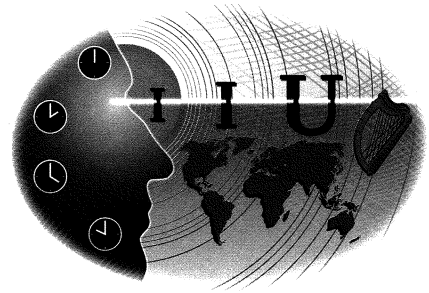


April 11th, 2006



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Dear Sir or Madam,

RE: Competition in the health insurance market

I am writing in response to your invitation for submissions regarding competition in the health insurance market in Ireland.

By way of introduction, International Investment and Underwriting ("IIU") is a private equity company that is owned and controlled by Dermot Desmond. We are a significant shareholder in Vivas, the early stage Irish health insurer which currently has c.1.5% of the market. We also hold a number of investments in the healthcare sector outside Ireland, including Barchester Healthcare, a leading residential and nursing home care provider in the UK with 166 nursing homes.

At present 52% (and rising) of Irish citizens have private health insurance. Health insurance is a critical interface between users and providers of healthcare services and is destined to become more so in the future. It follows that an open, competitive market in health insurance is absolutely essential if consumers are to be protected from exploitation, inefficiency and excessive costs. But, recent Government actions militate against this.

It is self-evident that a vibrant market in health insurance is needed to ensure competitive pricing. But the issues in Irish health insurance go much deeper than that. Dominance, (or, rather, abuse of dominance) in Irish health insurance has resulted in serious competition issues, effecting not just health insurance but private healthcare overall. The loser is the consumer in terms of both the cost and the quality of healthcare service.

The Irish health insurance market, through which consumers buy private medical services, is the least competitive of 16 comparable EU and Australasian markets¹. Vhi controls

¹ "Risk Equalisation and Competition in the Irish Health Insurance Market", Dr. Sean Barrett, Trinity College Dublin.

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approximately 73.5% of the insurance market while the ESB, Garda and Prison Officer schemes together represent another 4%. In total, the government controls 77.5% of the private health insurance market in Ireland.

The majority of Irish citizens are willing to pay for better health services as evidenced by their decision to buy private health insurance, and yet the Irish public is totally dissatisfied with the health service available to them. We have the third worst satisfaction level in Europe². The supply of private healthcare services falls far below the level demanded. Five out of six patients with private health cover are treated in public beds³ while Mary Harney TD, the Tánaiste and Minister for Health, recently described the queues in the country's A&E departments as a "national emergency"⁴.

Intuitively there is an opportunity for the private sector to step into the market to provide the healthcare services that are clearly demanded by the public. Yet, only 11% of hospitals in Ireland are privately owned and run on a for-profit basis – a statistic that compares poorly with, for instance, Germany and France where 21% and 53%⁵ respectively of hospitals are privately owned and run for profit.

Despite having the highest public demand for private health care services in Europe, Ireland has, thus far, failed to attract a material base of commercially run private healthcare service providers. The cause of this imbalance is the Vhi's use of its dominant position as a purchaser of healthcare services, a use that directly and intentionally reduces the profitability and supply of private healthcare services. The founder of the Blackrock and Galway Clinics, Mr Jimmy Sheehan, accuses the VHI of holding private healthcare "totally to ransom" and of "grossly abusing the situation"⁶. The tactics used by the Vhi in exploiting their dominant position include:

1. Withholding approval on facilities and procedures.

It appears that the Vhi frequently withholds approval on covering a new hospital, or in some cases a procedure within a hospital, until some time after the facility is in operation. This has obvious repercussions for the financing of these facilities, as, given that the Vhi represents 73.5% of those with private health insurance, a rejection from the Vhi would effectively destroy the economics by excluding the business from the majority of the market.

It would be interesting to know whether, in practice, the Vhi differentiates between third party facilities (e.g. the Galway Clinic) and facilities in which the Vhi has a stake

² The European Foundation for the Improvement of Living and Working Conditions pan-European survey 2003

³ The Sunday Business Post, December 2005

⁴ RTE, 28th March 2006

⁵ Goodbody Stockbrokers – "Cheering up the Patient" April 2005

⁶ Sunday Business Post, 19th February 2006

(e.g. the Vhi Swiftcare A&E facility in Dundrum), when it comes to the timing of its formal or tacit approval of the facilities for cover.

2. Imposition of aggregate limits on the cover which a hospital can claim for in any year.
It has been reported, to us, that the Vhi has attempted to cap the total reimbursements that new hospitals can charge in a year. If enforced this would cause the hospitals to either limit the quantity of services provided to the public or to provide those services for free, once the limit has been breached.

3. Imposition of sub-market rates for procedures and treatments.
Professor Ray Kinsella, the director for Insurance Studies at UCD, has stated that “By any comparison, reimbursement rates to private hospitals are far below international standards”⁷. In response to suggestions that the Vhi do not pay the full costs of procedures to hospitals, Dr Bernadette Carr of the Vhi said, “in our negotiations [we] insist that internal efficiencies, rather than price, be the first point of focus for hospital management.”⁸ This clearly suggests that the VHI are in such a dominant position that instead of having to negotiate on price, they can dictate matters of internal cost effectiveness to management.

The collective intent and effect of these tactics is to artificially undermine the profitability of providing private healthcare in Ireland, and in so doing, to limit the supply of healthcare available to its citizens. One suspects that a review of the new private hospitals, such as the Galway and Beacon Clinics, would reveal that, as a result of Vhi not paying the appropriate rates, they are making substantial trading losses.

In economic terms, a static analysis of the market might conclude that the Vhi's current pressure on healthcare providers is helping consumers by keeping prices below international norms. However, a dynamic analysis of the market would show that there is an excess of demand for healthcare services that is not being met and consequently, the consumer is being deprived of choice and a better healthcare service. The Vhi's behaviour, while clearly not in the consumer interest, is entirely rational from its perspective in that it has the effect of reducing its possible claims costs by restricting the supply of healthcare available to the community.

The result of all this is that the consumer must pay for services, the cost, quality and availability of which are determined by an immensely powerful market player rather than the marketplace itself. In such an important area as healthcare, this situation is clearly unacceptable. To correct it, everything must be done to establish a market, free from the

⁷ Sunday Business Post, 27th November 2005

⁸ Irish Times, 2nd August 2005

pervasive influence of a dominant player, with a broad spread of competitors. This would ensure that premiums remain low and private healthcare services are determined by consumer demand rather than the omnipotent presence of Vhi. Recent developments promoted by Government have done exactly the opposite.

The introduction of Risk Equalisation (RE) has effectively underpinned Vhi's market dominance.

The arguments for RE may be valid in a market with a balance in the size and power of competitors. In such circumstances RE is merely a method of recognising the different age profile of customers and should result in relatively small transfers between market participants. Indeed, to our knowledge, RE has only been introduced in jurisdictions where market power and influence are shared among a number of competitors and no party has market dominance. It is quite inappropriate to the Irish market as it stands

The introduction of RE where there is such an extraordinary imbalance in size between Vhi and its competitors means that new entrants must make very substantial payments to an entity that already totally dominates every aspect of the private healthcare market in which they must operate. The unfairness of this situation is clear when one looks at it from Vhi's perspective. Vhi can operate with all the advantages of scale, power and political patronage and then receive huge amounts to compensate for the costs associated with the age profile of its customer base from its less fortunate competitors. (It is ironic that, by and large, these older customers have paid premiums to Vhi throughout their younger years when they had lower claims costs)

The unfairness of RE in current circumstances is exacerbated by the fact that it is virtually impossible for new entrants to correct the age imbalance eventhough they are providing their products at the same price across the full age spectrum. Most of the customers a new entrant attracts will be either new to health insurance or in the younger cohort of those already in the market. Older customers already insured will not changehaving paid premiums over maybe thirty or forty years with few if any claims they will not leave just when they are most likely to claim. Emotionally it is difficult to have paid for something you've never used and stop when you may need it most.

So new entrants are penalised for something they can't fix by having to pay huge sums to a powerful competitor who has all the advantages of scale and market dominance (and is prepared to use them).

Rather than support the Vhi's dominance, we believe everything should be done to open up the market. Ideally there would be a minimum of three substantial providers of health

insurance and hence, a minimum of three substantial competing purchasers of private healthcare services in Ireland. The premature introduction of Risk Equalisation will serve to reinforce the Vhi and the state dominance in health insurance to the ultimate detriment of the consumer.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Michael Walsh', written in a cursive style.

Michael Walsh