VHI HEALTHCARE RESPONSE TO COMPETITION AUTHORITY REPORT

"COMPETITION IN THE PRIVATE HEALTH INSURANCE MARKET"

Vhi Healthcare welcomes the report from The Competition Authority on 'Competition in the Private Health Insurance Market' and is pleased to provide this initial response. The report covers much the same ground as the report on "Risk Equalisation and Competition in the Irish Health Insurance Market" which was prepared by the York Health Economics Consortium for the Health Insurance Authority.

We agree with almost all of the recommendations contained in the report and our summary observations on the 16 recommendations are set out in Appendix I.

We are disappointed that the comment and findings in the body of the report do not address some of the most important features of the health insurance market. For the sake of simplicity we have summarised our response to this aspect of the report by noting our reservations and/or disagreement against the relevant sections of the Executive Summary. These observations are set out in Appendix II.

The majority of our observations in Appendix II arise from six fundamental features of the Irish health insurance market which the report appears to have ignored:

1. SUBSIDY TO NEW ENTRANTS

The report essentially ignores the 'regulatory subsidy' available to new entrants into the market (through the exemption from Risk Equalisation transfers) and the impact this has on competition. BUPA enjoyed this exemption for 10 years and used it, in the main, to generate super normal profits which they then took with them when the exemption was removed. Over the past 10 years the existence of this regulatory subsidy has had the most material impact on competition in the health insurance market. This has not been addressed in the report.

2. NOT FOR PROFIT STATUS

There is no assessment of the positive impact on consumers of the not for profit status of Vhi Healthcare. Indeed the report appears to indicate that the Competition Authority has negative views on 'not for profit' status even though most health insurers around the world operate on a not for profit basis.

3. FAIRNESS OF RISK EQUALISATION SYSTEM

There is an acceptance of the need for Risk Equalisation in a Community Rated market but no analysis of the effectiveness of the current system to fairly compensate for differences in risk across insurers. This is surprising, given that BUPA gave as its reason for leaving

the market that this system was unfair and the report quotes VIVAS as saying that it is 'draconian'. The Competition Authority had access to the clear and convincing evidence which demonstrates that the current Risk Equalisation system under compensates insurers for the higher claims costs arising from an older and higher risk membership.

4. MARKET SEGMENTATION

There is no recognition that there are in effect two market segments within the private health insurance market. The first segment of approximately 20% of the market is largely company sponsored and is where all the profits are made. For example in 2005/06, when Vhi Healthcare had an underwriting loss of €50m, the top 400 company sponsored schemes comprising of 190,000 members generated profits of €40m approximately. The second segment is the rest of the market which is clearly loss-making. This feature has a number of profound implications for the competitiveness of the market:

i) Clearly all the marketing and competitive effort is directed at the 20% profitable segment
ii) These corporates regularly review their insurance arrangements and do switch insurers for small price savings or improved benefits.
iii) Under Community Rating rules, the same product offering made to these corporates must be offered to all other applicants in the market. Thus even an insurer with a small market share can have a very significant impact on the competitiveness of the market. As a consequence, overall market share and the general level of switching in the market are not good indicators of competitiveness.

5. PROFIT MAXIMISATION STRATEGY

There is a further reason that market share is a poor indicator of competitiveness, which the report also does not appear to appreciate. During the 10 years that BUPA have enjoyed an exemption from Risk Equalisation they chose not to pursue market share, via pricing policy, but rather pursued profit maximisation via a price following policy. BUPA could have a substantially higher customer base if they had chosen to pass their entire price advantage to consumers.

6. ECONOMIC ANALYSIS OF PRICING

The economic analysis underlying the Competition Authority's claim that average prices will increase as a result of the introduction of Risk Equalisation is fundamentally flawed. The introduction of Risk Equalisation would, all else equal, increase the prices charged by BUPA and VIVAS and decrease the prices charged by Vhi Healthcare. As such, the median price would certainly decrease. In addition, the introduction of Risk Equalisation would reduce considerably the opportunity (e.g. via price-following) for BUPA and VIVAS to earn super-normal profits. As such, the mean price would also decrease.

In Appendix I we have set out our observations on the recommendations contained in the report.

In Appendix II we have set out some observations on the report's findings using the numbering system in the Executive Summary.

OBSERVATIONS ON RECOMMENDATIONS OF REPORT ISSUED BY THE COMPETITION AUTHORITY IN JANUARY 2007 "COMPETITION IN THE PRIVATE HEALTH INSURANCE MARKET"

Recommendation	Observation
1. Require Vhi Healthcare to establish subsidiary or sister companies for activities other than health insurance.	Agreed. Decision already made by Minister for Health & Children.
2. Reassess the requirements placed on Vhi Healthcare to meet the Financial Regulator's reserve requirements.	Agreed in principle that derogation should be removed. Timescale needs to be considered in context of 10 years trading without Risk Equalisation. There should be no question of change to 'not for profit' status of Vhi Healthcare.
3. Remove the requirement for Vhi Healthcare to seek Ministerial approval for premium increases.	Agreed. Decision already made by Minister for Health & Children.
4. Regulate Vhi Healthcare as an insurance undertaking once it has reached the required reserves.	Agreed. No material issues involved.
5. Remove Vhi Healthcare's exemptions from the EU Non-Life Directives.	Agreed. No material issues involved.
6. Provide the Health Insurance Authority with wider powers to enforce the Health Insurance Acts.	Agreed. Long advocated by Vhi Healthcare.
7. Assign the Health Insurance Authority the function of promoting the interests of consumers.	Agreed. Any duplication between Financial Regulator and Health Insurance Authority needs to be addressed.
8. Employers should be made aware of their ability to set up multiple salary deduction mechanisms.	Agreed. Few employers are not aware of their ability on this point.

Recommendation	Observation
9. Implement a Switching Code for private health insurance.	Agreed. Vhi Healthcare is a membership based business which fully respects the wishes of all consumers.
10. Provide consumers with prescribed switching information at point of sale and renewal.	Agreed. Subject to cost considerations.
11. Vhi Healthcare should cease cancelling travel insurance policies where a customer switches from Vhi Healthcare to another health insurer.	We cannot understand why this recommendation singles out the Multi-Trip travel policy available from Vhi Healthcare. Notwithstanding the practical difficulties involved (the innovative travel insurance product eliminated the duplication of cover between travel and health insurance contracts) we would consider this recommendation only if it extended to a ban on any relationship between health insurance contracts and other contracts/services e.g. discounts, bundling, special conditions etc. If one type of condition has the potential to distort competition then so have other types of relationship e.g. a discount can be obtained on motor insurance through purchase of a competitor's health insurance policy.
12. The Minimum Benefit Regulations should be simplified and updated.	Agreed in principle subject to protection of Community Rating principles which Minimum Benefits are designed to protect.
13. The Health Insurance Authority should be allowed to approve limited-cover plans.	We believe some forms of limited cover plans are permitted under current legislation/regulation.
14. The likely effect of the Health Status Weight on the scope for price competition in the market should be taken into account when investigating its introduction.	Entirely a matter for Health Insurance Authority. The protection of Community Rating must be the priority consideration for the Health Insurance Authority.
15. Undertake a cost benefit analysis of moving to a prospective Risk Equalisation system.	Technical issue. We would be happy to contribute to such an analysis.

Recommendation	Observation
16. Clarify eligibility for Risk Equalisation payment exemptions.	Agreed, but recommendation does not go far enough. Urgent consideration should be given to removal of exemption period. It has been clearly abused to date.

OBSERVATIONS ON EXECUTIVE SUMMARY OF REPORT ISSUED BY THE COMPETITION AUTHORITY IN JANUARY 2007 "COMPETITION IN THE PRIVATE HEALTH INSURANCE MARKET"

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7. We welcome the finding that Community Rating limits the basis for competition in the health insurance market. This important point is frequently overlooked by commentators.

We are not aware of any constraint on health insurers in selecting the most efficient network of hospitals.

11. Derogation from minimum solvency requirements is clearly an issue. We agree in principle that it must be removed as soon as possible. The report would have gained from an acknowledgement that derogation had to exist as long as Risk Equalisation was not activated. This would also have resulted in an appreciation of the timescale required to build the required level of reserves.

There is no basis for suggesting that Vhi Healthcare gain an advantage through not having to establish subsidiaries for non-health insurance products. In fact the opposite is the case i.e. we suffer a competitive disadvantage in not having the statutory power to establish subsidiaries.

Also it is worth noting that the statutory powers of Vhi Healthcare do not convey the same commercial freedom to Vhi Healthcare as other insurers enjoy. There is no mention of this in the report or a recommendation that this issue be addressed alongside the issue of solvency.

12. This section refers to Vhi Healthcare's regulatory advantages. We are disappointed that the Competition Authority did not consider Vhi Healthcare's regulatory disadvantages.

13. It is surprising that, in addressing the issue of barriers to new health insurers entering the Irish market under the heading *"factors that inhibit and distort competition in private health insurance"*, no mention is made of the huge regulatory subsidy granted to new entrants in the form of the exemption from the obligations under the Risk Equalisation system. It follows that no mention is made of the use which BUPA made of this subsidy over a 10 year period i.e. to extract huge profits from the Irish healthcare market. This subsidy to BUPA over such a long period of time had a major impact on the cost of private health insurance and on competition.

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18. It is not correct to say that Risk Equalisation will lead to an increase in the cost of private health insurance. Vhi Healthcare had no option but to incur losses and deplete its reserves in order to remain competitive in the absence of Risk Equalisation. Thus it was the absence of Risk Equalisation and not the ability of Vhi Healthcare to reduce its reserves that distorted competition. Risk Equalisation will serve to reduce the rate of increase in the price of health insurance by removing the opportunity for insurers to make super normal profits. This relates to the point made under 13 above. The nature of the comments in this section raise concern with regard to the fundamental understanding of how the market operates.

19. It is again incorrect to suggest that the commencement of Risk Equalisation will allow Vhi Healthcare to increase its prices above competitive levels and sustain those prices for a significant level of time. Risk Equalisation in its present form under compensates the insurer (i.e. Vhi Healthcare) with the higher risk profile. Thus Risk Equalisation in itself will not even bring Vhi Healthcare prices back to a competitive level. We will have to be more efficient than competitors to achieve competitive break even prices. Apart altogether from being based on a false premise, the statement in section 19 of the Executive Summary completely ignores the 'not for profit' status of Vhi Healthcare. As a member based business our entire incentive is to keep premium rates as low as possible. The evidence of 50 years in business supports this contention.

32. It is incorrect and a misunderstanding of the position to state that the innovative introduction by Vhi Healthcare of travel insurance, dental insurance, health clinics etc. was a response to competition. This was a strategic response by Vhi Healthcare to the fact that health insurance in Ireland had reached the stage of being a 'mature industry' and thus Vhi Healthcare needed to diversify so as to continue to achieve dynamic growth into the future. We do not perceive any material competitive advantage in the health insurance market from the provision of these other products/services.

33. The report sets out the pricing policy of BUPA but does not include a finding of 'price following' by BUPA. This is surprising particularly when such a policy in economic terms was clearly designed to maximise profits. This surely impacts on competition in the market.

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34. The ability of both BUPA and VIVAS to offer a discount relative to Vhi Healthcare is noted but no analysis is provided of how this was possible, although extensive analysis is provided of the 'advantages' enjoyed by Vhi Healthcare. These discounts are feasible because of the substantial regulatory subsidy provided to BUPA and VIVAS through their exemption from Risk Equalisation.

45. The recommendation that Vhi Healthcare should build up its reserves other than through the accumulation of surplus might be regarded as suggesting an end to the 'not for profit' status of Vhi Healthcare. We would reject any such proposal as being totally contrary to the interest of our members or consumers in general. Most health insurers around the world operate on a 'not for profit' basis.

50. In addressing barriers to entry no mention is made of the huge regulatory subsidy available to new entrants. This major omission in the report has been referred to above.

76. There is no explanation with regard to the conclusion that the introduction of Risk Equalisation would lead to a 'sharp' rise in BUPA's prices. The price increase required would be less than the discount which BUPA has enjoyed relative to Vhi Healthcare prices or, if it proved to be more in the short term, this would only be because BUPA chose not to provide for Risk Equalisation in their prices in 2006. The Health Insurance Authority (HIA) has provided a detailed analysis of the impact of Risk Equalisation on BUPA's prices. The point should also have been made that Risk Equalisation will provide an incentive to insurers to compete for all customers as opposed to focusing on the younger market.

79. It is incorrect to say that Risk Equalisation will reduce the competitive pressure on Vhi Healthcare. Even after the activation of Risk Equalisation the insurer with the higher average age membership will bear a disproportionate share of the financial risk. Risk Equalisation will help even-out competitive pressures but these will still rest disproportionately with Vhi Healthcare.

83. It is far too simplistic to say that Risk Equalisation discourages new insurers from entering the market. This point was well covered in the report by the York Health Economic Consortium in their report to the HIA: *"The current attitude of potential new entrant insurers to Risk Equalisation is closely linked... to the perception that they would immediately benefit from a lower risk membership. If this is not the case Risk Equalisation could be seen as encouraging market entry as insurers would be re-insured, by Risk Equalisation, against the risk of recruiting high risk members. It is the strong likelihood that new entrants will*

Section Ref. *recruit lower risks that removes this benefit from Risk Equalisation and makes it appear as an additional charge on successful new entrants"*

83. The York report goes on to say *"Competition from new entrants, in the absence of Risk Equalisation, would not necessarily be beneficial for the market. Competition through lower premiums based on the ability to recruit younger members is socially undesirable."*

86. The statement *"Vhi Healthcare has been able to maintain prices above its competitors for comparable plans and Risk Equalisation would allow it to profitably raise its prices"* does not make sense for three reasons:

i) Vhi Healthcare had to charge higher prices because of the regulatory subsidy enjoyed by its competitors.
ii) Risk Equalisation will allow Vhi Healthcare bring its prices into line with those of competitors.
iii) Vhi Healthcare does not and never has pursued pricing strategies designed to maximise profits.

87. It is not true that Risk Equalisation would allow Vhi Healthcare increase its premiums above competitive levels for a sustained period of time. An analysis of the inadequacies in the Risk Equalisation system, which favour insurers who are required to make transfers, would show that the opposite is the case.

88. See the comment in relation to 18 above.