

ISSUES PAPER: PRIVATE HEALTH INSURANCE PREMIUM SETTING

Purpose

This paper provides a basis to discuss potential changes to the current premium setting process. The options raised in this paper are not exhaustive. They are drawn from a number of sources, including submissions from the 2015 private health insurance consultation process, previous reports commissioned by the industry, work commissioned by the department and internal departmental discussions.

Annual premium approval round

Changes to private health insurance premiums have been regulated by the Australian government since 1996. Under section 66-10 of the *Private Health Insurance Act 2007* (the Act), private health insurers must apply, at least 60 days before the day they propose the change to take effect, to the Minister for Health for approval of any premium changes to their policies.

Under section 66-10 (3) of the Act:

The Minister must, by written instrument, approve the proposed changed amount or amounts, unless the Minister is satisfied that a change that would increase the amount or amounts would be contrary to the public interest.

'Public interest' is not defined in the legislation, which provides the Minister with some degree of flexibility.

In the case of a refusal, the Minister must table her or his reasons in each House of Parliament. The Ministerial power to refuse a premium application has been used only once, in 2001 following the introduction of Lifetime Health Cover.

While not in legislation, since 2000 there has been an understanding between the Government and insurers that all premium applications are submitted for consideration at the same time each year, with an annual date of effect from 1 April. As this is not a regulated requirement, insurers could still apply for changes outside of this process.

The Department of Health has responsibility for the annual premium rounds, while the Australian Prudential Regulation Authority (APRA), the prudential regulator of the Australian financial services industry, oversees insurers' solvency and capital adequacy. In their applications, insurers must provide detailed financial information and cost and benefit projections to justify any increases they seek. The proposed increases are reviewed by the Department, and by APRA for prudential viability, and advice is provided to the Minister for Health.

The Minister cannot approve an increase which is different from the amount requested by the insurer; she or he can only approve or refuse to approve the requested amount. However as part of the administrative process for considering a premium increase the Minister may at times request insurers to resubmit applications with different increases, or provide further evidence to support the increase sought.

It should be noted that the premium round is only one input to APRA. APRA has the power to require insurers to report on their finances and operations and can independently audit insurers' finances.

2016 premium round

As part of the 2016 premium round process, the Minister requested that insurers resubmit their applications "for a lower premium increase or provide any evidence of extenuating circumstances". The Minister did not exercise her power to refuse a premium increase on public interest grounds, under the Act.

Twenty of the 33 insurers resubmitted a lower increase. On 2 March 2016, Minister Ley announced that private health insurance premiums would increase on average by 5.59 per cent from 1 April 2016 (compared with an industry weighted average of 6.18 per cent in 2015).

Influences on premium levels

There are many variables driving increased premiums which are independent of the approval process, including:

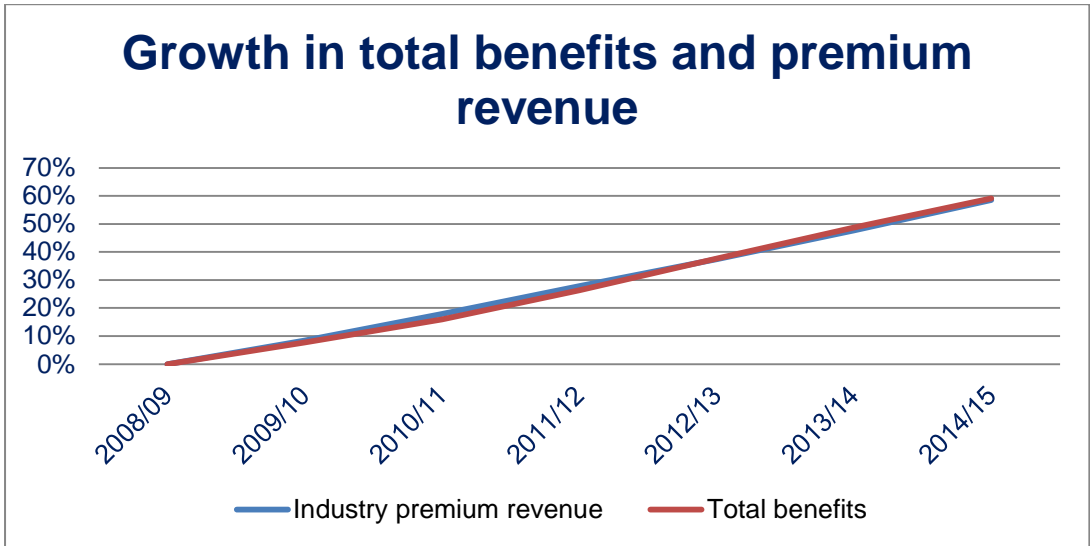
- Changes in the number of persons covered
- People upgrading and downgrading their policies
- The type of policies that new members are purchasing
- Changes to waiting periods, changes in benefits on products
- Increased costs for hospital treatment
- Changes to prostheses pricing (and utilisation of services)
- Increased compliance mechanisms to capture unnecessary admissions/readmissions
- Technology change which tends to result in new higher cost treatments
- Rising utilisation of hospital treatment

Insurers use actuaries to forecast benefits and to determine the necessary premium increase required to meet their organisation's needs, including benefit outlays, reserve requirements, risks and shareholder returns.

Legally, any Director of any Australian company must have an understanding of the financial health of their organisation; particularly an awareness of their duty to prevent insolvent trading. Directors should fully appreciate the financial implications of any proposed strategies, including premium changes, and associated risks.

It is not in insurers' long term interests to increase premiums without justification because higher prices (premiums) mean they are less competitive, and that undermines an insurer's viability as well as the viability of the industry as a whole.

The following graph shows that premiums are rising at the same rate as benefits paid. While this may indicate that insurers are not seeking excessive premium increases, it is not clear whether this is because of market forces or because of the Minister's role in the current approval process.



Issues

Premium increases impact Government spending through the Australian Government Rebate on Private Health Insurance (the PHI Rebate) paid to consumers. A rise in premiums will cause the cost of the PHI Rebate to increase, although this is limited to the Consumer Price Index (CPI). The PHI Rebate is annually indexed on 1 April by a Rebate Adjustment Factor representing the difference between the CPI and the industry weighted average increase in premiums.

There are a number of reasons which have been put forward for the current premium setting process, including an aim to:

- keep premium increases to the minimum necessary to keep private health insurance affordable
- create public and market certainty about how often and when premium increases will occur
- encourage insurers to carefully and correctly consider all relevant factors in making their pricing decisions.

However, there are limitations of the current process. There is little real opportunity for government to intervene and make a substantive difference in the rate of premium increases. Health insurers' Boards base their premium applications on extensive independent actuarial advice, and may find it difficult to vary their requests should the Minister ask them to resubmit their application.

The Minister's role in approving premium increases introduces a political element into what should be a commercial decision. This means the Government is often perceived as responsible for premium increases, despite powers to reject an application being limited to the public interest test. As a result, consumers often direct their frustration at the Government and insurers can take less responsibility for the increases.

Insurers have claimed that the current process restricts their pricing flexibility, without providing offsetting benefits for consumers. It has also been suggested that the long lag time between application and implementation may encourage insurers to be overly conservative in their forecasts, resulting in premiums which are higher than they might otherwise be.

Feedback received from some insurers is that they should be able to determine their premium increases without Government intervention. Industry suggests that premium costs for consumers are higher than they would be in a system that had less regulation of premiums.

It is unknown how deregulating the premium setting process will impact the industry and whether premiums would increase or decrease for consumers. However, as with any market based pricing, competition should tend to place downward pressure on premiums.

Recent government reviews (National Commission of Audit 2014, Competition Policy Review 2015) suggest that more competition would provide consumers with greater choice and more cost effective health care. The National Commission of Audit report suggests a lighter touch approach, replacing the current arrangements with a price monitoring system. The Competition Policy Review panel believe that prices should be fully deregulated when competition is deemed to be effective.

Case Study: compulsory third party insurance premium setting in NSW

Compulsory third party (CTP) insurance is similar to private health insurance in that commercial providers offer insurance cover but government regulates premiums. It provides a model for comparison.

In most states CTP insurance is a built-in registration component with a sole insurer, however in NSW, ACT and Queensland, drivers have the option of choosing the provider with whom they insure.

In NSW, insurance companies set premiums, however they must first lodge their premium schedules with State Insurance Regulatory Authority (SIRA) for approval. Insurers are required to submit premium filings to SIRA at least once a year. Additionally, insurers may notify SIRA that they wish to vary premiums at other times during the year.

SIRA may reject a filing of proposed premiums if it considers the premiums will not fully fund the insurer's liability, if it considers the premiums to be excessive, or if the premiums do not conform with its Premiums Determination Guidelines. For the purposes of the *Motor Accidents Compensation Act 1999*, a premium should be sufficient "to provide a profit margin in excess of all claims, cost and expenses that represents an adequate return on capital invested and compensation for the risk taken."

The NSW government does not subsidise or underwrite this insurance.

CTP is partially community rated, so insurers can vary premiums within certain limits. Insurers use different factors and apply different weighting to factors to determine the premiums they will charge. Factors which affect prices may include: geographic region, type of vehicle, driving and claims history. Geographic regions and vehicle classifications are designated by SIRA. SIRA issues Premiums Determination Guidelines as a mechanism to regulate the setting of prices. They also regulate the distribution and marketing through the Market Practice Guidelines.

It is worth noting that the current arrangements in NSW are under review, examining both prices and administration.

Options for consideration

This section considers possible options for change, and pros and cons of each. The options presented are intended to guide and encourage discussion, they are not exhaustive.

The following issues are relevant to each option below:

- The impact of the change on premiums is not known
- The timing of the proposed change needs to be considered
- The changes may require legislative change
- Any change that results in varying dates for premium increases and/multiple increases per year would require a new process for calculating the Rebate Adjustment Factor used for the PHI Rebate.

1. *Increase regulation*

Description

This option would increase the Government's role in premium setting through increased regulation, which could comprise a number of components, for example:

- Define 'public interest' in legislation
- Widen the Minister's powers to approve and reject premium applications
- Require publication of rationale and criteria used for assessment of premium increases
- Legislate how often premium changes can be made
- Allow the Minister to approve a different percentage change from the amount requested.

Pros

- Greater confidence and certainty for consumers.

Cons

- Potentially stifles innovation and competition – there is a view that there is already too much regulation.
- Increased regulation has potential to increase administrative workload for insurers and the department - this would lead to increased costs and increased premiums.
- Would be inconsistent with the Government's deregulation agenda.

2. *'Tweak' current regulatory environment*

Description

There are a number of alternative options which slightly change the regulatory landscape that could be considered, for example:

- Allow insurers to submit premium change applications:
 - at any time; or
 - at any time but up to a limited number of times each year; or
 - at set dates multiple times throughout the year, for example twice or thrice yearly – insurers could choose to change premiums at any or all of these times
- Multiyear approvals (with the ability for insurers to review if required)
- Reduce the amount of information insurers are required to provide in applications.

Pros

- Increased provider autonomy in process.

- Could be seen as supportive of the Government's deregulation agenda.

Cons

- Possible increased administrative burden.
- Possible increased regulatory costs with flow-on to increased premiums.
- Decrease in certainty for consumers.

3. *Banding premium approvals*

Description

Applications would be placed into bands based on the percentage increase requested. All applications with an average increase at or below a set 'cut-off' percentage would undergo a streamlined application and assessment process. Those above the increase would undergo more detailed scrutiny. Insurers would be advised of the 'cut-off' before undertaking their application processes. Options for ministerial approval of premiums include:

- a) All changes still require ministerial approval
- b) Only changes above the threshold percentage require approval
- c) Some changes (far above or below average increase) require approval.

Pros

- Lighter touch approach, with potentially less administrative burden and a lower workload for some providers (depending on application requirements).
- Possibly less administrative workload for Department and APRA.
- More certainty for providers.

Cons

- Potentially still a relatively lengthy application process (could be modified depending on what increase was).
- Less prudentially rigorous which may lead to increased financial risk.
- Possible incentive for insurers to set increases lower than needed – although this risk would be minimised by the Board's legal responsibilities.
- Changed regulation, not necessarily reduced.
- Does not improve flexibility of premium increase timing.

Other considerations

- How would the threshold percentage be determined? For example, it could be based on a capped gross margin or profit margin approach.

4. *Complete deregulation of premium setting*

Description

This option would involve removing the requirement for ministerial approval of premium changes. Premium changes would be market driven, with insurers able to make and implement pricing decisions to meet their individual circumstances.

Under this option, if other current regulation remains in place, health insurers would be required under the Act to notify the Secretary of the Department of any proposed premium change before the day on which the insurer proposes the change take effect, as they do for any other proposed rule change. Health insurers would also continue to be required to inform policy holders about proposed premium changes a reasonable time before the change takes effect.

Pros

- Encourages competition and innovation in the sector.
- Current portability arrangements remain, thus providing incentive for insurers to price competitively.
- More streamlined approach reduces regulatory and administrative burden on insurers (which could provide cost savings to industry and reduce pressure on insurers to increase premiums).
- Reflects insurer expertise in premium setting and the role of health insurer Boards.
- Removes annual premium application workload.
- Removes the political involvement in what is essentially a commercial decision.
- Consistent with Government's deregulation agenda.

Cons

- Consumer concern that premiums may unjustifiably increase.
- Reduced confidence in product because consumers view process as no longer being regulated by government (despite the Minister's limited powers currently).
- No checks on whether premiums increases are adequate to support financial viability – however there would remain legal responsibilities on health insurer Boards.
- Government still subject to criticism despite removing itself from the process.

Other considerations

- Need to work through implications for consumers. For example, does the premium purchase price lock-in for the year even if the consumer pays by instalments, or is the price only locked-in if the consumer pays for the year's premiums up front?
- This option may be more suited to an environment of annual insurance contracts.

5. Price monitoring system

Description

Under this option, the Government would cease its role as premium increase approver and a price monitoring system would be introduced to track private health insurance prices.

Insurers would have the flexibility to change their premiums how and when they choose, but prices would be monitored through an independent regulatory body such as the Australian Competition and Consumer Commission (ACCC). The ACCC regulates some national infrastructure services (such as communications and energy) and monitors other markets (such as fuel prices and airport car parking costs).

This option would be purely a price monitoring arrangement, not a regulatory arrangement. Price monitoring could be in place for a set period (for example, three years), and then be assessed to determine whether premium setting should be further deregulated, re-regulated or continue in a price monitoring arrangement.

Under legislation, the reason for price surveillance must be that, in the Minister's view, competitive pressures are not sufficient to achieve efficient prices and protect consumers. If this is the case, the Treasurer or Assistant Treasurer can request that the ACCC undertake price surveillance. The ACCC can also be requested to undertake informal monitoring, however this relies on the voluntary cooperation from industry to provide information.

Pros

- Price monitoring would allow some deregulation benefits.
- Consumers would continue to have readily available information about premium increases across the market.
- May encourage price competition.

Cons

- Legislation allows for price monitoring when there is limited competition - it would be difficult to argue that the private health insurance sector is not competitive.
- Consumer concern that premiums may unjustifiably increase.
- No certainty as to when premium increases would occur.
- Reduced confidence in product because consumers view process as no longer being regulated by government (despite the Minister's limited powers currently).
- The information published may not meet consumers' expectations regarding improved understanding of the relative value of different products.
- Provides information but no enforcement mechanism.
- No checks on whether premiums increases are adequate to support financial viability – however there would remain legal responsibilities on health insurer Boards.

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