

A Report to the Minister for Health and Children

Competition in the Irish Private Health Insurance Market

Executive Summary

January 2007

EXECUTIVE SUMMARY AND RECOMMENDATIONS

- E 1. The Irish private health insurance market is community rated. The community rating system is supported by regulations concerning lifetime cover, open enrolment, minimum benefit and risk equalisation. These regulations are necessary for the maintenance of a community rated market. While these regulations also impact on competition, the impact is fair and proportionate and the regulations facilitate competition between insurers. Nevertheless, the Irish market is highly concentrated and there are a number of measures recommended in this report that should be taken in order to benefit consumers by encouraging greater competition in the market.
- E 2. The Minister for Health and Children requested the Health Insurance Authority (the Authority) and the Competition Authority to report jointly on further measures to encourage competition in the private health insurance (PHI) market. Terms of Reference were agreed in March 2006 and a public consultation process was conducted in April. Work on the joint study was in its final stages when the Competition Authority notified the Health Insurance Authority on 18th December 2006 that it did not propose to submit a report jointly with the Health Insurance Authority but instead intended to submit a separate report to the Minister. As a result the Authority has completed a report on its own based on the Terms of Reference drafted in accordance with the Minister's request. The recommendations of the Authority are set out below.

Market Description and Definition

- E 3. Chapter 2 describes the Irish private health insurance market. The take-up of private health insurance (PHI) has grown steadily over the years and the coverage of PHI has now reached 51% of the population (48% for the three open enrolment insurers). By international standards, this is a high proportion for voluntary health insurance. Economic research has shown that the important determinants of demand for private health insurance in Ireland are the existence of waiting lists for elective treatment in the public hospital system and perceptions among the public of better care being available for private patients, the long established nature of voluntary health insurance in Ireland, and the community rated nature of the market. Growth in real incomes may also have been a significant driver of demand. This factor is additional to the rapid growth in the labour force and the population in the last ten years, which has resulted in corresponding growth in the demand for health insurance.
- E 4. In the absence of risk equalisation payments, insurers with younger age profiles have a significant regulatory advantage over insurers with older age profiles. This advantage has facilitated BUPA Ireland and VIVAS Health in charging significantly lower premiums than Vhi Healthcare. Since competition was first introduced in 1997, the market share of Vhi Healthcare has declined steadily and as at September, 2006 was 75%. (BUPA Ireland had 22% and VIVAS Health 3%). Vhi Healthcare's market share has declined at a rate of around 2.5 percentage points per annum.

- E 5. In Chapter 3, the relevant market is defined as the private health insurance market with open enrolment. Only reimbursement insurance that is regulated by the Health Insurance Authority is included in the market definition. Insurance schemes that restrict membership to certain work or occupational categories are not included. Non-indemnity type insurance, such as “cash plan” insurance and critical illness insurance, are not included either. There are currently three private health insurance providers, Vhi Healthcare, BUPA Ireland and VIVAS Health, and the majority of claims relate to private in-patient hospital stays.

Regulation

- E 6. Chapter 4 describes the regulation of the market and considers what changes could be made in order to assist the development of greater competition. Vhi Healthcare (officially the Voluntary Health Insurance Board) was founded under the VHI Act of 1957. Vhi Healthcare is a state owned body and was the sole provider of health insurance in Ireland until January 1997. BUPA Ireland commenced health insurance operations in January 1997 and VIVAS Health in October 2004. On the 14th December 2006, BUPA Ireland announced that it was commencing its withdrawal from the market. It explained its decision thus; “..this decision has been forced on it due to the scale of the payments required under the Risk Equalisation Scheme...”.
- E 7. The three insurance companies operate subject to the requirements of the 1994 Health Insurance Act (as amended in 2001 and 2003) and associated regulations, the main provisions of which are set out in Chapter 4. The primary regulatory principle is community rating, which means that insurers must, subject to certain limited exceptions, charge the same premium for an insurance product to all customers. In particular, insurers may not vary premiums on the basis of age or health status of the customer.
- E 8. The regulatory framework, established by the Health Insurance Acts and associated regulations, is designed to support community rating and includes regulations pertaining to, open enrolment, lifetime cover, minimum benefits and risk equalisation. The Minimum Benefit Regulations oblige insurers to provide cover in their hospital insurance products for all public hospitals and for treatment for almost all illnesses as well as maternity care. The Health Insurance Authority was established in 2001 and took over regulatory functions relating to this framework, which had hitherto been carried out by the Minister for Health and Children.
- E 9. Except for Vhi Healthcare, health insurance companies are subject to prudential regulation by the Financial Regulator in Ireland or an equivalent regulator in another EU member state. VIVAS Health is regulated by the Financial Regulator and BUPA by the Financial Services Authority in the United Kingdom. Both are also subject to the Financial Regulator’s Consumer Protection Code.
- E 10. The health insurance legislation applies equally to all insurers. However, under the VHI Acts, Vhi Healthcare is governed by a different statutory and regulatory regime to other insurers. It has an exemption from EU and member state insurance regulation by virtue

of derogations in the First and Third EU Non-Life Insurance Directives. As a result it does not have to satisfy prudential financial solvency requirements as an insurance company, although the Minister for Health and Children has announced that she intends to introduce legislation in the near future, which would require Vhi Healthcare to satisfy these requirements by 2012. A primary objective of this report's recommendations is to bring about the situation as soon as possible that all health insurers operate under the same regulatory framework. In practice this would only be feasible when risk equalisation payments are being made.

<u>Recommendation 1</u>	Action By
Vhi Healthcare should be obliged to operate in the provision of non-insurance services in the same manner as if it was regulated as an authorised non-life insurance company. The Minister for Health and Children should bring forward legislation to amend the Voluntary Health Insurance Acts including a requirement that Vhi Healthcare be allowed and obliged to establish associated companies (or subsidiaries) to carry out non-insurance activities.	Minister for Health and Children

<u>Recommendation 2</u>	Action By
In the context of the commencement of risk equalisation payments, Vhi Healthcare should be required to satisfy the relevant prudential solvency requirements as soon as is feasible. The proposed six-year timeframe allowed for Vhi Healthcare to attain the necessary level of reserves should be reviewed with a view to shortening it. Consideration should be given to methods of raising capital other than through the accumulation of surplus.	Minister for Health and Children

<u>Recommendation 3</u>	Action By
Vhi Healthcare should be subject to prudential regulation in its capacity as a PHI undertaking by the Financial Regulator. Vhi Healthcare's exemptions from the First and Third EU Non-Life Insurance Directives should be abolished. The Minister for Health and Children should seek the removal of these exemptions by the institutions of the EU once Vhi Healthcare is in a position to receive authorisation as an insurer.	Minister for Health and Children

<u>Recommendation 4</u>	Action By
The requirement for Ministerial approval for Vhi Healthcare premium increases under S.3 of the Voluntary Health Insurance (Amendment) Act, 1996 should be removed, once Vhi Healthcare's exemptions from the Non-Life Insurance Directives are removed. At that stage, consideration should be given to whether it is appropriate to continue price regulation by an independent regulatory body.	Minister for Health and Children

- E 11. The terms of reference included a brief to "identify duties that could be assigned under existing legislative provisions and additional functions that might possibly be assigned to the Health Insurance Authority" Research by the Authority indicates that difficulties that consumers have in understanding and comparing health insurance products and lack of consumer awareness of their rights may impact negatively on competition in the market. Effective legislation requires that the regulator should have proportionate powers to direct compliance with the legislation. Therefore, the Authority makes the following recommendations:

<u>Recommendation 5</u>	Action By
The Minister for Health and Children should bring forward legislation to amend the Health Insurance Acts to provide that the Health Insurance Authority has the power to direct that a health insurance undertaking alter its practices or its products to comply with the provisions of the Acts or regulations thereunder.	Minister for Health and Children

<u>Recommendation 6</u>	Action By
The Minister for Health and Children should bring forward legislation to amend the Health Insurance Acts to assign to the Health Insurance Authority the function of taking such action as it considers appropriate to increase awareness among members of the public of their rights as health insurance consumers and of available health services.	Minister for Health and Children

- E 12. There is a risk to the stability of a community rated market if it fails to attract sufficient younger consumers on an ongoing basis. The 1999 White Paper proposed the introduction of unfunded lifetime community rating and the Health Insurance (Amendment) Act 2001 provided for its introduction. It would reduce the adverse selection risk posed by the current system and thereby contribute to greater stability in the market. This would also facilitate competition on a level playing field in an insurance market with community rating.

<u>Recommendation 7</u>	Action By
The Minister for Health and Children should introduce unfunded lifetime community rating as provided for in the Health Insurance Act 1994 (as amended).	Minister for Health and Children

Risk Equalisation

- E 13. The effect of risk equalisation on competition in the health insurance market has been the subject of much discussion and analysis in Ireland since before the introduction of the Health Insurance Act 1994. This analysis has consistently agreed with the Health Insurance Authority's views in relation to the appropriateness of risk equalisation in a community rated market. The Harvey independent advisory group in 1998 concluded that a risk equalisation scheme is a necessary feature of the Irish private health insurance market.
- E 14. Judge McKechnie, in his November 2006 judgement in the High Court, concluded that "within the statutory framework of the Irish system, this market is potentially unstable without risk equalisation. The scheme is therefore absolutely necessary given our system. Moreover it is fair, reasonable and proportionate." The European Commission State Aid verdict at paragraph 52 concluded that the Risk Equalisation Scheme "is necessary to underpin the principles enforced by the Irish authorities ... it ensures that risks are shared appropriately across the market and allows for a level playing field in respect of the particular constraints of the Irish system. If, as an alternative, the Irish PMI market were risk rated, the Risk Equalisation Scheme would not be necessary." It concluded that the Scheme passed both the necessity and the proportionality test.
- E 15. The Authority considered the impact of risk equalisation in depth as part of its deliberations in relation to its recommendations on whether or not risk equalisation payments should be commenced. Having considered the submissions received as part of this study, the Authority maintains the views that were set out in its October 2005 report to the Minister, which recommended the commencement of risk equalisation payments. These views are outlined in Chapter 4.

Barriers to Entry

- E 16. In Chapter 5 the barriers to entry to the market are reviewed. Interviews with possible new entrants (which were undertaken in a previous Authority study) identified a number of factors that would deter entry into the market. Vhi Healthcare's high market share is a significant deterrent to market entry. Other factors, such as a perceived low level of profit or a high level of efficiency in the market, may deter new entrants but also benefit consumers, e.g. a market with inefficient incumbents making super-normal profits would not be benefiting consumers but would attract new entrants. However, there was also a perception that Vhi Healthcare benefits from some aspects of first mover advantage, for instance its brand and its strong buyer position with private hospitals.

- E 17. A number of interviewees identified risk equalisation as a deterrent to entry. Uncertainty concerning the future regulation of Vhi Healthcare and the future of the Risk Equalisation Scheme were also cited as deterrents to entry. However, a number of features of the Risk Equalisation Scheme, including an initial three year exemption from payments, are intended as incentives for market entry. The absence of risk equalisation payments in a community rated market gives a regulatory advantage to insurers with lower risk profiles. The Risk Equalisation Scheme is designed to reduce but not eliminate this regulatory advantage and insurers with lower risk profiles will continue to have a significant advantage, even with risk equalisation payments.
- E 18. In view of the very high market share of Vhi Healthcare and in order to encourage competition by providing regulatory incentives for market entry, there is scope to lengthen the phase-in period for full risk equalisation payments for new market entrants, while maintaining the essential features of the scheme and the intended long-term effect on the market. In the current Risk Equalisation Scheme, a new undertaking does not have to make risk equalisation payments for three years and there are fifty per cent payments in the fourth year with full payments thereafter. If the time period from nil to full payments was lengthened, there would be an increased incentive to enter the market. Therefore, the Authority recommends the following;

<u>Recommendation 8</u>	Action By
<p>The Minister for Health and Children should consider amending the Risk Equalisation Scheme by extending the phase-in period for new entrants, for example, as follows;</p> <ul style="list-style-type: none"> - no payments for the first three years - payments in the fourth year at 25% of the full amount, rising to 50% and 75% in subsequent years and reaching 100% in the seventh year. 	Minister for Health and Children

Barriers to Rivalry

- E 19. Chapter 6 discusses barriers to rivalry. Given the number of insurers in the marketplace, it is vital that they compete vigorously with each other if consumers are to benefit from competition. Although the actual process of switching insurers is simple and straightforward and there are no penalties involved, there are low levels of switching in the PHI market. Search costs and switching costs inhibit switching, while the psychological costs of switching promote inertia and cause people to remain with their incumbent insurer even where competitors offer better value products.
- E 20. To promote competitive PHI markets, consumers need to be aware that it is easy to switch. They also need the necessary information on competing products. In the Irish PHI market, transaction costs of switching are relatively low. However, the Authority's research

indicates that consumers of PHI have a propensity to succumb to the psychological costs of switching. Search and switching costs need to be lowered further. For switchers, premium reductions were by far the most commonly cited reason for switching.

- E 21. PHI firms require their customers to serve waiting periods upon commencement of their first health insurance policies. It is important for consumer information and awareness of switching that consumers are not under the impression that they are in any way restricted from switching due to the need to serve extra waiting periods. In order to reduce search costs, information on consumer rights and products should be provided to consumers at point of sale and at renewal. Accordingly, the Authority recommends as follows;

<u>Recommendation 9</u>	Action By
Pending the implementation of Recommendation 10, PHI companies should send out renewal notices to insured persons one calendar month prior to the renewal date. At a minimum, these renewal notices should give details of current PHI cover and cost of renewal of cover for a further year, at what age the insured can avail of reduced premiums, and information on waiting periods.	PHI companies

<u>Recommendation 10</u>	Action By
<p>Following consultation with the PHI industry, a statutory requirement should be introduced requiring insurers to provide certain information at point of sale and with renewal notices. The information to be provided would include information on consumer rights concerning health insurance, switching and waiting periods.</p> <p>In addition, in order to facilitate the comparison and understanding of products, each insurer would be required to illustrate the main details of an insurance policy and its price in a prescribed format.</p>	Minister for Health and Children

- E 22. It is recommended that a Switching Code be introduced as a means of further reducing transaction and psychological switching costs.

<u>Recommendation 11</u>	Action By
The insurance companies should work with the Authority to draft a Switching Code for PHI which would, in a brief, clear and definitive manner, detail the rights and duties of consumers, outgoing health insurers and incoming health insurers during the switching process.	HIA & PHI companies

- E 23. Vhi Healthcare’s offer of Vhi-brand MultiTrip Travel Insurance provides it with an advantageous position relative to its competitors and has the effect of creating barriers to switching for PHI consumers. Vhi Healthcare travel insurance is only available to members of Vhi Healthcare. Vhi Healthcare should be obliged to ensure that its travel insurance policy is not contingent on its PHI policy. If Vhi Healthcare were an entity regulated by the Financial Regulator, it would appear to be the case that the conditions of sale of its travel insurance policies would be in breach of the Financial Regulator’s Consumer Protection Code.

<u>Recommendation 12</u>	Action By
Vhi Healthcare should comply with the Financial Regulator’s Consumer Protection Code as if Vhi Healthcare was a regulated entity of the Financial Regulator. Ministerial approval for products for sale by Vhi Healthcare should only be given where it would not lead to a breach of the Financial Regulator’s Consumer Protection Code.	Vhi Healthcare and Minister for Health and Children

- E 24. In view of the complexity of PHI products, Minimum Benefit Regulations are necessary to protect consumers from the risk of being sold products with insufficient cover. The Regulations are also necessary to support community rating. However, the Regulations limit innovation and restrict competition by forcing PHI firms to cover certain procedures and hospitals. The report makes a number of recommendations concerning the Minimum Benefit Regulations that are designed to improve both the effectiveness of consumer protection and the opportunities for product innovation, while reducing the negative effects on competition.

<u>Recommendation 13</u>	Action By
<p>The Minister for Health and Children should amend the Health Insurance Act, 1994 (Minimum Benefit) Regulations, 1996 in order to accomplish the following goals:</p> <ul style="list-style-type: none"> • Simplify the system of minimum benefits • Remove restrictions on the PHI products which health insurers can offer, while maintaining an obligation to provide a certain minimum level of healthcare cover to any individual covered by a health insurance contract • Remove the fixed minimum monetary values • Specify benefits to be covered in non-monetary terms, if possible. 	Minister for Health and Children

Buyer Power

- E 25. Chapter 7 contains an assessment of buyer power in the PHI market, especially with reference to Vhi Healthcare. Statements were made in a number of submissions by (or on behalf of) private hospitals and developers of private hospitals that Vhi Healthcare was discouraging the development of new private hospitals. Vhi Healthcare deny this, although they accept that they have not concluded purchasing agreements with planned new hospitals in one or two instances until a few months before they were opened. They also deny that they currently operate claims ceilings, which was alleged in two submissions. Overall, there is some evidence of buyer power on the part of Vhi Healthcare. In the short term, health insurance customers appear to be benefiting in their premium rates from Vhi Healthcare's strong bargaining position. However, there is an argument that investment in the private hospital market will be discouraged and that consumers might lose out in the long run. Nevertheless, two new private hospitals or clinics have opened recently and more are expected to open in 2007.
- E 26. Vhi Healthcare states that it does not have "buyer power", although it may have "payer power". Vhi Healthcare's distinction relies on a central feature of healthcare services that doctors must, and do, make the decisions concerning treatment of patients. The public health service or insurance companies typically then pay the bills. Insurance companies also have some incentives to limit private hospital capacity, for instance to avoid possible supplier induced demand (if it exists) and to keep down average costs in private hospitals by ensuring high capacity utilisation rates. However, insurance companies in a voluntary health insurance market have a strong commercial incentive to ensure that there is adequate private bed capacity for their customers because prompt access to private hospital treatment is the dominant product characteristic that generates demand for voluntary health insurance in the first instance.

Market Power

- E 27. Chapter 8 of the Report contains an assessment of market power in the context of competition policy analysis with particular reference to

the situation of Vhi Healthcare. In general, market power is more likely to exist when a firm has a persistently high market share. The key issue in the Irish PHI market is whether Vhi Healthcare is able to maintain its prices above competitive levels.

- E 28. Vhi Healthcare does not explicitly attribute competition factors to its decision-making process on prices and, instead, it usually refers to the aggregate cost of claims and the rate of medical inflation. There is evidence from the 2002 to 2004 period that when Vhi Healthcare increased prices by an unusually high amount the rate of decline in its market share accelerated and that it responded to this by applying relatively low price increases in the subsequent two years. Although it did not acknowledge this competitive motivation at the time of the price increases. Vhi Healthcare itself is subject to price control by the Minister for Health and Children and Vhi Healthcare has not applied price increases that have led to a trend of relatively high and rising profits. Neither is there any evidence that Vhi Healthcare is a relatively inefficient organisation and utilises pricing power to recover sufficient revenues to remunerate a relatively high cost base.
- E 29. Vhi Healthcare's statutory situation further complicates an analysis of its market power. Vhi Healthcare is currently limited by the VHI Acts in the level of financial surplus that it can make. Even if there was no price control power available to the Minister, it would not be lawful for Vhi Healthcare (as it is currently constituted) to attempt to maximise its financial surplus.
- E 30. The evidence from an analysis of the market prior to the commencement of risk equalisation payments, and before BUPA Ireland announced that it was commencing its withdrawal from the market, indicates that Vhi Healthcare did not have substantial market power. However, both the commencement of full risk equalisation payments (which significantly reduces the regulatory advantage held by insurers with lower risk profiles) and the withdrawal of BUPA Ireland from the market will weaken the competitive constraints on Vhi Healthcare, although this effect would be offset by any further new entry into the market.

Market Structure

- E 31. The recommendations in the report are intended to increase competition in the PHI marketplace. Nevertheless, consumer choice will remain relatively limited in the absence of new market entrants. In view of these market circumstances, the question arises as to whether the radical step of splitting Vhi Healthcare into two or more entities should be considered. This would increase competition and consumer choice (it would not, of itself, affect the scale of risk equalisation transfers). While the precise dynamic benefits that would flow from the resulting increased competition are difficult to predict, they are likely to be significant and wide ranging, affecting areas including pricing and product innovation. It would also greatly reduce or eliminate any existing buyer power of Vhi Healthcare. However, there would be obvious difficulties, costs and risks involved, for instance; loss of economies of scale, extinguishing the brand, possible financial weakness of the new companies, and regulatory and logistical issues. Furthermore, Vhi Healthcare's members have chosen their insurer and their views should be considered. In this

context, it is quite unclear, so far as the Authority is concerned, whether the economic benefits of splitting Vhi Healthcare in terms of enhanced competition feeding through to better value for consumers would outweigh the costs and risks involved. Furthermore, detailed implementation plans would have to be considered, including the transitional economic and financial costs of implementation. In the Authority's view, the main determining factor in this matter should be consumer benefit. It is recommended that the Minister for Health and Children should commission a study on the issue of splitting Vhi Healthcare into two or more successor entities.

<u>Recommendation 14</u>	Action By
The Minister for Health and Children should commission a comprehensive independent study into the feasibility of splitting up Vhi Healthcare into two or more smaller entities, considering in particular the relative costs and benefits of such a move.	Minister for Health and Children

- E 32. A particular model of a PHI market has evolved in Ireland with a small number of competitors as a result of the history of Irish policy decisions and EU insurance legislation. In this Report, the different policy and legal principles of competition, insurance regulation, Irish healthcare and health insurance are considered together in a single consistent manner. The overall objective of the Report's recommendations is to encourage competition in the Irish PHI market in order to best serve society and health insurance consumers.
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