

Chapter 2

Key issues

2.1 As with most proposals to privatise or sell government owned entities, the government's decision to sell Medibank Private has attracted a range of comment, albeit not the same degree of controversy which has attended some recent sale decisions.

2.2 In evidence to the committee on the bill, concerns were raised in relation to Medibank's ownership and the government's right to sell it, the impact of the sale on Medibank's performance and the private health insurance market, protection of members and employees and the 'Australianess' provisions.

2.3 The committee has also taken account of concerns raised by the Scrutiny of Bills Committee report on a certain aspect of the bill.

2.4 Before examining these issues in turn, the committee notes the two main reasons for the government's decision to sell Medibank. The first is the lack of a sound public policy ground for the continued public ownership of a private health insurance provider in a mature and competitive market. As a related point, the Special Minister of State, the Hon. Gary Nairn, identified the possible conflict of interest which arises with a government-owned business operating in a market substantially regulated by the same government. Privatising Medibank removes such a risk.

2.5 The second reason for the sale is the importance of maximising competition in the private health industry with the consequent benefit of containing premiums.¹ Selling Medibank is expected to improve industry competition.

The question of ownership

2.6 The committee notes that some policy holders are of the view that Medibank is a unique public entity given that a significant portion of its financial reserves are derived from people who purchase policies. A number of opponents of the sale have questioned whether Medibank Private is the Government's to sell. Others have argued Medibank Private members possess rights which may stand in the way of the sale or entitle them to compensation in some form.² The committee considers these arguments misunderstand a number of points.

1 Second Reading Speech, Hon. Gary Nairn, *House Hansard*, 18 October 2006, p.6.

2 See, for example, *The Proposed Sale of Medibank Private: historical, legal and policy perspectives*, Research Brief, Parliamentary Library, September 2006, pp 18-26; Dr Ken Harvey, *Submission 1*, pp 6-7; Community and Public Sector Union/Save Medibank Alliance, *Submission 7*, p.6.

2.7 Medibank Private Limited is a public company listed by shares registered under the *Corporations Act 2001*. In this regard, it is no different to any other public company trading in Australia today, except that all 85 000 100 shares in the company are legally and beneficially with the Commonwealth. Ownership of, and responsibility for, Medibank was demonstrated most recently in 2004, when a capital injection of \$85 million was made by the Commonwealth to bring the capital structure of the company in line with industry practice.

2.8 On the question of members' (or contributors') rights, the Department of Finance and Administration told the committee:

... Medibank Private contributors will not be entitled to compensation on the sale. The government's legal advice is clear that Medibank Private contributors do not own an interest in the fund'.³

2.9 The government sought from Blake Dawson Waldron independent legal advice on the ownership of Medibank Private, as well as the Commonwealth's right to sell. The advice makes plain that the Commonwealth owns Medibank Private, and subject to the enactment of amendments contained in the bill before the committee, is free to sell its shares. Blake Dawson Waldron also considers that both legal and beneficial ownership of Medibank Private vests in the Commonwealth, thereby removing any right of claim by contributors against assets held by the company.⁴

2.10 This point deserves emphasis. A member of Medibank Private pays a premium in return for a product, in this case coverage against prescribed medical expenses. Medibank Private invests the premium revenues, generating a surplus that is used to make payouts to members as and when claims are accepted. The assets comprising the Medibank Private fund do not belong to the contributors. Nor do they belong to the Government. Although the Commonwealth owns Medibank Private, the assets comprising the fund are held by the company as an independent legal entity and not by any shareholder.

2.11 Unlike Medibank Private, some health insurance providers operate as 'mutual funds', whereby contributors buy an interest in the assets of the provider in addition to their insurance policy. The contributor becomes a part owner in the insurer itself. The rules which exist for each insurer make their status clear. Medibank Private has many contributors, but only one shareholder.

2.12 Members have a straightforward commercial relationship with Medibank Private and can in no way consider that their premiums are buying them a stake in the company or in the fund. To claim otherwise would be to say that a customer in a shop

3 Mr Butterworth, *Committee Hansard*, p.64.

4 Mr Tom Bathurst QC, Blake Dawson Waldron, 4 September 2006, "Parliamentary Library Research Brief, *The proposed sale of Medibank Private: historical, legal and policy perspectives*", tabled in the Senate, 4 September 2006.

believes that, in buying an item across the counter, they are also buying the shop. This is clearly not the case.

Competition and market effects

2.13 A common concern of those opposed to the sale has been that privatisation would lessen Medibank's ability to continue providing competition in the market, particularly through being a 'price setter'. Opponents of the sale have also questioned the nature and extent of possible efficiency gains resulting from Medibank's sale, as well as the associated impact these would have on Medibank's competitiveness with other funds. Dr Deeble argued the potential benefits were purely hypothetical and there was little evidence to support claims of increased efficiency. This was because, he said, the number of comparable 'for profit' health funds was small and thus the competition effects of the sale would be limited.⁵

2.14 On the other hand, Dr Deeble also concluded that under current proposals competition was unlikely to be affected adversely by the sale. The Australian Competition and Consumer Commission also supported this view.⁶

2.15 It needs to be noted that Medibank Private is already a market pace setter in efficiency and innovation.⁷ Of particular note has been Medibank's success in negotiating with health providers on the basis of its bulk buying power.⁸ This has brought gains for members in the form of contained premiums and served as a model for other private health insurers in the way they approach their business. Medibank Private is also highly competitive in terms of the ratio of revenue it spends on management, its member retention, and its very high market share.⁹

2.16 There is no reason why this should not continue under private ownership. Indeed, it is difficult to imagine a circumstance where future owners would risk their investment by running the company less competitively than its current managers.

2.17 A report by CRA International into the impact of privatisation on Medibank Private and health premiums found that efficiency gains are achievable and could bring down premiums. In summarising the results, the report stated:

A privatised Medibank Private would be able to actively and flexibly pursue all opportunities to achieve available efficiency improvements. On the basis of our modelling results we suggest that privatisation has the potential to allow Medibank Private to achieve additional efficiency

5 *Submission 5*, p.8.

6 Dr Deeble, *Submission 5*, p.13; Australian Competition and Consumer Commission, *Submission 6*, p.8.

7 Research Brief, pp. 32-35.

8 See, for example, Mr Morphy, *Committee Hansard*, Friday 3 November 2006, Canberra, p.61.

9 Research Brief, p.29.

improvements equal to 5 to 7 per cent of its existing costs. Approximately 1 percentage point of this efficiency gain would be required post-privatisation to allow Medibank Private to earn a pre-tax market rate of return on assets. The 4 to 6 percentage point residual could be applied to lowering real PHI [private health insurance] premiums.¹⁰

2.18 CRA is not alone in reaching these conclusions. Mr George Savvides, Chief Executive Officer of Medibank Private, has publicly acknowledged the possibility of even greater goals being achieved by the business under a different ownership model.¹¹ Other commentators have speculated on the possible benefits for Medibank through its expansion of business operations, both within the health insurance and in other insurance and financial markets.¹² The devolution of the business from government to private hands is the most efficient and successful method of achieving this type of expansion.

2.19 The sale of Medibank Private will also reduce the administrative burden on the business, as it will not longer be required to comply with the obligations befalling Government Business Enterprises, including extensive additional reporting requirements. This will enable Medibank to compete on an equal footing with other health insurance providers which are not subject to these obligations. It would also free Medibank Private to concentrate on its core business: the provision of competitive, efficient health insurance.¹³

2.20 Taking the above factors into consideration, the committee is satisfied there is no basis for concluding that competition between funds will be adversely affected by the sale. On the contrary, equalising the status of Medibank Private with other providers in the market promises to enhance competition and keep downward pressure on premiums.

The protection of members

2.21 The sale will not result in any reduction in the surety of the insurance product sold by Medibank Private. The capital adequacy and solvency provisions, which all private health insurers must meet, remain untouched by the bill. Medibank Private will be no less safe and solid than any of its competitors.

10 The impact of privatisation of Medibank Private on private health insurance premiums, CRA International, 31 October 2006, prepared for the Department of Finance and Administration, p.1.

11 Mr George Savvides, *Sale time for Medibank Private?*, Business Sunday television broadcast, October 23 2005, transcript available at <http://businesssunday.ninemsn.com.au/article.aspx?id=68145>.

12 See, for example, K. Harvey, *The sale of Medibank Private*, New Matilda, March 2006, p.3.

13 See, for example, Health Insurance Restricted Membership Association of Australia, *Submission 2*, p.2.

2.22 A raft of other measures and safeguards will also continue to protect fund members. The Minister for Health has wide-ranging powers in relation to health funds, all of which are directed at protecting the interests of policy holders. Mr Maskell-Knight, from the Department of Health and Ageing, listed some of these powers:

The minister has power to disallow rule changes and premium increases and to determine rules around gap cover schemes, loyalty bonus schemes and discounts on premiums. The minister has power to determine minimum default benefits and prostheses benefits. The minister has power to declare what is and is not a hospital or what is or is not a day hospital facility. He has power to seek to set performance indicators for the industry, to seek explanations from health funds, to investigate health funds, to seek enforceable undertakings from health funds, and to revoke their status as a participating insurer for the purposes of the 30 per cent premium reduction scheme.¹⁴

2.23 The quality of the insurance coverage offered by a privatised Medibank Private will remain protected. The committee received from the Private Health Insurance Ombudsman a submission which made his role in safeguarding members' rights clear. Any consumer dissatisfaction with service standards after the sale would likely result in more complaints to the ombudsman. The ombudsman is empowered to investigate complaints and report or make recommendations to funds following an investigation. The ombudsman may also report to the minister or the department on the conduct of a health fund. The ombudsman, Mr Powlay, noted the government's undertaking to maintain levels of service for policy holders in rural and remote Australia, and reported his intention to closely monitor the sale process to ensure standards of service in the bush were maintained.¹⁵

2.24 The ombudsman also reminded the committee that significant protections are in place to monitor increases in health premiums. Mr Powlay said that he had applied these protections appropriately in the past and that he would continue to oversee their application in the future.¹⁶ Furthermore, the ombudsman submitted that his office has sufficient powers and resources to carry out this role.¹⁷

2.25 Ms Ginnane from the Private Health Insurance Industry Administration Council (PHIAC) echoed the ombudsman's remarks when she said the council would continue to apply the same level of scrutiny to a privatised Medibank Private as it has received under Commonwealth ownership. Ms Ginnane left the committee in no doubt as to the rigour with which her office carries out its responsibilities:

14 *Committee Hansard*, Friday 3 November 2006, Canberra, p.10.

15 Private Health Insurance Ombudsman, *Submission 3*, p.2.

16 *Committee Hansard*, Friday 3 November 2006, Canberra, pp.1-2.

17 *Committee Hansard*, Friday 3 November 2006, Canberra, p.3.

PHIAC establishes prudential standards that they [private health insurance funds] must conform to. As I said, the issue for us is making sure that organisations that are in the industry are well managed and financially sound. We have a fairly limited sense of humour with organisations that breach those prudential standards.¹⁸

2.26 The committee notes the important role played by the Private Health Insurance Ombudsman and the Private Health Insurance Industry Administration Council in monitoring the conduct of health funds, especially in relation to increases in premiums. Along with extensive regulatory protections, these two offices will continue to provide a high degree of oversight and protection for members of a privatised Medibank.

The protection of employees

2.27 The Community and Public Sector Union/Save Medibank Alliance expressed concern that the sale of Medibank Private would lead to reduced security for Medibank employees.¹⁹ The committee appreciates that the prospect of changed ownership may be unsettling for staff but believes the union's concerns are unfounded.

2.28 For one thing, the bill presages no dilution in the entitlements and protections currently afforded Medibank's employees.

2.29 As described above, Medibank Private Limited is a public company limited by shares and existing employees work for this entity. The mere fact of Commonwealth ownership makes no difference to the legal position of its employees. Nor would the transition of ownership to private hands. Indeed, the restrictions which the bill places on foreign ownership and on the maintenance of Medibank's health insurance business provide safeguards which, while possibly not restricting commercial decisions in the long term, serve to protect against radical implementation of any changes in the short and medium term.

2.30 Medibank Private's representative at the committee's public hearing reassured the committee that employees were being kept abreast of developments with regard to the sale. Mr Morphy, manager of corporate development for Medibank, said that:

In relation to staff we have an extensive infrastructure for staff communications. It involves staff forums which are face-to-face. We have a phone-link process where we can have phone calls with our staff and we have a staff Q&A process where staff can ask questions; we have an intranet process where we post information and staff can obviously read it; we have a publication called *FYI* where we group together key issues and put that out as a publication through the business; and we have an email campaign that is actually called 'From George's Desk' where Mr George

18 *Committee Hansard*, Friday 3 November 2006, Canberra, p.7.

19 Community and Public Sector Union/Save Medibank Alliance, *Submission 7*, p.2.

Savvides would update people on any key issues that are in the business. So, it is a very extensive process of staff communication.²⁰

2.31 The committee notes these measures provide appropriate channels by which staff can keep themselves informed and also raise any concerns or questions they might have about the implications of Medibank's sale.

'Australianess' provisions

2.32 The bill imposes restrictions to ensure the company must remain incorporated and managed in Australia and not be broken up. No one shareholder (including associated entities) may hold more than 15 per cent of the company, and the majority of board members must be Australian citizens.

2.33 These 'Australianess' provisions protect against a variety of avoidance measures; interest in a share, for example, is very broadly defined and includes any legal or equitable interest whatsoever.²¹ Enforcement mechanisms are provided in the form of remedial orders to be issued by the Federal Court of Australia.

2.34 These restrictions on ownership and control cease to apply after five years.

2.35 The committee considers that this period will give Medibank the time it needs to establish itself as a fully independent and equal player in the market, while at the same time lending stability to protect the interests of members and employees.

Scrutiny of Bills Committee findings

2.36 The committee notes Alert Digest 13/06 arising from the deliberations of the Scrutiny of Bills Committee in which that committee raises concerns about the uncertainty which could arise were the Government not to sell all its Medibank shares in the short term.²² The Scrutiny of Bills Committee also expresses its concern that, as they stand, the provisions may trespass unduly on personal rights and liberties. It goes on to express its preference for a time limit for the sale to be set, and seeks the minister's advice whether this could occur.

2.37 The Minister for Finance and Administration responded to the issues raised by the Scrutiny of Bills committee on 20 November. In his letter, Senator Minchin explained the timing of the sale had yet to be fixed. He said market conditions are an important factor in timing the sale to optimise the outcome and should be left for the minister to determine.

20 *Committee Hansard*, Friday 3 November 2006, Canberra, p.57. See also answer to question on notice, 'Communications strategy', received from Medibank Private on 23 November 2006.

21 Second Reading Speech, p.6.

22 Alert Digest 13/06, tabled in the Senate 8 November 2006, p.28.

2.38 The committee understands the basis of the Scrutiny of Bills committee's concerns and agrees the practises which the committee promotes should be observed in general. However, this committee also accepts the minister's reasoning and concludes that, in this instance, the most practical course has been taken.

Recommendation

2.39 The Committee recommends that the bill be passed unamended.

**Senator Mitch Fifield
Chair**