12 December 2013

Hon Peter Dutton MP
Minister for Health
PO Box 6022
House of Representatives
Parliament House
Canberra ACT 2600

Via email: peter.dutton.mp@aph.gov.au

Dear Mr Dutton

Private Health Insurance Rebate

The Actuaries Institute ("Institute") is the sole professional body for actuaries in Australia. The Actuaries Institute represents over 4,100 members including 2,200 Fellows. Our members have had significant involvement in the development of health, general and life insurance and superannuation regulation, financial reporting, risk management and related practices in Australia and Asia.

We are writing to you with regard to the Private Health Insurance Legislation Amendment (Base Premium) Act 2013. The Amendment Act, which received assent on 29 June 2013 and came into effect from 1 July 2013, seeks to reduce the amount that the Federal government spends on PHI rebates and to decouple that expenditure from premium increases.

Summary

The policy intention of the previous Government was to reduce the cost of future rebate spending by linking the PHI rebate to increases in the nationally weighted consumer price index ("CPI") (which could be around 2% to 3%), instead of premium rate increase (which could be around 6%). We believe that the resulting Private Health Insurance Legislation Amendment (Base Premium) Act 2013 (the "Amendment Act") is inefficient in reducing Government expenditure on private health insurance rebates as well as being a confusing mechanism that will have significant adverse consequences.

We believe there are more efficient and less confusing methods to achieve similar aims, and have suggested alternatives in this letter. The alternatives allow the Government to achieve a similar reduction in rebate costs without unnecessary red tape, significantly reducing the complexity and administrative burden for policyholders and insurers. The suggested alternatives also eliminate perverse incentives for practices that may further erode the value proposition of private health insurance for policyholders.

PHI rebate mechanism

Health costs increase faster than the Consumer Price Index ("CPI"), whether those costs are part of the public or private health system. This reflects increasing utilisation of services at all ages, our ageing population, advances in technology and the labour-intensive nature of healthcare. To keep pace with increasing utilisation and costs, PHI premiums need to increase faster than CPI. In effect, by linking the PHI rebate to CPI instead of price rises or even health CPI, the Amendment Act phases out the rebate over many years.

Institute of Actuaries of Australia
ABN 69 000 423 656
Level 7, 4 Martin Place, Sydney NSW Australia 2000
t +61 (0) 2 9233 3466 **f** +61 (0) 2 9233 3446
e actuaries@actuaries.asn.au **w** www.actuaries.asn.au

Under the Amendment Act, from 1 July 2013 the rebate will be calculated as a percentage of a base premium (set equal to the policy premium at 1 April 2013) that is indexed each year by the lesser of the national weighted change in CPI and the actual premium increase. This is in contrast to the previous situation in which the rebate was calculated as a percentage of the actual premium. For a policyholder, the percentage rebate applicable to the base premium will continue to depend on the relevant rebate rates and income thresholds. For example, at 1 April 2014 with a 5% premium rate increase, the cost of a $2,000 policy increases to $2,100. With 2.5% CPI, the base premium increases to $2,050. The rebate applies to the $2,050 base premium not the $2,100 actual premium. For someone on the highest rebate level, a 30% rebate in 2013 effectively becomes a 29% in 2014 and this will be further eroded over time if premium rises outpace inflation. The core of the particular mechanism chosen by the Department and embedded in the Amendment Act is therefore the recording of *two separate premium rates* for each policy.

Efficiency

Under the chosen implementation method, there will be significant unnecessary administration, compliance and communication costs for insurers and regulators that may ultimately add to the cost of PHI products for consumers will find it harder to understand PHI and compare products.

Additionally, the chosen implementation method brings with it a range of unintended incentives for insurers to “game the system” in order to attract and retain policy holders. This gaming could mean that insurers focus on managing and marketing a product’s rebate percentage through various means, consuming management resources and adding to product costs while providing no benefit to consumers.

Competition and complexity

The chosen implementation method adds significantly to the complexity of PHI products. It will be more difficult for consumers to make meaningful and informed comparisons between different products. Effectively, there is a need for consumers to compare not two but four premiums. For example, compare two products that have the same premium in five years’ time, but which have experienced different premium rate rises along the way. Although the headline premium is the same, and the policyholder is entitled to a 30% rebate, Policy A is cheaper than Policy B because the rebate applies to a different base premium in each case:

	Policy A	**Policy B**
Premium at 1 April 2013 (before rebate)	$1,528	$1,457
Premium at 1 April 2013 (after 30% rebate)	$1,070	$1,020
Annual premium rises for 5 years	5% a year	6% a year
CPI increases for 5 years	2.5% a year	2.5% a year
Premium at 1 April 2018 (before rebate)	$1,950	$1,950
Base premium at 1 April 2018 (CPI increases)	$1,728	$1,649
Premium at 1 April 2013 (after 30% rebate)	$1,431	$1,455

Institute of Actuaries of Australia
ABN 69 000 423 656
Level 7, 4 Martin Place, Sydney NSW Australia 2000
t +61 (0) 2 9233 3466 **f** +61 (0) 2 9233 3446
e actuaries@actuaries.asn.au **w** www.actuaries.asn.au

Value proposition of PHI

One consequence of the implementation method is that insurers will be incentivised to maximise the rebate offered on their products by minimising benefit improvements. The likely outcome of this is an acceleration of the recent trend towards more exclusions, restrictions and greater out-of-pocket gap payments. As products provide less and less true insurance cover over time and consumers find themselves paying both premiums and large gap payments, they will increasingly question the value of their product.

Another possible consequence is that the rebate on hospital products may diminish much more rapidly than the rebate on ancillary products – reducing the value proposition of hospital products while leaving ancillary products relatively untouched. Due to the higher rate of inflation on hospital products compared to ancillary products (in recent years, roughly 8% compared to 3%), the standard rebate percentage on hospital products would be less than 20% in 10 years' time, compared to around 30% for ancillary products.

This would make ancillary products more attractive than hospital products. If it is the intention of the Government to encourage PHI membership, is it hospital rather than ancillary product membership that should be encouraged, representing as it does 'true' insurance cover and a more effective way of alleviating the burden on the public health system.

Alternatives

Given the disadvantages of the method set out in the Amendment Act, we suggest that the Government explore alternative methods which have a reduced impact on policyholders in terms of complexity, cost and the potential erosion of the PHI value proposition but achieve a similar (or greater) reduction in rebate costs incurred. These methods could include:

- **An explicit reduction in the percentage rebate (e.g. reducing the percentage rebate in steps, say 1.5% reductions to the 30% level, 0.5% reductions to the 10% level).**
- **Maintaining the 30%/20%/10% levels but controlling PHI rebate expenditure through non-indexation or lower than CPI indexation of the income thresholds.**

There are other simpler methods too, such as:

- **removing the rebate entirely on ancillary products, or on exclusionary and restricted products.**
- **removing the rebate on all products and subsidising a risk equalisation pool.**

We would welcome a discussion with you on rebate calculation methods that bring greater transparency for consumers. Please contact Elayne Grace, Deputy Chief Executive Officer of the Actuaries Institute (phone 02 9239 6128 or email Elayne.grace@actuaries.asn.au) to arrange this, or for any further information.

Yours sincerely

John Newman
President

Cc: Hon Catherine King MP, Shadow Minister for Health

Institute of Actuaries of Australia
ABN 69 000 423 656

Level 7, 4 Martin Place, Sydney NSW Australia 2000
t +61 (0) 2 9233 3466 **f** +61 (0) 2 9233 3446
e actuaries@actuaries.asn.au **w** www.actuaries.asn.au