COMPETITION IN THE PRIVATE HEALTH INSURANCE (PHI) MARKET.

SUBMISSION TO THE COMPETITION AUTHORITY AND HEALTH INSURANCE AUTHORITY FROM AMICUS TRADE UNION, 15 MERRION SQUARE, DUBLIN 2. TELEPHONE (01) 6611063

Amicus are the sole Union representing staff in VHI. We are not at this point formally recognised to represent members in BUPA or VIVAS,

VHI were the sole operator in the PHI market until 1997, when the market was opened to competition. There are currently three providers in the Irish market, VHI, BUPA and VIVAS.

Notwithstanding the fact that PHI is voluntary, over 50% of the population of Ireland are covered by a policy with one of three providers. This is a very high ratio, when compared internationally and reflects the fact PHI options available are very attractive in Ireland when measured against the public alternative.

VHI are the biggest providers of PHI. Amongst their members are a disproportionate amount of older members when compared with the other providers. There is a clear and unequivocal link between age profile of members and claims experience in the PHI market. Accordingly, proportion of claims to policyholders in the VHI is higher than within the two competitors. To compensate for the discrepancy in claims frequency, the principle of risk equalisation has been a bedrock of the market being opened to competition in 1997. No payments have effected under this scheme to date, which has put VHI at a competitive disadvantage. The Minister for Health announced the implementation of Risk Equalisation at end of 2005, and the first transfers are expected in 2006, subject to issues before the Courts being clarified. When risk equalisation is formally implemented, all Companies will be competing on a level playing field in respect of claims, expectations and barriers to competition will have been removed.

It is formal Amicus Trade Union policy and the policy of the ICTU that community rating must remain in place going forward in PHI market. Internationally, we have found no example where community rating is in place without risk equalisation. Indeed, it is understood that BUPA. One of the providers in the Irish market is a net beneficiary of risk equalisation in Australia.

Conclusion:

Over 50% of the workers of Ireland and their families have opted to be covered by PHI.

Amicus Trade Union have an official policy supporting community rating going forward and consequently risk equalisation become essential.

It is only through the implementation of risk equalisation that barriers to open competition can be removed.

In April 2005, a report in relation to community rating, risk equalisation and competition was compiled for this Union by independent consultants, Farrell Grant Sparks. A copy of the report is attached for your attention and information.

For any further information or clarification, please feel free to contact me at above email address or phone number.

COLM QUINLAN
REGIONAL OFFICER

AMICUS

Report On Impact Of Failure To Commence Risk Equalisation Payments In The Private Health Insurance Market In Ireland

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FOREWORD

Ireland's Private Health Insurance (PHI) market has been characterised by universal access for all (Open Enrolment) and non-differentiated premiums (Community Rating). Up until 1997, the operation of the PHI market was not problematic since the VHI, as the monopoly service provider, was able to maintain the Open Enrolment and Community Rating regime.

When competition came into the PHI market it was government policy to maintain Open Enrolment and Community Rating. However, it was recognised that in order to do so, the market would have to be regulated and that Risk Equalisation payments would have to be put in place. Without Risk Equalisation, new PHI service providers entering the market could target lower risk consumers and leave the dominant incumbent insurer (the VHI) carrying the higher risk/higher cost consumers. Fair competition would not be possible unless the risk carried by all the players in the market was equalised. New legislation reflected this reality.

BUPA entered the market in 1997 and Vivas entered in 2004. The regulator (The Health Insurance Authority) has not, to date, recommended the commencement of Risk Equalisation payments, although it has indicated that it now intends to do so. BUPA has indicated that it will challenge any such determination and has stated that it may exit the market if its challenge is not successful. Vivas has a moratorium on Risk Equalisation payments for three years after market entry so has yet to enter the debate.

Without Risk Equalisation, the PHI market has been operating in an unstable manner with a significant risk of further instability ahead and with BUPA making extraordinary profits.

The PHI market is now highly unstable. This is a serious issue for employees and former employees. If the market collapses or is not properly regulated to maintain Open Enrolment and Community Rating the potential consequences are very serious. Evidence from elsewhere suggests that, if PHI premiums were risk-related, then older subscribers, many of whom are employees or former employees, could face premium increases of 600/700%.

IT IS TIME TO END THE THEORETICAL DEBATE AND TO COMMENCE RISK EQUALISATION PAYMENTS IN ORDER TO PROTECT CONSUMER INTERESTS.

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1 INTRODUCTION

1.1 FGS Consulting was commissioned by Amicus to work with Montague Communications in developing a report on the impact of failure to commence Risk Equalisation payments in the Private Health Insurance (PHI) market in Ireland.

1.2 Amicus has identified the fact that threats to the PHI market, including threats to the continued viability of the largest provider of PHI services – the VHI, is a major issue of concern to employees and to those who have retired from employment.

1.3 Stability and certainty in the PHI market is a key issue for employees for a number of very significant reasons including:

- The need to keep PHI contributions at an affordable level. Otherwise PHI cover will inevitably become too expensive for the vast bulk of PAYE employees.
- The need to protect those who have contributed to PHI schemes throughout a significant portion of their working life from facing enormous price increases for cover as they reach retirement age and beyond.
- The need to ensure that large numbers of employees, who have traditionally been members of the VHI schemes, are not exposed to any potential failure of the VHI arising from threats to its continued viability caused by unfair market conditions and/or unfair competition.

1.4 The issues of concern arising from the current operation of the PHI market in Ireland for employees, and for former employees, are real and substantive. They need to be addressed against a background where:

- The public health service continues to be in crisis. Government has made it clear that an important element of the solution to the current health crisis will include a greater role for private health service providers. Affordable access to such providers for employees is, therefore, a critical issue.
- The economic, financial and policy debates relating to the PHI market are unnecessarily complicated, engaged with largely by insiders and vested interests and militate against the vast majority of employees being brought into the loop as regards potential implications for them and for their dependants now and into the future. The current risks to employees are not well explained and, as a consequence, tend to be underestimated by those more likely to be adversely impacted.
- The current PHI market in Ireland is in a state of flux with a high potential for developments to take place which will not be in the best interests of employees and former employees.
- The VHI, as the largest service provider, and with whom the majority of employees secure their PHI cover, is being put at a serious and potentially terminal disadvantage relative to new market entrants who have little interest, nor incentive, in providing PHI services to older employees nor to those in retirement from employment. What the VHI needs is a level playing pitch and it has clearly demonstrated its capacity to compete provided the market is not skewed against it as at present.

1.5 There are numerous expert reports in existence – the York Health Economics Report, the Report of the Advisory Group on Risk Equalisation etc. – which highlight the need for market stability and the maintenance of Community Rating and Open Enrolment to be underpinned by Risk Equalisation payments. Much of the debate in these reports is highly technical and at times confusing in relation to the jargon used. The real debate which needs to take place is not around the mechanics and formulae associated with the introduction of Risk Equalisation nor about the quantum of such payments per se. The real issue for debate is the effect on consumers, including employees and former employees, of continued failure to commence Risk Equalisation payments despite the fact that the PHI regime in Ireland was never designed to operate on a stable basis without them.

1.6 Against this background, FGS Consulting is delighted to put forward this report with a view to assisting the process whereby the issues in the PHI market can be brought to the attention of employees and former employees and whereby the risks they are now exposed to can be addressed by Government.

KEY ISSUE
THERE IS A NEED TO DEMYSTIFY THE JARGON SURROUNDING THE PHI MARKET AND TO INFORM EMPLOYEES AND FORMER EMPLOYEES OF THE RISKS THEY FACE IF GOVERNMENT DOES NOT ENSURE PROPER OPERATION OF THE PHI MARKET.

2 WHY IS PHI AVAILABILITY AT AFFORDABLE PRICES IMPORTANT TO EMPLOYEES AND FORMER EMPLOYEES?

2.1 PHI is a mechanism whereby those taking out such insurance seek to top-up the health services available to them from the tax-based state health regime.

By and large, people take out PHI cover for the following reasons:

- To widen their choice of health service providers.
- To ensure that they can get more priority and speedier access to hospital care.
- To access additional benefits over and above those available through the public health system.

2.2 At present, in Ireland, about 50% of the population is covered by PHI schemes (with the VHI having about an 80% market share).

Key features of the current market include the following:

- Almost 50% of PHI subscribers are members of group schemes the majority of which are work-related. While difficult to estimate accurately, some 0.5m to 0.75m employees and former employees are likely to be involved.
- Work-related group schemes are a primary mechanism for the marketing of PHI cover.
- Tax incentives, giving tax relief on subscriptions, seek to encourage widespread participation in PHI schemes.
- In some employments, payment, or part payment, of PHI subscriptions is offered as part of the employee reward package.

2.3 PHI cover, therefore, is a key issue for many employees. Risks to employees and former employees (especially those who have contributed over the years to PHI schemes) include the following:

- Market failure leading to premium increases on a scale which would be prohibitive for the vast majority of employees who would then have to depend solely on the public health system. In an unregulated market, not having Community Rating and Risk Equalisation, the cost of PHI cover for those in the 50/60+ age bracket would be vastly greater than the premium they are currently paying. Evidence from other countries where PHI premiums are risk related would indicate that older consumers could be faced with premiums more than 6/7 times their current levels.
- In some other countries, e.g. the UK, those in work-related schemes have to come off cover when they reach retirement (when they need such cover most) because they cannot afford to maintain their cover at the greatly increased rates charged.
- The potential introduction of risk-related premiums which would penalise older workers and those retired from work as well as those whose work and/or health status would be regarded as higher risk. For many, this would mean that they would be unable to afford PHI cover at the time when they most need it having, typically, been net contributors to PHI schemes for a large part of their working life.

- The risk of collapse of the VHI, which is the main PHI service provider for those in employment and those retired from employment. Such a collapse would be potentially catastrophic for employees and former employees as the price rises they would face in seeking alternative cover elsewhere would almost certainly make such cover unaffordable for many.

2.4 The reasons why the affordable availability of PHI cover is important to employees and former employees are largely self evident. This is all the more so the case in Ireland with a public health system that is manifestly unable to cope. The balance of this report addresses the risks to employees as to the future availability of affordable PHI cover and what is needed to be done to overcome such risks.

KEY FACTS SUMMARY
■ 50% of the population has PHI cover. ■ Most are in work-related group schemes. ■ PHI cover is important to employees. ■ The continued availability of affordable PHI cover is under threat and tackling the risks involved is a key concern to employees and former employees on which government action is now needed.

3 WHAT KIND OF PHI MARKET DO WE HAVE IN IRELAND?

3.1 Prior to 1997 there was no competition in the PHI market in Ireland. The VHI was the sole service provider. As a monopoly service provider, it operated without subsidy. Inducement was offered to the public to participate in VHI schemes through the mechanism of allowing VHI subscriptions to be tax deductible.

3.2 Key features of the pre – 1997 Health Insurance regime included the following:

- It was open to anyone to join the VHI. The VHI could not refuse admission to its schemes.
- Membership was on a totally voluntary basis.
- The VHI charged the same premiums for its schemes to all subscribers i.e. there was no price differential based on age, sex, health status etc.

3.3 The type of PHI market operated in Ireland is, based on the foregoing features, described as a market based on Community Rating. The term **Community Rating** effectively means that there is open, voluntary admission to membership and that premiums are not differentiated. In very broad terms, this type of market operates on the basis that members pay a higher premium than that arising from their risk profile when they are younger and pay a lower premium than their risk profile at later stages in life when they are more likely to be claimants (see Table 1).

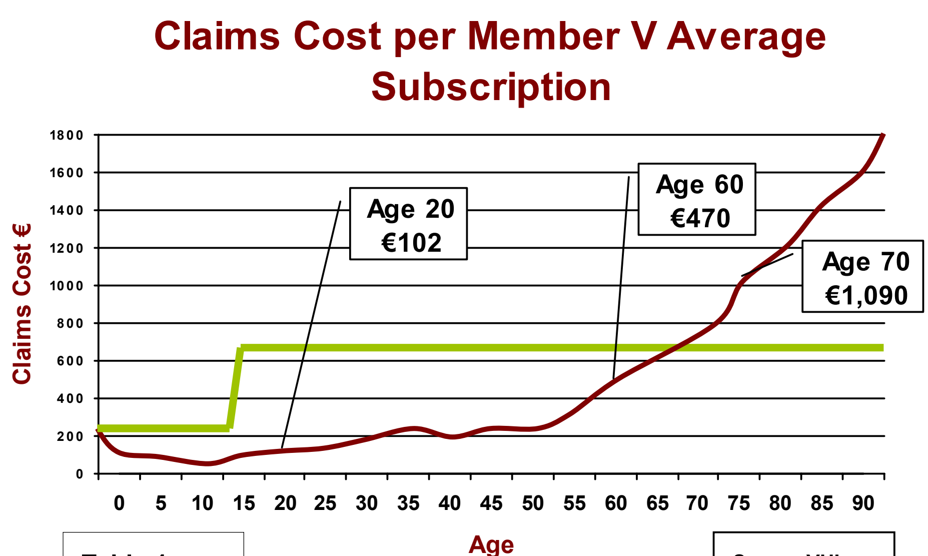


Table 1

3.4 PHI, as it has operated in the Irish market, is, therefore, very different from other insurance products such as traditional life cover or motor insurance. Again, the theory would be, that if risk-based premiums (including age as a risk factor) were to operate, as happens in other insurance markets, then PHI cover would not be affordable for the majority of the population at the time of life when such cover is most needed and most likely to be availed of by them.

3.5 The operation of a PHI regime in Ireland, based on **Community Rating** is a matter of Government Policy. This policy was put in place in order to achieve very laudable social policy objectives. As already pointed out, very many employees and former employees participate in PHI schemes as a result of this policy who otherwise would not have access to affordable cover.

3.6 Following an EU directive in the early 1990's it was necessary for Ireland to provide for competition in all non-life insurance markets. This included the PHI market. The conditions for a competitive market were set out in the 1994 Health Insurance Act (as amended in 2001). The conditions put in place for a competitive PHI market include:

- Open access to all and the availability of cover over the full life of span of persons joining.
- The maintenance of the **Community Rating** system i.e. all service providers to quote common rates to all risk groups with no differentiation based on gender, age, health status etc.
- Freedom of entry to the market for new companies to compete with the VHI, which previously had a monopoly.

3.7 It was recognised from the outset that an unregulated PHI market, left to its own devices, would result in an unstable market. Unfair competition would occur because:

- Prior to competition, the VHI had 100% of the market covering all ages, genders and risk categories.
- The incumbent service provider would have a much higher claims cost because the competitors would inevitably target younger members with a lower risk profile and a lower claims incidence.
- Older subscribers would be unlikely to switch to another service provider leaving the incumbent with its high risk profile and a disproportionate cost of claims relative to new insurers entering the market.

3.8 In order to ensure a properly functioning PHI market, two important elements, therefore, were put in place as follows:

- The PHI regime was to be underpinned by a process of Risk Equalisation. Risk Equalisation essentially means that there would be a cash transfer from service providers with a low risk-base and, therefore, a low cost of claims, to those carrying a proportionately higher risk base. Otherwise, the high risk base service provider (in this case, the VHI) would have much higher costs and would ultimately go out of business since it could not, by law, have access to the only alternative to Risk Equalisation payments i.e. charging differential, risk-based premiums.
- A regulator was put in place – the Health Insurance Authority (HIA) – to oversee the operation of the market and specifically to decide when market conditions dictated that the mandated Risk Equalisation payments, as set out in the legislation, would be triggered by reference to an agreed formula.

3.9 As an incentive to new entrants (insurance providers) to form the competitive market, a three year moratorium on the commencement of Risk Equalisation payments was put in place (from the time of market entry).

3.10 In the next section of our report, we examine how the PHI market has operated in practice having regard to the regime as envisaged and as put in place under the legislation. Obviously, a key issue for all stakeholders, especially employees and former employees, is the proper operation of a stable and sustainable market for PHI cover.

KEY CONSIDERATIONS
▪ The introduction of competition in the PHI market was an EU requirement. ▪ Government Policy is to maintain the Community Rating System of PHI cover. ▪ Government recognised, in putting the legislation in place, that Community Rating could not operate without Risk Equalisation. ▪ For most, especially PAYE employees and those in retirement, PHI cover is not affordable without Community Rating. ▪ Risk Equalisation and the Independent Regulator were put in place to prevent unfair competition and to ensure stability in the market. ▪ It was never envisaged that Community Rating would operate in the Irish PHI market without Risk Equalisation (other than for a short period to allow new entrants settle into the market and build up a reserve to meet such payments).

4 HOW HAS THE COMPETITIVE PHI MARKET OPERATED IN PRACTICE AND WHAT ARE THE IMPLICATIONS FOR EMPLOYEES?

Introduction

4.1 BUPA entered the market in 1997 and is now estimated to have a 20% market share. Vivas entered the market in late 2004 and, to date, has a negligible market share.

4.2 The market has operated to date as envisaged as regards Community Rating. However, in its two initial determinations (which it issues every 6 months), the HIA had decided not to recommend the commencement of the Risk Equalisation payments mandated by government legislation. In a preliminary third determination, issued recently, the HIA has indicated that it believes that Risk Equalisation payments should now commence. BUPA has already indicated that it intends to mount a legal challenge to any commencement of Risk Equalisation payments and, indeed has hinted at a likely withdrawal from the market if it cannot successfully see off the introduction of such payments.

4.3 The current HIA determination is of a preliminary (not definitive) nature. The HIA's function is to make a recommendation to the Minister for Health and Children which it is expected to do in the near future. The decision as to whether or not to commence Risk Equalisation payments is a matter for the Minister once the HIA has made a definitive positive recommendation.

4.4 A vital element of the operation of a competitive PHI market (Risk Equalisation) is still not in place and even a preliminary view from the HIA that the figures from the market show that it should now be introduced has led to threats of market exit from BUPA. It is appropriate, therefore, that we should address a number of key questions as regard the recent operation of the PHI market as follows:

- What are the key market dynamics?
- How has BUPA fared as a new entrant to the market?
- How has the VHI fared since the ending of its monopoly?
- Has the consumer benefited from competition?
- What is the current state of play and how is it likely to affect employees?
- What other considerations arise?

What are the key market dynamics?

4.5 There are certain dynamics in the PHI market which make it unusual. These include:

- Community Rating means that the normal mechanisms (e.g. risk-based price differentials) are not open to insurers who wish to manage their overall risk profile.
- General insurance markets operate on the basis that, with a proper risk-based pricing strategy, all cover offered can be profitable. This is not true of a Community Rating PHI

regime. Younger, lower risk customers will be profitable and older higher risk customers will have higher claims and are unlikely to yield profit.

- New entrants, while they cannot exclude anyone from cover, will target younger and low risk categories of customers. Customers in their 20's and early 30's have a claims record of less than 25% of those aged 60 and over.
- A primary mechanism for recruitment is, as pointed out, work-related schemes. These tend to be offered to new employees through payroll deduction schemes etc. New recruits coming through such schemes will be younger and more likely to be open to joining new schemes offered by new market entrants. Thus the traditional main recruitment mechanism will give new entrants a lower risk category of customer even if not specifically targeted by them in their marketing activity.
- New entrants can target advertising effort at a younger audience by using appropriate media and channels.
- Younger people are more likely to switch service provider. Older people, with higher claims risk, are significantly less likely to switch and, therefore, tend to remain with their existing service provider.
- There is strong evidence that even a passive new entrant will inevitably attract a younger less risky type of customer.
- New entrants will not wish to be too aggressive on pricing. If they are aggressive in their pricing strategy they will attract high risk/high cost customers from the established service provider (in this case the VHI). Lowballing on price, and gaining high market share, is not, therefore, necessarily the goal of a new market entrant in the PHI market in Ireland.

4.6 All of the foregoing factors, and, indeed, others, contribute to the PHI market being unique and, in some respects, counter intuitive. It is worth bearing in mind some of these factors in looking at what has actually happened since competition came into the PHI market in Ireland.

How has BUPA fared as a new market entrant?

4.7 As stated, BUPA is estimated to have about a 20% share of the market. There is considerable evidence (bearing in mind that global market share is not really the name of the game in PHI) that BUPA has been doing extraordinarily well from its Irish business.

4.8 We examine below some of the key metrics involved. BUPA does not disclose separate figures for its Irish operations. However, in its returns to the Financial Services Authority in the UK, it is required to show separate figures for its various geographic markets. We can, therefore, learn some key facts from how it has been doing despite its reluctance to be open and transparent as regards its Irish operations.

4.9 The table (appendix 3) is constructed from figures taken from the FSA and from the VHI annual reports. Key points to note are as follows:

- Since entry into the market BUPA has made significant windfall profits.
- BUPA's cost of claims (as a % of premium) at less than 60% is way below the VHI (80%) which is actually more in line with BUPA's UK record. This shows that mature,

established, players suffer enormously on the cost of claims relative to new entrants. Cost of claims is the main variable determining profitability.

4.10 Apart from the evidence of claims history, it is clear that BUPA is attracting younger less risky clients from the VHI. The table below sets out the age profile of VHI customer losses to BUPA based on market research carried out on behalf of the VHI.

Age Profile of losses to BUPA

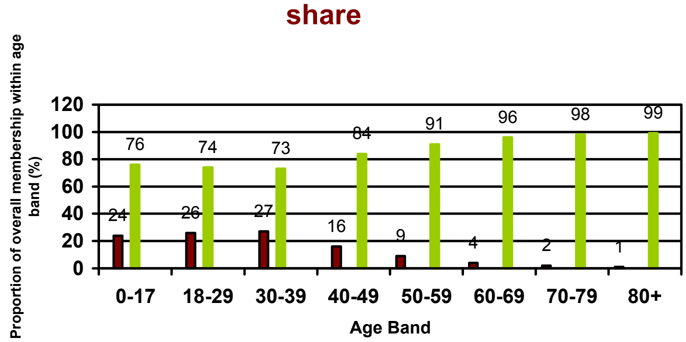
Age Band	Proportion
0-17	28%
18-29	20%
30-39	29%
40-49	14%
50-59	7%
60-69	2%
70-79	1%
80+	0%

Source: VHI

4.11 There is a strong prima facie case to be made that BUPA has generated its high profits on the back of unnecessarily high prices to the Irish Consumer. This has had the effect of keeping prices in general in the market at a level above what they should be. It has also forced up the VHI prices because it has taken away some of its lower risk customer base.

4.12 In total BUPA's age profile relative to the VHI can be seen in the table below.

Evidence of Bupa's favourable age profile by market share



Source: VHI

4.13 It is clear, therefore, that:

- BUPA is now successfully settled in the Irish PHI market.
- Its business is extraordinarily profitable relative to the VHI and also relative to its UK operations.
- Its Irish claims profile is much lower than the VHI or its UK operations.
- Its 20% market share is at the younger, lower risk end of the market. Not only is it getting new customers in this category externally, but it is enticing such customers away from the VHI thus worsening the VHI's overall risk profile.
- Cost of claims is the key metric determining performance for PHI providers.

4.14 It is, therefore, difficult for BUPA to make any case that Risk Equalisation payments should not be commenced. Risk Equalisation was deliberately put in place to prevent a new entrant from doing precisely what BUPA has done largely at a cost to the VHI. The HIA have obviously (and belatedly) recognised that Risk Equalisation must now be introduced. BUPA, however, seems determined to resist despite the available evidence that it can well afford to meet its Risk Equalisation obligations as envisaged under the legislation. BUPA cannot claim that Risk Equalisation payments were not always intended to be a feature of the Irish PHI market which it chose to enter. The only issue left open in the legislation governing the PHI market was the timing of the commencement of such payments.

How has the VHI fared since the ending of the Monopoly?

4.15 The VHI has performed exceptionally well given the adverse market conditions it has faced. It has maintained its membership, introduced new products, controlled its costs and managed its price increases to the benefit of its members. However, without a level playing pitch, it cannot continue to do so. The following issues relating to the VHI's performance, therefore, should be noted:

- The VHI is budgeting for a loss, for the first time in its long history, for the current financial year. Without the introduction of Risk Equalisation payments, such losses for the VHI are inevitable.
- VHI took the unprecedented step of keeping its most recent (last year's) price increase to 3% thereby eating into its reserves. Without Risk Equalisation, this was a necessary step in order to prevent predatory price following (see below) by BUPA and further erosion of the more profitable end of its customer base thereby threatening its financial stability. The VHI felt that it would be morally indefensible to change its members other than a Community Rated price not withstanding the absence of Risk Equalisation. Price increases in previous years had been put in place to compensate for the absence of Risk Equalisation.
- VHI's financial position is such that it could not now meet the solvency ratio which the Irish Financial Service Regulatory Authority would require of it were it not exempt from IFRSA's requirements in that regard. This is a serious and unsustainable situation for the VHI.
- VHI's difficulties manifestly arise from its cost of claims which in turn is a reflection of the risk profile of its customers many of whom are older, established employees and those who have retired from employment. Cost of claims is the largest influencing factor

impacting on profit. The VHI cannot compete on a level playing field with new entrants in that regard without Risk Equalisation.

- There is no evidence to suggest that the VHI's cost base is otherwise out of line with its competitors. While full transparency does not exit in this regard in relation to BUPA, there is a prima facie case that BUPA may not be as efficient as the VHI in core costs (i.e. costs other than cost of claims). The traditional argument that a state controlled monopoly will be less efficient than the private sector is, on the basis of the available evidence, unlikely to apply in the case of the VHI.

4.16 The difficulties facing the VHI should not be underestimated. While the VHI may, in the past, have left itself open to the charge of "Crying Wolf" too often, there is an inevitable reality to its current financial crisis which must not be overlooked. Were the VHI's position to remain unaltered, through a failure to introduce Risk Equalisation payments, the threats to its sustainability are very real. In such circumstances, apart from the VHI itself, the major losers would be employees, their dependents and those retired from employment. In particular, there would be a huge impact on those who have paid into work-related group schemes as net contributors over the greater part of their working career.

4.17 The VHI, therefore, has gone from a position of being able to build up reserves to meet the cost of claims, given the Community Rating basis on which it provides cover, to now facing losses, the depletion of its reserves and a threat to its viability due to unfair market conditions.

Has the Consumer benefited from Competition?

4.18 As pointed out earlier, there is little incentive in a Community Rating regime for aggressive price competition. Indeed, in a Community Rating system without Risk Equalisation, there is a strong incentive for competitors to an incumbent dominant player like the VHI to be a price follower so as not to expose themselves to attracting higher risk customers away from their existing service provider. All of the available evidence (see the Table below) points to the fact that BUPA has adopted a deliberate "price follower" strategy thus augmenting its windfall profits during the period when Risk Equalisation is not in operation.

VHI Healthcare		BUPA	
Date	**Prem. Increase**	**Date**	**Prem. Increase**
September 1999	9.4%	**February 2000**	9%
February 2001	6.25%	**February 2001**	6.25%
September 2001	9%	**March 2002**	9%

VHI Healthcare		BUPA	
Date	**Prem. Increase**	**Date**	**Prem. Increase**
September 2002	18%	**February 2003**	14.4%
September 2003	8%	**March 2004**	8.25%
September 2004	3%	**March 2005**	6%

Source: VHI

4.19 In a perverse manner, the major price benefit to the consumer came from the VHI's decision to peg its 2004 price increase to 3%. However, the reasons for this have more to do with the inappropriate application of regulation than they have to do with competitive market prices.

4.20 It is difficult to compare prices and products directly in this market. However, it would appear that BUPA, in general, initially bought a very targeted and profitable market share before its prices came back more into line with the VHI. Given the evidence of market behaviour to date, it is not clear that customers, across the full age range, feel that there is a consumer benefit deriving from the introduction of competition in the market.

4.21 There is, therefore, no appreciable evidence to suggest, that consumers have benefited in terms of premium prices from the introduction of competition. Neither is it clear that competition has led to cost reductions in the industry. If anything, it seems as if BUPA's windfall profits have enabled it to maintain a higher cost base than the VHI when cost of claims is excluded from the equation. This, surely, can not have been the rationale for introducing competition into the PHI market.

What is the current state of play and how is it likely to affect employees?

4.22 The current state of play is that Ireland is unique (see Section 5) in having a Community Rating PHI regime without Risk Equalisation. This is producing a highly distorted market which has the trappings of competition but none of the benefits (other than those accruing to new market entrants). If this situation persists, there are a number of inevitable consequences arising from instability in the market which will include:

- The VHI will have to substantially increase its rates and could still go out of business.

- Price competition will remain more theoretical than real.
- Overall market prices will continue at a level above what they should be because there is no incentive for new entrants to be aggressive on pricing.
- The VHI will not be able to sustain open access to its schemes.
- The VHI's reserves will be eroded and its overall financial position will continue to deteriorate towards unsustainability.

4.23 These consequences, should they come to pass through failure to activate Risk Equalisation, will disproportionately impact on employees and former employees with a particular adverse effect on employees in the 45+ age bracket.

What Other Considerations Arise?

4.24 Against the foregoing background, it is necessary for us to consider what should now be done by government. In the remaining sections of this report, therefore, we:

- Assess what lessons, if any, can be learned from international experience.
- Summarise the logical case for immediate commencement of Risk Equalisation.
- Draw together some overall conclusions from the perspective of employees and former employees, in particular.

LESSONS FROM THE ACTUAL OPERATION OF THE PHI MARKET TO DATE
■ The PHI Market is highly unusual and contravenes many of the commonly held norms of market behaviour. Clever regulation is needed and is not evidenced to date. The way regulation has operated to date is illogical and works against the interests of employees and former employees.
■ BUPA has done exceptionally well and has benefited enormously from the failure to complete the market by introducing Risk Equalisation. The arguments advanced by the HIA for not recommending the commencement of Risk Equalisation in its first two determinations on the issue are unclear and tenuous (see Appendix 1).
■ The PHI market is inherently unstable. Employees and former employees cannot afford for the VHI to fail as a result of such instability.
■ There is little evidence that competition, as currently operated, has benefited consumers to any substantial degree.
■ The current state of play is not sustainable. The major losers from any failure by government to act, will be employees and former employees.

5 LESSONS FROM INTERNATIONAL EXPERIENCE

Introduction

5.1 The PHI regime currently operated in Ireland is unique to this country. The core elements of the Irish PHI regime, i.e. Community Rating, Open Enrolment and no Risk Equalisation payments, as an alternative to the public health system (as currently operated and funded in Ireland), is not to be found in exactly the same format anywhere else in the world. However, if Risk Equalisation were commenced, both the South African and the Australian models would be close to that which would be operating in Ireland (see later).

5.2 There are a number of possible explanations for our unique approach to the PHI market:

- Firstly, we may have it right and others may be wrong.
- Secondly, we may be trying to do something which has demonstrably proven not to be possible based on the experience of other countries.
- Thirdly, the regime as operated in Ireland may be correct in its intent but may be wrong in terms of its actual implementation.

5.3 We examine, in the paragraphs which follow, some of the key lessons from international experience.

The European Union

5.4 It is difficult to look at EU approaches to PHI as a common block. All member states operate their insurance markets under the same EU directives as regards markets and competition for non-life insurance products. However, there is huge variability between the member states in terms of their core health service regimes and, therefore, in terms of the nature of PHI products and services made available to consumers.

5.5 In this regard, it should be noted that:

- The proportion of the population participating in PHI schemes varies enormously from country to country. Ireland is very much at the higher end of the spectrum.
- There is huge variability in terms of the products, the premium costs, the benefits and the regulatory regimes across the EU member states.
- From an employee's perspective, it is important to note that work-related group schemes are very important elements in countries such as, the UK, Sweden, the Netherlands, France, Portugal and Greece.

5.6 However, some relevant general trends can be determined as follows:

- Open Enrolment schemes such as that in operation in Ireland are not common.
- Most EU PHI markets are dominated by non-profit organisations such as the VHI.
- Non-profit PHI providers have been losing market share to commercial insurers. The overall market for PHI, however, has been static. The dynamic is, therefore, more one of a shift from non-commercial to commercial providers rather than net growth in the PHI market itself.

5.7 As matters of direct relevance to the way things are evolving in Ireland, the following should be noted:

- PHI premiums in most European countries rise with age. In some countries it is not possible to purchase cover over a certain age limit. This is due to the general lack of Open Enrolment policies and Community Rating on the lines of that currently operated in Ireland.
- Few EU countries provide tax incentives to people to join PHI schemes in contrast to the situation here in Ireland.
- Risk selection and variable premiums are commonplace. This phenomenon has now become problematic in many member states. Even without Open Enrolment (and full Community Rating) countries such as Belgium, the Netherlands and Germany have had to introduce risk adjustment measures with varying degrees of success.
- No other EU member state has tried Open Enrolment, full Community Rating and no Risk Equalisation payments. Ireland is the only country doing so.

South Africa

5.8 It is interesting to note that South Africa introduced its PHI regime around the same time as the new legislation was introduced here in Ireland. Their Act is a 1998 Act and ours was introduced in 1994 (although BUPA did not enter the market until 1997). The South Africa regime is also based on Community Rating and Open Enrolment. It also has minimum benefits prescribed under the relevant legislation.

5.9 Risk Equalisation was not introduced from the outset in South Africa. However, problems with the operation of the market caused the Government to set up an International Panel to advise it on the issue of Risk Equalisation. The International Panel recommended the urgent introduction of Risk Equalisation. The panel believed that such a measure was urgently needed in order to ensure market stability and sustainability. The South Africa Government has accepted this recommendation and Risk Equalisation payments are now to be an inherent part of the PHI regime in South Africa. It was found not possible to otherwise have a stable PHI market.

Australia

5.10 Historically, the Australian PHI regime was always regarded as being very close to the type of regime operated in Ireland. Voluntary private health insurance operated in parallel with a tax-based funding model for the public health system. Community Rating applies.

5.11 When compulsory state medical cover was introduced in 1984, it led to a large drop in the level of private voluntary health insurance taken out. This drop led to a major rise in premiums and to voluntary, top-up cover becoming unaffordable for most Australians.

5.12 The Australian Government set up a Commission of Enquiry into the PHI industry which reported in 2000. Based on the recommendations of the Commission of Enquiry, a new scheme of Lifetime Health Cover was introduced. The intention of the new scheme was to overcome the problems of the market with trying to implement Community Rating while having no safeguards against risk selection by insurance providers. The new scheme was designed to penalise late entry into PHI schemes by increasing the premiums for late entrants. It was hoped that this measure would reverse the trend of drop off in voluntary PHI membership by inducing younger, healthier people to sign up thus spreading the risk profile. This was intended to be a measure to lower premiums to a more affordable level.

5.13 However, the scheme did not work and premiums continued to rise as a result of increasing claims cost. The Australian experience points to the impossibility of having Community Rating, Open Enrolment and no Risk Equalisation payments. There is an inevitability of continuing rising premiums unless Risk Equalisation is a feature of Community Rating Schemes.

THE KEY LESSONS FROM INTERNATIONAL EXPERIENCE	
1.	The PHI regime in Ireland, as currently operated, is unique. This is not because it is better than elsewhere, it is because it is trying to do something that, all of the evidence would say, is impossible.
2.	No other country in the world has succeeded in having a PHI regime with Community Rating, Open Enrolment and no Risk Equalisation payments. Those that have tried have had to eventually resort to some form of risk adjustment.
3.	The intent of the Irish Regime is correct. Its application, without Risk Equalisation, is not correct.

6 WHY IMMEDIATE COMMENCEMENT OF RISK EQUALISATION IS NECESSARY.

SUMMARY OF KEY ARGUMENTS	
1.	The governing legislation envisaged Risk Equalisation as an integral element of the PHI regime in Ireland. Based on the evidence in this report the arguments put forward by the HIA for not commencing payments in its first two determinations on the matter are not convincing (see Appendix 1).
2.	The latest preliminary determination by the HIA to recommend the commencement of Risk Equalisation payments is the only logical conclusion which can be reached from the experience of how the competitive market has operated since the ending of the VHI monopoly. BUPA's (and presumably in due course Vivas's) objections to the commencement of Risk Equalisation should not be countenanced. BUPA, in particular, has had the benefit of enormous windfall profits.
3.	The PHI market will always be an unstable one for as long as Risk Equalisation payments are not commenced. There has to be a counterweight to risk selection by new entrants. Otherwise premiums will rise for those at greater risk.
4.	No country in the world has successfully managed to have a Community Rating, Open Enrolment PHI regime without risk adjustment. There is good reason for this to be the case. It is not possible based on all the available evidence.
5.	Community Rating is a must as regards a PHI regime which is affordable and fair to employees and former employees. Risk Equalisation is a key cornerstone of an Open Enrolment, Community Rating PHI regime.
6.	The major losers from continued instability in the market will be older employees, their independents and former employees most of whom will have been net contributors to PHI schemes over the bulk of their careers.
7.	You cannot have competition in relation to the cost of claims with only some of the players in the market allowed to manipulate their risk profile. The insurers should not be able to manipulate their Risk Profile. Competition should be based on the product offerings and on efficiency. Risk Equalisation prevents unfair competition and especially unfair exploitation of the position of an incumbent service provider such as the VHI which carries risk across the full age spectrum.

THERE IS NO SUSTAINABLE, CREDIBLE CASE FOR NOT COMMENCING RISK EQUALISATION PAYMENTS NOW.

7 SUMMARY OF CONCLUSIONS FROM THE PERSPECTIVE OF EMPLOYEES AND FORMER EMPLOYEES

7.1 The continued availability of affordable PHI cover is a key issue for employees and former employees. Up until 1997, and the introduction of competition into the Irish PHI market, this was not an issue which unduly concerned employees and former employees. The Governments policy of Community Rating with Open Enrolment ensured access for all with no differentiated premiums. Employees and former employees were not relatively disadvantaged in such a regime.

7.2 The manner in which competition and regulation has been brought into the Irish PHI market is problematic for employees and former employees. There are a number of key risks as follows:

- Premiums may rise dramatically for older employees and for former employees.
- If premiums rise significantly, employers who currently pay all or part of PHI subscriptions on behalf of employees may not continue to do so.
- The VHI may go out of business or be unable to sustain universal access.
- Predatory new entrants may cream off the less risky customers leaving those who have been long-term net contributors to PHI schemes high and dry when they need the cover most.

7.3 There is a simple safeguard to prevent the exploitation of employees and former employees by the unfair operation of a competitive PHI market. That simple measure – the commencement of Risk Equalisation – has been envisaged from the outset of the competitive market in Ireland and is provided for in the governing legislation. The Government must now commence Risk Equalisation payments. Failure by Government to act in this regard will be to the detriment of employees and former employees.

7.4 The technical arguments around the PHI market, have to date masked the seriousness of the issues involved for employees and former employees. This, however, is not a complicated matter. It has been made to appear so by key vested interests. Government needs to act now and not yield to pressures from commercial self interests. From the perspective of employees and former employees, there is no alternative to the commencement of Risk Equalisation payments if Open Enrolment and Community Rating is to be maintained.

EMPLOYEES AND FORMER EMPLOYEES ARE THE HIDDEN VICTIMS OF PHI MARKET INSTABILITY

APPENDICES

APPENDIX 1

HIA REASONS FOR NOT RECOMMENDING THE COMMENCEMENT OF RISK EQUALISATION

HIA FIRST REPORT		
REASONS GIVEN		OUR VIEWS
1.	Insufficient evidence of a threat to market stability	We do not know what the HIA understands by market stability. A market operating as described in this report cannot be regarded as stable.
2.	The benefits that would accrue to consumers from the transfer of funds appear to be small.	This argument revolves around the formula for calculating payments. There is no frame of reference given at all as to why transfer payments in a full year of €23m would be deemed to yield small benefits to consumers.
3.	The benefits are outweighed by uncertain competitive consequences which could arise.	Competition in the market is not analysed. It is unclear what "consequences" the HIA had in mind.

HIA SECOND REPORT		
REASONS GIVEN		**OUR VIEWS**
1.	The potential benefits by way of a percentage reduction in premiums directly from the transfer of funds would appear to be low.	There would appear to be acceptance that there would be some premium reduction. The other beneficial effects on the market are not analysed.
2.	The available evidence does not point to any imminent threat of market instability.	A PHI market having Community Rating without Risk Equalisation is inherently not stable. All of the evidence supports this view. The HIA has never proven otherwise. There is no analysis of the impact of market behaviour on the various players especially on the VHI which is under threat.
3.	The commencement of Risk Equalisation could reduce the competitive pressures which are leading to differential rate increases between insurers.	The VHI is tariff controlled – BUPA is not. There is no coherent analysis of relative pricing strategies and no attempt to analyse BUPA's "price follower" behaviour.
4.	There is seasonability in the data – further data may provide a more complete picture.	There is sufficient data already available to support the commencement of Risk Equalisation. Further delay cannot be justified.

APPENDIX 2

BIBLIOGRAPHY

1. Reports by the Health Insurance Authority.

2. York Health Economics Report on Risk Equalisation and competition.

3. EU Commission Report on Voluntary Health Insurance (2002).

4. Financial Services Authority (UK) Reports.

5. VHI Annual Reports.

6. VHI Submissions to the HIA

7. Web searches on PHI systems in Australia, South Africa and various EU Member States.

8. Various Irish Times Articles.

9. OECD Health working papers – A case study on PHI in Ireland.

10. Report of The Advisory Group on Risk Equalisation (1998).

11. BUPA (Ireland) briefing document on Risk Equalisation (2000).

APPENDIX 3

	BUPA Ireland €'000's				BUPA Insurance UK (ex Ire) £'M				VHI €'M			
	2000	2001	2002	2003	2000	2001	2002	2003	2000/1	2001/2	2002/3	2003/4
	€'000	€'000										
Earned Premium	41,118	61,936	81,531	115,059	744.2	1258.0	1258.1	1357.6	548.1	596.6	687.6	803.0
Claims Paid	21,022	33,146	45,979	68,331	588.5	886.6	988.8	1039.2	453.2	494.4	559.0	638.4
	51.1%	53.5%	56.4%	59.4%	79.1%	70.5%	78.6%	76.5%	82.7%	82.9%	81.3%	79.5%
Cash Flow	20,096	28,790	35,552	46,728	156	371	269	318	95	102	129	165
	49%	46%	44%	41%	21%	30%	21%	23%	17%	17%	19%	20%
Average for Irish Market	80.5%	80.1%	78.7%	77.0%								
Windfall profits over market average	12,070	16,470	18,151	20,243								

Notes 1. Figures in green are taken form FSA returns 2. Other figures are extrapolated from VHI reports and returns.