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Department of Health and Children
Hawkins House
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Subject:
Commencement of Risk Equalisation

Dear

Introduction

The Health Insurance (Amendment) Act, 2001 (the 2001 Act) together with the terms of the Risk Equalisation Scheme, 2003 (the Scheme) jointly define the basis on which risk equalisation may be introduced as a support to the Irish health insurance market.

In addition to considering the degree of risk differential in the market, the Health Insurance Authority (the HIA), is required to have regard to the best overall interests of health insurance consumers in making periodic recommendations to the Minister as to whethe to commence payments under the Scheme or not.

The HIA has submitted its report for the period July - December 2004. Having analysed and evaluated the returns submitted by undertakings and other related matters including representations made; it has recommended that the Minister ought now to commence risk equalisation payments.

The Minister has to determine whether or not she should accept this recommendation. The purpose of this letter is to provide input to this decision process in accordance with Section 12A(3) of the 2001 Act.

At outset we would confirm that it is our view, and an opinion shared by many experts including the Society of Actuaries in Ireland, that risk equalisation is a logical concomitant to the constraining requirements of community rating and open enrolment.

Furthermore we are satisfied that payments under the Scheme will only rebalance risk differentials that exist between undertakings. The Scheme achieves this by providing for transfers to or from undertakings that reflect the differences between their own risk profile and the profile of the market as a whole. This creates a level playing field in a community rated market and facilitates fair competition.

HIA Recommendation

The HIA's recommendation was contained in a letter dated 29th April to the Minister. This letter together with the Authority's letter dated 15th March to undertakings and an attached Staff Report to the members of the HIA constitute the report to the Minister.

The Staff Report contains an in depth analysis of the market including the nature and distribution of risks as well as a helpful summary of the pros and cons of commencing risk equalisation payments. Additionally the report includes various representations received as part of the consultative process and a point-by-point staff commentary on these.

The HIA's letter of 15th March sets out the reasons for its recommendation which can be summarised as:

(i) Potential risk equalisation payments (MPEA) increased from €11.8m (Jan - Jun 2004) to €16.7m (Jul - Dec 2004). The corresponding increase in the MEP was 1.2 percentage points from 3.5% to 4.7%. The Authority regarded this increase as significant and considered that the underlying trend is upward. This view has not been materially affected by any seasonality in the data.

(ii) It considered, in the light of (i) above, that the likelihood of a threat of instability had increased in the absence of risk equalisation.

(iii) It is concerned at the level of competitive pressure on insurers at present. Its previous concern that the introduction of risk equalisation payments would adversely impact on competition has receded in light of the emergence of a third player together with the growth in membership generally and the distribution of sales between insurers.

(iv) It expressed concern at apparent price following in the market and its potentially adverse implications for premium inflation.

Comments on the HIA's Recommendation

It is very evident from the HIA's report that that it has undertaken a thorough and comprehensive review of the current position of the market and has discharged its statutory duties in a very considered and responsible way. Accordingly the current recommendation of the Authority merits very serious consideration.

Given the checks and balances built into the legislative framework, however, any recommendation that risk equalisation should or should not be commenced at a particular point in time must be inevitably a finely balanced judgement call.

In general we would accept the evaluation and analysis in the HIA's report. In particular we would agree, based on the published data, that there is evidence of an upward trend in the extent of risk differences in the market. In the present circumstances however we would have some concern about the report's additional reliance on the recent change in the MEP and MPEA both as a rationale in its own right and as an indicator of the strength of the underlying trend.

The changes in the MEP over the past 3 periods have been:

Market Equalised Percentage (MEP)		
Jul –Dec 2003	Jan – Jun 2004	Jul –Dec 2004
3.7%	3.5%	4.7%

It is acknowledged in the HIA's report that 0.7 percentage points out of a total increase of 1.2 percentage points in the MEP over the last two periods can be attributed to random statistical variations related to those aged 80 and over and/or to seasonality. There is insufficient data available though to judge whether it is the most recent experience or that of previous periods which are outside the trend. While random statistical variations or seasonality, in the context of the long term operation of the Scheme, may be expected to even themselves out over time, commencing payments is a once off event.

However, even if - to allow for statistical/seasonal variations - the MEP were to be modified to 4.0%, the result would still amount to a potential risk equalisation transfer of between €13m and €14m for the six months in question. It is certainly arguable that this level of risk distortion is material.

The HIA's view that the threat of instability had increased was based to an extent at least on the increase observed in the MEP and therefore the comments above apply.

Finally we would draw particular attention to the statement of pros and cons in page 54 of the Staff Report. This is a good summary of the advantages and disadvantages of triggering risk equalisation payments. Although it is left to the reader to evaluate which of the issues should be given most weight.

Representations from Insurers

The Minister has received representations from two insurers in connection with the introduction of risk equalisation.

BUPA Ireland has urged the Minister not to commence payments based on a wide range of matters

we do not propose to comment further on them here.

VIVAS Healthcare has also urged that risk equalisation payments ought not to be commenced. In its submission, it outlines a number of arguments supporting this view which we have commented on below.

> ***Risk equalisation is an inappropriate measure in a market that includes a dominant player. The VHi's dominance has associated advantages which are not taken into account..***
>
> We would suggest that the dominant position of VHi is not particularly relevant to any decision in relation to risk equalisation payments. Even if VHi was broken into a number

of smaller entities, in aggregate those entities would continue to be in the same position as at present vis a vis potential risk equalisation payments. Risk equalisation is a mechanism designed to ensure that risk is fairly distributed across all health insurance consumers and does not interfere in any other way in the market. It is not designed, and would not in our view be well suited, as a tool to manage or counter balance the implications of VHi's market dominant position.

If, instead of being a community rated market, our market was risk rated with no requirement for risk equalisation, VHi would still enjoy the benefits of a dominant market position.

The unfairness of the current regulatory structure and VHi's exploitation of its preferential treatment

We believe VIVAS make valid arguments in relation to the absence of a level playing pitch from a regulatory perspective. Although technically separate to considerations relating to risk equalisation, we agree that it may be preferable if risk equalisation payments were triggered in the context of levelling other aspects of the playing field.

VHi's purported need for risk equalisation, in particular its precipitation of its financial difficulties.

VIVAS rejects the notion that VHi needs risk equalisation payments to ensure its continued viability and suggests that there is no evidence that it could not have continued to price at the current economic level and compete effectively. While this may well be the case, at least on the surface, we would point out that there is no evidence to the contrary either.

The negative influence that risk equalisation will have on competition in the market.

It is incontestable that the market is more attractive to new entrants without risk equalisation than it is with risk equalisation and this is widely interpreted as meaning that risk equalisation is bad for competition. We would argue that the right kind of competition is entirely welcome and beneficial to the market and the VIVAS report highlights some of the potential benefits. However for the time being the community rated, non risk adjusted model has created an environment where a new entrant's commercial interest (profitability) is best served by, in the main, shadow pricing and shadow servicing the market.

We would not accept that risk equalisation, which is fundamentally redistributive, would in its own right result in price increases in the market as a whole. In fact, to the extent that highly profitable price following tactics are curtailed, it might be expected to reduce cost.

We do not accept that risk equalisation will act as a disincentive to innovate in product design. On the contrary we believe it would create an environment where undertakings would seek to differentiate themselves from the competition through product innovation.

Concerns relating to the form of risk equalisation

We reiterate here, as we have done many times, that risk equalisation serves only to equalise risk differentials. It does not, and in our view should not, seek to interfere in other matters. VIVAS views in this regard are not new and will considered as part of the legal proceedings here and in the EU.

VIVAS position on entering the market, in particular its apparent belief that risk equalisation would not be triggered for the immediate future.

VIVAS suggestion that they were not aware of the potential for the introduction of a risk equalisation scheme when it entered the market is difficult to understand or accept. The methodology and approach has been clearly signalled over a number of years.

Conclusion

The arguments for commencing payments now include:

- Removing uncertainty in relation to the operation of risk equalisation generally. As mentioned earlier it is our view that risk equalisation is logically concomitant with community rating and open enrolment..

- Also removing VHi's considerable disadvantage in the market which results from its legacy risk profile. We would suggest that, in this environment, the focus of competition will become more broadly based than simply targeting the young and healthy and/or price following and this would have positive implications in terms of cost efficiency and market innovation.

On the other hand arguments against include:

- The advantages which VHI currently enjoys related to its favourable regulatory treatment and the absence of a commercial mandate will become more apparent once risk equalisation is triggered.

- The extent of the change in the MEP is subject to considerable random statistical variation/seasonality and would probably benefit from having at least one further corroborating data point to provide further confirmation in relation the underlying market trends. Given that the HIA has not indicated that a threat to stability is imminent, then deferring a decision for another six months is unlikely to have a materially adverse impact.

In conclusion it remains our view that, in the long term, risk equalisation is a necessary support to the community rated market and, therefore, triggering risk equalisation is probably a question of "When" rather than "If". While the arguments in favour of triggering payments now are strong it is also clear there are potential disadvantages in doing so.

On balance, having considered carefully the report of the HIA and the various representations received, we are not fully convinced that the Minister should make a determination at this time to commence risk equalisation payments.