Roundtable to mark the 30th Anniversary of Medicare

Shaun Gath, CEO, PHIAC
Australian Healthcare and Hospitals Association
Old Parliament House, Canberra, 30 January 2014

Thank you for the opportunity to be here today. It is a pleasure to be able to tell you a little bit about the work of the Private Health Insurance Administration Council (**PHIAC**) and in so doing offer some reflections on the role of private health insurance in the history of Medicare.

John Deeble

First, however, I would like to acknowledge the work and career of Dr John Deeble.

Like a number of you today I have had the pleasure of working with John. In my case it was when he was a board member of the Health Insurance Commission and I, as you have heard, was the HIC's General Counsel for almost 5 years from the late 1990s. I always enjoyed working with a man of great wisdom, courtesy and (thankfully from my point of view) infinite patience. It's nice to be involved with this event for that reason alone.

PHIAC's role

But now, into the present. I need to lay my cards on the table right from the outset. I am a regulator, not a policy-maker. That latter role falls to my colleagues in the Department of Health with whom we work closely. It is their responsibility, not ours, to examine the broader landscape of our health system and to help the government of the day to deliver the improvements the community expects.

PHIAC's role is a different one. It is described in our enabling legislation, the *Private Health Insurance Act 2007* in the following terms:[1]

> [In discharging its functions] the Council must take all reasonable steps to achieve an appropriate balance between the following objectives:
>
> • fostering an efficient and competitive health insurance industry
>
> • protecting the interests of consumers
>
> • ensuring the prudential safety of individual private health insurers

So, to put it another way, we are in the balancing business. It is our role to protect consumers' interests by fostering an efficient and competitive industry and, at the same time, ensure that the industry remains prudentially sound. These are not incompatible objectives of course, but they do sometimes generate some creative tension.

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[1] *Private Health Insurance Act 2007*, section 264-5.

Some of you may be interested to know that PHIAC itself has been around for almost 25 years. Indeed that particular milestone will be marked in August this year. So PHIAC and Medicare have been operating side by side in this space we share … the national health business … for quite a long time.

That said, it should be acknowledged that PHIAC is a somewhat curious creature. A specialist prudential regulator of the private health insurance industry. Such things are not common in other countries in the world.[2] Why then, you might ask, do we need such an agency? Surely, the job of prudential regulation of the private health insurance industry can be undertaken by the mainstream prudential regulator. After all, private health insurance is just another insurance product….right?

Well, actually, no. At least not in important ways that should be articulated from time to time.

So PHIAC is indeed a kind of "platypus". Half duck (insurance regulator) and half mammal (health sector agency). But on closer examination, I want to suggest to you that PHIAC is (like the platypus) really entirely a mammal… or, to end the tortured metaphor, entirely an agency that lives and breathes and plays its ultimate role *in the health sector*.

This is not because of who we are, or the skills we exercise … on the contrary, my organisation is full of actuaries, accountants and lawyers like other prudential regulators … but rather because of the industry we regulate.

PHI contributes about 12 or so percent of all the health dollars expended in Australia. Those funds come from Australians (about 47% of the population) who have often foregone other more desirable forms of expenditure in order to maintain their private health insurance.

In turn, those funds largely sustain and pay for:

- our private hospital sector,
- a significant component of medical services, in particular specialist services,
- virtually the entire dental profession, and
- large swathes of the paramedical professions as well.

Australian health policy commentators often speak favourably of the very effective public/private funding model we have developed in this country and how we have been able to have something of a "best of both worlds" outcome.

Well, that is true in my view. I think we do have something to be proud of in this country. And my job, with my board and colleagues, is to ensure the continuing viability of one of those "worlds". A key and highly integrated component of our national health system that ensures that Australians continue to have access to some of the best health services available anywhere.

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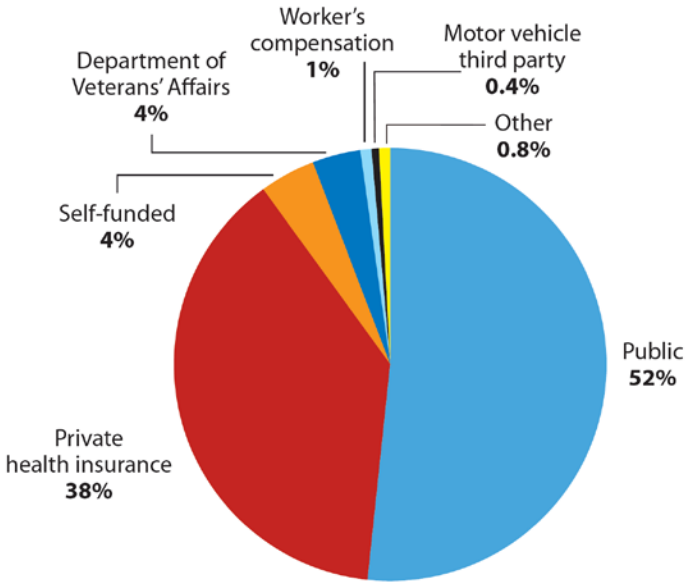
[2] Not entirely unique however. See, for example, the Dutch College voor zorgverzekeringen (Health Care Insurance Board) (www.cvz.nl) and the California Department of Managed Health Care (www.dmhca.ca.gov).

The significance of the role played by PHI in hospitalisations is clearly demonstrated by this chart drawn from the work of the Australian Institute of Health and Welfare.[3]



Source: AIHW 2011g.

Figure 7.13: Hospitalisations by principal source of funds, 2009–10

PHIAC's job, in a nutshell, is to ensure that (within the policy settings of the day) that *that* part of the system is operating efficiently and doing the job it is designed to do: support the health needs of members of PHI at a reasonable price and in so doing, taking some of the strain off the public health system.

PHI and Medicare

It is probably fair to say that no industry was more significantly impacted by the arrival of Medicare 30 years ago than was the PHI industry.

At the outset, you will recall I said I was happy to "offer some reflections on the role of private health insurance in the history of Medicare". In reality, it is probably better seen the other way around: PHI has been around a whole lot longer than Medicare or its predecessor, Medibank. Indeed it is worth recalling that some of our oldest insurers, still in business today, trace their history back to the 1880s and even earlier.

So in some ways, it is probably more accurate to speak of "the impact of Medicare on PHI."

Those intellectual niceties aside, the truth is that the impact on PHI has been profound, as this well-known PHIAC chart, tracing PHI membership levels as a percentage of the total population over the last 43 years demonstrates:

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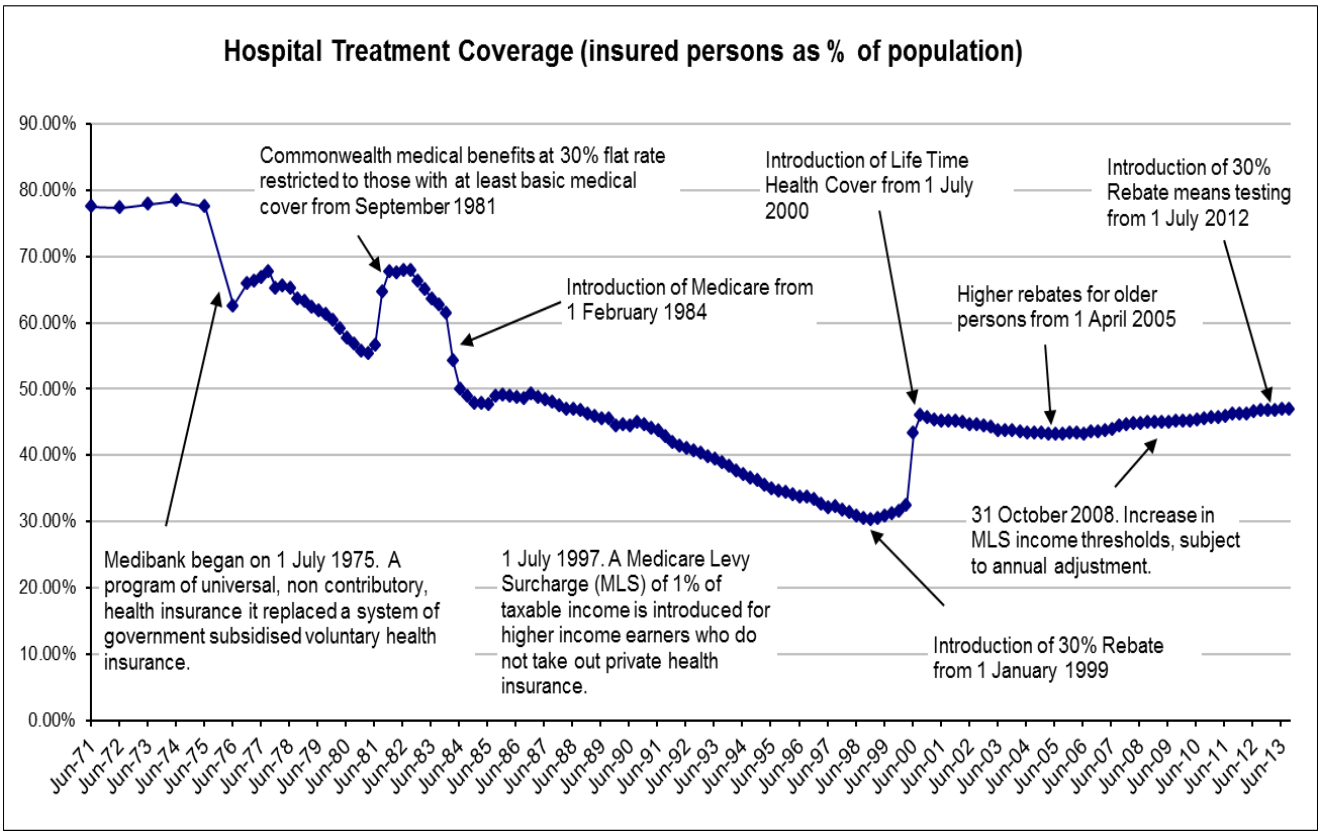
[3] Australian Institute of Health and Welfare, *Australia's Health 2012*, p 427.



Indeed, the single biggest impact on membership levels in the history of PHI was the introduction of Medibank in 1975 which saw memberships drop almost overnight by 16 percent. It is worth recalling, however, that PHI membership levels at the time were almost 80 percent.

Since then, we have seen what was first a bumpy period as successive Labor and Liberal Governments pursuing different policy options in the late 1970s (of which, many of you will aware, Medibank Private was a product) followed by a long steady decline in membership levels over the period of the Hawke and Keating Governments and the early years of the Howard Government. Then, a period of significant regulatory intervention designed to improve membership levels in the period 1999/2000 which resulted in a spike in memberships and more recently, an extended period of slow growth to the point that now 47% of Australians have some form of hospital cover.

The story here reveals two, possible contradictory, observations:

- **First**, there is no doubt that the most significant way to alter the levels of private health membership in this country is to change the offering in the public health sector. Australians are acutely aware of the value proposition being offered by PHI and will move away from the product if that equation doesn't stack up;
- **Second,** the story of the last 14 years has shown that PHI membership is also remarkable resilient. With policy settings that support the cost of the product and ensure that it priced equitably for all users, Australians will support PHI products that they regard as important at difficult times of their lives.

Moreover, they will be remarkably loyal to their insurer in the process, developing what are often life long and even inter-generational relationships with their PHI fund.

Report on the state of PHI

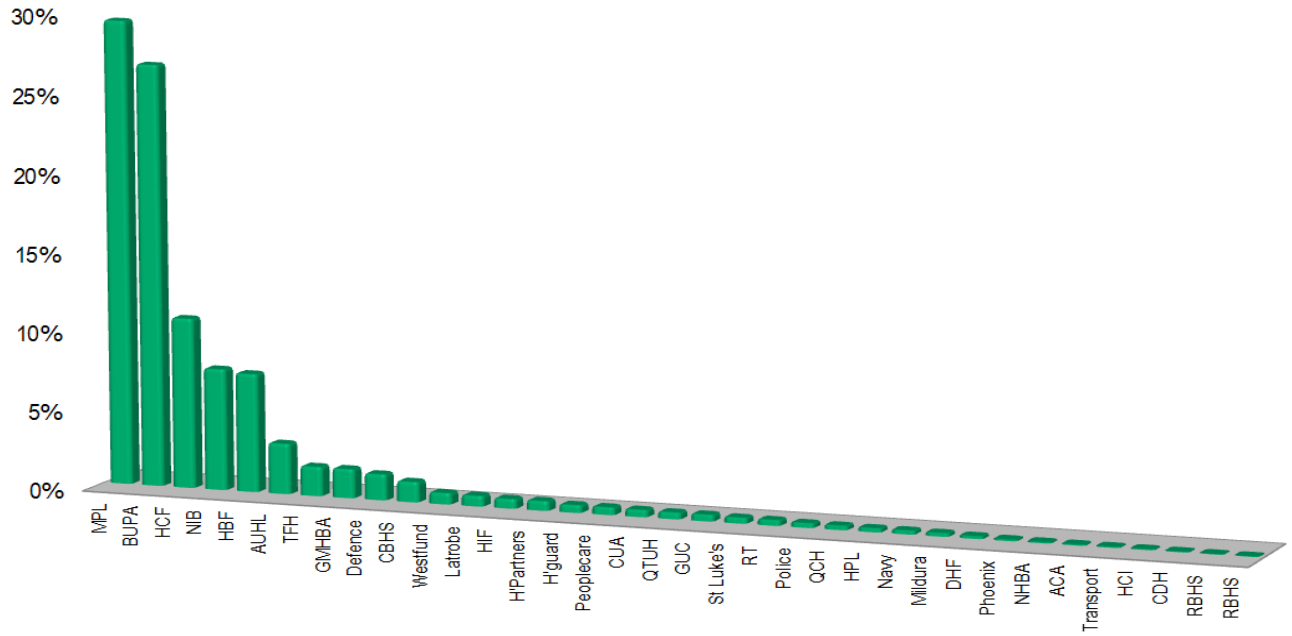
So how is the industry going at the moment?

PHIAC publishes an annual report on the operations of the private health insurers. Our legislation compels us to do so and our latest report (covering FY 2012-13) should be released pretty soon.

Without breaching the "under embargo" status of what is always a best seller (that is a joke, by the way!), I can disclose a few facts which demonstrate that the PHI industry is in pretty good (financial) knick at the moment.

First, just to remind, you … this is what our industry currently looks like:

Market share by total policies at 30 June 2013



So as you can see, we have two very large funds (Medibank and Bupa) about four or five mid ranking funds (the not-for-profits HCF and HBF and NIB and a couple of others) and a long tail of mostly restricted or regional insurers that many of you, I imagine, would never have heard of.

That picture has not really changed in the last decade (with the notable exception of the growth of Bupa which has merged the old HBF, MBF and Mutual Community funds to provide an industry powerhouse which now rivals Medibank Private at virtually every level).

So, not too much movement on that front.

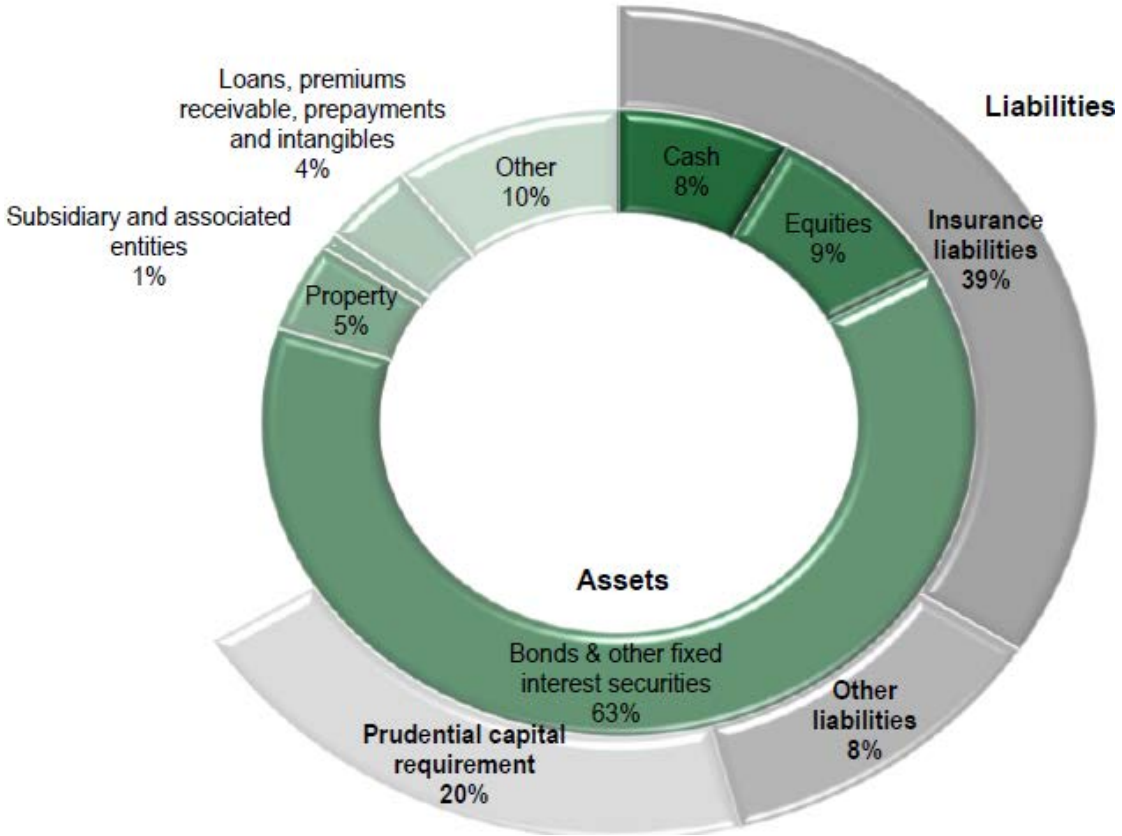
Likewise, the financial position of the industry

Industry profitability

Year	Average weighted premium increase on 1 April	Premium revenue ($'000)	Benefits payments ($'000)	Management expenses ($'000)	Gross margin	Net margin	Profit before tax ($'000)	Profit margin before tax
2012–13	**5.60%**	**17 975 604**	**15 624 820**	**1 576 293**	**13.1%**	**4.3%**	**1 382 911**	**7.7%**
2011–12	5.06%	16 720 849	14 336 644	1 559 896	14.3%	4.9%	1 269 058	7.6%
2010–11	5.56%	15 421 372	13 160 592	1 398 001	14.7%	5.6%	1 455 586	9.4%
2009–10	5.78%	14 170 292	12 226 721	1 299 774	13.7%	4.5%	1 174 946	8.3%
2008–09	6.02%	13 078 133	11 349 113	1 311 053	13.2%	3.2%	404 632	3.1%

This translates into an asset position for the industry at the end of the financial year which is summarised by this chart:

Health Benefits Funds Assets and Liabilities as at 30 June 2013.



As at the September quarter 2013 (the most recent statistics), the industry had assets of about $10.7 billion, almost $4 billion more than the minimum prudential capital requirement required to be held.

Deregulation and PHI

The mood of the times favours deregulation.

There have been calls from all levels of society and business for movements in this direction and it has been a constant theme of the current government dating from its times in opposition[4] to the pronouncements of the current parliamentary secretary formally given the task of advancing the "deregulation agenda" as it is known.[5]

PHIAC supports good regulation. It also supports deregulation wherever that is attainable.

It is a truism to say that PHI is a highly regulated industry. The main elements of this regulation – community rating, risk equalisation, minimum product requirements, the PHI rebate, the Medicare Levy Surcharge – are an integrated part of the Australian model of PHI that has developed in conjunction with Medicare over the last 30 years. They are also elements of the system that PHIAC has no control over.

PHIAC has, however, been working on two fronts which I need to mention briefly, both of which have a crucial impact on the future of the industry.

These are, first, capital management and, second, pricing.

I will be brief with both.

Capital Adequacy and Management

Invisibly to many of you I am sure, but in ways which are profoundly changing the whole way the PHI industry approaches risk management and capital provisioning for risk, PHIAC has undertaken a "root and branch" re-examination of its capital adequacy and solvency requirements. The new standards were formally made by the Council at its meeting in November last year and commence operation in about two months' time.

After about 13 years of operating under standards which carried a heavy template/rules-based component (reflecting the prudential difficulties which existed at that time), PHIAC has proposed a revolutionary new approach which requires insurers to essentially undertake their own capital management assessment and to provision accordingly. The key concepts are that they must:

- examine the three key risk dimensions of their business (underwriting risk, investment risk and "other risks") and set aside enough capital to be able to survive all but a "one in fifty bad year" or, as the actuaries call it, a 98% level of sufficiency. and

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[4] Hon Tony Abbot MP, Budget in Reply speech, *Hansard*, 16 May 2013.

[5] Josh Frydenberg MP, *The Abbott Government's Deregulation Agenda: Priorities and Strategies*, Speech to the Sydney Institute, 28 October 2013. See also Peter Dutton MP, *Speech to the Private Healthcare Australia Conference*, 28 November 2013.

- at the same time they must develop a capital management plan to be adopted at board level which then, following that endorsement, becomes their own legally enforceable standard of compliance.

Of course, this is not a “free for all”. Quite the contrary, the insurers have always been and will remain unswervingly cautious in their approach to these issues … and PHIAC retains a range of “backstop” powers if anyone gets too fast and loose with the rules. But the critical result will be that.. without meaningful loss of prudential safety … about a further $1billion will be released from the box currently labelled “statutory capital” and now be available to be used creatively in the interests of contributors and others with interests in the PHI fund.

This, we believe, will create a one off opportunity for the industry to engage broadly and more fully on a whole range of new levels to assist their contributors.

Pricing

The other significant deregulatory measure has been PHIAC’s work in the area of pricing. A process which, as you know, is overseen by the Minister for Health exercising powers under the *Private Health Insurance Act 2007*.

While we have always been a part of the process, two years ago a remarkable change was initiated… PHIAC was effectively given the entire job of advising the Minister on this most sensitive of issues.

To their great credit, the task did not come to us with any riding instructions from the Department of Health either. They invited us to perform the function in accordance with our values and strengths as the industry regulator, which we were happy to do.

The result has been a pricing process where a much stronger focus has been placed on the competitive disciplines of the market. PHIAC’s approach has been to ask “Is this insurer subject to significant market pressure in relation to its business? Will this price increase be subject to those competitive pressures?”

Of course, we have also undertaken our usual detailed actuarial analysis of forecasts and projections to ensure that the costs claimed to be “in the business” are actually there. Obviously, any egregious misrepresentation of the true state of benefit inflation would be quickly identified and stamped out.

But the benefit of this process has been significant. For the first time in memory, this year, the premium round was able to be completed before Christmas with no insurer required to go through the dreaded “resubmission” process.

The result has been an important dividend for the industry as well as PHIAC and the government. The process has been less time consuming, the data has been more frankly presented and most insurers believe that they are getting a clearer and more transparent reading of the pricing process as they seek to move their businesses forward.

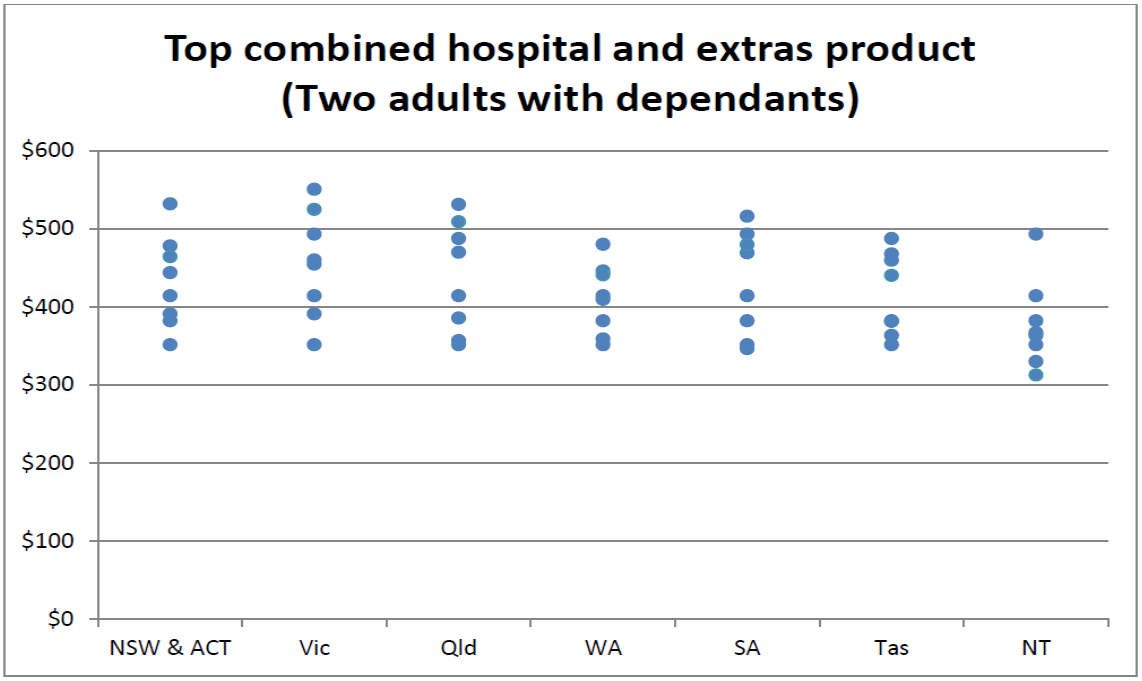
In the recent feedback loop with the industry about the process one leading insurer said:

> PHIAC score high in our eyes for "consistency" and "reliability" of process. PHIAC also score high on engagement whether at Board & CEO level or at Actuary team. Face to face meetings, and positive engagement with a culture of trust.

"So", I hear you say, "that's all very nice and lovey-dovey, but what about the poor old contributor who is getting hit in the back pocket by these increases? How are you looking after them?"

The answer is, of course, in many ways … principally by ensuring that their insurer no matter how big or how small stays in business and pays the claims that it receives. But also, critically, in performing our other role, by fostering efficiency and competition in the industry a matter we have been looking at closely recently.[6]

And in that spirit I want share with you one last chart:



This shows the current (i.e. predating the latest announced increases, which start on 1 April 2014) price points for what I have termed "top/top" combined products for all the unrestricted insurers in Australia based on the pricing jurisdiction. PHI products are notoriously hard to really get a pure "apples and apples" comparison because there is a lot of variability in the finer detail of the offering. But this analysis, with some caveats, does bear scrutiny in my view. We have taken the pricing currently advertised by all insurers combining their "top" hospital product with their "top" ancillary or general product. In most cases, these products offer the best level of cover available with little or no exclusions.

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[6] See PHIAC's Research Paper *Competition in the Australian Private Health Insurance Market*, June 2013, available on PHIAC's website.

What these numbers demonstrate is that there is significant value in the market for those that are prepared to look for it. In each jurisdiction, savings in the range of $150 to $200 per month are available if you are currently paying near the top of the scale. In some places the savings are even more significant. Do you think most Australians would be interested in saving $1,800 or more every year on a product that they are likely to hold for the rest of their lives? Remember too these are all prudentially-regulated, well-capitalised and competently-run organisations.

I have deleted the names of the relevant insurers, because I am seeking to make a point not to embarrass anyone, but the evidence is there. All you have to do is look at the government website, www.privatehealth.gov.au, which is run by my colleague the Private Health Insurance Ombudsman and all will be revealed.

Contrary to some misinformed commentary, there is a vibrant market for PHI products. I invite all consumers (and we all are) to go out and find it.

Thank you.