HIRMAA

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Submission

to the

Senate Standing Committee on Economics

Tax Laws Amendment (Medicare Levy Surcharge Thresholds) Bill 2008

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INTRODUCTION

HIRMAA is the peak industry body representing all thirteen restricted access private health insurers and three non-restricted insurers (Attachment A). HIRMAA funds exist because of their unique historical and contemporary links to various professions, trades, industries, unions or employers. They are *not-for-profit* organisations with nearly 380,000 contributors providing health insurance coverage for approximately 800,000 Australians.

Since its formation in 1978, HIRMAA has advocated for the preservation of competition, believing it to be fundamental to Australians having access to the best value health care services. HIRMAA has done this by:

- promoting legislation, regulations, policies and practices which increase the capacity of its member funds to deliver best value health care services; and,
- vigorously resisting the efforts of those who seek to gain by concentrating the provision of private health insurance into the hands of a few large insurers.

A number of characteristics distinguish the HIRMAA member funds. They:

- are value-based as opposed to being profit-based and are constituted to fulfill a social purpose rather than returning dividends to shareholders;
- optimize benefit entitlements and premiums as evidenced by the fact that their average benefit ratio is higher and their average management expense ratio is lower than the balance of the industry;
- offer insurance cover which is attuned to the requirements of their members at highly competitive premiums;
- continue to increase their membership at a faster rate than the balance of the industry;
- in the case of the restricted access insurers, have their unique nature acknowledged in the *Private Health Insurance Act 2007.*

HIRMAA is proud of the contribution it has made and continues to make. Of particular note it:

- founded and provides the majority membership of the Australian Health Service Alliance which is generally acknowledged as a highly effective negotiator of pricing agreements with hospitals and doctors and maintains the most comprehensive private sector health insurance database in the country;
- shares critical performance and operational information to promote enhanced efficiency and capability throughout its total membership;
- founded HAMB Systems Ltd, the software provider and developer for 23 insurers;
- provides objective input and underlying support to government and industry initiatives;
- provides an educational forum for its member funds and their staff; and,
- works cohesively and positively with the regulator, Ombudsman, Government and other relevant parties.

As part of HIRMAA's commitment to providing affordable and *value-for-money* policies and services, HIRMAA funds participate in an annual customer satisfaction survey. In summary:

- Eleven HIRMAA funds conducted member satisfaction research with their members in February 2008 to ascertain member satisfaction;
- This research was also conducted in 2006 and 2007, providing the funds with valuable year-on-year insights;
- Results were benchmarked across the 11 funds, enabling open discussions regarding best practice and opportunities for improvement;
- More than 13,000 members responded to the survey, providing quantitative feedback on

service delivery; and,
- The extremely positive results of 2006 and 2007 were replicated in 2008.

The **key findings** of the 2008 research are :

- 97% of members are satisfied with their health fund membership;
- 94% are satisfied with the level of communication from funds;
- 96% are satisfied with funds' telephone responsiveness;
- 95% are satisfied with written service (mail, fax or email) from their funds; and,
- 95% are satisfied with the speed of claim payments.

HIRMAA funds are committed to continuing this customer satisfaction research to ensure that the consumer *value proposition* is integral to the provision of private health insurance products by HIRMAA funds. HIRMAA would be pleased to share all findings of the 2008 research with the Committee.

INCREASE OF THE MEDICARE LEVY SURCHAGE (MLS) THRESHOLD

Community rating and the significance of Government incentives

The most fundamental characteristic of Australia's private health insurance is that a particular policy may be purchased for the same premium regardless of the age, gender, health condition, etc. of those insured. All Australians are rated as having the same health risk and insurers are prohibited from selecting low risk individuals and denying insurance to high risk individuals – the so-called 'community rating' policy.

An understandable consequence of this policy is that the young and healthy subsidise the old and sick. An equally understandable requirement is that there must be some external incentives for the young and healthy to purchase insurance, since insurers are required to structure and price policies for the average risk and the young and healthy, in the absence of external incentives, will assess their risk to be below the average. The subject MLS is one such external incentive.

The HIRMAA funds are very comfortable with the strength of the 'consumer proposition' underlying their insurance products and can point to higher than average membership growth. However, they are aware of the extent to which that proposition, in the case of the young and healthy, is dependent on the current Government incentives.

"Bracket creep"

The HIRMAA funds accept that the MLS has been the subject of 'bracket creep' due to the income thresholds not having been indexed. However, they are strongly of the opinion that the proposed increases are significantly in excess of those necessary to compensate for wage inflation. More reasonable thresholds which would be supported by the HIRMAA funds are $75,000 for singles and $125,000 for couples.

Loss of current contributors

The HIRMAA funds' best estimate is that on average, they will lose 3.5% of current contributors, being approximately 50% of the loss ratio quoted publicly by a number of insurers. HIRMAA's estimate is based on an analysis of policy ownership by age cohort and type of policy. The contributors who can be expected to most likely discontinue their insurance will be those who consider themselves to be healthy, particularly those under the age of 31years, since they do not fall within the ambit of the Government's Lifetime Health Cover initiative.

It is suggested that the HIRMAA funds' lower loss ratio is attributable to the strength of their underlying consumer proposition, the relative loyalty of the funds' members (largely due to the foregoing) and the fact that HIRMAA funds have not been designing and selling policies to achieve tax savings. We note that the latest *Choice* magazine rates hospital insurance products – NIB, MBF and GMHBA are rated as having the 'best value' products designed to eliminate the MLS.

Reduction in take-up

The HIRMAA funds estimate that there will be an average 4% reduction in the take-up of private hospital insurance. Again, the cohorts most affected will be those aged under 31 years for the reasons cited above.

Increase in average benefit payments

The expected loss of current contributors and the reduction in take-up by new contributors will have a disproportionately adverse effect on insurers due to those persons being, predominantly, young and healthy and therefore low claimers. The average risk of an average insured person will increase. Expressed alternatively, the funds will lose those who facilitate the cross subsidization necessary to support community rating.

Increase in risk equalisation payments

The HIRMAA funds are very concerned at what they assume is an unintended consequence of the proposed changes. The risk equalisation arrangements are fundamental to supporting community rating. In addition to the Government providing incentives for the young and healthy to purchase hospital insurance, it requires insurers to share a proportion of the relatively high benefit payments to older persons. The apportionment of these costs between insurers is on the basis of each insurer's relative membership.

The HIRMAA funds accept that the balance of the industry and, in particular a number of the large funds, will lose 7% to 10% of their current members. Their expected loss is twice that of the HIRMAA funds for the reasons cited above. As a consequence, the HIRMAA funds' combined market share will increase and they will be required to bear a larger proportion of the risk equalisation payments.

The figures below demonstrate the possible additional risk equalisation payments by HIRMAA funds based on a number of scenarios.

Potential loss of contributors (HIRMAA funds)	Potential loss of contributors (non-HIRMAA funds)	Additional risk equalisation costs to HIRMAA funds
0%	7%	$15.3M (22.3% increase)
3.5%	7%	$7.8M (11.2% increase)
3.5%	11%	$17.2M (25% increase)

The unintended consequence of the MLS change is an increase in risk equalisation payments by HIRMMA funds of $7.8 million, representing an 11.2% increase (based on the conservative 3.5% /

7.0% scenario detailed above.

It is unreasonable that the HIRMAA funds should bear additional costs due to them adopting a more responsible positioning of their products, in particular not promoting hospital insurance products on the basis of them being ‘tax effective’.

Limited capacity to bear reduced margins

The combined effect of a loss of current contributors, a reduction in the rate of take up, an increase in average benefit payments and an additional risk equalisation impost will place a heavy burden on health insurers. The impact will be particularly severe in the case of the HIRMAA funds given the thin margins on which they operate (due to their *not-for-profit* status and commitment to the value proposition). A reasonable assumption is that HIRMAA funds will be forced to maintain their financial viability by increasing premiums in April 2009 to a greater extent than would be the case if the increases in the MLS thresholds were only to the extent necessary to counter inflation.

Coincidence with poor investment returns

The effect of the magnitude of the increase in the thresholds is compounded by it coinciding with recent poor returns on funds’ investment portfolios, due in turn to the recent and current state of global and domestic investment markets.

CONCLUSION

The Government's proposed policy changes have the capacity to deliver serious consequences for the private health insurance industry, including the HIRMAA funds.

As stated above, the HIRMAA commitment to the underlying value proposition sees its funds having a higher benefit payout ratio and lower average management expense ratios than non-HIRMAA funds. As a consequence, these policies deliver *better-value-for-money* for HIRMAA members. At the same time, HIRMAA funds have less capacity or “buffer” to absorb economic shocks – especially when the shocks are multiple (direct loss of existing and potential Members, additional risk equalisation costs allied to significant declines in investment markets).

For HIRMAA funds, member premiums are essentially the only source of capital and sustained increases in benefit outlays can only be offset by increases in premiums.

PHIAC figures demonstrate that HIRMAA funds have been growing faster than other funds. They also play an important role in private health insurance sustainability as they generally have a much younger profile than other funds – ensuring cross subsidisation between the younger and the older within the industry and supporting community rating.

While HIRMAA member funds accept that there should be no ‘bracket creep’ and therefore accept that the MLS thresholds should be indexed, they are strongly of the opinion that too big an increase, compounded by its introduction at an inappropriate time will have an adverse impact upon the industry.

HIRMAA urges the Federal Government to reconsider its policy initiatives and to limit the MLS thresholds to $75,000 for singles and $125,000 for couples. These increases would be more in line with the general inflation in wages since its introduction.