



# DISCUSSION PAPER

## Governance, fit and proper, audit and disclosure requirements for private health insurers

February 2018

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# Contents

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Contents	3
Executive summary	4
Glossary	6
Chapter 1 Introduction	8
Chapter 2 Governance	11
Chapter 3 Fit and proper	14
Chapter 4 Audit	17
Chapter 5 Disclosure	20
Chapter 6 Consultation and next steps	21
Chapter 7 Cost-benefit analysis information	23

## Executive summary

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The Australian Prudential Regulation Authority (APRA) is an independent statutory authority established for the purposes of prudential supervision of financial institutions and for promoting financial system stability in Australia. The long-term stability of the financial system requires the community to have a high degree of trust and confidence that APRA-regulated institutions do not just meet their financial requirements, but are also well governed, prudently managed, and resilient to emerging risks. The requirements in APRA's prudential standards on governance, fit and proper, audit and disclosure are designed to facilitate effective decision making in the long term interests of regulated institutions and ensure that the right people are in place to support those governance arrangements.

APRA has undertaken a review of the prudential framework for private health insurers to ensure it is fit for purpose and aligns with APRA's mandate as outlined in the August 2016 letter to industry: *Private health insurance: prudential policy outlook*<sup>1</sup>. Consistent with the approach described in that letter, this paper proposes amendments to the prudential framework applying to private health insurers as it relates to governance, fit and proper, audit and disclosure. Specifically, the paper proposes to:

- replace the current *Prudential Standard HPS 510 Governance* (HPS 510) with the cross-industry *Prudential Standard CPS 510 Governance* (CPS 510) to ensure that it is effective in driving sound governance practices;
- extend the cross industry *Prudential Standard CPS 520 Fit and Proper* (CPS 520) to private health insurers, to ensure that responsible persons in those organisations have the technical competence and integrity necessary to perform their key roles;
- introduce a new *Prudential Standard HPS 310 Audit and Related Matters* (HPS 310), aligned to the audit prudential standards applying to other APRA-regulated institutions, in recognition of the important role auditors play in supporting prudential soundness;
- revoke *Prudential Standard HPS 350 Disclosure to APRA* (HPS 350), to streamline reporting and remove obsolete requirements; and
- update *Prudential Standard HPS 001 Definitions* (HPS 001) to include terminology referenced in CPS 510, CPS 520 and HPS 310.

The refreshed prudential framework is expected to improve resilience by increasing the likelihood that Boards, senior management, auditors and actuaries will identify and take proactive action on emerging issues. Policyholders are expected to benefit from a strengthening of the overall quality of governance of private health insurers through a reduction in the risk of failure arising from fraud, mismanagement, or other undesirable practices.

<sup>1</sup> <http://apra.gov.au/PHI/consultations/Pages/prudential-policy-outlook.aspx>.

This consultation focusses on the appropriateness of APRA's cross-industry standards in the PHI industry, including whether changes should be made to accommodate the specific circumstances of the industry.

Similar to the process adopted for the introduction of *Prudential Standard CPS 220 Risk Management* (CPS 220), applications for alternative arrangements will be considered once the standards are finalised. Subject to consultation outcomes, APRA intends to finalise the framework in 2018, to enable all new requirements to come into effect from 1 July 2019.

# Glossary

<b>Appointed Auditor</b>	The person appointed as the auditor of a private health insurer in accordance with the prudential standards.
<b>APRA</b>	Australian Prudential Regulation Authority.
<b>FOI Act</b>	<i>Freedom of Information Act 1982.</i>
<b>FSCODA</b>	<i>Financial Sector (Collection of Data) Act 2001.</i>
<b>PHI</b>	Private health insurance.
<b>PHIAC</b>	Private Health Insurance Administration Council (1989-2015).
<b>PHIPS Act</b>	<i>Private Health Insurance (Prudential Supervision) Act 2015.</i>
<b>prudential framework</b>	The legislation, prudential standards and prudential guidance for each industry that is applicable to APRA-regulated institutions.
<b>prudential requirement</b>	Requirements imposed by APRA on any APRA-regulated institution either through legislation, a prudential standard, the APRA rules, reporting standards made under FSCODA, or any requirements imposed by APRA in writing.
<b>prudential standard</b>	Refers to the prudential standards made under section 92(1) of the PHIPS Act.
<b>regulated institution</b>	Authorised deposit taking institutions registered under the <i>Banking Act 1959</i> , general insurers registered under the <i>Insurance Act 1973</i> , life companies registered under the <i>Life Insurance Act 1995</i> , private health insurers registered under the <i>Private Health Insurance (Prudential Supervision) Act 2015</i> , non-operating holding companies registered under the Banking Act, the Insurance Act or the Life Insurance Act, and Level 2 or Level 3 Heads.
<b>responsible person</b>	As defined in prudential standard CPS 520.
<b>senior management</b>	The Chief Executive Officer, or any other person who has, or exercises, senior management responsibilities within the meaning of the prudential standards.

## Prudential standard references

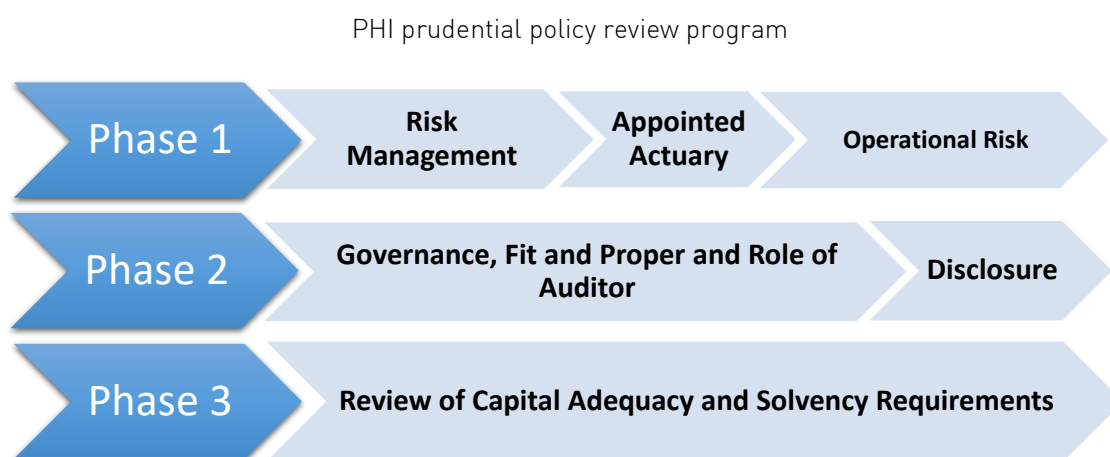
<b>CPS 220</b>	<i>Prudential Standard CPS 220 Risk Management</i>
<b>CPS 510</b>	<i>Prudential Standard CPS 510 Governance</i>
<b>CPS 520</b>	<i>Prudential Standard CPS 520 Fit and Proper</i>
<b>HPG 510</b>	<i>Prudential Practice Guide HPG 510 Governance</i>
<b>HPG 520</b>	<i>Prudential Practice Guide HPG 520 Fit and Proper</i>
<b>HPS 001</b>	<i>Prudential Standard HPS 001 Definitions</i>
<b>HPS 310</b>	<i>Prudential Standard HPS 310 Audit and Related Matters</i>
<b>HPS 350</b>	<i>Prudential Standard HPS 350 Disclosure to APRA</i>
<b>HPS 510</b>	<i>Prudential Standard HPS 510 Governance</i>
<b>PPG 511</b>	<i>Prudential Practice Guide PPG 511 Remuneration</i>

# Chapter 1 Introduction

APRA assumed responsibility for prudential regulation of the private health insurance (PHI) industry from the Private Health Insurance Administration Council (PHIAC) in July 2015. In assuming this responsibility, APRA committed to a systematic review of the PHI prudential framework in the medium term, with the objective of ensuring that the framework remains fit for purpose, and insurer resilience is strengthened through sound risk management, governance and capital practices.

In APRA's August 2016 letter to industry: *Private health insurance: prudential policy outlook*, APRA outlined its intention to conduct the review at a measured pace<sup>2</sup>. APRA's review of risk management concluded in July 2017 with the release of a response to submissions paper, prudential standard and prudential practice guide<sup>3</sup>. Broader cross-industry reviews of the role of the appointed actuary and operational risk (including outsourcing, business continuity management and IT security) remain ongoing.

This paper represents the next significant step in APRA's review of the PHI prudential framework, which is Phase 2.



## 1.1 The APRA mandate







The proposals in this paper are made in the context of APRA's mandate of ensuring financial safety, balanced by considerations of efficiency, competition, contestability and competitive neutrality, while promoting financial system stability<sup>4</sup>. APRA considers the proposals contained in this paper will achieve improvements in financial safety, financial system stability and efficiency as follows:

<sup>2</sup> <http://apra.gov.au/PHI/consultations/Pages/prudential-policy-outlook.aspx>.

<sup>3</sup> [July 2017 - Response to submissions: risk management prudential standard for private health insurance.](#)

<sup>4</sup> Refer to section 8(2) of the *Australian Prudential Regulation Authority Act 1998*.



PRIMARY OBJECTIVES	
<b>Financial safety</b> 	<b>Financial system stability</b> 
<b>Enhanced.</b> Insurer resilience will be strengthened through sounder governance, robust fit and proper checking and independent audit assurance.	<b>Marginally enhanced.</b> The proposals will promote system stability by supporting public trust and confidence in the industry.
OTHER CONSIDERATIONS	
<b>Efficiency</b> 	<b>Enhanced.</b> Operational efficiencies will be realised through the adoption of consistent terminology across the prudential standards and the revocation of obsolete prudential requirements. The supporting guidance material will aid insurer understanding of APRA's expectations.
<b>Competition</b> 	<b>Unchanged.</b> Adopting a principles-based approach will accommodate the diversity of insurers in the market, not altering the competitive balance.
<b>Contestability</b> 	<b>Unchanged.</b> Being principles based, the prudential standards are not expected to act as an undue constraint to potential new entrants, particularly those which are small in size or which employ non-traditional business models.
<b>Competitive Neutrality</b> 	<b>Unchanged.</b> No impact is expected on competitive neutrality.

## 1.2 Objectives of the review

In undertaking the review, APRA's objective is to ensure the prudential framework is fit for purpose, and to:

- protect policyholder interests and ensure sound prudential outcomes by setting sound governance, fit and proper, audit and disclosure requirements that apply consistently across all private health insurers and other APRA-regulated institutions where appropriate;
- clarify APRA's expectations and disseminate better practice; and
- use common language across sectors, to promote efficiency and minimise confusion.

## 1.3 Methodology

APRA seeks to adopt a consistent approach to setting prudential requirements in areas such as governance, where the fundamental principles of good practice do not materially vary between sectors.

In conducting the current review, APRA has compared the language and requirements of HPS 510 (relating to governance) against CPS 510. APRA has also considered the range of breaches of HPS 510 over recent years and whether a refreshed framework, including application of CPS 520 (relating to fit and proper) might reduce the risk of fraud and mismanagement.

In drafting HPS 310 (relating to audit), APRA has considered the established frameworks in other regulated industries. The standards relating to audit in other regulated industries support the risk management framework and provide APRA with independent assurance of the annual accounts and regulatory returns of regulated institutions by an appropriately qualified auditor. They also provide assurance to the Board of the regulated institution and APRA that the institution has appropriate and effective controls in place to allow them to comply with all APRA prudential requirements.

APRA has also considered comments provided by the industry to APRA during transition (2015) and the risk management thematic reviews (2015-2017) regarding the ongoing effectiveness of HPS 350.

APRA's assessment is that the core principles of CPS 510, CPS 520 and HPS 310 are appropriate for the industry and that these standards should be applied in their entirety. The process of reviewing an institution's governance policies and practices against the requirements of CPS 510 and CPS 520 is expected to put additional rigour around existing frameworks, whilst adoption of HPS 310 will largely formalise practices that a prudently run organisation should already have in place.

APRA's proposal to revoke HPS 350 (relating to disclosure to APRA) is based on finding that the requirements of this standard have led to duplicate, and, in some instances, redundant reporting. Revocation will reduce the compliance burden without affecting prudential safety.

Concurrent with the above reviews, APRA has also reviewed *Prudential Standard HPS 001 Definitions* to facilitate understanding of new terminology. The amended standard has been released in draft form with the other documents for consultation.

Should stakeholders provide sound argument during the consultation period that requirements of CPS 510, CPS 520 or HPS 310 are not appropriate to the industry, or that there is merit in retaining elements of HPS 350, APRA will consider modified requirements.

## Chapter 2 Governance

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Robust governance practices that support sound decision-making are essential to ensure regulated institutions remain resilient and able to adapt quickly to changes in the broader operating environment, while remaining prudentially sound. Introduced in 2009, the current PHI governance standard HPS 510 no longer reflects the latest experience in developing sound governance frameworks. This chapter discusses the proposed key changes to align the framework with contemporary practice and with CPS 510.

### 2.1 Board and senior management

APRA's expectations of the Board are broadly consistent across HPS 510 and CPS 510, particularly in terms of responsibilities, charters, delegations, performance assessments and renewal. Where the standards differ is the recognition in CPS 510 of the role senior managers' play in ensuring effective processes and procedures are in place to promote effective governance. For example, CPS 510 requires the Board to be satisfied that the skills of senior managers are appropriate to the positions they hold. It also requires directors to constructively challenge senior management proposals and decisions on all aspects of risk management arising from the institution's activities. How Boards maintain these assurances is at the discretion of individual institutions. Insurers can, however, expect the adequacy of a Board's oversight of senior management to be assessed as part of APRA's ongoing supervision of private health insurers<sup>5</sup>.

### 2.2 Independence and Board composition

Similar to HPS 510, CPS 510 includes requirements around the composition of the Board and the independence of its directors, to support the ability of the Board to provide appropriate oversight and challenge. The independence requirements of CPS 510 are, however, broader than those contained in HPS 510. For example, they enable independent directors on the Board of a parent company, or another subsidiary in a group, to sit as independent directors on other subsidiary Boards. The standard also enables senior managers of the parent company, or other subsidiaries to sit as non-executive directors on other subsidiary Boards.

In general, CPS 510 permits common directors between regulated institutions within a corporate group. APRA notes, however, that conflicts of interest can arise within group structures, particularly where one regulated entity is largely or wholly reliant on another for key corporate services, or where entities have common management. In such circumstances, the interests of the different regulated entities can diverge, and common Boards can make it difficult to manage conflicts of interest and ensure appropriate consideration is given to the policyholders of each regulated institution. APRA has used its power to adjust HPS 510 for newly licenced private health insurers to address the risks of such arrangements by imposing additional obligations, such as a requirement that one or more genuinely independent directors sit on each Board. APRA has observed that the appointment of directors independent of the group can significantly improve decision making by bringing an

<sup>5</sup> APRA's [Aid for Directors](#) (Oct 2014) can provide private health insurers with additional background on APRA's expectations of Boards and senior management.

objective perspective to discussions. The independence of those directors also makes them well placed to hold other directors accountable, particularly in relation to the conflicts of interest which can arise in group structures.

The requirements around the composition of the Board are broadly similar between HPS 510 and CPS 510. Depending, however, on the size of the Board, CPS 510 may require a larger number of independent directors, as it requires all locally incorporated regulated institutions to have a majority of independent directors at all times.

## **2.3 Board committees**

The Board of a private health insurer is likely to find that Board committees are an effective way of assisting it to perform its functions. In general, the committee structure adopted by each institution is a matter for it to determine. However, reflecting APRA's experience in supervising financial institutions as well as international standards and best practice, CPS 510 mandates three Board committees for all APRA-regulated institutions:

- a Board Audit Committee - to provide an objective, non-executive review of the institution's financial reporting and its risk management framework. CPS 510 describes the role and functions of the Board Audit Committee in greater detail than HPS 510;
- a Board Risk Committee - separate to the Board Audit Committee, to ensure adequate independent oversight of the management of risk and to provide the Board with assurance that management are appropriately implementing the Board's strategy for managing risk. CPS 510 does not preclude the Board Risk Committee having the same membership as the Board Audit Committee, but APRA has found that the discipline of separate meetings, separate agendas and a diversity of membership assist in the clear delineation of oversight responsibilities; and
- a Board Remuneration Committee - to oversee the remuneration policy, review processes, and to make recommendations to the Board on remuneration matters.

All private health insurers are encouraged to review their existing committee structures, composition, charter and policies against the proposed additional committee requirements of CPS 510.

## **2.4 Board performance, assessment and renewal**

CPS 510 contains performance assessment and renewal provisions that require regulated institutions to establish processes for assessing, appointing, re-appointing and removing directors. APRA has found that requiring Boards to document these processes has improved the integrity of appointments, annual performance assessments and dismissals, and has ensured clear and consistent criteria for these critical decision-making processes.

## **2.5 Remuneration policy**

CPS 510 requires regulated institutions to establish a written remuneration policy to align remuneration outcomes with prudent risk-taking. APRA does not have a view on the level of executive remuneration. The remuneration requirements in the standard are principles-

based and focussed on promoting effective governance, ensuring executive directors are not placed in a position of actual or perceived conflict of interest, and managing risk incentives associated with remuneration.

The remuneration requirements of CPS 510 and the guidance contained in *Prudential Practice Guide PPG 511 Remuneration* will assist private health insurers to put in place procedures, controls and performance measures, and to ensure prudent remuneration decisions, particularly in adverse circumstances.

## **2.6 Internal audit**

CPS 510 and CPS 220 place emphasis on the need for regulated institutions to identify and assess the risks inherent in their products and activities. The internal audit function forms part of the third line of defence and can assist institutions to meet APRA's expectations by conducting independent reviews of risks, controls and processes to identify and address potential and actual operational matters that may compromise the adequacy and effectiveness of the financial and risk management framework of the institution. Strengthening the role of the internal audit function will provide Boards, the Board Audit Committee and APRA with a greater level of assurance that a private health insurer's systems, procedures and internal controls relating to actuarial data integrity and financial reporting are adequate and effective.

## **2.7 Communications with APRA**

Ensuring that information of a prudential concern is promptly communicated to APRA is critical for ensuring APRA maintains a strong understanding of the industries it regulates and APRA's knowledge of each regulated institution. APRA's preference is for institutions to resolve emerging prudential issues without regulatory intervention, and for communication between a private health insurer and APRA to be open and timely.

With a view to ensuring regulated institutions do not attempt to prevent the provision of relevant prudential information to APRA, CPS 510 requires corporate policies to not constrain employees or contractors from discussing issues with APRA of relevance to the prudential supervision of the institution, or from providing documents under their control to APRA.

The standard also requires directors and senior managers to be available to meet with APRA on request. Such meetings provide the regulated institution with an opportunity to raise matters directly with APRA and to hear APRA's views on emerging issues.

## Chapter 3 Fit and proper

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Companies are subject to the risk that incompetence or dishonesty of persons who exercise a material influence over the operations of the company will lead to material losses. The application of CPS 520 to the PHI industry is intended to strengthen existing practices and to help reduce the risk of failure, by ensuring that responsible persons have the technical competence and integrity to perform their roles to the benefit and protection of the institution and policyholders.

This Chapter outlines the key requirements of CPS 520, which APRA proposes to apply to private health insurers.

### 3.1 Fit and proper policy

CPS 520 requires all regulated institutions establish a written fit and proper policy to assist in prudently managing the risk that responsible persons are not fit and proper. The policy forms a key part of the institution's broader risk management framework.

Establishing a written fit and proper policy allows decisions regarding the appropriateness of responsible persons for those roles to be dealt with proactively by the private health insurer, rather than relying on APRA, under section 120 of the PHIPS Act, to apply to the Federal Court to disqualify a person from being or acting on behalf of a private health insurer. APRA's preference is for private health insurers to be pro-active and to not rely on APRA to make such assessments. It is APRA's preference that the disqualification provisions of the PHIPS Act are only relied upon in circumstances where APRA disagrees with a private health insurer's determination as to the fitness and/or propriety of a responsible person.

### 3.2 Responsible persons

CPS 520 defines the responsible persons of a regulated institution as those persons whose conduct has the potential to impact significantly on the financial soundness and stability of the institution. The standard includes directors, the Chief Executive Officer, senior managers, the Appointed Actuary and the Appointed Auditor under this definition. A regulated institution can also include other members of staff or external providers under its fit and proper policy where the institution has identified that the person's activities may materially affect, either directly or indirectly, the financial affairs of the institution.

APRA may also determine if other persons working for an APRA-regulated institution are responsible persons. APRA will ordinarily only make such a determination after discussion with the institution.

### 3.3 Criteria to determine if a person is fit and proper

The skills and experience required of each responsible person will depend on the person's role and the institution's risk assessment and job description for that position or service. CPS 520 identifies the minimum criteria APRA-regulated institutions must consider when conducting a fit and proper assessment of a responsible person. Institutions can, of course,

add to these criteria in performing their assessments. The base criteria identified by CPS 520 includes whether the person:

- is not disqualified under applicable legislation from holding the position<sup>6</sup>;
- possesses the necessary skills, knowledge, expertise, diligence and soundness of judgement to fulfil the responsibilities of their role;
- has demonstrated appropriate competence and integrity in fulfilling professional responsibilities previously, or in the conduct of their current duties; and
- has any conflict of interest which may materially impact the institution.

If insufficient information is available to enable a private health insurer to make a determination of fitness and propriety in accordance with the criteria set out in CPS 520, the criteria would be deemed as not met and the person may not remain in, or be appointed to the position. They may, however, be found suitable for another position in the institution depending on the particular circumstances.

### **3.4 Additional criteria applying to Appointed Auditors and Appointed Actuaries**

To ensure the integrity, capabilities and independence of the Appointed Auditor and the Appointed Actuary, CPS 520 sets out additional criteria which must be considered when considering appointment of these specialists to an APRA-regulated institution. This reflects the importance of these positions to the ongoing prudential soundness of the institution.

### **3.5 Process for assessment of fitness and propriety**

Under CPS 520, the fit and proper policy of an APRA-regulated institution is required to include documentation of the processes for assessing fitness and propriety. Only material factors need to be considered in the assessment of a person's fitness and propriety. A regulated institution needs to weigh the burden of documenting information and the risk of unnecessary disclosure of personal information against the possibility that this information might be material.

The annual performance review is often when the annual assessment of a responsible person's fitness and propriety is undertaken. However, if material information adverse to the assessment becomes known to a regulated institution during the year, APRA expects the institution to resolve the issue then, not defer consideration to the scheduled annual review date.

In making an assessment under its fit and proper policy, regulated institutions can take into account other information than what is prescribed in CPS 520. For example, the Australian Securities and Investment Commission's assessment of fit and proper in relation to a

<sup>6</sup> For private health insurers, refer to section 119 of the PHIPS Act.

company auditor may be taken into account by a regulated institution in its assessment of the fitness and propriety of the Appointed Auditor.

### **3.6 Whistleblowing**

The whistleblowing requirements contained in CPS 520 reflect the importance APRA places on the institution and APRA being quickly informed should it be identified that a responsible person is not compliant with the requirements of CPS 520. For example, CPS 520 requires that an institution's fit and proper policy not restrict or discourage persons from disclosing information or providing documents to the person responsible for conducting the fit and proper assessments in the regulated institution or to APRA, if a person believes that there has been non-compliance with the requirements of CPS 520. The policy must ensure that no person making a disclosure in good faith is subject to, or threatened with a detriment because of any notification to APRA. It is also an important requirement of CPS 520 that the policy extend to past responsible persons as well as current responsible persons.

### **3.7 When a responsible person is not fit and proper**

CPS 520 requires regulated institutions to take all reasonable steps to ensure that a person is not appointed to or does not continue to hold a responsible position where it is identified that the person does not comply with the fit and proper criteria of the prudential standard. In such instances, the institution must take all steps to ensure that the person is not appointed to, or does not continue to hold, the responsible position.

### **3.8 Informing APRA**

Regulated institutions are required to provide APRA with details of every responsible person in the institution, including each responsible person's position, main responsibilities and a statement certifying the person's assessment under the institution's fit and proper policy. Institutions are to maintain the currency of the information and to notify APRA when a responsible person is no longer considered fit and proper.

Private health insurers currently provide APRA with most of this information using the Responsible Persons Information form available on the APRA external website at: <http://www.apra.gov.au/PHI/Pages/PHI-Forms.aspx>. That form will be updated to ensure consistency with the requirements of CPS 520 when the standard is implemented for private health insurers.



## Chapter 4 Audit

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The *Corporations Act 2001* prescribes independence<sup>7</sup> and quality requirements<sup>8</sup> for external auditors and imposes an obligation to follow 'auditing standard' (the standards issued by the Auditing and Assurance Standards Board). In recognition of the valuable role auditors play in promoting the prudential soundness of financial institutions, APRA proposes to build on these obligations for private health insurers in a new prudential standard *HPS 310 Audit and Related Matters* (HPS 310). The proposed standard would require private health insurers to appoint an auditor to provide independent advice on the operations, financial position and risk controls of the private health insurer. Improved audit outcomes will strengthen industry resilience and support the effectiveness of APRA's supervision.

CPS 220 requires all APRA-regulated institutions to have a risk management framework to identify, assess, respond and monitor risks with the potential to materially affect the institution's ability to meet its strategic, business and operational objectives. In the three lines of defence model of risk governance, independent assurance such as that provided by the Appointed Auditor is part of the third line of defence.

In other APRA regulated industries, external audits have improved prudential compliance by providing unfettered expert and impartial audit review of the operations, financial reporting and control environment of regulated institutions. Auditors can identify weaknesses in internal controls such as complex and inconsistent reporting, which can make it difficult for a Board to provide effective risk oversight. They can provide targeted advice to improve the business processes to reduce the risk of misreporting financial data where risk functions are not integrated, or there are gaps in risk coverage.

Currently, the PHI industry is the only APRA regulated industry which does not have an audit prudential standard. APRA's understanding is that external auditors in the PHI industry focus primarily on meeting existing obligations to provide assurance regarding the risk equalisation trust fund returns and other reporting to APRA in accordance with reporting standards made under the *Financial Sector (Collection of Data) Act 2001* (FSCODA).<sup>9</sup> The introduction of a PHI audit standard will enhance industry resilience by ensuring private health insurers give appropriate consideration to the identification and monitoring of all material risks.

### 4.1 Appointment of an Auditor

In practice, every private health insurer already has an external auditor to meet the requirements of the *Corporations Act 2001*. HPS 310 formalises this requirement, requiring the private health insurer to appoint an auditor to undertake the functions set out in the

<sup>7</sup> Divisions 3, 4 and 5 of Part 2M.4 and section 307C of the *Corporations Act 2001* refer.

<sup>8</sup> Section 307 of the *Corporations Act 2001* refers.

<sup>9</sup> Refer to *HRS 601.0 Statistical Data by State* and *HRS 602.0 Financial and Capital Data*.

Prudential Standard and to ensure, that, as appropriate, the Appointed Auditor is able to fulfil his or her responsibilities in accordance with the Standard.

## 4.2 Independence, skills and experience

HPS 310 reinforces the independence, skills and eligibility requirements of CPS 510, CPS 520 and the *Corporations Act 2001*. Meeting these obligations will ensure that the Appointed Auditor has the necessary independence and expertise to provide impartial and accurate advice to the Board Audit Committee and the Board. This includes the Appointed Auditor having five years relevant experience in the sector and not being employed by the same firm as the Appointed Actuary.

## 4.3 Access to contracts

HPS 310 requires a private health insurer to formalise the terms of engagement of the Appointed Auditor in a legally binding contract which complies with the requirements of HPS 310. APRA may require access to the contract between the private health insurer and Appointed Auditor to determine whether the scope and content of an Auditor's report is likely to provide sufficient assurance that the requirements of the prudential standards are being fully addressed.

## 4.4 Special purpose engagements

In addition to the annual prudential reporting requirements, HPS 310 allows APRA to require a private health insurer appoint an auditor (who may be the existing Appointed Auditor or another auditor chosen by APRA) to provide a report on a particular aspect of the private health insurer's operations, prudential reporting, risk management systems or financial position (special purpose engagement). This request may be imposed to generate a targeted, cost efficient response to address a prudential concern.

Unless otherwise agreed, HPS 310 requires the special purpose engagement report to be submitted simultaneously to APRA and the Board or Board Audit Committee. The report is to be completed within three months from the date commissioned. Details of the engagement would be the subject of a request from APRA and will require a separate engagement letter from the private health insurer to the Appointed Auditor based on APRA's request.

## 4.5 Review of systems, processes and internal controls

HPS 310 requires the private health insurer to engage its Appointed Auditor to prepare an annual report reviewing the private health insurer's systems, processes and internal controls. The report must provide limited assurance regarding whether, throughout the financial year, the insurer has:

- systems, procedures and internal controls in place to ensure that the private health insurer has complied with all applicable prudential requirements; and

- has provided reliable data to APRA in the reporting forms prepared under FSCODA.

To do this, the Appointed Auditor will need to undertake an assessment of the private health insurer's internal control environment, as evidenced by the terms of engagement, correspondence, audit working papers and final report.

Appointed Auditors will be required to perform further procedures where there are indications that the internal controls are not working as intended (for example, where the level of assurance is not consistent across traditional and emerging risks, where accountability for risk and control is unclear, or where the risks are not addressed in a timely manner). This report will provide the Board, Board Audit Committee and APRA with a greater level of assurance that the private health insurer's procedures and internal controls relating to actuarial data integrity and financial reporting are adequate and effective.

## Chapter 5 Disclosure to APRA

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*Prudential Standard HPS 350 Disclosure to APRA* (HPS 350), introduced by the PHIAC in 2010, was designed to capture information about unusual events with the potential to materially affect a private health insurer's operations. Its primary objective was to increase transparency and accountability so that the regulator could respond in a timely and effective manner to reduce the risk of a private health insurer failing. HPS 350 was transitioned to APRA in 2015 without amendment as part of APRA's commitment to minimizing industry disruption during the transfer period.

APRA does not have an equivalent Disclosure to APRA standard for other regulated industries<sup>10</sup>. APRA has found that there are sufficient reporting requirements contained in the primary industry legislation, FSCODA, the reporting standards and prudential standards to allow APRA to effectively supervise regulated institutions. Together these documents provide consistency about how regulated institutions identify, measure and report information to APRA about prudential matters and material risks.

With the application of CPS 220 to private health insurers from 1 April 2018, and the proposed application of CPS 510, CPS 520 and HPS 310 in 2019, APRA considers that HPS 350 will no longer be required. Accordingly, APRA proposes to revoke HPS 350 in 2019 as a means of further streamlining the prudential framework and reducing compliance costs.

<sup>10</sup> The focus of *Prudential Standard APS 330 Public Disclosure* is on information which must be disclosed to the public to contribute to the transparency of financial markets and to enhance market discipline.

## Chapter 6 Consultation and next steps

APRA welcomes submissions on the proposals in this paper, the draft prudential standards and the prudential practice guides. Submissions can be forwarded to APRA via email to: [insurance.policy@apra.gov.au](mailto:insurance.policy@apra.gov.au) marked for the attention of the General Manager, Policy Development.

### 6.1 Consultation questions

Submissions are welcome on all aspects of this discussion paper by 2 May 2018. Specific areas where stakeholder feedback on the proposed direction would assist APRA in finalising the framework are outlined below:

<b>Harmonisation</b>	Are there any features of the industry which warrant different treatment to the core principles of CPS 510, CPS 520 or HPS 310?
<b>Balance of APRA's mandate</b>	Do the proposals strike an appropriate balance between financial safety and considerations such as those relating to efficiency, competition, contestability and competitive neutrality?
<b>Cost analysis</b>	Are there any material new costs private health insurers may face in complying with the proposed standards <sup>11</sup> ?
<b>Transition</b>	Are any industry-wide transition arrangements necessary to support an orderly implementation of the prudential standards?

### 6.2 Adjustments and exclusions

Each prudential standard contains a provision giving APRA the discretion to adjust or exclude the application of a specific requirement contained in the standard for individual regulated institutions. This provision enables institutions which can demonstrate that a requirement of a standard is inappropriate for their particular circumstances to propose an alternate arrangement to APRA which meets in substance the principle underlying the requirement. Such applications will be considered on a case-by-case basis once the final form of each standard is settled. They should not form part of submissions to this first round of consultation, as the focus of this round is the broad applicability of the standards to the industry more broadly, not individual circumstances.

### 6.3 Important disclosure notice – publication of submissions

All information in submissions will be made available to the public on the APRA website unless a respondent expressly requests that all or part of the submission is to remain in-confidence. Automatically generated confidentiality statements in emails will not suffice for

<sup>11</sup> See Chapter 7 with respect to cost-benefit information.

this purpose. Respondents who would like part of their submission to remain in-confidence should provide this information clearly marked as confidential in a separate attachment.

Submissions may be the subject of a request for access made under the *Freedom of Information Act 1982* (FOI Act).

APRA will determine such requests, if any, in accordance with the provisions of the FOI Act. Information in submissions about any regulated institution which is not in the public domain and which is identified as confidential will be protected by section 56 of the *Australian Prudential Regulation Authority Act 1998* and will ordinarily be exempt from production under the FOI Act.

#### **6.4 APRA's response**

APRA will carefully consider all submissions, update proposals in this paper as appropriate and release a second paper responding to key questions and concerns raised during consultations on this paper (response paper). The response paper will identify any changes to the proposed approach as set out in this discussion paper and, if appropriate, include amended standards and practice guides as appropriate.

If significant change is necessary, a further round of consultations may be undertaken to ensure that all matters have been fully considered prior to finalising the standards.

#### **6.5 Next steps**

As stated in the preamble, APRA's current intention is to finalise any revisions to CPS 510, CPS 520, HPS 310 and HPS 001 during 2018, and that the new requirements for private health insurers will come into effect from 1 July 2019. Until that time, all existing governance prudential requirements will continue to apply to private health insurers.

APRA recognises that transitional arrangements may be necessary to allow for an orderly transition in respect of some aspects of the discussion paper. APRA welcomes submissions on appropriate transitional arrangements as part of the response to this consultation and will outline any formal transition arrangements in the response to submissions paper.

As noted in APRA's 2016 letter to all private health insurers, which discussed the prudential policy outlook for the PHI industry, once APRA's governance consultations are well advanced, APRA will commence a consultation process to review *Prudential Standards HPS 100 Solvency* and *HPS 110 Capital Adequacy*.

## Chapter 7 Cost-benefit analysis information

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To improve the quality of regulation, the Australian Government requires all policy proposals undergo a preliminary assessment to ascertain whether it is likely that there will be new material business compliance costs arising out of any proposed change. Compliance costs are defined as direct costs to businesses of performing activities associated with complying with government regulation.

APRA's preliminary analysis indicates that the majority of private health insurers already meet most requirements set out in the prudential standards. It is therefore not expected that transition to CPS 510, or the introduction of CPS 520 or HPS 310 will involve significant new costs on private health insurers. If, however, an insurer considers that compliance costs will increase significantly as a result of the proposals, it should provide in its submission an assessment of the impact of the proposals. In particular, APRA is interested in estimates of new costs associated with upgrading existing frameworks to comply with the requirements of CPS 510 or CPS 520; or expanding the role of auditors.

Consistent with the government's requirement, APRA will use the methodology in the regulatory burden measurement framework to assess any increase in compliance costs identified by submissions. This framework is designed to capture the relevant costs in a structured way, including a separate assessment of upfront and ongoing costs. Information on the framework information is available at: <http://www.dpmc.gov.au/office-best-practice-regulation/publication/regulatory-burden-measurement-framework-guidance-note>. Private health insurers are encouraged to use this methodology to estimate any increase in compliance costs as this will enable the data supplied to APRA to be aggregated and used in an industry-wide assessment.

When submitting cost assessments to APRA, private health insurers should include any assumptions made and, where relevant, any limitations inherent in their assessment. Feedback should only address additional material costs incurred as a result of complying with APRA's requirements or expectations, not activities an insurer would undertake regardless of regulatory requirements in their ordinary course of business.



 **APRA**