

Southern Cross Medical Care Society 52st Annual General Meeting 5 December 2013

This document contains the addresses delivered at the AGM by Chairman Graeme Hawkins, Southern Cross Healthcare Group Chief Executive Officer Ian McPherson and Southern Cross Health Society Chief Executive Peter Tynan.

Chairman, Graeme Hawkins

You should have received a copy of this year's Annual Report upon arrival. As well as outlining the financial position of the Society, the report includes commentary from myself, Southern Cross Healthcare Group CEO Ian McPherson, and Chief Executive of the Health Society, Peter Tynan on the Society's performance.

As detailed in the Annual Report, your Society is in a strong and stable financial position, while continuing to deliver very good value for its over 800,000 members. During the financial year, the Society earned \$725.5 million in premiums, up 2.6% from 2012, and incurred \$639.1 million in claims, up 5.5%. We closed the year in a healthy financial position, with a surplus of \$22.1 million.

This surplus, which falls within the range budgeted for, is retained in the Society for the benefit of members and is used to help mitigate future premium increases, to review and increase the value of policy benefits, and to maintain financial reserves at appropriate levels.

Southern Cross is one of the few not-for-profit health insurers in New Zealand. That means the Society's sole focus is on providing members with excellent value for their premiums, as opposed to making profits for a shareholder or overseas owner.

For every dollar received in premium income in the last financial year, on average 88.1 cents was returned to members in claims for healthcare services. Furthermore, careful management saw overheads come in under budget, evidence that operational cost-saving initiatives – such as digital services – are working.

Under the new Insurance (Prudential Supervision) Act, all insurers are required to be licensed by the Reserve Bank and to hold reserves. At year end, the Society's reserves sat at \$395.4 million, which is equivalent to seven months' worth of claims.

Members should note that these reserves have effectively been created without any capital contribution from the current membership – they are our legacy from the past to treasure and protect for you & future generations of members.

As well as providing reassurance of the Society's ability to pay future claims, reserves also work for the benefit of members. Reserves form the bulk of the Society's investment portfolio and income from this portfolio enables the Society to moderate premiums each year for its members.

As a Friendly Society, we have no access to external capital; hence income generated through investments is extremely important to us. It is therefore pleasing that the Society's investment

portfolio performed satisfactorily during the last year and generated income of \$21.9 million for the Society and its membership.

In keeping with Reserve Bank requirements, we have a conservative investment policy. We believe it is in the best interests of you, our members, that we continue to receive sustainable and predictable income over time, while maintaining a relatively low risk portfolio. This strategy has served Society members extremely well throughout the years – and particularly during the Global Financial Crisis.

Maintenance of our reserves have together helped the Society maintain its A+ financial strength rating from Standard and Poor's for the eleventh consecutive year. This stability and commitment to sustainability will ensure the Society will be here to meet members' healthcare funding requirements in years to come.

One of the key issues facing our Society is looking at ways to keep health insurance affordable. This is a fine balancing act because, as a not-for-profit insurer, our premiums directly reflect the cost of our claims and these costs are increasing.

In line with increasing medical inflation, the health insurance sector saw a small decline in the number of those insured – a decrease of 0.7% in the last financial year. The Society experienced a smaller decrease of 0.5%. As a result, our market share increased from 61.0% to 61.1% and the Society ended the year with 817,822 members.

Although membership declined, there were increases in some age groups, most notably among those aged 65 and over, who now number over 100,000. During the year for every dollar of premium, 91 cents on average was returned in claims to members aged 65 and over, which demonstrates excellent value for this group.

I would like to close by thanking you all for your continued loyalty and interest in the Society. We are proud to offer our members strong governance, a strong and stable financial performance and a clear strategy for the future. Please be assured we are doing all we can to provide you with the best possible value from your health insurance.

I now welcome Southern Cross Healthcare Group CEO Ian McPherson.

Group Chief Executive Officer, Ian McPherson

Good evening ladies and gentlemen.

As members who have chosen to take personal responsibility for your elective healthcare, it should come as no surprise to you that that New Zealand's healthcare system faces some serious funding challenges in the coming years.

Several factors are responsible, including:

- One, an ageing population
- Two, fewer people paying taxes
- Three, increasing incidence of chronic disease
- And four, mounting treatment costs and rampant medical inflation – driven by rising utilisation and increasing costs.

It is well known that the profile of our population is changing - and that when people get older, more healthcare is required. If projections follow through, by 2036 over 65s will make up 23% of our population - up from 14% today.

Furthermore, this age group currently consumes 36% of all public health spending. As this age group increases, it will consume more of the pie - a pie funded by a relatively smaller working population.

Secondly, the ratio of working-age people in the workforce is changing. Calculations carried out by the Commission for Financial Literacy and Retirement Income show that in the mid-1960s there were over 7 working-age people for every person over retirement age. This had dropped to 5 by 2011 and will fall to 2.6 working-age people by 2036. That's just over 20 years away.

So we will have fewer people filling the coffers over time. A shrinking tax-payer base isn't something we can radically change and it's certainly not unique to New Zealand, but it's something we all need to keep front of mind.

Next is the rise in chronic diseases that are consuming our health resources.

Chronic conditions are on-going, long-term or recurring conditions - we're talking diseases such as diabetes, heart disease, cancer and mental health. Lifestyle factors are big drivers behind their increase. They are treatable, and many preventable – but again, at a cost.

The fourth is the rapid expansion in the number of treatments and technologies keeping us alive and well. We can have titanium knees, new heart valves done non-surgically, and advanced cancer treatments – but this technology is costly and there simply isn't an unlimited pool of money; not in the public system and not in the private system.

So when the Society looks at new technologies and procedures we are looking for demonstrably proven benefits to support the expenditure of members' money.

At the same time medical costs are rising and are doing so at a rate that's much faster than general inflation. In the year to 30 June 2007 the Society's total claims costs were \$418 million, this year they were \$639 million.

At this point please remember that as a not-for-profit insurer, the Society's health insurance premiums directly reflect the level of claims made by members. In six years the memberships total claims costs have grown by 53%.

Peter Tynan will talk you through some of the strategies Southern Cross is employing to reign in rising costs long term. These specifically aim to minimize insurance premium increases for members.

That's important because health insurance has to be an accessible option for New Zealanders to fund their healthcare requirements into the future.

In the 2013 financial year Southern Cross Health Society processed three million claims and funded 153,000 elective surgeries – currently the same number of electives that the public system funds.

The Public System does a great job. Funding not just elective procedures but mental health services, acute, maternity and aged care. However, the increasing costs associated with medical technology, ageing and chronic diseases will outpace the Government's ability to continue providing the current healthcare services in a timely fashion. You, me and our children will have to fund more ourselves.

Earlier this year Treasury reported that since 1950, New Zealand's real per capita GDP has increased by 144%, while real per capita government spending on healthcare has increased by 412%.

Compounding this is that already we have only a small pool of taxpayers. In 2011 the Finance Minister pointed out that:

- 43 percent of all households currently receive more in income support than they pay in income tax.
- The 1.3 million households with incomes under \$110,000 a year collectively pay no net tax – that is, their total income support payments match their combined income tax.
- And the top 10 percent of households contribute over 70 percent of the net income tax.

With these figures, it's not surprising Treasury said that the country may have to adopt lower public healthcare spending and that this might involve trade-offs. These would include not funding some treatments or introducing part payments from patients for some services.

It's clear to me that in the future, some of the healthcare services Kiwis enjoy now may not be paid for in the public system. The reality is that greater personal contribution will be required.

Before handing over to Peter Tynan to discuss the operational issues of the Society, I would like to advise that this is my last AGM as Group CEO of Southern Cross. I have signalled to the Board that it is my intention to stand down from the CEO role at the end of June 2014.

Time marches on and my career plan has always been to move from management into governance at some point, both in New Zealand and internationally, but my first priority has been to do what works well for Southern Cross.

The Group's various businesses are all leaders in their respective fields, and commercially in strong positions. With all of the Southern Cross businesses in good shape, the time is right to start planning for the future.

I won't be leaving Southern Cross altogether, I will continue to work with the Chairman and Board part-time for a further year on important Southern Cross, health sector and strategic matters, and to enable a well-planned and smooth transition.

It's been a real privilege to serve you within one of New Zealand's most trusted, respected and important businesses.

Chairman, Graeme Hawkins

Thank you Ian.

On behalf of the Board I would like to thank you for your 12 years dedication to Southern Cross and to acknowledge your significant contribution over that time. Although it will be a loss for us, we understand and support your decision.

We appreciate the long lead time you have given us and the flexibility you have offered to ensure a smooth transition – and we wish you well for your future in the governance arena.

The Board will determine the process in the New Year to find a replacement. This will be likely to include considering internal, local and international candidates. Otherwise it will be business as usual through to the end of June 2014.

In wishing Ian all the best, I would also like to highlight that last week he was appointed as President of the International Federation of Health Plans. The iFHP was founded in 1968 by health plan industry leaders. It is now the leading global network in the industry, with more than one hundred member companies from twenty-five countries.

Ian's appointment is a testament to the experience, knowledge and respect that both he and Southern Cross bring to the health insurance sector internationally.

Getting back to the business at hand, I would now like to hand over to Peter Tynan, who leads the Society's day to day operations. Peter.

Peter Tynan, Chief Executive Officer

Thank you Graeme.

As a not-for-profit health insurer, the Society's premiums are a direct reflection of the claims we pay. While our membership numbers aren't increasing dramatically, our claims are.

Southern Cross can't control the volume of procedures members' need, that would defeat the point of having health insurance, nor can we prevent justifiable medical cost escalation. What we can tackle on behalf of our members is unreasonable prices.

Central to this is the Society's Affiliated Provider programme. Affiliated Providers are doctors, specialists and facilities contracted to provide Southern Cross members with certain healthcare services at agreed prices.

Contracting with providers through the Affiliated Provider programme is part of a long-term strategy to keep premium increases lower than they otherwise would be. In other words, it is an important way to minimise the impact on premiums.

The programme also means a more convenient member experience:

- the Affiliated Provider organises prior approval and processes the claim on the member's behalf
- members no longer have to pay for the service and then wait to be reimbursed
- and members know up-front how much, if anything, they have to pay.

We currently have over 700 Affiliated Provider agreements in place covering 20 different specialties. Claims for services from Affiliated Providers now account for 27% of the Society's total claims costs. We would like to see this figure grow to 60% by 2016.

Southern Cross is not the first insurer in New Zealand to introduce such agreements, we are following a well-trodden path. Contracting with providers is utilised by large insurers in Australia, US and the UK and also by the ACC here in New Zealand.

The expansion of this programme has been driven by a steady growth in the number of procedures specified as "Affiliated Provider-only". This means Southern Cross members on the majority of plans are only reimbursed for these procedures if they are carried out by an Affiliated Provider. Typically, the procedures we have chosen as Affiliated Provider-only are procedures which have high variability in pricing.

Examples include colonoscopy, cataract surgery, angioplasty and common orthopaedic surgeries.

In September, over 850 members were surveyed about the Affiliated Provider programme. 91% of those surveyed said they are happy with and support it or any programme that helps manage costs and makes claiming easier.

71% of those surveyed said they would rather travel up to three hours to see an Affiliated Provider than pay an extra \$1,200 for a procedure.

In order for you to benefit from the programme, I encourage you to ask your GP about Affiliated Providers when any future referrals are required.

Another key area in cost containment is assessing coverage of new medical technologies and techniques. There are some new technologies that appear to add significant cost to treatment, without a corresponding benefit for the patient. We carefully assess these, and in general, only provide cover where there is a very clear clinical benefit to our members at an acceptable cost.

This was behind the reasoning behind the decision not to allow an extra charge for cataract surgery using the new femtosecond laser technology. Although it shows promise, this technology has yet to prove significantly better outcomes than current methods of surgery.

Last year the Society funded 6,400 cataract surgeries at a total cost of \$24m. It's a big ticket item that our members simply cannot afford to continually pay more for. Affiliated Provider agreements are now in place for femtosecond laser to be funded for members at the same prices as a normal cataract procedure.

Unfortunately there are times when we have to make the decision not to fund new treatments. For example, we have reviewed whether to extend coverage to include Transcatheter Aortic Valve Replacement (TAVR).

It has been estimated that around 15 members per year would benefit for TAVR at a total cost of over \$980,000. Unfortunately, we cannot justify spending almost a million dollars of members money on 15 people.

Our stance may sound harsh - but these difficult calls have to be made. Elsewhere we continue to work towards meeting the evolving needs and expectations of our members, particularly in the digital space.

The Society's Easy-claim - electronic claiming service - allows members to claim instantly at the payment counter. Around New Zealand there are now over 500 Easy claim providers, including pharmacies, dental, optical and physiotherapy facilities.

In addition, My Southern Cross, our secure member portal has over 40,000 users and this will continue to increase as we are able to expand capability. As part of the strategy towards operational cost containment, in the last financial year the Society discontinued Alive magazine. We are committed to improving our services, keeping overheads down and evolve to keep pace with the needs and expectations of members.

To close I would like to thank the members for your continued support of the Society. I would also like to thank all our employees - and of course Ian, for the professional help and support he has provided me throughout the last ten years.

We are making every effort to ensure you continue to receive the best possible service and value from us.

Chairman, Graeme Hawkins

In the context of these observations and updates it is my pleasure to move that the Annual Report and Financial Statements, for the year ended 30 June 2013 including the Auditor's and Appointed Actuary's Reports thereon be received.

(Various resolutions were put and passed by the meeting, and Mr Hawkins addressed the meeting again under General Business)

Chairman, Graeme Hawkins

In the Notice of Meeting this year, we signalled a discussion on the topic of Director remuneration. By way of background, the Society's cap on the total amount of Director Remuneration has not increased since 1997.

A resolution to increase the total amount of Board remuneration was withdrawn at the Society's 2008 AGM as the Global Financial Crisis took hold and we took note of the economic realities of the time. However, remuneration has not been revisited since.

As disclosed on page 40 of the Annual Report, the current amount of \$361,000 still stands. This is apportioned among seven Board members. I think everybody in the room would agree that we can't expect the current and future Directors to go forward indefinitely without a pay rise – no employee does this.

Southern Cross Director fees are generally lower than in other organisations of a similar size or complexity. We would like to discuss bringing these back to market parity. We want to achieve remuneration at a level comparable to similar commercial organisations, so that the Society can continue to attract and retain Directors of a high professional standard.

We are not asking you at this AGM to approve any change to Director remuneration. Instead, we are interested in your feedback because we want to reach a solution that is considered fair and palatable for both members and directors.

We are looking to undertake consultation with members in 2014 about this and may put a resolution about Director Remuneration for member consideration at the 2014 AGM. Are there any questions or comments you would like to raise regarding this?

Ends