



Institute of Actuaries of Australia

15 July 2008

Committee Secretary
Senate Economics Committee
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600
Australia

Email: economics.sen@aph.gov.au

Dear Sir/Madam

Inquiry into the Tax Laws Amendment (Medicare Levy Surcharge Thresholds) Bill 2008 - Impact on Financial Condition of Insurers

The Institute of Actuaries of Australia ("the Institute") is the sole professional body for actuaries in Australia, representing the interests of over 1,400 Fellows and 2,000 other Members.

As you would be aware, the Private Health Insurance Act 2007 formalised the requirement that each private health insurer have an Appointed Actuary, with the associated Rules specifying that insurers must seek the advice of the Appointed Actuary on matters affecting the financial condition of the insurance fund.

The proposed changes to the Medicare Levy Surcharge thresholds are expected to lead to a reduction in membership of private health insurers. Because of the operation of the Lifetime Health Cover regime, the membership reduction is expected by many observers to be concentrated towards younger and relatively lower claiming members, with older and higher claiming members typically being more incentivised to retain their cover, despite the MLS changes.

To support the sustainability of the community rating system for premium-setting in Australian Private Health Insurance, the Commonwealth Government operates (through PHIAC) a compulsory Risk Equalisation Scheme. The effect of this scheme is that if disproportionate numbers of young and lower claiming members leave the industry, every health insurer is likely to experience an increase in their total claim cost (i.e. net of risk equalisation).

In recognition of this possibility, the Institute has provided an Information Note to actuaries that indicates the potential impacts of these changes they should consider when providing advice to private health insurers. An extract of the Information Note to Actuaries is as follows:

"Impacts [on health insurer financial condition and outlook] to consider include:

- *Initial increase in policyholder lapses and ongoing reduction in policyholder joins, including impacts on both hospital and ancillary coverage and impacts for each product.*

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- *Impact of changing policyholder volumes on premium income, claims experience, drawing (claim) rates and risk equalisation.*
- *Consideration of the claims and product profile of those policyholders most likely to be affected by the changes including the likelihood that those lapsing would generally have more favourable claims experience but may also make additional claims immediately prior to lapse.*
- *Whether the insurer's risk equalisation costs ('calculated deficits') per Single Equivalent Unit may increase significantly following a decline in industry coverage, without significant change in the insurer's risk equalisation recoveries ('actual deficits'), and whether this will affect the risk equalisation component of Outstanding Claims Provisions.*
- *Allowance for the impact of the potential change on forecasts used to assess the Renewal Option Amount and Liability Adequacy Test (constructive obligations).*
- *Any need for increased risk margins in regulatory capital and target capital assessments.*
- *Whether the proposed changes must be taken into account in the best estimate business projections that will underlie the risk margins and liabilities in the 30 June 2008 company accounts. In this matter the actuary should consider what consultation is appropriate with the insurer's CFO and/or auditor.*

It is expected that consideration of the impact of the potential changes, including comments on sensitivities, would be included in the Financial Condition Report for the year ended 30 June 2008.

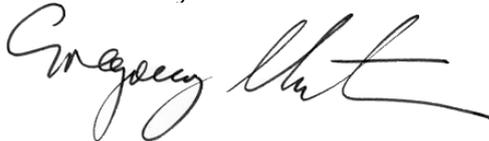
It is likely passing of the legislation will trigger a 'notifiable circumstance' under Rule 5(3)(j) of the Private Health Insurance (Insurer Obligations) Rules 2007.

If any Actuary is in doubt about the appropriate approach to advising their clients in these matters, they should consider consulting another suitably experienced actuary or a member of the Health Practice Committee."

Conclusion

We recognise that a number of areas within the Standing Committee's terms of reference are mentioned in the Information Note, and would be pleased to provide further evidence to the Committee on these matters, should you consider that desirable or helpful. Please do not hesitate to contact the Institute's Chief Executive Officer, Mr John Maroney (02 9233 3466; john.maroney@actuaries.asn.au).

Yours faithfully



Greg Martin
President