COMMUNITY AFFAIRS SENATE COMMITTEE

INQUIRY INTO:

PRIVATE HEALTH INSURANCE LEGISLATION AMENDMENT (BASE PREMIUM) BILL 2013

SUBMISSION BY THE AUSTRALIAN GOVERNMENT DEPARTMENT OF HEALTH AND AGEING

6 JUNE 2013

The purpose of the Bill

On 22 October 2012, the Government announced reforms to private health insurance as part of the 2012-13 Mid-Year Economic and Fiscal Outlook (MYEFO). The reform included changing the Government's contribution to private health insurance. The Government announced that from 1 April 2014, the Government's contribution to an individual's private health insurance rebate would be indexed annually by the lesser of the Consumer Price Index (CPI) or the actual increase in the premium charged by insurers.

The Bill amends the *Private Health Insurance Act 2007* (the PHI Act) so that from 1 April 2014 the Australian Government private health insurance rebate for each private health insurance policy will be set as a proportion of the premium charged for that policy as at 1 April 2013. The premium charged for a policy as at 1 April 2013 will be set as the base premium for that policy. From 1 April 2014, each private health insurance policy base premium will be indexed by the lesser of the CPI percentage change (using the All Groups Consumer Price Index number, being the weighted average of the 8 capital cities for the December quarter to December quarter published by the Australian Statistician) or the change of the premium charged by a private health insurer that is approved by the Minister under section 66-10 of the PHI Act. This measure will result in savings of $699.7 million over four years.

The effect of linking the rebate to a base premium is to ensure that, from 1 April 2014, the rebate is increased every year by the lesser of CPI or the actual commercial premium increase for private health insurance policies. The calculation of the rebate, based on income levels and age, remains the same but the rebate will no longer be a proportion of the full premium charged by private health insurers.

Policy rationale

Over recent years there has been substantial growth in private health insurance membership and consequentially Government expenditure on the rebate. The rate of new membership continues to outstrip population growth with more Australians being covered by private health insurance than at any other time in the past 37 years. According to the March 2013 quarter statistics released by the Private Health Insurance Administration Council (PHIAC) 10,763,182 people, or 46.9 per cent of the population now have private hospital cover. For the 12 months to 31 March 2013, the number of insured people with hospital cover has increased by 307,720. As at 31 March 2013, 54.7 per cent of the population had some form of general treatment cover.

Annual premium increases for private health insurance of around 5 to 7 per cent per annum, combined with higher participation in private health insurance across age groups, have led to 8 to 10 per cent increases in the annual outlay for the rebate for the last 7 years up to 2011-12.

The purpose of the rebate is to encourage people to take out private health insurance by contributing an income tested rebate to private health insurance premiums. On the basis of the long-term trend for participation rates, the Government has decided that a rebalance of the mechanism to continue this objective is required to ensure that maximum value for expenditure on the rebate is obtained and is kept sustainable. This Bill will help to ensure the sustainability of the rebate into the future by helping to reduce the long term costs in an area of health expenditure which is experiencing substantial growth.

The current arrangements

The Australian Government supports the affordability of private health insurance by providing a rebate of up to 40 per cent of the premium paid for a private health insurance policy depending on a person's age and income. Under the private health insurance income testing arrangements implemented on 1 July 2012, a person's rebate entitlement does not reach zero until they are earning $130,001 or more as a single, or $260,001 or more as a family. The table below explains the current tiers in 2012-13 by income and rebate and shows the current tier listing for 2012-13.

	Unchanged	**Tier 1**	**Tier 2**	**Tier 3**
Singles **Families**	**≤ $84,000** **≤ $168,000**	**$84,001-97,000** **$168,001-194,000**	**$97,001-130,000** **$194,001-260,000**	**≥ $130,001** **≥ $260,001**
REBATE				
< Age 65	30%	20%	10%	0%
Age 65-69	35%	25%	15%	0%
Age 70+	40%	30%	20%	0%

Note: The thresholds increase annually, based on growth in Average Weekly Ordinary Time Earnings. Single parents and couples (including de facto couples) are subject to the family tiers. For families with children, the thresholds are increased by $1,500 for each child after the first.

Each year, after the release of the December quarter Average Weekly Ordinary Time Earnings figures in February, income thresholds are indexed by the Australian Taxation Office (ATO).

The Tiers for 2013-14 are:

	Unchanged	**Tier 1**	**Tier 2**	**Tier 3**
Singles **Families**	**≤ $88,000** **≤ $176,000**	**$88,001-102,000** **$176,001-204,000**	**$102,001-136,000** **$204,001-272,000**	**≥ $136,001** **≥ $272,001**
REBATE				
< Age 65	30%	20%	10%	0%
Age 65-69	35%	25%	15%	0%
Age 70+	40%	30%	20%	0%
MEDICARE LEVY SURCHARGE				
All ages	0.0%	1.0%	1.25%	1.5%

Note: The thresholds increase annually, based on growth in Average Weekly Ordinary Time Earnings. Single parents and couples (including de facto couples) are subject to the family tiers. For families with children, the thresholds are increased by $1,500 for each child after the first.

Implementation

The changes will start on 1 April 2014.

Under this measure, the indexation will occur at a product level for each type of product subgroup that an insurer makes available. A product subgroup is defined in subsection 63-5(2A) of the PHI Act. A product subgroup is all the insurance policies within a product that covers people in the same risk equalisation jurisdiction and which covers the same type of groups (such as singles compared to couples and family policies).

Insurers are permitted to charge different premiums for each product subgroup. For example, an insurer can charge a different premium for their top hospital cover product offered to singles and another premium for the same top hospital cover product offered to families. Therefore a different base premium is required for each product subgroup.

Each product subgroup of a product made available by an insurer will be assigned a base premium which will be the premium that was charged by insurers on 1 April 2013. Policy holders will retain their current rebate entitlements and the rebate from 1 April 2014 onwards will be calculated as a percentage of the base premium, rather than the premium they are charged by the insurer.

Every insurance policy within the same product subgroup will have the same base premium regardless of lifetime health cover loadings or different discounts that policies may be subject to within a product subgroup.

Under section 66-10 of the PHI Act the Minister for Health approves premium changes. Indexation of the base premium would be applied on 1 April each year to align with the existing premium approval process.

By indexing the base premium, the rebate will be calculated using existing methodology in that it will continue to include consideration of the income testing tiers which came into effect on 1 July 2012.

Impact on consumers

All consumers who receive a rebate on their private health insurance policy will be impacted by these changes. The rebate will be determined according to a base premium and consumers will be able to access information from insurers on what their rebate would be if they were to change to a different policy or coverage level. Consumers will not be required to provide any additional information to their health insurer in respect of these policy changes.

Individuals who are in Tier 3 for the purposes of income-testing for the rebate (introduced on 1 July 2012) will not be impacted by this proposal, as they do not receive a rebate under the current income-testing arrangements.

Over time, the Government's contribution, through the rebate, will diminish if premium increases are consistently higher than CPI. The intention of this measure is, in part, to encourage greater competition between insurers on price and product innovation to mitigate this outcome. This effect is demonstrated below in the comparison between the rebate on the premium cost under the current arrangements and the reduction in the rebate to consumers after the changes take effect.

Example 1 – Base premium where the CPI is less than the premium indexation factor

On 1 April 2013 the new premium for an individual policy was $1,600. The base premium for that policy will be $1,600 and it is to this figure that indexation would be applied.

In the future premium processes, if the Minister agrees to a premium increase on full premiums of 5.5% per year for the policy but the relevant CPI yearly change is 2.5% the rebate is payable on the base premium as indexed by the lesser CPI increase, rather than being payable on the full premium cost.:

	April 2013	**April 2014**	**April 2015**	**April 2016**
Full Premium Cost (indexed by 5.5% or, as referred to in section 22-60 of the Bill, multiplied by a 'premium indexation factor' of 1.055)	$1,600	$1,688	$1,781	$1,879
Rebate on premium cost (current arrangement) (30%)	$480	$506	$534	$564
CPI Indexation factor (annual increase in CPI of 2.5% pa)		1.025	1.025	1.025
Base Premium (indexed by the lesser CPI indexation factor)	$1,600	$1,640	$1,681	$1,723
Rebate on base premium (30%)	$480	$492	$504	$517
Reduction in rebate to consumers (as a result of this Bill)	$0	$14	$30	$47

Example 2 - Base premium where premium indexation factor is less than the CPI

If the cost of premiums charged by an insurer increased by 2% per year and CPI increased at 2.5% per year, consumers will receive the Rebate on the full premium cost.

	April 2013	April 2014	April 2015	April 2016
Full Premium Cost (indexed by 2% or, as referred to in section 22-60 of the Bill, multiplied by a 'premium indexation factor' of 1.02)	$1,600	$1,632	$1,665	$1,697
Rebate on premium cost (current arrangement) (30%)	$480	$490	$500	$509
CPI indexation factor (annual increase in CPI of 2.5% pa)		1.025	1.025	1.025
Premium indexation factor (increase of 2% p.a)		1.020	1.020	1.020
Base Premium (indexed by the lesser premium indexation factor)	$1,600	$1,632	$1,665	$1,697
Rebate on base premium (30%)	$480	$490	$500	$509
Reduction in rebate to consumers (as a result of this Bill)	$0	$0	$0	$0

Example 3 -Base premium where premium indexation factor is less than the CPI indexation factor in some years but not others

	April 2013	April 2014	April 2015	April 2016
Full Premium Cost	$1,600	$1,632	$1,713	$1,747
Rebate on premium cost (current arrangement) (30%)	$480	$490	$514	$524
CPI indexation factor		1.025	1.023	1.030
Premium indexation factor		1.020	1.050	1.020
Base Premium	$1,600	$1,632 ($1,600 x 1.02)	$1,670 ($1,632 x 1.023)	$1,703 ($1,670 x 1.02)
Rebate on base premium (30%)	$480	$490	$501	$511
Reduction in rebate to consumers (as a result of this Bill)	$0	$0	$13	$13

If consumers choose to change insurance policies, their rebate will be based on a combination of their entitlement to the rebate after income testing and their base premium that applies to the policy they have chosen to change to. It is noted that section 22-50 of the Bill permits expression of the base premium amount as an amount per day (the smallest unit of time that a person is covered). As provided in the explanatory memorandum to the Bill, allowing the base premium to be expressed as a daily amount permits calculation of a proportional base premium and appropriate rebate amount based on the number of days that someone has paid in respect of their period of cover.

Consumers will not be required to provide any additional information to their health insurer or the ATO in respect of the changes made by this Bill. Consumers will continue to receive a rebate that is calculated based on the base premiums for their policy rather than the full premium charged by their insurer.

There will be no change to the existing administration of income testing for the purposes of the rebate. As noted above, people in the Tier 3 income testing tier are not entitled to a rebate and will therefore not be impacted by these changes.

It is anticipated that the initial annual impact of this change for an average family hospital policy costing $3,200, will be about $28 if premiums increase by 5.5% and CPI is 2.5%. For an average hospital singles policy costing $1,600, the anticipated impact will be about $14. The anticipated initial annual impact for a family policy covering both hospital and general treatment costing $4,500 will be about $40 and for a combined singles policy costing $2,300, the anticipated impact will be $20.

The rate at which consumers' rebate entitlement will change is very gradual so in the short to medium term it is not anticipated that there will be any impact on private health insurance membership. Over the longer term, there are expected to be changes over a range of variables that influence membership and these make it difficult to accurately determine the specific effects or future membership levels of this specific change.

New products introduced after 1 April 2013

The base premiums for all new products introduced after 1 April 2013 will be subject to the same indexation arrangements, the lesser of CPI or the premium increase, as per existing products. When new policies are introduced by insurers, it is proposed that a weighted average ratio (WAR) across their policies will be utilised to determine the base premium for the new policy. This approach will ensure consistency of rebate entitlement between existing and new policies.

Example 4 – the base premium for products made available after 1 April 2013

An insurer offers a range of existing product subgroups each with a base and full premium:

Existing product subgroup	**1**	**2**	**3**	**4**	**5**
% policyholders across products	5%	20%	50%	10%	15%
Base Premium	$1,000	$1,200	$1,600	$1,800	$2,000
Full Premium	$1,200	$1,400	$1,800	$2,000	$2,200

The WAR between full and base premiums is 88.4%.

This is calculated as:

(5% x 1,000/1,200) + (20% x 1,200/1,400) + (50% x 1,600/1,800) + (10% x 1,800/2,000) + (15% x 2,000/2,200)

Therefore if the insurer were to introduce five new product subgroups, the associated base premium would be determined using this ratio:

New Product	**6**	**7**	**8**	**9**	**10**
Base Premium	$1,149	$1,326	$1,503	$1,679	$2,210
Full Premium	$1,300	$1,500	$1,700	$1,900	$2,500

Similarly, it is proposed that if a new fund enters the market, a WAR across industry policies will be utilised to determine the base premium for the new insurers' policies. The applicable industry WAR would be provided by the Private Health Insurance Administration Council (PHIAC) and applied to their proposed new products in order to establish a base premium.

As mentioned by the Minister for Health, the Hon Tanya Plibersek MP, to the House of Representatives on 15 May 2013, the precise rules around calculating the WAR will be determined in consultation with the private health insurance industry and then detailed within the Private Health Insurance (Incentives) Rules prior to 1 April 2014. The relevant rules around calculation of the WAR will reflect the example above. The objective in further consulting with insurers will be to confirm detailed specifics including the precise types of existing product subgroups that are to be used for the purposes of calculating the WAR for a particular new product made available by an insurer and how this information will be verified.

The validation of new policy base premiums for both existing and new insurers will be undertaken by PHIAC.

Claiming the rebate

Currently there are three claiming channels for the rebate:

- Premium reduction through a private health insurer (PRS) (currently around 95% of total claims);
- As a tax offset through the annual tax return process (currently 5% of total claims); and
- As a direct payment from a Medicare office (IPS) (currently 0.01% of total claims).

At the time of lodging this submission, the Private Health Insurance Amendment (Lifetime Health Cover Loading and Other Measures) Bill 2012 has been passed by the House of Representatives and is currently before the Senate. The Private Health Insurance Amendment (Lifetime Health Cover Loading and Other Measures) Bill 2012 ceases the operation of the IPS. If that Bill is passed, the premium reduction and tax offset claiming channels will remain.

The process for purchasing health insurance and claiming the rebate will remain unchanged for those claiming through the PRS or as a tax offset.

Example 5 – Claiming the rebate

Premium Reduction Scheme

- A consumer purchases a policy at a cost of $1,688, with a base premium of $1,640 and a rebate of $492.
- They elect to receive their rebate through the premium reduction scheme (PRS), reducing the cost of the policy from $1,688 to $1,196 (full premium cost minus the rebate payable on the base premium).
- The insurer will then invoice the Department of Human Services for the cost of the rebate payable on the policy.

Tax offset

- For those people who claim their rebate through their annual tax return, the process will remain the same with an additional requirement for insurers to provide the ATO with advice on the base premium for the policy which the taxpayer had in the past financial year.

Impact on insurers

Individual insurers will be required to develop and maintain a schedule which includes both the base premium and full premium for each product they offer. This will need to be adjusted for products which are removed and new products they bring to the market.

From 1 April 2014 onwards, insurers will be required to annually adjust the base premium by the lesser of the prescribed CPI rate or approved premium increase.

Insurers will be required to provide base premium information for their available product subgroups to the Australian Taxation Office (ATO) and the Department of Human Services for the purposes of claiming the rebate through the tax offset and premium reduction scheme. Insurers will also need to provide the base premium as part of the statement provided to policyholders on 15 July in each income year, as this is the amount on which the rebate will be calculated.

Insurers will be required to advise consumers about policy details as well as the base premium and associated rebate in line with this measure.

In order to verify that insurers are applying the correct level of indexation to the base premium, the PHIAC will undertake a quality assurance process. This process would confirm that the correct indexation is applied to existing policies and that for new policies the weighted average ratio is correctly applied by insurers. PHIAC will be required to oversee the verification of base premiums and the correct application of indexation by insurers. PHIAC would undertake this through the analysis of information provided by insurers on base premium indexation and new products prior to public release.

The base premium and the associated rebate in respect of the base premium for each product subgroup will also be made available on the Standard Information Statements that are made available on the privatehealth.gov.au website administered by the Private Health Insurance Ombudsman.

Impact on private health insurance participation

It is estimated that this change will be unlikely to result in a significant number of people dropping their private health insurance cover. Since the introduction of income testing of the rebate on 1 July 2012, an additional 175,354 people have taken out private hospital cover in the three quarters since its introduction.

The Department of Health and Ageing will continue to monitor the impact of these changes on consumers through the quarterly PHIAC statistics on membership.

Communication and information

The Department has been funded to undertake a communications campaign to ensure that the public is made aware of the changes. Consumers will be able to access timely and accurate information through a variety of mediums including: the internet, Medicare offices, and individual insurers, the Private Health Insurance Ombudsman, and the Department of Health and Ageing. This funding is quarantined subject to consideration by the Service Delivery and Coordination Sub-Committee of the Expenditure Review Committee.

A communications strategy will also comprise ongoing liaison with the private health insurance industry and relevant stakeholders including the PHIAC and the Private Health Insurance Ombudsman, the Department of Human Services and the ATO.

As mentioned above, insurers will be required to advise consumers about policy details as well as the base premium and associated rebate in line with this measure.