

# Segment Summary

## Australian Health Insurance

Industry Performance	2007	2008	2009	Change
Premium \$m	\$11,127	\$12,190	\$13,076	7.3%
Total revenue	\$11,799	\$12,232	\$13,080	6.8%
Total claims	\$9,432	\$10,403	\$11,381	9.6%
Gross margin	15.2%	14.7%	13.0%	(6.0%)
MER	9.6%	10.5%	9.8%	(0.5%)
Net margin	5.6%	4.1%	3.2%	(28.6%)
Persons covered	10,561,848	10,942,616	11,257,885	2.9%

### Market Conditions

The number of Australians covered by private health insurance increased by 2.9% last year to reach 11.3 million at 30 June 2009. 44.6% of the Australian population has some form of private hospital cover.

Membership increased in all states with Western Australia, Northern Territory and Queensland showing the highest growth rates.

This year the market was characterised by consolidation activity among six of the 11 largest funds with heavy competition between the major funds and the online broker, iSelect.

### Performance

Industry premium income increased by 7.3% through a combination of

membership growth plus industry rate increases of around 6.02%. Published annual reports suggest most funds would have achieved a strong underwriting result. Claims inflation per customer unit was around 6% and in line with both this year's rate increase and prior years' experience. There was little or no contribution to industry reserves from investment income this year.

### Cost Drivers

The key cost drivers of health insurance are the number of claimed services per member and the average cost per service. Many of the underlying drivers of cost are not under the direct control of health insurers, with the charges for public hospitals, pharmaceutical benefits and the Medicare Schedule Fee set by government, with doctors deciding the site, cost and duration of hospital based care.

### Hospital Cover

The industry funded 8.3 million days of hospital care this year, equivalent to 1.2 days per customer unit. Utilisation grew by 3.5% on last year and was a very significant factor in the increasing cost of hospital cover.

The benefit cost of hospital care was \$8.2 billion, an average of \$994 per bed day made up as follows:

- Hospital accommodation: \$694 (+4.4%)
- Medical fees: \$158 (+4.1%)
- Prosthesis costs: \$141 (+6.3%)
- Total: \$994 (+4.6%)

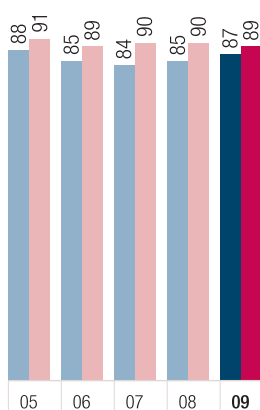
Higher utilisation charges increased the average cost per hospital customer unit by 7.3% in 2008/09 compared with 6.2% in 2007/08.

### General Treatment (Extras) Cover

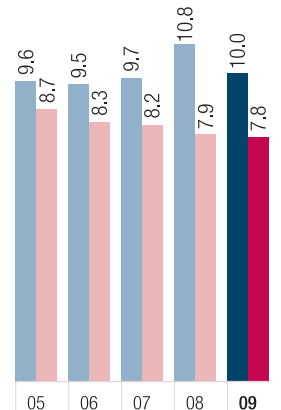
Changes to the way these policies are reported to PHIAC have affected analysis of utilisation statistics. HCF estimates based on publicly available data indicate the industry funded 63 million services at a total cost of \$2.8 billion. The average cost per service increased by 2.6% to \$45.20.

## How HCF Performed Compared with the Industry

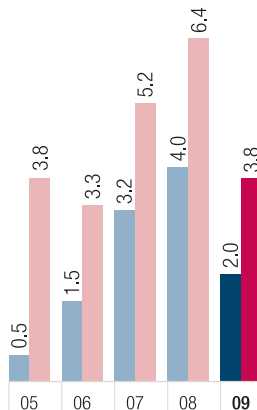
We return more to members (almost 90% of premiums)



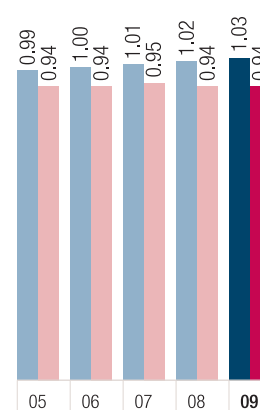
We spend less on management expenses (7.8%)



We exceeded industry growth for the sixth consecutive year (3.8%)



Our membership risk profile was 8% better than the industry



Benefit (%) of Contributions Management Expense Ratio (%) Membership Growth (%) Membership Risk Profile

■ Industry ■ HCF

## Management Expense

PHIAC's "Quarterly Statistics June 2009" suggests the industry management expense ratio will be slightly less this year (0.5%). Last year, the industry's costs were affected by one-off costs associated with demutualisations, mergers, acquisitions and the accompanying marketing expense. This year there were again such costs, but probably on a lesser scale. The industry's expense ratio for health insurance business has fallen from 10.5% to 9.8%, and will probably fall further in coming years.

PHIAC's "Quarterly Statistics June 2009" suggests that industry total costs rose 8.5% this year, of which about 2.3% can be attributed to membership growth. Underlying cost growth of 6.0% is similar to last year and the average rate increase approved by the federal government this year.

## Regulation Risk

The combination of the Private Health Insurance Rebates (30% and higher for members over 65), the Medicare Levy Surcharge (MLS) and Lifetime Health Cover have been central to the growth of private health insurance over the past decade. From July 2008, the MLS thresholds were increased from \$50,000 for single taxpayers and \$100,000 for couples and families to \$70,000 and \$140,000 respectively. These were subsequently indexed to \$73,000 and \$146,000 from July 2009.

Many commentators expected that some of the membership would lapse their cover, due to the increased thresholds of the MLS. This did not occur. The

effects on industry membership have been far less than had been expected. While the reasons are unknown, much of the industry has been trying to find and retain membership in the face of this challenge.

Despite the economic uncertainty, industry membership has grown. The Government introduced reforms in May 2009 to means-test Private Health Insurance Rebates from July 2010, with accompanying changes to rates of MLS. This did not occur. The legislation was defeated in the Senate in August 2009, with the Government stating it will reintroduce the legislation. The industry viewed the changes as making private health insurance more expensive for higher income earners, thereby dampening the growth of membership.

The Government's National Health and Hospitals Reform Commission's final report, released in July contained two recommendations which would have a significant effect on the conduct of private health insurance in Australia. The first is the establishment of Denticare, a social insurance program for basic dental care administered partly through private health insurers (recommendation 83) funded by a 0.75% levy similar to Medicare. This may affect general treatment health insurance business, as a major share of existing dental cover could transfer to the new program.

The second is the development of Medicare Select, a new governance model for the health system. Aimed at greater consumer choice and provider competition, better use of public and private health resources to improve responsiveness and efficiency of the

system and capacity for innovation. In this model all Australians would belong to a Government-operated plan, unless they elected to move to another operated by a not-for-profit or private enterprise operator.

## Retirement and Aged Care Facilities

During the year the Australian Government introduced regulatory amendments designed to update the funding of residential health care and provide greater certainty for residents by imposing strict financial reporting requirements on providers. In December 2008, the NSW, *Retirement Villages Act* was amended with only minor changes. As Manchester Unity's management and governance of its retirement facilities are of the highest standard, we anticipate no material financial or operational impacts from these amendments.

## Australian Life Insurance

The Australian life insurance market has continued to experience strong growth across all product lines. Low margin group insurance arrangements within superannuation funds have grown particularly rapidly, now representing over 30% of the market.

HCF Life is focussed on developing accident and illness policies that are closely aligned with health insurance and not available in the superannuation environment. These products offer the best opportunity of profitable growth of HCF into the future.

## Industry Outlook

Our overall outlook for private health insurers is positive with most strategic factors likely to improve during the coming year, despite earlier predictions to the contrary.

Health fund membership is growing in line with the population and on present trends this is likely to continue. Industry underwriting performance has remained strong throughout the global economic crisis although hospital related claims costs in particular continue to exceed the expectations of members, funds and government and put pressure on premiums.

In the short term, regulation risk is most likely to come from changes to the Private Health Insurance Rebate with the possible introduction of Denticare posing a longer term risk for the industry as a whole.

Economic factors are generally positive and improving. They are expected to have a positive effect on consumer confidence and improve returns on industry investments.

