



In urgent need of a cash injection

The health insurer must find more than €100 million by the end of the year to redress the unfair advantage the European Commission says it has over its competitors, writes **Fiona Reddan**

WHILE THE recapitalisation of the banking sector may continue to dominate the headlines, Irish banks are not the only institutions which need cash injections to survive. Private health insurer the VHI also needs to boost its capital base by more than €100 million over the coming month to meet regulatory requirements.

At the same time, it must also deal with the ongoing challenge posed by its customer base, with the insurer expected to lose €170 million from servicing its older customers this year alone. But can it overcome these obstacles or is the Irish State facing sanctions from the European Commission and the prospect of being sued by the other private health insurers operating in the Irish market?

Following several missed deadlines, the VHI must now boost its capital reserves by the end of this year. The impetus for such a move comes from the European Commission. It believes that the current state of play, whereby the VHI has a special derogation in the Irish market excluding it from prudential regulation, gives it an unfair advantage over its private competitors, Hibernian Aviva and Quinn Health. Already, the commission has instituted proceedings against the Irish State, and the case is listed at the European Court of Justice, on the grounds that the VHI is receiving preferential treatment.

"Until it [the VHI] is brought

within the regulatory sphere, we'll never have a level playing field," says Tom Carney, head of the EU and Competition Unit at Dillon Eustace, adding that the Irish State is "clearly in breach of European law".

But, to become regulated and obtain an insurance licence from the Financial Regulator, the VHI must meet the regulator's minimum solvency requirements, something it has been unable to do to date. The regulator requires that the premium income-to-reserves ratio stands at about 40 per cent.

However, the health insurer's solvency margin stands at 27.7 per cent as of December 2008, having fallen back from 35.9 per cent in 2007, due to a decline of €85 million in reserves.

So what can it do about it?

A capital injection from the State would be the easiest solution, but given the condition of the public finances this is unlikely in the current environment. As Carney points out, the reason why the Government keeps pushing the deadline out is due to the tight economic environment. "It will cost money to achieve the necessary result," he says.

Another option is a partial or full privatisation, which would go some way towards meeting the requirements, with an equity investment possibly solving the issue.

In the early autumn, speculation grew that the VHI was to be sold to a consortium backed by Munich Re, and led by former Vivas chief Oliver Tattan. However, it may well be that rather than a takeover bid, the VHI is in talks to buy reinsurance from the group.

While the insurer previously rejected this option, according to a VHI spokeswoman, to meet its solvency requirements, the insurer is looking for reinsurance and/or subordinated debt, as well as raising additional capital.

However, additional capital won't be easy to find. As **Colm Harmon**, professor of economics at University College Dublin, says: "You won't find a fairy godmother in this environment."

And, while according to the VHI it is a "strategic imperative

for us to achieve regulation", boosting its capital reserves is not the only obstacle in doing so. The insurer must also convince the Financial Regulator that it has a sustainable business within a community-rated market.

According to the VHI spokeswoman, the insurer's loss of customers in 2009 - 70,000 to the end of July and this trend has continued - together with an ageing customer base will be of concern to the Financial Regulator.

"The major challenge facing VHI Healthcare continues to be funding the cost of the healthcare needs of our older customers," says the spokeswoman, pointing out that in 2009, the VHI will lose €170 million in 2009 (€600 per member) in meeting the healthcare needs of its 280,000 customers over the age of 60.

It is the insurer's over-dependence on older customers, a legacy of its monopoly years, that may also preclude it from receiving outside investment.

"You could argue that it's a safe deal, buying into a State monopoly. But there is still a degree of uncertainty, and private equity would only care for the portion of VHI's risk book that looks more like its competitors," says Harmon.

While the VHI has just a 66 per cent overall market share, it has an 80 per cent-plus share of 60-69 year olds, 90 per cent-plus of 70-79 year olds and almost 95 per cent of the over-80s. This means that while customers over 60 account for 20 per cent of its customer base, they will account for 52 per cent of medical expenditure in 2009.

In comparison, according to the VHI, approximately 3-4 per cent of customers are over 60 for Hibernian Aviva Health, and 7-8 per cent for Quinn Healthcare.

The Government's risk equalisation scheme was to solve the problem of the high costs facing the VHI due to servicing its older customer base, but it was turned down in court. Instead, a health levy on insurance policies was introduced, as a short-term fix. Now, the VHI is reportedly looking to double this levy to €320 per adult, thereby increasing the burden on consumers, as insurers will most likely pass this cost directly onto them.

"You could allow someone to

take it [the VHI] over, but without restructuring it's pointless. It doesn't have a price it could be sold at," says Harmon. Instead, Harmon suggests that the Government could look to spin off the part of the VHI that could compete with Hibernian Aviva and Quinn Health. It could then underwrite policies for older people, and let the problem ride out.

Carney also supports breaking up the VHI into three or four "baby VHIs", some or all of which could be then sold on, generating a significant cash injection for the Government. "It could be very profitable if structured right," he says, adding that such a move would also be good for consumers, bringing as it would, increased competition for pricing and services.

However, rather than the Government holding onto older customers, he proposes that the older customer base could be evenly spread out among the companies created from the break-up of the insurer.

But it remains uncertain whether it can achieve any of these goals over the coming month. Already, Ireland's breach of EU law is a "key issue of embarrassment at political and diplomatic level", says Carney, adding that the insurer's move into ancillary markets is another issue.

One of the reasons why the VHI is exempted from regulation is on the grounds that it won't engage in other businesses. Despite this restriction, however, the insurer already offers additional services, such as travel insurance, and is ploughing ahead with new initiatives, such as its Swiftcare centres.

If the deadline is missed again, and the Irish State is found to be in breach of European law, then the commission could impose a fine. Moreover, according to Carney, it also opens up the possibility that the VHI's competitors could sue the Irish State before the national courts for its preferential treatment of the insurer.

Challenging times indeed.

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- Tom Carney, head

**of the EU and
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Image: Irish Times Pressphoto