Guaranteed Renewability And The Problem Of Risk Variation In Individual Insurance Markets

A way to stabilize coverage without government interference. (The full text of this paper is available online at www.healthaffairs.org/Web Exclusives/Pauly_Web_Excl_082802.htm, posted 28 August 2002.)

by Vip Patel and Mark V. Pauly

ABSTRACT: Trying to protect consumers against fluctuations in individual private insurance premiums, many states have turned to such regulatory schemes as community rating. Vip Patel and Mark Pauly suggest an alternative: guaranteed renewability of health insurance policies for the next coverage term at class average rates.

Unlike community rating, which can result in cream skimming and incentives for adverse selection, the authors argue that guaranteed renewability effectively pools risks and protects consumers from price spikes without resorting to heavy regulation of the market or reduced consumer choice. The Health Insurance Portability and Accountability Act (HIPAA) of 1996 required guaranteed renewability of health plans, but the law lacked teeth because it did not proscribe insurers from increasing rates, the authors write. In a survey of state insurance departments, however, the authors found that all but three protected consumers from rate increases related to their health status or claims history.

Patel and Pauly also acknowledge the potential ways that unregulated insurance plans might game the system, such as by raising the premiums of an underwriting class more than experience dictates in order to force the lower risks into another product, and then discontinue the original product for higher risks. Consumers, too, can game the system by choosing to enroll if they have knowledge of declining health status that the insurer cannot obtain.

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