

Changing Dynamics of Private Health Insurance – An Industry Poised for Change

SPEECH NOTES FOR ADDRESS BY

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Thank you to CEDA for the opportunity to speak to you again about the MBF Group's progress and the changes in our industry.

It is almost exactly three years since I last had the privilege of speaking at a CEDA gathering.

A great deal has happened since we last met. Much more change lies ahead for the private health insurance industry and for MBF. The industry is on the threshold of long awaited rationalisation with the proposed sale of Medibank Private next year, NIB's recent demutualisation and MBF's proposed demutualisation and listing.

It is an exciting environment – we live in interesting times.

2004 revisited

It might be useful to begin with, to revisit 2004 and update the topics that we discussed on that earlier occasion.

I noted that private health was playing a more prominent role in funding and delivering health services.

If anything, that has gathered pace and 'broader health cover' legislation has given health insurers a role outside the hospital gate.

Three years ago, MBF was just a year into a business strategy of growth and diversification with an expanded offering.

We are now well advanced in implementing this strategy. Life insurance and financial planning are integral to our customer value proposition.

In 2004, we discussed the challenge of providing health services to an ageing population and its impact on taxpayer-funded healthcare.

Earlier this year, the updated Intergenerational Report confirmed that this remains one of Australia's most significant economic challenges.

We discussed how Australia had too many private health insurers for a country with a population of 20 million people.

We still have around 40 health insurers – still too many, but at last we see the prospect of significant consolidation in the industry.

In 2004, the growth potential of the private health sector was yet to be recognised.

This has certainly changed. Interest in the sector has never been higher. Investors are aware of its potential for future domestic growth.



Perhaps the biggest change is that Australians are seeking more in terms of their health, financial and lifestyle security.

MBF's business strategy in which we have expanded the concept of private health protection has answered their needs.

MBF: A Disciplined Approach

MBF recognised that the world was changing rapidly and with it, the needs and values of its customers.

We needed to transform the organisation to be in a position to address their health, financial and lifestyle protection needs.

MBF's transformation remains a work in progress with a clear business purpose that is really all about the customer.

Our strategy is based on understanding customer segments and developing health and financial solutions tailored to their life stages.

Four pillars support the strategy:

- We strive to be cost effective and efficient.
- We work hard to deliver integrated sales and servicing excellence
- We believe our brand and corporate reputation is vital to success.
- And we remain on watch for acquisitions and alliances to grow the business – in ways that accord with our customers' focus on health, financial and lifestyle security.

These pillars are built on a foundation of:

- A Group culture and skills to support our expanded offering, and
- Information systems and infrastructure that can deliver a unified 'one business' approach.

That is the strategy in a nutshell – fine words and laudable aims but the real measure of success is to make them a reality.

We have delivered on all of the above in bringing the strategy to life and at the same time preparing MBF for future growth.

Adhering to the disciplines and accountabilities that would be expected of a listed organisation has been an essential element.



Focus on financial performance

Building the organisation's financial strength has been a very high priority for us.

In 2002 MBF had retained earnings of \$412 million. It took 55 years for the organisation to reach that figure.

Retained earnings now exceed \$1.1 billion representing a nearly three-fold increase over the past five years.

In 2006-2007, the MBF Group achieved a net profit of \$223.5 million – a 23% increase over the previous year.

All of our business units – Private Health Insurance, MBF Life and ClearView Retirement Solutions – exceeded their budgets.

The core private health insurance business – MBF Australia and MBF Alliances – recorded a solid underwriting profit of \$66.8 million.

MBF Life's net profit of \$8.6 million was \$2 million better than budget.

ClearView, now such an integral part of the Group, had a record sales year with funds under management surpassing \$2 billion.

The quality of the earnings is really the message I wish to convey. They are the result of efficient, cost effective day-to-day operations.

And they have been achieved while keeping business costs under control while we've invested in an entirely new computer system.

Furthermore, I reject any suggestion that our industry-leading profit is driven by higher-than-average health insurance premiums.

Indeed, our experience is the reverse – for all but one of the past five years MBF's annual premium increases were below the industry average.

We've confirmed the strong connection between financial strength and keeping private health insurance affordable for the long term.

Preparing for the next big step

As you may be aware, MBF has started on the path to demutualisation and listing to enable the Group to reach its full growth potential.

I want to refer to this historic decision in its 'big picture' context in industry terms and from a national perspective.

Three years ago we discussed private health's growing responsibility for providing healthcare to an ageing population.

At that time Australia was starting to come to terms with the stark and rather challenging reality of looming demographic change.

I noted then that the projected ageing of the population presented a compelling case for change but also a commercial opportunity.

The Australian Bureau of Statistics estimated that by the middle of this century:

- the median age would increase from 35.9 years to 49.9 years
- Life expectancy would increase from 77 years to 84 for men and from 84 to 87 years for women;
- The percentage of the population aged over 65 would increase from 13% to up to 30% and up to 9% of the population would be 85 and over.

We also discussed the dramatic growth in private health activity with more than half of all surgery being conducted in private hospitals.

In political terms, there is now bipartisan support for Australia's mixed public-private health system.

The controversy surrounding Michael Moore's film 'Sicko' highlighted a growing view in America that the Australian healthcare system is the one to emulate.

Private health will continue as a growth industry – in fact, health insurance has stronger growth potential than general insurance.

That couldn't have been said even as recently as five years ago.

Our strategy of growth and diversification has taken private health protection even further by adding financial services to our traditional health insurance offering.

It is a strategy, I might add, that is now being emulated by our major competitors.

The MBF Board and the MBF Council – a body representative of our policyholders – believe that demutualisation and listing is the most effective way to drive our growth strategy.

The Group's mutual structure has served the organisation well but, in the growth environment I have described, it also acts as a constraint.

In contrast, becoming a listed entity will provide access to capital to drive growth and allow policyholders to share in the underlying value of their company.



MBF Council and our policyholders tell us they want MBF to remain at the forefront of the industry, as the industry leader in charge of its own destiny.

At MBF, we have been preparing for this big step in the organisation's development for some time.

As I said earlier, to the fullest possible extent, we have behaved and operated as if we were already a listed entity.

We acquired a financial services capability via the acquisition of MBF Life (the former NRMA Life business) and ClearView.

In the coming years I expect our financial services business to be an increasingly significant part of our business relative to our core private health insurance business, to better balance the profile of the Group.

We have upgraded risk management with a high quality treasury function – it's hard to believe that five years ago we had no actuaries.

It wasn't thought necessary in a community rated health insurance environment. But nothing could be further from the truth. You have to be able to understand risk and the dynamics of the business.

We've also established a 'competency framework' to match skills and people to jobs in line with our growth strategy.

And we took a bold but necessary decision to replace our computer operating system to replace technology that was up to 30 years old.

Replacement of our computer system – our biggest ever investment in technology – will pay dividends in business agility and flexibility.

In summary, the MBF Group is in good shape as we propose to demutualise and list on the Australian Securities Exchange.

Industry rationalisation beckons

It is important to offer you an industry perspective of the major changes that are currently taking place on such a wide front.

The proposed sale of Medibank Private, NIB's demutualisation and our own proposed demutualisation and listing will result in a cascade of long awaited consolidation.

In my view, the structural change involving insurers that between them represent some 60% of the health insurance market will stimulate that long awaited rationalisation.



The private health insurance industry does not have the luxury of waiting for change to catch up with it somewhere down the road. It is already well overdue.

Indeed, the private health sector has been handed an historic mission and a great responsibility in funding and delivering health services in Australia.

After more than 30 years, economic and demographic imperatives have led to a shift towards the private health sector.

For three decades, the emphasis has been on taxpayer-funded healthcare but public health systems are no longer able to carry the healthcare burden alone.

They face the cost impact of population ageing, increased utilisation of health services and advances in medical technology and treatment.

Australia has at last recognised that our mixed public-private health system is efficient, effective and, actually, the world's best health system model.

We're certainly hearing that chorus from America where there is a growing movement best summed up as: 'if only we had the Australian model'.

It is vital for the private health insurance industry to be capable of taking on additional responsibility but to do that it must be more efficient and cost effective.

Consolidation of the private health insurance industry is an essential step.

The private hospital industry has been doing this for more than a decade.

Larger national private hospital groups are reaping the commercial benefits of economies of scale and improved operating efficiency.

The privately insured are getting the benefit of the ever-increasing sophistication of procedures and treatment in the private system.

The case for rationalisation of the private health insurance industry is a strong one and MBF intends to play a leading role and be an active participant in it – acting in the interests of our contributors.

Conclusion – a 'five year' horizon

In conclusion, I want to give you a brief picture of the MBF Group and the industry viewed from the perspective of a five-year horizon.

From an MBF perspective, I see an organisation with a much greater national footprint in which health insurance continues as the Group's mainstay.

I believe our financial services business will be significantly bigger almost certainly as a result of strategic acquisitions in coming years.

On the health side, we will be very active in encouraging and rewarding our customers for taking control of their health.

Disease management programs will also be increasingly important and we already have six of these programs in place.

I have no doubt that the MBF Group is up to the task of:

- Implementing its strategy of growth and diversification addressing customers' health and financial security.
- Improving customer value and increasing the depth and scale of our product offering.
- Competing nationally and participating in the transformation of the private health insurance industry.

From an industry perspective, we know that all the signs point to private health being an important economic growth sector.

It is a little harder to be more specific about the likely shape of the industry five years from now.

I believe there will be fewer insurers but they will be national organisations on a much stronger commercial footing.

Much of course depends on the structural change that is currently taking shape. This is an industry chapter that is still in the process of being written.

What are the chances of a more efficient customer focussed industry emerging within five years?

The standard answer might be 'time will tell' but I, for one, believe the change will be deep and wide and of value to the community and to the nation.

It is certainly a space worth watching!