The medical insurance market in Hong Kong – a time of opportunity for insurers but tread carefully as it is not a business for amateurs!

Medical insurance is currently the fastest growing line of general business in Hong Kong. According to provisional statistics recently released by the Office of the Commissioner of Insurance ("OCI"), gross direct premium for medical business increased by almost 22% from $3.1 billion in 2005 to $3.8 billion in 2006. In comparison, over the same period, more mature lines of business such as motor and property damage actually contracted in 2006 with reductions in gross direct premium of 7.8% and 4.0% respectively. While the troublesome Employee's Compensation line did see some growth in 2006, it was significantly lower than medical business at 7.1%.

While the "top line" premium growth statistics for medical business paint a rosy picture for the insurance market, the "bottom line" figure that really counts, namely underwriting profit, is not nearly as nice. In fact, it is quite ugly. In 2005, the OCI statistics revealed an overall market underwriting loss of $134 million, mainly arising from the poor performance of group medical business compared to individual business. Provisional figures for 2006 indicate a significant improvement, but still a loss for the market of $0.2 million.

So what conclusions can be drawn from the above statistics? Is medical business a good business for insurers to be in? As alluded to in the heading for this article, my personal view is that medical insurance offers great opportunities for insurers in Hong Kong in the current environment. However, with all opportunities come risks, and this is particularly the case for medical insurance business as I will discuss later in this article. Firstly, it is worth discussing the reasons why the medical insurance market is growing so rapidly in Hong Kong.

The quality of healthcare in Hong Kong is first class by world standards as reflected by the very long average life expectancies of its citizens (ranked first and second in the world for men and women respectively). These high standards have significantly been driven by the healthcare system in Hong Kong which to date, has been highly subsidised by the Government through tax revenue. For example, according to the Hong Kong Health, Welfare and Food Bureau website, the level of public subsidy from taxation revenue was around 97% and 87% of the total cost of inpatient care and outpatient services respectively in 2003.

With such a high level and high quality of publicly subsidised healthcare services available, it could be argued that Hong Kong citizens have not really needed medical insurance in the past unless they preferred to utilise more private sector services where the user pays.

However, such high levels of Government subsidy are very expensive to sustain, particularly in an ageing population such as Hong Kong's. For example, again according to the Hong Kong Health, Welfare and Food Bureau website, Government public healthcare expenditure in 2004-05 was a very high 14.4% of total Government expenditure. With increasing healthcare costs driven by advancements in medical technologies and an ageing population, this level of public subsidy is recognised as not being sustainable in the current taxation environment in Hong Kong.

In response to this issue, the Government has initiated a number of reforms to address the current over-reliance on the public healthcare system. These include: developing healthy lifestyle programs in the community; reducing the incentive for people to go to public hospitals for non-essential services that could more effectively be treated by primary services (e.g. GPs, home care etc.) by imposing restrictions or increased waiting periods on certain hospital services; and increasing fees or patient co-payments on certain hospitalisation services, particularly on those that can more readily afford to pay.

Such initiatives, which have really started to take shape over the last year or two, have been a major factor that has increased the attractiveness of medical insurance which funds private medical services and consequently, the demand and take-up for medical insurance has increased significantly in recent times.

Another factor in the growth of the medical insurance market has been the strong economic growth in Hong Kong since recovering from the SARS period in 2003. With a strong economy, people enjoy increased disposable income and therefore are more prepared to outlay money on private medical insurance.

The current environment in Hong Kong therefore places insurers in an ideal position to develop and expand their range of medical insurance products and services to meet the increasing demand as the healthcare system shifts to a more "user pays" model, particularly for those that have the financial means to fund their own healthcare costs.

However, insurers need to appreciate the significant financial risks of writing medical insurance business. As evidenced in many developed insurance markets throughout the world, insurers risk making significant losses from medical insurance business if they do not plan appropriately. There are a number of reasons for this, including the following: Medical insurance is a highly selective product. When a person buys most forms of insurance such as life, motor or property insurance, they do so as a protective measure i.e. they want the security of having insurance but in practice, they hope that they never have to make a claim. Medical insurance is very different to other insurance products as in practice, many people will buy medical insurance with an attitude that they expect and plan to make a claim in future. The attitude that medical insurance is a waste of money unless you can claim against the policy is unfortunately, very common.

There is also a very high correlation between medical insurance coverage and over-servicing by suppliers of medical services. As the insured person is covered by medical insurance, there is reduced incentive for that person to question or control the level and cost of treatment recommended by the provider. This can lead to excessive and unnecessary treatment which in the end, the insurer has to pay for.

The rapid improvements and advancements in medical technology that continue to occur throughout the world leads to significant ongoing increases in the cost of medical products and services covered by medical insurance. This leads to significant "medical cost inflation", well above the level of general price inflation in the economy and it usually means that the premiums that medical insurers charge for their products can become out of date and inadequate very rapidly.

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Most developed nations (Hong Kong included) are faced with an ageing population due to a combination of increasing life expectancy and reducing birth rates. As the incidence and severity of medical problems increases with age, the utilisation of medical services and products naturally also increases. This presents a significant challenge for medical insurers to be able to provide appropriate products for the community and at the same time, to control the costs of insurance.

Medical insurance business is a highly specialised class of insurance that can not easily be managed in the same way as other general or life insurance business. Quality underwriting and claims management are critical success factors for any insurance company wanting to enter this market. It is critical that product features, benefits and exclusions are very clearly defined in the policy documentation and that the company adopts a strict but fair enforcement policy in settling medical insurance claims.

In practice there needs to be a balance between providing attractive benefits and plan features for customers, but at the same time reducing the incentives for abuse by policy holders or over-servicing by medical suppliers. This all comes down to careful product design, pricing and underwriting as well as implementing a high quality claims management team that is specialised in healthcare and medical insurance. In the current insurance market in Hong Kong, this is rare in practice.

Intermediaries have an important role to play in helping to achieve a strong and sustainable medical insurance market in Hong Kong. As the main link between the customer and the insurance company, the intermediary is well placed to identify the needs of customers, to educate them on the purpose and benefits of medical insurance, and to work with insurance companies in helping them to design relevant medical insurance products that appropriately address customers' needs.

In conclusion, it is an exciting time for the medical insurance market in Hong Kong. It is a rapidly growing sector of the insurance market and this will continue to be the case for a number of years, thereby presenting very good opportunities for insurers to enter or expand in this market.

However, the insurance market in Hong Kong remains highly competitive and fragmented with many insurers striving for a slice of the pie. This is also the case with medical insurance business, making it very difficult for insurers to achieve economies of scale. In addition, the specialised nature of medical insurance makes it a very difficult line of business to manage effectively and profitably.

Insurers therefore need to think and plan carefully before committing to enter the medical insurance market as it is not a business for amateurs!

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