Australian Government
Department of Health

Information Brief

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To: Minister Hunt

Subject: **URGENT CAPPING PRIVATE HEALTH INSURANCE PREMIUMS**

Minister Hunt			**Date: 5/2/2018**
Comments:			
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Key Issues:

1. On 4 February 2018, the Opposition leader announced a proposal to cap private health insurance premiums at two per cent for two years.
2. Little detail about the policy is available, so it is not clear whether this would be permitted under the *Private Health Insurance Act 2007* (the Act), or would require legislative change.

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Background:

Modelling of two per cent premium cap

It appears that the proposed savings are calculated using a (long-term) 5.5% average premium growth. The proposal estimates that the two-year 2% cap will save:

- singles an average of $143
- a young couple with no children $290
- a single parent $264

- a family $344
- an older couple $347.

Your premium round media release said that a 3.95% increase equals $1.40 per week for a single person and $2.75 per week for families. That is an additional cost of around $73 per year ($146 over two years) and $143 per year ($286 over two years). If the base was around 5.5% to 6% and reduced by 4% to 2%, the saving would be around $70 per year ($140 over two years) and $140 per year ($280 over two years). Therefore the maths in the Opposition leader's media release can be supported.

It is unclear how the single parent, family and older couple savings were derived.

Risks of an artificial cap on PHI premium increases – APRA role, capital adequacy, consumer risk
Under the current regulatory framework insurers are required to manage their affairs so as to maintain a level of minimum solvency and capital adequacy under standards set by APRA.

The solvency standard is intended to protect policy holders in the short term, to ensure that: "assets of a health benefits fund are sufficiently liquid to meet its cash demands and unanticipated losses from its activities."

The capital adequacy standard is intended to support the health of the insurer on an ongoing basis, and "requires the private health insurer to demonstrate that the assets of its health benefits fund will be able to meet the liabilities of the fund after a 12 month period, allowing for the future business plans of the fund and adverse circumstances."

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As a matter of practice at the discretion of the boards, insurers maintain reserves greater than the absolute minimums set by APRA to ensure a further margin to account for adverse circumstances.

APRA role in the premium round
APRA's role is to advise the Department of Health on whether premium increase requests from insurers would result in an adverse prudential outcome for individual insurers.

APRA assesses the financial performance, capital position, risk profile, profitability, strategy and forecasts of each insurer from a prudential basis.

If prudential concerns arise, APRA advises the Department. If there are no prudential concerns regarding the capital position of the insurer, APRA advises that the application, if approved, would not raise concerns.

Any relevant history of such attempts being imposed in the past, and its impacts outcomes)
A cap has not previously been imposed. Depending upon the implementation approach to be taken, legislative change may be required to set a cap on premiums.

Otherwise the Minister may negotiate with each insurer, with the aim of securing a particular industry-wide outcome, consistent with standard premium round processes.

Post the introduction of the PHIIS (the precursor to the premium rebate) in 1996, government began to scrutinise premium increases much more closely, and there was a bureaucratic process of scrutiny and negotiation based on a policy of not approving any increase which would leave an insurer after twelve months with reserves measured as months of premium revenue of more than three months. Industry reserves fell by nine per cent.

The Ministerial power to refuse a premium application has been used once since it was introduced in 2001.

In that instance, HBF was refused a premium increase by the then Minister (Dr Michael Wooldridge). Dr Wooldridge intervened because no other insurer applied for a premium round increase in that year. Dr Wooldridge determined that HBF had enough financial capacity to manage its affairs, deliver a high level of services, and remain competitive in the market. There was also the public expectation that the introduction of Lifetime Health Cover would negate the need for any premium increases in that year.

Procedural Fairness
Insurers have access to a process for procedural fairness, if you refuse an application. This includes the insurer being offered the opportunity to resubmit their application with a lower increase or to provide further evidence to support their original application.

If after considering the insurer's resubmission or additional information supporting the original application, you are still inclined to refuse an insurer's application then the insurer should be provided with a Statement of Reasons (SoR) outlining the public interest grounds on which their application is to be refused. The insurer's response to the SoR should be taken into account in finalising the decision.

If a premium change is not approved, it is possible that the organisation will have to restructure their investment strategy, renegotiate funding arrangements with doctors (possibly resulting in a higher out-of-pocket expense for consumers), lower dividend payments to investors, or restructure their products to remove high cost items.

The public interest test requires that consideration be given to the best interest of the public to reduce premiums at the expense of profit and at the expense of these initiatives.

If you do not approve the application, you must table the reasons for refusal in each House of the Parliament no later than 15 sitting days of that House after the refusal.

Can the Department (legally) ask APRA for any detailed advice on the impact of an artificial cap?

Yes, the Department can ask APRA for advice on the impact of a cap. However, APRA are not required and cannot be compelled to provide that advice.

The Department could write to APRA and request that it models a two per cent premium for 2019 and 2020; and seek its advice on potential prudential risk for insurers, based on its modelling.

APRA could be asked to model this for all 37 insurers, however, a sample model may be requested instead (eg modelling on the three largest insurers (based on membership/market-share), three mid-range insurers and those insurers where some prudential risk has been flagged for 2018.

Risks/sensitivities:
PHI business operations involve a very complex set of possible parameters which APRA will not be able to model in their entirety. APRA's assessment is only on whether the requested increase is such to create concerning adverse prudential outcomes.

APRA is unlikely to be able to provide the level of detail on the matter of solvency if a cap was put on premium increases.

What aspects of the attached letter can be made public by the Minister in any comments he makes?
The letter and contents cannot be released without APRA agreement and it is anticipated that APRA would not wish to release anything that identifies insurers due to potential negative consequences on those insurers (i.e. customers leaving that insurer).

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