Financial Management within the Health Insurance Industry

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Head of Insurance Practice for Australia, NZ and SE Asia

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Seven key trends are driving the economics of the Australian private health insurance sector

1. Economic Crisis
2. Consumerism
3. Ageing Population
4. Disease Case Mix
5. Provider Challenges
6. Technology
7. Regulation

Underwriting performance turned around since 2002 due to small but steady volume increase, premium increases, benefits and MER controls and strong investment income.

However, outlook is less positive: with pressure on affordability of premiums, benefits paid and investment income in particular - and hence the operating result.
To compete in this new era, Health Funds are innovating across the value-chain.

PHI Profit & Loss Levers:
- Industry Consolidation
- Health and wellbeing
- Quality & Safety
- Provider Innovations
- Claims Management
- Distribution
- Product
- IT and e-Health

Premiums:
- Customer Focus
- Product Innovation
- Broader Offering

84.8%

5.6% + 6.0% = 11.6%

100.0%

11.6%
To improve customer value, reduce costs and minimise risks, the industry has recently seen increased M&A activity.

### Industry Challenges
- **Improve customer value proposition and member value**
- **Reduce management expenses**
- **Manage health and providers**
- **Minimise risk**

### Consolidation Driver
- **Customer Offer**
- **Economies of Scale**
- **Purchasing Power**
- **Enterprise Resilience**

### Expected Benefits
- **Broaden, strengthen and secure offering to members**
- **Release shareholder value**
- **Increased base over which to amortise operating and technology costs**
- **Employing more sophisticated approaches contain healthcare costs**
- **Broader member and capital base to help protect against volatility**

### Recent Industry Consolidation

<table>
<thead>
<tr>
<th>Year</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008/09</td>
<td>Medibank acquisition of AHM HCF bid for Manchester Unity</td>
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<tr>
<td>2007/08</td>
<td>BUPA acquired MBF</td>
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<tr>
<td>2005/06</td>
<td>Acorn (Druids-NSW) sold to AHM</td>
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<td></td>
<td>Federation Health sold to Latrobe Health</td>
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<td></td>
<td>GU sold to AU</td>
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<tr>
<td>2003/04</td>
<td>IOOF sold to NIB</td>
</tr>
<tr>
<td></td>
<td>IOR merged with HCF</td>
</tr>
<tr>
<td></td>
<td>NRMA Health sold to MBF Health</td>
</tr>
<tr>
<td>2002/03</td>
<td>AXA sold to BUPA</td>
</tr>
<tr>
<td></td>
<td>Goldfields sold to Healthguard</td>
</tr>
<tr>
<td>2001/02</td>
<td>National Mutual sold to AXA</td>
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</table>
To drive acquisition and retention, the Private Health Insurance industry is becoming increasingly customer focused.

**Australian PHI Market (FY07)**

- **New to PHI**
- **Exit PHI**
- **Switch between Providers**

<table>
<thead>
<tr>
<th>Low switching Population</th>
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<tbody>
<tr>
<td>430K</td>
</tr>
<tr>
<td>90K</td>
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<tr>
<td>240K</td>
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</table>

**Customer Segmentation**
- New Graduate
- Getting Married
- Raising a Family
- Self-employed

**Aetna (USA): Seven “Life Stage” segments**
- Between Jobs
- Empty Nesters
- Retiring Early

**Wellpoint (USA): Tonik offering**
- Target: Gen Y 19 - 29 year olds
- Offer: Low cost health insurance that minimises financial risk and encourages prevention - e.g. low price/high deductible, limits on visits, preventive care covered

**Emphasis on branding**
- "It's worth it"
- "You’ll thank yourself later"
- "If you're for health we're for you"
Insurers in Health (and General) Insurance are also developing innovative products that meet specific customer needs

New Product Innovations: Examples

- **Rewards Programs**
  - Enables the amount that can be claimed to increase each year of membership until a specific limit is reached - or discounts for not claiming

- **Wellness Offerings**
  - Variety of services focused on encouraging prevention of illness e.g.
    - Personalised on-line health managers
    - Discounts on gym memberships
    - Subsidised health assessments
    - Quit smoking/obesity initiatives

- **Health Service Accessibility**
  - PHI firms are starting to partner with retail health clinics in major drug stores in US to enable patients to have increased access to basic medical services, and locally there is increasing vertical integration

- **Segmented product & service offers**
  - Products & services designed to meet specific segment needs within the framework of Community Rating and broader regulatory environment, generally based on life stage or a specific interest
Some Health Funds are broadening their revenue streams through offering products related to PHI or relevant to their customers.
As an investment to improve outcomes and reduce benefits payouts, many Health Funds are investing in health and wellbeing.

Key Services

<table>
<thead>
<tr>
<th>Total Health</th>
<th>Info / Advice</th>
<th>Core Information / Advice Components</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hospital Prevention</td>
<td>Disease Management</td>
<td>Health Advice Line</td>
</tr>
<tr>
<td>Preventative Health</td>
<td>Demand Management</td>
<td>Elevated Risk Program</td>
</tr>
<tr>
<td></td>
<td></td>
<td>High Value Risk Program</td>
</tr>
</tbody>
</table>

Online Health Programs

- Regular Health Check
- Mental Health
- Fitness
- Premium Wellness
- Other Health Tests

Australian Unity and Anthem provide examples of Wellness offerings.
Investing in improved quality and safety of healthcare provision can improve outcomes and reduce healthcare cost inflation.

**Improved Quality & Safety improves outcomes and reduces costs**

Traditional view is that there is a compromise...however improved quality and safety can lead to lower cost and better service, for example through avoidable superbug infections and adverse drug interactions.

**Transparent Information in the hands of the consumer is critical**

- Accurate, published performance data
- And simple check lists

**Virtuous Cycle**

- Quality
- Speed
- Cost

**Other initiatives**

- Clinically agreed guidelines
- Best Practices Registries - cf. Cardiac, Prostheses
- Establish payments linked to outcomes
- E-Health enablers
To address ever-increasing claims costs there are opportunities for better provider management and “end-to-end” provider innovations

1. **Tougher Contracting**
   - High consolidation of private hospitals and increasing consolidation in ancillary services
   - Potential to leverage scale, linked to ability to influence customer

2. **Growing in the USA (e.g. specialist centres for specific conditions)**
   - Indian examples, e.g. Jaipur Foot, NH Cardiac Care
   - Drives economies of scale/knowledge

3. **Common in the USA and providers in Australia are moving increasingly into owning Optical and Dental assets**

4. **Convenient, Low-Cost Format Proliferation**
   - Introduction and growth of low cost, convenient provider formats (cost and service differentiation play)

5. **Working collaboratively with providers to contain costs**
   - Key challenges include staff shortages/wage inflation and increasing technology costs
   - Examples include National Joint Replacement and National Cardiac Registries

6. **Payment Linked to outcomes**
   - For example, Geisinger (USA) offers fixed pricing and 90 day warranties on heart by-passes
Ultimately globalisation may play a role in driving down provider costs

<table>
<thead>
<tr>
<th>Medical Tourism</th>
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<tbody>
<tr>
<td>Allows patients to obtain procedures at low costs (10-20% of the cost in the US)</td>
</tr>
<tr>
<td>500,000 Americans left the US last year to obtain treatment in a foreign countries</td>
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<tr>
<td>Top Procedures: dental treatments (relevant) and cosmetic surgery (less relevant)</td>
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<table>
<thead>
<tr>
<th>Clear Value Proposition</th>
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<tbody>
<tr>
<td>Medical tourism can have significant medical cost savings</td>
</tr>
<tr>
<td>Medical tourism offers a way to buy a convenient “bundle” of services</td>
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<table>
<thead>
<tr>
<th>Attention from Health Plans</th>
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<tbody>
<tr>
<td>United FL and BCBS SC offer a plan for Bumrungrad Hospital in Thailand</td>
</tr>
<tr>
<td>Aetna is exploring foreign facilities based on hospital criteria</td>
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<tr>
<td>CIGNA is exploring the option</td>
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<table>
<thead>
<tr>
<th>Quality / Safety</th>
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<tbody>
<tr>
<td>Loose accreditation, limited medical malpractice insurance, and low direct safety oversight</td>
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**Key Players**

- **Globally**: Indus Health

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**US Projected Growth of Medical Tourism**

<table>
<thead>
<tr>
<th>Year</th>
<th>Asia Medical Tourist Revenue ($B)</th>
</tr>
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<tbody>
<tr>
<td>2006</td>
<td>$0.7</td>
</tr>
<tr>
<td>2007</td>
<td>$0.9</td>
</tr>
<tr>
<td>2008</td>
<td>$1.2</td>
</tr>
<tr>
<td>2009</td>
<td>$1.6</td>
</tr>
<tr>
<td>2010</td>
<td>$3.0</td>
</tr>
<tr>
<td>2011</td>
<td>$4.0</td>
</tr>
<tr>
<td>2012</td>
<td>$4.0</td>
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</table>

**CAGR = 36%**

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Source: Literature Review, National Coalition on Health Care, Fierce Health, Booz Allen analysis
International trends highlight there are some “must haves” and choices in claims to improve effectiveness and efficiency

“Must haves” in Claims...
1. Greater customer focus
2. Proactive claims management, linked to risk
3. People are as important as IT
4. More sophisticated use of data
5. Active health and provider management

...with choices across the claims management value chain

- Uses electronic lodgement and workflow system to auto-adjudicate 86% of all claims
- Electronic injury reporting gateway
- Tailored business streams: straight-through processing for simple claims and proactive management for complex
- Information analytics - high cost claim potential, fraud, mispayments
- 60% online claims and multi-channel lodgement - enables early notification
- Workflow tool used to stream cases based on risk
- Active provider management
Health Funds have to make strategic choices relating to channel mix, the role of each channel and how to operationalise this.

**Major Channel considerations**

- **Sales**
  - Significant growth in online sales, especially across younger and more affluent and educated segments - with option of a direct connection to a call centre representative
  - Greater focus on consultative sales in retail and call centre, especially for segments with high health engagement
  - Some third-party and broker sales, but small

- **Service**
  - Service shifting to lower cost online and self-service call centres to minimise impact on customers
  - Increased claims through providers to minimise impact on customers

- **Wellness**
  - Wellness tailored by channel and segment
    - Retail face-to-face
    - Online info
    - Call centre accessibility

**Specific Examples**

- Players like iSelect have emerged
  - Smart centres support multiple channels
  - Geo-mapping can help optimise retail footprint
  - Wellness can be delivered in different formats
Product architecture can help balance customer choice and complexity in product, building on modular components

Striking a balance between complexity and differentiation

**Product Design Principles**

- Few product & service bundles, aligned to segment needs
- Degree of individual customisation focused on excess and individual packaging of pre-defined bundles
- Employ a customer facing modular architecture that uses common components across breadth of product array
A robust ICT strategy can optimise effectiveness and efficiency - supported by a broader e-Health strategy

ICT Value Management Framework

**Cost Transparency**
Communicating to key stakeholders across the organisation an understanding of ICT Costs and the business and technology based cost drivers

**Spend Effectiveness**
Using Information & Communications Technologies to achieve business objectives

**Operational Efficiency**
Using the resources allocated to Information & Communications Technologies in the most efficient way

**Leverage IT to create Business Value**
IT can be used as a true enabler to the organisation - both to reduce business support costs and/or increase revenue

Examples of typical national e-Health initiatives

- Electronic Health Record
- Medication Documentation
- Patient eReceipt
- Physician eCommunication
- Patient eFile
In summary, improving financial management will require Health Insurers to determine their best strategic and operational response.

To what extent should we invest in improving the health and wellbeing of our members, and if so how? Is the cost-benefit really there? How can we improve quality and safety and outcomes for our members?

What should our provide management strategy be? Should we vertically integrate and into which areas? What other innovations should we encourage?

What should our distribution strategy be?

How should we align all elements of our operating model to support our strategy - brand & marketing, products, channels, claims, operations/IT?

How do we respond to the wave of consolidation?

How can we better differentiate our offering and improve our customer value proposition?

What new innovative products could we launch?

How far should we broaden our business, vs. “stick to our knitting”?

<table>
<thead>
<tr>
<th>Component</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premiums</td>
<td>100.0%</td>
</tr>
<tr>
<td>- Benefits</td>
<td>84.8%</td>
</tr>
<tr>
<td>- Management Expense</td>
<td>9.6%</td>
</tr>
<tr>
<td>= Underwriting Result</td>
<td>5.6%</td>
</tr>
<tr>
<td>+ Investment Income</td>
<td>6.0%</td>
</tr>
<tr>
<td>= Operating Result</td>
<td>11.6%</td>
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Appendix: Booz & Company Profile
Booz & Company is a global management consulting firm, with over 90 years experience serving the senior agenda of our clients

Booz & Company Profile

- Known for the relevance of our ideas and our practical impact
- 90+ years experience serving the senior agenda of prestigious clients – world’s leading institutions, public and private
- Global firm: revenue: $1+ Billion with 3,300 staff and around 60 offices
- Collaborative spirit: with our clients and our global colleagues
- Incentive to bring the “best of Booz & Company” to any client engagement as rewarded on global performance
- Privately owned by 200 partners – guaranteeing firm’s independence
- Success based on client results - 85% of our assignments come from existing clients
Booz & Company’s senior team has deep, relevant experience in Insurance and Health

<table>
<thead>
<tr>
<th>Sarah Butler</th>
<th>Vanessa Wallace</th>
<th>Simon Gillies</th>
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</thead>
<tbody>
<tr>
<td><img src="image" alt="Sarah Butler" /></td>
<td><img src="image" alt="Vanessa Wallace" /></td>
<td><img src="image" alt="Simon Gillies" /></td>
</tr>
<tr>
<td>Director – 18 years</td>
<td>Director – 20 years</td>
<td>Director – 20 years senior management and consulting</td>
</tr>
<tr>
<td>Leads our Insurance practice, with experience across the value-chain</td>
<td>Leads our Financial Services practice, with experience in Health and government</td>
<td>experience</td>
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<tr>
<td></td>
<td></td>
<td>Leads our office in Melbourne, with experience in PHI</td>
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</table>

<table>
<thead>
<tr>
<th>Andrew Johnstone-Burt</th>
<th>Klaus Boehncke</th>
<th>Les Haines</th>
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<tr>
<td><img src="image" alt="Andrew Johnstone-Burt" /></td>
<td><img src="image" alt="Klaus Boehncke" /></td>
<td><img src="image" alt="Les Haines" /></td>
</tr>
<tr>
<td>Director – 15 years consulting experience</td>
<td>Principal – 10 years</td>
<td>Associate with &gt;25 years</td>
</tr>
<tr>
<td>Leads our Civil Government practice, with public sector experience including DHS</td>
<td>Leads our Health practice with deep experience in networked health care and eHealth</td>
<td>Deep experience in the health care sector including providers and government</td>
</tr>
</tbody>
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