

Some insurers remain opposed, and others are watching to see how much resistance American Medical faces. Three states have ordered the company to stop reunderwriting. Now Florida is trying to bar American Medical from selling insurance at all in the state.

Administrative Complaint

In an administrative complaint, Florida's insurance department accuses American Medical of illegally discriminating against customers based on their health. It also says the company violates unfair-trade-practices law by not warning policyholders that getting sick may drive up their rates. In addition, a class-action suit seeks refunds and damages for nearly 12,000 American Medical customers in Florida. The company sells individual policies in 27 states and says it uses reunderwriting in more than half of them.

American Medical says there is no discrimination because customers who present the same health hazard are treated the same. As for informing them their health could affect future premiums, it says that's up to the independent agents who sell the policies. American Medical also says it isn't covered by many of Florida's rules because of the way it markets to Floridians: They buy through a nonprofit association incorporated in Ohio, a state that doesn't regulate health-insurance rates.

Individual policies account for 10% of private health insurance in the U.S., the rest being mostly employers' group plans. Nothing in federal law bars insurers from reunderwriting these individual policies each year. But a 1996 federal law prevents insurers from canceling a policyholder for getting sick. It says all the policies must be "guaranteed renewable." Some regulators take this to mean insurers have to charge the same premium increases across a particular policy type or block of business. American Medical disagrees. It says coverage is guaranteed, but rates are not.

How It Works

At American Medical, shortly before a customer's annual renewal date, a computer program reviews any claims he or she has filed over the past 12 months for doctors' visits, prescriptions or medical procedures, as well as any disease diagnoses. It assigns points to various diagnoses and claims, based on their likelihood of generating future claims. A broken leg that heals normally wouldn't trigger higher premiums, explains chief actuary James Modaff. But a diagnosis of a chronic disease might, even if no claims have yet been filed.

In this annual review, the company puts each person into one of three tiers: preferred, manual or substandard. About 40% are preferred. The only rate increases they face that year are across-the-board ones based on medical inflation, unless they changed their benefits or moved to an area where medical costs are higher.

Another 40%, labeled manual, get a 5% rate increase that is due to their health and claims. The 20% or so in the substandard tier includes people with conditions such as cancer or diabetes. In addition to companywide increases, they face a 37% rise in their monthly premium that year and each year they stay in this tier.

American Medical says these tiers help it adjust, in part, for the risks of insuring the different groups. It says that for each dollar of premium from the preferred group, it pays out only 21 cents in claims. But in the substandard group, it pays out $1.71 in claims for each dollar of premium.

After Mrs. Wahl was diagnosed with cancer in September 1996, she says she and her husband paid a total of $18,180 in premiums over three years. The company paid $37,298 in claims for them in this period, she calculates, based on its paperwork. But Mrs. Wahl also estimates that in her full eight-plus years as a customer, her premiums have exceeded claims by about $10,000. The company declines to comment on her case or that of any other customer, citing privacy and the litigation.

Timothy Moore, American Medical's general counsel, says rate increases are "based on an individual's experience, just like auto or homeowners' insurance. If the risk changes, the premiums change."

Insurance regulators and researchers say health insurance is different, for several reasons. First, they say drivers and homeowners have more control over the likelihood of having a claim than people have over their health. Some state regulators also view health insurance differently because the stakes are higher. They note that reunderwriting could price people out of the market, leaving them uninsured and unable to afford medical care when they need it most.

"Their analogy between auto and health insurance is simply false, it's nonsense," says Joseph Belth, professor emeritus of insurance at Indiana University. "I am absolutely astounded they do this."

At most health insurers, buyers of individual policies are initially charged varying prices, based on medical history. Then all face roughly the same annual percentage increase, reflecting medical inflation and the claims filed by an entire policyholder group.

A key challenge in individual health insurance is keeping the healthier people enrolled. Their premiums are needed to subsidize those who get sick. The problem, under the traditional approach, is that the healthiest tend to drop out as rising medical costs gradually drive up premiums. As they drop out, the pool gets more and more concentrated with sick people and premiums go up and up, in what the industry calls a "death spiral."

Advocates of reunderwriting argue that because it gives smaller rate increases to the healthy, it keeps more of them enrolled and paying premiums, so that over the long run, it may help hold down rates. "Our tier-rating approach encourages more healthy people to remain in the system and keep rates lower for everybody," says American Medical's Mr. Modaff.

Up 60%

Arlene Shallan, a widow in Boca Raton, bought American Medical health coverage in 1994 because her job at a clothing store didn't provide any. In July 2000, she says, she broke down in tears when she opened a letter saying her premiums would soar 60% to $1,318 a month. A 37% health-related increase can reach 60% when companywide increases are added. Mrs. Shallan's new premium was more than her mortgage payment.

She called Susan Nelson, the company's underwriting chief, whose signature was on the notice. According to Mrs. Shallan, Ms. Nelson "asked, 'Do you know that you are a diabetic? Do you realize how terrible diabetes is?' I told her, 'What can I do about it? Someday we all get sick.' " The company says Ms. Nelson declines to comment.

Mrs. Shallan says she tried other insurers but none would sell her a policy because she had diabetes. Recently she turned 65, qualifying for Medicare.

Other Floridians were caught by another American Medical move that had the same effect as reunderwriting. Although insurers can't refuse to renew an individual policy, they can cancel an entire group. In 1999, American Medical canceled all of its policies held by Floridians, policies it had technically sold them through an Alabama trust. Then it offered them new policies purchased though a nonprofit group in another state. But for people whose health had worsened, the new policies were priced higher, sometimes several times as high.

Mary Rogers, who was paying $429 monthly, had just suffered a stroke. The new policy offered to her in 1999 had a premium more than triple the old one, $1,448 a month. This was more than twice the Social Security disability checks received by the former food-service worker.

Her children chipped in, but it still wasn't enough, so she took out a second mortgage on her home in Hollywood, Fla. "My mother had paid her premiums on time since 1994," says a daughter, Terry Rogers. "They can't be allowed to do what they have done." Mrs. Rogers complained to state regulators and is now a plaintiff in the class-action suit, in state court in West Palm Beach.

After negotiations between regulators and American Medical, the company agreed to cap the 1999 increases at 100%, and Mrs. Rogers's monthly premium went to $838. She has since become eligible for Medicare and dropped the policy.

Older customers like her bear the brunt of rate increases, since they are more prone to illness. But Larry and Dawn Smith, a couple in their 30s with two small children, also were snared. Mr. Smith had back surgery in 1999 and also learned he had HIV, which he says came from a transfusion. When American Medical canceled its Florida policies and offered new ones, the one he got in late 1999 doubled his premium to $217.

Later, the company placed him in its "substandard" tier and gave him 60% rate increases in 2000 and 2001. Mr. Smith limited one increase by raising his deductible. He currently pays $455 a month.

His wife and children had a separate policy. In February, the company deemed that one substandard as well, after three-year-old Savanna was diagnosed with a kidney ailment. The premium jumped 60% to $382. Unable to afford it, Mrs. Smith dropped the insurance and took a job as a pet groomer to help pay her husband's premiums.

"All the luxuries people take for granted get shaved away. Christmases and birthdays get cut back. At one time, we were putting money into a prepaid college-tuition account," says Mr. Smith, a former air-conditioning repairman who is 33. "They know I have HIV, and they know I can't go anywhere else."

From the point of view of insurance companies, individual health coverage is one of the least-attractive business lines. For one thing, it's much more expensive to sign up and bill customers one by one than to insure, say, an entire work force. In addition, while a work force includes many healthy people who are in the coverage pool simply because of their job, sellers of individual policies face "adverse selection": A certain percentage of customers are buying the policies because they expect to have claims to file.

Making It Work

Nonetheless, American Medical Security has prospered by selling more individual policies. The Green Bay, Wis., company had a hefty $25.9 million net loss in its first full year after going public in late 1998, a time when its main business was selling group insurance to small companies. As that line faced stricter regulation, the company turned more to individual policies. It had first tried annual reunderwriting with some of these in 1993, and the practice grew along with its focus on individual policies, which now are 45% of its business. The company posted a $2.7 million net profit in 2000 and increased that to $4.2 million last year.

American Medical says reunderwriting doesn't boost premium revenue. Though it raises premiums for those who fall ill or appear likely to file claims, it holds down rates for those in good health. Overall revenue declined 11% last year, to $877 million. Annual reunderwriting "is not a methodology to develop more profits or premium [but] to create a stable underwriting environment," says Mr. Moore, the general counsel.

However, the pricing system can help the bottom line if it encourages those who file very few claims to stay enrolled and those who file a lot of claims to leave.

While American Medical insured 19% fewer people last year than in 2000, the average policy became significantly more profitable.

Its "loss ratio" -- how much of each premium dollar the company spent on claims -- improved sharply to just 72.6% last year from 77.2% the year before, meaning it kept more of each premium. Overall, health insurers paid out 79.2% of premiums in claims in 2000, says rating firm A.M. Best Co.

American Medical Chief Executive Samuel V. Miller, in announcing improved 2001 results, ascribed them partly to "aggressive rate action over several quarters." Investors have been impressed. On the New York Stock Exchange, the stock hit a 52-week high of $17.94 Monday.

Some rivals think American Medical's pricing tactics give it an unfair edge.

"It is extremely frustrating to be competing in an unlevel manner," says Steven Smith, director of state legislative relations at Blue Cross and Blue Shield of Florida Inc.

That company says it considers reunderwriting of individual health policies illegal and wouldn't consider it.

Another rival, Fortis Health, is closely watching American Medical's experience with reunderwriting. "If it's done in a modest way, I think it can be helpful," says Jim Oatman, a top Fortis actuary. But "if it's done in the extreme, you are asking people to pay for their claims ... . You are taking away the insurance contract they were promised at the point of sale."

Who's Told What

Uniformly, Florida customers say they weren't made aware of American Medical's pricing system when they bought insurance. The company says explaining this to customers is the responsibility of the 25,000 independent agents who sell its policies. "Our agents by and large are or should be aware of how we do renewal underwriting," Mr. Moore says. "We are very upfront about it."

But many agents say they didn't realize the company raised premiums to reflect claims or diagnoses. Jay Horowitz of Bonita Springs, Fla., a top seller, says he found out about reunderwriting only when he asked a company manager why many of his customers had big increases. "Reunderwriting has never been discussed in any of the classes" the company holds to train agents, Mr. Horowitz says.

Some Florida agents say that in January, the notices they got about customers' rate increases began to include more detail, showing what part of the increase was a "diagnosis adjustment." The company won't say whether customers now get the same breakdown. Those in Florida don't appear to, but one in Wisconsin did.

Outraged

Miami insurance agent George Bernstein quit selling American Medical policies, outraged, he says, that the premium for a 64-year-old client who has diabetes and a cardiac pacemaker jumped 60% on April 1 to $4,861 a month, or $58,332 a year. It was just $252 a month when she bought her coverage nine years ago. "It's highway robbery," says Mr. Bernstein, whose granddaughter also faced health-related increases from American Medical. "I have been in this industry 48 years, and this is the most egregious handling of people I have ever seen." He says his client intends to pay the new premium. She won't discuss the case, nor will American Medical.

A few states have ordered the company to stop reunderwriting. Alabama did so in 1999, Colorado in 2000 and Michigan this past December. Colorado negotiated refunds for customers, from a few hundred dollars to $6,000. Last year, Louisiana regulators also grew concerned, but they found nothing in state law that barred the practice. The company agreed to a 300% lifetime cap on increases there.

About a half-dozen states not only bar reunderwriting, but don't even let companies do individual underwriting when they first sign up customers. These states, including New York and New Jersey, make insurers charge everybody in a certain geographic area the same rates, regardless of health, age, sex or smoking habits. American Medical avoids those states.

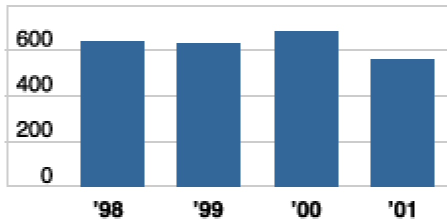
In Florida, American Medical aims not to let premiums rise more than 60% at a time. This "was an arbitrary number which was believed to be the percent at which we start receiving complaints," the company's underwriting director, John McVey, wrote in a May 2000 memo. Outside of Florida, the cap is generally 75%. The company also has a lifetime cap, which limits rates to no more than 500% of its current lowest available rate.

American Republic Insurance in Des Moines recently began its own variety of annual reunderwriting. At renewal time, it imposes 7% increases on health-insurance customers if it spent 61% or more of their premium to pay claims in the past 12 months. On the flip side, if it paid out no more than 16% of their premium in claims, it gives them what the company calls a 7% "good-health discount."

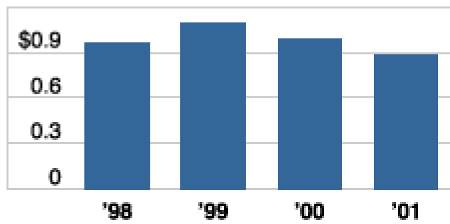
AMERICAN MEDICAL SECURITY

It provides health insurance to fewer people...

Enrollment, in thousands

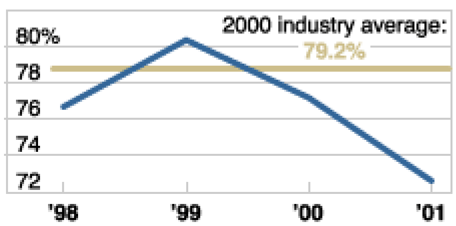


Revenue, in billions

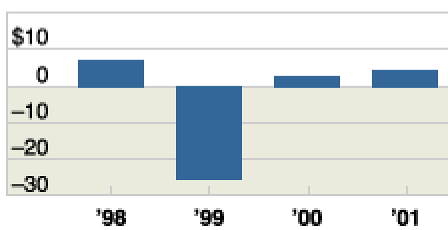


But becomes more profitable

Loss ratio, the percentage of each premium dollar paid out in claims



Net income/loss, in millions



Note: Includes both group and individual insurance

Sources: American Medical Security; A.M. Best

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American Medical Plans To Stop 'Reunderwriting'

Wall Street Journal, August 7, 2002

American Medical Security Group Inc., which championed the practice of raising individuals' health-insurance premiums when they become ill or file claims, said it would stop the practice -- known as "reunderwriting" -- in 20 states effective Jan. 1.

The decision by the Green Bay, Wis., company to entirely quit reunderwriting sick policyholders is a blow to the controversial rating practice, which has captured the interest of many insurers selling individual policies. Rising health-care costs have forced insurers and state regulators to explore new ways to keep coverage affordable in a country with 38 million people uninsured.

Proponents of reunderwriting, which is also called tier rating, say that it limits rate increases for the healthiest customers and encourages them to remain insured. In the long run, they say, this helps keep rates lower for everybody. But some insurance companies and industry observers reject reunderwriting as punishing the sick and violating the basic tenet of risk-sharing in insurance.

Reunderwriting snared Larry and Tracy Rawls of Pflugerville, Texas, earlier this year. American Medical told the couple that the premium for them and their two children would increase 75% in May to $764 per month. Ms. Rawls, 42 years old, said the company told her the family's rates increased primarily because she was diagnosed with breast cancer in December and had to undergo chemotherapy and surgery. That accounted for more than half their increase; they also received an across-the-board rate increase.

"I shouldn't be penalized for getting cancer," said Ms. Rawls, who said she can't find other insurance because of her medical condition. She said she hopes American Medical's decision may offer some relief from further double-digit rate increases.

A spokesman for American Medical said the company still believes that reunderwriting "is an acceptable and appropriate way of rating our business." The company declined to comment on individual policyholders.

But in a statement explaining the decision Tuesday, American Medical Chairman and Chief Executive Samuel V. Miller said "we cannot risk the long-term confidence of our agents and insureds because of misperceptions about tier rating."

A spokeswoman for U.S. Sen. Bob Graham (D., Fla.) said he still plans to sponsor legislation next month that would prohibit insurers from targeting individuals for premium increases based on their health.

Last month, the Florida Department of Insurance suspended the license of American Medical for one year over its use of reunderwriting. A state appeals court has lifted the suspension pending an appeal from the company. Shortly after that decision, American Medical announced it would stop reunderwriting in Florida and switch to the more traditional method of "block rating," where insurers generally charge the same premium increases across a particular policy type. The company now will make the same change in another 20 states where it has reunderwritten individual policies.

"We are generally pleased by [American Medical's decision] because the practice of reunderwriting at renewal violates state law," said William Goodman, a special counsel for the Texas Department of Insurance. "Any company that engages in this practice will come under our scrutiny." He declined to comment on whether American Medical was the subject of any state investigation.

American Medical said Tuesday's decision isn't expected to have "any material effect on future earnings." In the past year, American Medical's share price has nearly tripled. In 4 p.m. New York Stock Exchange composite trading Tuesday, the company's shares were up 40 cents at $13.40.