Memorandum

To	Workshop participants
From	Finity
Date	6 April 2022
Subject	Stakeholder forum on MLS and PHI Rebate studies – background information

Executive summary

Purpose of meeting

This paper provides information on the MLS and PHI Rebate studies which are underway. We seek your feedback on our planned focus areas, specifically, whether our preliminary evaluation criteria are appropriate, and the options we are focusing on.

Scope

Our scope of work is to investigate the effectiveness of the MLS and PHI Rebate. We have been asked to identify and model whether alternatives could improve the affordability and value of PHI, participation in PHI, and the sustainability of the mixed model of private and public healthcare[1].

Why incentives are required?

As PHI is community rated, premiums for people in good health will exceed expected claim costs. Policy responses are required to incentivise people with low expected claim costs to insure, which in turn reduces average premium rates.

There are two broad types of incentives:

- Subsidies (eg, the PHI Rebate): Encourage people to insure by reducing price.
- Charges (eg the MLS): Encourage people to insure by introducing a cost.

Evaluation criteria

Evaluation criteria allow us to measure the extent to which each option is consistent with the objectives, and are necessary because concepts such as sustainability cannot be measured directly. Our evaluation criteria include measures relating to participation, affordability for individuals and cost to government, choice, equity and market dynamics.

The assessment against criteria is relative rather than absolute. In particular, the criteria allow us to identify options which represent marginal or material improvements.

Initial findings

Subsidies such as the PHI Rebate help make PHI more affordable.

- There may be opportunities to optimise the rebate available for different groups or products, and we expect these options would represent a small improvement when assessed against the evaluation

[1] The Department of Health commissioned this study as part of the budget measure "Improving affordability and sustainability of private health insurance". Further details on this budget measure can be found here.

criteria. These options include changing the rebate rate, thresholds, or other aspects of the calculations.

- There are limited opportunities to use subsidies to create a material improvement. This is because research suggests even very large price reductions may not result in significant extra PHI participation, given premiums would remain well above expected claim costs for those in good health, and everyone is able to access free public healthcare.

Charges such as the MLS have a significant impact on those they target. Options have been identified which we anticipate would represent a marginal improvement on the current system, however changing MLS is unlikely to result in material improvements. For example:

- Options could encourage people who currently pay the MLS to insure, for example, by making PHI rather than paying the MLS the default option. However, these options would only have a marginal impact, as the overwhelming majority of people buy PHI rather than pay the MLS (the PHI participation rate exceeds 90% for the highest earners).
- Requiring people with capacity to pay to buy more comprehensive PHI to avoid the MLS – we also assess this option as having a marginal impact because most older people with PHI do not choose basic or bronze policies.
- Expanding the scope of MLS to include those on lower incomes would increase participation, however incentivising people on low incomes to buy PHI may not be regarded as fair.

There may also be opportunities to simplify and integrate the PHI Rebate, MLS and LHC. While there are benefits of simplification, it is unlikely to be sufficient in itself to give a material improvement against the evaluation criteria.

We are examining options which may have a more material impact, and are within our scope of work. A focus area is incentivising people to purchase more comprehensive PHI. All hospital policies make a significant financial contribution to the affordability of PHI for older Australians and provide some cover for the policyholder. Compared to Basic and Bronze level products, more comprehensive PHI covers a broader range of services with generally lower out of pocket costs, meaning the policyholder is more likely to use the private system if treatment is required. This paper includes an option for incentivising comprehensive PHI for younger people, as this segment is frequently identified by stakeholders as an area where significant change may be required.

Information for stakeholder forum

Purpose

There is a stakeholder forum on the MLS and PHI Rebate studies on 7 April 2022. This paper provides background information on the studies, including:

- The "guiding framework" for the project: what Finity has been asked to investigate, our understanding of the Department's objectives, and the preliminary evaluation criteria we have developed.
- Our initial assessment of the effectiveness of these settings.
- Options identified through previous stakeholder engagement.

The purpose of the workshop and this paper is to provide you with information on the progress of these studies, to encourage stakeholders to consider and raise issues and different perspectives, and seek your feedback on:

- Areas of focus:
  - Criteria: How do we evaluate?
  - Success: What would material improvement look like?
  - Options: What options deliver?
- Further engagement: What do you need to know as the studies progress?

Guiding framework for project

Scope

The Department has engaged Finity to investigate the effectiveness of the MLS and PHI Rebate, and identify and model alternatives.

We also consider LHC as it is important that PHI incentives are aligned.

Objective

The Department is reviewing PHI regulatory settings to improve:

- The affordability and value of PHI, as well as participation in PHI.
- The sustainability of the mixed model of private and public healthcare.

A link to the corresponding budget measure was included in the executive summary.

Criteria

Evaluation criteria allow us to measure the extent to which each option is consistent with the objectives, and are necessary because concepts such as sustainability cannot be measured directly.

The assessment against the criteria is relative rather than absolute. That is, we compare the assessment for each option against the results if there are no PHI policy changes. The main criteria are summarised below.

Table 1 – Summary of evaluation criteria

Area	Example measures	Description	Met/exceeded
Participation – numbers	% of population with PHI (total, and by age)	Participation (total, and by age) are seen as lead indicators of PHI sustainability.	Higher participation
Participation - value	Total premium revenue and claims paid	Claim costs are a proxy for health status of the people insured together with the breadth of the cover. Also indicates the amount of private healthcare funded through PHI.	More people buy comprehensive products (e.g. greater purchase of higher tier products). More $ funded than under current system.
Affordable to community and individuals	PHI premium (after PHI Rebate) as percentage of household earnings. Calculate for each ABS income quintile.	Allows comparison of options - how they change affordability, and for whom.	More affordable for lower income quintiles
Government finances	PHI Rebate / MLS transfers ($) Number of people subject to MLS or receiving PHI Rebate, by age and income cohorts.	Necessary to allow government to consider whether options represent a stable, long-term basis for the funding of the health delivery system.	Impact on government spending / revenue represents good value, given improvement in other criteria. The system is expected to continue to meet objectives in future.
Choice and equity	Necessarily judgemental	The priority is to ensure there is enough choice for consumers to meet their needs. Equity considers whether those with more capacity to pay, pay more.	Enough choice to meet varying needs. Consistent with a normal view of equity.

Area	Example measures	Description	Met/exceeded
Market dynamics	Able to be implemented in a reasonable timeframe. Able to respond to changing circumstances.	Other considerations include complexity, and incentives for competition and innovation.	Mechanisms are in place to identify and offer incentives to provide the best value for policyholders and government.

It should be noted that this listing is not exhaustive, and will be added to or amended over time. We welcome feedback on whether these are appropriate as the main criteria to be considered, and whether any are more important than others.

Effectiveness of current policy settings

We have reviewed the effectiveness of the current policy settings, and briefly summarise our preliminary findings below.

Summary

Indicators that PHI policy settings may not be optimised include:

- Participation - numbers: The proportion of Australians with hospital cover was reducing prior to the pandemic, declining from 47.4% in June 2015 to 43.6% in June 2020. While participation increased to 44.9% in December 2021, this increase may not be sustained over the medium term. The average age of people with PHI has been increasing both prior to and during the pandemic. Declining participation and increases in average age impacts the sustainability of the community rated PHI model.
- Participation – value: More people who have PHI are purchasing policies with exclusions, which may not cover all commonly accessed treatments. Those who do buy PHI may not be satisfied because, should treatment be required, there may be large out of pocket costs. This suggests PHI could do more to reduce pressure on the public system and individuals who require treatment, and support those who choose to purchase cover.
- Policy choice by capacity to pay: For some people the product choice may reflect affordability, however policy choice primarily reflects age rather than income. Choosing basic policies may result in savings for policyholders in good health, but impacts the affordability of more comprehensive covers.
- Complexity: Due to stakeholder concerns, there have been a number of policy responses over time which has increased complexity (for example, youth discounts). There may be an opportunity to streamline regulatory arrangements.
- Innovation / market dynamics: There is limited evidence of stakeholders using innovative approaches to encourage people to buy comprehensive hospital cover. In our stakeholder interviews for the LHC/RE projects, several insurers said that innovation was limited by legislation, with preventative healthcare identified as an area where insurers would like to do more.

Our preliminary assessment against the criteria set out above is that the current PHI policy settings are not optimal. The comments below provide additional information on specific policy settings.

MLS

Description	A levy on people earning higher incomes who do not hold an appropriate level of private health insurance.
Objective	Incentivise those who can afford to contribute to the cost of their own healthcare to do so through PHI.
Main finding MLS has a powerful impact on the groups it targets	• Evidence: Over 80% of individuals aged over 30 with taxable incomes exceeding $100k have PHI. Participation is over 90% for higher incomes and older ages. • Policy considerations include: Does MLS target the right people, and incentivise appropriate actions? Specific considerations include whether MLS should require people on higher incomes to make a greater contribution to their healthcare costs, and whether more people on lower incomes should be MLS exempt.
Secondary finding MLS is least effective for individuals who are under 30, or have taxable incomes below $100k	• Evidence: For example, 66% of 25-29 year olds with taxable incomes between $90k-$100k have PHI, and participation rates have declined in recent years. • Policy considerations include: Consider adjusting MLS settings for this group, or other opportunities relating to product design, communication and the PHI opt-in process.

PHI Rebate

Description	Government contribution to PHI premiums, depending on policyholder income and age.
Objective	Improve access to PHI by making premiums more affordable, both directly through subsidy and indirectly by making PHI more attractive to those in good health.
Main finding Some stakeholders strongly argue for significant PHI Rebate increases, and others support its removal. It is important to consider options in the context of the project objectives, and make data driven recommendations.	• Evidence: Our previous research indicates PHI purchasing decisions are generally price inelastic, however a focus area should be how the PHI Rebate impacts decision making by particular segments, especially those not subject to MLS. • Policy considerations include: Equitable optimisation, given government and consumer objectives. The consequences of changes in participation would also need to be examined, including changes in the amounts of treatment undertaken in both the public and private health systems.

LHC

Description	Increases the premium to be paid if an individual takes out PHI for the first time after age 30, or has a significant break in cover.
Objective	Support community rating by providing incentives for people to obtain private hospital cover earlier in life, and encourage them to maintain it.
Main finding LHC makes a positive contribution to PHI participation (through its focus on obtaining and maintaining participants), and there is no immediate imperative to change. LHC is closely integrated with MLS (and PHI Rebate), so options should consider the PHI incentive policies together.	Evidence: LHC has, historically, seemed to contribute to PHI participation outcomes in excess of that expected from a pure price or economic argument, suggesting it plays an important role in contributing to community 'norms' and attitudes. There is evidence that this behavioural role is weakening or becoming less relevant for younger Australians in the face of affordability challenges. While any LHC reforms should be directed at enhancing the effectiveness of the 'obtain' objective, they must also be assessed against their impact on the incentive for insured Australians to maintain PHI cover. • Policy considerations include: Opportunities for integration and simplification of the three PHI policy incentives (LHC, MLS, PHI Rebate). In addition, there is support for adjusting other policy levers, such as the frequency of appropriate and targeted communication.

Options

Based on analysis to date and interviews with a broad range of stakeholders, the options identified can be categorised as follows.

We order the options in terms of the level of change from the current policies. We also propose where our analysis should focus.

Option category	Examples	Proposed approach for this project
Administration	Indexation process: round result to 1dp, index every 3 years. Dependants: remove/change complex family size adjustments to income thresholds.	Opportunities for simplification will be captured and considered in context of substantive reform options.

Option category	Examples	Proposed approach for this project
Optimisation Maintain separate PHI Rebate, MLS and LHC policies, but optimise settings.	Change MLS rate or thresholds. MLS mechanics: Make PHI (rather than paying MLS) the default option, by enrolling people in insurance rather than simply collecting the surcharge. PHI Rebate: change rates, thresholds, or other aspects of the calculation (for example, how PHI Rebate varies by age).	<u>Short term</u> Examine opportunities for incremental change, including: • Whether PHI Rebate should reflect measures in addition to or alternatives to income and age. • Options for lower middle-income earners, especially younger people earning just above $90k who may currently pay the MLS. <u>Longer term</u> Other option types expected to have a greater longer term potential impact.
Incentivise more comprehensive coverage Investigate linking PHI incentives or funding to product value/ scope of coverage. Current settings are that MLS/LHC incentivises hospital participation, and PHI Rebate incentivises any PHI participation.	MLS scope: As income increases, require higher tier / comprehensive hospital coverage be held to avoid MLS. PHI Rebate scope: vary rebate by product tier, or product type (hospital / extras). Linking funding to product features, for example, where products offer benefits for particular services, or have other desirable features such as low/no out of pocket amounts.	<u>Short term</u> For high earners, require greater than Basic hospital cover to avoid MLS. <u>Longer term</u> Changes which impact more people, and focus incentives to facilitate improved access to private healthcare.
Integrate policies by combining where possible Simpler, more understandable policies may be more effective.	For example, combine elements of rebate and LHC into a single policy. This can be further integrated with changes in what is incentivised, for example, where MLS and PHI Rebate reflect income and product tier.	Investigate and model opportunities for simplification.

Option category	Examples	Proposed approach for this project
Redirect PHI Rebate within PHI Government funding continues to support PHI affordability, but not necessarily solely via a premium rebate.	Divert some PHI Rebate funding to RE.	<u>Short term:</u> Identify opportunities to address specific areas such as mental health, by directing government funding via RE. May be offset by optimisation options (e.g. funds from higher MLS or lower rebate used to fund mental health through RE). <u>Longer term:</u> Estimate the impact of removing MLS and PHI Rebate, to better understand the cohorts impacted by these policies, which may in turn identify opportunities for refinement.
Alternatives or additions to PHI Rebate / MLS. For example: • New funding sources for PHI, such as employers. • Create a more valuable regulated product for the consumer, for example, remove out of pockets, greater focus on preventative healthcare, no claim discount. • Use tools other than PHI to help people access private healthcare.	Self-insurance Health savings account	Consideration of options will have regard to existing alternatives to insurance and identify links or issues for further consideration.

An example of an option representing a more material change would be to introduce a "foundation" hospital product to incentivise greater participation by younger adults in a more comprehensive PHI product. A possible definition of a younger adult is someone who is over 18, not a dependent, and under 40.

Reason for considering this age group

- PHI for younger adults matters because people of any age can require hospital treatment. Young people also ensure community rated PHI remains financially sustainable due to the significant subsidies between age groups.
- Participation rates for young adults have been declining, which impacts affordability for older policyholders. Many young people who do insure buy products which are unlikely to provide them with access to comprehensive private treatment, should this be required.

Product design

- While anyone may need hospital treatment, the average expected hospital claim costs for young people are much lower than for older people. If a single, standard hospital product design is available to young

adults taking out PHI, low average expected treatment needs mean it is possible to provide comprehensive cover and maintain significant subsidies to older members for an affordable premium.

- The essential features of the product design could include:
  - Covers treatment which young adults may need, such as mental health and pregnancy services.
  - Supports community rating:
    - A significant subsidy continues to be paid from younger to older policyholders. However, that subsidy need not be at the same level as now, any could vary by age, sex, income or other characteristics.
    - A standard hospital product design means there is a single community rated risk pool for younger people. While some young people will have significant treatment needs, average claim costs are low and therefore premiums would be more affordable than for current comprehensive cover.
- While most aspects of the product design would be standardised, insurers would be given significant discretion to offer appealing preventative healthcare benefits on these products. This incentivises insurers to innovate in this area, as this would be one of the ways in addition to customer service and pricing they can differentiate their product offering.

Initial assessment against evaluation criteria

- This foundational product could improve PHI by:
  - Significantly improving the value of PHI for young people: Including by enhancing the cover available to younger people.
  - Making PHI simpler for young people: Young adults no longer need to navigate complex product ranges and government policies, but instead have a single option.
  - Support the ongoing financial sustainability of community rated PHI, which would especially benefit older Australians.

Discussion

Thank you for taking the time to read this paper. At the workshop, we will invite feedback on:

- Where we intend to focus:
  - Are the evaluation criteria appropriate?
  - What options would deliver meaningful benefits for current and future policyholders?
- Further engagement: What do you need to know as the studies progress?

Alternatively, please provide your comments to health@finity.com.au and/or phi@health.gov.au.

Reliances and limitations

This paper is being provided to workshop participants for the purpose set out on page 1.

The paper sets out our preliminary views on options we may consider as part of actuarial studies, and therefore no commercial decisions should be taken based on the contents of this paper.