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Rescissions: Much Ado About Nothing

Written by John Goodman

How many times have you heard President Obama say, “Health insurers won’t be able to drop your coverage just because you get sick?” Or Kathleen Sebelius? Or the Democratic leadership in Congress? Or the mainstream news media?

You would think that the private health insurance industry was being revolutionized.

In fact, it has been illegal since 1997, under the Health Insurance Portability and Accountability Act, for insurers to drop coverage because someone gets sick. And even before then, the practice almost never happened.

Think of it this way: Do you think there would be a vibrant, active, ongoing life insurance industry if insurers could renege on their part of the contract after someone dies? How many of us would buy fire insurance if the insurers could change their minds and refuse to pay after our house burns down? Would you buy auto insurance from Allstate if the “good hands” could disappear after a collision occurs?

These things do not happen because

1. Insurers are contractually obligated to keep their side of the bargain and courts enforce these obligations just like any other contract;

2. Regulatory agencies enforce good behavior, quite apart from any lawsuit, and;

3. An insurer that routinely refused to pay claims would lose customers and go out of business.

So what’s the fuss all about?

It’s about rescissions. This occurs when an insurer cancels a policy and returns the premiums to the policyholder, thus voiding the original contract. It almost always happens because the insurance application form is discovered to have fraudulent, misleading or simply wrong information on it.

Rescissions are very rare. They apply only to the individual market (less than 10% of private health insurance) and even then they occur less than 4/10ths of 1% of the time. Even when it does happen, there is almost always an appeals process where the decision is reviewed by an internal committee and often submitted to outside reviewers. Further, when insurers are wrong – as they may sometimes be – it is the job of state regulators to correct this injustice.

This has not stopped the Obama administration from demagoguing the issue, however. Based on a Reuters story, Secretary Sebelius accused WellPoint of

targeting thousands of female policyholders for rescission after they were diagnosed with breast cancer, and President Obama repeated the charge in his weekend radio address. WellPoint's response: The insurer paid for 200,000 cases of breast cancer last year and rescinded exactly four policies for fraudulent or misleading statements.

Even though such instances are rare, they can provoke differences of opinion on the proper response. Some cases are fairly straightforward. Suppose on my insurance application I say I am in good health when in fact I have chronic renal failure. Should the insurance company have to pay for my kidney dialysis? Obviously not.

Other cases get murky. Most life insurers will not sell to someone who is obese (girth measurement is often the test). Suppose I lie about this information, then get hit by a truck and killed. Should the insurance have to pay off?

On the one hand, you could argue that the lie I told about my obesity was irrelevant. Yes, I lied. But the lie had no material impact on the cause of my death.

On the other hand, my lie was not innocuous. It allowed my family to reap a cash benefit it otherwise would not have been entitled to. It caused the insurer, and therefore the policyholders, to incur a cost they otherwise could have avoided.

Regardless of how you come down on this case, if you find the discussion to be one worth having it is probably because you believe there is economic value in a market for risk in which competition tends to price risk accurately.

Yet this White House does not believe in a market for health care risks. It certainly does not believe in pricing risk accurately. Indeed, they tend to think that the only legitimate function of health insurance companies is to pay medical bills. The reason they think ideal health insurance is a single-payer public plan is because they think government can write checks with less administrative hassle than private companies.

And if the truth were known, I suspect that these views are not confined to health care. I suspect they don't really believe in a market for any kind of risk.