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Competition under a regime of imperfect risk adjustment: The Swiss experience

In their reply, Winkelhake and John¹ focus on the fact that statutory funds are generally not allowed to maintain personal accounts for their clients. As long as an insurer has no possibility to merge its expenditure data with the personal identification data, it has no chance to identify high risks and to exclude them.

Apart from the fact that there are still other tricks to achieve this goal and to attract good risks only, there are further important problems that require improvement of the risk adjustment formula.

The Swiss risk equalization fund

In 1993, the Swiss federal government introduced a risk equalization fund for social health insurers, to be in force until 2005. Insurers having an age and sex structure that compares favourably with that of the general Swiss population must contribute to this fund, while those showing a competitive disadvantage in this regard will receive a subsidy from it. This measure was part of a revision of the law on social health insurance, which passed in a referendum the following year, on 4 December 1994.

Together with the new law, freedom of choice among sickness funds was introduced in 1996. Since then, risk equalization schemes (RES) for Germany and Switzerland have become comparable. In contrast to the German scheme, the Swiss formula is less complex, takes into account regional differences (although Switzerland is smaller than Bavaria) and does without any exceptions for certain social groups². But its restriction on age and gender as risk factors shows the same shortcomings as the ones already discussed for the German formula by Wysong and Abel³. Our own findings show that only 3.9% of total variation in health expenditure data can be explained by the official Swiss formula⁴. There we demonstrate in a simulation that cream skimming under the regime of risk adjustment is still profitable. But our simulation works explicitly with the individual expenditure files at hand. A law similar to § 305 SGB V would certainly reduce the effect of risk selection.

The problem of asymmetric mobility in the Swiss health insurance market

But even if this law prevents insurers from cream skimming, there

is still a problem left that RES has to deal with. Differences in risk profiles among different health insurers can also arise because of inertia and adverse selection. Inertia means that only a small part or none of the insured will change funds. Adverse selection occurs when this small part isn't a random sample of the total population but a low risk sample.

Meanwhile we have first evidence of inertia and perhaps of adverse selection, too. In our data we find an impressive lack of mobility. For example in 1996, due to an inconsistency in the new regulation, CSS had to offer about 680'000 of their insured an option with exactly the same cover but less premium. The savings in premiums were different for different cantons going up to a maximum of SFr. 295.– a year. In spite of a lot of publicity about this option only 240'000 individuals changed their contracts. The majority accepted higher premiums for the same cover. This is an example of inertia inside a fund. But mobility from one fund to the next is also limited and asymmetric. A sample of 44'217 individual data shows, that all those people who changed the fund had had in the preceding year significant lower costs than the other who stayed put. Average expenditure per month

and person for those who remained was SFr. 144.– but only SFr. 67.– for those who left. As clear as these figures are (the level of significance is over 0.999), they leave open the question, whether this difference is a result of adverse selection or of illegal obstacles raised against high risks. Probably both factors are responsible. So even if severe constraints exist regarding the use of matched data, there is still an adverse selection effect, that should be balanced out by the RES.

And as long as the RES is imperfect, adverse selection can even produce cream skimming as a result. One of the largest Swiss sickness funds was blamed in the newspapers recently for 'shaking out' its high risk members. This illegal activity was the consequence of the fund's being the victim of adverse selection for years. If the RES were better, it would have compensated the victim for its unfavourable structure and at the same time eliminated any incentive to discriminate against high risks.

The consequences of restrictive laws on data handling

The Enthoven reform⁵, the prototype of a lot of health care reforms

originating in the eighties and nineties postulates competition to give the sickness funds the incentive to lower health care costs. On the one hand, funds could lower their own administrative costs. Since running a social insurance is not so expensive (in Switzerland between 7 and 10% of premiums are required), lowering of administration cost can only have a limited effect on premiums.

On the other hand, funds could try to reduce the amount they have to pay to practitioners, hospitals and so forth. Therefore Swiss legislation gives the insurers the freedom to introduce all kind of managed care programs. Knowledge of the data in all their details is required to handle such programs in an innovative and effective way.

But a law like the one discussed prevents not only misuse of data but any use at all.

Therefore we conclude, that revision of the RES is an important task because improving the formula would prevent cream skimming too as well as compensating the victims of adverse selection and leaving room for further innovations like managed care programs, while restrictions on the data handling hinder together with cream skimming every productive and socially desirable use of the data.

References

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