

# Chairman's Report

At HCF we set ourselves realistic, but challenging, growth targets and take pride when we achieve and exceed them. I am pleased to report that we have again done this.



After the challenges of the international financial crisis and the consequent difficulties in the Australian economy, we have emerged stronger. Through our performance, combined with the advantages of being a not-for-profit insurer, we have again continued to return more to our members in benefits than other funds.

Principally, we set ourselves targets to remain financially strong, to increase membership in high value segments, to deliver services to members at low cost to maintain efficiency and control expenses and to continue to develop our people to service our members better.

We have met these targets in each case, with Group profit after tax and abnormals growing by 242% to \$74 million and Group guarantors' equity reaching \$653 million. We exceeded our benchmark investment objective and achieved a return of 8.4%, 5.3 percentage points above plan.

## Our Performance

The HCF Group, with the successful integration of Manchester Unity applying for the full year, has registered a significant growth in policyholders to 571,000. This means that more than 1.3 million Australians are now protected by our health insurance cover. Management expense ratio (MER) reduced from 9.6% to 8.1% for the Group and 7.7% for our health insurance operations. We have maintained staff engagement and satisfaction ratings. Details of these achievements are shown later in this report. We have increased our national share of the health insurance market to 11.9% and have successfully defended our share of our largest market, NSW, while achieving profitable interstate growth.

Disappointments included the underwriting profit which at \$43 million was 13% below target, the result of a reduced gross margin and a decline in Manchester Unity membership higher than we budgeted for. Strategies are in place to address both of these disappointments, and by year end our membership retention rate was improving.

## Health Insurance Environment

The private health insurance industry has grown significantly in 2009/10. Membership (as measured by hospital policies) is up from 44.4% to 44.6%, a better result than just keeping pace with population growth of 1.9%. Industry premium revenue increased 8.3% to \$14.2 billion, and benefits payable rose 7.9% to \$12.2 billion. Profit after tax has risen to \$932 million (up from \$324 million) mainly as a result of improved investment returns and other income of \$554 million (last year showed a \$9 million loss). The industry's management expense ratio has been reduced from 10.0% to 9.1%.

Policyholder response is very encouraging despite the difficult economic circumstances and the changes occurring in the political environment. With the federal election now resolved, the Government may well proceed with its announced health agenda. Ultimately, this will include health and hospital reforms that may go as far as Denticare (a national insurance scheme for dental services) and Medicare Select (a new form of insurance to increase choice and competition in health financing).

Before this, the Government's proposed hospital changes would see reforms to management and administration of public sector hospital services. Of concern is the announced policy to reintroduce legislation to enact rebate tiers, under which private health insurance rebates would be means-tested, with an accompanying increase to the Medicare levy surcharge rates and thresholds. We see this policy as leading to some downgrading of levels of cover, with consequent upward pressures on contribution rates and increased usage of already stretched public sector facilities.

Among the private health insurers, there has been some rationalisation. MBF and BUPA have completed their merger as we have with Manchester Unity and some diversification, with both BUPA and Medibank Private

extending their participation in health service delivery. Such trends may well continue in coming years.

## Not-For-Profit

HCF has operated as a not-for-profit entity since writing its first health insurance policy in 1932. During the year, we reviewed and reconfirmed our strategy to remain as a not-for-profit organisation. We see this as being very much in the policyholders' interest and detail what we see as the advantages for members as part of this report.

## More for Members

In May 2009, we successfully launched one of the most innovative health initiatives in the private health insurance sector. The My Health Guardian program is a proactive package of health management services available through online and telephone based programs where members are able to access initial health assessment and ongoing management advice from health specialists, at no cost. By 30 June 2010, more than 25,000 members were participating in the scheme. We anticipate continued growth and, more importantly, continued improvement in the health of our members as a result of the instant availability of advice and monitoring of participant health status. Early data indicates that hospital admissions have reduced among participants. As a not-for-profit insurer, HCF will apply any savings achieved to keeping premiums down to benefit our members.

As stated, HCF remains committed to its not-for-profit origins, and we will continue to deliver value for members. Our policy of returning around 90 cents in the dollar of premiums to HCF and Manchester Unity members, through better health care benefits, is firmly in place. This year's return was 90.4 cents compared with the average return for all other funds of 86.4 cents.

The HCF Board remains committed to the not-for-profit model and considers that the model is best placed to continue to serve members' interests.

## Benefits of remaining not-for-profit:

- 1 HCF is free of short-term shareholder dividend pressure.
- 2 HCF, after allowing for sufficient capital reserves, returns surplus funds for the benefit of members. (We consistently return around 90% of premiums received in benefits to members, well above the industry average of 86%.)
- 3 HCF has commitment to accountability and transparency and voluntarily follows Australian Securities Exchange guidelines for best practice in corporate governance.
- 4 HCF continues to strive for efficiencies in a competitive market and has achieved one of the lowest expense ratios in the industry.
- 5 HCF has the flexibility to invest in innovation for the long term.

Our members consistently say they value our not-for-profit status.

HCF members continue to take advantage of the Manchester Unity retirement villages and aged health care facilities. Manchester Unity members have full access to all HCF branches, services and health care provider networks.

## Meeting our Social Responsibility

The Group's operations this year generated \$223.8 million in gross economic value added. From this, we paid \$57.5 million in federal and state taxes, ambulance levies and staff superannuation, and \$87.8 million in salaries to our 1,179 employees.

HCF believes that our activities should be economically viable, environmentally sound and socially responsible. Our health, life insurance and aged care services contribute to social wellbeing, and this year we contributed \$5 million to the HCF Health and Medical Research Foundation and we also continue to support the Manchester Unity funding of HeartKids Australia research. The Foundation provided funding for major research programs, including projects addressing clinical evidence, rehabilitation after knee replacement, mobility in elderly Australians and translational research in coronary heart disease.

## Corporate Governance

Since the close of the financial year, the board has appointed Lynn Anderson Consulting to undertake an independent review of the corporate governance structure of the Company. This review will examine subjects including governance structure, Board size, method of Director election and appointment, succession planning and renewal, governance, committee structures and performance. The aims of the review are to see that the governance structure of the Company is operating efficiently and as intended, and to measure our practices against what is considered as best practice.

The review may well lead to recommended changes or refinements to the Constitution, which, if required, would be the subject of a special meeting.

## Looking Ahead

The outlook for HCF and the private health insurance market remains positive. We are confident that our financial strength will ensure our long-term viability and allow us to take advantage of opportunities and to meet threats which may emerge.

The potential for change is complicated by the uncertainty following the federal election outcome and we will work with the new Government to achieve the best outcome in health for all Australians. As Australia's biggest not-for-profit health insurer, we are in a strong position to support worthwhile and well planned and appropriately funded improvements to the national health schemes.

However, we urge health authorities to consult thoroughly with industry participants and to implement agreed-upon changes promptly to remove uncertainty for our members and the Australian public. HCF will continue to represent our members' interests and welfare, and ensure their access to private health care benefits are at the lowest possible cost. We have demonstrated our commitment to the critical issue of disease management programs by the introduction of the online system My Health Guardian described in this report and are confident that such initiatives will provide the key to slowing the onset of disease and improving the health of chronic sufferers.

## HCF People

Dr Christine (Tina) Clifton has served HCF as a Director since 1994. Her current term expires at this annual meeting and she is not standing for re-election. During her 16 ½ years of service, HCF has experienced enormous growth. People covered by HCF policies have increased from 515,000 to 1.3 million, health insurance management expense has decreased from 13.1% of contributions to 7.7% and is even lower today. Benefits paid have risen from \$263 million to \$1 billion. Tina is entitled to bask in HCF's success. She has contributed to it.

The terms of Stuart Coppock and Graham Wright also expire at this time and I am pleased that they both wish to stand. Stuart is a voting contributor elected Director and Graham a Board appointed Director. Their new terms will expire in November 2012.

Terry Smith retired after serving as CEO for more than 20 years. Subsequent to his retirement from management, he was appointed to the board as a non-executive Director. Elsewhere in this report, we pay tribute to him and to Tony Hutchinson, who has retired after 25 years with the Group, leading HCF Life. Individually they have contributed enormously to the present success and standing of HCF. All of us in HCF are in their debt. They leave the company in excellent shape. The Board has appointed Shaun Larkin as Managing Director. Shaun, who leads a strong and committed management team, has been with HCF for 12 years in senior management positions.

Whilst we pay special homage to Terry Smith, Tony Hutchinson and Tina Clifton and thank the Board and management team for their very significant efforts, we are particularly mindful that it is our people at large who are responsible for our continuing success. In the end it is neither a board nor a management team alone or together which can produce the results. It is the HCF team continually striving for excellence. It is they who make the difference; they who lift us above the norm and set us apart and we thank them again for contributing so much.

John Dunlop AM  
Chairman

30 September 2010