Southern Cross
Health Society

Member Tenure Project:
Recognising members of long standing

Report to the Board of the
Southern Cross Medical Care Society

August 2012

Contents

1.0 Introduction

At the Society's 2011 Annual General Meeting two resolutions were passed which asked:

- That the Board investigate and report to Members on ways and means by which Member longevity and loyalty may be recognised, and
- That the Board further investigates a means of reducing the rates to long term Members.

Terms of Reference[1] were finalised and the Member Tenure Project team, comprised of suitably skilled and experienced Southern Cross management, was appointed in March 2012.

This document is the Member Tenure Project's report to the Board, outlining its investigations and findings.

"As you know far better than I, there are no easy answers to this problem, or they would have been adopted years ago."

James, aged 75.
Member for 30 years.

[1] Appendix 1

2.0 Executive summary

The Member Tenure Project pursued three streams of work in order to advise the Board regarding possible ways and means to recognise members of long-standing, including (but not limited to) reduction of premium rates. Those work streams included:

- A detailed analysis of the environment in which the Society operates as a health insurer (section 3.0). This included assessment of historical, regulatory and legal context as well as consideration of market competition, dynamics of the health sector and demographic trends.
- Data analysis and modelling (section 4.0). This included a review of relevant actuarial studies undertaken in previous years, analysis of the current membership profile with respect to tenure and claims behaviour, and assessment of the effects of possible discount approaches today and in the future.
- Member consultation and research (section 5.0). This included a month-long consultation in which members and consumer, industry and governmental organisations were invited to participate: 124 members and one organisation made submissions. Quantitative research, with over 1,600 respondents, was also undertaken to better understand the views of the membership as a whole.

The project's findings are detailed in section 6.0 of this report and summarised below.

<u>Findings related to premium discounts for long-standing members</u>

- There is broad-based support among members, at a conceptual level, for a long standing member discount to help moderate the high cost of health insurance premiums (and the resulting financial strain) for older members.
- However, that support dissipates when members consider how such a discount would work and the potential premium impacts for non-qualifying members. It's evident that many younger / shorter duration members would not want to pay more in premiums to fund a discount for older / longer term members.
- A tenure-based discount might result in many older members (perhaps a majority of them) not qualifying, and hence paying more rather than less for their health insurance cover.
- A tenure-based discount may be open to challenge as discriminatory under the Human Rights Act if it were found to directly or indirectly advantage older members at the expense of younger members.
- An increase in premiums for shorter-duration members to fund discounts for long-standing members would have an impact on Southern Cross's competitiveness in the new business market.
- A long-standing member discount introduced today would have an increasing financial impact on non-qualifying members in future years. Under one scenario, non-qualifying members would face 2.5% higher premiums initially, rising to around 10% within 14 years.
- Long-standing members already receive greater value on average than members of the same age who have been with the Society for a shorter duration, because they tend to claim significantly more. This can be seen as an existing "loyalty" reward for long-standing members.

- There is no actuarial basis to implement a fixed-term discount, such as the 2005-2007 Founding Members Reward which returned capital to long term members, because all members are now on an “equal footing” with respect to contributions to the Society’s financial reserves / capital.

Other findings

- A low claims discount that takes into consideration claims history over a longer period of membership (for example, 10 instead of the current two years) warrants further investigation.
- Non-financial recognition of member tenure would not address the primary need expressed by older members to moderate premiums.
- Some members may continue to question the level of financial reserves held by the Society but, when presented with information about the role and size of the reserves, most accept that the Society’s approach is necessary and prudent.
- The issue of rising claims costs, and their impact on premiums, remains. A discount for long-standing members would, at best, provide temporary relief for a minority of members without addressing the underlying cause of premium escalation. Society initiatives to address claims cost increases continue to be important.

Refer to section 6.0 for an explanation of each of these findings, plus cross-references to the sections of the report that describe the project team’s activities, methods and outcomes that led to these conclusions.

3.0 Context

This section of the report discusses the environment or context within which options to recognise members of long standing can be assessed by the Southern Cross Health Society, including:

- Historical context
- Regulatory and legal context
- Competitive context
- Health sector context
- Demographic context.

3.1 Historical context

Southern Cross opened for business in 1961 and grew gradually during the 1960s, then more rapidly in the 1970s and 80s as New Zealanders sought access to private health services rather than face delays for treatment in the public health system (notably elective surgical treatment). This was the period during which today's long-standing members joined the Society.

In these early decades Southern Cross had a simple approach to setting premiums, with broad "community rates" for children (0-18 years), adults (19-64 years) and the 65 and over age group. The 65 and over rate was set as a fixed ratio relative to the adult age rate, rather than being based on claims costs.

The effect of this approach to premium setting was that younger members within the adult community band cross-subsidised older members in that band, while all members cross-subsidised those in the 65 and over community band.

Market characteristics changed significantly in the 1990s. Government health reforms and a rapidly growing range of health services were driving increased consumer demand in the private health system. At the same time, the cost of those health services was growing far ahead of the rate of general inflation.

A consequence for Southern Cross members was a series of premium price increases through the early 1990s. The Society's chief executive at the time, Peter Smith, described the situation in his book *The Private Prescription*[2]:

> *Older members were the most aggrieved. A basic problem was that many people in their sixties and seventies, having completed their working lives, felt that they were entitled to concessionary pricing for their health insurance, just as they were for other services. After all, going to the movies was cheaper, car and house insurance discounts were available, bus fares were reduced and so forth. The difference with health insurance was that with age, the risk goes up, not down. And it goes up rapidly.*

This quote demonstrates that the perceptions and expectations raised in discussion of the 2011 AGM resolutions to investigate recognition of member tenure are not new and have, in fact, been evident for decades.

Another significant development during the 1990s was the approach taken by competing health insurers to attract younger, "low risk" customers. Instead of Southern Cross's community rating approach, competitors typically used five or single year "age bands" to calculate premiums that were significantly more attractive to younger people. The result, as outlined in an actuarial report by Tacit Group in 2000, was that insufficient younger members were joining (and/or remaining) with the Society, and the average age of the membership increased rapidly from 34.4 years in 1990 to 39 years in 1999.[3]

<u>Transition from community rating to age banding</u>

As a consequence of the many changes in the health environment, the Southern Cross Board of the day came to the conclusion that, despite being unpopular with parts of the membership, fundamental changes were necessary to put the Society back on a financially sustainable path.

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[2] The Private Prescription, Peter A Smith, 2000. Page 183.
[3] Tacit Group, The Next 10 Years, May 2000

This view was confirmed in actuarial studies, including one by independent consulting actuaries PriceWaterhouseCoopers in 2003, which determined that the age-related approach to premiums was the only practical option for the Society to achieve a satisfactory and sustainable solvency position.[4]

Following the introduction of age banded premiums for working-age adults (aged 18-64 years) the Society's Board, in discussion with a member-representative group, set up an Actuarial Working Group (AWG) in 2003 to address questions related to longer-standing members.

The AWG's work is an important reference point for the Member Tenure Project because its primary purpose was to:

- Recommend a premium calculation basis that maintained broad equity for all generations of Society members
- Consider the appropriateness of a scheme to recognise and reward length of membership.

The AWG was comprised of three actuaries, including an independent actuary representing the members' group, and it undertook detailed analysis of claims and premium data that went back to 1970.

In its 2004 report to the Board, the AWG outlined two key findings, which it emphasised were different and distinct aspects of the membership tenure question: historical capital contributions and an on-going loyalty discount.[5]

- On the subject of capital contributions, the AWG found that current members (as at 2003) who had joined the Society prior to 1983 had made a positive capital contribution to the Society's reserves and that it would be appropriate to return this capital to those members through a discount applied to premiums for a fixed term.
- On the subject of loyalty discounts, the AWG reported that it would be difficult for Southern Cross to justify the introduction of such a scheme on technical insurance grounds because long standing members, on average, claim more than members with shorter tenure. The AWG observed that there may be other reasons (e.g. marketing reasons) for wanting to introduce a loyalty discount but that these considerations were outside the AWG's scope.

On the basis of these AWG findings, the Society's Board in 2004: [6]

- Approved implementation of the "Founding Members Reward", returning positive capital contributions (assessed at $26 million) to 130,000 long-standing members over a two year period through premium discounts. The minutes of the Society's 2004 AGM note that the chairman of the members' group, on behalf of long-standing members, complimented the Board on introducing this reward.
- Did not pursue an on-going loyalty discount for long-standing members because of the AWG's finding that they already received greater benefit than shorter term members through higher average claims payments. This was communicated to members in the Summer 2004 edition of the Society's member magazine.

[4] Independent Review of August 2002 Premium Rate Increases, PriceWaterhouseCoopers, 2003.
[5] Actuarial Working Group Report, 2004
[6] Board Paper BP2588S, 3 August 2004.

The Board also adopted the AWG's recommendations for a premium calculation approach that maintained broad equity for all generations of Society members. These pricing principles (summarised below) still apply to the way the Society sets premiums today:

- **General**: Premium rates and investment income should be sufficient to meet the cost of claims, the cost of providing the Society's services, and maintaining adequate reserves.
- **Age rating**: Premiums should generally be rated by age based on cost of claims. Premiums for members under 21 and over 64 are "community" rated, while working-age adult members are rated in one year age bands.
- **Low claims discount**: Allowance may be made for a low claims discount.
- **Claims Related and Administrative Expenses**: These will be analysed and allocated across the membership appropriately.
- **Cross-Subsidies**: Cross-subsidies between business segments, products and age bands should be minimised.
- **Management of Surplus**: The Society must maintain surplus assets (reserves) to ensure that in all reasonably foreseeable circumstances the Society will be able to meet all due claims.
- **Actuarial judgement**: The Society's actuaries will exercise professional judgement and utilise extensive analysis in reaching its pricing recommendations.

Consulting actuaries, Finity Consulting, in a March 2012 review of the AWG's findings[7] found the pricing principles identified and considered all relevant issues, were reasonable, and "achieved the objective of maintaining broad equity for all generations of members" (see section 4.1).

Members were generally supportive of these pricing principles during the Member Tenure consultation process in April 2012 (see section 5.1).

<u>The role of the Society's financial reserves</u>

It is a legal requirement that the Society holds sufficient financial reserves (see section 3.2). The financial reserves built up incrementally within the Society over the past 50 years are also used in various ways for the benefit of current and future generations of members.

- **Moderating the impact of claims inflation**: Reserves enable the Society to 'smooth' the impact of claims costs volatility on members. For example in the 2009 and 2010 financial years (periods of high claims cost inflation) the Society deliberately set out to operate in "deficit" to cushion the impact on members' premiums. The deficits in those periods ($16.1m in 2009 and $7.1m in 2010) were funded from the Society's reserves.
- **Investment returns**: Financial assets are invested to generate income that helps meet the Society's claims and operating costs, and also contributes to the maintenance of reserves at a level appropriate for the size of the insurance business. Net income from investments in the 2011 year was $21.8 million.
- **Financial strength rating**: A strong solvency position has helped the Society maintain an A+ financial strength rating from ratings agency Standard & Poor's for nine consecutive years, despite considerable uncertainty in financial markets during that time. This demonstrates to employer group schemes, insurance advisers, existing members and potential new members that the Society is financially stable.

Currently, the benefits derived from the reserves are applied across the membership in proportion to the size of each member's premium in a given period. This approach is consistent

[7] Review of Actuarial Working Group Report June 2004, Finity Consulting Pty Limited, March 2012

with the philosophy of many mutual or co-operative organisations[8]. However, it has been suggested at various times that long-standing members ought to have greater claim to the benefits derived from Southern Cross' reserves.

The 2004 Actuarial Working Group determined that the majority of the Society's reserves (net of positive capital contributions returned to long-standing members via the Founding Members Reward) were a "Capital Estate" made up primarily of positive capital contributions prior to 1983 from members who had left the Society, and which existed for the benefit of current and future members. The AWG found that in the years between 1983 and 2003 the Capital Estate grew incrementally, keeping pace with the level of financial reserves required by the Society without need of additional capital contributions from members.[9]

Finity Consulting's March 2012 AWG review described the Founding Members Reward as putting long-standing members on an "equal footing" with more recent members regarding capital contributions[10].

Finity's analysis of the Society's financial results also showed that there has been no positive contribution to capital from members between 2003 and 30 June 2011, with the increase in reserves over this period being less than the investment income earned. Finity, therefore, found no actuarial basis to repeat a scheme such as the 2005-2007 Founding Members Reward.

[8] www.nz.coop/understanding-cooperatives-principles/
[9] Actuarial Working Group Report, 2004
[10] Review of Actuarial Working Group Report June 2004, Finity Consulting Pty Limited, March 2012

3.2 Regulatory and legal context

Compared with many other countries, the health insurance market in New Zealand is lightly regulated. There is little in the New Zealand legislative or regulatory environment that incentivises the uptake or retention of health insurance, or that prescribes characteristics of health insurance products, services or prices.

By way of contrast, in Australia the Private Health Insurance Act 2007 and associated regulations outline incentives to encourage people to have private health insurance (a 30%, means tested, tax rebate); rules governing private health insurance products; and requirements related to how insurers conduct their health insurance business.[11]

In the US, President Obama's Affordable Care Act 2010 requires those who can afford it to buy health insurance or pay a penalty; premiums attract tax credits to incentivise purchase; states set up health insurance exchanges to provide options for everyone who can't afford health insurance; employers who have more than 50 employees face penalties if they don't offer health insurance; and policies are required to cover preventive treatments.[12]

Prescriptive legislation specific to the health insurance market does not exist in New Zealand. However, some legislation and associated regulations apply to aspects of health insurance practice and premium setting.

<u>Insurance (Prudential Supervision) Act</u>

The Insurance (Prudential Supervision) Act 2010[13] was conceived to promote consumer confidence in the insurance sector. It outlines requirements and/or processes for all organisations wanting to operate as an insurer in New Zealand, including:

- Solvency standards (i.e. holding sufficient financial reserves to meet claims liabilities)
- Risk management
- Financial strength ratings
- Prudential supervision by the Reserve Bank of New Zealand
- 'Fit and proper' certification of directors and key officers.

Provisions relating to solvency standards and risk management have relevance to the Society's premium calculation principles and assessment of appropriate financial reserve levels. The regulator of licensed insurers, the Reserve Bank, issued extensive new regulations last year in relation to the appropriate level of reserves held by insurers[14].

In general terms, the size of an insurer's reserves will reflect the size of the business's insurance risk. The Solvency Standards require insurers to consider and make appropriate provision for the potential impact of unexpected, adverse claims events or shocks that are relevant to their business sector.

It is the Society's assessment that health insurers are vulnerable to changes in the marketplace that could unexpectedly affect claims costs, such as: significant changes or "cost shifting" from the public health system or ACC to private patients; a tightening of legislation or regulations related to ACC cover or pay-outs; and rapid increases in health providers' charges. If a series of

[11] www.comlaw.gov.au/Details/C2009C00338
[12] www.freep.com/article/20120628/FEATURES08/306250001/Affordable-Care-Act
[13] www.rbnz.govt.nz/finstab/insurance/
[14] www.rbnz.govt.nz/finstab/insurance/4551596.pdf

such events were to coincide - perhaps triggered by international economic events or political change - claims made by the membership could unexpectedly outstrip the Society's income in a given financial period, and the resulting deficit would need to be met out of the Society's reserves.

While the Reserve Bank insurer solvency regulations are relatively new, the Society has been managing reserves levels for some years based on benchmarks from Australian health insurers and guidelines developed here in New Zealand through the Health Funds Association of New Zealand.

The Society has developed and tested its own 'risk models' to take into account the volatility of health claims costs, the nature of health insurance contracts, and the fact that as a mutual Friendly Society Southern Cross cannot readily generate new capital if it was required. These models, based on actuarial methods, are used to derive a target solvency range within which the Society's financial reserves should sit to ensure the Society does not fall below the minimum solvency capital required to continue operating as an insurer in New Zealand, even in the event of sustained adverse claims impacts such as those discussed above.

The Society's reserves currently sit just above the middle of the target solvency range, and are equivalent to around 7.5 months' worth of claims expected in the 2012-13 year.

In the context of solvency levels it is worth noting that another mutual insurer, AMI Insurance, recently faced a potentially significant shortfall in its reserves (and hence a need for a significant capital injection) as a result of the Christchurch earthquakes. Various commentators acknowledged the difficulty AMI had, as a mutual insurer, raising new capital from its 85,000 policyholders. Following Government intervention, AMI was forced to restructure and was sold in April 2012 to Australian insurer IAG.[15]

<u>Human Rights Act</u>

Aspects of the Human Rights Act 1993 (HRA) have direct relevance to the concept of tenure or long-standing member discounts. These include provisions that allow health insurance to be provided on different terms and conditions to people of different ages, provided those differences can be justified by relevant actuarial or statistical data.[16]

Guidelines to the HRA, prepared by the Health Funds Association industry group in 2003, warn that younger persons who are charged substantially higher premiums than their risk profile may be discriminated against under Section 65, unless health insurers have good reasons.[17]

The Human Rights Commission's submission to the Society's Member Tenure consultation process was that recognition of length of membership would not necessarily raise issues under the HRA because length of membership is not an illegal basis for discrimination. However, the Commission did raise two areas of concern:

- If a member's age is part of the qualifying criteria (e.g. only people over a specific age qualify for the discount) this could be directly discriminatory, or
- If the effect of a tenure discount was to disproportionately advantage older members at the expense of younger members this could constitute "indirect discrimination".[18]

[15] www.iag.co.nz/News/Pages/IAG-completes-acquisition-of-AMI.aspx
[16] Guidelines: Insurance and the Human Rights Act 1993, Human Rights Commission
[17] www.healthfunds.org.nz/pdf/Guidancenote.pdf
[18] Letter from Human Rights Commission dated 14 June 2012

While the project team is not aware of insurance-related case law on this point in New Zealand, an Australian case illustrates the potential problem. In 2005 the Australian Administrative Appeals Tribunal found against a Western Australia-based health insurer, HBF, which proposed to introduce a loyalty scheme in which benefits increased with length of membership, accruing until the member reached age 65, at which time they were available to be used. The Tribunal found that "the proposed scheme, if implemented, would discriminate in favour of contributors who are over the age of 65 years."

It was argued by HBF that the "scheme only discriminates in a positive way to assist those who have attained the age of 65 years." However, the Tribunal found that: "It is not so much the provision of benefits to people over the age of 65 which is the concern, but rather the fact that contributors of any other age, whether it be at age 20, 30, 40 or whatever age, have no right at that age to receive any financial benefit under the scheme."[19]

Tax incentives

As mentioned above, a feature of both the Australian and US systems is financial incentives/penalties to encourage uptake and retention of health insurance. No such incentives/penalties exist in New Zealand.

Southern Cross has been active, alongside the Health Funds Association industry group, in lobbying the Government to look at tax rebates on premiums for people of retirement age, in order make health insurance more affordable for a greater number of older New Zealanders. A Southern Cross position paper published in 2010 pointed out that:

> *Older New Zealanders place heavy reliance on their insurance cover to access treatment that will help keep them as fit and active as possible. Yet for many New Zealanders aged 65 or older their ability to afford health insurance can be cause for concern. Providing a tax rebate for New Zealanders aged 65 years and over, to encourage greater health insurance coverage, would have a significant impact on the lives of this age group, while at the same time easing pressure on the public health system.*[20]

Southern Cross alone funded 158,000 elective surgical procedures in the 2011 financial year[21], while the public system funded 145,000 elective discharges in a similar period[22]. While "procedures" and "discharges" are not directly comparable, these statistics demonstrate the importance of private health insurance funding in enabling access for New Zealanders to elective surgery.

Despite some encouraging signals in recent years[23], the idea of tax rebates for health insurance premiums has now been effectively ruled out by the current Health Minister, Tony Ryall.

> *In response to the Health Funds Association of New Zealand proposal, the Ministry of Health worked with the Inland Revenue Department and the Treasury to analyse the costs and benefits of providing tax rebates to people who use medical insurance for*

[19] www.austlii.edu.au/au/cases/cth/aat/2005/599.html
[20] www.southerncross.co.nz/AboutTheGroup/HealthSectorIssues/tabid/305/vw/1/ItemID/310/Position-Health-insurance-rebate-for-65-age-group.aspx
[21] 2011 Annual Report.
[22] www.national.org.nz/Article.aspx?articleId=36917
[23] www.stuff.co.nz/sunday-star-times/business/3040069/Elderly-in-call-for-tax-relief-on-premiums

elective surgical treatment. The results showed that savings in public health expenditure from such tax rebates are unlikely to outweigh the costs.[24]

I am aware of…the positive contribution made by the private health sector to the health of New Zealanders. However, there is a major cost to this proposal and there is simply no extra money at this time.[25]

[24] Sunday Star Times, 26 February 2012.
[25] Waikato times, 17 July 2012

3.3 Competitive context

A suggestion from one of the 2011 AGM resolution proposers was that Southern Cross, as a not-for-profit Friendly Society and with its economies of scale, enjoys a new business "price advantage" that it could transfer to its longest serving members. This is a useful hypothesis through which to consider the Society's competitive position in the health insurance market.

There are numerous health insurers operating in New Zealand. They include 'for profit' companies like Tower, Sovereign and One Path; and not-for-profit organisations like Southern Cross, Unimed and Accuro. Eleven health insurers, including all named above, belong to the Health Funds Association of New Zealand industry group.

To the extent that Southern Cross's market share has grown (albeit gradually from 60.1% in June 2008[26] to 61% in March 2012[27]) it can be demonstrated that Southern Cross does compete effectively in the New Zealand health insurance market. Media and consumer health insurance price comparisons – such as a widely published May 2012 article that found Southern Cross and another not-for-profit insurer "are generally cheaper"[28] – also suggest that Southern Cross premiums are competitive. Southern Cross's own competitive intelligence gathering puts its premium rates for most age groups below those of its main "for-profit" competitors and in a similar range to other not-for-profit insurers.

In reality, however, a variety of factors exist that make it difficult to definitively compare insurers' new business premiums:

- There is variation in the level of cover or benefits offered by different health insurers and different insurance plans
- Premiums are adjusted regularly and, at any given time insurers may be in different stages of their premium review cycles
- New insurers, or established insurers in expansion mode or offering "new" products, may from time to time pitch premiums at a level designed to be attractive to new business but which may, over the medium to long term, become relatively more expensive as customers develop health conditions and establish claiming patterns.

Consequently, there is no clear basis to conclude that Southern Cross premium pricing for new business is sufficiently low, compared to all other insurers, to absorb increases over-and-above what is justified based on claims costs.

Southern Cross sales management's assessment is that the market for new / younger business is keenly competitive and price sensitive, and that Southern Cross is having to work hard to maintain its share of new business in a contracting market. They believe any increase in Southern Cross premium pricing for new business, relative to other insurers, would make that significantly harder.

A further factor in the current competitive environment is the state of the New Zealand economy and the impact it is having on the health insurance market overall. From its recent high point in June 2009, the size of the health insurance market has declined by 3.1% from 1.394 million to 1.351 million in March 2012[29]. Southern Cross has not been immune to this contraction but it has fared better than its competitors. Southern Cross contracted by 2.3% from 843,000 to

[26] www.healthfunds.org.nz/pdf/HealthInsuranceStatisticsJune2008.pdf and Southern Cross 2008 annual report
[27] www.healthfunds.org.nz/pdf/2012MarHealthInsuranceStatistics.pdf and Southern Cross internal data
[28] www.stuff.co.nz/business/money/6997884/10-ways-to-save-on-your-health-insurance
[29] www.healthfunds.org.nz/Statistics.asp

823,500 in the June 2009 - March 2012 period [30] while the rest of the market contracted by 4.3% from 551,000 to 527,500.

<u>Delivering value</u>

The project team notes that premiums are one measure of competitiveness. Another, and one which the Society places considerable importance on, is the proportion of premium returned to members in claims payments. By this measure Southern Cross delivers very good value to its customers compared with competing insurers.

In the 2011 financial year 87.1 cents was paid in claims by the Society for every $1 paid in premiums.[31] While directly comparable information isn't available to the Society from individual competitor companies, analysis of industry claims and premium data from the Health Funds Association demonstrates that the rest of the industry returned an average of 70.9 cents in claims for every $1 paid to the insurer. [32] On this basis, Southern Cross delivered nearly 23% greater value to its health insurance customers than its competitors did on average in the 2011 financial year.

[30] Southern Cross data
[31] Southern Cross Medical Care Society Annual Report 2011
[32] www.healthfunds.org.nz/pdf/2011JunHealthInsuranceStatistics.pdf and Southern Cross internal data

3.4 Health sector context

Southern Cross is part of a New Zealand health system that delivers a broad range of essential health care services for New Zealanders. The system is summarised in this table.

Essential health service sectors	What do they provide?	Who pays for these services?
Public	Emergency care, most cancer care, specialist care and elective surgery in public hospitals; GP visits and prescriptions are subsidised to make them more affordable.	Tax payers
ACC	Treatment and rehabilitation costs arising from accidents (whether at work, at home, on the sports field or as a result of a car accident).	ACC levy payers (e.g. employers, employees, vehicle licensees etc)
Private	Elective surgery and cancer care in private facilities and private specialist care; the un-subsidised portion of GP visits and prescriptions.	Private individuals, out of their own pockets or via health insurance

Every part of the New Zealand health system is under pressure from rising costs and that pressure will only increase in years to come.

In 2009 Treasury forecast that Government health spending as a proportion of New Zealand's Gross Domestic Product (GDP) would grow from 6.9% to 10.7% in 2050[33]. At the same time as public health expenditure increases, it's expected that spending in the private health sector (much of it funded by health insurance) will also need to grow to meet demand, notably for elective surgery.

As a not-for-profit insurer, the Society's health insurance premiums directly reflect the level of claims made by members. And those claims costs have been rising rapidly for the best part of two decades [34].

Between 2005 and 2011 the Society's claims costs grew by 52% from $378.6 million to $577.1 million[35]. Factors responsible for this increase can be better understood by analysing a specific procedure - knee replacement surgery:

- The average price charged for this operation was 33% higher in 2011 than 2005
- Members claimed for 19% more knee replacements in 2011 than 2005
- Hence, the claims costs associated with this one procedure grew 59% in six years.

Taking into consideration growth in the membership, overall claims costs-per-member grew by 46% during this six year period - nearly two and a half times the general rate of inflation as measured by the consumer price index. The growth in claims has been even more pronounced for members aged 65 and over, with claims costs-per-member for this age group increasing 65% over the 2005-2011 period - more than three times the general rate of inflation[36].

[33] www.treasury.govt.nz/government/longterm/fiscalposition/2009/ltfs-09.pdf
[34] The Private Prescription, Peter A Smith, 2000. Page 185.
[35] Southern Cross Annual Reports, 2005 and 2011
[36] Southern Cross claims data and Reserve Bank inflation calculator (www.rbnz.govt.nz/statistics/0135595.html)

Rising healthcare costs, and their impact on health insurance premiums is, quite clearly, a significant factor behind the call to reduce premiums for long-standing members. This is evident in the comments from the members who proposed the 2011 AGM resolutions to investigate recognition of member longevity; it's evident in news media coverage and letters to the editor related to this project; and it's evident in the submissions received in the project's member consultation initiative (see section 5.2).

Unfortunately, there are no easy answers to rising healthcare costs: insurers and governments all over the developed world are facing the same challenge. A recent article in an authoritative UK actuaries publication talked about health insurance premiums there rising 10% per year for the past ten years, as a result of rising healthcare costs.[37]

The claims cost phenomenon has been a regular theme in Southern Cross Annual Reports in recent years, as well as in various speeches and media statements. In March 2012 Group Chief Executive Officer, Dr Ian McPherson, acknowledged in the Sunday Star Times that some members are finding it expensive to maintain their health insurance and that this had long been a concern to Southern Cross. He also noted that "Southern Cross can't control the number of procedures members need. Nor can we stop justifiable medical cost increases. What we can work on is unreasonable price increases."[38]

The Society has pursued a range of initiatives that it believes will have a moderating effect on the rate at which claims costs increase:

- Working with providers to try to manage or moderate their prices and streamline member experience through the Affiliated Provider programme
- Amending policy benefits to encourage more simple surgical procedures to be done in lower-cost environments such as GPs' rooms rather than hospital operating theatres
- Ensuring ACC correctly funds members' qualifying injury claims
- Automation and efficiency initiatives to moderate operating expenses and increase member convenience
- Assessing the cost/benefit of adding new treatments or technology to our policies.

The goal of these programmes is to slow the rate at which claims costs increase and, hence, the rate at which premiums increase. However, it is reluctantly acknowledged by health funders across New Zealand and the developed world, that healthcare cost inflation will continue to grow faster than general inflation.

Another New Zealand health insurer was quoted in the Sunday Star Times in April 2012 as saying that medical inflation is between 9 per cent and 11 per cent every year, and the effect was that the size of the health insurance market was shrinking "simply because more people can't afford it."[39]

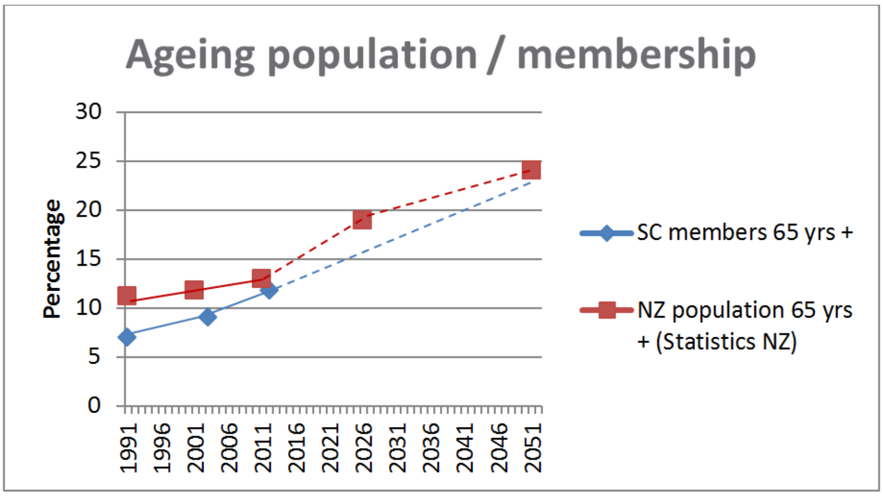
In this context it is noted that a tenure discount would not address the underlying problem of medical claims inflation and the impact it has on premiums paid by older members. It would, at best, be temporary relief for those members who qualify for the discount, while potentially contributing to further premium increases for non-qualifying members.

[37] www.theactuary.com/opinion/2012/05/soapbox-data-analytics-vs-your-gp/
[38] Sunday Star Times, 18 March 2012. Money Page 8.
[39] Tower chief executive Rob Flannagan, Sunday Star Times, 15 April 2012. Money Page 8.

3.5 Demographic context

The New Zealand population and the Southern Cross membership is ageing.

In 1991, 7% of Southern Cross members were 65 or older, compared with 11.1% of the population in general. Today, partly as a result of the maturing of the Southern Cross “insurance book” over its 50 years’ existence, the proportion of Southern Cross members who are 65 or over is around 12%, compared with 13% of the population in general. And it’s likely that the proportion of Southern Cross members 65 years and over will continue to grow in line with the increasing size of this demographic group in the general population.[40]



If each age group is paying premiums that reflect their own claims, the proportion of members aged 65 doesn’t cause any specific problems from an insurance viewpoint because the pool of funds available to meet claims from that age group would grow in direct proportion to the number of older members who are insured.

However, if inter-generational cross subsidies exist (such as would be the case if older/long-standing members are cross subsidised by younger/shorter duration members) the result of an ageing membership would be to steadily increase the level of cross-subsidy required from younger/shorter-duration members to top up the pool of funds available to meet the claims of older/longer-duration members.

The potential effects of the ageing of the Southern Cross membership, with respect to tenure discounts, are investigated in section 4.5.

An Information Paper for Health Minister Tony Ryall from the Health Funds Association in December 2011 noted that “the huge demographic shift” heralded by the first of the Baby Boomer generation turning 65 will significantly increase both pension and health costs over the next decade and beyond.[41]

The paper also notes that gains made in recent times by the public health system in reducing waiting times for some elective surgical procedures could be undone if older New Zealanders relinquish their health insurance in increasing numbers.

[40] www.stats.govt.nz/browse_for_stats/population/estimates_and_projections.aspx
[41] www.healthfunds.org.nz/pdf/Information%20paper%20for%20incoming%20Minister%20of%20Health.pdf

4.0 Data Analysis

A range of data analysis work has been undertaken at various stages of the Member Tenure project. This has included:

- Review of the 2004 Actuarial Working Group's methods and conclusions
- Analysis of the membership with respect to member tenure
- Analysis of claims with respect to membership duration
- Assessing possible discount approaches
- Projecting the effects of discount approaches in future years, and
- Considering possible "adverse selection" impacts.

Some of this analysis was used to inform members and gauge reaction in the consultation and quantitative research phases of the project (see section 5.0).

4.1 Review of 2004 Actuarial Working Group methods and conclusions

At the outset of the Member Tenure Project the Board asked consulting actuaries Finity Consulting Pty Limited to review the 2004 Actuarial Working Group report and to consider:

1. Whether the approach adopted by the AWG:
   - to the long term pricing policy, and the conclusions reached, was reasonable
   - to capital contributions and tenure discount, and the conclusions reached, was reasonable
2. Whether anything material had changed in the external environment since June 2004 (e.g. actuarial practice, regulatory, market/competitive) which would change Finity's view in relation to 1 above
3. Whether the Society's pricing decisions since that time had been consistent with the pricing principles/models adopted

And, then to:

4. Update the capital estate position calculations undertaken by the AWG in June 2003.

Key findings:

Finity Consulting's findings, in its opinion dated 15 March 2012 [42], were:

- _Long Term Pricing Policy_

  The AWG's recommended long term pricing policy identifies and considers all of the relevant issues. This includes detailed consideration of generational equity where this is relevant, balancing fairness with practical considerations.

  The policy allows Directors to exercise judgement in determining the premiums. For example, a decision by the Southern Cross Board to limit the level of premium increases at a time of very high claim cost escalation contributed to deficits in 2009 and 2010.

  Our opinion is that the approach adopted by the AWG was reasonable and that the conclusions regarding pricing policy remain reasonable.

  We have been provided with copies of past pricing recommendations and decisions. Based on the information provided we conclude that past pricing decisions have been made in a manner consistent with the Pricing Principles adopted by the Board following the AWG report.

- _Capital Contributions_

  The AWG considered insurance results and capital contributions over the period 1970 to 2003. The AWG concluded that members who joined the Society in 1982 or earlier had been net capital contributors to the Society, and that Stakeholders joining after this date were net users of capital.

  The Board subsequently implemented a Founding Members Reward to return capital to these long-standing members. As a result all current members who were also members at 30 June 2003 can be thought of as being on an "equal footing" with respect to their capital contributions to the Society.

[42] Review of Actuarial Working Group Report June 2004, Finity Consulting Pty Limited, March 2012

The approach adopted by the AWG to examine the capital contributions of members was reasonable and appropriate for the purpose. There has been no change to the external environment since the AWG report that changes this opinion.

- *Updated Capital Position*

  The cumulative capital position in the period since the AWG completed its work to June 2011 is a deficit of $27.1m. This is in part due to the pricing decisions taken during periods of high claim cost escalation. This means that members have not contributed to the capital of the Society since 2003, and it would not be appropriate to repeat a scheme such as the Founding Members Reward at this time.

- *Loyalty Discounts*

  The AWG considered loyalty discounts and undertook an analysis of claims experienced by duration of membership on an age-standardised basis.

  The AWG concluded that health insurance claims experience deteriorates with length of membership, and it would be difficult to justify the introduction of a loyalty discount on technical insurance grounds.

  We have verified that the relationship between claim cost and duration persists, and concur with AWG's findings.

Various of Finity Consulting's findings were referenced in the Member Tenure consultation discussion document[43] published in April 2012 to provide participating members with an up-to-date actuarial assessment of these matters (see section 5.1).

[43] www.southerncross.co.nz/Portals/0/Group/Corporate/12%20Member%20Tenure%20Project%20Discussion%20 Document%20(Final).pdf

4.2 Member tenure analysis

The Member Tenure Project Terms of Reference (appendix 1) asked that data relating to the current makeup of the membership with respect to tenure be analysed to provide a basis for defining categories of member tenure and financial modelling. The following data was used in the discussion document published to inform the Member Tenure consultation in April 2012 (see section 5.1).

Data

Membership tenure breakdown for the whole membership [44]

A significant proportion of members have been with the Society for long durations: 31.2% (257,000) of members have been with the Society for 20 or more years; 11.1% (92,000) have been members for 30 or more years.

Length of membership	Number of members	% of members
Less than 20 years tenure	568,018	68.8
20-29 years	165,716	20.1
30-39 years	74,380	9.0
40 + years	17,175	2.1
Total membership	825,289	100.0

Membership tenure broken down by age group

The following table demonstrates that members of long-standing are not necessarily in the 65 plus age bracket: 21,000 members with 30+ years membership tenure are under the age of 55; a further 26,500 are aged 55 to 64.

This table also demonstrates that not all members in the 65 plus age bracket would necessarily be classified as members of long standing for the purposes of a discount or other forms of recognition. If the threshold was 20 years membership, 20,000 members aged 65 or more would not qualify; if the threshold was 30 years membership, 54,000 members aged 65 or over would not qualify.

Length of membership	Members aged 0-54 years	Members aged 55-64 years	Members aged 65 or older	Total members
Less than 20 years tenure	491,860	56,330	19,828	568,018
20-29 years	87,762	43,629	34,325	165,716
30-39 years	18,265	24,510	31,605	74,380
40 + years	2,645	2,055	12,475	17,175
Total membership	600,532	126,524	98,233	825,289

[44] Based on membership as at 29 February 2012

4.3 Analysis of claims by membership duration

Separate studies undertaken by the AWG in 2004 and by Southern Cross's chief actuary in 2008[45] demonstrated that, on average, members of long standing receive more money back in claims than members who have been with the Society for shorter durations. This work was updated by consulting actuaries Finity Consulting and the Southern Cross actuarial team in March 2012. The following data was used in the discussion document published to inform the Member Tenure consultation in April 2012 (see section 5.1).

Data

Age cohort of members	Value of claims paid out for each $1 of premium paid in[46]		
	Members for 0-9 years	Members for 10-19 years	Members for 20+ years
20s			
30s			
40s			
50s			
60s			
70+			
Total (all adults)	**76 cents**	**90 cents**	**93 cents**

Some data in this table has been removed because it is commercially sensitive.

2011 claims data shows that members in all tenure groups are receiving better average value than customers of other New Zealand health insurers[47]. However, those members who have been with the Society for 20 or more years receive an even higher level of average value - 15-20 cents more per $1 of premium compared with members of 0-9 years tenure. This pattern of higher claims reimbursements for longer-duration members is evident through all adult age groups in the Southern Cross membership except members in their 20s.

This data demonstrates the value of what can be seen as an existing "loyalty" benefit for long-standing members, arising from the concept of "guaranteed renewability".

In some forms of insurance, an insurer may decline renewal of a policy, or put loadings onto premiums, if it decides the risk associated with the policy is too high. That's not the case with Southern Cross's health insurance contracts, where qualifying health conditions developed after the policy has commenced continue to be covered (subject to policy terms) until the policy is changed or relinquished by the member.

If a pure "insurance risk" approach was taken in relation to this data, a premium loading (rather than a discount) would be applied to long-standing members. Some health insurers achieve this, in effect, by "ring-fencing" groups of members or closing a policy to new business. For reasons of member equity, this is not Southern Cross's preferred approach.

[45] Durational Effects in a Health Insurance Portfolio, 2008.
[46] Claims for year ended 30 June 2011, excluding subsidised employer group schemes.
[47] See section 3.3.

4.4 Assessing discount scenarios

Following the member consultation phase of the project, some simple discount models were developed to hypothetically assess current and future impacts on premiums for qualifying and non-qualifying members. The results were then incorporated into quantitative research to test member reaction and preferences (section 5.1).

Based on earlier data analysis and feedback from the member consultation, 30 years tenure was selected as a realistic qualifying threshold, and a discount level of 10% was selected in order to deliver a tangible premium reduction. An important premise for this analysis is that the only sustainable means to fund a discount for a group of members is to charge other members a higher premium.

Data

Option 1: 10% discount to all members with 30+ years tenure

Under this scenario, based on the age and tenure profile of today's membership:

- Approximately 11% of members would qualify for the 10% discount
- Premiums for non-qualifying members would increase by approximately 2.5%.

Premiums paid by members vary considerably based on the member's age and their plan type. If these percentage decreases / increases were applied today to RegularCare plan premiums the following examples indicate the effects in real dollar terms [48]:

- A qualifying member aged 65 would pay $235.14 less per annum
- A qualifying member aged 50 would pay $81.08 less per annum
- A qualifying member aged 35 would pay $50.48 less per annum
- A non-qualifying member aged 65 would pay $58.78 more per annum
- A non-qualifying member aged 50 would pay $20.27 more per annum
- A non-qualifying member aged 35 would pay $12.62 more per annum.

The following table shows the proportion of members in each age bracket that would experience premium increases and decreases.

Age Group	Percentage paying more	Percentage paying less
0-54 years	96.5%	3.5%
55-64 years	79.0%	21.0%
65 and older	55.1%	44.9%
Whole membership	89.0%	11.0%

[48] Based on standard individual RegularCare premium rates available on the Southern Cross web site @ June 2012, including the Healthy Lifestyle/Low Claims Reward and payment by direct debit

Option 2: 10% discount to all members aged 65 or older who have 30+ years tenure

Under this scenario, based on the age and tenure profile of today's membership:

- Approximately 5% of members would qualify for the 10% discount
- Premiums for non-qualifying members would increase by approximately 1.5%.

If these percentage decreases / increases were applied today to RegularCare plan premiums the impact would be:

- A qualifying member aged 65 would pay $235.14 less per annum
- A non-qualifying member aged 65 would pay $35.27 more per annum
- All members aged 50 would pay $12.16 more per annum
- All members aged 35 would pay $7.57 more per annum.

The following table shows the proportion of members in each age bracket that would experience premium increases and decreases.

Age Group	Percentage paying more	Percentage paying less
0-54 years	100.0%	0.0%
55-64 years	100.0%	0.0%
65 and older	55.1%	44.9%
Whole membership	95.0%	5.0%

Discussion

The premium impacts for young and middle-aged, non-qualifying members on the RegularCare plan are relatively modest: Under option 1 the additional premium payable by a family of 4 (parents aged 50, and two children) is just over $50 per year; a non-qualifying SuperCare family would pay an additional $100 a year; a non-qualifying UltraCare family would pay an additional $117.

However, under both option 1 and option 2 (assuming that the discount is funded in even proportion by all non-qualifying members) there would be adverse consequences for non-qualifying members aged 65 and over. More than half of all members in this age bracket would pay more to fund the discount. For a retired couple on the RegularCare plan this would be around $118 per annum for option 1.

An adjustment on the funding side to address the undesirable consequence of some older members paying more would result in an increase in the level of cross subsidy payable by non-qualifying members under the age of 65. For example, by exempting non-qualifying members aged 65 and over from funding the tenure discount, premiums for non-qualifying under 65s would increase from 2.5% to 3.3% for option 1; and from 1.5% to 2.0% for option 2.

4.5 Future modelling

In this phase of the data analysis work, the tenure discount scenarios assessed in section 4.4 were projected forward to gauge impacts in future years, taking into account the ageing of the population (notably the “baby boom” bulge that is now starting to reach retirement age) and the on-going maturing of the Southern Cross membership.

Data

The assumptions table below summarises the factors used for projecting option 1 and 2 discounts into the future. Those assumptions include:

- NZ population estimates are Statistics New Zealand’s projections assuming medium fertility, medium mortality and long-run annual net migration of 10,000
- The Southern Cross membership is assumed to grow (both numerically and as a proportion of the population) based on ageing current members to maintain the demographic shape of the membership
- Cessation and new business rates are assessed at levels approximating industry norms for health insurance books like Southern Cross’s.

It is noted that there are many other factors that could affect future growth or contraction of the Southern Cross membership which are unknown and have <u>not</u> been accounted for in these projections. Examples include:

- The growth in the cost of healthcare services (and their impact on health insurance costs) relative to household budgets
- The performance of the tax-payer funded public health system (which will affect demand for private sector health services)
- The possible (albeit unlikely in the medium term) introduction of Government-funded health insurance incentives (e.g. a tax rebate)
- The degree to which any tenure discount might make Southern Cross relatively more/less attractive to new members and/or relatively more/less attractive to existing members (i.e. “adverse selection” which is discussed in section 4.6).

<u>Assumptions</u>

	Total members	NZ Population[49]	Members as % of NZ Population	Annual cessation rate	New business rate
31-May-12	822,628				
30-Jun-16	837,980	4,562,000	18%		
30-Jun-21	886,437	4,683,000	19%		
30-Jun-26	933,882	4,782,000	20%		
30-Jun-31	982,762	4,859,000	20%		
30-Jun-36	1,030,774	4,911,000	21%		
30-Jun-41	1,075,952	4,938,000	22%		

Some data in this table has been removed because it is commercially sensitive.

[49] www.stats.govt.nz/browse_for_stats/population/estimates_and_projections.aspx

Option 1: 10% discount for all members with 30+ years tenure

As the current membership matures, the proportion of members with 30 or more years tenure also grows. With more members qualifying for the discount, and a smaller proportion of non-qualifying members available to fund the discount, the impact on the premiums of non-qualifying members is projected to grow from 2.5% to nearly 10% within 14 years.

	Total members	Total members with 30+ years tenure	Proportion of members with 30+ years tenure	Approx effect on premiums of non-qualifying members
31-May-12	822,628	83,195	10%	2.5%
30-Jun-16	837,980	115,802	14%	4.2%
30-Jun-21	886,437	171,582	19%	7.0%
30-Jun-26	933,882	226,922	24%	9.9%
30-Jun-31	982,762	269,369	27%	12.1%
30-Jun-36	1,030,774	298,489	29%	13.0%
30-Jun-41	1,075,952	331,922	31%	13.6%

Option 2: 10% discount for all members aged 65 or older who have 30+ years tenure

With the addition of age criteria, the number of qualifying members is smaller throughout the projected time period. However, the pattern of increasing impact on the premiums of non-qualifying members is similar, growing from a 1.5% increase today to 8.5% within 14 years.

	Total members	Total members with 30+ tenure and age 65+	Proportion of members with 30+ tenure and age 65+	Approx effect on premiums of non-qualifying members
31-May-12	822,628	41,766	5%	1.5%
30-Jun-16	837,980	69,022	8%	3.1%
30-Jun-21	886,437	117,368	13%	5.7%
30-Jun-26	933,882	167,441	18%	8.5%
30-Jun-31	982,762	211,447	22%	10.8%
30-Jun-36	1,030,774	244,059	24%	11.8%
30-Jun-41	1,075,952	277,904	26%	12.6%

4.6 Adverse selection

The future projections discussed in 4.5 indicate that a tenure discount introduced today would represent an increasing cost to the Society's non-qualifying members in future years.

The rising cost to non-qualifying members might also have a worsening impact on the Society's ability to offer competitive premium rates that are considered necessary to attract new business and retain short-tenure members. This would encourage "adverse selection" which would add further questions about the sustainability of any tenure discount approach.

Adverse selection is an insurance phenomenon which can accelerate when insurance premium rates are set by means other than the assessment of "risk" or underlying claims costs.

For example, if a health insurer's premiums for "low risk" individuals (e.g. new members who will tend to be younger and claim less on average) are artificially high, those individuals are likely to seek out competing insurers offering lower premiums. And, if the health insurer's premiums for "high risk" individuals (e.g. long term members who will tend to be older and claim more on average) are artificially low, those individuals will be more likely to stay with the insurer.

The possible long term effect of a tenure discount, therefore, is that an insurer might:

- Lose new /short-term members (who, on average, are likely to be younger and lower claimers), and
- Retain longer term members (who, on average, are likely to be older and higher claimers)

The potential impact would be:

- A further reduction in the ratio of qualifying to non-qualifying members (on top of demographic effects) thereby increasing the premium impact for non-qualifying members, and
- A gradual increase in the average age and risk profile of the insurer's customer base (which will tend to push premiums up for all customers)

The project team notes that it was a process of "adverse selection" that saw a rapid ageing of the Society's membership, from 34.4 years to 39.0 years during the 1990s (discussed in section 3.1). The Society's "community rating" approach of the time (which had all working age adults – 19-64 years - paying the same premium) was more expensive for younger members than the alternative five year or single year "age banded" premiums offered by competing insurers.

In 2002, when the Society changed from community rates to age banded rates for working age adults, this adverse selection trend was broken and the Society's membership profile stabilised.

5.0 Members' views

Two initiatives were undertaken by the project team to better understand members' views related to recognising members of long standing in general, and to test reactions to specific aspects or ideas related to the topic.

- Member and stakeholder consultation (April 2012)
- Quantitative research (May/June 2012).

5.1 Member and stakeholder consultation

The Member Tenure consultation was launched on 1 April 2012. Members and other interested parties were invited to provide submissions by 30 April 2012.

The purpose of the consultation process was to share pertinent information and enable members to tell the Society what they thought about the idea of recognising members of long-standing. It was envisaged that insights gained in the consultation process could be explored further, and quantified, in subsequent research (see section 5.2).

Publicity

To facilitate informed discussion of the subject, a discussion document titled "Recognising members of long-standing. What do you think?" [50] was published. Various methods were used to make the consultation process and discussion document available to members and other stakeholders, including:

- A story in the March/April issue of the Society's Alive magazine that goes to all policyholders
- Mailing of discussion documents to a list of members who had contacted the Society or written letters to the New Zealand Herald regarding the loyalty recognition AGM resolutions between November 2011 and March 2012
- Mailing of discussion documents to consumer, Government and industry organisations who might have an interest in the subject
- Media publicity that achieved stories in the Sunday Star Times and most daily newspapers around the country in the week commencing 1 April
- Prominent advertisements on the Southern Cross web site's home page during April
- Placement of an advertisement in 4 metropolitan daily papers on 14 April
- A story in the April issue of the Society's Healthy Business newsletter that goes to representatives of companies that operate Southern Cross Employer Group schemes.

Participation

An estimated 600-800 visits, over and above what we'd normally expect during this period, were made to the Southern Cross Board News page [51] where members could access information and the discussion document in a range of formats.

Discussion documents were sent to various organisations inviting input, including Grey Power, Age Concern and the Consumers Institute. Acknowledgement of this invitation was received from the NZ Cooperatives Association, Reserve Bank and Human Rights Commission. A submission was subsequently received from the Human Rights Commission (see section 3.2).

Member submissions

124 member submissions were received by 1 May 2012, totalling 62,000 words (average = 500 words per submission).

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50 www.southerncross.co.nz/Portals/0/Group/Corporate/12%20Member%20Tenure%20Project%20Discussion%20Document%20(Final).pdf

51 www.southerncross.co.nz/boardnews

Submitter demographics

Submitters ranged in age from 23 to 86 years (average 68, median 70).

Age group	20s	30s	40s	50s	60s	70s	80s	Unknown
Submitters	3	3	6	9	35	52	15	1

Submitters ranged in length of membership from 0 to 50 years[52] (average 30 years, median 31).

Tenure	0-9 years	10-19	20-29	30-39	40-50	Unknown
Submitters	11	14	26	40	32	1

Feedback summary

Overall assessment of submissions:

- 48 (39%) were broadly in favour of some form of recognition of long-standing members
- 40 (32%) were broadly against recognition of long-standing members
- 36 (29%) were assessed as not being clearly in favour of one outcome or the other.

The following tables summarise the feedback received from members in response to the topics and information provided in the various sections of the discussion document.

Length of membership
The discussion document outlined statistical information about the current make-up of the membership (e.g. that 31% of members had 20+ years of tenure) and sought views on what length of membership might be considered worthy of recognition. • A broad range of views were expressed with no strong consensus. • Some members felt a period of 10 years was worthy of recognition, while others felt 35-40 years was the benchmark. The weight of opinion appeared to fall around 20 and 30 years. • Some members offered reasons for their views. David (75) believed long standing members were "entitled" to recognition. Others felt some form of recognition would be a means to help older members meet their premium costs and remain with the Society. • Some members stated they did not feel a discount based on tenure was justified.
The discussion document identified some sub-sets of the membership and asked if any of these groups should be treated differently in relation to tenure recognition. Supporting statistics pointed out that long-standing members cover a broad age range (e.g. 109,000 members with 20 years tenure were aged 20-54). • Most submitters stated that there should be no different treatment of identified groups of members with respect to tenure. • However, a few members saw justification for different treatment: One argued that only membership as an adult should count; one suggested that only those aged 65+ should be recognised; others suggested members that looked after their own health or had low claims should be recognised.

[52] Where members stated a membership duration, this number was used. Where no duration was provided, the data was accessed on Southern Cross's systems.

Recognition of long membership

The discussion document outlined that in order to provide a discount to one group of members, it would be necessary to increase premiums for other members. Reaction to this was invited.

- A reasonable number of submitters expressed support for lowering premiums for long serving and/or older members and distributing the cost to other members:
  - Mike, 75: "I…believe that we should be on some type of discount as….we are finding if VERY difficult to pay the premiums."
- However, in many cases, submitters saw other factors (age, claims history, healthy living, the potential role of the Government to assist) as being additional or even more important bases for premium discounts:
  - Deanne, 49: "More factors around lifestyle choices and long term loyalty should be built in"
  - David, 72: "I would support a scale of discounts based on the claim history of past years."
- A handful of submitters indicated that only a substantial discount, in real dollar terms, would be worthwhile:
  - Susan,68: "Any discount on premiums would need to be significant for longer term members ie $1000 not $100".
  - And Stephen, 72: "A loyalty rebate under $500 per annum is a waste of time".
- Submitters opposed to tenure recognition gave their reasons in their responses to this section
  - James, 71: "…and in the inevitable absence of something like a government guarantee, the society would be promoting a Ponsi scheme. Accumulating funds to cover future expectations would have many issues."
  - James, 75: "Where and how would these rewards kick in? Award them too early and the cost is too great. Leave them too late and hardly anyone benefits…the overall cost of any scheme would pose the problems".
- Some responses indicated a degree of inter-generational antipathy[53]:
  - Victoria, 24: "Charging more so baby boomers can reap the benefits is unfair and unsustainable. I know I will be shopping around if I have to pay more".
  - Christine, 54: "Is there no end to the demands of the elderly in this country?"

The discussion document provided brief details of two Australian health insurers' loyalty schemes based on "rewards dollars" or discounts at allied retailers, and sought reaction to this kind of recognition.

- A large majority of submitters were opposed to tenure recognition taking the form of rewards dollars or vouchers:
  - Clive, 47: "I don't have any interest in non-cash loyalty schemes".
- A number of submitters referenced Southern Cross's current voucher scheme and remarked that many of the offers did not correspond with what they, personally, would be interested in:
  - Elizabeth, 79: "The Society already arranges discounts on some products and services but few are appropriate for older age groups."

[53] Inter-generational equity has become a topic of some debate in news media and online social networks. When the Stuff web site published a story about Southern Cross considering a long-standing member reward (www.stuff.co.nz/business/industries/6681980/Young-v-old-Southern-Crosss-dilemma) more than 50 readers contributed comments, many referring to inter-generational fairness issues. Commentators, like the NZ Herald's Fran O'Sullivan (www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=10820293) have also called for greater consideration of generational equity to ensure NZ Superannuation does not become unsustainable in future years.

Premium pricing principles

The discussion document outlined the Society's pricing principles adopted in 2004 following Actuarial Working Group recommendations (see section 3.1 of this report) and sought members reaction.

- Most submitters were generally supportive of the Society's pricing principles, albeit in many cases with a caveat or two, such as:
  - Increase or remove low claims reward
  - Introduce healthy lifestyle rebate
  - Change age threshold for older members' community band
  - Allow for some cross-subsidisation etc.
- A few submitters proposed very different approaches to the Society's rating principles such as:
  - Harry (23): "individualised premiums" based primarily on an individual's claiming rather than their age
  - Derek (71): "premiums should be set and fixed (apart from inflation and medical technology cost increases) at the time the policy is taken out.

The discussion document related the concept of "cross subsidies" to the idea of discounts based on length of membership. Data indicating that long standing members on average received a greater level of claims reimbursement than shorter duration members of the same age was outlined.

- Many submitters did not acknowledge or recognise the "average" reference, and appeared to argue that this could not be so because their personal claims had always been very low.
- Some submitters did not appear to recognise the distinction that the discussion document was trying to draw between "age" and "long tenure".
- One very strong reaction from younger members was observed. Five members under the age of 40 provided comments related to this section – all but one of them said that they would leave or look elsewhere for alternatives if they were required to contribute to an age or tenure cross subsidy. Numerous older members also believed that younger members might react in this way.

Reserves

The discussion document outlined the Society's legal obligation to maintain financial reserves to meet potential liabilities, how the size of financial reserves is assessed by the Society's actuaries, and how the reserves are used.

- The clear majority of submitters were happy with the outline of the Society's approach to reserves.
- Some acknowledged the importance of a prudent and cautious approach to reserves, although others questioned whether reserve levels may be too high.
- Some submitters in favour of tenure/age discounts saw an opportunity to use returns on invested reserves as a means to fund a tenure discount:
  - Gary, 66: "I agree with the society's approach to reserves in principle. However it may be necessary to modify the current way reserves are used if some form of recognition is given to long-standing / loyal members."
- Some supporters of tenure discounts also felt long standing members had helped build the Society's reserves so were entitled to special consideration:
  - Allen, 65: "…it is only fair and reasonable that these long term members should benefit the most from these reserves when called upon".
- Some submitters who elsewhere had expressed opposition to the concept of a tenure discount had contrary views:
  - Christine, 54: Reserves should not "…be compromised to provide special favours for any particular group".

The future

The discussion document provided an overview of the trends and issues that are on the Society's radar, and outlined the health insurance sector's discussion with Government about tax relief associated with health insurance premiums.

- Tax rebates for over 65s was one of the most discussed aspects in this section of members' submissions. The general sentiment was that the Society should continue to push, or push even harder, to get the Government on-board with this idea. However, some submitters saw this as a lost or hopeless cause.
- A number of submissions indicated a level of anxiety about the state of the health system generally and (particularly among younger submitters) concern about what services will be available and/or affordable in future.

The discussion document looked into the matter of the ageing population and back-grounded some of the issues that led to the Society's change 10 years ago from community rating to age banding for working-age adults. Views were sought on whether today's younger generation would be happy to pay more to subsidise older members, and whether it was appropriate to incentivise this with a promise of cheaper future premiums.

- Many diverse views were expressed:
  - Warren, 65: "I am fed up with inter-generational effects. Our children will not thank us"
  - Margaret, 74: "This is exactly the proposition that was put to us as younger members in the 1970s."
  - V, 84: "It's nice if younger members can subsidise older ones but I want the society to continue for the sake of my children. So let's not push it."
- Some members acknowledged the challenges the Society faces:
  - Merv, 68: "Sounds like the rock & hard place."
  - Terry, 78: "The problem is not Southern Cross as such, only how to make changes that will be most help to everybody of all ages."

Final thoughts

The discussion document invited members to provide any further thoughts they might have regarding recognition of long-standing members.

- Some submitters mentioned gratitude and satisfaction in relation to their dealings with Southern Cross. Others highlighted issues or problems they perceived with aspects of Southern Cross products and services.
- Many comments in this section (as was the case in various other parts of the survey) discussed what members saw as potential solutions to challenges raised in the discussion document. Proposed solutions included:
  - Formulae for tenure discounts
  - Premium caps or freezes for over 65s
  - Taking a harder line with providers over costs
  - Rewarding healthy lifestyles
  - Cutting the Society's operating costs
  - Modifying or introducing new products
  - Lobbying Govt, etc.

5.2 Quantitative research

Quantitative research was undertaken in May/June 2012 using the Society's online "Viewpoint" member panel. The purpose of the study was to better understand the views of the membership as a whole on the subject of recognising members of long-standing.

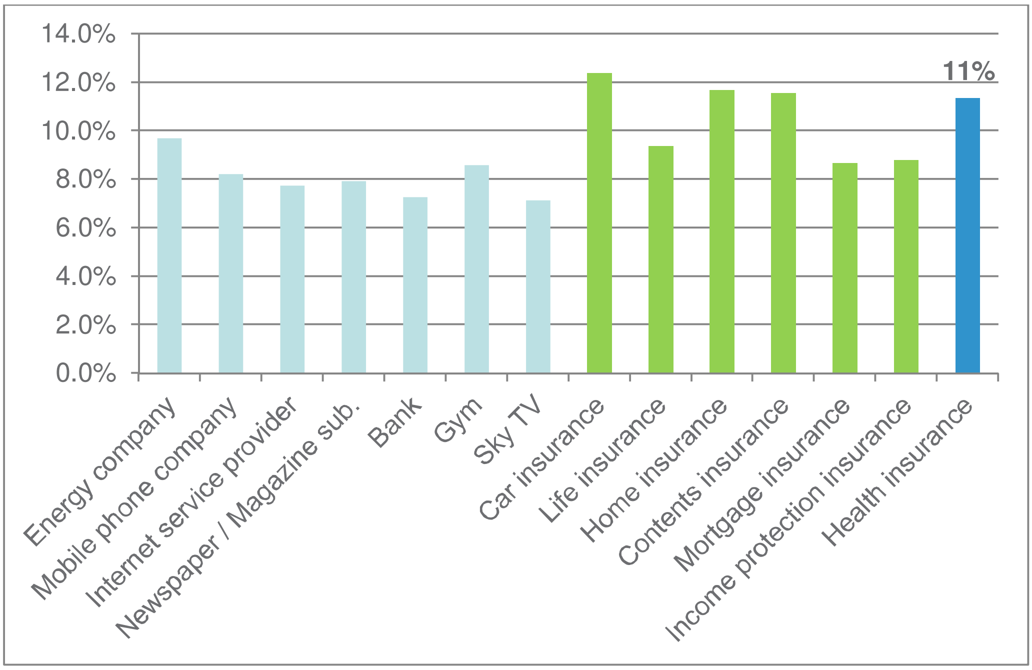
4,000 email invitations to participate were sent to Viewpoint panellists. A very high 41% (1,630) members completed the survey. Results were weighted to reflect the characteristics of the membership with respect to age, gender and length of membership.

Discount experiences and expectations

An initial section of the research sought to understand views and expectations with respect to discounts in general, and long-time customer discounts in particular.

Around 20% reported they had received long-time customer discounts in relation to a number of common insurance types – car, life, home and contents.

Respondents were also asked what level of discount they expected to receive for being a "loyal or "long standing customer" with a range of insurance and other businesses.



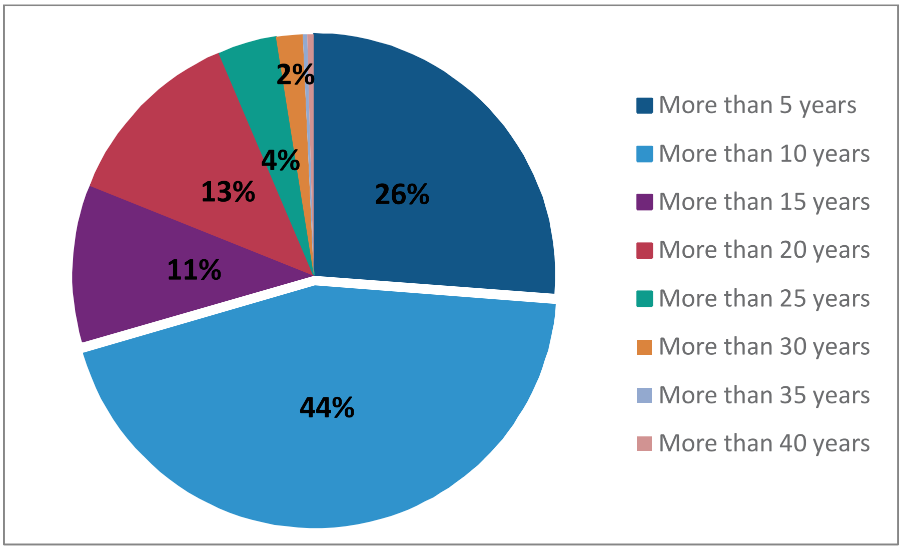
- The graph indicates an average expectation of subscription / fee discounts of around 7% for services such as banks and Sky TV.
- Expectations range up to 11% - 12% for some types of insurance.

<u>Comments</u>

It is noted here that the project team identified some examples of discounts linked with the length of a commercial relationship. However, in general, tenure discounts (per se) do not appear to be commonly applied by New Zealand insurers or non-insurance businesses. Despite this, members' expectations that they should/do receive such discounts appears to be high.

What is "long-standing"

The next section of the research introduced the resolutions passed at the 2011 AGM to investigate recognition of long standing members and asked what duration members thought would qualify someone as "long standing". This was done without specific reference to the tenure characteristics of the current Southern Cross membership:



- Among all members, 70% thought an individual should qualify as long standing by the time they had been with the Society for 10 years.

Comments

Members' responses to this question were strongly correlated to their own membership duration: less than 1% of members with 1-19 years tenure selected a threshold period greater than 20 years; whereas a third of members in the 30-39 tenure category, and 50% of the 40+ tenure category selected a threshold greater than 20 years.

Support for a long-standing member discount

Members were asked to indicate on a scale of 1-10 how strongly they agreed that long standing Southern Cross members should receive discounts on their health insurance premiums. This was done without specific reference to the tenure characteristics of the current Southern Cross membership or how such a discount might work.

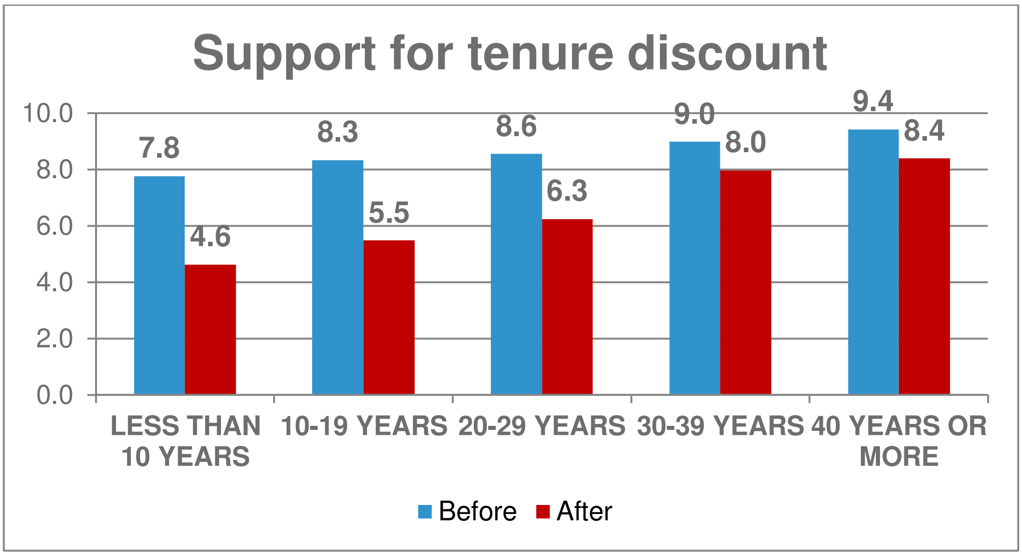
8.2

- The average score of 8.2 across the whole membership indicates a strong level of agreement with the concept of a long-standing member discount
- Long standing members were most supportive, with an average score of 9.0 and higher in tenure categories above 30 years
- Shorter duration members were also supportive, with an average score of 7.8 from members with less than 10 years tenure.

Members were then provided with more specific information about how a long-standing member discount might work. It was explained that if 30 years membership was the threshold around 11% of members would qualify, and that in order to give those qualifying members a 10% discount it would be necessary to increase premiums for all other members by around 2.5%.

Based on that approach, members were asked again to indicate on a scale of 1-10 how strongly they agreed that long standing Southern Cross members should receive discounts on their health insurance premiums.

8.2 → 5.4



- The average score of 5.4 indicates a pronounced drop in agreement levels
- Support remained strong among members with 30 years or more tenure, dropping from 9.0 or higher to 8.0 or higher
- However, support fell away more significantly among members with shorter tenure, from 7.8 to 4.6 in the case of members with less than 10 years membership.

Long standing membership versus other premium discount criteria

Members were asked how strongly (on a scale of 1-10) they agreed that various member characteristics should be used in determining health insurance premium discounts.

Member characteristics	Scores
Members who are 20 years or younger	4.8
Members who eat 5 or more servings of fruit/vegetables per day	5.7
Members who are 65 years or older	5.9
Members who exercise at least 3 times a week	6.3
Members with low or moderate alcohol intake	6.6
Members who maintain a healthy weight	6.9
Members who pass annual doctor's check ups	7.2
Members who make low claims	7.4
Long standing members	7.4
Members who keep up with scheduled smears or breast/prostate examinations	7.7
Members who are non-smokers	8.5

- The only characteristics to receive a reasonably strong level of agreement (above 7.5) were "members who are non-smokers" (8.0) and "members who keep up with scheduled smears etc (7.7).
- "Long standing members" achieved moderate agreement, as did "members who make low claims" and "members who pass annual doctor's check-ups".
- Agreement levels were similar across all age groups and regardless of length of tenure, except in relation to "long standing members" (where shorter duration members were significantly less supportive than long standing members) and "members who are 65 years or older" (where younger and shorter duration members were significantly less supportive than older and longer-standing members).

Discount concept testing

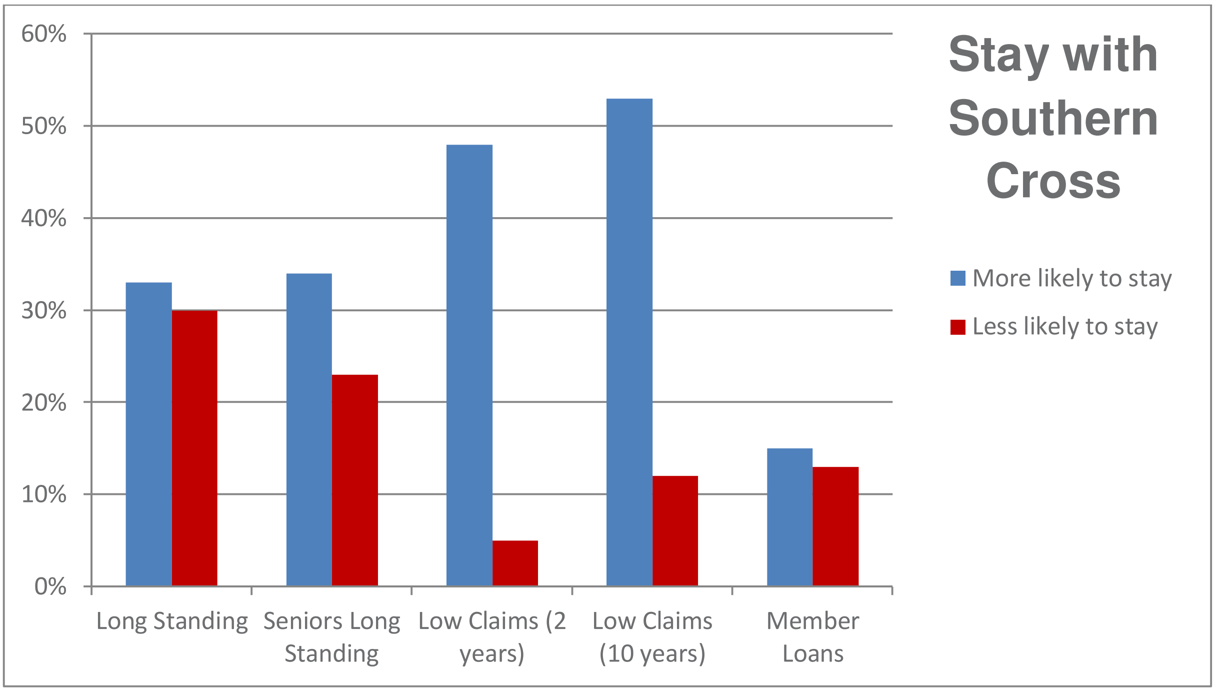
Five discount concepts (as described below) were tested to gauge the extent to which members felt they demonstrated positive attributes (e.g. “Cares for its members”, “Provides good value” etc) about Southern Cross.

Discount concept descriptions	Average of attribute scores
Long Standing Membership Reward *A 10% discount for all members (regardless of their age) who have had continuous membership with the Society for 30 years or longer. In order to pay for this it would be necessary to increase premiums for all other members by around 2.5%.*	6.0
Seniors / Long Standing Membership Reward *A 10% discount for members aged 65 or older, and who have had continuous membership with the Society for 30 years or longer. In order to pay for this it would be necessary to increase premiums for all other members by between 1.5% - 2.0%.*	6.7
Low Claims Reward (based on past 2 years claims) *A 10% discount for around 7 out of every 10 adult members whose claims over the previous two years are below low claims thresholds. This reward is already operating. The way it works is that each year a member’s premium may lose or gain the 10% discount depending on the member’s total claims over the preceding 2 years.*	7.1
Low Claims Reward (based on claims over the previous 10 years) *A discount of 5%, 10% or 15% for around 7 out of every 10 adult members, based on a member’s claims history over the past 10 years. This would replace the current low claims reward. The way it would work is that a member’s premium may move up or down one step in the discount scale depending on the member’s total claims over the preceding 10 years.*	6.6
Member Loans Programme *The Society would offer or help arrange loans to 65+ members to enable them to continue paying health insurance premiums. The loans would be secured against the member’s home or estate, and would be repaid, along with interest and costs associated with setting up the loan, upon the member’s death.*	6.3

- The existing Low Claims Reward achieved the highest levels of agreement across the whole membership. However, with an average score of 7.1, agreement was moderate rather than strong.
- The Long Standing Membership Reward did not score well, while the Seniors-only version was somewhat more popular.

Likelihood to remain a member

In relation to the five discount concepts (outlined above) members were asked to indicate whether the concept would make them more or less likely to remain a Southern Cross member.



- The two Long Standing reward concepts polarised opinion, with those saying they'd be more likely to stay edging ahead of those saying they'd be less likely to stay.
- Support for the Long Standing rewards was strongest among members with 20 or more years membership: 56% of 20-29 year tenure members, and over 73% of 30+ year tenure members, indicated they would have enhanced allegiance to the Society if the Long Standing Membership Reward was introduced.
- Support was weaker among members with less than 20 years membership: just 19% of 1-9 year tenure members said they were "somewhat more" or "a lot more" likely to remain members.
- The Long Standing Membership Reward scored the highest levels of negative reaction: 30% overall said they would be "somewhat less" or "a lot less" likely to remain with the Society if it was introduced; among 1-9 year tenure members that number was 41%.
- The 10 year Low Claims Reward achieved the highest positive reaction with 53% indicating enhanced allegiance. This level was reasonably consistent across different age and tenure groupings, but rose to 62% among members that reported making no claims over the previous year.
- The Member Loans Programme did not provoke strong reactions, with 72% of members stating that they would be neither more nor less likely to remain with the Society if this concept was introduced.

6.0 Findings

On the basis of the work outlined in sections 3.0 to 5.0 of this report, the project team's key findings relating to recognising members of long-standing are as follows:

Premium discounts for long-standing members

6.1 There is broad based support among members, at a conceptual level, for a long standing member discount to help moderate the high cost of health insurance premiums (and the resulting financial strain) for older members.

The cost of health insurance premiums for older members is a key driver behind the call for the Society to investigate recognition of long standing members by means of premium discounts.

This issue has been evident for many years as a result of on-going growth in demand for, and cost of, healthcare services accessed by older members via their health insurance cover. This is not a Southern Cross-specific problem. It's an issue that's impacting all funders of healthcare services around the developed world (section 3.4).

There are no easy answers. The Society has pursued various initiatives to moderate the rate at which claims costs (and hence premium costs) have been rising, most notably the Affiliated Provider programme (section 3.4). The Society has also been active in lobbying the Government to consider tax rebates for older New Zealanders so health insurance can remain more affordable (section 3.2).

A common sentiment among the 124 members that participated in the project's consultation phase was that any form of significant discount would be welcome to help retired members meet rising premium costs (section 5.1).

Our quantitative research also demonstrated that there was wide spread support, at a conceptual level, for a discount that would recognise members of long-standing (section 5.2).

- The average score of 8.2 out of 10 across the whole membership indicated a strong level of agreement with the concept of a long-standing member discount
- Long standing members were most supportive, with an average score of 9.0 and higher in tenure categories above 30 years
- Shorter duration members were also supportive, with an average score of 7.8 among members with less than 10 years tenure.

The quantitative research also indicated a high level of expectation among some members that they should, or already did, receive long-term customer discounts from a broad range of other insurance and business services. While it is possible to find examples of discounts that are connected with the duration of a customer relationship, it is the project team's observation that they are not commonplace (section 5.2).

6.2 Support for a long standing member discount dissipates when members consider how such a discount would work and the potential premium impacts for non-qualifying members. It's evident that many younger / shorter duration members would not want to pay more in premiums to fund a discount for older / longer term members.

The Member Tenure discussion document outlined a range of information about how a long-standing member discount might be implemented. It noted that nearly a third of Southern Cross members had been with the Society for 20 years or more, and that any discount offered to one group of members would have to be funded by non-qualifying members (section 5.1).

Some members felt that they had paid their premiums over many years and were now entitled to a discount. However, others were uncomfortable with the fact that a discount for some members would cause premiums to increase for others, and felt that this was unfair and might undermine the sustainability of the Society (section 5.1).

It is noteworthy that 4 out of the 5 members aged under 40 that took part in the consultation process said they would look elsewhere for their insurance if they were required to fund a subsidy for older members (section 5.1).

Reaction to the details of how a long-standing member discount might work was explored further in our quantitative research. It was explained that to provide a discount of 10% to long-standing members, others members would need to pay 2.5% more. On this basis, support for the long-standing member discount concept collapsed from a score of 8.2 out of 10 to 5.4. This change of heart was most evident among younger/shorter duration members (section 5.2).

6.3 A tenure-based discount might result in many older members (perhaps a majority of them) not qualifying, and hence paying more rather than less for their health insurance cover.

As discussed in 6.1, the call for an investigation of ways to recognise long standing members was motivated, at least in part, by a desire to moderate premiums for older members. However, many participants in our consultation with members did not appear to recognise or acknowledge the difference between "recognition for long standing members" and "recognition for elderly members" (section 5.1).

If the goal is to moderate premiums for older members in general, recognising membership tenure is not an effective way to achieve it. If a discount for members of 30 or more years tenure was introduced today, around 45,000 members aged 65 and older would qualify. A further 54,000 in that age bracket would not qualify and might end up paying higher premiums to help fund the discount programme (section 4.2).

6.4 A tenure-based discount may be open to challenge as discriminatory under the Human Rights Act if it were found to directly or indirectly advantage older members at the expense of younger members.

The Human Rights Act 1993 (HRA) includes provisions that allow health insurance to be provided on different terms and conditions to people of different ages, provided those differences can be justified by relevant actuarial or statistical data.

Guidelines to the HRA, prepared by the Health Funds Association industry group in 2003, warn that younger persons who are charged substantially higher premiums than their risk profile may be discriminated against under Section 65, unless health insurers have good reasons. The Society has also received preliminary comments from the Human Rights Commission that there is potential for a membership tenure discount scheme to be challenged as discriminatory under provisions of the Human Rights Act 1993 if a member's age is part of the qualifying criteria, and/or if the effect of a discount was to disproportionately advantage older members at the expense of younger members. A tenure-based reward scheme in Australia was discontinued in 2005 after a legal challenge on grounds of age discrimination (section 3.2).

6.5 An increase in premiums for shorter-duration members to fund discounts for long-standing members would have an impact on Southern Cross's competitiveness in the new business market.

The Society operates in a competitive health insurance market. The Society's premiums are generally considered to be lower than most other insurers, and it can be demonstrated that Southern Cross delivers more than 20% greater value to customers via claims payments than other insurers on average (section 3.3). Even so, the new business market is keenly competitive and price sensitive, and any increase in new business rates to subsidise premiums for long standing members could affect the Society's ability to attract new / young members, and hence raise questions as to the sustainability of a cross-subsidised premium structure (section 3.3).

6.6 A long-standing member discount introduced today would have an increasing financial impact on non-qualifying members in future years. Under one scenario, non-qualifying members would face 2.5% higher premiums initially, rising to around 10% within 14 years.

Two possible approaches to a long term membership discount were analysed. Projections showed that under the first scenario the ratio of people receiving the discount versus those funding the discount would change from 1:9 to just 1:3 over 14 years and the impact on premiums for those funding the discount would rise from 2.5% to around 10% in that time (section 4.5). Under the second scenario, similar effects were observed but over a longer time period.

These effects would have a worsening impact on the Society's ability to offer competitive premium rates to attract new business and retain shorter term members, giving rise to younger/lower risk individuals seeking lower cost insurance elsewhere, while older/higher risk individuals would disproportionately remain with the Society (section 4.5). This process of "adverse selection" would likely accelerate the numerical decline and ageing of the Southern Cross membership (section 4.6).

There are additional issues associated with what may, in effect, be an inter-generational cross-subsidy. With the advent of a discount based on tenure, those younger / shorter term members choosing to insure with Southern Cross may do so in the belief / expectation that they would at some future point benefit from the tenure discount. If the discount proved unsustainable (as projections suggest that it might) the Society would have to discontinue it and those younger / shorter term members would feel aggrieved (section 5.1).

6.7 Long-standing members already receive greater value on average than members of the same age who have been with the Society for a shorter duration because they tend to claim significantly more. This can be seen as an existing "loyalty" reward for long-standing members.

The Actuarial Working Group in 2004 found long-standing members, on average, claim more than members with shorter tenure. Its view was that an on-going premium discount to recognise length of membership was therefore hard to justify on technical insurance grounds. As a consequence the Board of the day did not pursue an on-going loyalty discount, and this was advised to the membership in the Society's Summer 2004 member magazine (section 3.1).

This finding of the AWG persists today. Analysis of the Society's 2011 claims data shows that, on average, members with 20 or more years tenure receive 15-20 cents more in claims reimbursement for every $1 paid in premium, compared with members with 0-9 years tenure. This is a reflection of the "guaranteed renewability" of Southern Cross's health insurance contracts, and can be seen as an existing "loyalty" benefit for long-standing members (section 4.3).

For some members, support for a tenure-based discount appears to be linked with a perception that they, themselves, have not received good value over the duration of their membership, because they have made few (if any) large claims. They believe, therefore, that their personal account with Southern Cross is in "credit" and that some return of that credit balance must be justified (section 5.1). The reality is that health insurance does not operate like a bank account. Health insurance premiums – like those for home, contents, car, and modern life insurance policies - relate to the risk that an individual in a defined group will claim in a corresponding period. They do not relate to (or make provision for) possible future claims beyond the period covered by the premium.

Some members have asserted that the Society's financial reserves are a pool of funds that can (and/or was intended to) meet members' future claims (section 5.1). That's not the case. The Society's reserves exist to ensure the Society can meet claims liabilities in periods of volatility or under adverse circumstances (section 3.2).

6.8 There is no actuarial basis to implement a fixed-term discount, such as the 2005-2007 Founding Members Reward which returned capital to long term members, because all members are on an "equal footing" with respect to contributions to the Society's financial reserves / capital.

The Actuarial Working Group in 2004 found that members that had joined the Society prior to 1982 had made a positive capital contribution to the Society's reserves and that it would be appropriate to return that capital to those members through a discount applied for a fixed term. This was implemented between 2005 and 2007 in the form of the Founding Members Reward that returned $26 million to long-standing members (section 3.1).

In the years since 2003 long standing members net capital contributions have been no different to those of shorter term members. External actuaries, Finity Consulting, reviewed and updated the AWG's work and found that the Founding Members Reward put all members on an "equal footing" with respect to capital contributions in 2003, and that this continues to be the case today. On that basis, Finity found no actuarial grounds for a repeat of the Founding Members Reward, or for utilising the proceeds from the investment of the Society's reserves in favour of any particular group of members (section 3.1) .

Other findings

6.9 A low claims reward that takes into consideration claims history over a longer period of membership (for example, 10 instead of the current two years) warrants further investigation.

The Society's current Low Claims Reward (LCR) provides a discount of 10% to around 70% of eligible members, based on their level of claims in the previous two years. Replacing that scheme with one that extends the claims assessment period to 10 years could enable the Society to take on-board an element of membership tenure recognition while staying true to accepted and sustainable insurance practices.

A longer term LCR would address a reasonably common theme in our consultation with members – i.e. that a member's claims history, good health or healthy lifestyle habits should be taken into consideration when applying a discount (section 5.1). The desired effect of a longer term LCR would be to remain revenue neutral overall, but deliver a slightly greater level of recognition to members who have been long-term low claimers. A corresponding effect would be that long-term high claimers may pay slightly more in premiums, but overall would still receive good value as a result of their claims reimbursement level.

This idea was looked at in our quantitative research, where a Low Claims Reward with a 10 year assessment period and a tiered discount structure from 0% to 15% was put to members alongside the existing Low Claims Reward and variations of a Long Standing Member Reward. The 10 year LCR did not stand out when members were asked if it demonstrated positive attributes of Southern Cross, like caring, trustworthiness, value etc. However, it did perform strongly when members were asked if such a reward would make them more likely to stay with Southern Cross (section 5.2).

On this basis, it would be appropriate to take a more detailed look at the costs, benefits, popularity and practicality of a long-term low claim reward.

It is noted here that another concept tested in our quantitative research – Member Loans Programme – does not appear to warrant further investigation. The concept – a loan secured against an older member's home or estate – was looked at after discussion with the proposers of the 2011 AGM resolutions. Member reaction was conspicuously neutral. Products similar to this (e.g. reverse equity mortgages) are available from other providers, and Southern Cross currently has no particular expertise in this aspect of financial services.

6.10 Non-financial recognition of member tenure would not address the primary need expressed by older members to moderate premiums.

In our consultation with members it was apparent that the clear majority of submitters did not want voucher or points reward schemes to recognise length of tenure because such rewards would not address the main perceived issue i.e. moderation of premiums for older members in retirement (section 5.1). No further project resources were used in exploring these options. However, it is noted that the Society's approach to added value reward programmes is currently under review.

6.11 Some members may continue to question the level of financial reserves held by the Society but, when presented with information about the role and size of the reserves, most accept that the Society's approach is necessary and prudent.

The Insurance (Prudential Supervision) Act 2010 requires all insurers to satisfy licensing requirements with respect to the sufficiency of financial reserves to meet the potential impact of unexpected, adverse claims events or shocks that are relevant to their business sector (section 3.2).

Based on the Member Tenure discussion document's explanation of the pricing principles and financial reserves regulations, most members participating in the consultation process indicated they were comfortable with the Society's prudent and conservative approach (section 5.1).

6.12 The issue of rising claims costs, and their impact on premiums, remains. A discount for long standing members would, at best, provide temporary relief for a minority of members without addressing the underlying cause of premium escalation. Society initiatives to address claims cost increases continue to be important.

Rising claims costs, and their impact on health insurance premiums especially for older members, is one of the foremost factors in the call for recognition of long standing members. However, a tenure discount would only provide temporary relief for those who qualify, while compounding the impact of rising claims costs on those who do not qualify (section 4.4). On this basis, the Society's efforts to moderate the impact of rising claims costs on behalf of all members, notably through the Affiliated Provider programme (section 3.4), continue to be important.

7.0 Appendices

Appendix 1

Member Tenure Project Terms of Reference

March 2012

Background

Two member-initiated resolutions were passed at the 2011 AGM asking the Board to investigate ways to recognise members of long standing:

- To consider and, if thought fit, pass the resolution that the Board investigate and report to Members on ways and means by which Member longevity and loyalty may be recognised (proposed by Bruce Sheppard)

- To consider and, if thought fit, to pass the resolution that the Board further investigates a means of reducing the rates to long term Members (proposed by Michael Pinkney).

The Board has decided to commence a project to look at these matters in accordance with these Terms of Reference.

Actuarial Working Group

An important reference point for this project is a comprehensive study undertaken in 2003-2004 by an Actuarial Working Group (AWG), reporting to the Board of the Society. The AWG's primary purpose was to recommend a premium calculation basis that maintained broad equity for all generations of Society members, and considered the appropriateness of a scheme to recognise and reward length of membership.

The AWG was established by the Board and included an independent actuary representing a members' group. Using data that went back to 1970, the scope of the AWG's work/analysis included:

- Considering the factors and determining the sources of surplus that may have led to the reserves then held by the Society
- Considering the Rules of the Society and determining a basis (if relevant) for how accumulated reserves may be notionally allocated to generations of members for the purposes of maintaining equity
- Establishing a long term pricing policy for the Society that considers the following issues as they relate to the tenure of a member:
    - The maintenance of equity between generations of existing members and also future new members
    - Existing reserve levels
    - Allocation of investment income on reserves
    - The prudent level of reserves and how any increases in the reserves should be funded by the membership
    - The basis for allocation of expenses
    - The expected morbidity effect of underwriting new members

- The anti-selective effect of withdrawals and the effect on the expected morbidity of remaining members
- Allowance for the costs of guaranteed insurability
- The costs of implementing and maintaining a tenure-based premium structure and the flow-through effect to overall premium rates.

The AWG noted that it was important not to confuse recognition of historical capital contributions with a loyalty discount.

On the subject of capital contributions, the AWG found that current (2003) members who had joined the Society prior to 1983 had made a positive capital contribution to the Society's reserves and that it would be appropriate to return this capital to those members through a discount applied to premiums for a fixed term. This was the basis upon which the Board implemented a "Founding Members Reward" that returned $26m to 130,000 long standing members over a two year period, commencing in 2005.

On the subject of loyalty, the AWG reported that it would be difficult for Southern Cross to justify the introduction of a loyalty discount on technical insurance grounds because long standing members, on average, claim more than members with shorter tenure. The AWG observed that there may be other reasons (e.g. marketing reasons) for wanting to introduce a loyalty discount but that these considerations were outside the AWG's scope.

The Member Tenure Project

The Society Board is initiating a project to –

1. Review and consider the workings/findings of the AWG as they relate to the Society today.
2. Consult and analyse input from members and other stakeholders.
3. Advise the Board if there are further ways and means by which length of membership could be recognised including (but not limited to) reduction of premium rates.

Important principles

Any proposed ways and means to recognise length of membership identified by the project should be consistent with these important principles:

- Equity and fairness - among members and between generations of members.

- The on-going existence (and hence financial sustainability) of the Society for the benefit of future generations.

Project Scope

- In order to make best use of the Society's resources, a single project addressing both AGM resolutions will be undertaken.

- Both resolutions explicitly reference length of membership as the basis upon which any recognition or rate reduction should be made. However, an implicit consideration is the moderation of premium costs for older members. The Board has determined that the project's primary focus will be on member tenure while secondary consideration may be given to whether / how the age of a member might also be factored into recognition of tenure.

- The project team will not limit its activities to actuarial or insurance pricing principles (although these are of central importance).

- The project will report its findings/conclusions to the Board. The Board will determine what (if any) further action it may take.

Project Activities

The Project Team will consult widely, analyse and report to the Board on a range of matters including, but not limited to, the following:

- Data relating to the current makeup of the membership with respect to tenure to provide a basis for defining categories of member tenure and financial modelling.

- Historical documentation on premium pricing structures and member tenure, including actuarial reports produced by Tacit (1999), PWC (2003) and the Actuarial Working Group (2004), focussing on any differences in scope from the current project; changes in material factors/assumptions considered in those reports (demographic, regulatory, environmental, political, economic, competitive); the actuarial soundness of their conclusions in the current environment.

- Whether members of long standing have contributed disproportionately to the Society's reserves since 2003 – and whether these members might be entitled to some recognition/consideration in relation to those reserves or income generated by them.

- The concept of cross subsidisation as it relates to insurance and member equity.

- The Society's current premium pricing principles, and how the concept of cross-subsidisation between groups of members relates to those principles.

- The degree to which Southern Cross has any premium price advantage/disadvantage compared with other health insurers; and what impact any recognition of tenure would have on the commercial competitiveness of the Society.

- Modelling of the Society's financial sustainability and commercial competitiveness over the medium to long term in relation to cross-subsidised premium structures, taking into account a) the ageing of the Society's insurance book / business b) the ageing of the population/membership and c) any other factors the project team considers to be material.

- The linkage between cover for "developed conditions" or "guaranteed renewability" and tenure.

- The relevance (if any) of age of members in determining whether or how long-standing membership may be recognised.

- The current legal and regulatory environment and what (if any) constraints it places on the Society with respect to premium pricing approaches (including Human Rights Act, Friendly Societies and Credit Unions Act, and the Insurance (Prudential Supervision) Act).

- The benefit to existing members and the sustainability of the Society arising from its commercial competitiveness and, hence, ability to recruit new members; and the effect (if any) that a scheme to recognise long-standing members might have (e.g. effect on new member recruitment).

- The relevance and impact of tenure discussions in relation to different subsets of membership, e.g. subsidised and voluntary employer group schemes, members that joined the Society via the purchase of Aetna etc.

- Whether, or to what extent, premium discounts for long-standing members could be funded sustainably and equitably.

- Whether additional value for long-standing members could be created cost-effectively through ways and means other than premium adjustments. Areas to consider include insurance products or other benefits.

Member and Stakeholder Consultation

The project team will undertake consultation with members and other stakeholders / interested parties (such as employers who operate Group health insurance schemes, through which many Southern Cross members are enrolled), commencing with preparation / publication of a Discussion Document.

It is anticipated that the Society's online Viewpoint research panel will be used to obtain member input and feedback in relation to aspects of the project.

The proposers of the AGM resolutions will be invited to comment on the draft Terms of Reference, the Discussion Document and the findings of the project.

Project Team

The Board has overall ownership and responsibility for the project and its outputs (including these Terms of Reference and the findings). The Chairman will be the primary point of contact/liaison between Board meetings as required.

The Board delegates the leadership of the project team and implementation of the project to Southern Cross Health Society CEO Peter Tynan.

The Southern Cross Health Society CEO will provide updates to the Board through his regular Board reports.

The project team will be comprised of senior/expert Southern Cross management with the following skills and experience:

- Project management
- Actuarial and data analysis
- Marketing and distribution
- Product development
- Consultation, research and communication.

The project team will be supported by the Southern Cross Healthcare Group Corporate Office.

External Review

The Board may engage suitably-qualified, independent, external experts to review the project's methods, outputs and/or findings.

Indicative Outputs / Timeline

Following is an indicative timeline for the project, including allowance for the level of member and stakeholder consultation indicated in these Terms of Reference. If less time is required to fully discharge the tasks outlined in these Terms of Reference, the Board expects that the project team will report its findings sooner than indicated. Conversely, if the project team requires more time, it can seek permission from the Board to extend its reporting deadlines.

February	Board provides feedback on draft Terms of Reference at its February meeting.
	AGM resolution proposers invited to provide feedback on the draft Terms of Reference.
	Board considers feedback from proposers
March	Terms or Reference finalised and adopted by the Board.
	AGM resolution proposers invited to provide feedback on the draft Discussion Document.
	Discussion Document approved by the Board.
	Project and initial consultation phase commences with publication of Discussion Document.
May	Update provided to Board at its May meeting.
June	Update provided to Board at its June meeting.
August	Update provided to Board at its August meeting.
September	Draft findings tabled and discussed with Board at its September meeting.
	Draft findings discussed with AGM resolution proposers.
	Board considers feedback from proposers
October	Findings finalised.
November	Findings to be received by the Board at its November meeting.
	Board communication to the membership via website.