THE HEALTH INSURANCE AUTHORITY

Policy Paper

Risk Equalisation in the Private Health Insurance Market in Ireland

September 2002

1 Introduction and purpose

The purpose of this policy paper is to set out The Health Insurance Authority's ("the Authority") considerations on its role in relation to recommending whether or not the Minister for Health and Children ("the Minister") should commence risk equalisation in the Irish private health insurance market.

Legislation sets out a significant role for the Authority in relation to the Minister's decision to implement risk equalisation. In this context the legislation stipulates that the Authority must have regard to the best overall interests of health insurance consumers. The Authority engaged in a consultation process throughout March and April 2002 in relation to the exercise of this role, following publication of a consultation paper on 19 February, 2002. Having considered the issues, the Authority has formed preliminary views, which it sets out in this paper.

This paper begins by briefly describing the consultation process engaged in by the Authority and then describes the Authority's preliminary views with regard to the appropriateness of commencing risk equalisation. The paper concludes by setting out some comments on the methodology to be used in relation to risk equalisation.

2 Consultation Process

The Authority issued a consultation paper on 19 February, 2002 regarding risk equalisation in the Irish private health insurance market. This paper 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.

The following provided submissions in response to the Authority's consultation paper:

- BUPA Ireland
- Former members of the Advisory Group on Risk Equalisation
- Health Boards and ERHA Chief Executive Officers' Group
- Irish Medical Organisation
- Professor Ray Kinsella
- Royal & SunAlliance Restricted Membership Undertaking
- The Competition Authority
- The Society of Actuaries in Ireland
- Vhi Healthcare
- Vhi Members' Advisory Council

The Office of the Director of Consumer Affairs responded that the issues do not directly come within the remit of the Director. The Minister for Health and Children and officials of the Department of Health and Children declined formal discussion at this point and stated that they had no matters to raise at this juncture.

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

The Authority is grateful for the submissions received and wishes to acknowledge the assistance that these contributions provided to the Authority during the course of its deliberations.

3 Preliminary views of The Health Insurance Authority

The Authority's role in relation to risk equalisation is set out in the Health Insurance (Amendment) Act, 2001. The Act states that the Authority, when making its report to the Minister, should in certain circumstances "*include in that report a recommendation by it that the Minister ought or ought not (as it considers appropriate having regard to the best overall interests of health insurance consumers) to exercise the power hereafter mentioned*".

The Act goes on to provide some guidance on the definition of the best overall interests of health insurance consumers. It states "*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*". In recommending whether or not risk equalisation ought to be implemented, the Authority must therefore have regard to the best overall interests of health insurance consumers. The Act requires the Authority to consider specifically maintaining community rating and facilitating competition in defining the best overall interests of health insurance consumers. When considering whether consumer interests are being served in the market, the Authority will consider all health insurance consumers, i.e. young, old, healthy and less healthy consumers.

The principle of community rating, together with open enrolment and lifetime cover helps to make private health insurance affordable for those who need it most. However, the Authority is aware of the difficulties that can arise for a community rated market, particularly the difficulties that can arise when risk profiles differ significantly between insurers in the market. Two potential difficulties that concern the Authority are described below.

Price Following

An insurer with a significantly lower risk profile might be in a position to charge a considerably lower premium as a result of its lower claim costs. However, it might choose instead to set its premium at a level slightly below the premium of other insurers with higher risk profiles. From the point of view of the insurer with the lower risk profile this could be viewed as a sensible strategy. Setting its price slightly below the prices of other insurers would assist in attracting a significant proportion of the new entrants to the market and some better risks from the other insurers, but would avoid attracting too many higher risks from the other insurers[1]. This could result in the claim costs of the insurers with the higher risk profiles rising further as they fail to attract or retain sufficient low risk consumers. The insurer with the lower risk profile could again follow these price increases and the process would continue.

The overall market effect would be that all consumers would pay a premium close to the premium required to cover the claims of the insurers with the highest risk profiles and if the risk profiles of these insurers continued to worsen as described above, the premiums for all consumers would continue to rise.

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[1]This is based on the argument that higher risk consumers are less likely to change insurer. It has been argued that a higher level of inertia exists amongst older policyholders due to factors such as the perceived risk of changing insurers at a time of ill health and the higher level of brand loyalty acquired over many years with an insurer. While the Authority is aware of evidence supporting this argument, it intends to conduct research into the validity of the argument as it pertains to the Irish private health insurance market.

Predatory pricing
The scenario is that an insurer with a much lower risk profile chooses to charge a significantly lower premium because it experiences lower claim costs. This premium might be significantly lower than the cost of insuring the market as a whole. The average claim of other insurers may increase, as the insurer charging a low premium might primarily attract younger, healthier, more mobile consumers with relatively low claim costs. The other insurers may not be able to reduce premiums to attract the low risk consumers back as their average claim would be too high. These insurers may ultimately be forced out of the market.

Older consumers would have the option, of course, of joining the insurer charging the lower premium, however, many older consumers might be more reluctant to move their insurance. If the insurers with higher risk profiles were driven out of the market, older consumers would join the insurer charging the lower premium. This insurer's average premium would have to rise to cover the higher risk consumers and another insurer with a low risk profile could pursue a predatory pricing strategy. Alternatively the insurer may not be willing to accept all of the high risk consumers and may opt instead to leave the market entirely or another possibility is that confidence in the market might be undermined causing some consumers to opt out of health insurance completely.

In the absence of other mitigating factors, the above scenarios are clearly not in the "best overall interests of health insurance consumers". The potential for them to arise stems directly from a significant difference in risk profiles existing in a community rated market with open enrolment and lifetime cover. The Authority is therefore of the view that the introduction of risk equalisation could be justified in the appropriate circumstances. However, the Authority recognises 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.

The Authority will need to be mindful of the likely effectiveness of risk equalisation in addressing any problems existing in the market and any potential harm that the commencement of risk equalisation may cause to the best overall interests of consumers. In this context the Authority will be particularly mindful of the level of competition existing in the market at the time and of the likely effect that risk equalisation would have on competition in the market.

When considering whether or not risk equalisation should be commenced in the best overall interests of health insurance consumers, the Authority will therefore 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.

4 Utilisation in the risk equalisation formula

Finally, it is envisaged that the Authority will be given discretion regarding the weighting that will be applied to utilisation in the risk equalisation formula. The Authority would initially propose to apply a 0% weighting to utilisation (i.e. use an age and gender only formula).

Applying a weighting to utilisation would potentially result in insurers sharing some efficiencies and cost savings. The Authority would wish to eliminate any such sharing of efficiencies or cost savings because of the detrimental effect that this would have on competition. If the Authority observes material differences in claims within age bands, the source of this difference will be investigated further. If the Authority finds that the source of these differences is health status, then further consideration will be given to using a weighting for utilisation.