Private Healthcare Australia
Better Cover. Better Access. Better Care.

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SUBMISSION: STRENGTHENING PRUDENTIAL REQUIREMENTS FOR REMUNERATION

About Private Healthcare Australia

Private Healthcare Australia (PHA) is the industry association representing the private health insurance (PHI) industry. Its 22 member funds collectively issue more than 97% of all private health insurance policies issued in Australia.

PHA appreciates the opportunity to provide feedback in response to APRA's proposal to introduce a new cross-industry prudential standard for remuneration. We note that APRA's proposals have been drafted to address recommendations from the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Royal Commission) and insights gained from the APRA's own *Prudential Inquiry into the Commonwealth Bank of Australia*.

There are several aspects of the legislative framework surrounding private health insurance which differentiate it from other APRA-regulated industries and those at the centre of the Royal Commission. In this submission, we identify aspects of the draft Standard where alternative arrangements for PHIs would allow for greater flexibility while still meeting the aims of the standard.

Significant Financial Institutions

The PHI industry supports the direction and objectives of APRA's proposals. We note however that this is a cross-industry standard containing sections which have been designed at least in part as a response to conduct identified within other industries through the Royal Commission. To this end we strongly support the proposal to exclude PHIs in the categorisation of Significant Financial Institutions (SFIs) at this stage.

The discussion paper cites the broader reforms being undertaken to the PHI prudential framework as the reason for not applying the SFI categorisation to PHI. We submit that PHI also represents a lower risk for the type of misconduct cited in the Royal Commission and the CBA inquiry because of:

- Short-tail policy risk. Unlike other forms of insurance, claims made under a PHI policy are made during the term of the policy, which lasts for one year.
- Low financial exposure of PHI customers relative to other financial services sectors. The average PHI policy costs $3,678 per year[1] and customers have the option of cancelling their policy at any time and receiving a full refund of any premiums paid in advance. In addition, the PHI Code of Conduct (which covers more than 99% of all PHI policies issued) provides for a 'cooling off period' enabling customers to cancel their policy and receive a full refund if they change their mind within 30 days of purchase.
- The legislative framework around PHI premium setting, which requires Ministerial approval of all premium increases, locks in the price of a PHI policy for 12 months, ensures that all customers pay the same price for the same policy, and ensures regular public and media attention on the cost of PHI premiums.
- The fact that, on average, more than 86% of PHI premium revenue is returned to policyholders in benefits for healthcare received each year.[2]

In the context of the above, it may not be appropriate or necessary to apply the SFI categorisation to any PHI at any stage in the future.

Measurement of outcomes – financial and non-financial measures

We submit that the factors identified above also justify a more flexible, principles-based approach to remuneration design, particularly the proposed 50% upper limit on financial performance metrics contained in clause 38 of the Draft Standard:

> *"For any variable remuneration arrangement of an APRA-regulated entity, financial performance measures must not comprise more than 50 per cent of total measures used to allocate variable remuneration. Each individual financial performance measures must not comprise more than 25 per cent of total measures."*

While we appreciate the 50% minimum has been established to ensure focus on control and compliance, customer outcomes, market integrity objectives, reputation and strategic alignment in addition to meeting financial targets, a prescriptive approach can lead to:

- A preference by employees and potential employees for fixed remuneration or a greater proportion of fixed remuneration which could lead to an increase in the cost of employing people with required skill sets.
- Reduced ability for PHI Boards to incentivise performance in some areas of business performance.
- Performance bonuses being awarded where financial metrics are not met and where the individual's position may be unsustainable.
- Increased difficulty in assessing performance, as non-financial measures are generally more difficult to identify and measure.
- Compliance costs and red tape being imposed on entities required to amend their remuneration frameworks.

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[1] APRA Quarterly Private Health Insurance Statistics – June 2019 (released 20 August 2019)
[2] APRA Quarterly Private Health Insurance Statistics – June 2019 (released 20 August 2019)

We propose that this clause be amended to exclude private health insurers. Instead, the Boards of PHIs could be required to determine an appropriate level of financial and non-financial performance measures within variable remuneration schemes as part of developing the remuneration framework. This could be undertaken in consideration of the entity's risk profile, performance, long-term soundness and remuneration objectives.

The increased flexibility of our proposed approach would allow PHIs to identify over time the most appropriate measures and the optimal proportion of financial/non-financial measures for various roles within the organisation.

Regular reviews of the remuneration framework

We support the requirement for triennial effectiveness reviews of the remuneration framework. The discussion paper states that the review must be undertaken by "operationally independent appropriately experience and competent persons…" This appears to indicate that, in some circumstances, the review could be undertaken internally rather than by engaging external expertise. For the sake of clarity, we submit that it may be appropriate for this review to be conducted internally by a suitably qualified and experienced person who is operationally independent.

[redacted]