# Submission to The Health Insurance Authority – Risk Equalisation in the Private Health Insurance Market in Ireland

## Background

Given the legislative background against which the current consultation is taking place, issues concerning the implementation of a risk equalisation scheme clearly fall outside the scope of the Competition Acts, as amended. Without considering in detail the merits of the decision to apply the principle of community rating, it is clear that policy makers believe that there are important public policy reasons why such a principle should be protected in the legislative framework. Among other things, the manner in which community rating has heretofore been implemented has caused an unsustainable instability in the private health insurance market. This has been clearly outlined in the report of the Advisory Group on the Risk Equalisation Scheme ("the Harvey Report"), where they refer to the current system of community rating as "unduly unstable". Proposals to relate premiums and coverage upgrades to age at entry are important innovations that will help to bolster the stability of the private health insurance market.

## Risk Equalisation – A Barrier to Entry

Risk equalisation is a barrier to entry into the Irish private health insurance market. Many large EU health insurance firms have explicitly stated that this is the case. This fact was also explicitly recognised in the Harvey Report[1] where it was stated that "risk equalisation is a barrier to market entry." However, given the over-riding importance attached to the public policy objective of maintaining community rating, some system of risk equalisation is likely to be necessary to support the principle of community rating. The Advisory Group in the Harvey Report found:

> " … based on its own deliberations and on the basis of arguments made and evidence presented to it, that risk equalisation is essential to underpin community rating[2]."

BUPA, who are the only new entrant into the Irish market, have consistently argued that risk equalization:

[1] Harvey Report, p 42.
[2] Harvey Report, p 30.

- is not necessary;
- rewards companies that do not contain costs (or do not introduce new products); and
- hinders competition.

Risk equalisation, or the prospect of it, is however, just one element of a range of issues that make the Irish private health insurance market, unattractive to new entrants. It may well be that any ongoing uncertainty as to how any potential risk equalization scheme may work is also reducing the attractiveness of the Irish market, which is small in comparison to most EU markets. Notwithstanding this, a very large proportion of the population has private health insurance in comparison to other EU states. Given the incentive to join a community rated scheme, this indicates that it is probably a mature market outside the younger age groups.

Other concerns surround the relationship between VHI and the Department of Health and Children generally. In particular, as stated in the Harvey report:

> "There is a perception that the market is not one where all insurers will have an equal relationship with the various agencies of the State.[3]"

In other words, there exists a fear in the market that regulatory decisions may not be made on the basis of what is "good" for the industry and consumers, but instead on the basis of what is "good" for the VHI. In this context, the Harvey report stresses the importance of establishing a "level playing pitch" for all market players.

With this as a background it may be best that the Health Insurance Authority should have a much clearer and stronger role in terms of both when to apply a risk equalization scheme and, indeed, how such a scheme should be applied. With this in mind, it would be helpful if there were no circumstances where the Minister alone could implement a risk equalisation scheme. This would require a scrapping of "Threshold 2" or setting it at such a level so that it could never be an option. It would probably be preferable that it was removed as an option. As Mr. Martin O'Rourke (CEO of BUPA Ireland) was quoted in the Irish Times of 7th June 2001:

> "We think that the proposed Health Insurance Authority should have a reserve power to recommend a risk-equalisation scheme if such a scheme was independently considered necessary by the Authority to maintain market stability"

[3] Harvey Report, p 46.

Mr. O'Rourke is quoted as saying that such an assessment should be based on objective criteria such as the downsizing of the market, the exit of older-aged policy-holders or the impending financial collapse of one or more insurers. Without commenting on the merits of any reported statements, the general principle that the decision to implement a risk equalisation scheme should be de-politicised as much as possible has much to recommend it. The Health Insurance Authority has to be supported in terms of ensuring that it conducts a wide and comprehensive public consultation on the issues. It has embraced the need to be transparent and fair in its procedures and its work can do much to settle anxieties that exist in the wider marketplace.

**Consumer interests**

The Health Insurance (Amendment) Act, 2001 states that the Authority must have regard to the best overall interests of health insurance consumers in formulating its recommendations to the Minister to commence risk equalisation or not. Specifically the Act in Section 10(a)(iii) 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."

The Competition Authority has made its views known in many varied circumstances that competition is the best protector of consumer's interests. Competition will ensure that higher service levels are provided at lower prices to consumers. Deviations in public policy away from this principle are, however, acceptable to the Competition Authority if they address a clear market failure or public policy objective that cannot be addressed in a manner that is less restrictive of competition. In this the concept of proportionality is key.

In terms of considering consumer interests in the case of private health insurance it is important to bear in mind that the interests of current consumers can be distinct from the interests of future or potential consumers. In fact, the interests of current consumers may not coincide with those of future consumers given the "pay-as-you-go" nature of the market. In this manner, it could be argued that consumer's interests are also served by the stability of the private health insurance market. However, as the Harvey report points out, the nature of the "pay-as-you-go" scheme has many of the elements of a pyramid selling scheme. From this perspective, the stability of the scheme should be a key public policy objective.

**Medical Inflation, Market Stability and Competition**

As the Harvey Report points out, the best option would be to move to a fully funded private health insurance scheme, which would remove the need for the young to pay for today's old (who themselves paid for the previously old). However, movement from a "pay-as-you-go" system to a fully funded system involves an unfunded liability. Data presented in the Harvey report shows that this unfunded liability is rising over time due to the various pressures that contribute to medical inflation. In this environment, a decision to move to a fully funded system is more and more difficult to take as time elapses.

If medical inflation is not tackled, it is clear that a serious instability is being stored up for future generations (in the not too distant future) which has the potential to collapse the private health insurance market in Ireland. As is pointed out in the Harvey Report, medical inflation has a huge impact on the size of the unfunded liability. If medical inflation were to rise at the rate of general inflation (normally it rises at a multiple of this) the size of the unfunded liability was estimated in 1998 to be IR£3.3bn. This estimate rises to IR£23.6bn if medical inflation exceeds general inflation by 6%. As stated in the Harvey Report:

> " … if medical inflation is not contained … the spectre of adverse selection[4] would loom large, and the current system of private health insurance would probably collapse.[5]"

The causes of medical inflation are complex but the interests of the Health Insurance Authority, the Competition Authority and the general public coincide in terms of highlighting areas where competition can bring medical inflation under control.

It should be immediately possible to introduce greater competition by exploiting the benefits of international trade in medical services. Many of our EU neighbours have significant excess supply of services for which there is an unfulfilled demand here in Ireland. Health insurance companies should be encouraged to conclude agreements with such institutions. This presents the potential for mutually beneficial trades to occur, which can address both the problems of congestion and escalating costs in the Irish system. Of course, some consumers would prefer not to be treated outside Ireland, but those who do could be rewarded by earlier treatment and/or lower deductibles. Those consumers who have a very strong preference to be treated locally will, of course, benefit indirectly.

[4] Adverse selection occurs in insurance markets where only high-risk individuals have an incentive to obtain insurance. This raises the cost of insurance and the set of people who remain insured are even more high risk. This can cause an insurance market to collapse.
[5] Harvey Report, p 29.

It would not be possible to highlight areas that could benefit from the introduction of competition absent of some detailed study of the issues involved. However, that they do exist in a substantial number of cases can be seen from this quote from the Harvey Report:

> "The Advisory Group has been struck by the extraordinary absence of a culture of market efficiency and competitiveness in many areas of the healthcare sector.[6]"

Such a study would provide a basis for the optimal introduction of competition with a view to containing many of the containable elements of medical inflation.

In so far as is practical, the Health Insurance Authority should endeavour to allow competition to flourish between health insurance providers. Any risk equalisation scheme should be as supportive of competition as can be practically achieved. In addition, competition should be used as a basis for driving cost control and efficiency through the system generally.

**Concluding Comments**

While the decision in principle to implement some form of risk equalisation scheme in the Irish private health insurance market has already (for public policy reasons) been made, such a scheme does represent a barrier to entry. However, it is only one of a range of factors that discourage entry. In particular, the fact that the market penetration rate is already relatively high, that the former State monopoly retains close links with the regulating bodies and that there exists the potential for excessive politicisation of key regulatory decisions such as when to implement the risk equalisation scheme, all make the Irish private health insurance market less attractive to new entrants. Clearly, even in the context of a risk equalisation scheme much can be done to make private health insurance market more attractive and conducive to competition. The lack of a culture of competitiveness in the healthcare market is also a concern and may contribute to medical inflation.

The Competition Authority remains available to discuss any of the issues raised here, or indeed any other competition issues.

**Isolde Goggin**

**Director of the Regulated Markets Division**

**Competition Authority**

[6] Harvey Report, p 41.