

The Senate

Standing Committee on
Finance and Public Administration

Medibank Private Sale Bill 2006 [Provisions]

November 2006

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Senate Finance and Public Administration Committee

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Chapter 1

Introduction

Background

1.1 The Medibank Private Sale Bill 2006 (the bill) was introduced into the House of Representatives on 18 October 2006 by the Special Minister of State, the Hon. Gary Nairn MP.

Reference of the bill

1.2 On 19 October 2006, the Senate adopted the Selection of Bills Committee Report No. 12 of 2006 and referred the provisions of the bill to the Senate Finance and Public Administration Standing Committee for inquiry and report by 27 November 2006.

Purpose of the bill

1.3 The purpose of the bill is to implement the Government's policy in relation to the sale of Medibank Private, primarily through the amendment of existing arrangements which render Medibank a 'not for profit' Commonwealth Business Enterprise. The passing of the bill is intended to establish a framework to give the Government the flexibility it needs to sell Medibank in the method and form best suited to the achievement of its objectives. These objectives include:

- to contribute to an efficient, competitive and viable private health insurance industry;
- to maintain service and quality levels for Medibank Private contributors, including in rural and regional Australia;
- to ensure the sale process treats Medibank Private Limited employees in a fair manner, including through the preservation of accrued entitlements;
- to minimise post sale residual risk and liabilities to the Commonwealth; and
- having regard to the other objectives, to maximise the net sale proceeds from the sale.¹

1.4 The bill also sets out a number of other conditions for the conduct of the sale, and for exemptions from other legislation which are necessary for the sale to proceed according to the objectives set out above.

1 Explanatory Memorandum, p.2.

Submissions

1.5 The committee advertised its inquiry in *The Australian* on 25 October 2006. In addition, the committee contacted a number of individuals and organisations in writing alerting them to the inquiry and inviting them to make a submission. A list of submissions received appears at Appendix 1.

Hearing and evidence

1.6 The committee held a public hearing at Parliament House, Canberra on 3 November 2006. Witnesses who appeared before the committee at the hearing are listed at Appendix 2.

1.7 Copies of the Hansard transcript from the hearing are tabled for the information of the Senate. It can be accessed on the internet at <http://aph.gov.au/hansard>.

Acknowledgment

1.8 The committee wishes to thank all those who assisted with its inquiry.

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**

Opposition Senators' Report

Introduction

1.1 Opposition senators are concerned that the Government's stated reasons for selling Medibank Private have been asserted rather than demonstrated or substantiated.

1.2 The Government has asserted that private health insurance members will enjoy 'downward pressure on their premiums'. Until the release of the CRA International Report, the Government had failed to release any evidence to support this claim. It had previously told Labor that a separate scoping study included modelling which came to this conclusion, but has repeatedly refused to release the study, claiming it was not policy to release that documentation in relation to asset sales.

1.3 During estimates hearings for the Department of Health and Ageing, a representative of the Department of health and Ageing dismissed remarks about the sale's impact on premiums as 'pure conjecture and speculation'.¹ Later that afternoon, the Minister for Finance and Administration released the CRA report, which stated that 'Medibank Private's premiums will have to rise irrespective of who owns Medibank Private'.² The report also states that, if privatised, Medibank's technical efficiency could be improved and that this could result in lower premiums. However, the report fails to mention that, as a 'for profit' fund, the benefit of any efficiencies would also be directed to shareholders, and not to members, as is currently the case.

1.4 The Government asserts that the sale will increase competition in the private health insurance market. Again, because it is allegedly contained in the scoping study, evidence to support this contention has not been produced.

1.5 For the first five years after the sale, the company will be protected from any international takeover, although this protection ends after this period leaving Medibank open to overseas interests. However, within this period another Australian fund would be at liberty to launch a bid, subject to the likely interest of the Australian Competition and Consumer Commission.

1.6 The Government also asserts that privatisation will liberate the fund from administrative requirements associated with government ownership. Currently, these requirements include an annual corporate plan and statement of intent. A float would not lessen these reporting requirements but require the fund to report to the market

1 Mr Charles Maskell-Knight, Senate Community Affairs Committee, *Proof Estimates Hansard*, 1 November 2006, p.14.

2 CRA International (commissioned by the Department of Finance and Administration), *The impact of privatisation of Medibank Private on private health insurance premiums*, 31 October 2006, p.1.

rather than the minister. In any case, current reporting requirements do not appear to have had an impact on Medibank's ability to keep its expense ratio below ten per cent, less than MBF, HCF and HBF.

1.7 The Government also asserts that the sale will allow Medibank Private access to other insurance markets. Medibank already offers products in other markets, for example travel insurance, under its own brand. Insurance products not related to private health insurance must be underwritten by another company. This has no bearing on Medibank's ownership. It is a feature of industry regulation.

1.8 Opposition senators also put on record their disappointment at the lack of responsiveness of the Department of Finance and Administration to questions taken on notice. The committee was told early in the inquiry process that DOFA is the lead agency for the sale of Medibank. However, DOFA not only declined to provide a written submission to the inquiry but also failed to provide answers to questions on notice in time to allow consideration of them, despite repeated calls from the secretariat.

1.9 Apart from hampering the committee's examination of the bill, this apparent delaying strategy has merely compounded our concerns that the Government is withholding information relevant to Medibank's sale. The department's failure to provide answers within a reasonable time also highlights the unrealistic timeframe the Government forced upon the committee for considering a bill of major significance to the health insurance market, not to mention the almost 3 million Australians who are Medibank Private members.

Ownership of Medibank Private

1.10 Resolving whether the Commonwealth Government has the legal right to sell Medibank Private is central to the examination of the bill. Contrary to the Government's simplistic analysis of ownership, opposition senators consider the Commonwealth's ability to sell Medibank Private is anything but clear cut.

1.11 The management of Medibank Private was transferred to Medibank Private Limited in March 1998. Two months later the Commonwealth became the sole shareholder in Medibank Private Limited. Further shares were purchased by the Commonwealth in 2005. The Commonwealth is therefore the owner of Medibank Private Limited and can treat that company as its property.

1.12 That is not at issue. What is open to question is whether the Commonwealth has the lawful right to sell Medibank Private Limited's assets.

1.13 The *National Health Act 1953* (Cth) (the Act) allows Medibank Private Limited to apply, invest and manage the assets of Medibank Private.³ The Act draws a distinction between the two entities. The Commonwealth may be the legal and

3 Subsection 73AAC(1) *National Health Act 1953* (Cth).

beneficial owner of Medibank Private Limited, however, the beneficial ownership of Medibank Private could be considered a separate issue and would be determined according to who has the right to control Medibank Private and is entitled to its residual earnings.⁴

1.14 Medibank Private Limited manages Medibank Private but it does not have the right to control significant aspects of the fund. Most importantly, the Commonwealth has imposed legislative restrictions on Medibank Private Limited in relation to the selling of assets and distribution of profits. Distribution of profits would only be permissible if Medibank Private Limited had been *established for profit*. Additionally, Medibank Private Limited is obliged to give priority to the interests of members of Medibank Private. These factors indicate that the Commonwealth's right to control the fund is subject to the statutory rights and interests of the members of Medibank Private. In such a case, it would be difficult to maintain that the Commonwealth is the owner of Medibank Private.

1.15 The members of Medibank Private have no apparent right to control the fund. Control of the fund by the members would be impracticable and contrary to standard commercial practice. It would also be unnecessary.

1.16 However, the members of Medibank Private have substantial statutory rights in relation to how Medibank Private is managed by Medibank Private Limited, including the right to benefits, investments being made on behalf of the fund, and for the non-distribution of profits.⁵ Members have joined Medibank Private on the understanding that they are entitled to these statutory protections. Medibank Private's assets are undoubtedly protected to provide for members' needs and to prevent Medibank Private Limited from otherwise stripping the fund of its assets. In view of the relevant provisions of the Act, there is an argument that the beneficial owners of Medibank Private are its members.

1.17 Opposition senators are aware of the proposition that Medibank Private is a 'mutual organisation' owned by its members. The test for mutuality is similar to that of beneficial ownership.⁶ It is therefore possible that the members of Medibank Private are the legal and not just the beneficial owners of the fund. This is not inconsistent with the classification of Medibank Private as a government controlled 'not for profit' organisation.⁷

4 *The Proposed Sale of Medibank Private: historical, legal and policy perspectives*, Research Brief, Parliamentary Library, September 2006, p.18, discussing H. Hansmann, *The Ownership of Enterprise*, Harvard University Press, Cambridge, MA, 1996. See also, *Wood Preservation Ltd v Prior* [1969] 1 WLR 1077 cited in *Commissioner of Taxation v Linter Textiles Australia Ltd (in liquidation)* [2003] FCAFC 63.

5 Subsection 73AAD *National Health Act 1953* (Cth).

6 Research Brief, p.21, discussing *Faulconbridge v National Mutual General Insurance Association* [1952]1 Lloyd's List Law Reports 17, cited in *Re NRMA Ltd: Re NRMA Insurance Ltd* [2000] NSWSC 82.

7 Research Brief, p.23.

1.18 Finally, the opposition senators note the attempted equation of Medibank Private to other types of insurance or product.⁸ This is arguably ill founded. Members of Medibank Private enjoy statutory rights, which arise through their membership of the fund and which are protective in nature. These rights are not comparable to consumer rights which arise upon breach of alternate statutory or common law.

1.19 At best, this leaves the ownership of Medibank Private unresolved, and the committee has credible evidence that members of the fund may well have a right of claim against its assets. If the sale proceeded as planned, the implications of such a claim being subsequently found to exist would be disastrous. Even if other arguments in favour of sale are accepted, opposition senators plead common sense in calling for the question of ownership to be more thoroughly examined before the sale process proceeds any further.

Impact on the industry

1.20 Opposition senators are keenly aware that the proposed sale of Medibank Private raises a number of critical considerations, not least its impact on members' interests, market competition and industry viability.

The primacy of members

1.21 The Government asserts that Medibank Private Limited's conversion to a 'for profit' company will not affect contributors because it will still have to comply with its prudential obligations, namely solvency and capital adequacy standards. This argument acknowledges the members' fundamental interest in the asset position of Medibank Private. It also presents a very limited view of members' rights. At the very least, it is questionable whether it is in the members' best interests for Medibank Private Limited to maintain only minimum statutory requirements.

1.22 Medibank Private Limited is obliged, under the National Health Act, to give 'priority to the interests of the contributors to the fund'.⁹ The interests of the contributors do not necessarily entail devolving assets belonging to Medibank Private. As Mr Peter Kirby, Chairman of Medibank Private has stated, 'investing in the business ...ensure[s] we are equipped to serve the future needs of our members'.¹⁰ The devolution of assets would likely lead to rising premiums for members, which could never be said to be in their interests.

1.23 Opposition senators note that any public interest test or ministerial discretion over the change in profit status has been excluded by the bill. Were it not excluded by the bill, section 78 of the National Health Act provides that a change in profit status shall be a disallowable instrument, and subject to parliamentary scrutiny. The

8 Medibank Private Sale Bill 2006, Bills Digest No. 47, Parliamentary Library, 30 October 2006, p.3.

9 Subsection 73AAC(1) National Health Act 1953 (Cth).

10 Medibank Private, *Annual Report 2006*, Melbourne, 2006, p.4.

provision also entitles the Minister for Health to disallow the change on public interest grounds. This means that Medibank's change in status from a 'not for profit' to a 'for profit' will occur without the checks and balances which would normally apply.

The level of premiums

1.24 The Australian Medical Association, for one, considers premiums will rise in the event of a sale.¹¹ Opposition senators agree increases are likely. No-one can predict with any certainty what members' future needs would entail. Based on an examination of industry wide trends, it is highly likely that Medibank Private will increasingly require the benefit of its assets. The Act maintains the assets of Medibank Private for this very purpose.¹² If the assets were no longer available, then alternative funds would need to be sourced. A scenario of this kind would threaten Medibank Private's viability as an efficient and competitive private health insurance provider.

1.25 One important variable in this regard is the level of membership. It is difficult to predict how many members will remain with Medibank Private on completion of the sale. The bill provides for members of Medibank Private to 'opt out' of the fund but the Commonwealth is undoubtedly relying upon existing members to remain with Medibank Private. There is no guarantee that current membership levels will be maintained. If a significant number of members did choose to transfer their membership to another health insurance organisation, then Medibank Private would lose its dominant market position and the industry wide influence that position entails.

1.26 Mr Tim Morphy, representing Medibank Private, confirmed that premium levels were determined by the cost of health services, and not by ownership. He also confirmed that there was no guarantee the sale would lower premiums.¹³ The representative of the Department of Health and Ageing was similarly unable to offer the committee any assurances, saying that predictions about premiums after the sale were mere speculation.¹⁴

Value for money and the broader role of Medibank Private

1.27 The impact of sale will extend further than rising premiums. Medibank Private has traditionally played a role in promoting broader community interests in addition to those of its members. This has included support for 'community rating', as opposed to 'risk rating', to achieve a balance between social justice and community need. In that role Medibank Private has also provided informed analysis and advocacy based on the principles of universality and equity. Medibank Private appears to play an instrumental and possibly otherwise overlooked moral role as the 'conscience of the

11 Australian Medical Association, *Submission 8*, p.3.

12 Subsections 68(2)(b)(ii) and 73AAAC(2) *National Health Act 1953* (Cth).

13 Mr Tim Morphy, *Committee Hansard*, Friday 3 November 2006, Canberra, p.61.

14 Mr Charles Maskell-Knight, *Committee Hansard*, Friday 3 November 2006, Canberra, p.11.

industry'.¹⁵ If Medibank Private is privatised, then this voice will be lost. In the absence of further regulation, private health insurers might then conduct private health funds with less regard to consumers' interests. This was at the heart of one argument put by the Community and Public Sector Union:

We do not believe that Medibank Private is just another asset for a government to sell. We believe it is a living part of our own health system. We believe it provides very important ballast in that system and, if you like, it helps keep the whole system balanced and afloat. If there is a change to Medibank Private, which is envisaged at the moment by this government, then the whole system is going to change. I think the evidence that you are starting to hear from various experts is starting to show you that other pressures will start to emerge once there is a change in the way that Medibank Private operates in the market.¹⁶

1.28 The Government's argument that there is no public policy basis upon which to retain ownership of a private health insurer does not stand up to even rudimentary analysis. This government has regulated private health like no other. Formerly a Health Insurance Commissioner and eminent health economist, Dr John Deeble's comments in relation to this are worth noting at length:

In fact, the policy interest in private health insurance is now far greater than ever before. Why would this not include a public presence in the private insurance market? There are at least two major arguments for that presence. The first is the conventional one that it that it would not only be a competitor in financial terms but could also lead in developing products of benefit to its members in terms of healthcare outcomes, not simply money. The present government has actually gone much further in controlling the financial affairs of private insurers than was ever contemplated through Medibank Private's presence. However, its proposals have still placed great emphasis on the competitive advantages of a privatised, profit seeking [Medibank Private], although that seems to reflect more ideology than evidence.

The second and in my view much more important argument, is that [Medibank Private's] presence affirms the broader public interest in private health insurance. I have always believed that Medicare is a national system of health care financing which includes the private sector and its insurers, not just a Commonwealth scheme of benefits for medical care and public hospital treatment. The two parts are complementary in ways which go beyond the market place, although there are vested interests with a reason to argue otherwise.¹⁷

15 Dr John Deeble quoted in *Sale time for Medibank Private?*-Business Sunday, transcript, television broadcast, Nine Network, 23 October 2006.

16 Ms Gillespie, *Proof Committee Hansard*, Friday 3 November 2006, Canberra, p.39.

17 Dr John Deeble, *Submission 5*, pp.5-6.

1.29 Dr Deeble went on to argue that comparisons between Medibank Private and BUPA, the largest 'for profit' fund in Australia, do nothing to demonstrate the good sense in selling Medibank, particularly from the consumer's perspective. A critical factor is the change in tax status which is part and parcel of becoming a 'for profit' entity. Dr Deeble argued that:

BUPA is an efficient organisation and a commercially successful one, although if profitability as measured by 'net margin' is the test, MBF was even better. However maximising size, profits or return on funds are surely not the major public interest criteria for a publicly-supported health insurance fund. Value-for-money must count more. BUPA charges higher premiums and pays a lower proportion of its revenue as benefits than MPL. Its administrative expenses are a little lower but they have to be because BUPA has a tax liability which MPL does not. Its pre-tax profit margin was therefore nearly 60% higher than that for MPL, for a very similar post-tax result. How could this outcome be seen as more in the public interest than the present? The Treasury would certainly gain from the privatisation of MPL but the customer would not. In fact, the import of these figures is actually the opposite of what is often claimed. The only logical conclusion is that it is the tax-exempt status of the non-profit funds which has held premiums down, not the incentives of for-profit operation.¹⁸

1.30 The AMA views the devolution of assets, as well as the increased tax payable by a 'for profit' entity, as creating a financial hole which would require filling from other sources; most likely members' pockets, through increased premiums or reduced member benefits:

It is obvious that a buyer would have to put up equity funds and that this equity will have to be serviced (dividends paid). There is market speculation that Medibank Private could attract bids of between \$1 billion and \$2 billion. The AMA is not in a position to independently assess whether this is a likely range but it serves to illustrate the point. If it is assumed that a buyer will seek a rate of return of 15 per cent per annum EBITA (earnings before interest, tax and amortization), then it follows that Medibank Private would have to generate an extra \$150 million to \$300 million [per annum] in net revenues to service the equity. Where would this extra money come from?¹⁹

1.31 Proponents of the sale argue that privatisation of Medibank Private Limited will enhance Medibank Private's competitive edge. One of Medibank Private's most competitive advantages is that it is managed by the Commonwealth. Members have the comfort of knowing that their interests will be advanced as part of broader policy objectives. This is quite different to 'for profit' health insurers, which are normally motivated primarily by profit. Medibank Private offers its members a distinguishable choice of insurer, which makes it a real competitor within the industry.

18 Dr John Deeble, *Submission 5*, p.11.

19 AMA, *Submission 8*, p.3.

1.32 The Commonwealth's unique position also works to its advantage. As the owner of Medibank Private, the Commonwealth has substantial influence within the industry, including in relation to premium levels and contract bargaining, and independent of its regulatory abilities. The private health industry is already complex and highly regulated, which is sometimes said to stymie innovation and competition.²⁰

1.33 The Government has argued privatisation will reduce administrative requirements, boosting competition. This is not necessarily true. While Government Business Enterprises reporting requirements would no longer be relevant, as with all publicly listed companies Medibank Private Limited would instead have to regularly report to its numerous shareholders. It could be argued this will simply put Medibank Private on the same footing with other private health insurers, rather than provide a competitive advantage.

1.34 It is mere supposition that administrative requirements, and hence operating costs, will be reduced upon sale leading to greater efficiency within Medibank Private and enhancing industry competition. Administrative costs do not represent a significant proportion of health fund expenditure in any event. Opposition senators particularly note that Medibank Private is already highly competitive and has the lowest management expenses of its three main competitors.²¹ The highly respected ratings agency, Standard and Poor's, attributes this success to 'strategies that deliver long term profitability and efficiencies', *not* Medibank Private's form of ownership.²²

1.35 Instead, as with all other private health insurance organisations, Medibank Private's 'creditworthiness is constrained by the highly regulated private health insurance industry, with limited growth prospects, and restrictions on selecting and pricing risk'.²³ There is therefore no reason to believe that private ownership of Medibank Private will increase its efficiency, innovation, expansion and competition any more than is now the case. The AMA submitted that the opposite could be true:

Sale to another significant extant private health fund would mean a substantial reduction in competition, a reduction in choice of fund and a reduction in the availability of choice of products. The outcome could be even worse if Medibank Private were broken up and sold off to players with dominance in particular markets.²⁴

20 Dr Ken Harvey, *Submission 1*, p. 8. This point was also made by CHOICE, *Submission 11*, p.1.

21 Private Health Insurance Ombudsman, *State of the Funds Report*, Standard and Poor's, 2005.

22 Private Health Insurance Ombudsman, *State of the Funds Report*, Standard and Poor's 2006, p. 24.

23 Standard and Poor's.

24 Australian Medical Association, *Submission 8*, p.5.

1.36 Dr Deeble put paid to the suggestion large savings can be made from insurers such as Medibank negotiating with health providers to obtain bulk discounts. Dr Deeble said that:

The health funds pay out about between 84 and 86 per cent or thereabouts, depending on what their gross margins are, of their income as benefits. That is determined by two things: the price of the service and the volume. They cannot do much about the volume, because that is predetermined; people have used the service. Actually, they are precluded from running managed care because the government has got a provision that stops the funds managing care too much. But they can affect the price, and that is bargain down the business. But, again, it is not the doctors; they cannot do that with the doctors. But they can do that with the hospitals. Basically the only way that they can push costs down is to try and push the hospital costs down. At some point that will run into quality problems. Since private insurance is sold on the basis of quality and access, you cannot push the producers down to a level where quality and access start to decline.²⁵

1.37 The Government is unable to point to any robust evidence that privatisation will bring about efficiency gains, and any argument that competition will be enhanced by the sale consequently rests on unstable foundations. Indeed, it was submitted competition will almost certainly suffer from the sale. The added possibility the Government may proceed with the sale other than through a 'float' adds weight to such concerns, and leads opposition senators to express grave fears for levels of competition within the PHI industry post-sale and following the expiration of the five year limit on foreign ownership. This means that consolidation in the sector could occur via a takeover by a local or foreign entity, such as BUPA. This would lead to greater concentration, and arguably less competition.

1.38 Little comfort can be derived from the report from CRA International, commissioned by the Department of Finance and Administration in an attempt to give weight to its argument that efficiencies are possible. While the report concluded that potential savings could be made, at least one significant submitter questioned the reliability of its conclusions. Dr Yong, AMA Vice President, told the committee that:

We were not sure whether the methodology takes full account of the finite structures of the fund memberships. In other words the demographics of membership of some of the funds could differ quite significantly, but we are not sure if that has been taken into account. That has a big bearing on the premiums that they are charging and what return on the premiums they are getting. There is no evidence that CRA International has taken account of the fact that there are significant variations in the various health insurance products offered by the funds. There are vast differences.²⁶

1.39 Dr Yong added that:

25 *Committee Hansard*, Friday 3 November 2006, Canberra, p.32. See also Australian Medical Association, *Supplementary Submission 8A*, pp.2-3.

26 *Committee Hansard*, Friday 3 November 2006, Canberra, p.15.

The other concern we have is that the level of benefits paid is influenced by the proportions of policies that are front-end deductible and exclusionary, as well as the proportions of policies that are eligible for no-gap or known-gap. From the analysis that we have seen so far, it looks like all insurance products would have been treated as if they were comparable, but they are not. That is why we concluded that they did not compare like with like.²⁷

1.40 The AMA was not alone in expressing misgivings on the CRA methodology. Dr Deeble put it bluntly:

My criticism of the CRA report is the method that they have used, which is dressed up in all sorts of academic gobbledegook, which I know, or should know any way. The methodology they have used there has been misapplied.²⁸

1.41 The Government is similarly unable to substantiate its assertion that the sale would avert a conflict of interest which is inherent in it owning a fund which operates in an industry it also regulates. This could only materialise where the Commonwealth enacted laws which gave favourable treatment to its own insurer. No such conflict exists, and the committee heard no evidence that it ever has.²⁹

Service and quality levels

1.42 A specific concern regarding the sale of Medibank Private Limited involves the well-known tension between the need to provide a quality service and the need to make a profit. On the one hand, there are the interests of shareholders and on the other hand, the interests of Medibank Private members.

1.43 One of the Commonwealth's arguments for privatisation is the elimination of its conflict of interest as the regulator of the industry and as the owner of the main health fund. If correct, the bill seems to merely substitute one conflict for another. Opposition senators note that the Commonwealth is at least accountable for its actions and, arguably, possesses a greater social conscience than might a commercial entity.

1.44 There is a risk Medibank Private Limited could give priority to its shareholders at the expense of Medibank Private members.³⁰ For instance, cost cutting measures might be implemented in order to maximise profits and dividends. If the number of services and quality levels were to decline, then this would likely affect the membership base and members' premiums. It would also affect Medibank Private's bargaining position with health providers, which has been credited as one of Medibank Private's greatest innovations and competitive advantages. In this scenario,

27 *Committee Hansard*, Friday 3 November 2006, Canberra, p.15.

28 *Committee Hansard*, Friday 3 November 2006, Canberra, p.38. Dr Deeble goes on to elaborate on the nature and extent of the erroneous methodology.

29 Opposition senators note that, curiously, averting a conflict of interest does not appear as an objective of the sale in the Explanatory Memorandum.

30 Community & Public Sector Union/Save Medibank Alliance, *Submission 7*, p.3.

neither members' interests nor Medibank Private's industry position would be well served.

Fair treatment of employees

1.45 There is insufficient evidence to assess whether or not the sale process will treat Medibank Private Limited employees in a fair manner. Comment can, however, be made in relation to their position subsequent to the sale.

1.46 The Government is unable to give any assurance that current Medibank Private employees will not lose their jobs. This is a matter of serious concern to opposition senators. The placement of caps on ownership and the requirement for domestic management is time limited. The so-called 'Australianess' provisions provide only limited protection to employees, who will find their employment contingent on the full rigours of commercial practice in five years' time.

1.47 The bill is ambiguous in relation to the ultimate ownership of Medibank Private Limited. There is no permanent restriction on either full or partial foreign ownership. It is conceivable that in the long-term, Medibank Private Limited and all its assets could be owned by overseas interests.

1.48 The bill relies upon a successful domestic share float within a nominated period but there is no certainty in this regard. It is not clear why the nominated time frame is five years. Foreign ownership could result in significant capital being taken off shore and commercial decisions being made with little regard, if any, to local employees or consumers. The latter circumstance could have a substantial impact upon the Australian private health insurance industry and also upon public health resources.

Residual risk: the question of compensation

1.49 A key feature of the bill is to convert Medibank Private to a 'for profit' organisation with the ensuing ability to distribute profits and return capital to shareholders, that is, the Commonwealth. This would include any profits generated prior to the conversion.³¹ It would appear iniquitous for capital contributed by members of Medibank Private and retrospective profits generated by those capital contributions to be 'returned' to anyone other than the members of the fund. Some opponents of the sale have used this argument to support their call for mutualisation of Medibank Private.³²

1.50 Opposition senators are concerned the sale of Medibank Private's assets could represent an unjust acquisition for which the Commonwealth would be liable to pay compensation in accordance with section 51(xxxi) of the Constitution.

31 Explanatory Memorandum, p.7.

32 Australian Medical Association, Media Release, 5 September 2006 available at: <http://www.ama.com.au/web.nsf/doc/WEEN-6TC8XU>.

1.51 The Commonwealth has received legal advice, which concludes 'the Commonwealth will not be liable to pay compensation'.³³ Opposition senators do not accept this conclusion is necessarily correct. While the issue of compensation attracts divergent opinions, at least one witness criticised the Government's legal advice as 'ridiculously narrow and probably wrong' in its conclusion that rights to compensation do not exist.³⁴ The Bills Digest prepared by the Parliamentary Library provides an exhaustive analysis of the legal situation of Medibank and its policy holders, and concludes 'it is arguable that members of Medibank Private could be entitled to compensation if the terms of any sale do not adequately account for their right to the benefit of fund assets'.³⁵ There is no question that, if compensation were found to be payable, the Commonwealth would be liable.³⁶

1.52 The Act includes 'safety net' provisions, including an express right to compensation for members of Medibank Private. The Government has committed itself to including some entitlement for existing fund members in the eventual sale plan, but has not committed itself to any further detail.³⁷ This uncertainty is unhelpful for both Medibank Private and its members, and suggests the Government continues to harbour reservations as to the nature and extent of members' rights and the bill should not attempt to contain the issue so much as resolve it.

1.53 There is also concern as to what effect the granting of entitlements might have on the industry. There is no real indication of precisely which members would receive entitlements. It is therefore possible consumers might base their decision to join a health fund on the expectation of receiving the entitlement. Portability rights might also be exercised in consideration of the entitlement. If the entitlement relates to a shareholding, then it is possible members might remain with Medibank Private until the shareholding attains its optimal value. This membership base will in turn enable Medibank Private to increase its market power and contract bargaining position. 'Locking in' members might work to the competitive advantage of Medibank Private and its members but it will not necessarily enhance competition within the private health insurance industry.

Scrutiny of Bills Committee

1.54 Opposition senators also note that the Scrutiny of Bills committee has raised concerns about the fact that the Parliament is considering the passage of bill which will not be implemented until some time after the next election. This allows for no further parliamentary scrutiny of the impact of the bill on the community or policy

33 Blake Dawson & Waldron, Legal Advice, Paragraph 5(f) tabled on 4 September 2006.

34 Dr Deeble, *Committee Hansard*, Friday 3 November 2006, Canberra, p.37.

35 Bills Digest, p.11.

36 Mr Staines, Department of Finance and Administration, *Committee Hansard*, Friday 3 November 2006, Canberra, p.71.

37 J Breusch, 'Howard builds roadblock to Medibank takeover', *Australian Financial Review*, 18 October 2006, p.4.

holders in the future and the circumstances which may prevail at that time. Senator Minchin's response to the Scrutiny Committee does nothing to alleviate opposition senators' concerns.

Sale proceeds

1.55 A stated objective of the bill is to maximise the net sale proceeds from the sale of Medibank Private. Distribution of the profits accrued to date is probably designed to attract potential shareholders and increase the price of shares.³⁸ If the proposal is perceived as an unjust acquisition or a further example of short-term government profiteering, then the opposite effect could be achieved.

1.56 The Government acknowledges the full financial costs and benefits are difficult to quantify at this stage.³⁹ Most significantly, there is nothing solid to suggest the full sale potential will be realised in the current climate. The bill does not disclose the financial implications of the sale nor estimate the cost of rendering preparatory assistance. The Department of Finance and Administration was unable to advise the committee whether the risks to the Commonwealth have been quantified, in the event of a future claim, but confirmed that the Commonwealth will be liable to pay any claim which may arise.⁴⁰

1.57 Opposition senators are concerned at the cloud which continues to hang over the legalities of the sale and the existence of credible evidence of members' rights to compensation.

1.58 The Government's refusal to publish the scoping study for the sale is also ground for concern about the impact of the sale on the private health insurance market. If the scoping study found the sale would be trouble-free and not adversely affect premiums, then why has the government not released it to support its case? At the very least the Parliament should be able to examine this study to satisfy itself of the *costs* and *benefits* of selling Medibank Private.

1.59 The risk that taxpayers may be required to meet the cost of compensation claims arising from the sale, combined with the uncertainty over the market impact of the sale, makes it untenable to support the sale of Medibank Private at this stage.

38 Dr Ken Harvey, *Submission 1*, p.6.

39 Explanatory Memorandum, p.8.

40 Mr Andrew Staines, Department of Finance and Administration, *Committee Hansard*, Friday 3 November 2006, Canberra, p.64.

Recommendation 1

1.60 Opposition members urge the Senate to reject the bill.

**Senator Michael Forshaw
Deputy Chair**

Senator Jan McLucas

Senator Carol Brown

Senator Claire Moore

AUSTRALIAN DEMOCRATS

MINORITY REPORT

Introduction

1.1 The purpose of the Medibank Private Sale Bill 2006 (the bill) is to make changes to the relevant legislation to facilitate the sale of Medibank Private by the Government in due course. The bill is comprised of three schedules.

1.2 Schedule One modifies provisions in the *Health Insurance Commission (Reform and Separation of Functions) Act 1997* (HICA) and the *National Health Act 1953* (NHA) to allow the Commonwealth to sell its equity in Medibank Private Limited (MPL). Schedule Two provides for the MPL sale scheme. Schedule Three contains amendments relating to various operational aspects of MPL which will cease to exist once MPL is privatised.

1.1 In comparison to public concern and debate on previous Commonwealth privatisations, this proposed privatisation of Medibank has not been highly contentious. Nevertheless, putting the bill through a Senate Inquiry has been useful in fleshing out the opportunities and risks attendant to the proposed sale.

1.2 Although it is important in the interests of good governance and the democratic tradition that there be a full, informed and aware debate in relation to the sale of Medibank Private, that debate is unlikely to result in delay or to stop the sale proceeding. The Howard Government holds a majority in both houses of the federal parliament and the bill will likely pass, meaning Medibank Private will likely be sold as intended in 2008. As I remarked in the Senate Committee Hearing:

... unless there is a Snowy River type revolt in government ranks, they have the numbers to pass this bill. So we should therefore presume...that it will pass out of government hands.¹

1.3 Therefore, while it is important for me to indicate my position on the proposed sale, it is probably more important to try to maximise the benefits of what seems to be an inevitable sale. In that regard, the bill could be improved.

1.4 The Australian Democrats are not automatically opposed to privatisation of government assets. Each case of privatisation should be assessed on its merits, and

1 Senator Andrew Murray, *Committee Hansard*, Friday 3 November 2006, Canberra, p.48.

should not be driven by ideology.² What should drive asset sales is the community benefit and the public interest.³ In situations where privatisation is genuinely in the public interest and benefits the community, then it should be supported.

1.5 With respect to this proposed sale the questions are generic to all sales:

- Is the public interest better served by the asset remaining in public hands?
- Can the sale realise funds that can be put to a better use?
- Is the net funds flow positive with respect to government finances?
-

Commonwealth objectives for the sale of Medibank Private

1.6 There is a considerable distance between the *real* reasons for this sale and the *stated* reasons for the sale. I believe the real reasons for the sale are these:

- The Government can see little policy benefit arising from keeping Medibank Private in public hands;
- The Commonwealth earns no income from Medibank Private; and, most importantly of all,
- The Government can make a windfall of several billion dollars from this sale.

1.7 In other words – the sale is mostly about money. That is not necessarily a bad motive, depending on what the money will be used for.

1.8 The Government has not been as open about its motives as that. It has dressed up its sales objectives. According to the Explanatory Memorandum (EM), there are five objectives for the sale of MPL. In my view, the last one is the one that really counts for the Government:

- to contribute to an efficient, competitive and viable private health insurance industry;
- to maintain service and quality levels for Medibank Private contributors, including in regional and rural Australia;
- to ensure the sale process treats Medibank Private Limited employees in a fair manner, including through the preservation of accrued entitlements;
- to minimise any post sale residual risk and liabilities to the Commonwealth; and
- *having regard to the above objectives, to maximise the net sale proceeds from the sale.*⁴

2 Australian Democrats, 2004 Election Issues Sheet ‘Public Service’, p.1.

3 Australian Democrats, 2004 Election Issues Sheet ‘Public Service’, p.1.

4 Medibank Private Sale Bill 2006 Explanatory Memorandum, p.2.

1.9 I find it remarkable that there is no mention of the removal of the ‘conflict of interest’ as an objective, especially in view of how often it has been mentioned:

the specific phrase ‘conflict of interest’ and its motivation for the government getting out of Medibank Private has been constantly used over many months and perhaps years.⁵

1.10 At the Senate Committee Public Hearing, I entered into a discussion with Mr Rob Butterworth (Division Manager, Shareholder and Asset Sales, Department of Finance and Administration) on this point:

Senator MURRAY—I want to draw your attention to item 11, which is the Commonwealth’s objectives for sale. There are five of them, (a) to (e). Can you tell me why removing conflict of interest issues is not part of the Commonwealth’s objectives for the sale? Why were conflict of interest problems omitted?

Mr Butterworth—Arguably they are covered by the first objective of ‘to contribute to an efficient, competitive and viable private health insurance industry’.

Senator MURRAY—You know I am not going to buy that. Was it an oversight?

Mr Butterworth—And, item (d):

- to minimise any post sale residual risk and liabilities to the Australian Government;

...

Mr Butterworth—The sale objectives we have here are the ones that we have in the broad consistently used for previous asset sales. They have been tailored slightly to the circumstances of Medibank Private, but I am not aware that the issue was considered in the way that you are suggesting.

Senator MURRAY—I will ask you directly: do you consider one of the objectives for the sale to be to rid the government of its conflict of interest?

Mr Butterworth—Yes.⁶

1.11 The term ‘conflict of interest’ has a strong meaning in the public mind, and its minimisation is generally viewed as a positive thing by the community at large. However, this applies to *genuine* conflicts of interest. I am not the only Senator who is concerned that the perceived conflict of interest is somewhat of a weak proposition:

Senator McLUCAS—How does the sale of Medibank Private resolve a conflict of interest?

Mr Maskell-Knight—One postulates that the government may find itself in a position where it is trying to decide how to regulate the industry, having regard to the fact that it owns a major player in it. If it no longer owns a major player in it, it can make decisions about regulatory policy based on first principles.

5 Senator Andrew Murray, *Committee Hansard*, Friday 3 November 2006, Canberra, p.62.

6 *Committee Hansard*, Friday 3 November 2006, Canberra, pp.62-63.

Senator McLUCAS—Can you identify any time where the government has regulated differently because it owns the major player?

Mr Maskell-Knight—Not that I can think of.⁷

1.12 As well as the missing ‘conflict of interest’ objective, the objective that the sale of MPL will “contribute to an efficient, competitive and viable health insurance industry”⁸ warrants further discussion.

1.13 Whilst such an objective is to be commended if it is true and achievable, claims of increasing efficiency and competition in the context of the proposed sale seem to be just motherhood statements, in effect. The Government has not said *how* this could be achieved. The expert witness Dr Deeble described the functioning of the private health insurance market in the following interchange:

Senator MURRAY—....One of the points you make very clearly in your long discourse.....is that the private health insurance industry is in no sense a free market, it is a very managed market. It is a market characterised by high subsidies, high government intervention, high regulation, very low mobility of customers between funds and extremely poor customer knowledge because of lack of comparability. In other words, it is, to use an economist’s term, a most imperfect market.

Dr Deeble—Absolutely.

Senator MURRAY—That is right, isn’t it, as a summary.

Dr Deeble—And it is an oligopolistic market—six major funds dominate.

Senator MURRAY—I am in something of a difficulty in this discussion in that my party actually took a more free market view of private health insurance in that the Democrats opposed the private health insurance rebate. We believed that premiums should be set where they may and that the moneys being spent on supporting private health insurers should rather be put into public health, and reinforced there.

Dr Deeble—In general, I would agree with you.

Senator MURRAY—The difficulty we have, I think, arising from your views is that we are asked as a Senate committee, as a parliament, to appraise the benefits of the sale in the public interest, and yet the normal market comparators are not available to us. That is right, isn’t it?

Dr Deeble—When people say a profitable industry is a good one, the assumption is that it is an informed market and that its ability to make a profit indicates that it serves that market better than the other funds do or the other firms do.

Senator MURRAY—My point is that, if there are marked market rigidities because of a lack of mobility, understanding and so on, it is very difficult, then, to compare efficiencies, administration fee levels and profitability in the sense of retained assets. It is also difficult to compare products. That is the point that you have made.

.....

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

8 Medibank Private Sale Bill 2006 Explanatory Memorandum, p.2.

Senator MURRAY—Where I am going to with this—I am conscious that the government has the numbers to push through its legislation if it wishes—is that if the government is taking a market oriented view and saying, ‘Well, we should not be engaged in the provision of private health insurance through Medibank Private,’ which has 30 per cent of the market, then logically it has to review subsidies, tax concessions and also review just how competitive the market is with respect to choice, the availability of product disclosure statements, information and so on. I can give you an analogy, which is the superannuation choice regime. Effectively that introduced a far more market oriented approach in what was a market which was highly rigidified prior and is no longer as rigid. Isn’t that the logical consequence of the government stepping out of this particular investment?

Dr Deeble—If you think of all of the subsidies and benefits the government gives to the health insurance business, they are really enormous, but it flows through to the providers and to the people who are supported by private health insurance. There is the rebate. There are the various encouragements that people have to go into it, including their own tax position and there is the tax exempt position of the health funds. Nearly all but one of them are tax exempt because in the past it was seen as not to be a business that the private people would go into because it would never be profitable enough—that is, the for-profits would not go into it. I agree that if a government then moved its own fund into the for-profit area, it is changing the balance of that enormously and changing lots of the assumptions that underpinned its subsidies. Does that answer your question?⁹

1.14 I can only go on the evidence before me, and that evidence does not persuade me that (given current policy and market settings) a more efficient, competitive and viable health insurance industry will necessarily result if Medibank Private moves into *private hands*. On this point, I should note the Government has failed to put on the public record a strong case to show the market benefits of privatising Medibank Private. The release of the CRA report was supposed to trump criticism of the sale in this respect. However, Dr Deeble and the AMA respectively presented a strong critique of the limitations of the CRA report.¹⁰ The Government has also withheld the scoping study on the sale from scrutiny. Its hand would have been stronger if it had published the findings of this study, assuming the study demonstrated the advantages to the industry and consumers of the sale.

1.15 The question is whether a more efficient, competitive and viable health insurance industry will result if Medibank Private remains in *public hands*. On this point the answers of one of the departmental¹¹ witnesses was instructive:

9 *Committee Hansard*, Friday 3 November 2006, Canberra, pp.34-35.

10 AMA, *Committee Hansard*, 3 November 2006, Canberra, pp.13-14; Dr Deeble, *Committee Hansard*, 3 November 2006, Canberra, pp.30-31 and esp. 37. See also AMA *Submission 8a*, pp.2-3.

11 Mr Charles Maskell-Knight, Principal Adviser, Acute Care Division, Department of Health and Ageing.

Senator MURRAY—Do you think that Medibank at present contributes to an efficient, competitive and viable private health insurance industry?

Mr Maskell-Knight—You are asking me to think, and I do not know that I do that readily about those sorts of issues.

Senator MURRAY—Do not be smart.

Mr Maskell-Knight—I am sorry, but you are asking for an expression of opinion. I believe that Medibank Private is an efficient, well-run fund, yes.

Senator MURRAY—The explanatory memorandum specifically says: The Commonwealth’s objectives for the sale of Medibank Private Limited are:

(a) to contribute to an efficient, competitive and viable private health insurance industry;

I do not want a smart answer from you. That would either imply that it is not at present or that it would become more efficient, competitive and viable if sold. As someone who is involved with an agency with intimate connections with Medibank Private, I want to know if you think it does contribute at present to an efficient, competitive and viable private health insurance industry and whether, if it were to be sold, it would do a better job in that respect?

Mr Maskell-Knight—The questions about the statements in the explanatory memorandum should be directed to the department which wrote it, which is not the Department of Health and Ageing. As I said, I believe that Medibank is an efficient and well-run fund on the evidence available to us at the moment. It is a matter for speculation about what would happen were it to be in different ownership.¹²

1.16 The Australian Medical Association (AMA) was more straightforward. In its submission, the AMA expressed concern at the changing market structure that would result from the sale of MPL. The AMA is of the opinion that “the sale of Medibank Private would reduce competition in the sector...”¹³ The AMA argues that there is no national market for private health insurance and the acquisition of MPL by another private health fund would result in a market which is dominated by a single player, even more so than at the moment.¹⁴

1.17 Whilst such a situation as the AMA foresees seems unlikely in the medium term, given the ownership restrictions in the bill that will apply for the first five years, there can be no guarantee that such a situation will not emerge in the longer term.

1.18 There is often a perception that government involvement somehow makes things inherently more equitable and accessible, and that privatisation will result in declining standards and consumer detriment. Whilst this may be true in some cases, it cannot be said to be the norm. Increased competition in a market place usually results in benefits to the consumer market, as companies are forced to offer better services or lower prices in a bid to maintain their market share.

12 *Committee Hansard*, Friday 3 November 2006, Canberra, pp.11-12.

13 Australian Medical Association, *Submission 8*, p.4, paraphrased.

14 Australian Medical Association, *Submission 8*, p.4.

1.19 In my view the AMA argument is not that a more competitive market will result if MPL remains a public asset – it is an argument that the sale of MPL is insufficient of itself to produce greater competition.

1.20 The evidence before me does not persuade me that (given current policy and market settings) a more efficient, competitive and viable health insurance industry will result if Medibank Private stays in *public hands*. From a policy perspective that means there is no sound reason as to why the Government should continue its participation in the private health insurance market.

1.21 That means too that the government focus should be restored to the provision of public health services. Perhaps it is this point (the role of the government in public health services) that is the real cause of many people's fears over the sale of MPL. I would suggest that maybe many are not so much directly concerned with the sale as such. Rather, they are concerned with the government absenting themselves even more from the health services and insurance market.

1.22 The government has shown no signs that they will focus more of their efforts on public health as a result of exiting the private health insurance market, and has made no guarantee that the proceeds from the sale will even be placed back into health care.

1.23 One counter to the fears expressed by the AMA and others is for a more competitive market to be actively promoted by government. Simply sitting back after selling Medibank Private and expecting significant new competition to emerge is relying too much on hope. It would indeed be advantageous for policy to be developed so that a more competitive market did become a feature of private health insurance. In that respect recent superannuation industry experience is instructive. In that industry, mobility, portability, comparability, choice, and so on, have all helped create a much more competitive market than formerly.

1.24 As increasing competition is a stated objective for the sale of MPL, and it is obvious that the sale of MPL alone will not result in marked changes to the competitive characteristics of the private health insurance market in Australia, I think it is crucial that as part of the sale process, the Productivity Commission be required to inquire into competition in the private health insurance market. The last time such a project was carried out was almost ten years ago with the Productivity Commission's 1997 report 'Private Health Insurance' and, given the circumstances, it is an opportune time for that report to be updated and reviewed.

1.25 Price is an issue. Will prices rise if Medibank is privatised? The changing nature of competition in the market also flows on to the issue of health insurance premiums, concerns over which have been raised throughout the committee stage. In the report by CRA International commissioned by the Department of Finance and Administration, it is concluded that:

Irrespective of any change in ownership, Medibank Private's premiums will need to rise to cover a substantial increase in benefits necessitated by such factors as the ageing of the Australian population, increased cost per day of hospital care and increases in the number and value of ancillary claims.¹⁵

1.26 Extending this line, I would add that there may be additional sources of upwards pressure on premiums if MPL is privatised to become a for-profit entity. For instance the surplus may reduce as a result of changes in tax status. There are negative tax implications of MPL changing its status from a not-for-profit organisation to one that is operated on a for-profit basis. Once MPL becomes a for-profit entity there is an associated additional tax burden.

1.27 A second source of pressure potentially forcing premiums upwards is the changing motives of management. Currently, MPL is focused on the provision of health services. Although management prudentially aim for operating surpluses, by and large, the focus is on provision of services. However, privatisation via a public float (as against a sale to members, discussed below) may change the focus, and result in the pursuit of profits being the dominant goal.

1.28 Chasing profits is always going to be an ownership aim. Paying several billion dollars for MPL will mean the new owners will want a commensurate return on investment. To claim that MPL will not need to raise premiums because it will become more efficient once it is privatised is to claim that it is being run inefficiently now, and the Committee has been given no evidence of this.

1.29 There are only so many ways that greater profits can be pursued, such as: raising prices; gaining market share; innovation and diversification of products; improvements in administrative efficiency; and by lowering costs associated with the provision of services, such as by cutting services back.

1.30 As a government owned entity it is difficult for MPL at present to diversify its products – this would certainly be possible once MPL is removed from government hands.

1.31 There is the possibility of lowering the standards of service to increase profit margins. In an ordinary market, this would not be a concern: if standards fell, consumers could change their service provider. However, private health insurance is no ordinary market, as the earlier quoted discussion with Dr Deeble illustrates. The private health insurance industry is oligopolistic in nature, and there is low portability and mobility between insurers: it is a captive market.

1.32 Different outcomes on product pricing and services will arise according to the nature of sale and ownership. The mutualisation of MPL and associated assets

15 CRA International, *The impact of privatisation of Medibank Private on private health insurance premiums*, 2006, p11.

deserves further consideration and should not be automatically discounted as an option by the government. A proposal is outlined below (under ‘Method of privatisation’) but in my view, it seems to be a ‘best outcomes’ approach. Members who have a vested interest will not be interested in lowering the standards of service which they use. But equally, they will not be interested in seeing a company in which they have a vested interest collapse. Member-owners will be in the best position to find a balance between the pursuit of profits and the provision of services, with the freedom to diversify the business.

The issues of MPL ownership and compensation

1.33 At the centre of the debate about whether or not the Government should sell MPL has partly been the question of who owns Medibank Private and in particular whether members of MPL have any claim to compensation if it is sold.¹⁶

1.34 MPL was established in December 1997 as a public company, limited by shares. All the shares were vested in the Commonwealth and section 35 of the HICA provides that: *the Commonwealth must not transfer any of its shares in the nominated company.*

1.35 The Medibank Private Fund and associated assets (into which member contributions are placed, and out of which member benefits are paid) has been operated by MPL since 1998.

1.36 As noted above, Schedule One will enable the Government to sell MPL. It repeals section 35 of the HICA which currently has the effect of prohibiting the Commonwealth from transferring its shares in MPL. Schedule One also amends the NHA to provide for the fact that once sold MPL will become a for-profit organisation and have a resulting need to distribute profits. Finally, Schedule One also creates a new section, section 73AADA, which provides (in the words of the EM) a ‘constitutional safety net’, allowing for the payment of compensation if property is acquired from a person other than on just terms.

1.37 The real contention, then, lies not in the ownership of MPL: both the Blake Dawson Waldron advice to the Department of Finance and Administration, and the Parliamentary Library Research Brief, are in agreement on this matter. What is really at the centre of contention is who owns the fund and its associated assets.

1.38 The bill is predicated on the belief that the Government is entitled to sell off MPL without any specific regard as to possible risks or claims to compensation by members. This (to be punnish) seems like a risky proposition.

16 Parliamentary Library, Bills Digest No 47, 30 October 2006.

Senator MURRAY—I will go to the question of compensation possibilities. I accept the view of the library's advice, which I read into the record earlier as expressed on page 11:

'[I]t is arguable that members of Medibank Private could be entitled to compensation if the terms of any sale do not adequately account for their right to the benefit of fund assets. It was not asserted in the Research Brief, and is not asserted here, that this means that Medibank Private is owned by its members, or that members could block the sale.'

I accept the government not only has the right to dispose of the asset but has the ability to dispose of the asset subject to parliament's finding, which is essentially the position of the department. So what is left of the issue is a potential class action with respect to compensation. I assume there will be a class action rather than individual members. My question to you is: is it possible to compute the level of compensation that could be sought? I am not asking here for a hypothetical. I am really asking: in view of your experience within DOFA in the sale of assets where these issues are raised, are there aspects or areas to which compensation claims such as these might focus—for instance, the total level of surpluses or the total break-up value of the fund? Is there a standard kind of area to which these claims of compensation can be directed?

Mr Butterworth—I will say before answering that that it is certainly our strong view that 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.

Senator MURRAY—What I am trying to compute here is the level of risk. If I were the buyer, I would get my own legal advice and then I would seek to get you to indemnify me from a risk, and that is therefore a cost to you, because it either results in a lower sale price or a higher sale price with a potential risk. You would want to calculate the risk. The way in which you deal with that is perhaps to cap what risk you agree to expose yourself to, but as soon as you do that and you nominate a figure you are telling anybody who is going to sue you what figure to target. As a seller, my preference would be not to indemnify them, to tell them that it is their risk and put that into the contract, but that may affect the price. I have not raised this with you in a hypothetical sense; I have raised it in a real risk sense. I understand that the government thinks it is on firm ground, but I have heard that from many defendants in courts. Are you able to assist the committee at all? One of the things that the committee might need to take into account is, regardless of what we think the risk might or might not be, how the Commonwealth should deal with any risk, notional or otherwise?

Mr Butterworth—The entire process of preparing for a sale of a government asset is focussed on minimising those risks. We think that the process we have gone through reduces those legal and commercial risks to the minimum. We are confident of that position.

Senator MURRAY—Can you answer this question? If you cannot, can you take it on notice? If the committee was of the view that the government should not indemnify for compensation, would that mean that the committee would need to recommend that the legislation explicitly specify that?

Mr Butterworth—I am happy to consider that question.

Mr Staines—From the legislation that is drafted at the moment, any liability for the Commonwealth arising out of the sale process itself would lie with the Commonwealth.

Senator MURRAY—It would lie with the Commonwealth?

Mr Staines—Yes.

Senator MURRAY—Exactly. That means that you have accepted that there is risk. You might be able to, but I doubt you will want to, quantify that risk.

Mr Butterworth—Again, we have researched this issue. We have drafted this legislation. We will approach the process between now and the sale with a view to minimising that risk. We do not think that risk is significant.¹⁷

1.39 The majority report accepts the Government's position, and the Blake Dawson Waldron advice, that the government is entitled to sell MPL and does not need to be concerned with members claiming any rights against assets, or bringing actions for compensation against the government. Yet representatives from the Department of Finance and Administration confirm that the bill specifically includes a liability clause that lays the cost of any compensation claim at the taxpayer's door:

Senator MURRAY—...Let me try a different direction. Blake Dawson Waldron says in item 5(f) on page 3:

For this reason, the Commonwealth will not be liable to pay compensation as suggested in the Brief.

They have given us this guarantee. Do you think we should add an amendment to this bill that says, if there is any claim for compensation, Blake Dawson Waldron is liable? You are convinced this advice is good, so let them wear the responsibility if it is not. What do you think of that?

Mr Butterworth—I do not think they would find that acceptable.

Senator MURRAY—Therefore, they have no faith in their brief? Is that what you are saying to me?

Mr Butterworth—No, I am not saying that at all.

Senator MURRAY—That is what it says to me. If somebody says that they will not be liable to pay compensation, let them put their money where their mouth is.

Mr Butterworth—I am saying that they have staked their reputation on that advice.

Senator MURRAY—So later on, in five years time, when the Commonwealth is hit with a class action for \$200 million, we are going to remember that the reputation of Blake Dawson Waldron was wonderful? Do you see where I am going with this? Neither you nor I can forecast the future with the cleverness of lawyers or courts. I have seen dozens of legal briefs, some to my cost and some to my benefit, which have been very firm in their opinion and have been wrong, and so have you.

Mr Butterworth—We have been conscious of certain risks. We have been conscious of the potential for risks. We have gone through a very thorough

17 *Committee Hansard*, 3 November 2006, Canberra, pp.62-63.

process. We have taken the best advice. We will continue to apply the sale processes with a view to minimising those risks.

Senator MURRAY—You are not at risk. Blake Dawson Waldron is not at risk. The buyer is not at risk. But the taxpayers of Australia are potentially at risk because you are going to give the buyer an indemnity. That is what is happening. Is that right? If there is any risk, it is to the taxpayers of Australia, is it not?

Mr Butterworth—The Commonwealth as the vendor is accepting that risk at the end of the day.¹⁸

1.40 The Government say that the liability clause is a standard one.¹⁹ In other words it is a precautionary provision – it prevents the validity of the bill being challenged if it did not allow for compensation under the just terms provisions of the Australian constitution. This is a circular argument. In the absence of such a liability clause no one would challenge the validity of the legislation unless they thought there *was* a case for compensation.

1.41 The fact is that the bill specifically anticipates the risk of a compensation claim, and allows for the taxpayer to pick up any compensation tab. The only sure-fire way to avoid this risk altogether is to sell MPL to the members.

Method of privatisation

1.42 As previously noted, Schedule Two deals with the actual process of selling MPL. It does not limit the method or timing of the sale, and recognises that the Government may wish to use a number of strategies to obtain the maximum revenue from the sale. Importantly, it also contains provisions which will enable MPL to modify its constitution and rules such that it can alter its not-for-profit status, and operate (once sold) on a for-profit basis. With respect to the timing of the sale I agree with the Majority's concerns, reflecting that of the Senate Scrutiny of Bills Committee.²⁰

1.43 Schedule Two also contains two appropriations clauses in relation to the costs of the MPL sale scheme, and a number of other situations in which expenses may arise. Within the second schedule are also provisions which relate to the ownership of a privatised MPL. Under the bill, there will be a five year period in which the maximum stake that can be held by anyone in MPL will be fifteen per cent.

1.44 The bill also contains requirements relating to the 'Australian nature' of MPL, including that the company is to remain incorporated in Australia, that the majority of directors must be Australian citizens, and ensure that its central management and control is ordinarily exercised in Australia.

18 *Committee Hansard*, 3 November 2006, Canberra, p.65.

19 *Committee Hansard*, 3 November 2006, Canberra, p.64.

20 Senate Scrutiny of Bills Committee Alert Digest 13/06.

1.45 As the quotes in the previous section show, the method of sale of MPL may determine the Commonwealth's (i.e. the public's) exposure to risk. Although the majority report is silent on the way in which MPL is sold and does not offer any recommendations or comments on the issue, I feel it is of central concern.

Senator MURRAY—Moving on to the issue of the actual sale, can you tell me whether any of the following are explicitly ruled in or ruled out? I know some of the answers, but I would like them on the record. Firstly, is mutualisation ruled in or ruled out?

Mr Butterworth—The government has announced that they will be offering the shares in the company through an IPO.

Senator MURRAY—That would rule out mutualisation. Is a public float ruled in or ruled out?

Mr Butterworth—An IPO is a public float.

Senator MURRAY—Is a private placement ruled in or ruled out?

Mr Butterworth—The government has announced that they will be offering shares by way of an IPO.

Senator MURRAY—Is an offer to Medibank members ruled in or ruled out?

Mr Butterworth—Medibank members would be free to participate in an IPO.

Senator MURRAY—Is the IPO announcement in the legislation or in the general policy announcement of the government?

Mr Butterworth—The legislation provides the scope for an IPO. The government has indicated in its public announcements that it will be pursuing the sale as an IPO.²¹

1.46 It is my opinion that one method stands out above all others as the preferred option and the avenue which should be taken: the sale of MPL to its members. For example, if there are 1.2 million members of MPL, each member could be offered a shareholding equivalent to \$1,500. This would give the Government \$1.8 billion, a figure at the upper end of estimates that have been suggested it might raise in public sale, and at a lower cost than otherwise might be the case with a public float. Those share portions which were left over as a result of members opting out could then be sold to the general public. The members of MPL could then operate it as they saw fit, including a public float later if they so wished.

1.47 In my mind this removes any risk that the Government may be exposed to, satisfies the members by giving them right of first refusal in buying into MPL, and satisfies the Government who receive their budgeted sale revenue. The only people that it might not satisfy are the companies and commission-makers looking to get a hold of MPL, or members of the general public who feel aggrieved that they cannot buy shares in MPL. However, they may still get the option to buy shares later – they are just not guaranteed a right to buy shares in the initial sale.

21 *Committee Hansard*, Friday 3 November 2006, Canberra, p.63.

1.48 So far, the Government have been unwilling to seriously consider this approach. As I remarked in the Senate Committee Hearing:

...I cannot quite understand why that option should automatically be excluded...it seems to me there is an automatic assumption in the government mind that, if it were to be sold, it needs to be sold either in a private placement to the highest bidder, which takes it out of the hands of the members, or that it should be a public float ...²²

1.51 For this reason, and despite the apparent freedom of choice that the government of the day will have in relation to the sale scheme I would like to see an amendment incorporated into the bill. In addition to those options currently contained in the bill (indicated by the list of items in Schedule 2, Part 2, Item 5, Subsection 6), I wish to see a specific subsection which provides that the Government may sell MPL via:

- mutualisation;
- public float;
- private placement; or
- any other method the government feels is appropriate.

Proceeds of sale revenue

1.49 The sale of MPL will create a substantial windfall for the Government. They are naturally interested in maximising their revenue from the sale, and make no secrets of the fact: it is one of the stated objectives for the sale.

Senator MURRAY—... We might disagree with it, but the idea that you should make a couple of billion for the people of Australia through a sale is not a reprehensible one. I do not impute a bad motive...²³

1.50 In terms of what the sale of MPL would raise, figures close to \$2 billion have been seen as a reasonable sum. The important question then becomes “what is to be done with the proceeds of the sale?” \$2 billion is a substantial amount, and there should be cause for concern about how the Government puts the sale proceeds to work.

1.51 The bill, not surprisingly, is silent on the matter. It would be poor financial management to put the proceeds of asset sales into general revenue for current expenditure. Tipping the money into the Future Fund to meet future superannuation liabilities of public servants would be a singularly unattractive option, as opposed to the far more immediate alternative represented by the need for current health capital expenditure.

1.52 That suggests there should be a hypothecation of funds. This would ensure that the proceeds from the sale are kept within the domain of public health services

22 *Committee Hansard*, Friday 3 November 2006, Canberra, p.48.

23 *Committee Hansard*, Friday 3 November 2006, p.49.

expenditure. When the possibility of hypothecation was raised in the Senate Committee Hearing, it was received with interest by the representatives of the Australian Medical Association.²⁴

Senator MURRAY—...In other words, could the sale be made more palatable to somebody like the AMA, for example, just taking a figure, if it realised \$1 billion and that billion was hypothecated into mental health, dental health or something in the health regime, which meant that you might have given up something on the one hand but you have gained on another in the health context? Would this be more palatable to you as a policy if there were a hypothecation—in other words, if the sale proceeds were directly reinvested back into public health services?

Dr Yong—That is an interesting question.

Senator MURRAY—It is my job to ask you.

Mr O’Dea—In the material the government is talking about putting money into research. Clearly, from our point of view, if there is a sale it is better that the money stays in health. We have not covered that in our submission. We have not looked at it and it is very complicated. From our point of view, it is certainly better that the money stays in health rather than going into Defence or wherever.

Senator MURRAY—You have got to be careful of the government’s promises. The legislation does not hypothecate the money.²⁵

1.53 Whilst on the evidence before me I can see no sound policy reason for the government to continue to maintain a position in the private health insurance market, there is an ongoing need for it to play a role in the provision of public health insurance and services. The Democrats have been anxious for some years about declining levels of Government expenditure on mental and dental health, as well as on public health measures. The hypothecation of the sale proceeds to specific health areas would undoubtedly make the sale of MPL less contentious and more in the public interest.

Conclusions and recommendations

1.54 In my opening remarks of this Minority Report I said that with respect to this proposed sale these questions are generic to all sales:

- Is the public interest better served by the asset remaining in public hands?
- Can the sale realise funds that can be put to a better use?
- Is the net funds flow positive with respect to government finances?

1.55 A strong case has *not* been made for Medibank Private remaining in public hands. The net funds flow is positive with respect to government finances. The weakest aspect is with regard to the present intended use of the realised sale funds.

24 *Committee Hansard*, Friday 3 November 2006, p.16-17.

25 *Committee Hansard*, 3 November 2006, Canberra, p.16.

1.56 I wish to reiterate the point I made at the start of this minority: the Democrats are not opposed to the privatisation of Commonwealth assets if they are *genuinely* in the public interest and for the benefit of the community. I do not believe that the government needs to continue to play an ownership role in the private health insurance market. The public health market is the area in which the government should focus on.

1.57 However, I do not wish to see the Medibank Private Sale Bill pushed through parliament without regard for some of the key issues that the proposal raises, especially when there are potential consequences for the people of Australia. The concern over the risks of compensation claims must be taken seriously and effort should be spent in minimising the potential for these risks where possible.

1.58 Additionally, the revenue that would be raised from the sale of MPL must be dealt with specifically by the bill. To not do so would be to leave the door open for its appropriation into general revenue, or for ‘vote-buying’ by the government of the day.

Recommendation 1

1.59 That the bill be amended to

- require that the net sale proceeds be hypothecated for health expenditure; and,
- to include a list of unrestricted options for the sale of MPL: mutualisation; public float; private placement; or any other method the government considers appropriate.

Recommendation 2

1.60 That the sale to members of MPL be the first option for sale.

Recommendation 3

1.61 That prior to the sale, the Productivity Commission be required to conduct an inquiry into the private health insurance industry, with specific attention to enabling an efficient, competitive and viable private health insurance industry.

Recommendation 4

1.62 That prior to the sale, the government of the day be required to prepare and present a discussion paper to the Parliament addressing the (eventual) method of sale of MPL, with particular reference as to why that particular method was chosen over alternative methods.

Senator Andrew Murray
Australian Democrats
Senator for Western Australia

FAMILY FIRST

Dissenting Report

Provisions of the Medibank Private Sale Bill 2006

1.1 FAMILY FIRST believes the government is selling out Australian families by selling Medibank Private. Profits should not come before families.

1.2 Private health insurance is important to Australian families, where take-up rates are highest among couples who have children.

1.3 Private health insurance has become an essential service for these families, who want access to quality hospitals at affordable prices. Private health cover gives families a sense of security and peace of mind.

1.4 The Government is partly responsible for this situation. It has forced many Australians into private health insurance by offering discounts on cover and punishing families with higher fees if they sign up later on.

1.5 FAMILY FIRST believes the needs of Australian families must always come first.

1.6 Instead, the government has turned its back on families by selling our largest health insurer, Medibank Private.

1.7 The needs of the market are more important to the Government than the needs of families.

1.8 The sell-off of Medibank Private is yet another example of the Government's so-called 'family-friendly' policies being nothing more than 'market-friendly'.

1.9 A privatised Medibank Private would first and foremost have to make money for its shareholders - lots of money. Its top priority would be profits – delivering maximum returns to shareholders. This would lead to increased premiums and reduced services.

1.10 Australian families are already struggling and they would be worse off with a privatised Medibank Private motivated solely by profits and the bottom line.

1.11 The Government announced in September that it would sell Medibank Private by share market float in 2008.¹ That was a mistake.

1.12 The Government should ditch its plans to sell Medibank Private.

1.13 The Government should retain ownership of Medibank Private for the public good, to ensure affordable health insurance and quality health services for Australian families.

1.14 The Government continues to have a legitimate role as owner of a not-for-profit Medibank Private to ensure that the company focuses on the needs of its members rather than just profits.

Focus on the needs of members

1.15 FAMILY FIRST wants the best for Australian families, and families would be worse off if Medibank Private is sold as its sole focus would then be profits rather than the needs of its members.

1.16 Medibank Private members want good quality health cover at the lowest possible prices. In October, Medibank Private announced a record \$200 million profit which " ... has been achieved while keeping the member at the centre of our strategies."² But as a company controlled by shareholders, the shareholders would take precedence over members. This would mean fewer services for members, and higher fees.

1.17 International studies validate FAMILY FIRST's concerns that members would be worse off. A recent OECD (Organisation for Economic Co-operation and Development) report into private health insurance found that, in general, for-profit medical insurers tend to be more motivated by profit and satisfying the interests of shareholders, while not-for-profit health insurance funds are in general terms more member and community focused.³

1.18 Medibank Private is not a mutual fund, but as a not-for-profit government-owned business it has characteristics similar to a mutual of putting members' interests before profits or shareholders.

1.19 It was reported that comparisons of mutual funds with profit making insurers found that mutuals were able to offer more to their members.

1 *Medibank Private to be Floated in 2008*, Media Release: Senator Nick Minchin, Minister for Finance, 12 September 2006.

2 *Membership growth drives record result for Medibank*. Media Release, Medibank Private, 5 October 2006.

3 The OECD Health Project, *Private Health Insurance in OECD Countries*, OECD, 2004.

A 1999 study by global insurance giant Swiss Re concluded that in the health insurance sector, mutuals were generally more efficient than for-profit companies, enabling them to offer their members a better premium-to-payments ratio. And in a 2001 survey of 97 insurance companies in Western Europe, the International and Co-operative Mutual Insurance Association found that mutuals were more efficient and had lower premiums relative to claims payments.⁴

1.20 Dr John Deeble, a former commissioner in the Health Insurance Commission over the 14 years that the Commission managed Medibank Private, explained:

We always interpreted our task as one of giving standard private cover at affordable prices. We were not there to make profits; we were there to provide a service to people at the lowest price that we could do that at, but also not just to operate as a commercial operation which maximised its market but to be concerned with the quality of the health care that people got as well ... [I]t was not just a business to make money for government; it was established to provide a service.⁵

1.21 Another health fund argued that shifting the focus from the needs of members is less efficient:

Our view where a shareholder is placed above a member, as could happen in a for profit health fund, policies in regard to claim payments would become more focussed towards the stakeholder return than the outcome for the member, which in our view is not efficient or competitive.⁶

1.22 FAMILY FIRST has a fundamental disagreement with the Government over the aims of Medibank Private. The objective of Medibank should be to provide a service to consumers at the best possible price – not to make as much profit as it can. As health insurance has become an essential service to many Australian families, there is a legitimate role for government to provide these services to satisfy customers rather than profits.

Privatisation, efficiency and cutting benefits

1.23 A report by CRA International, commissioned by the Department of Finance, found that Medibank Private was efficient, but "... has scope to increase efficiency by a further 5 to 7 per cent to match the efficiency of the better performing open health funds."⁷

4 Breusch, J, 'The prognosis is uncertain', *Australian Financial Review*, 13 September 2006, p.61.

5 Dr Deeble, *Committee Hansard*, 3 November 2006, Canberra, p.29.

6 Westfund, *Submission 10*.

7 CRA International, *The Impact of Privatisation of Medibank Private on Private Health Insurance Premiums*, 21 October 2006, p.1.

1.24 But this report has not gone unchallenged. The Australian Medical Association questioned the scope for extra efficiencies:

We doubt that Medibank Private has fully exploited the scope for scale efficiencies. Were they to manage as efficiently as BUPA (the most efficient of the large funds), they could save some \$30 million per annum in management expenses. The report by CRA International (CRAI) argues that Medibank Private could achieve efficiency gains of 5 to 7%. Based on 2004-5 figures, that would imply cutting costs (management expenses and benefits paid) by between \$127 and \$178 million per annum. It is simply not possible to cut nearly \$180 million out of management expenses of \$238 million. Such cuts in costs would necessarily require cuts in benefits paid.⁸

1.25 It was argued that the CRA report focused on profits at the expense of benefits for members:

They have defined 'efficiency' as profit making. You will make a higher profit obviously if you can get your costs down. They have phrased it in such a way that people would believe that this relates to administrative expenses. But when you actually go through and see what they are saying, they are not talking about that. The seven per cent has got to come out of benefits ... [T]he only way they can get a higher gross margin and a higher net margin that is feasible is to pay less out in benefits. Is that a gain in efficiency for the members?⁹

1.26 The AMA points out that "the CRAI report cites MBF as a more efficient fund than Medibank Private on the grounds that MBF pays lower benefits."¹⁰

1.27 The issue comes back again to a fundamental disagreement over what the overall objectives of Medibank Private should be – to make a profit or to serve members. FAMILY FIRST believes that Medibank Private's main objective should be to serve members.

Premiums are likely to rise

1.28 The Government argues that privatising Medibank Private will put downward pressure on premiums.

1.29 FAMILY FIRST believes this is nonsense, as there is already competition between health insurance funds. Privatising Medibank Private will in fact put extra upward pressure on premiums.

8 Australian Medical Association, *submission 8A*.

9 Dr John Deeble, *Committee Hansard*, 3 November 2006, Canberra, p.38.

10 Australian Medical Association, *submission 8A*.

1.30 The Australian Medical Association argued that a privatised Medibank Private would face the extra pressure of having to make more money for shareholders:

Our concern is that, in order to get that return on the investment another entity would make to buy out Medibank Private, there are only a few ways that they can do it. One is to gain huge efficiencies in management, and we are not convinced that there are huge efficiencies to be gained. The other one is to reduce benefits. The problem with that is that may lead to a loss of membership of the fund. Another way to do it is to increase the income into the fund. There is a limit to how much can be done with non-premium income. There might be some efficiencies there in terms of investing money more wisely, but it would be hard to see a fund like Medibank Private not already effectively investing its assets. The conclusion is that premiums would probably have to go up as a result of the sale.¹¹

1.31 Dr Deeble argues that privatisation would not make the health fund more competitive and that private ownership is not the best way to hold down costs:

Under the present proposals for a float, nothing significant would change. Despite conventional wisdom and convictions, there is no Australian evidence that private ownership and for-profit status has produced any efficiency gains sufficient to offset the higher cost of private capital; and good reason to believe that non-profit status, not the incentives of private ownership, has been the largest controlling influence on premiums.¹²

1.32 In addition, for-profit health funds have to earn more than other funds just to cover tax:

To give a return on funds, a for-profit fund has to earn 30 per cent more because it pays 30 per cent tax. In principle it is as simple as that. It is the tax exempt status of the non-profit funds which has kept premiums down, not the profit incentive of the for-profit ones.¹³

1.33 An extra pressure which may help increase premiums is people's reluctance to change funds, in the same way people are unlikely to change banks because of the hassle.

1.34 Medibank Private argued that health insurance is a competitive market:

... [P]eople do compare products and people do switch. They now have full portability. Those dynamics of competition are at their most intense now than they have ever been in the history of private health insurance in Australia.¹⁴

11 Dr Yong, Australian Medical Association, *Committee Hansard*, 3 November 2006, Canberra, p.16.

12 Dr John Deeble, *submission 5*.

13 Dr John Deeble, *Committee Hansard*, 3 November 2006, Canberra, p.31.

14 Mr Morphy, Medibank Private, *Committee Hansard*, 3 November 2006, Canberra, p.61.

1.35 But Dr Deeble argued that people tended not to switch health funds despite differences in premiums:

... [health insurance] is not very price elastic at all. I can tell you that, in 15 years or so on that board, we could be five or 10 per cent or more above or below our competitors with no effect on our contributor membership at all.¹⁵

People make a decision on their health insurance membership when they join. There is, or there has been in all that time, almost no transfer between institutions on the basis of price. Also, all of the funds make it extremely difficult—and this is ordinary commercial practice which does not only apply to health funds, it applies to almost every other product—or almost impossible to compare prices directly because that is not what they want them to do.¹⁶

1.36 It is tempting for health funds to increase premiums to boost profits for shareholders.

Important role of government ownership

1.37 There is a variety of views about what should happen to Medibank Private. Some have argued it should be "... sold to the right buyer, creating the right market structure " rather than floated on the share market.¹⁷

1.38 The Australian Medical Association would support the Government selling Medibank Private if it became a mutual, rather than a company floated on the stock exchange.¹⁸

1.39 But the best way to ensure families can afford health insurance is for the government to be a player in the sector to keep everyone honest.

1.40 If the Government no longer has a financial interest in the industry, how long will it be before its role of regulating premiums will become nothing more than a rubber stamp?

1.41 Dr Deeble argues that:

... MPL's presence affirms the broader public interest in private health insurance. I have always believed that Medicare is a national system of health care financing which includes the private sector and its insurers, not just a Commonwealth scheme of benefits for medical care and public hospital treatment. The two parts are complementary in ways which go

15 Dr John Deeble, *Committee Hansard*, 3 November 2006, Canberra, p.29.

16 Dr John Deeble, *Committee Hansard*, 3 November 2006, Canberra, p.29.

17 Mr Francis Sullivan, 'Health insurers need competition', *Australian Financial Review*, 6 September 2006, page 63.

18 *Committee Hansard*, 3 November 2006, Canberra, p.16.

beyond the market place, although there are vested interests with a reason to argue otherwise.¹⁹

1.42 It was also argued that:

Poor co-ordination between the public and private provision of health care is a major, and justified, criticism of the Australian system and I see the continuing emphasis on separating them even further as our major policy mistake ... [B]ut the whole thrust of these proposals is to move Medibank Private Limited further away from the health service sector and into the more general finance industry. If the largest fund does so, others would probably follow. Integration would then be even less likely.²⁰

1.43 Private health insurance is important to Australians. More than one in two adults have made the financial sacrifice to take out insurance, with the largest rates of private health insurance among couples with children. However, two thirds of those who do not have health insurance say it is because it is too expensive.²¹ Given the significant government subsidies for health insurance, it is vital that the government continue to ensure access to private cover is affordable and accessible to as many Australians as possible.

Demutualisation has been bad for consumers

1.44 There have been cases in the broader insurance industry where organisations that have been demutualised and made into for-profit companies have not appeared to serve their members well.

1.45 When the NRMA (National Roads and Motorists' Association) was demutualised in 2000 and removed as the leading premium-rebating insurer, others in the industry rejoiced. It became a management-focused company intent on delivering to shareholders ahead of policyholders.

1.46 In 2003 it was reported that NRMA members "... with 'basic care' membership [for road service] will have their fees hiked by 23 per cent or \$12.50 to \$67.50 while 'premium care' customer fees will jump by 33 per cent or \$34.60 to \$140 ..."²²

1.47 Former NRMA board member Richard Talbot criticised the price hikes, saying:

19 Dr John Deeble, *submission 5*.

20 Dr John Deeble, *submission 5*.

21 Australian Bureau of Statistics, *Private Health Insurance: A snapshot, 2004-05*, 22 November 2006, Catalogue 4185.055.001.

22 Belinda Tasker, 'NRMA to introduce hefty fee increases', *The Canberra Times*, 24 April 2003, p.19.

Members were told just two years ago that, after demutualisation, the road service would be in a stronger financial position ... Now they find, instead of a \$20 million annual profit for 2003 [forecast at the time of demutualisation], we have massive losses ...²³

1.48 It was also commented that:

Any student of demutualisation or reorganisation of insurance companies over the past two year would notice the only consequence which is certain is that the remuneration of senior management immediately improves ... Benefits to customers – that's a less certain prospect as any AMP (or NRMA) shareholder might agree.²⁴

1.49 While not a mutual, the sale of Medibank Private will follow the same path. Rewarding shareholders will be the top priority, which will be at the expense of members and their needs.

Conclusion

1.50 The Government is selling out Australian families by selling Medibank Private. Profits should not come before families.

1.51 If the Government is serious when it claims to care about Australian families, it should ditch its plans to sell Medibank Private which will lead to higher premiums and reduced services.

1.52 Australian families will be worse off if Medibank Private is sold and the financial bottom line dictates decisions.

1.53 Families are already struggling to make ends meet and they will suffer further from a privatised Medibank Private.

1.54 The needs of families must always come first. For this reason, FAMILY FIRST calls on the Government to admit it has made a mistake and retain ownership of Medibank Private to ensure quality health cover at the lowest possible premiums.

Senator Steve Fielding
Leader of the FAMILY FIRST Party
FAMILY FIRST Senator for Victoria

23 Anthony Hughes and Kate Askew, 'Now the NRMA lemon puts the squeeze on members', *The Sydney Morning Herald*, 4 March 2003, p.1.

24 Jack Waterford, 'Milking a cash cow leaves us feeling sick', *The Canberra Times*, 5 April 2006, p.17.

Appendix 1

Submissions and Additional Information Received

Submission Number	Submitter
1	Dr Ken Harvey
2	Health Insurance Restricted Membership Association of Australia (HIRMAA)
3	Private Health Insurance Ombudsman
4	Confidential
5	Dr John Deeble
6	Australian Competition & Consumer Commission (ACCC)
7	Community and Public Sector Union (PSU Group)
8	Australian Medical Association (AMA)
8a	Australian Medical Association (AMA)
9	National Liaison Committee (NLC)
10	Westfund
11	Choice
12	Young People In Nursing Homes National Alliance

ADDITIONAL INFORMATION

1. Received from Department of Finance and Administration – A report from CRA International on the impact of the privatisation of Medibank Private Limited on private health insurance premiums.
2. Received from Australian Medical Association (AMA) – tabled documents at public hearing on Friday, 3 November 2006 – Medibank Private: Operating Surplus/Deficit and Management Expenses.
3. Received from Save Medibank – tabled documents at public hearing held on Friday, 3 November 2006.
4. Received from Medibank Private – responses to questions taken on notice at public hearing on Friday, 3 November 2006.
5. Received from Department of Finance and Administration – responses to questions taken on notice at public hearing on Friday, 3 November 2006.
6. Received from David Wawn, Chief of Staff, Office of Senator The Hon Nich Minchin, Minister for Finance and Administration – responses to questions taken on notice at public hearing on Friday, 3 November 2006.

Appendix 2

Public Hearing and Witnesses

Friday, 3 November 2006 - Canberra

BUTTERWORTH, Mr Robert, Division Manager, Shareholder and Asset Sales,
Department of Finance and Administration

DEEBLE, Dr John Stewart, Private capacity

GILLESPIE, Ms Margaret, Acting National Secretary
Community and Public Sector Union

GINNANE, Ms Gayle Elizabeth, Chief Executive Officer, Private Health Insurance
Administration Council

MASKELL-KNIGHT, Mr Charles, Principal Adviser, Acute Care Division
Department of Health and Ageing

MORPHY, Mr Tim, Manager, Corporate Development
Medibank Private

O'DEA, Mr John, Director, Medical Practice Department
Australian Medical Association

POWLAY, Mr John, Ombudsman
Private Health Insurance Ombudsman

RAHILL, Ms Alison, National Research Officer
Community and Public Sector Union

RENEWICK, Mr Robin, Branch Manager, Asset Sales Branch
Department of Finance and Administration

STAINES, Mr Andrew, Director, Asset Sales Branch
Department of Finance and Administration

YONG, Dr Choong-Siew, Vice President
Australian Medication Association