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Competition and "cream skimming" in Germany: Incentives and opportunities

In their reply, Winkelhake and John raise important issues for the German insurance system and others that depend on risk equalization schemes (RES) to insure fair competition and prevent cream skimming. In essence, they argue that German data protection laws "make it impossible" to individually identify good or bad risks among existing enrollees by using utilization data. We agree. They conclude, therefore, that there is no need to improve the RES. We disagree, and argue that a careful consideration of both the incentives *and* opportunities for cream skimming in the German system will show that cream skimming is still possible and likely unless the RES is substantially improved. Further continued use of the existing RES is likely to mean that sickness funds with higher proportions of the terminally ill, disabled and other high risk groups will not be able to compete effectively with other funds on the basis of price (e.g. contribution rate).

– We agree that the very strict German data protection laws do protect sickness fund members from the most blatant forms of cream skimming. If high risk individuals cannot be personally identified by their own sickness funds, they cannot be "dumped" or disenrolled by the fund, or "black listed" by other funds. In fact, and in sharp contrast to the U.S., German insurance law does not permit any risk selection, or "medical underwriting" based on individual health statistics or other characteristics.

– Yet the law does not prohibit other forms of cream skimming that are based on identification of high and low risk groups. And as competition between sickness funds increases, the incentives and opportunities for cream skimming also increase. As indicated in our earlier article, research in the U.S. and Netherlands shows that while the top two percent are responsible for about 40% of all health expenditures, the bottom 50% are responsible for only 3%[1]. In short, the skewed distribution of health expenditures in modern health systems is a very powerful incentive for risk selection – that is to identify and attract low risk groups and avoid high risk groups.

– The U.S. experience suggests that when competition increases, insurers quickly learn how to promote risk selection by offering selected benefits and through targeted marketing. U.S. insurers have learned, for example, that the chronically ill are likely to be more concerned about whether an insurance plan offers benefits they are likely to need, such as mental health or long term care, than they are about price. The result is that many U.S. firms avoid or minimize benefits that are likely to attract high risk, high cost enrollees. U.S. firms have also learned that benefits for health promotion and fitness are likely to attract younger, healthier enrollees[2,3]. While the German situation is substantially different because of mandated benefits, and restrictions on advertising, many sickness funds have increased their activities in health promotion and fitness, and prevention[4]. Only time will tell whether sickness funds also develop strategies to avoid or minimize their attraction to higher risk groups.

– Our major concern about the existing RES is that it will not achieve the major objectives it was designed for: to reduce differences in fund contribution rates based on differences in risk structures, so that funds can compete primarily on the basis of administrative efficiency and service. Winkelhake and John's analysis of 1992 German data agrees with previous findings from the U.S., the Netherlands, and Switzerland. RES based on socio-demographic measures consistently explain only a small part of total use and expenditures,

while measures based on chronic illness, disability, previous utilization, diagnosis, and death rates explain much more, especially in combination[5–7].

– These findings mean, in turn, that sickness funds that include higher proportions of the chronically ill, disabled, and other high risk groups will not be fully compensated for the high risk groups they actually serve. If they are not, their expenditures and contribution rates will remain higher, and they will be at a continuing price disadvantage with substitute funds and others that have more favorable risk structures. In short, if German citizens choose funds primarily on the basis of price, high risk, high price funds are likely to lose a lot of members to funds that have lower contribution rates. Research in the U.S. also shows that price is the single most important factor in the insurance choices of low risk individuals[2]. If German citizens follow this pattern, high price funds may increasingly be left with even higher proportions of high risk groups.

In conclusion, we express our thanks to Winkelhake and John for their important contributions on these issues, and to the journal for the opportunity to respond. We still conclude that the RES needs to be substantially improved to promote competition based on efficiency and service, rather than differences between funds in risk structures. Further, despite the protections of the German insurance law, wich are important and considerable, we believe that increased competition under the existing RES will lead funds to engage in creative ways to avoid high risk and attract low risk groups, i.e. to engage in some forms of cream skimming. In our view, these considerations clearly suggest the need for additional research, not only on improving the RES, but on the consequences of the recent changes for risk segmentation, expenditures, contribution rates, promotion, disease management, marketing, and consolidation.

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