

House of Representatives Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Review of the Australian Prudential Regulation Authority Annual Report 2020

Division/Agency: Australian Prudential Regulation Authority

Question No: APRAQoN09

Topic: Adverse selection in insurance

Reference: Page 18 Hansard, (29 March 2021)

Member: Daniel Mulino

Question:

Dr MULINO: I have a couple of last questions on insurance. Do you test and measure whether there is adverse selection in health insurance and life insurance?

Mr Khoo: Certainly on health insurance I don't believe so. On life insurance I think there are clearly some issues around affordability, particularly with some of the premium increases that we've seen in various lines that have been loss-making. But I think that would be about the extent of it.

Dr MULINO: I raise this because I've seen some academic and other studies. Obviously there's a lot of interest in health and life insurance markets globally and there are some tests of whether it exists and, if so, how much and where. There's obviously also potential for advantageous selection; for example, if risk-averse people with low risks purchase health insurance or life insurance. But I would have thought this would be a first-order issue for you.

Mr Byres: Maybe I can add to Brandon's comment. One of the things we've called out—I think this is an example, although it mightn't be quite what you are referring to—for some time and it's well-known is that in the health sector, on the whole, young, fit people are not taking up private health insurance and, in fact, some of them are opting out of private health insurance. Those who are older and more in need of it are staying in, and that is changing the population pool and making it a riskier pool within the private health insurance sector. If that's what you are referring to in adverse selection then I think, yes, that is happening. But I think it's happening openly and transparently. Everyone understands it. It is not something that is happening in the background.

Mrs Rowell: I think there's a similar experience in the life insurance sector with younger, healthier people not taking out life insurance, which means that those that have life insurance are older and less healthy and therefore the claims experience is impacted. We would not necessarily do analysis on anti-selection ourselves. We would monitor the data that's reported to us but we would also look at the work that the insurers themselves are doing in that space to monitor their experience and how it's influenced by selection based on different factors.

Dr MULINO: As far as I can see there are two layers to this from the government's perspective. One is that there's a range of potential policy responses that you could take, and we've seen government take a range of policy responses to this over the last number of years. But I suppose the starting point is to establish what is actually happening in the market before you start thinking about whether to implement this kind of subsidy or this kind of mandate or whatever it might be. I would have thought that you'd want a very rigorous and granular understanding of the extent to which there is adverse selection or advantageous selection or whatever might be occurring in the market before government looks at different policy responses. I would have thought you're in a pretty good position to undertake that analysis.

Mr Byres: Certainly when it comes to things like the changing demographic, for want of a better term, of the PHI membership base, the private health insurance membership base, we do have good data on that and we have shared that with the Department of Health and other arms of government. The private health insurance sector is a sector that is heavily integrated

into the broader health sector. There's very strong government involvement and there are all sorts of subsidies and ways in which the government is engaged in that sector. We do our bit there where we can.

Dr MULINO: How much of that analysis is public?

Mr Byres: Certainly a lot of the data is public. I'd have to go back and have a look at some examples of things where we have talked ourselves about those issues, but we published a lot of data on the membership cohorts within the private health insurance sector and, as I said, I don't think it's any secret that the longer-term trends in declining membership rates with younger people opting out and leaving older people in the system is changing the economics of the PHI industry in an adverse way.

Dr MULINO: On notice, I'd be interested in not just the high-level data but more rigorous analysis to get a detailed sense of how this issue is getting worse or potentially not in different parts of the market in both health and life.

Mr Byres: We'll have a look at what we can provide.

Answer:

In answering this question, APRA defines 'adverse selection' as the reduced participation of low risk policyholders within either life insurance or private health insurance. Given APRA collects different data for life insurance and private health insurance, each industry is addressed separately below.

Private health insurance

APRA has grown increasingly concerned about the risks posed to both the private health insurance industry and its policyholders by the twin challenges of declining affordability and adverse selection. APRA has spoken about this publicly on a number of occasions and placed expectations on insurers to enhance scenario analysis on a severe adverse selection scenario as well as their strategies for managing the risks of affordability.

APRA's analysis and communication on adverse selection in the private health insurance industry, along with the relationship of this to affordability and sustainability challenges in the industry, are explored in the following publications and speeches:

- Statistics/ analysis – Quarterly private health insurance statistics December 2020 – highlights. Released 23 February 2021. Available here: https://www.apra.gov.au/sites/default/files/2021-02/Quarterly%20private%20health%20insurance%20statistics%20highlights%20December%202020_0.pdf
- Speech – APRA General Manager, Advice and Approvals, Peter Kohlhagen – Speech to 19th Annual Health Insurance Summit. 27 October 2020. Available here: <https://www.apra.gov.au/news-and-publications/apra-general-manager-advice-and-approvals-peter-kohlhagen-speech-to-19th>
- Speech – APRA Member Geoff Summerhayes – Speech to the Members Health Directors Professional Development Program. 4 February 2020. Available here: <https://www.apra.gov.au/news-and-publications/apra-member-geoff-summerhayes-speech-to-members-health-directors-professional>

- Speech – APRA Member Geoff Summerhayes – Members Health Directors Professional Development Program. 8 February 2018. Available here: <https://www.apra.gov.au/news-and-publications/health-insurer-heal-thyself-apra%E2%80%99s-prescription-for-financial-sustainability>

APRA collects and publishes quarterly data on private health insurance membership coverage and trends. This data provides insights into private health insurance membership, including emerging trends such as adverse selection.

- APRA’s quarterly private health insurance membership and coverage statistics contains data on the number of insured persons for hospital and general treatment, and the proportion of the population these persons represent, on a state and territory basis. The December 2020 edition is available here: [https://www.apra.gov.au/sites/default/files/2021-02/Quarterly private health insurance membership and coverage December 2020.xlsx](https://www.apra.gov.au/sites/default/files/2021-02/Quarterly%20private%20health%20insurance%20membership%20and%20coverage%20December%202020.xlsx)
- APRA’s quarterly private health insurance membership trends publication reports historical trends in the number of insured persons and benefits and benefits paid for hospital and general treatment. The December 2020 edition is available here: [https://www.apra.gov.au/sites/default/files/2021-02/Quarterly private health insurance membership trends December 2020.xlsx](https://www.apra.gov.au/sites/default/files/2021-02/Quarterly%20private%20health%20insurance%20membership%20trends%20December%202020.xlsx)
- A full list of APRA’s quarterly private health insurance statistics are available here: <https://www.apra.gov.au/quarterly-private-health-insurance-statistics>

Life insurance

The life insurance data APRA collects does not provide granular insights into adverse selection in the life insurance industry. While APRA collects information about life insurance policies which have not been renewed by customers (i.e. lapse rates), the information collected is not granular enough to determine whether adverse selection is occurring.

For a number of years, the life insurance industry has experienced increasing claims costs and declining profitability. Adverse selection may be one of multiple drivers contributing to this. Other, and possibly more significant, factors include declining investment income in a low interest rate environment and an increase in claims incidence, particularly mental health claims.