6 June 2013

Committee Secretary
Standing Committee on Community Affairs
PO Box 6100
Parliament House
Canberra
ACT 2600

By email: community.affairs.sen@aph.gov.au

Inquiry into the Private Health Insurance Legislation Amendment (Base Premium) Bill 2013

Dear Committee Secretary,

Bupa welcomes the opportunity to contribute to the Inquiry into the Private Health Insurance Legislation Amendment (Base Premium) Bill 2013 (the Bill).

Bupa appreciates that continued growth in private health insurance membership has lead to an increase in the Government's rebate expenditure and understands the Government's desire to restrict its liability. However, Bupa does not believe that indexing the rebate to the Consumer Price Index (CPI) is the best system to achieve this objective.

Please find set out below Bupa's detailed comments on the Bill.

About Bupa Australia and New Zealand

Bupa Australia and New Zealand's purpose is to help people live longer, healthier, happier lives.

Bupa is Australia's largest privately managed health insurer, covering around 3.5 million people. Our products and services include hospital cover, medical, ancillary and ambulance services; as well as access to travel, car and home insurance.

Bupa's private health insurance business is regarded as an industry leader in the promotion of preventive health and wellness via health phone coaching (Bupa Health Dialog), corporate health services (Bupa Wellness), eye care (Blink Optical) and dental (Dental Corporation). Bupa is also the largest private operator of residential aged care facilities in Australia and New Zealand. Our employees provide care and services to more than 9000 residents across 107 homes; and we offer respite, low, high and dementia care, enabling residents to age respectfully and in peace.

Additionally, we operate 20 retirement villages, a post traumatic brain injury rehabilitation service and have more than 11,000 personal medical alarm customers in New Zealand.

Bupa focuses on providing sustainable healthcare solutions that represent real value. Bupa's Australian and New Zealand businesses are part of the international Bupa Group, which cares for more than 13 million people in over 190 countries.

SUMMARY

While Bupa accepts the underlying rationale for the Bill and acknowledges that the Government wants to move away from the current system of uncapped liability, we do not think indexation of premium rebates to the CPI is the most sensible method to achieve this end. Bupa wishes to draw the Committee's attention to the fact that as a result of this change it is estimated that on average *all* Australians will experience an increase in their premiums of around 1.3% p.a each year, in addition to the increase they would have otherwise experienced. This means, for example, that a fund average premium increase of 5.6% p.a. will become 6.9% p.a. See Appendix A which contains a table that indicates the impact that CPI indexation would have had on the industry average premium increases that have occurred from 2009 to 2013.

Section B of this submission sets out in detail the reasons that Bupa believes the CPI is not the correct indexation and proposes an alternative.

While Bupa does not advocate the indexation of premium rebates to the CPI, should Government proceed with these proposed savings measures, Bupa believes that it is essential that an alternative implementation method is utilised to the one set out in the Bill, the proposed alternative is set out in Section A below.

Bupa has numerous concerns about the impact of the implementation model on insurers and also on consumers; these are detailed in Section A. The alternative method proposed below would achieve the same cost savings for government as the current proposed implementation process but would avoid many of these issues for both insurers and importantly consumers.

SECTION A – Alternative Implementation

1. Bupa's preferred implementation model

As the Committee may be aware, the implementation approach proposed in the Bill is to tie the rebate payable to the premium of *each product* as at 1 April 2013, where the product was in existence on that date and to a notional premium for products which are introduced after 1 April 2013. This will necessitate the creation of two premiums for each product. It will result in the percentage that the rebate represents for each product in the industry potentially becoming unique over time. In addition, customers generally have two products (e.g. a hospital and ancillary product) and each would have its own unique rebate percentage under the model proposed in the Bill. The treatment of new products is slightly different but equally problematic as discussed further below.

While it may appear that the implementation of CPI indexation for the rebate will be relatively straight forward, there are substantial issues with the proposed approach for both insurers and consumers. Bupa therefore strongly recommends that a far more simplistic implementation model be applied in order to administer the proposed capping of the government rebate to the CPI.

As the intended effect of the Bill and its planned implementation is to reduce the percentage of rebate applicable to premiums for private health insurance (PHI) over time, Bupa believes that the implementation should be transparent and simply reflect this reality.

Bupa proposes that the rebate percentage be adjusted each year to reflect the CPI indexation for the previous year at an individual fund level. This would result in little additional administrative burden to each fund as well as being more easily explainable to the customer. This differs from the implementation proposed in the Bill as this will not index rebates at the product level but rather at the fund level, however, it still caps total government expenditure by indexation to a maximum of CPI.

At 31 March each year, by considering differences between the CPI and the approved average premium increase for each fund, a rebate percentage would be calculated and given to each fund for equitable application across all their products from 1 April.

This option would be simpler and clearer to customers. The proportion of premium they are entitled to receive as a rebate would be transparent and equitable across products. It will ensure that innovation continues to be encouraged and in particular, that insurers are more likely to introduce features to existing products rather than simply stripping out benefits in order to preserve a favourable rebate position.

In addition to delivering savings in line with the current proposed implementation method, the above option also has the additional benefit of enhancing competition between funds. In a scenario in which indexation is applied at the fund level, funds are motivated to keep premiums lower than their competitors in order to protect the level of rebates for their customers. This creates a level of competition that would not exist in the implementation model as outlined in the Bill. In addition, fund level application of rebates allows efficiently performing funds to enjoy the competitive advantage of their lower premium increases.

Further, as the implementation of this preferred model is very similar to current arrangements, it would not create any significant additional administration costs for the industry with regard to implementation and ongoing expenses. This preferred model would reduce the complexity of conversations with customers, especially those wanting to move between products within the same fund.

Bupa contends that this proposed method of implementation would alleviate many of the problems that the implementation as described in the Bill would create, which we have outlined below.

Bupa understands that some other industry participants support an alternative implementation model targeted at the industry level, rather than the fund level. While Bupa prefers changes to the rebate being made at the fund level, we would like to make clear that should a decision be made to move to implementation at an industry level, we would not object. We believe that application at an industry level will also aid with reducing complexity for customers and administrative costs for insurers and is far more preferable that the current proposed product level implementation approach.

2 Problems with the implementation method proposed in the Bill

2.1 Increased confusion for customers

Bupa believes that the proposed implementation method will result in a significant increase in customer confusion. If rebates are indexed to the CPI in the proposed way they will no longer be easily relatable to the premium payable and will not be equally applied across all products or all funds. Rather, each product, across each insurer across each year will be uniquely calculated. Further, as customers tend to have a hospital and ancillary product, there will be no simple way for customers to predict their rebate level going forward.

In addition, the introduction of income testing in July 2012 has already introduced a significant level of complexity regarding rebate, with customers having to consider their potential income level for the year and how that might impact on their rebate entitlement. It is not clear how the tiered reduction of the rebate will work with an overlay of a CPI reduced rebate for each product.

Communications with current and prospective customers regarding rebates will become more complex and increasingly frustrating for customers. This could lead to a lower rate of PHI growth with some customers leaving the industry altogether.

2.2 Impact on customer behaviour

Bupa is concerned that the implementation of the CPI indexation in the manner proposed is going to introduce yet another factor that will lead to customers failing to make decisions based on the product that best meets their needs. In addition to looking at the full premium for a product customers will now be concerned about the level of rebate that an individual product is likely to provide. This may mean that customers are less likely to be inclined to shop around if their product currently attracts a relatively high rebate or when shopping around they may choose one product over another based on the rebate it attracts rather than the suitability of the actual product. Given that the CPI is so far below the historic rate of benefit inflation, it is most likely that the products that retain the highest rebate to premium ratio will be those that provide a lower level of cover. Accordingly, the government’s proposed approach is likely to result in a considerable increase in downgrading across the industry.

We are also concerned about the potential impact on industry growth as this will further add to the perception in the minds of potential customers that health insurance is complicated and difficult to understand.

2.3 Treatment of New Products

If the method proposed in the Bill is implemented, Bupa will need to request further clarification on how the rebate will be determined in relation to new products. We understand from initial discussions with the Department of Health & Ageing (the Department) that a weighted average ratio (WAR) is to be calculated to determine the applicable base premium for any product that is introduced after 1 April 2013. However the Department has not provided details regarding how this WAR will be calculated other than to say it will be based upon all the products the insurer offers and the calculation will be developed in consultation with industry. Bupa does not believe that it will be possible to calculate a WAR for a new product in a manner that is reasonable and appropriate, as it would be difficult to determine which products are comparable for the purposes of the calculation.

Bupa also notes it is proposed that the determination of the base premium for new products will need to be verified by PHIAC. Bupa is concerned about this process, as it implies that there is an element of subjectivity which PHIAC will need to monitor. Any time there is an element of subjectivity, there is an opportunity to game the system. Bupa is also concerned about the time that will be taken for this to occur, and the impact that such a timeframe will have on innovation and speed to market for new products. We are also concerned about the additional red tape required for documentation, adding further administration burden on insurers for the implementing the proposed method.

2.4 Impact on innovation

CPI indexation as described in the Bill will create a significant deterrent for insurers to add or improve benefits to existing products. Base premiums will be set as at April 1, 2013 and there would be no scope for insurers to seek a re-evaluation of the base premium. Therefore, product innovation will lead to customers bearing the full cost of premium increases required to deliver the new or improved benefits. This will act as a strong disincentive to innovate existing products.

This situation is likely to add further complexity and confusion to the system given that, in order to introduce additional benefits, insurers will have little choice but to create whole new products. As such, there will be an ever increasing number of products which will lead to more confusion among customers and an increasing administrative burden on insurers to explain and then manage their growing product range.

2.5 Administrative burden on insurers

Bupa is concerned that the Government has not considered the considerable regulatory burden that the proposed implementation of CPI indexation will have on industry. Annual rebate certificate audits will be progressively more complex and expensive, this alone will add significant cost for all insurers, which they have no control over.

Further, the proposed method of CPI indexation will lead to complexities in PHI not before experienced and therefore not understood by customers. Consequently, Bupa expects customer queries to multiply. This will have a major impact on front line services and an inevitable flow through increase in management expenses.

In addition Bupa wishes to bring to the Committee's attention the fact that it has already borne significant administration costs in the past 12 months regarding the impact of income testing of the rebate on annual tax statements as well as preparation related to the potential implementation of the removal of the rebate from Lifetime Health Cover Loadings.

The combination of both the additional costs associated with implementation of the CPI indexation together with the costs of implementation of previous changes will need to be borne by *all* customers through a higher premium increase in 2014, being the first year of operation. Reducing the rebate for *all* customers as well delivering a premium increase that is higher than would otherwise be required, will further exacerbate the cost pressures involved with CPI indexation.

SECTION B

1. Alternative index

Bupa believes that CPI is an inadequate indication of healthcare cost escalation and as such, we believe that it will inevitably lead to an erosion of the affordability of PHI and/or deterioration in product benefits. Accordingly, it is not an appropriate choice to index the rebate to and Bupa recommends that an alternative option be considered to achieve the desired rebate savings.

One such alternative could be the creation of a more appropriate index. This index could be an agreed percentage or a new composite index based on a weighted basket of health goods and services. Indexation to a figure that more appropriately considers health inflation would mean fairer outcomes for all Australians.

Importantly, unlike CPI indexation, indexation to a more realistic indicator of benefit inflation may result in lower premiums for customers. This is because insurers will then realistically be able to strive to stay closer to the indexation level.

2. Problems with using CPI as the index

2.1 Product pricing

The gap between historic CPI and benefit inflation is considerable and this is shown in appendix A.

It would be irresponsible for an insurer to limit premium increases to CPI levels, with the benefit inflation level being so much higher. Further, even if an insurer is able to limit premium increases to CPI for one year on a product or a set of products without stripping out benefits or cross subsidisation, it is inevitable that the required premium increase in the following year for those products would be substantial in order to ensure that they remain viable.

2.2 Stripping of benefits

The gap between the CPI and health inflation is so great that, in order to keep premium increases at or close to CPI, insurers will need to introduce products that pay lower levels of benefits such as by introducing restrictions or exclusions or increasing excess levels.

The stripping of benefits will lead to the creation of more and more products with exclusions and restrictions, representing low value for customers. These products will inevitably have holes in coverage forcing customers to rely on the public system. Further and importantly, the creation of low value products will erode the value of PHI in customers' minds, possibly influencing them to drop out of PHI altogether.

Without stripping benefits, the prices of products offering comprehensive cover will attract less and less of a rebate and will become proportionately more expensive. This will impact upon affordability of access for many low and middle income earners who are particularly price sensitive. This could lead to a situation in which customers' product choice is based on the percentage of government rebate available rather than which cover is most suitable. PHI customers may regrettably then elect to downgrade to a lower and cheaper form of coverage despite it not being suitable for their needs.

2.3 Increase in private health insurance costs for all customers

"It is generally acknowledged that healthcare costs rise at about 2 ½ times the rate of the CPI, which means that the value of the rebate will continually erode in real terms."[1] Given that benefit outlays escalate at a faster rate than CPI, the financial impact of this indexation to all PHI customers will be significant and will only grow over time.

As stated in Section A, while insurers could try to limit premium increases to CPI levels, the gap between benefit inflation and the CPI is simply too substantial for this to be sustained. As such, premiums will need to increase above the CPI to remain viable and *all* customers will experience an increase in premium prices. With affordability eroded as the gap between price and rebate paid expands, low and middle income earners will be disproportionately impacted.

2.4 Increasing competition

Bupa understands that one of the goals of this legislation is to aid in increasing competition within the PHI industry. Bupa contends that the health insurance industry is already competitive, and that CPI indexation will not further increase competition and that deregulation of pricing is the next step in fostering competition.

Insurers have little control over large portions of their supply chain. Increasing insurers' power to control their inputs and therefore their claims inflation will foster competition by driving efficiency. Only by increasing control of benefit inflation can insurers have the best chance of keeping premium increases low.

Bupa thanks the Committee for the opportunity to contribute to this Inquiry. In addition to the views presented within this submission, Bupa looks forward to engaging further with the Government during future consultation regarding implementation processes.

If you have any questions or require further information, please do not hesitate to contact me

Yours sincerely,

Ayela Thilo
Head of Government, Policy and Regulatory Affairs
Bupa

[1] Australian Private Hospitals Association CEO Mr Michael Roff. From Senior Australian News and Research

Appendix A

Possible scenario for members should premium rebates be indexed to the CPI

	Industry Headline Rate Increase April	Headline CPI April	Gap
Average 2009-2013	**5.60%**	**2.56%**	**3.04%**
2013	5.60%	2.50%	3.10%
2012	5.06%	1.60%	3.46%
2011	5.56%	3.30%	2.26%
2010	5.78%	2.90%	2.88%
2009	6.02%	2.50%	3.52%

Fund premium increase on average	**5.60%**
Government rebate to increase on average	**2.56%**
Member premium to increase on average	**6.91%**
Effective higher member increase p.a.	***1.30%***

Considering the figures in the tables above, if CPI indexation is introduced, on average, the member's portion of the premium will be around 1.3% p.a. higher than it would otherwise have been.