



THE HEALTH
INSURANCE
AUTHORITY

Report of The Health Insurance Authority to the Tánaiste and Minister for Health and Children pursuant to Article 10 of the Risk Equalisation Scheme, 2003 for the period 1 January, 2004 to 30 June, 2004.

27 October, 2004

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Introduction

The Health Insurance Authority (“the Authority”) is pleased to furnish this written report to the Minister for Health and Children (“the Minister”) as required by Article 10 of the Risk Equalisation Scheme, 2003 (“the Scheme”).

The report was compiled by the Authority following a careful evaluation and analysis of returns made to it under the Scheme pertaining to the period 1 January, 2004 to 30 June, 2004. As required by the Scheme, the report gives details of the evaluation and analysis carried out by the Authority and specifies the market equalisation percentage determined and the health status weight adopted for the purpose of the determination.

As the market equalisation percentage determined is between 2% and 10%, the report includes a recommendation on whether the Minister ought or ought not to exercise her powers under Article 13 of the Scheme and the reasons for the recommendation provided.

The report also contains information and advice concerning the carrying on of health insurance business, and developments in relation to health insurance generally, which the Authority considers ought to be included as a result of its evaluation and analysis.

Background

Historical Background

The Health Insurance Act, 1994 provided for the opening of the health insurance market to competition. The Act included provision for the establishment of the Authority and for a risk equalisation scheme. BUPA Ireland was the first undertaking to enter the health insurance market following the Act and remained the sole competitor to Vhi Healthcare in Ireland in respect of the generality of the market until the entry of Vivas Insurance Limited, trading as Vivas Health, in October, 2004.

Risk Equalisation Regulations were introduced in 1996 but payments were never commenced under them. Instead, the Regulations were subjected to significant analysis by an independent group, the Advisory Group on the Risk Equalisation Scheme (“the Advisory Group”). The then Minister for Health and Children also published a White Paper on “Private Health Insurance” in 1999, which set out the Government’s policy objectives and proposals regarding the role of private health insurance in the overall healthcare system. During this time, the 1996 Risk Equalisation Regulations were revoked.

The Government’s White Paper reaffirmed a recommendation by the Advisory Group that The Health Insurance Authority be established.

The Authority was established on 1 February, 2001 and its role, as set out in the Health Insurance Act, 1994 was amended by the Health Insurance (Amendment) Acts of 2001 and 2003. This legislation specified the Authority’s responsibilities with regard to risk equalisation as well as providing that the Authority may advise the Minister on matters relating to the functions of the Minister under the Health Insurance Acts, 1994 –2003, the functions of the Authority and health insurance generally.

The Risk Equalisation Scheme, 2003

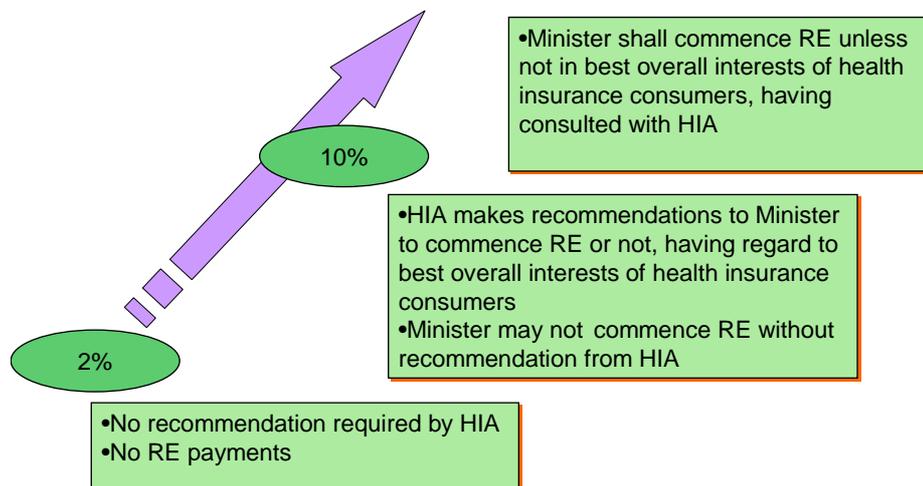
The Scheme came into effect on 1 July, 2003. The Scheme sets out the process under which any determination to commence risk equalisation payments would be made, as well as setting out the responsibilities of the Minister, the Authority and Scheme undertakings. The Authority’s role in relation to recommending, to the Minister, whether or not risk equalisation payments should be commenced is key. This role differs at three levels of risk difference between health insurers.

- If the level of risk difference between insurers is such that the Market Equalisation Percentage is below 2%, then a recommendation is not required from the Authority to the Minister and risk equalisation payments will not be commenced under any circumstances.
- If the level of risk difference between insurers is such that the Market Equalisation Percentage is between 2% and 10%, then the Authority is required to make a

recommendation to the Minister whether or not to commence risk equalisation having regard to the best overall interests of health insurance consumers. The Minister may not commence risk equalisation payments without a recommendation to so do from the Authority while the Market Equalisation Percentage falls between 2% and 10%.

- If the Market Equalisation Percentage is above 10% the Minister shall implement risk equalisation unless he or she believes it not to be in the best overall interests of health insurance consumers, having consulted with the Authority (referred to as HIA in the graph below).

Risk Equalisation Thresholds as per the Scheme



We see from the above diagram that the exact role of the Authority in relation to the Scheme is determined by the value of the Market Equalisation Percentage. However, this measure is by no means the sole determinant of the Authority's recommendation. The Scheme specifically states that the Authority's recommendation must have regard to the best overall interests of health insurance consumers, which 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, and it is in this context that the Authority's deliberations took place.

Consultations

In preparation for its role in relation to the Scheme, the Authority has consulted widely with interested parties and has engaged in in-depth research in areas that are relevant to its recommendation.

The Authority issued a consultation paper in February, 2002 regarding risk equalisation in the Irish private health insurance market. This paper was made publicly available and was distributed to a large number of stakeholders including consumer groups, insurance undertakings, professional bodies, industry bodies, legislators and healthcare providers. Comment from a wider audience was invited through newspaper advertisements. The consultation paper requested comments on issues relating to risk equalisation and specifically on the relationship between risk equalisation and consumer interests, the circumstances in which risk equalisation should be implemented and the methodology that should be used.

In the interests of transparency the Authority decided to publish the responses received in relation to the consultation paper except where an individual specifically requested that his response not be published. Responses are published on the Authority's website at www.hia.ie.

Following consideration of the representations received, the Authority issued a Policy Paper, which was forwarded to the then Minister for Health and Children and your Department, in September, 2002. In this Policy Paper the Authority stated that it was of the preliminary view that the introduction of risk equalisation could be justified in the appropriate circumstances. However, the Policy Paper went on to state that intervention may not always be appropriate to address difficulties in the private health insurance market and, where intervention is necessary, risk equalisation may not be the most appropriate, or even an appropriate, form of intervention to use.

In its Policy Paper, the Authority also stated that, when deliberating on whether or not risk equalisation should be commenced in the best overall interests of health insurance consumers, it would consider, *inter alia*, matters such as

- the differences in risk profiles between insurers,
- the relative sizes of insurers,
- the age / sex profile of insurers' policyholders,
- the rate of premium inflation,
- the number of insurers in the market / new entrants to the market,
- the effect of any transfer on premiums payable by consumers,
- the overall size of the market,
- the effect of payments on the business plans or solvency of insurers and
- the commercial status of insurers.

Subsequent to the publication of its Policy Paper the Authority remained open to the views of stakeholders and interested parties.

The Authority now discharges its functions in accordance with the Scheme.

Research and Commissioned Reports

The Authority has conducted, and continues to conduct, research into the health insurance market in Ireland and comparisons with overseas markets. This research

covers issues including, *inter alia*, premiums, premium inflation and medical inflation, market size and growth, age profiles, the operation of community rating and risk equalisation, adverse selection, alternatives to private health insurance and the interaction between private and public healthcare systems.

The Authority's research includes a survey of consumers¹, which was undertaken in late 2002. A report on this research was published in April, 2003. The initial reason for commissioning this research was to assess the degree of switching by consumers between health insurers in the Irish market. In its Policy Paper on Risk Equalisation in the Private Health Insurance Market in Ireland, the Authority noted some difficulties that could arise in a community rated market, such as those that could result from price following and predatory pricing. The arguments in the Policy Paper included the hypothesis that younger (and therefore lower-risk) health insurance consumers would be more likely to switch provider than older (higher-risk) health insurance consumers. The scope of this research was broadened to include other matters of interest to the Authority concerning the private health insurance market, which are detailed in the published report (*ibid*).

In addition, as appropriate, the Authority has also engaged independent expert advisers to report to the Authority on matters relevant to risk equalisation. Specifically, the Authority commissioned the following expert reports:

- A report from Arthur Andersen, dated April, 2002, proposing criteria that could be used by the Authority in deciding whether risk equalisation payments should be commenced and proposing a decision making process. Arthur Andersen's criteria differ depending on whether, in their words an "interventionist" or a "non-interventionist" approach is adopted. While the Authority are of the view that the Arthur Andersen report was useful and contained many valuable insights, neither the proposed criteria, nor the proposed decision making process were ultimately adopted by the Authority.
- A report from the UK Government Actuary's Department ("UKGAD"), dated July, 2002, outlining the views of UKGAD in relation to many of the arguments concerning risk equalisation and proposing a number of matters to be considered as part of the Authority's decision making process.
- A report from York Health Economics Consortium ("YHEC") concerning competition in the Irish private health insurance market. This report examined the current level of competition in the market, how that would be affected by risk equalisation, what impact risk equalisation would have on the likelihood of new competitors entering the market and what effects a change in the commercial status of Vhi Healthcare might have on the level of competition in the market.

All of these expert reports are attached as appendices to this report. It will be noted from a review of the reports that application of either the "interventionist approach" or the "non-interventionist" approach suggested by Arthur Andersen would result, in current circumstances, in a recommendation not to commence risk equalisation

¹ This research was conducted by Amárach Consulting on behalf of the Authority and was published and forwarded to the then Minister and the Department of Health and Children in April, 2003. A copy is available on the Authority's website (www.hia.ie).

payments, that UKGAD expressed the view that risk equalisation payments should not be commenced and that YHEC expressed the view that payments should be commenced. While the Authority is cognizant of the views expressed in these expert reports and of other views expressed in consultations and in representations, it recognises that it alone is the body mandated by statute to make a recommendation to the Minister on this matter.

The Evaluation and Analysis of Returns

On or before 30 July, 2004, in accordance with the requirements of the Scheme, the Authority received returns, for the period 1 January, 2004 to 30 June, 2004, from each of the three Scheme undertakings; namely BUPA Insurance Ltd (trading in Ireland as BUPA Ireland), ESB Staff Medical Provident Fund and The Voluntary Health Insurance Board (trading as Vhi Healthcare). Each of the returns was accompanied by an independent accountants' report, which is required by the Authority under sub-article 9(6) of the Scheme in order to further validate the returns. The Authority also sought and received additional information (including, for example, financial information) in relation to the three Scheme undertakings.

The Authority evaluated and analysed each return made to it and all three 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. The HSW is the weight given to calculations, which aim to equalise the level of utilisation of hospital accommodation as well as age and gender profile.

From the evaluation and analysis the Authority has, for the period 1 January, 2004 to 30 June 2004, determined the following:

The Total Market Insured Persons ("MIP(Total)")² is equal to 1,869,918
 The Total Market Equalised Benefits ("MEB(Total)")³ is equal to €36,075,492
 The Market Positive Equalisation Adjustments ("MPEA")⁴ is equal to €1,803,918
 The Market Equalisation Percentage ("MEP")⁵ is equal to 3.5%

The evaluation and analysis included consideration of each of the matters listed in the Authority's Policy Paper and earlier in this paper, as well as consideration of the extent to which any risk equalisation payments could involve the sharing of efficiencies. These matters were considered in the context of the best overall interests of health insurance consumers, including the need to maintain the application of community rating across the market for health insurance and to facilitate competition between undertakings.

The Members of the Authority met on 31 August, 2004 in order to, *inter alia*, discuss the evaluation and analysis. At this meeting, the Authority decided what the nature of the recommendation that it would propose to make ought to be.

² 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 January, 2004 and the corresponding number taken at 1 April, 2004.

³ The MEB(Total) represents the amount of benefit that is subject to risk equalisation that was paid by undertakings in the 6 month period.

⁴ 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.

⁵ The MEP is equal to MPEA divided by MEB(Total).

The Authority wrote to all Scheme undertakings on 3 September, 2004 giving notice of the fact that it proposed to recommend on this occasion that the Minister not exercise his or her powers under Article 13 of the Scheme. By means of the notice, the Authority invited undertakings to make representations in relation to the nature of the recommendation that, in the undertaking's opinion, ought to be included in the report. The Authority received representations from BUPA Insurance Limited and The Voluntary Health Insurance Board on 24 September, 2004. These representations received careful analysis and consideration and the Authority took full account of them before finally deciding what the nature of its recommendation ought to be.

The Members of the Authority met again on 5 October, 2004 and, at this meeting, formally decided what the nature of its recommendation ought to be. Subsequent to this meeting the Members of the Authority agreed the content of this report.

The Recommendation

In light of its careful 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 recommends on this occasion that the Minister ought not 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:

- As a proportion of the level of claims paid in the market the MPEA has reduced since the previous report. This is reflected in the value of the MEP, which has reduced from 3.7% to 3.5%, with a Health Status Weight equal to 0.

While the MPEA has reduced as a proportion of the level of claims, its absolute value for the six-month period from 1 January, 2004 to 30 June, 2004 has risen from €1.6m to €1.8m since the previous report. When viewed in the context of the number of health insurance consumers in the market and the amount of premium paid (c. €1 billion in 2003) the value of the MPEA, therefore, remains relatively low. As a result, the potential benefits, by way of any possible percentage reduction in premiums, which could accrue to individual health insurance consumers directly from the transfer of funds, would appear to be small.

- As detailed in its Policy Paper [see, in particular, Section 3], the Authority is cognizant 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 in order to address such instability.

If the Authority considered, based on the information available to it, that such a threat 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. However, based on its analysis, the Authority does not consider that such a threat is imminent or will inevitably arise. Such a threat is, however, a possibility that the Authority has taken and continues to take very seriously.

Specifically, as part of its deliberations the Authority considered analyses of certain trends in the market, including 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 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. While some data in relation to matters such as lapses and sales give rise to some concern and will continue to

be monitored, there was not sufficient evidence of such a threat when the totality of the data available to the Authority was considered.

The possibility of a threat to the stability of the market arising, which 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, levels of profitability were considered relevant and 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.

- The Authority notes that premium increases in the market in recent years have averaged c. 9% p.a., although this rate of increase appears to have slowed dramatically of late with the announcement of a c. 3% increase in Vhi Healthcare's premiums for contracts renewing in 2004 / 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, the Authority is concerned about the level of competitive pressure on each insurer in the market.

The Authority considers that the introduction of risk equalisation, in the present circumstances, could reduce the competitive pressures within the market without significantly increasing benefits to health insurance consumers. Noting the scale of recent rises in premiums and mindful of the real and potential benefits of competition the Authority considers that to recommend, at this time, that risk equalisation payments be commenced would not be in the best overall interests of health insurance consumers.

- Furthermore, there appears to be some seasonality in the data of at least certain undertakings disclosed in the returns. In this context, the Authority recognises that over time further data (including more returns), which may provide a more complete picture, will become available and will inform future deliberations.

The Authority's Future Deliberations

The Authority's recommendation is made in the context of the evidence currently available to it. This recommendation should not be understood as an indication that the Authority will not, in the future, recommend the commencement of risk equalisation payments. The Authority remains of the view that, in the appropriate circumstances, the best overall interests of health insurance consumers in a community rated market could be served by the commencement of risk equalisation payments.

Information and Advice Concerning the Carrying on of Health Insurance Business

Sub-article 10(3) of the Scheme states that this report may contain “information and advice concerning the carrying on of health insurance business, and developments in relation to health insurance generally”. Accordingly, the Authority wishes to apprise the Minister of a number of relevant matters and, where appropriate, provide advice.

The Health Status Weight (HSW)

Historical Background

At the time of its risk equalisation consultation process the Authority anticipated that it would have discretion in relation to the extent to which utilisation of hospital accommodation would be included, as a proxy for health status in any risk equalisation calculations. The Authority, therefore, included this matter in its consultations. The Authority shares the concerns of the independent experts who expressed a view that including utilisation in the formulae for risk equalisation could have a detrimental effect on competition, through sharing efficiencies, and result in increased inflation of insurance premiums. The Authority expressed this view in its Policy Paper of September, 2002 and proposed that the initial weighting given to utilisation should be 0% but that this weighting could be reviewed based on a specified process.

There were no objections to this proposal subsequent to its publication. Following the Authority’s first proposed recommendation in March, 2004 Vhi Healthcare raised concerns regarding the value of the Health Status Weight and has made a number of representations arguing that it be increased.

The Risk Equalisation Scheme, 2003

The process for setting the value of the Health Status Weight specified in the Scheme, published in 2003, accords to a large extent with the process set out by the Authority in its Policy Paper. Specifically, the Authority may only change the value of the HSW if:

1. It has observed that there are material differences in claims experience within prescribed age and gender cells.
2. It has carried out an investigation into the reasons for such material differences.
3. As a result of the investigation it has “concluded that the said material differences are wholly or substantially attributable to variations as between ... health status ... rather than ... efficiency levels” and
4. The Authority considers that the making of such a determination is in the best overall interests of health insurance consumers.

If the Authority decides to change the value of the HSW it must provide six months notice to all Scheme undertakings.

The Authority received a submission from Vhi Healthcare in July, 2004 arguing that the HSW should be increased “immediately”. Even if the Authority were minded to do this it would clearly not be possible in the context of the statutory process outlined above.

Evaluation of Returns

The Authority attempts, insofar as is possible, from its analysis and evaluation of returns, to gauge the effect of the age and gender profiles, variations in health status within age and gender cells and other factors on the claim profiles of the Scheme undertakings. It is clear from the Authority’s analysis that the difference in claim profiles between Scheme undertakings not accounted for by differences in the proportions within age and gender cells was significantly greater for the period January to June, 2004 than it was for the period July to December, 2003. This is evidenced by comparisons of the MEP calculated with a HSW of 0 and with a HSW of 0.5 as in the table below.

	MEP with HSW = 0.0	MEP with HSW = 0.5
July to December 2003	3.7	4.0
January to June 2004	3.5	4.4

On the basis of this analysis and other analyses of the returns carried out pursuant to Article 10(2) of Part IV of the Scheme, the Authority has observed that there are material differences in claims experience within prescribed age and gender cells as between Scheme undertakings evidenced in the returns received. However, it should be noted that there is little consistency between the two sets of returns in relation to this matter and seasonal influences could be having an effect.

Following this analysis the Authority engaged actuarial consultants to advise it in relation to points 1 to 4 of the process outlined on the previous page and to undertake research necessary to inform the advice. The Authority will contact scheme undertakings shortly in relation to this matter and will inform the Department of Health and Children of developments as appropriate.

Technical Annexe: Working Experience of the Scheme

Consistency of Returns

In its previous report, dated 28 April, 2004, the Authority outlined difficulties that it encountered in terms of ensuring consistency in the returns forwarded to it. While the issues that led to inconsistencies in the returns received for the period July to December, 2003 were resolved, a further inconsistency, relating to the application of the definition of a health services provider and, in particular, whether the cost of treatment in diagnostic centres should be included in returns arose.

This inconsistency was not of sufficient magnitude to affect the Authority's recommendation for this period. Nevertheless, the Authority will endeavour to resolve this matter through discussions with the Scheme undertakings.

The Authority notes the willingness of the Department of Health and Children to consider an expansion of the definition of health services provider and recommends that this be done in the context of other amendments to the Scheme recommended by the Authority in its previous report.

In order to assist in its verification and validation of returns and to help it to minimise the possibility of further inconsistencies in the manner in which returns are compiled, the Authority proposes to contact insurers with the aim of requesting further information to be included with returns. This information would, *inter alia*, outline the amounts of claims excluded from returns and the reasons for excluding each amount.

Appendix I: Arthur Andersen Paper Prepared for The Health Insurance Authority Workshop on Risk Equalisation of 2 May, 2002.

Arthur Andersen was retained on a consultancy basis to provide advices to the Authority.

The following paper was presented in the form of Powerpoint slides to a meeting of the Authority on 2 May, 2002. The slides and accompanying speakers notes are published here.

Appendix II: UK Government Actuary's Department Paper of 29 July, 2002.

The UK Government Actuary's Department ("UKGAD") was retained by the Authority to provide advices on a consultancy basis.

The following paper is in the form of a letter to the Chief Executive / Registrar of the Authority dated 29 July, 2002. At the request of UKGAD a further letter dated 11 October, 2004 is also attached. This letter sets out, *inter alia*, the purpose and scope of the UK GAD paper of July, 2002.

**Appendix III: The York Health Economic Consortium Report Titled
“Assessment of Risk Equalisation and Competition in the Irish Health Insurance
Market”.**

The Authority, in 2003, commissioned research into competition in the private health insurance market in Ireland.

In order to gauge the effect on competition of its decisions, the Authority considered it appropriate to first assess the existing level of competition, how this is affected by existing legislation and market conditions and whether (or to what extent) barriers to entry exist in the market.

After a competitive tendering process, this project was awarded to York Health Economics Consortium. The final report of this project was produced in November, 2003.