



14 September 2018

TO: ALL PRIVATE HEALTH INSURERS

STRENGTHENING GOVERNANCE, FIT AND PROPRIETY AND AUDIT REQUIREMENTS FOR PRIVATE HEALTH INSURERS AND REVOKING THE DISCLOSURE STANDARD

APRA has released final prudential standards to strengthen governance, fitness and propriety and audit requirements for private health insurers (PHI). The final standards will also enhance consistency, where appropriate, between standards that apply to PHIs and other APRA-regulated institutions. Robust governance practices that support sound decision-making are essential to ensure that private health insurers remain sustainable and continue to meet the interests of policy holders.

The new prudential standards and prudential practice guides released today are:

- *Prudential Standard CPS 510 Governance* (CPS 510);
- *Prudential Standard CPS 520 Fit and Proper* (CPS 520);
- *Prudential Standard HPS 310 Audit and Related Matters* (HPS 310);
- *Prudential Standard HPS 001 Definitions*; (HPS 001);
- *Prudential Practice Guide HPG 510 Governance* (HPG 510); and
- *Prudential Practice Guide HPG 520 Fit and Proper* (HPG 520).

Prudential Standard HPS 350 Disclosure to APRA (HPS 350) has been revoked.

These proposals were outlined in a consultation package, titled *Governance, fit and proper, audit and disclosure requirements for private health insurers* released in February this year.¹ The eight non-confidential submissions received in response to the package are available on the APRA website. Key issues raised in submissions were APRA's guidance around tenure of directors, and auditor experience and rotation requirements. APRA has given careful consideration to the feedback received, and its responses to the key issues are set out in Attachment A.

Next steps and timing of implementation

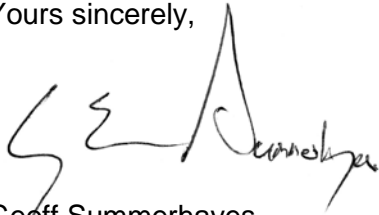
The revised prudential standards come into effect on 1 July 2019. APRA will consider further transitional arrangements on a case-by-case basis where an insurer can satisfy APRA that the proposed transitional arrangement is necessary and appropriate. APRA expects that the need for such arrangements would be relatively limited given the extensive consultation undertaken. Any applications for alternative arrangements should be submitted to APRA prior to 28 February 2019.

APRA expects that, when fully implemented, these prudential standards and guidance will drive sound governance practices, increase focus on the competence and propriety of responsible persons and strengthen the external audit function.

¹ <https://www.apra.gov.au/governance-fit-and-proper-and-audit-prudential-standards-private-health-insurance-industry>

If you have any questions regarding this letter, please contact Peter Kohlhagen (peter.kohlhagen@apra.gov.au or 02 9210 3363) or your responsible supervisor.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Geoff Summerhayes'. The signature is fluid and cursive, with a large, prominent 'A' at the end.

Geoff Summerhayes
Member
Australian Prudential Regulation Authority

Attachment A – APRA’s response to issues raised in submissions

Director independence

PHIs are currently required to have a board renewal policy. Under the policy, the PHI must consider the length of time a director has served on the board and whether this could affect his or her ability to perform his or her duties.

Draft HPG 510 included guidance to PHIs on expectations for board renewal policies. The draft stated there are limited circumstances in which maximum tenure limits exceeding 12 years would be appropriate. The draft also noted that circumstances where a person is re-appointed as a director at the end of the maximum tenure period would be exceptional. These statements reflect APRA’s view, based on experience, that periods of long director tenure can impact on the ability of directors to exercise independent judgement.

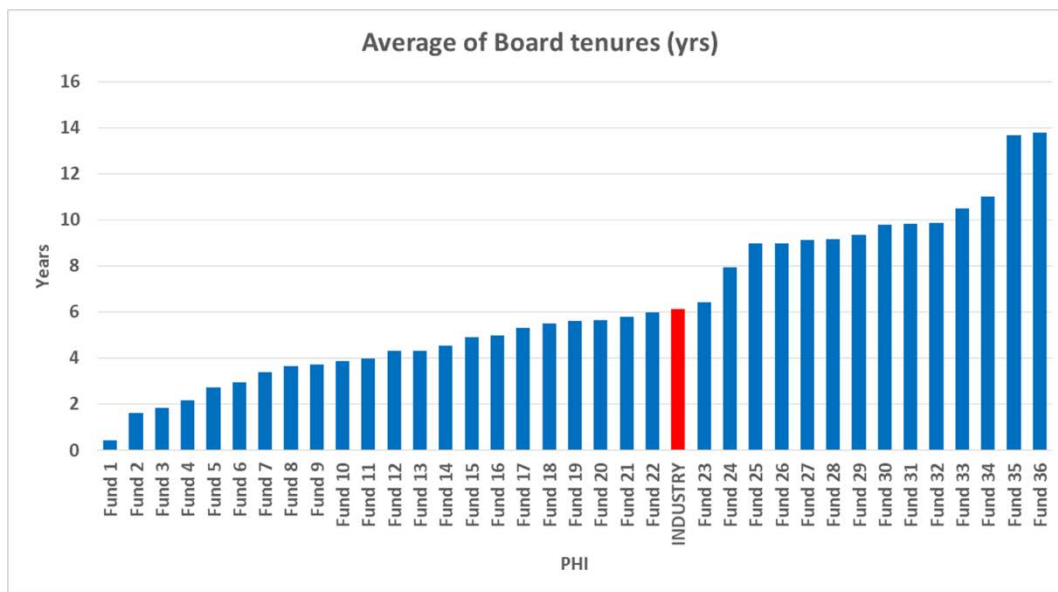
Some stakeholders perceived the guidance as mandatory and made submissions strongly opposing director tenure limits. Some submissions questioned why this guidance should apply to the PHI and superannuation sectors and not to general and life insurance sectors. It was further submitted that boards could be distracted from other matters while considering board renewal and that regional funds could stand to lose long standing directors with extensive region-based knowledge.

APRA has carefully considered the submissions on this issue and confirms the guidance on director tenure is APRA’s strong expectation of sound governance practices and not a mandatory prudential requirement. Private health insurers can adopt an alternative approach in appropriate circumstances, but APRA expects the entity to be able to demonstrate that board renewal and succession planning is given sufficiently high priority.

Given this, APRA considers the drafting to be appropriate and no changes have been made. APRA considers the guidance is relevant across all APRA-regulated institutions and will update guidance for the other industries when a suitable opportunity arises. It is consistent with international better governance practice and will encourage PHI boards to have sound board renewal and succession planning processes and policies that strike an appropriate balance between ensuring continuity and bringing diversity and fresh perspectives.

APRA does not agree with the statement that considering board renewal may distract the board from other matters. The effective operation of the board is critical and on that basis APRA sees time spent by boards ensuring renewal is time well spent.

APRA data on the length of director tenure below indicates that around 16 per cent of non-executive directors of PHI boards have more than 12 years tenure, 27 per cent exceed 10 years tenure and there are six non-executive directors with tenure between 20 and 31 years. This raises the question as to whether current board renewal policies have been paid sufficient attention.



APRA’s supervisors will consider the composition and membership of the board as part of ongoing supervision. Where concerns are identified, including concerns around board renewal, APRA will discuss these with the insurer involved and agree a rectification plan where necessary. In doing so, APRA does not intend to create a disorderly transition and recognises that some restricted access and regionally based insurers may face a more limited pool of appropriately skilled and experienced directors. In such cases, APRA will look to understand the board renewal policy of those insurers and the process the insurer is taking to succession planning and identification of suitably qualified director candidates.

Frequency of the Appointed Auditor’s report on the review of systems, processes and internal controls

APRA proposed to require PHIs to appoint an auditor for prudential purposes and engage that auditor to conduct an annual review of the insurer’s systems, processes and internal controls and report to the board on the insurer’s compliance with all applicable prudential requirements. APRA proposed to require the auditor’s report to assess the impact of these controls on data integrity and financial reporting risks.

It was submitted to APRA that this proposal was onerous and suggested that a less frequent review would satisfy the board and APRA that no significant systemic failures were in effect. APRA considers the proposed annual review to be an appropriate interval for review and will ensure proper focus on assurance regarding these important prudential controls. It will harmonise the auditing requirements on PHIs with the balance of the insurance industry.

Required experience for the Appointed Auditor

CPS 520 paragraph 32(b) requires the Appointed Auditor in APRA-regulated industries to have ‘a minimum of five years’ relevant experience in the audit of APRA-regulated institutions in the industry within which they are working.’ In addition, paragraph 32(d) provides the experience must be ‘sufficiently relevant and recent to provide reasonable assurance that the person is familiar with current issues in the audit of that type of APRA-regulated institution.’

The consultation package proposed to extend this requirement to the PHI sector. Three submissions supported this requirement, three contended it was too restrictive and one argued it should be more prescriptive. APRA considers the current wording as to the requisite level of auditor experience to be appropriate. This provision has not been the subject of any ambiguity in

other APRA-regulated industries and it reflects APRA's expectations as to the level of experience required for the Appointed Auditor to appropriately perform their role.

Pending changes to auditor rotation requirements arising from APES 110 Code of Ethics for Professional Accountants

The *Corporations Act 2001* currently requires auditors who play a significant role in the audit of a listed company for five successive financial years to take a 'time out' period of at least two successive financial years.² The policy objective of the rotation requirements is to promote auditor independence. It ensures that auditors do not remain with the audited body for significant periods that may result in inappropriate relationships developing between the auditor and the audited body, compromising the independence of the audit function. Auditor independence enhances the reliability and credibility of financial reports.

CPS 510 paragraph 99 mirrors the 5/2 auditor rotation requirement for APRA-regulated institutions, and APRA proposed to extend this to PHIs as part of applying CPS 510.

One submission advised that a pending change to an Accounting Standard in APES 110 will introduce stricter auditor rotation requirements³. It was submitted that APRA's requirements should be aligned with the pending changes to the Ethics, Accounting and Auditing Standards which will transition the current two successive year time out period for the Appointed Auditor to three years in 2019 and five years from 2024.

At this stage, APRA will continue to align the auditor rotation provisions in CPS 510 with those in the *Corporations Act 2001*. APRA does not propose to amend CPS 510. It is a matter for the insurer to ensure that their Appointed Auditor meets any additional requirements that go beyond APRA's relevant prudential standards.

The new APRA prudential standards commence 1 July 2019. If an insurer needs to apply for a variation to a requirement in one of the standards, it should discuss the reasons why it is unable to comply, and the date by which it can comply, directly with the APRA supervisor closer to the commencement date. APRA will assess such applications on a case-by-case basis.

² Section 324DA refers.

³ *Amendments to Long Association of Personnel with an Audit or Assurance Client requirements in APES 110 Code of Ethics for Professional Accountants* (Amended APES 110).