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Executive Summary

Study of competition and free market access in insurance of medical expenses

Federal Economic Competition Commission

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Resumen ejecutivo. Estudio de competencia y libre concurrencia en seguros de gastos médicos.

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CONTENT

Executive Summary

The present study on the market of Insurance of Medical Expense (SGM for its acronym in Spanish) identifies problems of competition and free market access and proposes a set of recommendations to mitigate them.

The SGM are financial instruments that allow the transfer of negative economic results caused by damages or health risks, so that the economic loss faced by an individual is shared among a group of people who resist such damages or risks in a collectively.

The analysis of the SGM market is justified for several reasons, among them:

- Out-of-pocket spending in Mexico is one of the highest in the world. SGM prevent families from having to pay large sums for care, which can be catastrophic.
- 13 million people in our country are covered by SGM.
- The Mexican population is aging and will demand more health services. This phenomenon implies carrying out actions to finance the prevention and care of chronic degenerative diseases.
- Digital platforms are driving technological innovation in the insurance sector internationally, through the use of Big Data, machine learning, artificial intelligence and blockchain.

Diagnosis

The SGM market is characterized by having few large competitors.

- The four largest insurers account for 75% of SGM premiums. This concentration in a few competitors is observed in both individual and group insurance.
- In Mexico, SGM is the most concentrated line of insurance with the exception for health insurance.

The SGM market does not function efficiently.

- The dispersion of premiums or policy prices among insurers is high, even in standardized basic insurance, which is a homogeneous product. This is an indication that the market is not functioning properly, since microeconomic theory predicts that in a market with perfect competition and homogeneous goods there can be no price discrimination.
- Premiums also vary considerably by state. Premiums are higher in the states that have the hospitals with the most beds and the highest GDP *per capita*.

Neither does the related market for hospital care services function efficiently.

- The premiums of SGM policies have an upward trend, which is directly related to the increase in costs experienced by insurers due, to a greater extent, to claims paid to hospitals.
- The large hospital groups, which have the largest hospitals, are critical in providing services to insured persons. Although many small hospitals participate in the market, they generally do not have the specialists and infrastructure to handle complex and costly illnesses and emergencies. Hospitals need to be certified by the General Health Council (CSG for its initials in Spanish) in order for insurers to pay claims directly.
- Mexico City, Jalisco, Nuevo León and the State of Mexico concentrate 79% of hospitals with more than 100 beds and 70% of insurance payments. The prices of hospital services are significantly higher in these entities, even for common conditions whose care should be standard. This may indicate that insurers have little bargaining power relative to larger hospitals.
- The econometric results show that the premiums of individual SGM policies are 12% more expensive in states with private hospitals with more than 100 beds. In addition, the concentration of insurers has an imperceptible effect on premiums. This suggests that when the costs of hospital services are higher, insurers pass part of these costs on to consumers through higher premiums.
- Other econometric results show that hospitalization costs tend to decrease when insurer concentration rises, however, they rise when

hospital concentration strengthens. However, this effect occurs mainly in markets that do not have large hospitals, since in the presence of the latter, hospital care costs increase by 34%.

Consumers face high costs for switching insurers.

- The costs of switching insurers cause many people to be tied to their first choice of insurer (lock-in). Consumers who already have insurance cannot move to insurers with more attractive plans in terms of price or quality, which harms competition.
- Insurers are not obliged to recognize the seniority of customers coming from other insurers, so consumers prefer to stay with the same insurer. In addition, insurers do not cover pre-existing conditions and waiting periods for the care for some conditions are back to square one. Finally, in some cases policyholders pay penalties for early cancellations, even when they do not use the policy.

The purchase decisions of the insured are made difficult by the offer of different, poorly differentiated options, lack of information and uncertainty about the consequences of a future illness.

- Consumers face uncertainty about the future of their health. Illnesses that will require costly treatments are unpredictable and the quality of care cannot be known in advance. Added to this is uncertainty about the impact that the illness will have on the individual's overall health conditions, family income, and recovery. Uncertainty makes it difficult to make the best decision to contract an SGM.
- SGMs are complex products where consumers find it difficult to correctly assess their value for money. According to the National Survey on Financial Inclusion (ENIF for its initials in Spanish) (2018), 20% of Mexican users did not know the cost of the SGM premium they purchased. This leads to markets not functioning properly, as insurers do not have sufficient incentives to offer products with adequate value for money.
- Consumers' cognitive capacity to analyze all the options for complex products has a limit (bounded rationality). This difficulty increases when insurers offer different plans with differences that are not very noticeable to consumers. Each insurer offers, on average, seven different individual SGM plans. At the extreme, one insurer offers as many as 33 seemingly different options.

The distribution and commercialization of insurance through agents and the way they are remunerated discourages entry.

- Agents are the main sales channel for SGM, as eight out of ten individual or group products are commercialized through them. Due to the wide variety of products on the market, insurance agents play the role of resolving the doubts of interested parties and offering the option that would best suit their needs.
- Insurers that want to enter the SGM market, in addition to having a medical and service network, also need access to a network of sales agents. Incoming insurers could market their products through existing agent networks, persuading them to include their products in their portfolio; however, agents have incentives to work harder to sell products for which they receive higher commissions and bonuses. Larger insurers pay higher direct commissions to agents, which is an indication that commissions would be deterring new entrants.
- Agents can sell insurance from a single company or from several companies. Some insurers have a strategy of paying commissions conditional on reaching certain sales goals, so they are called contingent, which consist of bonuses or annual trips. As a result, agents have an incentive to work harder to sell the products with which they will reach the goal that will earn them the contingent commissions. This strategy prevents incoming insurers from incorporating their products into the portfolios of registered agents, which constitutes a barrier to entry.
- At the international level, the European Commission recommended prohibiting the linking of commissions received by agents to sales targets, as this creates a conflict of interest. Agents focus on selling a specific plan or a particular insurer, without fully considering the characteristics of their clients.

Legal uncertainty affects the entry of new companies and innovation through new models.

- *Insurtech* technology companies have the potential to increase the variety, quantity and quality of insurance and make its commercialization more efficient. The novel models' scheme is a way to drive innovation and facilitate the entry of new players. Although the National Insurance and Bonding Commission (CNSF, for its initials in Spanish) has already published provisions to regulate the operation of innovative insurance models and to register them in a public registry, it has not received applications to authorize them.

- The regulation regarding the interconnection and sharing of insurers' data through Application Programming Interface (API) (*open finance*) has not been issued. This regulation could facilitate the exchange of data from established companies with entrants, upon payment by the applicant. This would lead to both the entry of companies dedicated to offering services based on user data (data brokers), as well as *insurtech* technology companies. The absence of this regulation would reduce the legal certainty needed to invest.

Recommendations

In order to promote competition and free market access, as well as to make the SGM market more efficient, this study proposes eleven recommendations that are grouped under four areas:

I. Promotion of transparency in the related hospital services market.

II. Improvement of consumer mobility.

III. Decrease of search costs for consumers.

IV. Reduction of barriers to entry.

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