GUARANTEED RENEWABILITY IN HEALTH INSURANCE: TAKING INTO ACCOUNT CHANGES IN RISK STATUS AND COST OF DYING

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IMPORTANCE Guaranteed renewability protects policyholders from reclassification risk. Being an important characteristic of social health insurance, the potential for private insurance markets is high given its property of competing with risk selection. Without regulation, since healthcare expenditures increase strongly near death, it seems questionable whether insurers will be able to sustain guaranteed renewability in the long run - rather than investing in risk selection activity.

OBJECTIVES In this study, we extend the seminal model of Pauly et al. (1995) to include (1) policyholders with improving risk status over time, and (2) policyholders' high cost of dying. The objective is to find out about the actuarially fair guaranteed renewable premium in realistic conditions when taking into account these two extensions.

FINDINGS It is shown that the actuarially fair guaranteed renewable premium in realistic conditions becomes lower, suggesting that prior studies have overestimated the economic cost of guaranteed renewability, making it more affordable and accessible in practice. Our findings illustrate the potential to overcome the common market failure associated with risk selection by introducing guaranteed renewability into an existing risk-based system.

CONCLUSION & RELEVANCE When health insurance premiums are risk-based and do not protect against reclassification risk, younger and healthier individuals may not purchase coverage, while older and sicker individuals have no choice and are left with excessively high premiums as they grow older. If guaranteed renewability becomes more affordable and accessible, younger individuals may have a higher incentive to "lock-in" their health insurance premiums, and such a market failure may more easily be overcome by introducing guaranteed renewability as a contract feature into an existing risk-based system. Hence, as a result of the analysis in this paper, introducing guaranteed renewability may be a way to ensure long-term health insurance coverage without risk selection issues for an entire population. For regulators concerned about adverse selection and cream skimming, the alternative to guaranteed renewability would be to maintain strong regulatory rules, which entail community rating and limits on risk rating. Guaranteed renewability can alleviate market failures due to adverse selection, and at the same time requires less regulation than in a purely risk-rated system.