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Mr Tim Holland
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{by email to mergers@acc.gov.au}



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Dear Mr Holland

SUBMISSION RE SALE OF MEDIBANK PRIVATE

Thank you for the invitation to comment on the proposed sale of Medibank Private.

The comments that follow (in relation to the effect on competition in the private health insurance market) should be understood against the AMA's general policy position on the proposed sale of Medibank Private, in brief:

- ❑ The AMA is concerned that the sale will lift premiums charged by Medibank Private due to the need to service the equity;
- ❑ The AMA is concerned that the sale could reduce competition in the private health insurance market, noting that this depends upon whether or not the buyer(s) is a new player in that market or an existing player; and
- ❑ The AMA, while not wishing to comment on the legality of the situation, doubts the morality of the sale given that much of the value of Medibank Private is in its financial reserves which were not contributed by the government but rather, extracted from the members in compliance with regulatory requirements. This does not imply any criticism of the regulatory requirements. Reserves are necessary for proper prudential management of private health funds. However, if the Government no longer wishes to be involved as an operator of a private health fund, there is a strong case for mutualising Medibank Private and retaining the equity with those who have contributed it, namely the members.

Relevant markets

It is difficult to argue that there is a national market for private health insurance given the existence of state-based contribution tables and given also that cross-border utilisation of private health services is limited to a few areas only. The AMA agrees with the ACCC's assessment that hospital markets have become more localised over time with the emergence of health fund/private hospital contracting and the promotion of policies that effectively restrict consumer choice of hospital and doctor.

The private health insurance market is an oligopoly in nature. Although there were 40 funds registered as at end-June 2005, the 6 largest funds then commanded 77 per cent of the coverage of private health funds and, in the 2004-05 financial year, three quarters of the total contributions to health funds. This gives them considerable market power which they wield against both consumers (their members) and providers. The private health insurance market is much less competitive in nature than the private hospital market or the market in medical services.

Medibank Private's market share in 2004-05 (measured nationally) was 28% measured either way (coverage or contributions income). It is very important to observe that most state markets are dominated by two to three funds (Medibank Private and one or two others). Therefore, if another significant extant private health fund were to purchase Medibank Private, it could potentially end up with a stranglehold on one or more state markets to the great detriment of consumers and providers. Therefore, the significance of the purchase of Medibank Private by another significant extant private health fund cannot be assessed with reference to its market share measured nationally. It is necessary to consider competition effects within market segments.

Comments on specific questions

1. There is not a great deal of evidence that the private health funds do compete with each other. The industry puts a great deal of effort into lobbying government for arrangements which lessen competition between funds. These include the sticks and carrots offered or imposed by the Government to lift participation and the very high degree of price and product regulation of the industry. In short, the industry benefits from a relatively cosy, protected environment. For example, the health funds vigorously opposed a good government decision to improve portability of membership between health funds.
2. The funds contend that the Medicare arrangements exclude them from certain segments of the health insurance market and, therefore, limit their ability to provide value to their members. They say, for example, that "*we have to compete against free care*" (although the force of that claim has receded over the years given that the right to free elective surgery treatment in a public hospital has mutated to a place in a queue which may stretch to many years). To the extent that the limitations on the private health funds are relevant to the issue of competition within the industry, then we conclude that the issue is receding as the Commonwealth and State governments pull back on the role of publicly funded services and cost-shift onto private health insurance. This is particularly pertinent in the case of medical procedures. It is increasingly difficult to argue that Medicare is a significant competitive constraint on the health funds.
3. The threat of loss of benefits while re-serving a waiting period is a significant obstacle to members switching funds. The funds erected significant obstacles to portability of private health fund membership, a situation which is, hopefully, now changing. Portability should be as easy as it is in the telecommunications or superannuation sectors. The product information issued by funds is generally of a poor quality, complex and often misleading. Products are structured so as to make comparisons difficult. Consumers have little idea what their entitlements are. The funds seek to obstruct providers in giving patients information which would help them negotiate with the funds. Given that there is little price competition between the private funds, consumers tend to be lethargic when it comes to changing funds. All of that said, the PHIO has done a fine job of improving the quality of information provided to consumers and in curbing the worst market abuses by the funds.
4. See (3) above. No further comment.
5. The price regulation of the funds is actually against the interest of consumers. Because of the annual cycle, the funds have a significant incentive to game the system to get the biggest increases they can. For its part, the Commonwealth Government has few degrees of freedom. Given the prudential requirements (namely, the requirement to maintain reserves at certain levels) the Federal Health Minister cannot realistically deny

price increases so as to place a fund in contravention of the prudential requirements. The price and product regulation stifles innovation. The funds should be free to explore new options including health savings products but they are not. The price regulation saps the will to compete. It spawns mediocrity. The Commonwealth Government should introduce reforms to increase competition between funds and abolish price regulation altogether. It does not work to the benefit of the consumer.

6. We are aware of one circumstance (some years ago) when the Federal Health Department intervened actively (and unsuccessfully) in an attempt to prevent a major fund from establishing operations in a state on the grounds that there was enough competition in the market already (a market with only two significant players). The change to national registration of funds will prevent a repetition of that bizarre event. Apart from BUPA's attempts to expand its market share, there is little if any evidence of competing vigorously against each other.
7. The AMA is not aware of any significant competitive activity by any health fund since an unsuccessful attempt by an overseas company to penetrate the market in the late 1980s.
8. Health fund mergers have occurred and will continue to occur because the overall regulatory environment is conducive to the market being shared among a few dominant players. This does not serve consumer interests. The increasing concentration of the private health insurance industry has had a counterpart in the private hospital industry where there has been consolidation in an endeavour to counter the increasing market power of the funds. The end result is less choice for the consumer.
9. If you regard Medibank Private as a mutual fund (in effect as opposed to the strict legal interpretation), then the industry is dominated by mutual funds. Despite the significant growth of the funds, there is little evidence that they have reaped the economies of scale that they should have. Obvious advances in the use of IT have been slow coming. The funds persist with outmoded models for the lodging and processing claims. Management expense ratios remain inexplicably high until you understand that the lack of competition industry between funds allows that to happen.
10. Yes, of course. It should be addressed by excluding all existing players from bidding for Medibank Private. Sale to an existing player not only has the potential to reduce premium competition but also to reduce competition in terms of the insurance products on offer. Medibank Private offers both 'Known Gap' and 'No Gap' products but MBF and HCF do not offer the former.
11. See comments under "Relevant markets" above. Hospital contracting should, in theory, have increased competition in the private hospital market but many smaller providers (eg day hospitals) are simply unable to obtain contracts. Of course, there is evidence that the funds have used their market power to force the private hospitals to accept lower charges. That could have been of benefit to consumers if the funds had similarly increased their efficiency (and reduced their management costs). Unfortunately, the counterpart of a reduced operating surplus in the private hospitals sector seems to be higher costs and a higher operating surplus in the private insurance sector. The private health funds show only limited understanding of the inter-dependence between themselves and the private hospitals (if there are no private hospitals, they have nothing to sell) and they do not take a longer term view of the sustainability of the providers.
12. Yes, of course. It should be addressed by excluding all existing players from bidding for Medibank Private.

13. The medical practitioners most relevant to the operations of the private health funds (surgical and medical specialists) are mostly likely to practice as solo practitioners. This structure is more likely to engender competition than the structures seen in the private health insurance and private hospital industries or in some other areas of ancillary service provision (eg prosthetic providers). That said, the shortage of medical practitioners gives them some market power and there are similar shortages among paramedical professions for much the same reasons. The Commonwealth Government has created a shortage of medical practitioners in many disciplines by restricting medical school intakes in the past. The State governments continue to aid and abet this by limiting training opportunities in the teaching hospitals. Both levels of government seek to transfer blame to the learned colleges for their own mismanagement of medical training. Many other western nations have similarly failed to train enough medical practitioners for their needs (populations are ageing throughout the western world) and it is now more difficult than ever before for Australia to solve its shortfall by recruiting doctors from overseas. These issues transcend the particular characteristics of the private insurance market. The solutions, likewise, are largely elsewhere. In a latter day rethink, the Commonwealth Government has significantly increased medical school intakes. This has the potential to ease doctor shortages down the track. Thus far, however, the Commonwealth and State governments have not agreed to put in place the necessary teaching hospital funding and infrastructure. The acquisition of Medibank Private by any significant health fund would certainly have some impact on dealings with the medical practitioner and ancillary service industries. There is potential for adverse outcomes for consumers. For example, Medibank Private offers 'known gap' products which meet consumer and provider preferences. MBF does not. If MBF purchased Medibank Private and withdrew "known gap" products, that would reduce the diversity and utility of private health insurance products. It is recognised, of course, that medical and ancillary services are not considered the "main game" by the funds but they are important to contributors. The vast majority of the benefits they pay are for hospital services.

In conclusion, while further concentration of the private health insurance industry seems very likely to occur as the weak minor players fall off the field, it is generally not in the interests of consumers and there is no need to exacerbate it by allowing a significant extant health fund to purchase Medibank Private. There is an obvious conflict of interest for the Commonwealth Government, whether to pursue a sale strategy to maximise revenue or whether to accept a lesser price in the hope of doing less damage to competition. The AMA equates the latter to excluding significant extant health funds from the bidding for Medibank Private. If Medibank Private is worth more to a significant extant health fund than to another bidder, it is only because the new combined entity will have greater power to exploit its market. The history of the private health funds is that they use their market power against both the providers of care and the consumers of care.

Yours sincerely



Dr E Robyn Mason
Secretary General