Submission to the Senate Community Affairs Legislation Committee

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

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Medibank welcomes the invitation to provide a submission to the Senate Community Affairs Legislation Committee Inquiry into the Private Health Insurance Legislation Amendment (Base Premium) Bill 2013. This submission addresses significant issues relating to the impact on private health insurance members and the costs to implement the proposed change.

About Medibank

Medibank is Australia's largest integrated private health insurance and health services group. With 3.5 million resident members we cover approximately 30% of the private health insurance market nationally. We also cover over 200,000 overseas visitors and students. Each year, we pay billions of dollars' worth of hospital and allied health claims and directly deliver almost 600,000 clinical services, helping millions of Australians live healthier, fuller lives.

Introduction

The Private Health Insurance Legislation Amendment (Base Premium) Bill 2013 will add substantial new regulation to the already heavy regulatory burden associated with private health insurance.

The Base Premium Bill will amend the Private Health Insurance Act and subordinate legislation via the introduction of two new concepts that must be used in the calculation of premiums. These are:

- Base Premium – the component of the total premium to which the Australian Government Rebate will be applied, equal to the premium applying on 1 April 2013. On 1 April of each future year the base premium will be indexed by the lesser of the Consumer Price Index (CPI) or the actual increase in premiums and the Rebate calculated accordingly.
- Weighted Average Ratio – a yet to be confirmed system to determine the base premium for products and product subgroups that did not exist on 1 April 13.

Like any funder of health services, Medibank is facing the challenges associated with an ageing population, the growth in chronic disease and increasing use of expensive health technology. Taken together these factors suggest that benefit payments for health services consumed by our members are likely to continue to grow at between 7-10% per annum. This further implies private health insurance premiums growth rates are likely to stay above CPI for the foreseeable future.

As a result of this circumstance and the effect of the Base Premium Bill, overtime there will be a divergence between the Base Premium as defined in the Bill and the full premium paid by the customer. Because the Base Premium will be the component upon which the Australian Government Rebate is calculated, in real terms the percentage of each individual's full premium covered by the Rebate will diminish. This will produce savings for the Australian Government; however, affordability of private health insurance will decline. The effect over five years is illustrated in Table 1 below.

Table 1

Base Premium Bill - impact on Rebate							
Year	CPI %	Product Increase %	Annual Premium	Indexation Base Premium	Rebate Amount	Rebate as % of full premium	Net cost to customer
2013			$2,000	$2,000	$600	30.00	$1,400
2014	2.50	5.00	$2,100	$2,050	$615	29.29	$1,485
2015	2.50	5.00	$2,205	$2,101	$630	28.59	$1,575

2016	2.50	5.00	$2,315	$2,154	$646	27.91	$1,669
2017	2.50	5.00	$2,431	$2,208	$662	27.24	$1,769
2018	2.50	5.00	$2,553	$2,263	$679	26.59	$1,874

In this submission Medibank seeks to draw attention on the initial and ongoing impacts of the Base Premium Bill to customers and the substantial implementation costs that apply due to the methodology used in the Bill. The submission also propose an alternative approach to indexation that will guarantee the savings Government seeks but will not produce the negative customer experience impact and implementation costs.

Customer experience

Increased complexity and customer confusion

People purchasing private health insurance for the first time after 1 April 2014, or existing privately insured people who want to make a change to their product or want to change funds after 1 April 2014 will be adversely impacted by the changes proposed in the Base Premium Bill.

Despite attempts by insurers and intermediaries to reduce complexity, private health insurance remains a complex product. In part this complexity is a result of the regulation that permeates the industry, applying to everything from the design of products, to insurer's abilities to control their cost bases, to the very incentives intended to encourage people to purchase the product.

Complexity is a significant problem for private health insurance. A recent industry survey found 78% of customers see an urgent need to simplify private health insurance, with pricing structures a key source of confusion. Moreover 66% of survey respondents who had recently enquired about taking out private health insurance said complexity and confusion deterred them from proceeding. A further 45% of people without private insurance say they 'tune out' to the possibility of purchasing the product due to complexity and confusion[1].

As currently proposed, the Base Premium Bill introduces a substantial new layer of complexity to private health insurance products that is likely to result in confusion for customers on an ongoing basis. In particular we are concerned about the requirement to list a base premium, which over time will become unrelated to the full cost of the product.

The Department of Health and Ageing has stated "Insurers will be required to develop and maintain a schedule of base premiums and full premiums for each product they offer…Insurers will be required to advise consumers about policy details as well as the base premium and associated Rebate in line with this measure"[2].

In practice this will effectively mean there are two sets of premiums for a product. The full premium will reflect the total cost to the customer, taking into account the product, state of residence and scale, prior to calculating Rebate eligibility, LHC loading and level of rebate applicable to the product. The second premium, the base premium, is only used in calculating the Rebate and will not relate at all to the amount paid by the customer.

The implications of this feature of the regulation will be felt by customers and potential customers anytime they want to make a change to purchase a new product or change an existing product. Customers will see two prices in advertising material, in marketing communications materials, and in premium quotes, with sales and service staff left to try to explain to the customer why there are two different premiums that seemingly apply to the same product.

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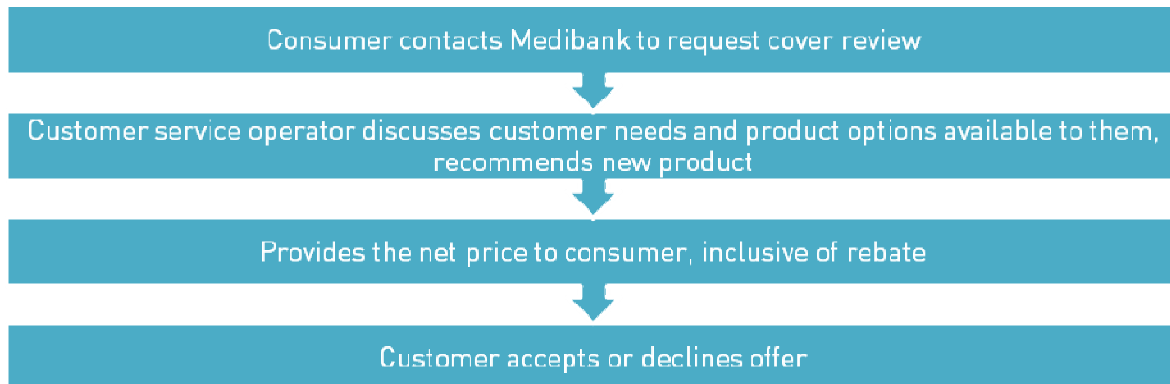
[1] IPSOS, *Health Care & Insurance Australia 2011*, p181

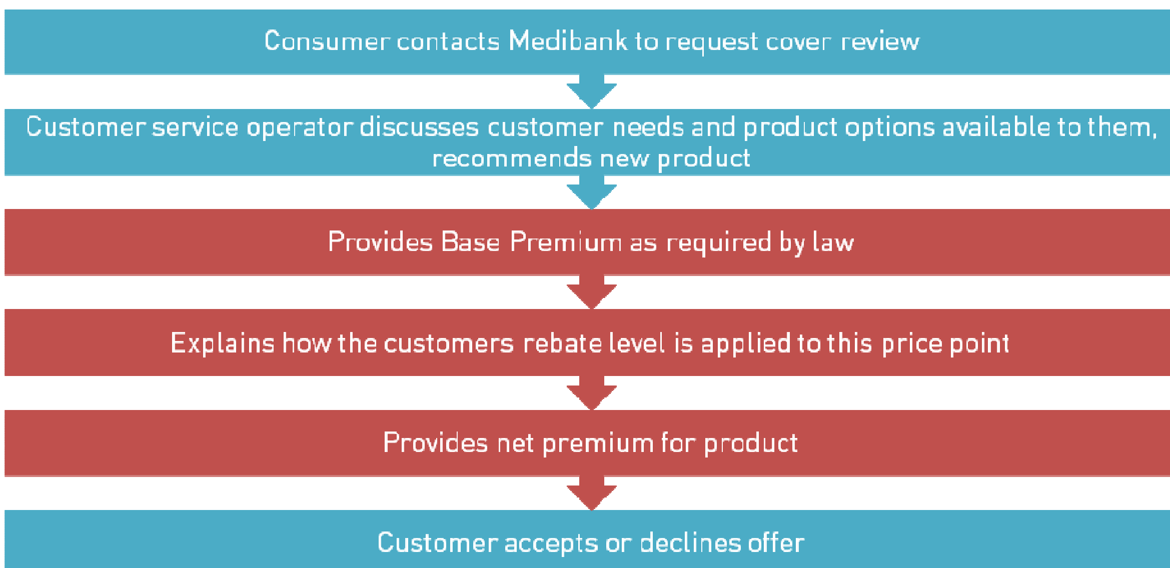
[2] DoHA, *Private Health Insurance Rebate: Indexing the Government's Contribution (CPI) and the Weighted Average Ratio (WAR)*, presentation to the PHIR Co-Design Workshop #4, 28 May 2013, p16.

Medibank has not been able to identify a similar dual pricing system in any other industry that might allow modelling of the impacts, however it is highly likely customers will find it misleading and not understand why they are being quoted two different prices or the technical rationale for this. They are likely to seek to deduct the rebate from the lower Base Premium and identify this as the price they should pay, misunderstanding that the net cost to them is different. It will also be difficult for customers to understand how the dollar reduction in the full price of the product is related to the nominal rebate percentage they are entitled to at their age and income level.

Consider a typical customer interaction such as a health cover review. Presently the complexity for the customer is in understanding the features and benefits of the products, identifying which suits their needs and comparing it too alternatives. Although this is far from a linear discussion, in simplified form this process looks something like this:



From 1 April 2014 there will be added layers of complexity related to explaining the Base Premium and explaining how the customer's level of rebate is derived.



As customers are likely to want to compare products within and between funds, and because each product will have different rebate percentages relative to the full cost of the product, they are likely to be confused. In practice this will create new barriers to entry and a muting of competition between funds as customers opt out of frustration to remain on current products, or to defer purchase.

Erosion of community rating

The concept of community rating underpins private health insurance in Australia. Community rating ensures that customers are not discriminated against on the basis of their health status by mandating all customers pay the same price for a given product. For example older people who are more likely to consume healthcare services and who in a risk-rated insurance environment would be considered a bad risk and charged a higher premium are, in a community rated system, charged the same premium as a younger person less likely to consume healthcare services.

An effect of the Base Premium Bill will be to undermine this principle. This will occur because of a product based indexation will accelerate the direct cost to customers on the products most used by older and less healthy people.

To grasp this impact it is first necessary to understand that due to the phenomenon of adverse selection higher priced comprehensive products tend to attract members who are more likely to claim – i.e. older and less healthy people. All other things being equal these products will tend to see higher premium increases over time than products with restrictions and exclusions that attract customers who are less likely to claim.

The higher premium increases will cause a faster divergence between the Base Premium and the full premium and, because the Base Premium Bill sets the rebate on the Base Premium only, overtime the proportion of the full premium covered by the rebate will diminish and the proportion paid by customers will increase.

This effect is represented below. Table 2 illustrates an exclusionary product that attracts people less likely to claim, while Table 3 illustrates a product where high benefit outlays leads to higher premium increases. As can be seen the rebate as a percentage of the full premium will drop on the product subject to higher benefit outlays and the net cost to customers will increase.

Table 2

Low benefit outlay product subject to lower premium increase							
Year	CPI %	Product Increase %	Annual Premium	Indexation Base Premium	Rebate Amount	Rebate as % of full premium	Net cost to customer
2013	-	-	$2,000	$2,000	$600	30.00	$1,400
2014	2.50	3.00	$2,060	$2,050	$615	29.85	$1,445
2015	2.50	3.00	$2,122	$2,101	$630	29.71	$1,491
2016	2.50	3.00	$2,185	$2,154	$646	29.57	$1,539
2017	2.50	3.00	$2,251	$2,208	$662	29.42	$1,589
2018	2.50	3.00	$2,319	$2,263	$679	29.28	$1,640

Table 3

Exclusionary product subject to higher premium increase							
Year	CPI %	Product Increase %	Annual Premium	Indexation Base Premium	Rebate Amount	Rebate as % of full premium	Net cost to customer
2013	-	-	$2,000	$2,000	$600	30.00	$1,400
2014	2.50	8.00	$2,160	$2,050	$615	28.47	$1,545
2015	2.50	8.00	$2,333	$2,101	$630	27.02	$1,702
2016	2.50	8.00	$2,519	$2,154	$646	25.65	$1,873
2017	2.50	8.00	$2,721	$2,208	$662	24.34	$2,059
2018	2.50	8.00	$2,939	$2,263	$679	23.10	$2,260

Apart from the direct equity and Community Rating issues a second likely effect of this is an increased propensity for customers to downgrade to cheaper exclusionary products. This may lead to these customers relying more on the public health system than they otherwise would have.

Implementation costs

Early indications are the product level implementation costs associated with the Base Premium Bill are substantial. A preliminary scoping of the changes required by the Bill include:

- a complete overhaul of premium calculation functionality across all Medibank IT and customer management systems
- redesign of all customer facing artefacts, incorporating websites and printed collateral
- significant and ongoing written and verbal communications with members to explain the nature of the premium change
- substantial staff training costs.

For Medibank alone the costs are expected to run to over $6 million. We anticipate each of the 35 funds across the industry would have similar costs. These will ultimately be passed onto customers in the form of higher premiums.

Alternative approaches

Medibank appreciates the Australian Government seeks to slow the rate of growth in the Australian Government Rebate and that indexing it to the CPI will achieve this. However we submit this goal can be achieved without adding to product complexity, adding to customer confusion, eroding Community Rating and customer equity or incurring the large implementation costs detailed above.

Industry level indexation

We suggest the concept of the Base Premium be removed from the Bill and the methodology of indexing be lifted from the product level to an industry wide level. This would see the current Australian Government Rebate levels adjusted annually. Each year the Rebate levels would be reduced by the difference between the growth in premiums and the change in CPI. For example, assuming annual inflation of 2.5 per cent and annual premium rises of 5 per cent, then over 5 years the industry wide rebate level for people currently receiving the 30% level of rebate would be reduced as illustrated in Table 4 below:

Table 4

Industry wide rebate indexation							
Year	CPI %	Industry wide average premium increase %	Rebate reduction factor %	New industry wide rebate	Annual Premium	Rebate Amount	Net cost to customer
2013	-	-	-	30.00	$2,000	$600	$1,400
2014	2.50	5.00	2.50	29.25	$2,100	$614	$1,486
2015	2.50	5.00	2.50	28.52	$2,205	$629	$1,576
2016	2.50	5.00	2.50	27.81	$2,315	$644	$1,671
2017	2.50	5.00	2.50	27.11	$2,431	$659	$1,772
2018	2.50	5.00	2.50	26.43	$2,553	$675	$1,878

The other rebate levels across the age and income categories would likewise be reduced by the same percentage.

A comparison with Table 1 earlier in this document illustrates that the outcome is essentially the same for customers and still creates the certainty of savings Government is seeking. However the alternative process reduces complexity for customers by simplifying the pricing conversation and, ultimately, boosts competition within the industry. It also preserves community rating by obviating the effect noted earlier in this paper.

Transparency benefits

The simpler and fairer system model proposed by Medibank places a premium on transparency. By making clear that indexation to CPI will lead to a gradual reduction of the rebate in real terms it will be aligned with the principles of best practice regulation. It will also mitigate any dissatisfaction amongst customers when they try to calculate their rebate percentage and find it is only maintained at the pre-indexation level when compared to the Base Premium concept created by the Base Premium Bill.

We recognise that for the Australian Government this level of transparency poses a communication problem. We therefore propose that this impact be mitigated by private health insurance funds driving greater visibility for the significant contribution Government makes to individual's private health insurance premiums. This can be done via a move to 100% price quoting.

Move to 100% price quoting

As a part of the alternative model, and in keeping with the approach to reduce complexity and customer confusion over pricing, Medibank advocates a move by the private health insurance industry to 100% price quoting. Currently the industry tends to quote and advertise prices that are 70% of the full cost. This is an artefact of the period when all Australian's were entitled to a 30% rebate on their product. With the advent of means testing this is no longer correct.

By way of a simplified example, the current scenario looks much like this:

- Customer sees advertising to purchase a private health insurance product at $70/month. Unless they read the caveats associated with this price they will most likely be unaware that actual premium is $100 reduced by the most common 30% rebate level.
- Customer transacts with insurer and will be charged up to $100 depending on their rebate eligibility.
- At best, they have purchased based on their expectation. At worst they have been charged an additional $30 (43%) higher than their expectation.

We propose an alternate scenario:

- Customer sees advertising to purchase PHI at advertised price of $100/month. This is the full price of the product.
- Customer transacts with insurer and will be charged a maximum of $100 down to $70 depending on their rebate eligibility.
- At worst, they have purchased based on their expectation. At best they have received a 30% discount, courtesy of the AGR.

This alternative scenario provides for a strong reference point in the transaction for eligible customers to see and clearly understand they are receiving a benefit from the Australian Government.

While there is no actual increase in customer cost with this approach, a shift to 100% pricing does nonetheless run the risk of lowering perceptions of affordability and therefor reducing private health insurance participation. However if bearing this risk is sufficient to offset the communication difficulties for Government associated with industry level indexation then it is worth consideration.

Lower implementation costs

Medibank estimates moving to an industry wide indexation approach would significantly decrease the number and cost of system changes and staff training costs, with savings to be in the order of 80% over the product based implementation model currently envisaged. We estimate savings across the industry would be of a similar magnitude.

Alternative two: fund level implementation

An alternative put forward by other segments of the industry is for fund level indexation. This model would still deliver the savings the Australian Government seeks but, whilst preferable to the product level indexation proposed in the Base Premium Bill, would still result in added complexity for customers.

Recommendations

- The Australian Government acknowledge the substantial additional complexity product based indexation will create for privately insured people.
- The Australian Government amend the legislation to shift indexation from a product based model to an industry wide model. We would be pleased to work with the Government to achieve this goal.