Response to Medical Health Reform

Consultation Paper

By

HSBC Insurance

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Reply to Government on Healthcare Reform Consultation Paper

1. Introduction

Hong Kong has for some time provided one of the best healthcare systems in the world with a high quality and efficient platform supported by dedicated medical professionals. However, like the rest of the world, due to an ageing population and rising medical costs, the system now faces serious challenges. There has been regular debate on the provision and financing of healthcare services in Hong Kong for some time, including the 1993 "Rainbow Report", the 1999 "Harvard Report" and the 2000 and 2005 "Healthcare Consultation" papers.

HSBC Insurance agrees that there is an urgent need for healthcare reform and we believe in the principle of the medical service delivery model proposed in the "Healthcare Reform Consultation Document", which seeks to strengthen the current healthcare system and proposes alternative financing options. We appreciate and welcome the Government's initiative in its proposal to reform the system and also its recognition of the need to re-examine the options available for financing community wide healthcare.

As the market leader in Hong Kong both in the provision of private medical insurance and also in the provision of retirement benefit services through our MPF and ORSO businesses, we believe we are uniquely placed in Hong Kong to share our knowledge and experience with the Government on both medical insurance and also community-wide compulsory savings via this consultation process.

2. Executive Summary

Of the options proposed in the Government's consultation document, HSBC Insurance supports the Personal Healthcare Reserve (PHR) option. However we feel it important to note that there are a number of very important additional requirements that must be imposed on this structure in order for it to provide a sustainable long term solution to the financing of healthcare within the community.

We believe it is essential that these additional requirements be addressed by the Government, as they are crucial to prevent the collapse of the system as has been witnessed in other parts of the world.

We believe that the key additional ingredients for a stable Healthcare system are as follows:

- Appropriate incentives or penalties to ensure a substantial rate of participation by the community
    - Incentives would effectively mean financial support from the government,
    - Penalties may include a financial disincentive to individuals to join the system at an advanced age;
- Risk equalisation between providers – to ensure that insurers with a larger share of older or less healthy customers do not suffer financial loss as a result;
- Strong legislative support – to prevent the discrimination between customers on grounds of risk;
- A trusted and cost effective platform for administering medical savings accounts for each participating individual – we believe that the MPF infrastructure provides such a platform and should be used to administer the savings accounts;

- A capital model which requires insurers to protect the public by holding sufficient reserves and solvency margins, and a pricing model which is consistent and allows insurers to build up and service the required solvency capital.

We also note that a structure where premiums vary with age and gender avoids many of the problems of community rating; however premiums at the oldest ages can be high.

In addition to the issues noted above, it will also be very important to ensure that there are sufficient incentives for providers to participate in the scheme. This means that insurers need not only to be able to cover their expenses, both in administering and also acquiring business, but also to be able to make sufficient margin to support the capital they will need to hold in order to underwrite the medical risks.

The ability for insurers to make an appropriate margin in writing this business needs to be considered both in respect of the provision of mandatory cover and also for top-up insurance. In particular in the current environment the supply of high quality medical services may be insufficient to support a meaningful top-up insurance market for those wishing to enjoy a higher quality of medical service compared to that offered under the mandatory scheme. In this case it will be necessary for there to be margins available for insurers for providing the mandatory cover insurance.

In terms of the premium rate for the mandatory cover illustrated within the Government's consultation paper, we note an absence of loadings in the premium rate to allow for:

- the fact that claims from a population group with no underwriting is expected to be considerably higher than current insured populations
- the cost of distributing the business, including marketing brochures, business and IT set-up costs, etc., and
- sufficient margin to cover capital funding costs.

The result of this is that the rate may prove insufficient to attract insurers to provide the mandatory cover that is necessary to ensure the long term sustainability of the proposed system.

Hence, we would strongly recommend further statistical analysis and scenario testing to ensure that premiums set for mandatory cover are sustainable long term.

Finally, careful thought needs to be given to the transition arrangements for the population which is currently already covered by some form of private medical insurance (be it corporate or individual medical insurance schemes), to ensure that there are appropriate incentives in place for this population to continue to finance their healthcare and that money is not inadvertently drawn out of the system.

Further details on all of these issues are provided in the remaining sections of our response.

In section 3 we outline our thoughts on the different financing options proposed by the Government.

In sections 4 and 5 we discuss issues on the medical savings accounts and other issues in relation to the long term financing of medical care.

Section 6 deals with some of the detailed issues that need to be thought through in terms of the community rating approach, and borrows from the experience of other parts of the world.

Finally in section 7 we discuss the potential market for top-up insurance and in section 8 we consider alternative methods of premium rating.

3. HSBC's Response to Options Proposed by Government

HSBC Insurance strongly supports the Public-Private Partnership (PPP) model. In our view, the integration and partnership between the private and public sectors to develop medical care will improve the utilization and sharing of healthcare resources over the longer term and provide customers with increased choice. This move is needed to relieve the burden on public hospitals and to allow a better focus on the treatment of acute cases and complex illness requiring costly treatment.

Concerning the development of supplementary financing options, HSBC Insurance supports the Personal Healthcare Reserve (PHR) option among the six proposed financing methods in the paper. The basic concept of this option is to require those above a certain income level in the working population to deposit a fixed percentage of their income to their own PHR account with part of the savings used to subscribe a mandatory regulated medical insurance scheme for immediate use and the rest accrued in a savings account to provide for the cost of continued healthcare after retirement. In our view, this can not only provide continued protection to the public, but also ensure sustainable financing to support the whole healthcare system in the long run.

If the mandatory insurance scheme is realised it will allow people of all ages and health conditions to enjoy an affordable premium rate for basic medical cover. It will be possible to provide cover to high-risk groups and individuals with pre-existing conditions while sharing and spreading the risks within a large insured pool. However, the size of PHR population is a critical factor to sustain the lower premium and the Government has to seriously consider the criteria in defining mandatory participation in the PHR.

HSBC Insurance agrees to the regulation of the mandatory healthcare coverage by the Government with some flexibility for the insurers to compete in a free market. There is no doubt that competition can drive service providers to provide a better service at reasonable cost and provide consumers with a wider range of choice for their cover.

However, within the framework of this review the Government must seriously evaluate the capacity of the private hospitals to cater for the increasing healthcare burden in the Hong Kong SAR.

4. Medical Savings Accounts

The PHR financing method described above relies on creating individual savings accounts for each eligible member of the population. Keeping premium rates at affordable rates will require the development of a cost effective way of administering both the medical insurance and also the savings accounts required to support the increasing cost of healthcare at older ages and after retirement, or should premium rates need to increase to support the rising costs of the mandatory health system as a whole.

HSBC Insurance believes that the current system for administering MPF retirement funds would provide an appropriate platform on which to build the individual savings accounts needed under this financing option. Naturally the savings accounts would need to be held separately and be subject to the appropriate Healthcare regulatory control. Nonetheless we feel that the use of the existing MPF infrastructure is the only cost effective solution for administering these savings accounts.

We also believe that further evaluation is required of the level of mandatory savings to ensure an appropriate balance between the payment of medical insurance premiums and the need to accumulate sufficient funds to finance healthcare post retirement. In particular it is not clear that a contribution rate of between 3% to 5% of the monthly income would provide sufficient funds to finance

post retirement care for individuals on a monthly salary of say $10,000, allowing for the premium rates illustrated in the document and the expected future escalation of the healthcare costs.

It should also be noted that individuals may exhaust their savings accounts in old age, either if the amount contributed in not sufficient or if the cots of healthcare at advanced ages is greater than expected. Indeed in other countries it has proved incredibly difficult to predict these healthcare costs at older ages, and indeed we are aware of cases in Singapore where even a contribution level of 7% has not always proved sufficient.

As a result we believe it will be important to set up a control mechanism including projections of the adequacy of contribution rates over say a 10 year period, and agreed measures for cases where it is appears that funding will not be sufficient.

5. Other Financing Issues

If the proposed mandatory medical scheme is adopted, it will cover the specific population group regardless of their age and health conditions.

We would however strongly recommend that consideration and evaluation is given to the scenario under which claims costs increase more rapidly than expected in which case the premium rates for the mandatory cover may prove insufficient. Under these circumstances there will need to be enough flexibility built into the system either to review and adjust the premium rates on a regular basis, or for subsidies to be available to loss making insurers from the Government.

We have particular concerns over the arrangements which will need to be put into place for current chronically ill or disabled members of the population for whom the mandatory premium rates will be clearly insufficient. In order to ensure a stable structure which aligns the interests of all parties, we believe special treatment involving Government subsidies will need to be made for these individuals.

6. Community Rating

6.1 Overview

HSBC recognises that there are advantages and disadvantages to a community rated system.

The main advantage of community rating is ‘Access’. Higher risk categories (e.g. the aged, those with pre-existing conditions) can obtain cover at prices no less affordable than for healthy people. This is an important social benefit.

However, the major risk of a community rating is that it is a financially unstable system. This is because the price for an individual person is not related to the risk. As a result:

- Healthy individuals have an incentive to avoid joining (creating a non-compliance incentive which would produce a requirement for close monitoring of the take up of mandatory cover).
- Insurers have a powerful incentive to make it difficult for unhealthy people to join their scheme.
- It is likely that a proportion of insurers will be unable to finance their claim costs out of premiums.

Because of the advantages that arise from a community rated system, methods for dealing with the financial instability have been implemented in other parts of the world, including Australia, South

Africa, and Ireland. Generally these require support from the government (administrative, financial and moral) if they are to succeed.

Because healthy people cross-subsidise unhealthy people, community-rating is a 'zero-sum game' with clear winners and losers identifiable in advance – unless a third party contributes to the cost of claims.

We recognise that the experience in Australia has seen over 50% of the population covered by some form of voluntary health insurance in recent years, including nearly 45% with hospital coverage. This shows that when commercial insurance operations are actively supported by the government, community rating can operate successfully. Conversely the Australian experience during the 1990s also shows how quickly a community rated system can fail if the government ceases to actively support the system or to allow insurers to operate commercially.

6.2 Required Support

We recognise from experience in other countries that to remain financially stable, a community-rated system requires a degree of structural support. In most cases, this is a combination of more than one element. Such structural support normally focuses on the areas below:

a. **Substantial membership take up** – this can be achieved through financial encouragement / penalty (as in Australia); or by making it compulsory (as proposed for Hong Kong). The result is that the total risk pool should experience a relatively stable claim experience. As with MPF, the Government will need to consider monitoring the take up of mandatory cover and also the application of penalties in the case of non-compliance.

b. **Risk equalisation between insurers** – if insurers whose customers are old or unhealthy make large losses, they will find a way to turn away those customers. In effect, the system would incentivise insurers to defeat its greatest advantage ('Access'); and those insurers carrying the least of the social burden (i.e. insuring the healthy) would make the highest profit.

   To avoid this, countries such as Australia, Ireland and South Africa have each adopted a 'risk equalisation scheme'. Generally these work by pooling the cost of high-risk members and sharing the pool costs across the industry.

   HSBC considers that if community rating is adopted in Hong Kong, then a risk equalisation scheme is essential. We would be pleased to consult further with the government on the forms such a scheme could take.

c. **Third party contribution** – if a third party (such as the government) makes a contribution to the cost of claims, a community rated system ceases to be a zero-sum game. This transforms the financial logic for members, and it becomes financially rational for healthy people to join. This is a virtuous circle, as the more that healthy people join, the lower are the resulting premiums.

d. **Legislative support** – a well-respected regulatory system to prevent the discrimination between customers on grounds of risk should underpin a national community-rated scheme.

6.3 Potential for abuse or unfair competition

HSBC is concerned that a community-rated system may be open to abuse or unfair competition despite any structural system support provided by the Government.

a. **Unfair Discrimination**
   No risk equalisation scheme is perfect, and insurers will always have some incentive to attract

more healthy and fewer unhealthy members.

b. Ineffective Price Signals

Because each member pays a premium un-related to their own risk of claiming

- disincentives for over-use of health services are reduced
- cost escalation in the underlying services (whether caused by scarcity or by profiteering) is dissipated across all members, and so is less easily opposed by the normal market forces.

The above should be further studied with consideration given to appropriate measures to ensure that abuse of unfair competition does not develop.

6.4 Demographic issues

An underlying rationale for the entire health reform is that demographic change will reduce the working population available to pay for services. A community-rating health insurance system does little or nothing to solve this – it still requires the working population (generally healthy) to subsidise the retired population (less healthy).

If a separate community-rated system operates after retirement (one of the options in the consultation document), then the 'Access' benefits of the system are diluted, because the highest premiums still fall on those not working.

6.5 Specific Comment on the Proposed Community-Rated Premiums

a. **Increasing Premiums**

The analyses provided in the Government paper shows very substantial increases in the community-rated premium over time. These forecasts do not show any levelling out, even in 2023. We question whether such a scheme is stable, especially as the forecasts ignore any increase in utilisation arising from the scheme.

b. **Profitability and Solvency**

Both proposed mandatory designs appear to assume that insurers will bear the claim risk. Both also state that premiums will be set so that insurers will make no profit. HSBC believes this may not be financially stable, for two reasons:

(i) If premiums are fixed and claims are variable, it is logically almost certain that insurers cannot make a zero insurance profit.

(ii) If insurers are required to meet normal solvency requirements for this business, then they must supply additional capital related to the size of claim risks, and this additional capital requires a margin to service it.

c. **Premium Level**

HSBC has attempted to reproduce the premium using data from its own insured base. Our conclusion is that it remains unclear whether the premium rates illustrated will prove sufficient when allowing for

- the lack of underwriting possible under the mandatory scheme - therefore resulting in higher expected claims cost as compared to our current insured population,
- the need to cover not only administration costs but also the costs associated with acquiring new business such as explaining the policy and nature of cover to policy holders (the sales process) and capturing relevant data and capturing the relevant policyholder data onto the IT platforms needed to administer the business, and;

- the lack of any allowance for an additional margin to allow providers to cover the risk the business will weaken their balance sheets and also to support the capital required to underwrite the risks.

We believe further detailed analysis and investigation is required including scenario testing before finalising the structure and level of the premium rates for the mandatory cover.

6.6 Summary

HSBC recognises that a community-rated system may best meet the needs of the Hong Kong health system.

However we are concerned that for community rating to succeed, sophisticated supporting structures must be put in place, with full government support. If this is not understood then HSBC is concerned that adoption of a community rated system may prevent achievement of the government's aim from the health reforms, specifically from

- the potential to disguise costs and hence cost increases
- the demographic problems which arise with such schemes
- the incentive that healthy people have to avoid buying community-rated health insurance

If a community rated system is adopted HSBC believes that it is essential to also introduce the supporting structures described here.

HSBC does recognise that there are social "access" advantages from a community rated system.

7. Scope for Voluntary Top-up Insurance

7.1 Rationale

The schemes presented in the consultation documents assume that insurers will participate in the mandatory element at zero profit, because there will be an opportunity for a more attractive return from the related "top-up" health insurance products.

For this to be possible there must be a large enough market for top-up cover. This requires:

- a large enough supply of the 'high quality' health services which top-up cover can enable;
- a large enough gap between the mandatory insurance benefits and the cost of 'higher quality' health services;
- limits on the supply of 'basic' (i.e. not higher quality) health services.

If these conditions cannot be met from the outset, then our view is that insurers are unlikely to participate unless they can make a sufficient margin on the mandatory cover, as the top-up market will not be large enough on its own.

HSBC's experience is that people do not buy top-up cover because they like high cover. Instead they buy it because they want better quality treatment than the mandatory cover will provide.

Our research suggests that consumers will regard a health service as 'high quality' if it:

- provides a more comfortable or personal setting (e.g. higher standard of hospital wards),
- provides a faster service or avoids a long waiting list, and
- enables choices that are important to the customer (e.g. choice of hospital or doctor).

7.2 Transition

An aim of the reforms is to encourage greater private provision of healthcare finance. Currently over 38% of citizens already make private contributions totalling about 13% of total healthcare expenditure or $8.5 billion coming into the system through payment of medical insurance premiums. *(sources: Thematic Household Survey Report No 30, Page 134 of Healthcare Reform Consultation Document)*

The way in which these customers and products are transitioned into the new system is important. HSBC suggests that two principles should be adopted to allow the aims of the reforms to be met:

a. Transition provisions encourage existing policy-holders not to reduce their contribution to the system;

b. Transition provisions enhance the credibility of voluntary top-up health insurance cover and its perceived value to customers.

In the next phase of the review, HSBC would welcome the opportunity to discuss in detail how these principles could be met in practice.

The proposals set out a mandatory lower level of cover and invite insurers to provide top-up cover above this level. We expect that over time, the government will need to revise the mandatory levels. Such revisions will have negative effect on insurers. HSBC proposes that in order to allow insurers to commit to this market, the government should set out in advance the principles that would apply in any revision. Insurers are then free to assess the risk of change, and will respond accordingly.

If the proposal that insurers supply the mandatory cover with no profit margin is implemented, it will be important that the government encourages the take up of top-up cover. This should include:

- repeated public statements and encouragements;
- ideally some kind of perceived financial encouragement.

7.3 Specific issues arising from the Proposals

a. Competition from the Public (Base) System

Table 2 of the Population-wide mandatory scheme description illustrates clearly the danger of supplying too many 'base' level hospital places. If citizens are to be encouraged to place less strain on the public system, there must be less opportunity to obtain treatment with only a minimal patient payout and the minimum mandatory health insurance.

b. Unfunded Transfer of Liability?

The proposals appear to suggest that individuals with existing health conditions that predictably require future treatment will become supported by the private insurers instead of by the Health Authority. It is not clear that the costs of those individuals can be met out of the illustrated premiums; and if not, then instead these liabilities would need to be met by a payment from the government. If

instead the liabilities are to be met out of premiums, then this will adversely affect the take up of voluntary insurance.

HSBC will seek further discussion with the government on this aspect of the reforms, to help ensure the reforms meet their objectives.

8. Alternative Premium Bases

8.1 Overview

As discussed in Section 6, there are weaknesses in a community rating system. In this section, we comment on some alternatives to community rating for the mandatory insurance cover.

8.2 Age & Gender Based Mandatory Premiums

A structure where premiums vary with age and gender avoids many of the problems of community rating, but premiums at the oldest ages can be high.

Insurance cover must be guaranteed renewable, and a compulsory scheme would not allow underwriting of new entrants, meaning that the premiums are still partly unrelated to the risks assumed.

8.3 Risk-rated with Broad Premium Bands

A rating system where premiums are the same for very broad age groups (e.g. 31-40, 75-80, 80-85, etc.) would still allow premiums to rise as the membership ages, and has some of the cost-sharing benefits of community rating. However it fails to match premiums to the predictable age/gender risk levels. In our view it would be less desirable than either a full community rated or a full age/gender rated system.

8.4 Age-based Premiums integrated with a Health Savings Scheme

Provided that contributions to the savings account are high enough, a system where health savings accounts for individuals are integrated with an age/gender rated insurance system would avoid the main disadvantages of both community rating and a standalone age/gender rating system.

8.5 Solvency & Financing Capital Requirements

HSBC is concerned that insurers offering the new mandatory cover will be required to hold capital to meet solvency margins, but will be unable to finance the cost of this capital from premiums. The proposed administration fee may not meet this need, as it will not be related to the size and variability of risks undertaken. Premium bases that allow for a return on the capital employed are economically superior.

On a related matter, if community rating is adopted, it will be important to ensure that the regulatory solvency regime does not create unreasonable capital requirements.

8.6 ‘No Profit’ should mean “No Insurance Risk”

Earlier we have mentioned that if insurers carry true insurance risk then they almost certainly cannot make a zero profit. If it is essential that premiums contain no profit margin, then the risk must be passed to another carrier. Alternatives to achieve this include:

a. all insurance risk carried by a government pool;
b. creation of a rebate loading/rebate payment system.

HSBC’s strong recommendation is that insurers be encouraged to carry the insurance risk (which is their raison d’être), and that an appropriate additional margin be included in mandatory premiums to enable insurers to perform their role effectively.