AMA

SUBMISSION TO THE SENATE STANDING COMMITTEE ON PUBLIC FINANCE AND ADMINISTRATION

Inquiry into the provisions of the Medibank Private Sale Bill 2006

AUSTRALIAN MEDICAL ASSOCIATION

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1 INTRODUCTION

The Australian Medical Association (AMA) is pleased to respond to the invitation by the Standing Committee on Finance and Public Administration to make this submission to the ***Inquiry into the provisions of the Medibank Private Sale Bill 2006***.

The AMA has been advised that the matters under consideration by the Standing Committee include the effect of the sale on current Medibank Private members, competition and efficiency in the private health insurance sector particularly premiums, health and insurance markets across the states and territories and the overall access and equity implications for healthcare.

1.1 A framework for assessing the issues

In the AMA's view, the proposed sale of Medibank Private should be considered against the key public policy objectives for private health insurance (PHI). Good public policy will be underpinned in every case by a strong economic rationale.

The AMA believes that the key elements of policy which set the backdrop for the proposed sale of Medibank Private are:

PHI should be an efficient mechanism for people to share the risk of ill health. For this to occur:

- Policy settings should encourage strong participation in private health insurance to enable a sufficient pool of people across the full range from healthy to sick (so the privately insured population is a reasonable representation of the whole population).
- Premiums need to be set so that benefit levels are sensible and a proper insurance function is performed. PHI is undone as a mechanism for people to share the risk of ill-health if insurers bear down hard on benefits paid so that they cover a limited share of the actual costs of health care.
- The private health insurance industry needs to be competitive to drive efficiency. There should be relatively free entry and exit to the private health insurance market and government regulation should be light so there are not excessive costs of compliance. We note that there are moves to simplify the legislation around private health insurance. The desirable outcome should be a reduction in regulation of the industry.

Consumers should enjoy choice of health fund and health fund products. For this to occur:

- There must be a reasonable number of health funds competing in the major markets. The private health insurance market is an oligopoly in nature. Although there were 40 funds registered as at end-June 2005, the 6 largest funds then commanded 77 per cent of the coverage of private health funds and, in the 2004-05 financial year, three quarters of the total contributions to health funds. This gives them considerable market power which they wield against both consumers (their own members) and providers. The private health insurance market is much less competitive in nature than the private hospital market or the market in medical services.
- Consumer choice needs strong protection of portability. The health funds have never been keen to in any way encourage portability which has been a useful anti competitive mechanism for them. The AMA believes that the actions in train by the Government to ensure portability are entirely appropriate. In the past health funds have denied their members portability on quite spurious grounds.

- Effective consumer choice of health funds and health fund products requires a well informed market. Many surveys have confirmed that members are not aware of the benefits of their health fund product and there has been a reluctance to make information readily available. In addition at the point of use of the product ie approaching hospitalisation, there is very little contact between the member and the health fund for advice on benefit payments. Initiatives by the Private Health Insurance Ombudsman to improve product assessment are encouraging.
- Effective choice means products must be available which are relevant to the needs of all members. Some members will want to purchase front-end deductible products or exclusionary products as they are prepared to take on a level of financial or insurance risk. Others will be more risk averse and will want to have high levels of cover so there is the minimum of surprise.

Where there is failure to deliver consumer choice, the value of PHI to families is diminished.

1.2 A framework for an efficient PHI sector

In order to keep PHI premiums low, there are only three avenues open to the funds:

- ***Reduce benefits:*** This destroys the value in PHI to the consumer;
- ***Control management costs:*** The PHI industry has had a rather chequered history in this department;
- ***Manage financial assets more expertly to increase non-premium income:*** There are some limitations on what can be achieved in this area because financial reserves are required to be held for prudential reasons and the funds must maintain some of their assets in highly liquid (and relatively low-yielding) forms.

Unless there is competition between private health insurance funds, management costs will be poorly controlled.

There are some costs that PHI funds cannot control. These include the costs that are shifted onto them by State and Federal Governments, State government taxes (levies) and the costs of complying with regulation.

If Governments are genuinely committed to an efficient PHI sector, then they will think carefully before adding to the imposts on the sector.

1.3 AMA assessment

The AMA has assessed the proposed sale of Medibank Private against this policy framework. The conclusions follow.

2 THE EFFECT ON PREMIUMS PAYABLE

The AMA concludes that the sale of Medibank Private would lift PHI premiums.

Regardless of the legal structure, Medibank Private has been run much the same way as the mutual funds. There is no equity partner providing capital in return for an income stream. Instead, Medibank Private has been self-funding (save for one minor capital injection).

PHIAC has reported that, as at 30 June 2005, Medibank Private had some $650 million in net assets. These assets were not contributed by the Government. They were extracted from the members by charging premiums at a level to generate a surplus year-by-year to build both an assets base and the financial reserves that are required.

This strategy is broadly appropriate. A large financial organisation needs an asset base to operate. The holding of financial reserves is prudent. Indeed, it is required by Government regulation.

The purpose of the reserves is to make the organisation stable and sustainable. It is essentially about consumer protection.

Having regulated to require Medibank Private to build up and hold reserves (in the same way as all other funds), the Government now proposes to sell the asset. 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 p.a. in net revenues to service the equity.

Where would this extra money come from?

It is not possible to cut that much out of Medibank Private's management expenses ($238m in 2005-06, representing 10.4 per cent of benefits paid). The industry average is 10.8 per cent of benefits paid. Medibank Private is below the average but short of best practice (several large competing funds spend less than 10 per cent of benefits paid on management expenses). There is some room for improvement in Medibank Private but nothing like $150 million.

It is possible that Medibank Private's strategies for investing reserves and liquid assets could generate more non-premium revenue but again, nothing like $150 million.

So that only leaves reducing benefits which, if pursued, would reduce the value for money in Medibank Private and almost certainly result in a loss of market share.

Unless Medibank Private is sold off very cheaply, the obvious conclusion is that it will have to increase its premiums to generate the revenue to service the equity. This will have an immediate impact on its own members but, by virtue of making Medibank Private less competitive in the market, there will be industry-wide flow-on effects on premiums.

3 THE EFFECT ON COMPETITION

The AMA concludes that the sale of Medibank Private would reduce competition in the sector on the basis of premium increases alone.

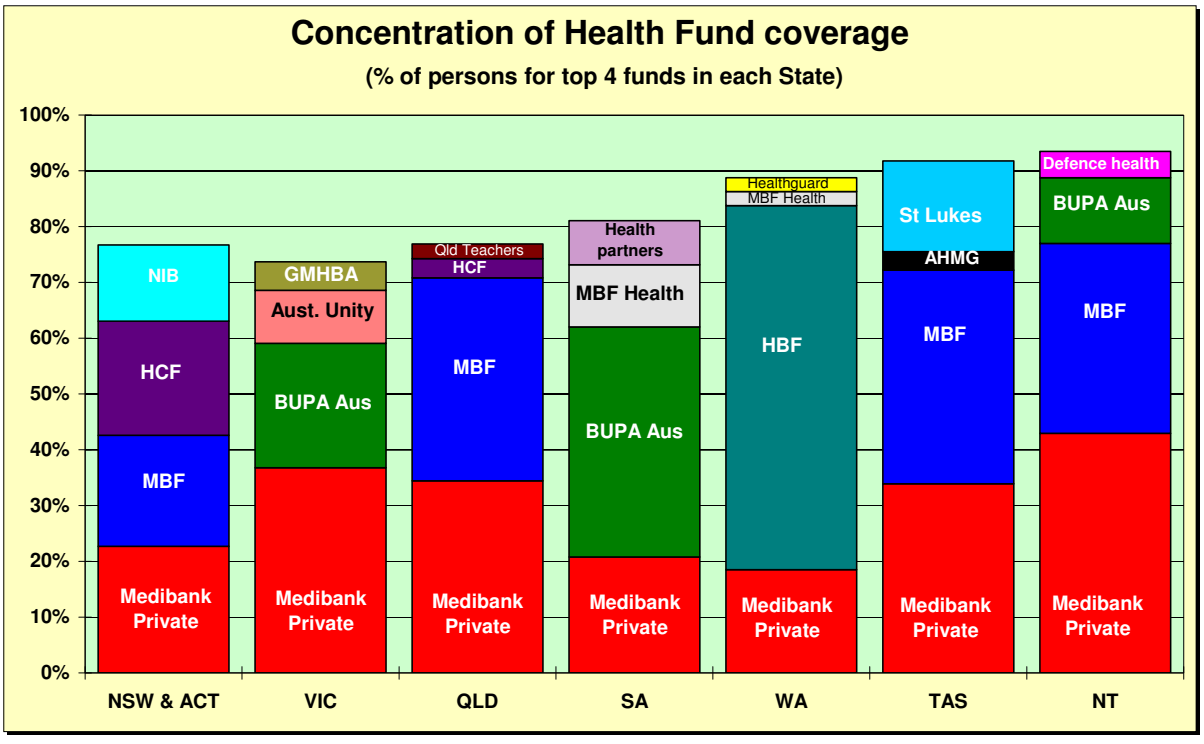
There is another potential source for diminution in competition, that being if an existing fund is allowed to purchase Medibank Private.

Our comments in this latter area are necessarily speculative because there is no decision, as yet, as to whether Medibank Private will be disposed of via a trade sale or a public float. The only provision in the Bill that appears to be relevant is a clause preventing overseas ownership (subject to a 5-year sunset).

Medibank Private's market share in 2004-05 (measured nationally) was 28% measured either way (coverage or contributions income). Its market share varies from a low of 18.5 per cent in WA to a high of 42.9 per cent in the NT.

In effect, there is no national market in private health insurance. Rather, there are distinct geographical markets (state/territory). Most state markets are dominated by two to three funds (Medibank Private and one or two others). Chart 1 makes the point that the top four funds in each market control at least three quarters of the market (and, in two cases, more than 90 per cent).

Chart 1: The top four funds in each State/Territory



If another significant extant private health fund were allowed to purchase Medibank Private, it could potentially end up with a stranglehold on one or more state markets to the great detriment of consumers and providers alike.

For example, if the purchaser were MBF, the combined entity would control more than 70 per cent of the market in three states (for a national market share of 44 per cent). Similarly, if the

purchaser were BUPA Australia, the combined entity would control more than 55 per cent of the market in three states (for a national market share of 37 per cent).

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.

There would be a loss in the variety of products on offer. For example, Medibank Private offers both no gap and known gap medical insurance products. MBF and HCF do not offer known gap products so disposal of Medibank Private to either of these existing funds would almost certainly lead to a reduction in the range of products available.

4 INDUSTRY EFFICIENCY

The AMA doubts the claims that Medibank Private will be considerably more efficient if sold off to the private sector. This would necessarily imply that Medibank Private is being badly run now. The AMA has seen no clear evidence to support such a proposition.

Of course, the AMA has some quite robust dealings with private health funds, Medibank Private included. There are times when the PHI industry pursues policies that are strongly against the interest of patients and quality health care. In those circumstances, the medical profession can always be expected to take up the cudgels. None of this implies that the AMA believes that the funds are grossly inefficient or that the AMA lacks respect for those who manage Medibank Private.

All the funds can lift their game of course, the more so if some of the ineffective elements of the regulatory environment were removed. It is arguable that Government over-regulation of the funds gives rise to far greater problems than government ownership.

In that sense, the PHI industry is no different to any other sector. Indeed, we would venture to suggest that there is scope to improve the efficiency of the Parliament.

5 LEGAL ISSUES

At present, there is a legal debate around the issue of who owns Medibank Private, with contesting arguments from Blake Dawson Waldron (advisers to the Government) and the Parliamentary Library.

The AMA does not have the legal expertise to join this debate and has very serious doubts that it is germane to the questions before the Standing Committee.

Regardless of the legal conclusion, there are moral issues which need to be considered. In our submission to the ACCC, we commented that we doubted the morality of the sale

> "*… given that much of the value of Medibank Private is in its financial reserves which were not contributed by the government but rather, extracted from the members in compliance with regulatory requirements. This does not imply any criticism of the regulatory requirements. Reserves are necessary for proper prudential management of private health funds. However, if the Government no longer wishes to be involved as an operator of a private health fund, there is a strong case for mutualising Medibank Private and retaining the equity with those who have contributed it, namely the members.*"

Since we made that submission, we have not seen any compelling arguments which would lead us to change our view.

The members of Medibank Private have, in economic reality, put up the capital that is needed for the organisation to operate and to be managed according to strong prudential principles. The members have a reasonable expectation that the money they put up will be used for the purposes for which they were extracted.

6 OTHER ISSUES

In the past, there have been examples where overseas entrants to parts of the Australian health sector have brought values and systems that are out of kilter with the expectations of the Australian community. Australians do not want US-style managed care imposed on a system that now produces superior health outcomes at lower cost. We support the government's proposal to block overseas ownership of Medibank Private for 5 years and suggest it might be made a permanent feature.

In a similar vein, there have been attempts at vertical integration between insurers and providers (for example, the MBF foray into the operation of private hospitals). AMA policy supports a strong separation between insurers and providers of care. We do not believe that it is possible to reconcile the conflict of interest inherent in a vertically integrated organisation that spans both the funding and the provision of care.

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