

## Market imperfection and health insurance contract compliance: incentive mechanisms

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### Abstract

This paper analyzes the contractual mechanisms in health insurance in the presence of an opportunistic insurer. This work focuses on modeling the opportunistic behavior of the insurer in a deferred settlement insurer-policyholder relationship model, followed by the value of the contractual relationship in a 2 to N agent model. This modeling is based on the model of Greif, (2003) and Fafchamps, (2004) in the context of the customer-supplier relationship. In this model, we deal with moral hazard in the insurer-insured relationship. Under the assumption that policyholders respect the terms of the contract and that there are two types of insurers, we obtain the following results: (1) for the contractual relationship to continue to exist, the penalties must be high enough to dissuade opportunistic behavior, but not so high as to scare away potential insurers. Penalties must also be effective enough to be a deterrent. (2) for a discount rate close to one and a positive profit margin, the fear of losing a relationship can by itself ensure that contractual commitments are respected and the insured-insurer relationship maintained. This result can be extended to a model with N agents. These results assume the existence of a relevant judicial mechanism.

**Keywords:** health insurance contract, incentive mechanism, opportunistic behavior, market imperfection.

J.E.L : C02, D15, D81, D86, I13

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Academic Journal of Business, Administration, Law and Social Sciences ISSN 2410-3918 (print)

ISSN 2410-8693 (online)

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