

## Rising medical costs in Asia: Challenges and strategies for insurers

In recent years, the rise in medical costs has become a critical issue across Asia. This increase has placed considerable strain on insurance companies by driving up medical claims expenses. Many insurers view healthcare costs as one of the most significant risks to their operations, prompting them to seek ways to address this challenge.

To understand the impact of medical inflation on insurance companies, we have conducted a survey amongst life and health insurers across seven Asian regions: Hong Kong (HK), Indonesia (IN), Malaysia (MY), Philippines (PH), Singapore (SG), Thailand (TH) and Vietnam (VN). We received responses from 59 companies.

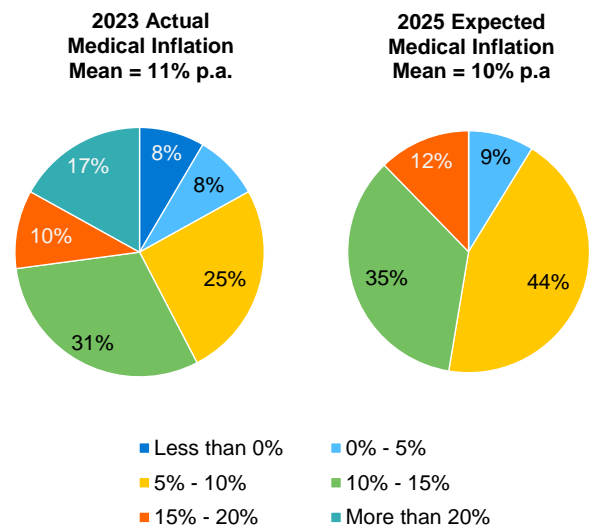
The survey covered various aspects, including the future outlook of individual medical and health (M&H) business, the approaches adopted in the valuation and repricing of M&H business and the key concerns in the management of this business. This e-Alert aims to provide valuable insights on these areas based on the survey results.

### What is medical inflation?

There are several definitions of medical inflation in the context of increasing healthcare costs. Some define medical inflation as only the increase in the average or unit cost of a healthcare service over a historical period; others consider increases in both utilisation and the unit costs of services. It is thus important when talking about medical inflation to understand what is included in the definition. In this survey, we define annual medical inflation as the annual increase in risk premium for medical claims (compared to the previous year's risk premium). Therefore, implicitly we include both utilisation increases that are irrespective of changes in the average risk of the population, *plus* the change in the unit cost of services.

### What is the current and future outlook on medical inflation rate?

FIGURE 1: ACTUAL AND FUTURE EXPECTED MEDICAL INFLATION RATE

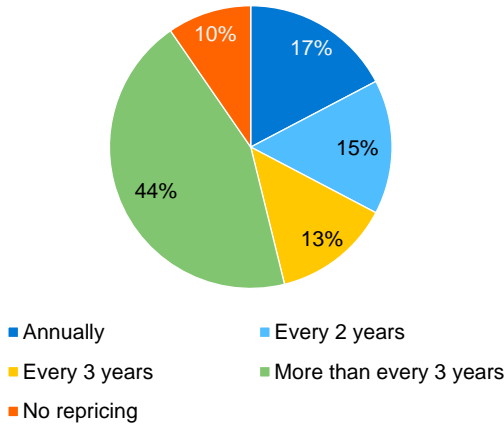


As shown in Figure 1, the average annual medical inflation rate reported by the survey participants in 2023 was 11%. Around 60% of the survey participants reported their experienced medical inflation had exceeded 10% per annum (p.a.) in 2023, with over 10% of the survey respondents observing inflation rates surpassing 20% p.a. This high rate of medical inflation combined with insurers' challenges in adjusting premiums promptly to keep up with rising costs has significantly affected the profitability within the insurance industry.

Most survey participants anticipate 2025 inflation rates to range between 5% and 15%, although around 10% of survey respondents still believe that medical inflation will exceed 20% p.a. in the short term. The continued high medical inflation is expected to pose a substantial challenge for companies operating in the medical business sector in the near future.

## How often did insurers reprice their M&H business?

FIGURE 2: REPRICING FREQUENCY

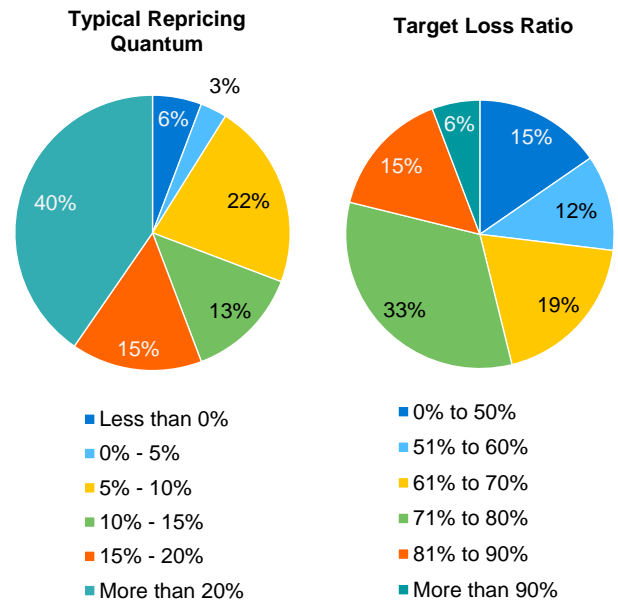


To restore the profitability of existing medical products, insurance companies often rely on repricing strategies. Our survey revealed that 90% of survey respondents have undertaken repricing exercises for their medical business in the last decade. However, only about one-third reported doing so frequently—annually or every two years and most of them are Singapore and Hong Kong based insurers where annual repricing reflect market practice. The majority indicated they reprice their M&H business less often, typically every three years or longer. Infrequent repricing is a key issue contributing to the high loss ratios observed by insurers in their M&H business.

### What are the future repricing expectations?

Our survey results indicated that around 80% of respondents would set their target loss ratios upon repricing of M&H business to 80% or below. Consequently, in terms of the quantum of repricing, the survey respondents have increased their premiums by 16% on average during each repricing. From the survey, only 17% of survey respondents have conducted their repricing annually. Hence, if repricing was performed every two to three years or longer, and the historical medical inflation is 10% p.a., then the premium increase is likely to be insufficient relative to the medical inflation. This suggests that profit margins for M&H products are likely being eroded despite repricing efforts.

FIGURE 3: TYPICAL REPRICING QUANTUM AND TARGET LOSS RATIO %



Additionally, most survey respondents plan to implement more frequent repricing in the future, with the majority targeting an annual or biennial schedule. This marks a shift in practice, as only one-third of survey respondents reported conducting repricing annually or every two years. The change reflects a growing commitment among companies to take a more proactive approach in managing the profitability of their M&H business, ensuring pricing remains aligned with rising medical costs.

### Does more frequent repricing solve the problem of increasing claim costs?

More frequent repricing can help address increasing claim costs by ensuring that premiums are adjusted in line with rising medical expenses and inflation in the short to medium term. However, while it is an important strategy, it may not fully solve the problem on its own in the long run. More frequent repricing will give rise to other challenges such as affordability and sustainability issues for policyholders. Addressing the long-term issue of medical cost requires a comprehensive and multifaceted approach. A crucial first step is to identify and understand the key drivers of medical inflation.

### What are the key drivers to the increasing claim costs?

Our survey asked whether medical inflation is driven by an increase in frequency, severity or both. Most companies indicated that both factors have contributed to rising inflation over time. Advancements in medical technology may have led to newer, more effective—yet often more expensive—

treatments, which could contribute to an increase in both claim severity and frequency. While there may be legitimate reasons that have contributed to the rise in medical inflation, factors such as fraud, wastage or abuse within the healthcare system may also be concerning contributors. Our survey identified the following top three concerns for insurers in managing their medical business:

- Excessive doctor and hospital charges (for example, where the hospital charges are not subject to appropriate controls, resulting in abuse)
- Unnecessary hospitalisations (for instance, when the patient is hospitalised despite outpatient treatment being sufficient, resulting in both wastage and abuse)
- Fraud cases

To address the issue of rising medical claims ratios, the most common risk mitigation strategies adopted by our survey respondents are outlined below:

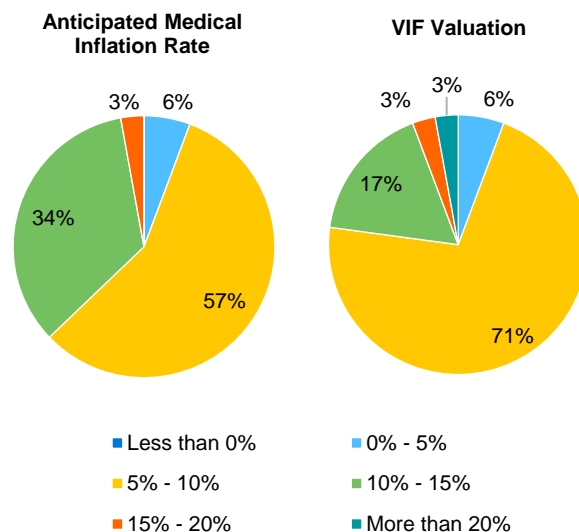
- Provider management, where insurers negotiate better rates or form preferred provider networks to control costs
- Tighter underwriting rules, enabling insurers to more accurately price their risk
- Incorporating claims deductibles in their M&H products, which encourages policyholders to be more mindful of their healthcare usage and minimise abuse and wastage

These strategies aim to control the overall rise in healthcare expenses. However, we recognise that many insurers in the region are still actively exploring ways to manage their medical business more effectively.

## Valuation of M&H business

In Asia, value of new business (VNB) and value of in-force (VIF) are often key metrics in tracking the value of insurance companies. In our survey, we asked insurers about the expected future medical inflation typically assumed in their calculations of VIF and VNB. The results are summarised in Figure 4.

FIGURE 4: ANTICIPATED AND VIF/VNB VALUATION MEDICAL INFLATION RATE



\*Excluding companies that assume medical inflation aligns with medical repricing and do not include it under VIF/VNB valuation.

Our survey respondents indicated the anticipated long-term medical inflation rate to be around 9.2% p.a. on average. This is broadly in line with the average best estimate medical inflation rate of 8.7% p.a. assumed by insurers in the calculations of VIF and VNB. However, around 40% of the survey respondents expect a long-term medical inflation rate in excess of 10% p.a. In contrast, only around 20% of the survey respondents have assumed such levels of inflation rates in their valuations. This discrepancy suggests that some companies may adopt a more optimistic view of future medical inflation in their valuations.

Given the rising claim costs and challenges of repricing, the survey also revealed that insurers are using various approaches to determine the VIF and VNB of their M&H business. Over a third of respondents do not account for future medical inflation and future repricing when calculating VIF and VNB. Among those that do, more than 85% assume implicitly that future repricing will align with the rate of medical inflation, thus maintaining a constant loss ratio.

However, in practice companies cannot always adjust premiums to achieve their target loss ratios. This discrepancy creates a gap between the model assumptions and actual practices.

## Conclusions

The challenges in managing M&H business will likely require a multifaceted approach, involving collaboration from different stakeholders to reform the healthcare ecosystem. If the insurance industry continues to face double-digit medical inflation rates, then insurers will likely need to conduct more frequent repricing exercises to keep up with rising medical costs. However, this approach may prove unsustainable in the long term. In addition, the challenges faced by different markets vary, and therefore, there is no one-size-fits-all solution to these issues. If medical inflation continues to outpace the annual average salary growth, it could potentially make M&H insurance unaffordable for many consumers. A collaborative effort in managing medical costs is crucial to enable both the private healthcare and insurance industry to thrive in harmony, and this would typically require some form of government intervention.

Milliman consultants have worked with insurers and governments globally in managing M&H business. For more details, please contact the authors of this e-Alert, or your usual Milliman consultants.

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