

# **No Free Lunch – But Government Sponsored Reinsurance Could Improve the Balance**

**Katherine Swartz**  
*Harvard School of Public Health*

**National Academy of Social Insurance:  
“Getting to Universal Health Insurance Coverage”**  
*January 31, 2008*

# Points

- **Targeting of subsidies: poor people and/or very sick people?**
- **Government reinsurance program provides a back-end subsidy – and targets adverse selection concerns**
- **Reinsurance, requirements to buy coverage, and risk-adjustments to premiums**

# Subsidies

- Usually targeted at low-income people
- But adverse selection creates risk in individual insurance markets – higher premiums for people with incomes above “low income”
- Subsidies based on low income do not address adverse selection risk → become a transfer to insurers

# Risk of Adverse Selection

- “risk premium” for adverse selection risk
- Accurately predicting who is going to be in the top 1 or 2% of the expenditure distribution is impossible
- Left with “unaffordable” higher premiums and uninsured middle-class people

# Reinsurance Targets Risk of Adverse Selection

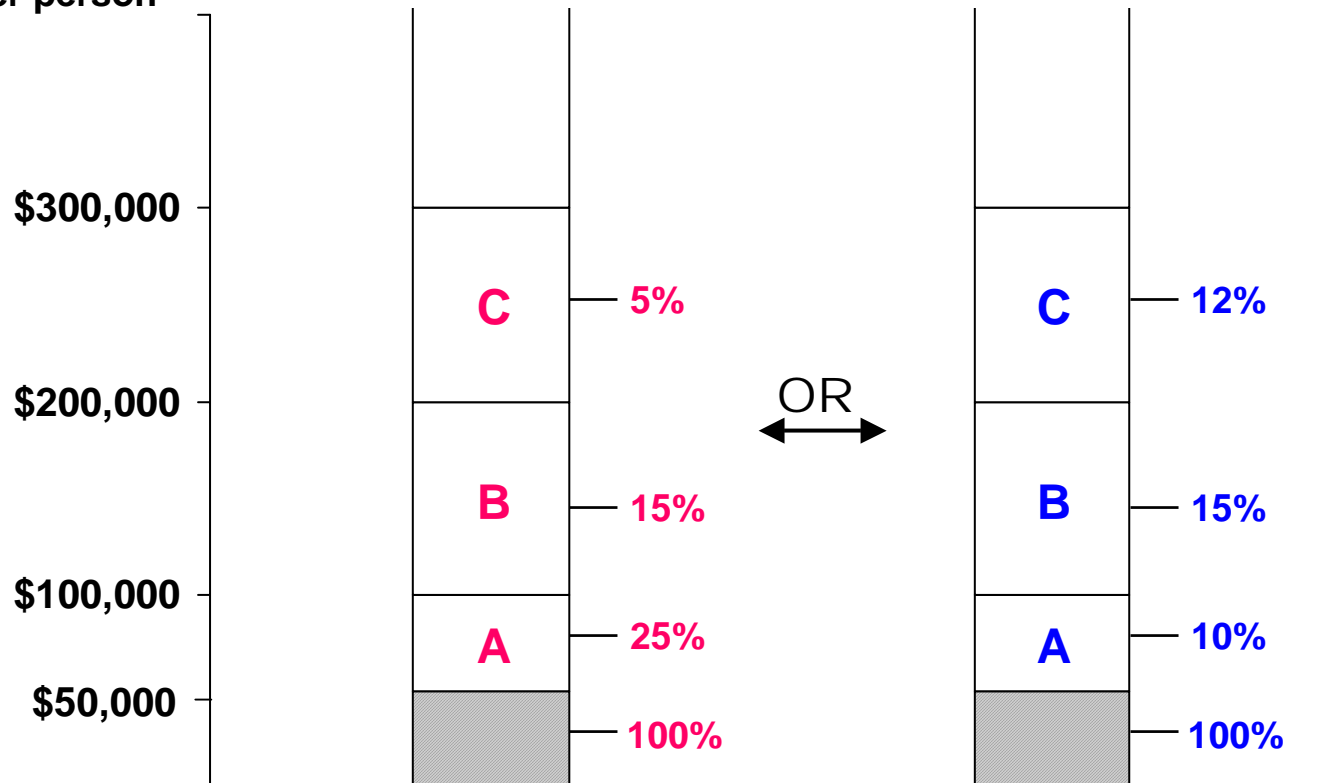
- Reinsurance payouts based on who actually had high annual health spending – not predictions of risk
- Government-sponsored reinsurance is financed by broad tax base – shifts risk (and costs) of very sick people to population
- Premiums decline, helping to stabilize private insurance market for everyone

# How Reinsurance Works

- **Insurance for insurers**
- **Sold as layers of coverage**
- **Cost-sharing between reinsurer and originating insurer → originating insurer retains portion of risk**

# Risk Sharing by Layers of Reinsurance: % of Risk Retained by Insurer

\$ of expenses  
per person



# Why Excess-of-Loss Design?

- **1<sup>st</sup> goal:** reduce insurers' risk of individuals with very-high-costs  
– so insurers reduce premiums  
→ back-end subsidy to everyone
- **2<sup>nd</sup> goal:** align incentives for insurers to manage individuals' medical care



# Reinsurance, Requirement to Buy Coverage, and Risk Adjustments

- Requirement that everyone buy coverage reduces risk of adverse selection in individual markets – and need for reinsurance
- Adverse selection across plans and insurers remains
- Risk adjustment of premiums? – the Netherlands' experience

# Targeting of Subsidies

- **Balance between well-targeted aid to low-income people and goal of universal coverage**
- **Hurdle to universal coverage is risk premium in individual markets – which reinsurance addresses**
- **Back-end, less well-targeted subsidies make insurance more widely affordable (Healthy New York)**
- **Both types of subsidies needed**

# Summary

- **Risk of very high-cost people makes individual premiums high**
- **Government reinsurance shifts this risk to general population – reducing premiums and creating incentive to manage medical care**
- **Creating affordability – but no free lunch**