Chapter 11 SUPPLEMENTARY FINANCING OPTION (4) - VOLUNTARY PRIVATE HEALTH INSURANCE

Voluntary Private Health Insurance as Supplementary Financing

11.1 Voluntary private health insurance includes both employer-provided medical benefits and individually-purchased medical insurance. In the case where individuals take out health insurance on their own, the premium is assessed on the basis of their health risk, based on their age, gender and other health-related factors. Under-writing and other measures such as health checks are often required in order to assess the health risks more accurately, adding to the cost of taking out insurance. In the case of schemes tailored for specific groups such as group policies taken out by employers for the employees of a company, the premium is rated on the basis of the profile of members of the group.

11.2 However, it is difficult for an insurer to determine the health risk of an individual with complete accuracy. A major factor that affects the premium and viability of voluntary private health insurance is anti-selection (or adverse selection)[8], i.e. the tendency of those with higher risk who are likely to benefit to take out insurance, leading to higher premium, which in turn further deter those with lower risk from staying insured. Risk-selection[9] by insurers, such as exclusion of pre-existing medical conditions or increasing the premium for those with claims, is thus common and has the effect of excluding those with high risks from getting insured.

11.3 Another major factor that affects voluntary private health insurance is moral hazards, i.e. the tendency for providers to over-supply and over-charge and patients to over-use and over-claim healthcare services under insurance, which would lead to increasing premium. This is particularly the case for services which are less risk-based and more prone to inappropriate use or abuse, e.g. out-patient services and diagnostic tests. Requirement of co-payment or deductible is often employed as a means to curb moral hazards, but this may also reduce the

---

[8] Anti-selection, or adverse selection, in the context of insurance, is the situation where, because the insurer does not have perfect information to assess the precise risks of each individual, those with risks higher than that priced under an insurance are more likely to self select to take out the insurance, resulting in the insured gaining an undue advantage over the insurer. In economic terms, this represents a market failure due to information asymmetries between the insurer and the insured that prevent the risks from being fairly and accurately priced.

[9] Risk-selection means the insurers tries to select only those with low risk to insure while rejecting the high-risk individuals, in order to keep the overall risk level of an insurance scheme at a lower and manageable level, and at the same time avoid insuring high risks which may be difficult to price due to anti-selection and other information asymmetries.

attractiveness of a voluntary medical insurance policy, especially when companies compete on the basis of terms and premium in a free and unregulated market.

11.4 As a result of these factors, where the premium is individually-rated, cherry-picking is common in that insurers would tend to favour less risky clients. Persons with relatively higher health risk, including the chronically-ill, the elderly, those with previous illnesses that may recur, and those with family members having illnesses that may be hereditary, would usually find it more expensive, or not possible at all, to get insured in a free market where insurance companies operate for profits. It is also not uncommon for individuals who get certain illnesses with a likelihood of recurrence to have their insurance premium increased subsequent to their illnesses. Even for group insurance policies, it is not uncommon to exclude pre-existing medical conditions for the purpose of cost control.

Financing Implications

11.5 In Hong Kong, voluntary private health insurance, including both employer-provided medical benefits and individually-purchased medical insurance, is already a supplementary source of financing under the current system. It accounts for some 12.5% of total health expenditure in 2004/05 (employer-provided medical benefits account for some 7.6% and individual-purchased medical insurance account for 4.8%), or 27.6% of private health expenditure. The share of voluntary private health insurance in Hong Kong as a source of funding in total health expenditure is relatively high among advanced economies except when compared with the United States.

11.6 To rely solely on voluntary private health insurance as a source of supplementary financing to provide the extra health expenditure required to meet the needs of the community (on the assumption that the insured will either use private services or pay full cost for using public services), it is estimated that the amount of financing from insurance will have to at least triple to provide around 34% of the total health expenditure in 2033 or 53% of private health expenditure. It is difficult to envisage any viable scheme that could expand the current voluntary insurance market by that magnitude, an on a voluntary basis.

Overseas Experience

11.7 Voluntary private health insurance exists at varying degree in almost all the advanced economies we have studied. However, it serves as a major financing source only in the case of the United States. It has also been proactively promoted

as a means of addressing financing challenges to the tax-funded public hospital system in Australia.

The United States

11.8 In the US, voluntary private health insurance is the predominant means of healthcare financing. The safety net is provided through two programmes: (i) the Medicaid programme which is a tax-funded scheme to provide a minimum set of services for the low-income groups and needy families; and (ii) the Medicare programme which is a social health insurance funded by payroll taxes to provide health insurance for the elderly and the disabled. For those outside the safety net coverage, their access to healthcare depend heavily on their private insurance coverage, and in turn their ability to pay the premium if they do not have any or adequate employer-provided medical insurance, which can be expensive to the lower income or those with pre-existing medical conditions. It has been estimated that some 46 million (16%) of the population in the US are without health insurance coverage.

11.9 A major problem that has arisen in the US is the escalation of healthcare cost and in turn insurance premium, with spending largely driven by the demand of the patients who want the latest and the best treatment after having paid the insurance premium. This has resulted in rapidly growing total health expenditure – over the past 20 years, the total health expenditure in the US as a percentage of GDP has increased from 10.2% in 1986 to 15.3% in 2005.

11.10 Another problem is the financial sustainability of the Medicare and Medicaid programmes. The actuaries who track the costs of the programmes have estimated that the funding from payroll taxes is inadequate to fund the Medicare programme as the working population is not growing as fast as the elderly population. Reform to the healthcare system, especially on financing these programmes as well as to provide coverage for the uninsured, remains a controversial issue in the US.

Australia

11.11 In Australia, where the government budget is the primary source of funding, voluntary private health insurance is strongly encouraged by the government and plays a supplementary role.

11.12 The Australian government emphasizes the role of private health insurance as a means of reducing demand on public hospitals and thereby diminishing cost pressures on the public healthcare system. It therefore tightly regulates private

health insurance funds' offers and activities in an attempt to maintain broad participation in the private health insurance market across different risk cohorts. For example, private health insurance funds have to accept all applicants within certain membership categories. Risk selection/discrimination on the basis of gender, age, health status etc. is prohibited. Premiums are community-rated for each product and the funds cannot refuse renewal of insurance policies. It should also be noted that out of the 38 registered private health insurance funds operating in Australia, only 6 of them are for-profit organizations.

11.13 Since the Australian Government attaches much importance to private insurance, it is very much concerned with drops in the level of private health insurance uptake, or membership as it is termed in Australia. The Australian Government therefore also implements a number of 'carrot and stick' policies to boost the uptake of private health insurance and maintain it at a level that can sustain a private healthcare market which is capable of reducing demand on the public healthcare system. The most effective of these include –

(a) a 30% rebate of the premium offered by the government (and an even higher rebate for the elderly);

(b) "Lifetime Health Cover", which requires Health funds to apply the same base premiums, calculated at age 30, as long as individuals take out insurance cover before 30 and remain insured thereafter. Insurers can apply premium increase to individuals buying health coverage after age 30 that equal to 2% of the base premium per each year of age above 30, with a maximum increase of 70%; and

(c) levying a surcharge of 1% on the taxable income of individuals in the highest income band who have failed to take up private hospital insurance.

11.14 While the taking up of health insurance in Australia is not compulsory, with government interventions in the Australian private health insurance market and the carrots and sticks provided, the take up of health insurance in Australia by individuals is very different from that of people in the US or in any other economy where the government does not proactively implement measures to maintain a high take-up rate. In many respects, the Australian-style voluntary private health insurance scheme is more similar to the mandatory private health insurance schemes adopted by Switzerland and the Netherlands.

11.15 Like the mandatory schemes in Switzerland and the Netherlands, private health insurance in Australia is useful in improving individual choice. Those who

have private insurance cover can use a greater variety of providers (public or private hospitals and doctors of their choice) than patients relying solely on Medicare, Australia's publicly funded healthcare system. One considerable advantage of private health insurance with hospital cover is that it may allow flexibility over the timing of care, and access to more timely care, particularly for elective surgery. This is a significant advantage in Australia where public hospital patients have to endure long waiting times for elective surgery. The Australian public hospital system guarantees access to care in case of catastrophic or life-threatening conditions. However, access to elective surgeries is rationed, with priority for admission assigned on the basis of need.

11.16 Private health insurance is being developed in Australia as an increasing source of financing apart from government funding especially for private hospital activity - it accounts for some 6.7% of the total health expenditure of Australia in 2004 or some 20.4% of the private health expenditure. It has contributed finances to the development of a large private hospital sector and has helped to fill its capacity. The pros of the Australian-style voluntary private health insurance are that it not only provides a supplementary source of funding, but also more choice for patients with a vibrant private medical sector that shares out the demand of the public healthcare system. The Australian experience, however, also indicates that the problem of how to maintain a sizeable take-up rate must be resolved for private health insurance to function well and be sustained in the long run.

Advantages as Supplementary Financing

11.17 Providing incentives for the taking out of voluntary private health insurance (e.g. tax deduction) with a view to providing a supplementary source of financing has the following advantages –

(a) **Individuals' choice to reduce financial risk**: it remains an individual's choice to take out voluntary private health insurance. Through the insurance and premium payment, the insured can effectively off-load a substantial portion of his financial risks arising from falling ill. Private health insurance can be an effective and efficient means to provide risk-pooling for an individual's health risks, provided that issues such as anti-selection and moral hazards can be effectively addressed.

(b) **More choice of services**: private health insurance provides an individual with more choice of healthcare services. It not only provides individuals with a choice of healthcare services from both the public and private sectors, but also allows an individual to customize the scope of services, the

level of benefits, and the class of amenities to be covered by the insurance according to his own choice.

Disadvantages as Supplementary Financing

11.18 On the other hand, relying on voluntary private health insurance as a supplementary source of financing has the following disadvantages –

(a) **Expensive for the high-risk groups**: under a voluntary insurance scheme, the insurance premium for the high-risk groups such as those with chronic illness, the elderly, those with pre-existing medical conditions, or those with risks of hereditary illnesses can be very expensive.

(b) **Costly premium due to anti-selection**: under a voluntary insurance scheme, there can be a significant degree of anti-selection. If the insured pool is small as with the case of most voluntary health insurance schemes at present, the effect of anti-selection and the cost of underwriting to avoid such would also lead to more costly insurance premium.

(c) **Coverage may exclude pre-existing medical conditions**: exclusion of pre-existing medical conditions is often employed as a means of avoiding anti-selection under a voluntary insurance scheme. This makes it even harder for those already with illnesses to get insured. Reportedly there are disputes between insurers and insurees over the exact coverage and the exclusion of the insurance, especially when the exclusion is based on self-declaration.

(d) **No guarantee of continuity especially at old age**: voluntary private health insurance for individuals rarely provides guarantee on premium or renewal. Insurance premium will usually increase with age as health risks increase. It is also often the case that those having insurance claims for illnesses may have their premium increased, sometimes to an unaffordable level. Reportedly some may also have their insurance policies terminated. In addition, medical insurance provided by employers for their employees will usually cease coverage once the employees leave employment (e.g. on changing jobs or after retirement).

(e) **Little protection for consumers if unregulated**: currently voluntary private health insurance policies are not subject to regulation on their terms and coverage. Individual insurees are also often at a disadvantaged position

vis-à-vis insurers as they would be less capable of understanding the legal terms of insurance as well as defending their contractual rights.

(f) **Little control on healthcare utilization and costs**: without a regulatory framework, it is difficult to control utilization and costs of healthcare services including those in the private sector under a voluntary private health insurance.

(g) **May encourage tendency to overuse healthcare**: given the potential for moral hazards, voluntary private health insurance may encourage the tendency to overuse healthcare, when providers and patients may have the incentives to over-supply and over-use healthcare. The rapidly increasing healthcare costs and insurance premium in the US is a case in point.

(h) **Increasing premium over time**: The increase in utilization particularly the excessive use of healthcare due to moral hazards will increase insurance premium over time. The lack of effective benchmarking of healthcare price and cost would also contribute to increasing premium. For individuals, the premium will also increase over time as they get older or if chronic or other illnesses occur to them.

(i) **Not helping individuals to save to meet future healthcare needs**: while some insurance plans provide a savings component, voluntary health insurance in general does not provide reserve funding for individuals to meet their future healthcare needs. If we rely on voluntary health insurance as supplementary financing, as the healthcare needs of the population increase, the amount of financing expected from voluntary health insurance will increase as well.

(j) **Incur administration and other insurance costs**: apart from the administration costs for underwriting, private health insurance would also incur administration costs for claims processing and reimbursement, as well as commissions for agents and profits for insurers. On average, the claims payout from voluntary private health insurance currently in the market amount to some 70% of the amount of premium paid, the rest being costs and profits or sums set aside for meeting future liabilities.

(k) **Not relieving the pressure on the public healthcare system**: at present in Hong Kong, even for those with voluntary private health insurance (both employer-provided and individually-purchased), it is estimated that some 62% of their in-patient needs are still being met by the public hospitals. A

possible reason is the significant price differential between the public and private sectors, and the residual financial risks (i.e. the payment that the insured has to make after the insurance benefit limit has been reached) even with insurance. If the insured goes to public hospitals, the insured will be sure that they would not need to pay for any co-payment, and the insurers will only need to pay the highly-subsidized fees ($100 per day). Reportedly some insurance even offer cash allowance for the insured if they choose services from public hospitals. Thus for acute care and other healthcare services where there are relatively higher priorities and shorter queues in public hospitals, there is still significant incentives for the insured to go to public hospitals instead of private ones (and for the insurers to encourage them to do so), and in those cases the voluntary insurance would not provide any additional supplementary financing for those services.

(l) **Unpredictable and inadequate supplementary financing**: it would be difficult to predict the amount of financing that would be available through voluntary private health insurance, especially as the taking out of private health insurance could be subject to economic cycles. Even with financial incentives such as tax deduction, the size of private health insurance is also unlikely to increase to such a size that can provide an adequate source of supplementary financing. For comparison, in Australia where the Government has proactively promoted voluntary private health insurance, it still amounts to only 6.7% of financing for the total health expenditure or 20.4% of private health expenditure.