

## Southern Cross Medical Care Society 54th Annual General Meeting 1 December 2015

This document contains the addresses delivered at the AGM by Chairman Greg Gent, Chief Executive Officer Peter Tynan and Head of Finance, Risk & Compliance Stefan Azzopardi .

### **Chairman Greg Gent**

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Southern Cross continues to deliver value to its members. For every dollar we received in premium last year we paid out 90.2 cents in claims. This is an industry leading rate, and well above the average for the industry's for-profit insurers of 60.2 cents.

As a not-for-profit friendly society, we are proud of this level of return we provide to our members – highlighted further by the fact that despite our members making up 61 percent of the health insurance market, we pay 73 percent of the country's health insurance claims.

Though our membership fell slightly this year by half a percent to 811,462 - the number of policies we administered rose by 775 to 385,881.

There has been a recent uptake of insurance in the younger - 25 to 35 - age group across the wider industry. This is attributed to the popularity of a newer category of more basic low cost day-to-day cover healthcare plans.

While we acknowledge it is very important to attract new younger members, the majority of our business is to provide financial support to members requiring otherwise unaffordable elective surgical treatment.

It's clear from the claims we pay, relative to the industry average, that Southern Cross has a very large role to play in this area and the health of New Zealanders.

Claims inflation remains our single largest issue, one which all developed countries are grappling with. As you can see from the graph behind me, it's a consistent theme throughout developed countries.

To put this further in perspective, we have pulled out Southern Cross' medical inflation and put it alongside our country's consumer price index – which measures changes in the price level of consumer goods and services purchased by households.

You can then see just how much our health costs outpace the cost of our day to day standard of living. We know the main reasons for these increases lie in our aging population, the increasing cost of treatments, and a greater range of treatment options available.

There is no one simple solution. However, over the past decade, our members have given us a clear and vocal mandate to get them better value healthcare. As such, it is our responsibility to address this issue, both internally and within the wider sector. Maintaining dialogue and working with central Government is crucial to this.

Most recently, we have been lobbying for changes proposed by New Zealand First's Affordable Healthcare Bill. This Bill proposes:

1. A 25 percent health insurance premium rebate for people aged over 65, up to the value of \$500 a year,
2. And the removal of fringe benefit tax from health insurance to encourage employers to offer it as part of their employee remuneration packages.

We support these proposals.

We know that the rising cost of health and health insurance for those over 65 is a real concern – in fact many have pointed out that a \$500 subsidy may well not be enough. At a time in their lives when they are most likely to need health insurance, some members are lowering coverage or cancelling policies due to premium cost.

The proposed rebate would help older members stay insured so they can receive timely medical access when they need it.

We also very strongly support the removal of fringe benefit tax on employer-subsidised health insurance. Our research tells us that if fringe benefit tax was removed, over half of New Zealand businesses not currently providing health insurance would look to do so. Employees returning to work faster from illness will lead to higher productivity and savings for businesses, economic growth for the country and a better quality of life for more New Zealanders.

There will be direct savings to the public health system due to elective surgeries being picked up in the private sector. This in turn will reduce the incidence of more expensive debilitating conditions, reduce carers' costs and enable many New Zealanders not currently able to get on waiting lists to do so.

While we do not expect the Bill to get past the first reading in Parliament, the Bill serves to highlight the need for clear and open debate about the ongoing affordability of healthcare.

We can't rely solely on the Government and their policies to address cost and access issues but we will continue to pursue with Government elements of the Bill on your behalf.

We're also addressing this internally. And have a programme in place to address some of the costs. To provide some background, medical costs fall into three main categories:

1. Hospital costs – the facility and nurses
2. Specialist costs – surgeon and anaesthetist
3. And consumables – equipment, prosthetics and drugs

and they are very approximately a third each.

Our main vehicle for cost containment is the Affiliated Provider programme, where doctors, specialists and facilities are contracted to provide Southern Cross members with certain healthcare services at agreed prices.

We are an organisation founded by surgeons who believed in a sustainable private sector. The continued growth in the number of providers and facilities participating in the programme shows this sentiment is alive and well. By joining us, they are showing support for a sustainable private healthcare sector that remains accessible and affordable for New Zealanders. Peter Tynan will expand on the Affiliated Provider programme shortly.

The next area we must turn our attention to is consumables. For example, the ability to access private cancer care is an area of increasing importance to members. In the past decade Southern Cross has added a radiotherapy benefit and significantly expanded its chemotherapy benefit.

Members can claim up to \$60,000 per claims year for chemotherapy and up to \$10,000 for non-Pharmac approved MedSafe indicated chemotherapy drugs.

The role of Pharmac and MedSafe is to carry out comprehensive analysis on drugs that should be approved for funding or use and those that shouldn't. Pharmac has to achieve a balance between good health outcomes while containing pharmaceutical costs. Southern Cross has a similar objective.

However, we are aware of the recent growth in private oncology services and the extensive promotion of new cancer drug treatments by some drug manufacturers and insurers. We have recently been advised that increasing the limit Southern Cross funds for these treatments could trigger large cost escalation of over \$100 million per annum.

This increase would see premiums become unaffordable for a large number of members; particularly those in the older age group. That said, we are in the process of undertaking a review of private cancer care coverage in New Zealand, including costs. This will involve discussions with oncologists and drug manufacturers. These parties will need to actively contract and participate with us in cost containment strategies for our policy benefits to increase.

In summary, we are reviewing the cover and will look to negotiate contracts with oncologists and drug manufacturers to keep costs realistic.

I'd like to close by thanking Chief Executive Peter Tynan and his dedicated team for the work they do on our behalf. This is my first year as Board Chair. I wish to thank my fellow Directors for their counsel and dedication to our Society. It is also Carole Durbin's last meeting as a Director. I will thank Carole later in the meeting. And lastly, to you our members for your ongoing support.

I now welcome Society Chief Executive Officer Peter Tynan.

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#### **Chief Executive Officer, Peter Tynan**

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As Greg said, the 2015 financial year was a sound one for Southern Cross. We processed 3.1 million claims. This included 405,000 specialist consultations, 687,000 prescriptions, 781,000 GP visits and 170,000 elective surgical procedures – that is more elective surgeries than the entire public system.

However, the cost of claims is continuing to increase.

If we do not wish to reduce medical cover - then the obvious area where we can effect change is in the moderation of prices charged by specialists and facilities. For example, we see some specialist charges for elective surgery at more than double the industry average and at the extreme, charging more than \$9,000 per hour for standard treatments.

Our members can't afford this and we won't sit by and passively allow this to occur. Our response has been the Affiliated Provider programme, where doctors, specialists and facilities carry out certain healthcare services for members at agreed prices.

We now have the support of over 1,300 healthcare providers nationwide across 20 medical specialities. Currently, these providers account for over 45 percent of all claims costs.

For members, the Affiliated Provider programme means:

- They know up-front how much, if anything, the surgery will cost them;
- Prior approval is organised on their behalf;
- They don't need to submit a claim, so members aren't left out of pocket while the claim is being processed.

For Affiliated Providers, payment can be claimed as soon as the service is provided. An Affiliated Provider is generally paid by Southern Cross within two days - as opposed to waiting for members to submit the claim for payment - which takes on average 30 days, sometimes longer.

The Affiliated Provider programme also moderates claims inflation. Take general surgery for example. This includes endoscopy, colonoscopy and hernia repairs. We introduced the Affiliated Provider programme for these procedures in 2010. Since then, claims inflation has fallen from 7 percent to 3.3 percent. Colonoscopies singularly fell even further to 1.7 percent.

Another area adding value – and one that sets us apart from our competitors, is the Southern Cross ACC review service. This small team ensure members' claims for elective surgery are funded by the right organisation. In the last year the Society helped 294 members with their ACC review, resulting in cost recovery of over \$4.8 million.

We support our members in reviews not only to ensure treatment costs are met by the right insurer, but also because members may have other entitlements under ACC, such as earnings compensation, rehabilitation and home help.

Like ACC, the volume of claims we process dictate that our services need to be timely and flexible – which has seen us focus in recent years on a digital strategy. Use of our online service, My Southern Cross, has more than doubled in the last year.

It currently has more than 100,000 registered users, who are able to change their details, apply for prior approval, claim and track the progress of their claim when and where they choose.

Similarly, Easy Claim, which allows claiming for eligible items over the counter, has also had strong growth in the last year. The service now covers 1,300 providers, such as GPs, pharmacies, physiotherapists, optometrists, audiologists and dentists – who facilitated 233,000 claims in the last year.

While we remain very aware of the overheads associated with running our business, the development, implementation and running of these growing online and electronic platforms demands additional investment.

To that end, the financial year saw us make the conscious decision to invest in overheads. We budgeted for a 5 percent increase – the majority of which was an investment in people, expertise and capability to drive our strategies.

As you can see from the graph behind me, the areas of largest growth are the Affiliated Provider programme through our Clinical Operations and Member Services teams and in our Information Systems department with digital services. Much of this investment is a by-product of the age in which we live.

In order to develop, implement, and run consumer-friendly digital systems with appropriate cyber protection, we need capability and the right people. Further, processing higher volumes of claims through more channels, as well as servicing an increasing number of policies each year, requires people.

It's important to note however, that several areas of spending result in overall savings. For example:

- The new fraud team estimates that claiming anomalies they've investigated and rectified will save \$1 million in the coming year.
- We also continue to invest in the clinical operations team to drive the Affiliated Provider programme. The savings from these activities are embedded in lower claims costs.

For example, inflation last year for non-Affiliated Provider procedures was 3.6 percent. By comparison, procedures contracted under the Affiliated Provider programme ran at 0.9 percent. The reduced inflation under the Affiliated Provider programme saved the business an estimated \$9.6 million.

This is all good news for members and their premiums – we can't contract fast enough.

In closing I'd like to thank you all for your continued support. My thanks also to Southern Cross staff, who work hard to provide you with the value and service you expect of us.

#### **Head of Finance, Risk & Compliance Stefan Azzopardi**

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During the last financial year we received premium income of \$818 million, up 6.4 percent from the previous financial year. At the same time, we paid out \$738 million in claims, which was up 6.2 percent from last year.

After accounting for overheads and investment income, this resulted in a modest surplus of \$5.8 million.

This is aligned with our financial goal of maintaining our solvency ratio, whilst ensuring that as a Friendly Society, any surpluses we do make that are over and above those required to maintain solvency, are used for the benefit of members – either expanding benefits available in our policies, improving services, strengthening reserves or in running the Society.

At year end, our reserves were sitting at \$400 million. This equates to around seven months of claims.

This meets both statutory Reserve Bank requirements and sits within the target solvency range established by the Board.

Our target solvency range reflects that, as a Friendly Society, Southern Cross cannot readily generate new capital if it was required to.

It is therefore essential that we prudently manage and preserve our capital base, rather than operating at a bare minimum level.

Our investment activity in the financial markets can be described as procedural in nature and low risk. This prudent management of our capital base meant we retained an A+ credit rating from Standard and Poor's.

Traditionally, we have purchased interest-bearing investments and held them to maturity, with very little active trading. Losses have been minimised and steady interest income has helped us mitigate premium increases for members. This approach has enabled the Society to receive its investment income free of tax.

Last financial year our investments generated income of \$23 million on our portfolio of just under \$500m, or a return of around 4.7 percent for the year. This is an increase of 24 percent from the 2014 financial year, due to a mix of higher yields, revaluation gains and a slightly larger portfolio.

However, we are mindful that, in the current economic environment, returns on interest bearing investments have fallen and look set to remain low for some time. In view of this, management is currently reviewing the Society's options for changing its investment strategy, those options always being mindful to ensure that the Society's tax exempt status is not put at risk.

In summary, we have had a successful year with a moderate surplus. We've met all regulatory requirements and maintained an A+ credit rating. Financially the business is in a good state.