Time to look at competition in the insurance industry

WE RECENTLY watched the fiasco of Prudential offering to buy AIA for US$35.5 billion. The US government owns 80 per cent of AIA and accepted the offer. Shortly thereafter, Prudential decided that it was paying too much and lowered its price to US$30 billion. The US wouldn’t go for it and the deal fell through.

In Singapore, the combination might have reduced competition. The Competition Commission of Singapore was about to look into it and — as I will explain — maybe they still should.

The irony is that there is plenty of competition in the insurance business. But it’s all the wrong type. It is what economists call “monopolistic competition”, where firms compete on the basis of costs rather than price. Companies fight for market share with aggressive advertising and agent recruitment. We now have an army of over 15,000 sales agents, and life insurers say that they plan to grow by recruiting more.

This competition benefits advertisers, insurance agents and financial advisers. It doesn’t help consumers at all. Comparison shopping and price competition is almost non-existent, and insurance continues to be sold as it always has been, on the basis of “relationships”.

Our big-five insurers are AIA, Aviva, GE Life, NTUC Income and Prudential. Each offers slightly different products, making price comparisons difficult. No one even attempts ranking insurers from least to most expensive, as is done with home loans.

We have invested an incredible $60,000 per household into whole life and endowment policies. It is the second largest investment after our home but few understand how it really works. While it’s called insurance, it is mostly an investment product with less than 0.5 per cent of the premiums going towards term insurance. The rest goes to pay for expenses and investments.

The types of investments vary. Some insurers put the money mostly into bonds. Others take more risks and invest in property and shares. It all goes into the insurer’s “policyholders’ fund”, also called the “life fund”. It is one huge fund where everyone shares identical investments, making it impossible to adjust for individual risk preferences.

That’s one problem. Another is we don’t know the basics like the returns that investors earn. It is standard information for unit trusts, but life insurers don’t disclose it (although one claims that it does).

Costs are nearly as difficult to compare. In theory, one could take a typical customer and compare the “deductions from yield” in the benefit illustration of each insurer. It doesn’t happen, partly because of slight differences in each insurer’s product, but also because no one has a financial incentive to do it. Substantial profits are achieved from the status quo.

Health insurance policies also have subtle but important differences. Some are “as charged” so they pay the entire bill while others have sub-limits for each medical procedure. There are policies with lifetime coverage while others stop at age 80 or 85. Some offer riders to pay co-insurance, deductibles or both. Others do not. Each private shield plan sets its own rules for overseas coverage, some of which are “informal”.

This all combines to make health insurance policies hard to compare. It means that price competition is absent, bringing us back to monopolistic competition.

Health insurers also make it hard to know commission costs. Most policyholders don’t even know that they pay them since the charges are built into the premiums. They cannot be broken out. We also don’t know an insurer’s history of denied coverage for applicants, or denied claims for policies with big payouts such as critical illness.

As a first step, perhaps health insurers could provide a history of their “claims to premiums ratio” which insurers call it a “loss ratio” (since our gain is their loss). It measures how much of our premiums insurers pay back in claims vs how much they keep in profits. It is widely used within the industry but never disclosed to customers.

There you have it: the sorry state of competition in the insurance industry. The good news is the failure of the Prudential-AIA deal won’t reduce competition. The bad news is there wasn’t much to begin with.

Are the problems big enough to trigger an investigation by the Competition Commission? Well, they don’t get much bigger.

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