

15 March, 2005

Dear

Introduction

As you are aware, the role of The Health Insurance Authority (“the Authority”) in relation to risk equalisation is set out in the Health Insurance Act, 1994, as amended (“the Act”) and in the Risk Equalisation Scheme, 2003, as amended (“the Scheme”). The Scheme stipulates that the Authority evaluate returns made to it under the Scheme and determine the Market Equalisation Percentage (“the MEP”) for the particular period under consideration.

Where, as a result of its evaluation and analysis, the Authority determines the nature and distribution of risks among scheme undertakings, as expressed in the Scheme by the MEP, to be not less than 2%, and not more than 10% the Authority is required by the Scheme to make a recommendation to the Minister. Article 10 of the Scheme provides that in any such recommendation: -

“The Authority shall inform the Minister whether he/she ought or ought not, as it considers appropriate having had regard to the best overall interests of health insurance consumers, to exercise his/her powers [to commence with equalisation payments]. The Authority’s report shall contain the reasons for the recommendation provided”.

The Act goes on to provide some guidance as to the best overall interests of health insurance consumers. It states that *“the best overall interests of health insurance consumers includes a reference to the need to maintain the application of community rating across the market for health insurance and to facilitate competition between undertakings”.*

Preparation for role

In 2002 the Authority engaged in a consultation process on risk equalisation in the Irish private health insurance market. This consultation process led to the publication by the Authority of a Policy Paper in September, 2002. In its Policy Paper the Authority outlined some of the risks that can arise in a community rated market and where the implementation of risk equalisation may be appropriate. Subsequent to the publication of the Policy Paper the Minister for Health and Children promulgated the Risk Equalisation Scheme, 2003 which came into effect from 1 July, 2003.

The Authority considers that it is entirely appropriate that an independent body should review the necessity for risk equalisation in view of *inter alia* the risks to a community rated market discussed in the Authority's Policy Paper and the extent of the impact that any introduction of risk equalisation could have on the market.

In order to better enable it to fulfil its task, the Authority consulted with the market and commissioned research in relation to matters that the Authority considered to be relevant.

The Evaluation and Analysis of Returns

In accordance with the terms of the Risk Equalisation Scheme, 2003, the Authority received returns at the end of January, 2004 and at the end of July, 2004 in relation to the two six-month periods 1 July – 31 December, 2003 and 1 January – 30, June, 2004 respectively. The Authority also sought and received additional information (including, for example, financial information) in relation to three scheme undertakings.

At the end of January, 2005 the Authority received further returns from scheme undertakings. These returns relate to the period 1 July, 2004 to 31 December, 2004. The Authority again sought and received additional information in relation to the three scheme undertakings.

On 28 February 2005 a data adjustment was received from one insurer. The Authority took the view that the data adjustment did not have a material effect on the Authority's evaluation and analysis. For example, as a result of the data adjustment the Market Positive Equalisation Adjustment changed by less than €50,000.

The Authority evaluated and analysed each of the three sets of returns received in January 2005 and the data adjustment received in February, 2005 and all returns collectively, for the purpose of ascertaining the differences, if any, in the nature and distribution of insured risks among scheme undertakings. A Health Status Weight ("HSW") equal to zero was adopted for the purposes of the evaluation and analysis. From the evaluation and analysis the Authority has, for the period 1 July, 2004 to 31 December, 2004, determined the following (allowing for the data adjustment received in February):

The Total Market Insured Persons ("MIP(Total)")¹ is equal to 1,906,218
The Total Market Equalised Benefits ("MEB(Total)")² is equal to €355,465,630
The Market Positive Equalisation Adjustments ("MPEA")³ is equal to €16,715,770
The Market Equalisation Percentage ("MEP")⁴ is equal to 4.7%

¹ The MIP(Total) represents the average of the number of persons insured with products that are subject to risk equalisation (excluding those serving initial waiting periods) at 1 July, 2004 and the corresponding number taken at 1 October 2004.

² The MEB(Total) represents the amount of benefit that is subject to risk equalisation that was paid by undertakings in the 6 month period

³ The MPEA represents the amount of the transfer that would have been paid in respect of the 6 month period if risk equalisation were in force and no phasing applied to the payments.

⁴ The MEP is equal to MPEA divided by MEB(Total).

Proposed recommendation of the Authority

In light of the foregoing evaluation and analysis, and having regard to the best overall interests of health insurance consumers, including the need to maintain community rating across the market for health insurance and to facilitate competition between undertakings, the Authority proposes to include in its report, which it will shortly furnish to the Tánaiste and Minister for Health and Children, a recommendation that the Tánaiste and Minister for Health and Children ought to exercise her powers under Article 13 of the Scheme (which relate to the commencement of risk equalisation payments).

The Authority makes this recommendation for the following reasons:

- The MPEA has increased significantly from €1.8m to €6.7m since the previous report. These figures are in respect of the transfers that would have arisen in respect of the two six-month periods January to June, 2004 and July to December, 2004 respectively if risk equalisation payments had been commenced and there was no phasing. This increase is reflected in the value of the MEP, which has increased significantly from 3.5% to 4.7%, with a Health Status Weight equal to 0. The growth in the MEP reflects the growth in the MPEA as a proportion of claims subject to risk equalisation.

As a result, the potential benefits, for example, by way of any possible average reduction in premiums paid by consumers across the market, which could accrue to individual health insurance consumers directly from the transfer of funds, would also appear to have increased. While it could be argued that, when viewed in relation to the number of health insurance consumers and the level of premium paid in the market (just over €1bn in 2004), the MPEA remains small, the Authority considers the increase to be significant and is of the view that the underlying trend is upward. Furthermore, in the Authority's view this trend is likely to continue in the absence of risk equalisation payments commencing.

- As detailed in its Policy Paper (see, in particular, Section 3), the Authority is cognisant of the possibility of instability arising in a community rated market, which would threaten the maintenance of community rating across the market, and that in certain circumstances the commencement of risk equalisation payments might be appropriate including in order to address such instability.

The Authority previously stated that if it considered, based on the information available to it, that such a threat emanating from the regulatory regime were imminent or would inevitably arise, it would, all else being equal, recommend the commencement of risk equalisation payments in order to maintain community rating. In its previous report the Authority did not consider that such a threat was imminent or would inevitably arise. However, it recognised that such a threat is a possibility that the Authority must take very seriously.

Specifically, as part of its deliberations the Authority considered analyses of certain trends in the market, including trends in the values of the MEP and

MPEA, the levels of lapses and sales for different insurers, the growth in the memberships of different insurers, the total growth of the market, the risk profiles of insurers as well as other matters detailed in its Policy Paper (see, in particular, Section 3). In doing so it aimed, among other things, to ascertain whether there is a possibility of a threat to the stability of the market arising, which should be addressed at this stage by the immediate commencement of risk equalisation payments.

The possibility of a threat to the stability of the community rated market arising that would warrant the immediate commencement of risk equalisation payments was also considered in the context of the financial positions of the insurers. In particular, in assessing whether such a threat to individual insurers exists, which could lead to instability in the private health insurance market as a whole, levels of profitability were considered relevant. In this context the Authority considered both publicly available information (Annual Report for Vhi Healthcare, returns to the UK Financial Services Authority by BUPA Insurance Limited) and other financial information provided to the Authority on a confidential basis by Scheme undertakings.

In light of the increase in the MEP and the MPEA and in the underlying trend of these figures, the Authority is of the view, based on the data available to it, that the likelihood of a threat to the stability of the community rated market arising in the absence of risk equalisation has increased. The Authority further considers that a threat to the stability of the market, in itself, would be counter to the best overall interests of consumers and that the stability of the community rated market and the best overall interests of consumers would be best protected by acting before such a threat arises.

- The Authority notes that premium increases in the market since 1997 have averaged c. 9% p.a. While this rate of increase appears to have slowed dramatically of late with a c. 3% increase in Vhi Healthcare's (September, 2004) and a 6% increase in BUPA Ireland's premiums (March, 2005), the Authority also notes that in 2002 / 2003 Vhi Healthcare increased their premiums by 18%, while BUPA Ireland increased their premiums by 14.4%. In this context and in the context of the ratios between claims incurred and premiums earned, the Authority is concerned about the level of competitive pressure on each insurer in the market.

It would appear from the growth in membership of the insurers and from other data provided by the insurers that sales are now more evenly spread between the two main insurers than was previously the case. Furthermore, there has been a new entrant to the market, which may further increase the level of competition.

Against this background, the Authority's previously expressed concern as to a possible reduction in competitive pressure if risk equalisation payments are commenced has now diminished. The Authority is now of the view that the benefits to health insurance consumers, which would accrue from the commencement of risk equalisation payments would outweigh any countervailing factors.

The Authority also sees merit in arguments that the commencement of risk equalisation payments could potentially benefit competition in the market in some ways, for example, by increasing competition for older policyholders.

- While there may be some seasonality in the data being included in returns received under the Scheme, the Authority is satisfied that the underlying trend in the MEP and in the MPEA is upward and is likely to so continue. Furthermore, the Authority considers that the basis for this view would not be materially affected by any seasonality in the data.
- In the points above, the Authority has discussed the direct benefits that could flow from the introduction of risk equalisation payments, and the impact of risk equalisation payments on the maintenance of a community rated market and on the facilitation of competition. The Authority recognises that these matters are interlinked. The Authority sees merit in the argument that circumstances in which a threat to the stability of a community rated market without risk equalisation might be avoided for a time are circumstances where price following exists. However, price following could lead to excessive inflation of health insurance premiums to the benefit of one or more insurers and to the detriment of consumers. In this context, the Authority notes that both Vhi Healthcare and BUPA Ireland premiums have increased by the same proportion, 98%, since BUPA Ireland entered the market. Of course, the higher premium inflation that would result from an uncompetitive market, in which price following exists (and which would be facilitated by the regulatory regime in the absence of risk equalisation) might also increase the possibility of a threat to the stability of the market. This threat might arise from any increasing difficulties that consumers might have in being able to afford higher health insurance premiums in future. For example, a threat may arise if younger people either choose not to purchase health insurance or allow their policies to lapse to a greater extent than older persons.

The Authority's recommendation is made in the context of the evidence available to it.

It may also be noted that the proposed commencement of risk equalisation payments will have the consequential effect of removing any uncertainty concerning when and if risk equalisation payments may commence, which might currently affect the market.

Representations

By means of this notice, the Authority invites [RELEVANT REGISTERED UNDERTAKING] to make, within 21 days from this date (i.e. on or before 5 April, 2005), representations to the Authority in relation to the nature of the recommendation that in the opinion of [RELEVANT REGISTERED UNDERTAKING] the Authority ought to include in its report to the Tánaiste and Minister for Health and Children.

In accordance with Section 12(5)(c) of the 1994 Act (as amended), the Authority will take account of any such representations made to it within the period specified above

before finally deciding what the nature of its recommendation to the Tánaiste and Minister for Health and Children ought to be.

Yours sincerely

Dermot Ryan
Chief Executive/Registrar

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