# Private health insurance in China: Finding the winning formula

As China is moving toward full enrollment of the population into basic medical insurance schemes, limitations of the public system become apparent. What roles can private insurers play to address unmet needs in China's evolving market?

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**China's health insurance market** is characterized by two conflicting attributes: nearly universal coverage by public insurance yet widespread concern about the burden of medical expenses to individual patients. Acknowledging the challenges, the government is increasingly looking beyond public insurance for ways to improve the provision of medical insurance. As private insurers step into this market, what role can they play?

Expanding the coverage of public health insurance has been among the most striking achievements of China's healthcare reform. Within less than ten years, approximately 900 million people were enrolled in various public health insurance schemes, extending coverage to more than 95 percent of Chinese citizens.[1]

Universal insurance coverage is a key component of the government's effort to address the increasing burden of healthcare costs for individuals and families. But has nearly universal coverage achieved this goal?

Unfortunately, problems remain as China's rapidly aging population is experiencing the dual burdens of a rising rate in chronic diseases and climbing costs for healthcare. Although healthcare is increasingly accessible and sophisticated, its high cost has incited public debate and criticism. China's citizens still feel compelled to hoard cash in their savings accounts in order to protect themselves and their families against health-related emergencies. A close look at the exclusions and co-pay requirements of public insurance policies reveals why: in reality, the coverage for health-related expenses remains patchy for most people.

The existing gaps in public insurance coverage would seem to open up attractive opportunities for private insurers in the world's most populous market. But private companies have yet to make much headway in navigating through China's complex landscape.

To get to the bottom of what is really happening with health insurance in China, we start by taking a close look at why individuals are not adequately protected from high healthcare costs despite nearly universal public insurance coverage. Then we turn our attention to the private insurance market, examining the market landscape and exploring why private insurers face challenges in the market despite having an opportunity to fill the gaps in public insurance. We conclude by discussing some key issues and emerging success factors that private health insurers should be thinking about as they consider their China strategy.

## Mind the gaps

An examination of public health insurance schemes readily explains why individuals believe they are inadequately protected from healthcare costs despite nearly universal coverage. High co-pay requirements, drug exclusions, and inflexible plans together undermine the value of protection.

### Significant out-of-pocket payments

Undoubtedly, there has been much progress regarding the scope of insurance coverage and government funding of insurance under the three public insurance schemes.

However, patients still need to contribute significant out-of-pocket sums. Inpatient costs can easily add up to several times the average annual income levels, especially if they involve complex procedures, expensive devices, or patented drugs. These costs also require 10 percent to 20 percent out-of-pocket co-payments

[1] According to official government statistics, public health insurance had achieved a 95 percent coverage of the population by the end of 2011; the actual figure is likely to be lower because people with multiple types of public health insurance would sometimes have been counted more than once.

even under the more generous urban plans: Urban Employee Basic Medical Insurance (UEBMI) and Urban Resident Basic Medical Insurance (URBMI). In the New Rural Cooperative Medical Scheme (NRCMS), co-payments for inpatient care are as high as 25 percent to 35 percent.

For chronic diseases that are primarily treated in an outpatient setting, such as diabetes, reimbursement rates still tend to be quite low. Although considerable variability exists across different cities and regions, out-of-pocket co-payments are substantial under the two more generous urban plans. They can exceed 90 percent of the bill for NRCMS, leaving those conditions essentially uncovered. This coverage gap exists for other outpatient treatments as well, and leaves the insured population vulnerable to under-diagnosing, inappropriate treatment, and secondary complications from chronic diseases.

Relatively low caps for total reimbursement likewise increase the risk that patients with serious acute or chronic conditions will end up paying a large portion of their healthcare bills out-of-pocket.

Lastly, although insurance plans have established lists of reimbursable drugs, cutting-edge innovative drugs and novel treatments might be excluded from reimbursement, or the reimbursed portion may cover only a small part of the high costs. Typical examples include areas such as autoimmune disease or malignancies with novel biologics as the latest treatment options.

### Inflexible plans

Insurance plans are inflexible and do not provide room for premium healthcare. Beneficiaries cannot tailor their insurance coverage according to their needs and willingness to pay. Moreover, special needs, such as single-room inpatient care, are excluded from coverage.

While these public insurance schemes reduce the possibility that healthcare costs will wipe out savings or even lead to a family's financial ruin, they do not eliminate that possibility, especially for those most vulnerable to large-ticket medical expenses. Not surprisingly, wealthier cities provide more generous coverage; however, the current system cannot provide truly comprehensive healthcare coverage. In fact, it is the wealthy cities that already feel pressure on their medical insurance funds driven by high reimbursement rates and demographic changes—substantial expansion of coverage depth is unlikely to be an option. Chinese citizens are well aware of the gaps in public insurance coverage, and these shortcomings have prevented them from feeling protected against soaring healthcare costs. McKinsey research shows that fear of health-related expenses is still the single most important reason why Chinese people keep their money in savings accounts.[2] These fears are justified, as out-of-pocket spending remains high at an estimated 35 percent of the country's total medical spending, according to public sources.[3] This number may understate the real problem, as many patients still have to forgo necessary prevention and treatment altogether because they lack adequate insurance coverage.

In regard to public insurance, this situation is not likely to change significantly in the near to mid-term. The inadequacies of public insurance coverage reflect the government's concern about its ability to sustain the social benefits system. For example, the UEBMI, which enjoys the highest level of funding from employers and individuals, has a sizable surplus at present. However, driven by an aging population and a relatively early retirement age, this favorable situation may turn into a deficit as soon as 2017 if the scheme continues to run under the current policies. In fact, URBMI is already running current deficits in Beijing and Shanghai, and Shanghai is running a negative balance on the much more sizable UEBMI plan.[4]

Private insurance is expected to play a major role in addressing the implications of this looming funding deficit. Indeed, the government intends for public insurance to cover only basic healthcare, while endorsing the idea that a thriving private insurance sector can address the diverse additional needs in the market. The government has specifically set the goal of actively developing private health insurance to meet diverse healthcare needs and has encouraged enterprises and individuals to join private health insurance plans. This policy thrust was reinforced in the State Council's announcement of the 12th Five-Year Plan's healthcare reform goals in March 2012.

### What is the market landscape for private insurance?

This environment provides a unique opportunity for private health insurers to step in and fill the coverage gaps in public insurance. McKinsey research confirms that approximately 30 percent of China's urban population currently possess some kind of private health insurance, while another approximately 20 percent are planning to buy some form of health insurance in the near future.[5] Not surprisingly, health insurance penetration increases with economic status: while the mass segment (monthly household income up to 4,500 renminbi) shows 27 percent penetration of private health insurance, this rises to close to 40 percent in the upper middle class segment (monthly household income between 4,500 and 11,000 renminbi) and to more than 50 percent for the mass affluent segment (monthly household income more than 11,000 renminbi).

While these penetration numbers look impressive at first glance, they are somewhat misleading. In reality, the health insurance market is still immature and the level of sophistication is low for the majority of both insurers and consumers. In fact, much of the private healthcare coverage that individuals obtain is acquired as an "add-on," that is, it is purchased as part of a product bundle or as a rider on savings products or life and accident insurance products.

Our research further suggests that the majority of consumers do not understand the details of their private coverage and its exclusions: in a recent survey of more than 1,000 consumers

[2] *Insights China*, 2011.
[3] Announcement in a recent speech of China's Minister of Health regarding 2011 out-of-pocket spending.
[4] MoHRSS 2010 statistics; McKinsey analysis.
[5] *Insights China*, 2009; McKinsey Patient & Physician Survey 2012.

on healthcare topics, half of those who had private health insurance stated that they were unclear about the scope of conditions covered.[6] Less than 20 percent stated that they fully understood their insurance policy. It is difficult to fault consumers, as there is little evidence that insurers apply customer-focused business models that provide customers with value-adding solutions described in terms that they can understand. Insurers might respond that they have found it challenging to sell more sophisticated and comprehensive health insurance plans at accordingly higher premiums. Many Chinese consumers have yet to fully understand the concept of a long-term, ongoing investment in health insurance. The complexity of explaining the value of such products to consumers has impeded their widespread uptake.

Private health insurance may become increasingly relevant to providers as well. As many hospitals tighten their budgets for spending within the publicly reimbursable categories, physicians increasingly notice the difference between providing care to patients who have private insurance and to those who do not. In a recent McKinsey survey of more than 100 physicians in public hospitals, roughly two-thirds agreed that private health insurance made it easier for them to provide optimal care to patients.

Finally, employers and employees alike increasingly regard private health benefits as an important element of a job's value proposition. Many employers have improved their health benefits to attract much-sought-after talent in China.

## Why are private insurers struggling?

With four key stakeholder groups (the government, consumers, providers, and employers), all lined up to endorse private health insurance, one would expect to see a thriving market for such products in China. However, while the market is growing rapidly, it is still surprisingly small. It accounts for only 56 billion renminbi in annual gross written premiums (GWP) for China's insurance companies, compared with one trillion renminbi in the life insurance market, and 79 billion renminbi in the accident insurance market.[7] To make matters worse, profitability has been challenging, as the leading health insurers have struggled to make money in the market.

Several factors combined make the China health insurance market a challenging one for most private insurers:

### Poor understanding of customer needs

Most health insurance products in China provide a certain degree of financial protection for a limited number of diseases or health-related circumstances. Classic examples are one-off payments when a critical illness is diagnosed. In reality, such products fall short because they do not address two customer needs:

- **Access to high-quality healthcare.** Results from the 2012 McKinsey Patient & Physician Survey, among more than 1,000 upper middle class consumers (yearly income greater than 80,000 renminbi) suggest that especially for more affluent people (who are most likely to purchase health insurance), financial protection is not the only concern and may not be the most important one.[6] When asked about their satisfaction with health provision in the public system, the same proportion of respondents (two-thirds) expressed dissatisfaction with access to quality care as with price. Yet, most health insurance products currently do not address access to care.

[6] McKinsey Patient & Physician Survey 2012.
[7] *China Insurance Yearbook*, 2010.

- **Complete, worry-free coverage.** Capped payments for a defined group of diseases fail to provide customers with "peace of mind" regarding possible catastrophic health events. As described above, a large proportion of those who have private insurance do not fully grasp the nature of their coverage. This creates an additional barrier to customers developing a sense of being properly secured and protected.

The existence of these unmet needs suggests that significant changes are required before private health insurance can provide the desired value, both actual and perceived, to Chinese customers. But it also shows that there are real opportunities for product solutions that address customer needs.

### Lack of standardized data and medical insurance expertise

In mature healthcare markets, a comprehensive and standardized data environment, as well as coherent medical records, enable insurers to offer tailored insurance, manage risk in underwriting, conduct an informed claim and reimbursement process, and even manage the health of the insured population. In the relatively young Chinese healthcare system, these standardized data systems are not currently available. And even if data transparency improves going forward, insurers will have to do some catching up to build the skills and knowledge required for applying that data to become smarter in their operations.

### Undifferentiated products

In the absence of high-quality data, insurers have been unable to differentiate their offerings and are largely competing in the same space. For example, the large local health insurers (PICC Health, Ping An Health, Kunlun Health, and Hexie Health) all offer a similar portfolio that includes protection for "dreaded diseases" (such as malignant diseases), allowance or reimbursement for hospitalization, accident insurance, and premium insurance that covers "VIP standard" amenities in hospitals. Products are bundled into multiple arrays of different diseases and services, and coverage is subject to different caps, all of which leads to a confusing landscape of plans that collectively lack true differentiation. This in turn has led to competition based on price and brokerage commissions, which eats into the profit margins of insurance providers.

### High-cost distribution models

The majority of health insurance companies rely on large in-house sales forces or brokers as key distribution channels. For insurers with in-house sales forces, it is challenging to find the right talent and bear the cost of quickly rising wages. Those relying on brokers must pay a significant amount for commissions, as brokers are in a good position relative to insurers competing for market access and share.

### Few incentives for providers to cooperate

China's Class 3 hospitals, the key pillars of high-quality healthcare, have had plenty of business. Indeed, they have been overrun with patients, and their revenues are mostly generated in a fee-for-service model and from margins on prescribed drugs and procedures. As a result, these providers have little incentive to collaborate with insurance companies to optimize patient streams by applying approaches common in many Western countries. These include increasing patient volumes, achieving a favorable case mix, or reducing length of stay. The government is currently exploring novel reimbursement policies to lead hospitals toward more cost-efficient operating models. Although the effects of these reforms have unfolded slowly so far, they may provide a starting point for more collaborative models between insurers and hospitals.

### Lack of tax incentives

Unlike many mature health insurance markets, China does not offer tax incentives that would encourage employers to buy health insurance for their employees. This in turn has prevented group health insurance from taking off at a large scale outside of multinational companies.

For these reasons, the Chinese healthcare market has yet to become as thriving, innovative, and diverse as one might expect.

Even some multinational companies have struggled to deploy their core competencies on the ground in China. Of the many foreign companies that entered China boasting of sophisticated health insurance expertise in mature markets, only some have filled attractive but limited niches. Cigna, Aetna, and MSH have introduced high-end health insurance that caters mainly to expatriates. These products rely on an established network of high-end providers as well as the option of flying insured individuals to other countries for top-notch healthcare. While to date none of the foreign companies have achieved large scale with comprehensive health insurance products, some are exploring broader offerings in order to expand their reach in China.

## Tapping into the opportunity

Although China poses several significant challenges to health insurers, a closer look at China's market trends, in healthcare and beyond, suggests that there are several options health insurers could explore to tap into the opportunity.

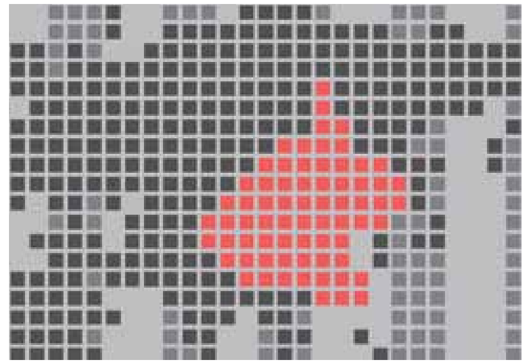
### Shape the rules of the game

In its most recent announcement on medical reform plans, released on March 14, 2012, the National Development and Reform Commission (NDRC) clearly states the intention to increase the role of private health insurance—this may open the door to more proactive collaboration with regulators. On national, provincial, and city levels, insurers should try to proactively shape the future of the insurance market on several topics. These range from establishing tax incentives to removing operational barriers that restrict insurers' business models (for example, allowing the paperless closing of policies with electronic signatures). These topics are clearly "on the radar" at the regulatory level. In the State Council's recent announcement of healthcare reform goals, "implementation of preferential tax policies" and "simplified claims settlement" are explicitly mentioned. It is now up to insurers to work with regulators to translate these stated goals into tangible improvements in the regulatory landscape. We expect that companies that have built a good rapport and relationship with regulators will find a receptive partner in this effort and may be able to significantly influence the "ground rules" of the market.

### Build provider networks to enable quality and access

To provide truly comprehensive health insurance plans (as opposed to products that simply supplement public-insurance protection), insurers must build a high-quality provider network. This will enable insurers to provide the key ingredient that is currently missing for most health insurance propositions: fast, reliable access to high-quality healthcare. It will also likely be a sustainable source of competitive advantage, because enrolling hospitals at a large scale and setting up the needed systems and processes (such as for direct reimbursement) require skills and relationships that are relatively difficult to replicate.

Because hospital reform measures have created pressure on hospitals to operate efficiently and manage medical expenses, it is more likely that providers will be open to collaborate with insurers. Hospitals will be especially receptive to collaborative efforts that offer added value by increasing patient streams or improving expertise in hospital management. Many multi-



national companies apply these capabilities in their home markets. Bringing them to China could make these companies an attractive partner not only for private hospitals, but increasingly for public providers as well. Indeed, several multinational companies have started to build provider networks, most notably MSH with roughly 180 providers in its network. Cigna & CMC Life Insurance Company, the joint venture of Cigna and China Merchants Bank, has built a network of approximately 150 providers during the past two years. BUPA offers quality accreditation to eight top hospitals in Shanghai and Beijing, thereby gaining insights into hospital operations that will ease any selection of hospitals in light of network building.

### Get smart about medical data

Although it is still early, the rollout of public insurance and reimbursement schemes is producing a trove of health-related data that could offer valuable insights into healthcare needs and risks. That said, insurers should not raise their hopes too high just yet, as these data sets are not up to the standards of those available in developed markets, which provide a granular, population-wide view on morbidity and health risks. Nonetheless, insurers should start interacting with the Ministry of Human Resources and Social Security (MoHRSS) to explore ways to leverage these data in order to better understand the market and to shape the future of the data environment in China.

### Explore new channels

One of the most striking trends in China's consumer landscape is the digital boom, with approximately 500 million people online,[8] 180 million Internet shoppers, and 300 million consumers using social media.[9] Indeed, in many ways China has leapfrogged the development stages of mature markets. This provides a unique opportunity for insurance companies to develop new digital distribution channels. By applying telemarketing, Internet, and mobile solutions, companies can overcome the disadvantages of using large in-house sales forces or brokers, as discussed earlier. Judging from experiences in Europe and some Asian markets, where direct insurance sales models have become an established business model, it seems plausible that the digital channel could soon play an important role in health insurance distribution in China. However, whether it can evolve into a channel that also sells higher-end, comprehensive health insurance products remains to be seen.

### Consider adjacencies

It may be worthwhile for insurance companies to get creative in looking for new opportunities in China's healthcare ecosystem. Such opportunities could lie in government-level partnerships on data and claims management; in participation in the development, piloting, and implementation of electronic medical records and electronic health cards; or in vertical integration as a healthcare provider, regional health systems manager, or population-based disease manager. Such adjacent opportunities are now more plausible because the government has lifted restrictions on foreign investment in health providers.

Finally, insurance companies should step back and think about additional stakeholders that may have an interest in insurance coverage as well as the economic muscle and entrepreneurial skills to make a move into this market. As examples, consider pharmaceutical and device companies. Many of these companies regard the need to make their patented products affordable as a key obstacle to unlocking the full potential in China, and therefore should have a keen interest in rolling out targeted insurance companies. This could open doors for game-changing partnerships or for the entry of new companies into this market.

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The healthcare system in China is going through a transformational process that is opening up novel opportunities for health insurers. To capitalize on these opportunities, insurers need to take a granular approach to the market, build a deeper understanding of key stakeholder needs, and invest in building the knowledge and capabilities to take health insurance in China to the next level of sophistication. With the potentially huge opportunity represented by the world's most populous country, we expect further dynamic development and activity by local and international health insurance companies, all in a quest to provide comprehensive health insurance solutions to China's more than 1.3 billion people. ○

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[8] Internet World Stats data, as of December 2011.
[9] 2012 McKinsey iConsumer survey on Chinese consumers.