

## Recommendations for sustainable indemnity health insurance

### ABSTRACT

There are growing concerns about the sustainability of indemnity health insurance (private health insurance) as its loss ratio rises. The threats to sustainability include not only the adverse selection and moral hazard problems that arise from asymmetric information, but the limited system improvement due to the long-term nature of holding contracts and the poor non-fee schedule treatment evaluation methods.

We recommend that financial authorities need to induce transitions to a new contract to sustain indemnity health insurance. Both no claim discount(no claim bonus) system and product innovation that enhance the loss control of non-fee schedule coverage are required to address adverse selection and moral hazard problems of the indemnity health insurance. Regulating non-fee schedule medical expenses is an issue that can no longer be delayed from the perspective of the national healthcare system. We propose the establishment of a reasonable non-fee schedule assessment system in active cooperation between public and private entities.

### 1. Threats

Recently, the loss ratio of indemnity health insurance has risen sharply, raising concerns about the sustainability of the insurance product. In the first half of 2019, the loss ratio of indemnity health insurance rose to 130%, the highest level since 2016. If the loss ratio continues to rise, premium rates that currently a 40-years-old policyholder will pay at or above the age of 60 are expected to increase by 7 to 17 times current rates, it will be unaffordable in their old age.

Indemnity health insurance is inherently prone to adverse selection and moral hazard problems of asymmetric information and the variations in health risk among consumers are much greater than other insurance contracts.

If the indemnity health insurance market is plagued with adverse selection problems, only high-risk consumers who are willing to pay high premiums will remain, leading to a market failure in which the market will shrink or eventually stop supplying.

Indemnity health insurance is vulnerable to moral hazard due to its comprehensive coverage, imposing ‘burden on all insureds from misuse or abuse treatment that causes premium rates go up.’ Consequently, most insured with no moral hazard have no choice but to share this burden.

Besides, the product innovation itself has a limited effect because of the long-term nature of insurance contracts. Since contract renewal is automatic up to 100 years old, as of now, 80% of the contracts have the remaining policy period longer than 20 years.

Furthermore, insurers do not have proper measures which can reduce losses. There is no official review and assessment system in which insurers can scrutinize non-fee schedule medical expenses that accounts for a large portion of insurance costs. Insurers lack the grounds to refuse to pay benefits even if they suspect medical institutions misuse or abuse treatment.

## 2. Recommendations

It is high time to publicize contract transitions encouraging the policyholder to transit to a new product (‘Good indemnity health insurance II’) having options of low-premium with low-coverage. In case the drastic increase in insurance premiums makes it difficult for existing policyholders to maintain indemnity health insurance, this would eventually hurt the policyholders. It requires active policy interventions of financial regulatory authorities

To prevent adverse selection, it is necessary to consider the introduction of no claim discount in which premium rates are linked to individual claim amounts (by utilization of medical services). No claim discount is a kind of bonus-malus system, which encourages insureds to stay healthy and use medical services only when necessary. While the right to health and medical access of patients is an important value, it is in public interest to introduce no claim discount system to sustain indemnity health insurance.

To reduce moral hazard-induced utilization, comprehensive coverage should be separated into fee schedule and non-fee schedule products, and the loss control for non-fee schedule coverage should be strengthened. Non-fee schedule products need to be reviewed regularly through the operation of the 'committee on the non-fee schedule coverage(tentative name)', consisting of the national health care, insurance industry, and supervisory authorities. In particular, it is necessary to modify coverage structure for the medical treatments in which misuse and abuse are serious.

It is imperative to establish non-fee schedule medical expenses assessment system. Non-fee schedule medical expenses are now the substantial part of the national healthcare expenditure. Both public and private insurers need to recognize the common interest in managing non-fee schedule medical expenses successfully and actively cooperate to achieve this goal.

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