Submission of the Health Insurance Authority to the Oireachtas Joint Committee on Health and Children

14 December 2009

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1. The Health Insurance Authority

The Authority is a statutory body that was established in 2001 as a regulator of private health insurance. (The Financial Regulator also has responsibilities in the health insurance market, including in relation to solvency). The principal functions of the Authority as provided for in the Health Insurance Acts include the following:

- To monitor the health insurance market and to advise the Minister for Health and Children ("the Minister") (either at his or her request or on its own initiative) on matters relating to health insurance;
- To monitor the operation of the Health Insurance Acts and, where appropriate, to issue enforcement notices to enforce compliance with the Acts;
- To carry out certain functions in relation to health insurance stamp duty and age related tax credits and in relation to any risk equalisation scheme that may be introduced;
- To take such action as it considers appropriate to increase the awareness of members of the public of their rights as consumers of health insurance and of health insurance services available to them; and
- To maintain "The Register of Health Benefits Undertakings" and "The Register of Health Insurance Contracts".

The Authority is independent in the performance of its functions.

The following are some examples of work undertaken by the Authority in recent times:

- In 2007, the Authority issued a comprehensive report on competition in the health insurance market.
- Following the 2008 Supreme Court Decision to set aside the Risk Equalisation Scheme then applying, the Authority submitted a Report to the Minister setting out the Authority's advice in relation to how community rating could be supported in the changed circumstances. Subsequently, the Health Insurance (Miscellaneous Provisions) Act 2009 was introduced, which provided for an interim tax credit / levy system to support community rating as well as other measures, for example pertaining to consumer information and enforcement.
- The Authority carries out periodic surveys into consumer attitudes and behaviour in relation to health insurance, most recently in 2008.
- In October 2009 the Authority submitted a Report to the Minister under the 2009 Act providing advice in relation to the review of the tax credit / levy arrangements.
- The Authority provides assistance to consumers in relation to health insurance and dealt with over 1,000 cases over the last 12 months.
- The Authority recently launched a new website, which includes a product comparison tool that consumers can use to find the products that best suit their needs as to both coverage and price.

- In November 2009, the Authority submitted a preliminary report to the Minister outlining considerations to be taken into account in applying risk equalisation to factors other than age and gender.

2. Regulation Required to Support Community Rating

Ireland, like many other countries, has a community rated health insurance market. In such a market consumers are charged the same premium for health insurance irrespective of age or state of health.[1] Because, on average, claims for older and unhealthy people are much higher than for younger and healthy people a community rated market requires support to function in the interests of consumers. Internationally, the norm is for community rated markets to be supported by a special regulatory framework including risk equalisation.

In 2005, the Minister decided, on the Authority's recommendation, to commence risk equalisation under the then applicable legislation as from 1 January 2006, but in the event the relevant legislation was set aside in the Courts in 2008. The problems faced by the market at present would be much less challenging if it had been possible to introduce risk equalisation from 2006 as intended.

Following the Supreme Court Decision, the Authority provided advice to the Minister in relation to how to support the operation of community rating in the interests of consumers in the changed circumstances. The Authority advised that the alternatives were either to reconstitute the Risk Equalisation Scheme in some form or introduce some form of levy based or tax based loss compensation system. The Authority noted that the reintroduction of a comprehensive system was likely to take time and that significant risks could arise in the interim.

In order to support community rating in the interim, the Oireachtas introduced the current tax credit / levy based system in the Health Insurance (Miscellaneous Provisions) Act 2009 and at the same time the Minister stated the intention design a permanent replacement for the 2003 Risk Equalisation Scheme. It is envisaged in the legislation that the interim system will apply for three years. The Act provides for insurers to receive a higher premium in respect of older people, the extra premium being funded by way of tax credits. In turn, the tax credits are funded by a health insurance levy, which is set so that the system as a whole is projected to be revenue neutral for the Exchequer and for the market. The tax credits are currently set to equal 50% of the higher costs of insuring older people and, in this way, insurers of older people are partially compensated for the extra costs arising.

The interim measures included in the Health Insurance (Miscellaneous Provisions) Act 2009 and the intention to follow on with a comprehensive risk equalisation system is an important and necessary support to the operation of community rating.

In a community rated market without a comprehensive risk equalisation system, as is currently the case, a newer insurer will have significant automatic advantages because both new health insurance consumers and switchers will tend to be younger and healthier

[1] In Ireland, open membership insurers may only vary premiums for group schemes (maximum discount 10%, children and students).

on average and older consumers will likely be already insured and less likely on average to switch. Furthermore, in such a market, older and unhealthy consumers will tend to be extremely unprofitable on average. The following consequences arise:

- The incentive for insurers is to segment risks so that older and unhealthy customers are sold products that cost more or include a lower level of benefits.
- Insurers are incentivized to design and market products so as to select better risks.
- Insurers with favourable risk profiles have a marked competitive advantage.
- The most successful insurers are likely to be those with the best risk profiles, not necessarily those that provide the best service.
- Insurers with worse risk profiles are obliged to charge higher premiums or incur losses. Switching of younger customers will exacerbate this problem.

3. Current State of the Market

Trend in Market Size

As can be seen from Appendix 1, the health insurance market grew steadily for many years. The total market increased from 1,871,000 at the end of 2001, the year the Authority was established, to 2,299,000 at the end of 2008. For the first time, the total market size has declined this year. While the reduction to date is small in relative terms, the fact that the market has ceased to grow is significant and raises the question of whether the current economic downturn will result in a more substantial decline in the next few years. In a community rated market based on intergenerational solidarity, retention of existing profitable members and an influx of new younger members are key to market stability. A significant acceleration of the declining trend this year could therefore have serious consequences for the market. In this context, the proposed introduction of Lifetime Community Rating (i.e. age at entry loadings) would help to support the market to some extent.

Appendix 2 gives details of trends in market share and a breakdown of current market shares by age as between insurers. It can be seen that market shares differ substantially for different age groups. This is significant because claim rates rise rapidly with age. This is starkly illustrated in Appendix 3.

Market Segmentation

Because the current interim measures to support community rating only compensate for 50% of age related claim differences, it is very profitable for insurers to recruit younger healthier consumers and avoid older less healthy ones. Where insurers provide cover to older consumers, there is an incentive to sell different products to older and younger consumers in order to allow differential pricing. Despite community rating, there is evidence of this in the market place. This is not intended as a criticism of insurers who are doing no more than acting in their commercial interest. What we have in the market at present is a rather diluted form of community rating, which reflects the limited support to community rating provided by the interim tax credit / levy system.

Insurers have run special offers/marketing campaigns aimed at preferred segments of the market. These have involved one day sales on corporate plans, products aimed at group schemes offering more favourable terms and additional benefits such as teeth whitening that are aimed at younger customers. All insurers have better value plans, the full details and prices of which are not easily found on their websites. These plans are sold directly to lower risk corporate group schemes. Certain measures, for example prior notification of new products to the Authority, introduced by the Health Insurance (Miscellaneous Provisions) Act 2009 should address some of these issues to an extent.

In the first 10 years of a competitive market Vhi Healthcare experienced a relatively steady decline in market share of around 0.5 percentage points per quarter. The rate of decline in Vhi Healthcare's market share has increased in recent years and in the last 12 months Vhi Healthcare has lost market share at a rate of 0.8 percentage points per quarter. This reflects more intense competition from Quinn Healthcare and Hibernian AVIVA Health over the period.

Unsurprisingly, Vhi Healthcare's losses in terms of market share are mainly in the younger age cohorts. By the middle of 2009, Quinn Healthcare and Hibernian AVIVA Health, between them, had around 40% of the 30 to 39 age group, but less than 5% of the over 80s. In addition, the Authority expects that, within age groups, Vhi Healthcare would have a disproportionately high share of unhealthy lives. The Authority is of this view because it considers that unhealthy people are less likely to switch insurer due to perceived risks involved.

Over the period since competition began, Vhi Healthcare has also been able to recruit a significant number of younger and healthier consumers and this has been important. However, it is worth noting that, over much of this period, favourable economic conditions, including substantial employment and population growth, existed in Ireland. These favourable economic conditions assisted all insurers in recruiting younger customers. In the first half of 2009, the number of people under the age of 50 insured with Vhi Healthcare fell by around 50,000.

The net effect of segmentation of risk both between and within insurers is that older and less healthy people are, on average, paying more for health insurance cover. This is why a comprehensive risk equalisation system is needed. In the meantime, the recently introduced product comparison tool on the Authority's website will provide assistance in this area.

<u>The effect on the market of the changed economic conditions</u>

The differences that changed economic conditions may make to the market are firstly that price elasticity is likely to increase and that there may be greater price competition for younger and healthier people. Secondly, younger people in particular may be less likely to take out health insurance and more likely to allow their policies to lapse or to switch to a lower cost provider. An insurer with a younger age profile will be in a financial position to offer discounted insurance plans, which are likely to be targeted at younger people. An insurer with an older age profile may endeavour to further segment its risks so that more expensive products are sold to older and less healthy customers while other products are designed to appeal to younger people and to compete with the products of its competitors. Products marketed to younger and healthier people could be deliberately designed with features to discourage older and less healthy people from purchasing them.

Furthermore, the absence of a comprehensive risk equalisation system will have a negative impact on the financial and competitive position of an insurer with a worse risk

profile. In the changed economic conditions a number of effects may be expected to combine to accentuate market trends, viz;

a) In view of the fact that the interim measures to protect community rating do not equate to a comprehensive risk equalisation scheme, insurers with a better risk profile are in a position to offer cheaper policies targeted at younger consumers. Consequently, an insurer with a worse risk profile would be expected to experience an increased rate of lapsing with negative consequences for its premium income, but without a similar reduction in its claims.
b) The economic environment may lead to a reduction in the inflow of young first time health insurance consumers.
c) In the absence of a comprehensive risk equalisation system, insurers have a strong commercial incentive not to sell insurance to older less healthy consumers, including by switching.
d) The participants in the market are now all well established with the result that relative risk profile advantages and disadvantages are a more significant issue.

In this context, it is likely that an insurer with a less advantageous risk profile would lose market share in the younger age cohorts more rapidly, forcing it to apply higher price increases or incur increasing financial deficits.

Consumer Attitudes

The above paragraphs focus on the need to strengthen regulation to support community rating in the interests of consumers. At the same time it is worth noting that the latest research published by the Authority indicates that there is a high level of consumer satisfaction with health insurance across a range of categories.

4. Future of the Market

In a community-rated market without comprehensive risk equalisation, insurers with lower risk profiles will be more profitable even if they are less efficient. Also, insurers that attract less healthy consumers by meeting their needs would be penalised by incurring claim costs that are higher than the community rated premium. On the other hand, both consumers and efficient insurers would benefit from a properly functioning competitive market. Consumers would benefit from price and product competition. Insurers that design, sell and administer attractive products in a cost effective manner would be profitable. This would not necessarily be the case in the current community rated health insurance market without a comprehensive risk equalisation system.

Impact on consumers

Risk selection and segmentation are vital to the commercial success or failure of health insurance providers in a community rated market without a comprehensive risk equalisation system. In order to compete in such a market, it would be expected that insurers would focus their commercial activity on improving their risk profiles rather than, for example, on improving their efficiency. As younger and healthier consumers are profitable, insurers would actively seek them out as customers and these customers would be likely to benefit, in the short to medium term. As older less healthy consumers are not profitable, insurers may make their products less attractive to them. In other words, recent trends could well accelerate.

In addition, because the emphasis in the market will be on risk selection rather than efficiency, one is likely to see a deterioration in the level of efficiency in the delivery of health insurance and in and in the extent of efficiency benefits passed to consumers, with a growing proportion of expenditure being directed at the marketing of products to those who are less likely to claim.

Impact on the market

A systemic issue arises for the market because risks are created for the long term viability of insurers with less favourable risk profiles and consequently for the stability of the health insurance market as a whole. Regardless of its level of efficiency, an insurer with a less favourable risk profile, such as Vhi Healthcare, will be obliged to either increase its premiums or incur significant losses. If it increases its premiums it is more likely to lose younger than older customers and its worsening risk profile may oblige it to increase premiums further, resulting in a cycle that could threaten the long term viability of the insurer, which would have consequences for the market as a whole. It is important to note that, because competition is distorted, an insurer would not incur such difficulties because it is less efficient or because it has poor products; such difficulties would result directly from its relatively disadvantageous risk profile.

In addition, the fact that insurers with favourable risk profiles are protected from competition from insurers with older memberships could result in higher premiums for health insurance consumers in total.

Possible impact on public health services

As noted above, insurers will have an incentive not to market health insurance to older and less healthy consumers and to sell products that do not cover treatments used by older people. If insurance products restrict cover for treatments required by older or less healthy people or if a significant number of these people allow their insurance to lapse then there will be a reduction in demand for private hospital services and a corresponding increase in demand for public hospital services.

5. Other Issues

Competition is also distorted by the current regulatory position of Vhi Healthcare, whereby it is not authorised by the Financial Regulator and consequently not required to comply with the Financial Regulator's solvency requirements. There is wide consensus that this matter needs to be addressed. The Authority has recommended, including in its 2007 Competition Report, that Vhi Healthcare become an authorised insurer and be subject to all of the requirements of the Financial Regulator. Much progress was made in this regard through the enactment of the Voluntary Health Insurance Act 2008. However, the Supreme Court subsequently set aside the Risk Equalisation Scheme and it is difficult to see how the current regulatory situation would not impact negatively on Vhi Healthcare's ability to satisfy the Financial Regulator's authorisation requirements. Any competitive advantage gained by Vhi Healthcare as a result of its non-authorisation by the Financial Regulator is, in the Authority's view of much lesser import than the disadvantage of its relative risk profile.

It is also considered that the competitive distortions referred to throughout this paper have contributed to premium inflation in the health insurance market. It is important to note that, on average, the rate of premium inflation has been higher for older and less healthy people than for younger and healthier consumers, both because younger and healthier consumers are less risk averse and more likely to switch to lower cost plans and because insurers are incentivised to target younger and healthier people with better value products.

6. Conclusion

In the view of the Health Insurance Authority the best outcome over the medium term would be the introduction of a comprehensive risk equalisation system coupled with the authorisation of Vhi Healthcare as a regulated insurer by the Financial Regulator. This outcome would serve to support community rating and competition in the interests of consumers generally.

Appendix 1 – Market Size

The following table shows the trend in market size since the establishment of the Authority.

	Market Size	Change in Period	Percentage of Population with health insurance
December 2001	1,871,000		48%
December 2002	1,941,000	70,000	49%
December 2003	2,000,000	59,000	50%
December 2004	2,054,000	54,000	50%
December 2005	2,115,000	61,000	51%
December 2006	2,174,000	59,000	51%
December 2007	2,245,000	71,000	51%
December 2008	2,299,000	54,000	52%
September 2009	2,267,000	-32,000	51%

Appendix 2 – Market Shares

The following table shows how market shares have changed since the establishment of the Authority.

	Vhi Healthcare	Quinn Healthcare*	Hibernian AVIVA Health**	Restricted Membership Undertakings***
2001	83	12	-	5
2002	81	14	-	5
2003	78	17	-	5
2004	76	19	-	5
2005	74	21	1	5
2006	72	21	3	4
2007	70	21	5	4
2008	67	21	7	4
2009	64	22	10	4

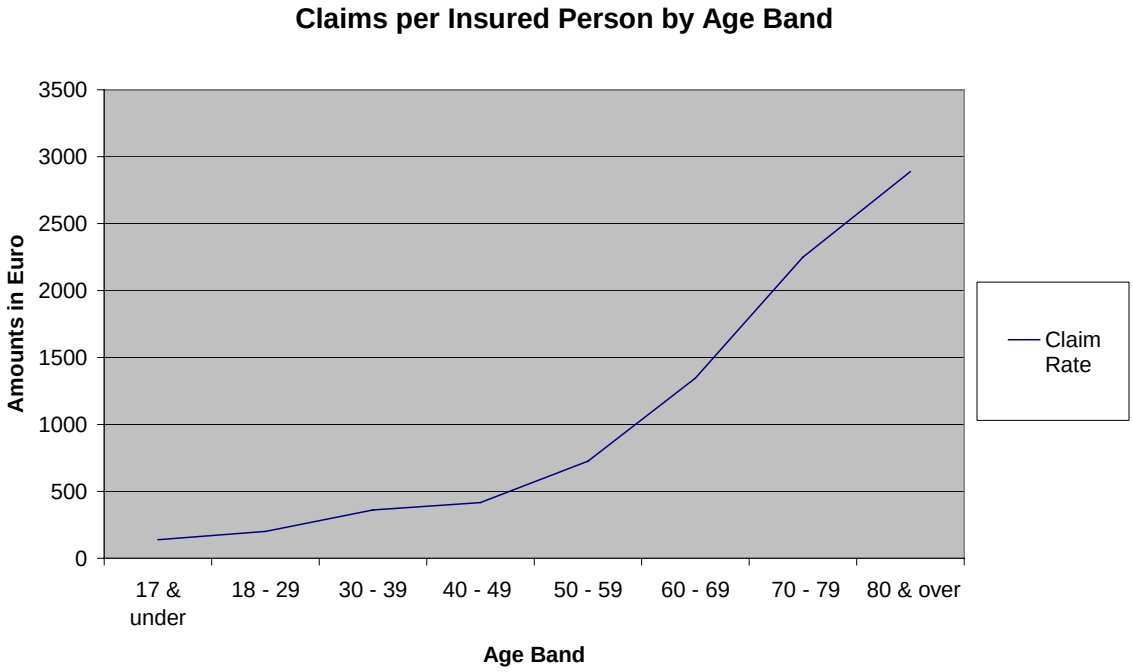
* In respect of 2006 and earlier years the data relates to BUPA Ireland.
** In respect of 2007 and earlier years the data relates to VIVAS Health
*** Mainly, the Garda, ESB and Prison Officer Schemes

The following table shows how market shares vary with age as at July 2009. The table below refers to open membership insurers only and excludes the restricted membership undertakings.

Age Group	Vhi Healthcare %	Quinn Healthcare %	Hibernian AVIVA Health %
0-49	63	26	11
50-59	71	21	8
60-69	80	16	4
70-79	90	8	2
80 and over	95	3	1

Appendix 3 – Claim Variation by Age

As health insurance in Ireland is community rated, premiums do not vary by age. However, the underlying claims paid by insurance companies vary considerably in accordance with the age of the insured person. The following chart illustrates how claims increase with the age of the insured person[2].



[2] Data for the chart is taken from data returns provided to the Authority for Jan to July 2009. Claim rates are annualised. Claims data is only for the approximately 80% of claims paid in the market that are included in returns.