

**ADDRESS BY CHAIRMAN MR JEFF TODD
TO THE SOUTHERN CROSS MEDICAL CARE SOCIETY'S
47TH ANNUAL GENERAL MEETING
27 NOVEMBER 2008**



This has been a very good year for the Medical Care Society. Your Society finished the financial year in a sound position, with higher membership, higher premium income and a very positive claims to premium ratio.

We received \$523 million in premium income. This is \$32 million ahead of the previous financial year.

We paid out \$464 million in claims, an increase of almost \$65 million.

And we have a claims to premiums ratio of 89.6%.

To put that another way - for every dollar received in premiums, the Society paid out nearly 90 cents in claims. No other New Zealand health insurers to our knowledge, are matching that performance. By way of comparison our largest competitor last year reported an average ratio of less than 60 cents in the dollar. Of course, they are a for-profit organisation!

Claims inflation has continued to outstrip premium increases over the past 15 months and our claims to premium ratio for the first quarter of this year has climbed further to 98.3 cents in the dollar. While this represents extremely good value for members, it is something we have to monitor closely. I'll come back to this shortly.

Financial performance

Our operating expenses for last year were \$72 million, an increase of just over 5 per cent from the previous financial year.

This is a small rise when factors such as inflation, membership growth, improved service levels for claims settlement, the development of a fast-track claims system for Affiliated Providers and the launch of the Plus Programme are taken into account.

Our surplus for the year was a modest \$7.8 million. This is down from last year. We are very comfortable with that result as members have benefited from higher claims. We are however concerned that the trend of higher claims is continuing.

The reduced surplus this financial year was due to an increase in claims as well as an unrealised \$15 million write down in the mark-to-market value of our investment portfolio. However, because investments are held to maturity, gains are expected to

be made on this write-down in future years. Overall the Society's investment portfolio remains sound at more than \$413 million.

Over the financial year our reserves increased by 2.5% to \$329 million.

This robust solvency position and strong management of our investments has seen the Society maintain its A+ credit rating from Standard and Poors for the sixth consecutive year.

Membership growth

Our membership has grown in the last year by over 9,200 to 834,967. This gain in membership accounted for 72% of the total increase in New Zealanders covered by health insurance in the 12 months to 30 June 2008.

In the financial year that ended 30 June 2008, we saw that New Zealanders continued to recognise the value of health insurance. Leading into an election year, this was a period where media were heavily publicising that the public system could not provide all health care demands. The percentage of growth captured by Southern Cross in that period demonstrates that we remain New Zealanders' health insurer of choice.

However, as economic conditions have altered significantly in the last few months, we will be watching the level of membership growth closely.

Currently, despite growing unemployment, demands from KiwiSaver contributions and the provision of four weeks annual leave, so far we are seeing New Zealand employers stay loyal to health insurance and benefits.

Our figures show that 83% of our membership increase for last year came from employer health insurance schemes. This is where we access the majority of our younger membership that helps to keep the business sustainable long-term.

Industry data shows claims settled by New Zealand health insurers in the year to June 30 totaled \$657 million.

Southern Cross again accounted for 71% of those claims despite serving just over 60 percent of New Zealand's total private health insurance market.

This underlines the value for money that the Society delivers to its members. We continue to look for opportunities to add value for our members. The Plus programme, which Dr McPherson will discuss shortly, is one of those. Part of its development benefited from the creation of the Activa health-linked financial product which established very good relationships with partners who are now offering

attractive benefits to our members. Again, Dr McPherson will provide an update on Activa today.

Claims cost escalation

Providing value for money is something Southern Cross will remain focussed on. Claims cost escalation however, has been, and will continue to be a major issue for Southern Cross, because higher claims costs mean that premiums need to increase - all things being equal.

Overall claims cost escalation recorded by Southern Cross in the year ended 30 June 2008 was 6.36%.

This was nearly double the previous year's increase. Factors such as the cost of new technology, more procedures being covered, medical professional wages and hospital charges – most of which are largely outside our control – contribute to this increase. This trend is expected to continue with claims inflation currently running ahead of projections.

Take a common procedure shown on the slide - like the removal of a skin lesion. Our claims costs for this procedure have risen by 13% in 12 months. Two factors drove that. First, the average cost of this procedure rose 9%. Second the number of claims rose by 3% on the previous year. In other words, we had more people claiming and those people made higher valued claims than the year before. As you can see the overall cost escalation for some procedures is up over 50 per cent.

In addition, there have been significant increases in claiming for specialist tests, due to some regions now charging private patients for this. In the three months ended 30 September we have also seen evidence of further increases, the largest being an additional \$5 million in surgical claims. Claims cost escalation is the main driver of premiums, so we are monitoring this trend very closely. We will also be monitoring other trends, such as the impending decision from Auckland DHBs around whether or not costs for lab tests will be shifted to private patients.

We are a not for profit and very proud of our track record of consistently returning most of our premium income to members to meet members' claims. We also have very healthy reserves and can absorb some of the rising costs by utilising the surplus – we do this as a matter of course but are particularly mindful of what can be done for members this year in the current economic environment. However, it does have to be stated that as a large NZ business with obligations to our members we need to ensure that premiums are sufficient to cover claims and overheads – ensuring our long term sustainability.

So what are we doing to help manage medical inflation?

One thing we do is moderate prices through our expanding Affiliated Provider network. An Affiliated Provider is a medical provider with whom Southern Cross negotiates on behalf of members to gain a better deal than members can get for themselves. This then enables Southern Cross to provide cover while somewhat mitigating adverse impacts on premiums over time.

Affordability

To talk further on the topic of premiums...

While we used our strong financial reserves during the year to hold the average base rate premiums down, some individuals have received an increase. Base rates are adjusted to reflect claiming patterns by age group and plan type.

The trend in recent years is that claims costs have increased more rapidly for older people.

Southern Cross is very proud that it provides health insurance for 71% of the 133,000 New Zealanders aged 65 plus. And there are initiatives, specifically for this age group, that we have been lobbying the government and political parties about such as targeted assistance which the new government did warm to, but is unlikely to put into policy given the current financial crisis.

However, it is this age group where we get the bulk of the claims - hence premiums have tended to increase to keep pace with costs.

For example, as at 30 June 2008, while those aged over 65 make up just 11% of our membership base, they account for 32% of claims and almost a third of Southern Cross members aged 65 years and over has an operation each year. What this has meant is that in some cases, significant premium rate increases have been necessary for older members on some of our surgical policies where total claims paid have been greater than premiums received.

We do appreciate that affordability continues to be an issue for many of our members – our older members perhaps more than most – which is why, as much as possible, we use our reserves to mitigate premium increases for our membership.

So I hope that helps you understand some of the features of our year - which has been a very good year in the history of Southern Cross. And our investment portfolio at 30 June 2008, of \$413 million remains very sound.

In conclusion, I'd like to thank you for your loyalty throughout the year, and now hand over to the Society's Chief Executive Officer, Dr Ian McPherson.