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Summary of the report

Barriers to entry and expansion in the Dutch health insurance market

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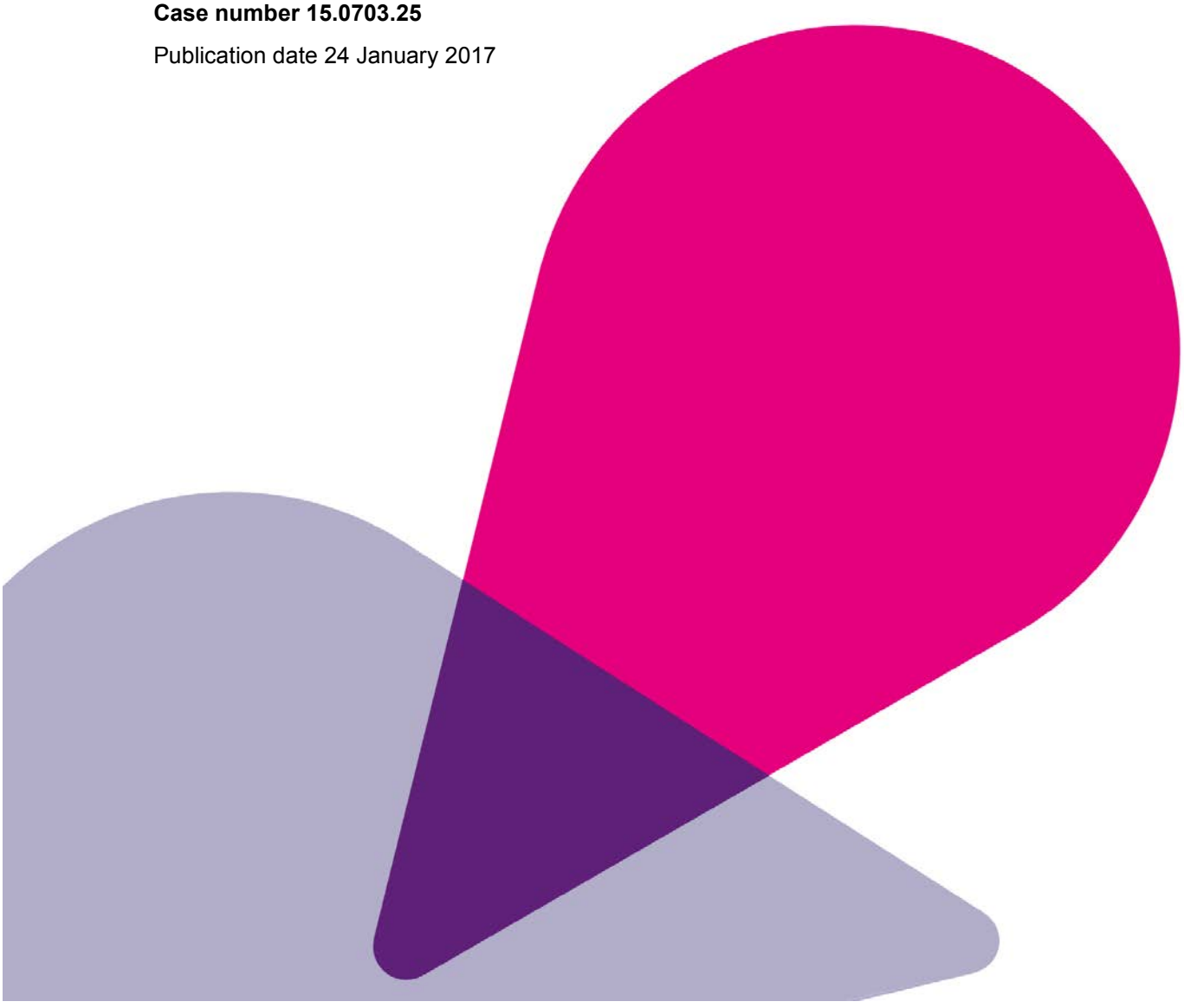

Opportunities & options for businesses and consumers

Executive Summary

Competition between health insurers plays a key role in the current Dutch health care system

With the introduction of the Dutch Health Insurance Act (HIA, in Dutch: Zorgverzekeringswet) in 2006, the Netherlands has opted for a system of regulated competition. The HIA has four objectives: accessibility, quality, efficiency and affordability of health care. Competition between health insurers is a key element of the current health care system, because it is able to contribute to the last three objectives in particular. After all, in order to compete, health insurers must set themselves apart in a positive way. One of the ways to do so is by procuring the best care from health care providers at an affordable price.

Lowering barriers to entry and expansion may increase competition between health insurers

The Netherlands Authority for Consumers and Markets (ACM) concluded in early-2016 that competition between health insurers is suboptimal. One important reason for this conclusion is the existence of high barriers to entry and expansion. Removing or lowering these barriers thus makes for an effective way of stimulating competition. The entry of new competitors - or merely the threat thereof - will increase competition in this market.

The objective of this study is to identify the most important barriers to entry and expansion in the health insurance market and how to lower these. The most important barriers, according to this study, are:

- meeting the European capital requirement (Solvency II);
- obtaining a license from the Dutch central bank (DNB, in Dutch: de Nederlandsche Bank); and
- regulatory uncertainty experienced by market participants.

It should be noted that these barriers cannot be removed completely, because each barrier is the result of a specific policy objective from which Dutch society as a whole benefits. The ACM is aware of this, and wants to use this study to promote that the importance of competition receives enough weight by policymakers.

Barrier: meeting the European capital requirement

A mandatory level of capital, based on the risk profile of the insurer, is one of the components of the new European framework for prudential oversight. The primary objective of Solvency II is the protection of the insured, and the secondary objective is safeguarding financial stability. This framework came into force in the Netherlands on January 1, 2016, and has led to a substantial increase in capital requirements for health insurers.

The ACM has examined whether capital requirements form an *unnecessarily* high barrier to entry and expansion in the health insurance market. In doing so, the ACM investigated three elements: the justification for capital regulation of health insurers, the level of capital requirements, and the opportunities for health insurers to meet the capital requirement.

Justification for capital regulation on the health insurance market
It is unclear to the ACM how the bankruptcy of a health insurer could lead to an increase in instability in the financial system. The interconnectedness of health insurers with the financial system is limited, and, as a result, the likelihood of contagion in case of liquidity problems is relatively low. Safeguarding financial stability is therefore not a clear justification for capital regulation of health insurers.

The protection of insured individuals *does* offer some justification because of the existence of information asymmetry between those individuals and health insurers. Insured individuals are able to estimate the likelihood of a bankruptcy less well than health insurers. This may give health insurers an incentive to hold too little capital. As a result, the risk of bankruptcy for a health insurer will increase, which could lead to social costs.

Level of capital requirements for health insurers
The starting point of the Solvency II framework when calculating the capital requirement is the desired level of confidence that an insurer will not go bankrupt. The higher this level is, the more capital an insurer is required to hold. Insurers need to hold sufficient capital so that the chance is at least 99.5% that they are able to meet their financial obligations over the next 12 months. The capital requirement has been fleshed out for the Netherlands, and has been laid down in national legislation, which is enforced by DNB. In the implementation of Solvency II, the Netherlands has some latitude with regard to proportionality. For example, the interpretation of existing laws and regulations that influence the risk profile of a health insurer.

The desired level of confidence within the Solvency II framework is identical for all types of insurers. However, the financial damage caused by an insurer's bankruptcy varies among types of insurance firms. The ACM doubts whether the desired level of confidence, and thus the proportionality of capital requirements, on the health insurance market are consistent with the harm caused by an health insurer's possible bankruptcy.

Opportunities for meeting the capital requirement
In addition to the uncertainty surrounding the level and proportionality of capital requirements, the ACM has established that potential entrants and incumbent health insurers with ambitions for expansion are limited in their opportunities to meet the capital requirement.

First, health insurers experience pressure from the public and politicians to give profits back as much as possible to the insured in the form of insurance premium cuts in the following year. Using profits to lower premiums consequently means that these profits cannot be used to increase the level of capital, and, as a result thereof, the opportunity to attract more customers in the future. This reduces the incentive for smaller health insurers to grow, and, also takes the edge off of the competitive process, which is crucial to the health care system. In addition, health insurers may decide not to invest returned profits in the development of better health care.

Last year, a bill was submitted to the Dutch House of Representatives (in Dutch: Tweede Kamer). This bill proposed to prohibit, from January 1, 2018, 'all health insurers from paying out profits under any circumstances to capital providers'. Such a prohibition will make it harder for potential entrants and incumbent health insurers with expansion ambitions to attract capital. After all, capital providers would like to receive a reasonable return on their investment. If this is not the case, they will not invest in the Dutch health insurance market.

On January 31, 2017, the House of Representatives passed this bill. This bill will now be submitted to the Dutch Senate.

Conclusion ACM
On the one hand, health insurers are confronted with stringent and possibly disproportional capital requirements. On the other hand, they are also restricted in their opportunities to meet those requirements. This combination forms an *unnecessarily* high barrier to entry and expansion in the health insurance market.

In general, it is preferable to choose the form and elaboration of regulation that will address the market failure, while disrupting competition the least. The ACM has not been able to establish whether or not, in the implementation of Solvency II, the effects on competition have sufficiently been taken into account. From a competition perspective, further research into the proportionality of capital regulation in the Dutch health insurance market would thus be welcome. In addition, this form of regulation should go hand in hand with the freedom for health insurers to decide for themselves how to invest their profits.

Barrier: obtaining a license

New insurers need to apply for a license with DNB before they can enter the health insurance market. Going through the licensing process is therefore a barrier to entry. The licensing system in the Netherlands is designed to protect the customers of financial companies against bankruptcy and fraudulent practices.

According to the ACM, the licensing process is an *unnecessarily* high barrier to entry for new health insurers because DNB has so far provided relatively little public information about the licensing process of insurers and the requirements that have to be met in order to obtain a license. This may lead to higher costs for the entrant, and to the application being processed longer. Without prejudice to the criteria for obtaining a license, this barrier could be lowered by providing more public information.

Conclusion ACM
This year, DNB will implement similar improvements in the licensing process of health insurers as have been done previously in the licensing process of payment institutions. Furthermore, DNB plans to carry out a periodic evaluation of the processed license applications and the implemented improvements. The ACM welcomes these initiatives because they will lower an important barrier to entry in the health insurance market.

Barrier: regulatory uncertainty

The objective of regulation of the health insurance market is safeguarding the accessibility of the health care system and preventing market failure. Discussions about new laws or regulations in the health insurance market have the side effect of creating uncertainty among new entrants and incumbent health insurers. However, new laws and regulations, and the discussions about them, do not need to be an *unnecessarily* high barrier, as they may contribute directly to one or more objectives of the HIA. Policymakers need to make an explicit assessment between, on the one hand, the immediate benefit of the new law, and, on the other hand, the additional uncertainty that the decision-making process may create for market participants. In general, the ACM cannot make this assessment because it will vary from situation to situation.

Inherent imperfections in the (ex-ante) risk settlement system, too, form an uncertainty for potential entrants and incumbent health insurers. This is because the composition of their customer base differs from the composition of the average Dutch population. They are therefore more sensitive to structural undercompensation of certain groups of insured. In the risk settlement system, the government could consider a policy measure in the form of a temporary ex-post correction for new health insurers.

Another policy measure that the government could consider for new health insurers is a temporary, limited interpretation of the acceptance obligation (Article 3 HIA). New health insurers are currently required to accept all new customers even when they are faced with capacity restrictions. In theory, they may be so successful that they could face problems with attracting sufficient capital. DNB takes this risk into account when calculating the capital requirement. This risk can be mitigated by giving a new health insurer in the first years after entry more control over its own growth path and the thereto-related capital requirement.

Conclusion ACM
It would be good if the regulatory uncertainty that potential entrants and incumbent health insurers face were reduced. That would lower an important barrier to entry and expansion in the health insurance market. Policymakers can contribute to this by, on a structural basis, making an explicit assessment between the social objective that the new regulation intends to achieve, and the importance of having effective competition in the health care system.

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This study was carried out by the Monitor Financial Sector (MFS). The MFS is a team of economists and part of the Competition Department of the ACM. It carries out studies into the degree and developments of competition on financial markets in the Netherlands. The MFS can be reached by email at MFS@acm.nl. Feel free to ask any questions about this study.