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ADDRESSING MARKET SEGMENTATION AND INCENTIVES FOR RISK SELECTION

HOW WELL DOES RISK EQUALISATION IN THE IRISH PRIVATE HEALTH INSURANCE MARKET WORK?

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ADDRESSING MARKET SEGMENTATION AND INCENTIVES FOR RISK SELECTION: HOW WELL DOES RISK EQUALISATION IN THE IRISH PRIVATE HEALTH INSURANCE MARKET WORK?[1]

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INTRODUCTION

Community rating restricts health insurers from varying premiums based on insurees' risk profiles. It is a key feature of many health insurance markets. While designed to promote equity, this regulation incentivises insurers to focus on attracting low-risk (profitable) consumers while avoiding high-risk (unprofitable) consumers. This phenomenon is known as "risk selection". Risk selection has a number of negative consequences, such as market segmentation and poor quality service to high-risk individuals (e.g. the old and sick). It also causes inefficiency where investment focusses on attracting low-risk individuals (e.g. the young and healthy) rather than improving price and quality. The best strategy for reducing risk selection incentives is good risk equalisation. Commonly, this involves providing risk-adjusted premium subsidies to insurers based on insurees' risk profiles. These subsidies are generally administered through a risk equalisation scheme.

Our study investigated the performance of Ireland's scheme. Despite the liberalisation of the Irish health insurance market in the mid-1990s, bona-fide risk equalisation payments only commenced in 2013. The current risk equalisation system allocates risk-adjusted subsidies to insurers based on the age, sex, level of cover, and hospital utilisation, of insurees.

[1] This Bulletin summaries the findings from: Keegan, C., Teljeur, C., Turner, B., and Thomas, S. "Addressing Market Segmentation and Incentives for Risk Selection: How Well Does Risk Equalisation in the Irish Private Health Insurance Market Work?", *The Economic and Social Review*, Vol. 48, No. 1, Spring, 2017, pp. 61-84. Available online: http://www.esr.ie/article/view/676/154

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DATA AND METHODS

Data for this study were provided by Vhi Healthcare, the largest insurer in the market in terms of both market share and claims payout. The analysis used statistical models to give insight into how current and alternative risk equalisation specifications affect incentives for risk selection, by testing how well risk equalisation payments help match actual insurer claim expenditures on care. Of particular interest was whether, and to what extent, including information on diagnosis can improve the risk equalisation design. The main source of diagnostic information used in this analysis related to 35 high-cost diagnostic groups (e.g. renal failure, congestive heart failure). Basing payments on diagnostic information is a feature of more sophisticated risk equalisation designs, internationally.

RESULTS

Overall, the models suggest that the current risk equalisation design performs quite poorly. Moreover, replacing the current utilisation-based scheme with a high-cost diagnosis-based one improves performance substantially, reducing incentives for risk selection. A diagnosis-based scheme may also improve incentives for efficiency relative to a utilisation-based scheme.

CONCLUSIONS

Despite these potential benefits, policymakers need to be aware of a number of challenges regarding the introduction of diagnosis-based risk equalisation into the Irish health insurance market. For instance, newer entrants to the market may oppose such a move as the market risk distribution would most likely reinforce the transfer of risk-equalisation funds to Vhi Healthcare. A greater administrative burden would also be placed on both insurers and the regulator in relation to submitting and auditing diagnostic information. It is presently unclear whether all insurers have the ability to capture and code relevant diagnostic information.

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