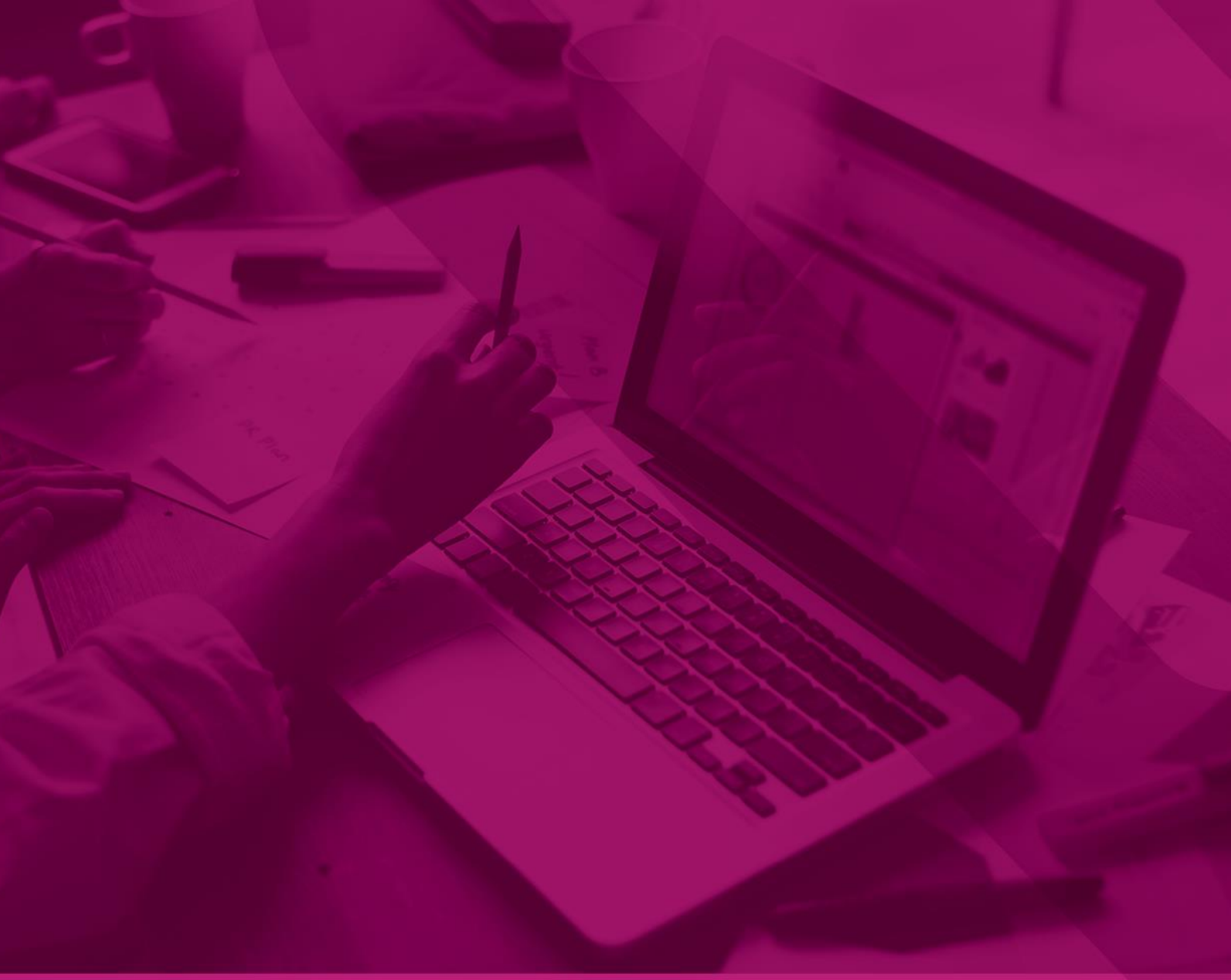

Members Health Fund Alliance

Presentation: Response to: APRA Discussion Paper 'Governance, fit and proper, audit and disclosure requirements for private health insurers'.
Date: May 2018

Members Health FUND ALLIANCE

Putting members' health before profit

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EXECUTIVE SUMMARY:

Members Health is pleased to provide the following response to the APRA Discussion Paper: *Governance, fit and proper, audit and disclosure requirements for private health insurers,* released in February 2018.

As a starting point Members Health would like to acknowledge the effective manner in which APRA has consulted with Members Health in the lead up to, and following, the release of this paper.

Although broadly supportive of the proposed reforms we have significant concern regarding 'Board Renewal' proposals under 'Item 1', specifically, the requirement that term limits be implemented. Any move in this direction will have significant adverse impacts on the industry and consumers, as such, we draw your attention to this section of our submission as a priority.

We also note that the Discussion Paper comes at a time when private health insurers are already designing systems and implementing 'Phase 1' of APRAs reform agenda. Insurers are further developing strategies to implement a significant reform agenda outlined by the Minster for Health.

Further, the industry is also busy scenario planning for the implementation of policies announced by the Federal Opposition in the event that a change of Federal Government takes place at the next Commonwealth election.

While we are entirely confident in the capability of the industry to fully consider and implement those reforms, both announced and anticipated, it is important to recognise that health funds are currently under significant pressure as a result of widespread changes to the regulatory and policy settings of the industry.

Because of the significant change being faced by health funds it is important to highlight the broad necessity of flexibility in terms of both timeframes and implementation of new regulatory requirements.

Additionally, we encourage APRA to consult early with the industry on timeframes for future reform areas (such as cyber security and business continuity) in order to ensure that expectations for additional reform obligations are reasonable in terms of timeframes and cost impacts.

We acknowledge that the intent of APRA reform is to strengthen the private health industry and to ensure its long term sustainability, and we look forward to a continued strong and productive working relationship.

Thank you for the opportunity to provide feedback on the Discussion Paper.

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Item 1: Replace the current *Prudential Standard HPS 510 Governance* (HPS 510) with the cross industry *Prudential Standard CPS 510 Governance* (CPS 510).

Areas of key change and notable requirements

- **'Board independence' - A majority of independent directors at all times**

Members Health does not object in principle that a health fund be required to have a majority independent Board at all times.

With particular respect to closed funds and community based funds, what constitutes an 'independent Director' may cause some confusion. It is suggested that health funds be provided with greater clarity around the definition of independence within this context.

- **'Board renewal' – A Board renewal policy should document the maximum tenure period for each director, including the circumstances where the private health insurer may deviate from the terms of its tenure policy (there would be limited circumstances in which maximum tenure limits exceeding 12 years would be appropriate).**

Members Health objects in the strongest terms to the imposition of Director term limits. Specifically, the requirement that "there would be limited circumstances in which maximum tenure limits exceeding 12 years would be appropriate".

Members Health funds, like all insurers, are subject to very significant and active oversight and regulation. Under these active supervisions, Members Health funds have a strong history of high quality administration which has not resulted in adverse outcomes necessitating a heavy handed regulatory approach to Board makeup.

We believe that fundamentally rewriting the manner in which funds can select and maintain a Board of proven experience and capability flies in the face of the 'light touch' philosophy espoused by APRA in this space.

We have significant concern that any move towards term limits fails to recognise the unique role of many Members Health funds, many of which serve regional and rural communities, such as: Launceston, Burnie, Townsville , Lithgow, Wollongong, Newcastle and the Latrobe Valley. They also serve key industry groups, such as: The Defence Forces, Police, Doctors, Teachers, Emergency Services and Nurses. Introducing term limits fails to fully appreciate and recognise the important connection that Boards bridge between the health fund and their communities of interest and the often limited pool of highly qualified Directors, therein, to choose from.

Many of these communities have unique challenges with respect to health services, and funds serving these communities greatly benefit from experienced Board members with a long history in the relevent community. The dilution of the community focus of these health funds

through the forced removal of dedicated Board members with proven experience will be detrimental to these funds in the longer term.

We are also concerned that the application of Director term limits will act as a distracting influence on Boards which are tasked with key strategic decision making in the long term interests of their fund and its membership.

Members Health also has significant concern that mandated Board tenure will result in a significant loss of corporate knowledge across the private health system. This knowledge is a key source of sector input into Discussion Papers and submissions to important policy directions from the Government and APRA.

With respect to the technical aspect of the proposal we note that under Section 92(6) of the Private Health Insurance (Prudential Supervision) Act 2015 (Cth), all prudential standards applicable to private health insurers are legislative instruments.

It is our understanding that as a legislative instrument the proposed CPS 510, as amended, is governed by the requirements of the Legislative Instruments Act 2003 (Cth), meaning that it must be laid before the Parliament and is subject to a possible motion of disallowance within 15 sitting days after it has been tabled in the House of Representatives. Given the significance of the proposed intervention on the Board machinations of private health funds we do not believe that the utilization of a prudential practice guide (in this case HPG 510), which is not a legislative instrument, is appropriate in this instance.

If the imposition of a maximum period of tenure for Directors of private health insurers is of such importance, it should have been included within the terms of the proposed prudential standard and not within a document that is not subject to Parliamentary scrutiny. That is especially so because the same restriction is not being imposed on any other APRA-regulated institutions.

Additionally, CPS 510 applies to all APRA-regulated institutions and within its terms the only reference to tenure now (and when amended) is (and will be) to Director independence in Attachment A to CPS 510 and then by reference to the ASX Corporate Governance Principles and Recommendations (2nd edition 2007) in footnote 26 of Attachment A. It cross refers to box 2.1 in the ASX Principles and the factors to consider when assessing Director independence.

Not only is that reference to footnote 26 in the current and the proposed CPS 510 out of date the ASX Corporate Governance Council removed the previous provisions dealing with possible maximum tenure (9 years). The 2014, 3rd edition of the ASX Principles box 2.1 has become box 2.3 and it states that the person has been a Director of the entity 'for such a period that his or her independence may have been compromised'. There is no suggestion of any specified period of tenure when independence may be in doubt. This is a far more reasonable approach.

According to the papers issued by the ASX about the review of the Principles there were many comments and complaints made about arbitrary tenure figures. The ASX Corporate Governance Council stated they recognised:

> *"that the interest of the listed entity and its security holders are likely to be well served by having a mix of directors, some with a longer tenure with a deep understanding of the entity and its business and some with a shorter tenure with fresh ideas and perspective. It also recognises that the chair of the board will frequently fall into the former category rather than the latter."*

Of particular importance is this statement from the Council:

> *"The mere fact that a director has served on a board for a substantial period does not mean that he or she has become too close to management to be considered independent. However the board should regularly assess whether that might be the case for any director who has served in that position for more than 10 years."*

For APRA to now issue a proposed guidance stating (paragraph 37) that "APRA expects that the circumstances where a person is re-appointed as a Director at the end of the private health insurer's maximum tenure period would be exceptional":

(a) is tantamount to a prudential mandate of maximum terms and it would be a brave regulated body (or Director) that acted contrary to it;
(b) perpetuates the misleading and out of date reference in the statutory instrument;
(c) appears to give APRA powers not contemplated by Parliament;
(d) does not rate a mention in the Discussion Paper.

Given all of these factors, and the fact that Members Health does support the need for Board Renewal policies as the key driver for Board appointments, reviews and terminations we again object in the strongest terms to any move that would jepordise the ability of our funds to continue to engage quality Directors on their own terms.

- **'Board committees' – Establishment and operation of a Board Risk Committee and Board Remuneration Committee**

Members Health does not object to the requirement that the Boards be required to establish and operate a Risk Committee and a Remuneration Committee, each with a charter of roles and responsibilities, and each comprising not less than three members with all members being independent non-executive directors. We note that such Board Committees are already a common feature of our member funds.

Members Health does not broadly object to the requirement that a health fund's Risk Committee and Remuneration Committee be comprised of independent non-executive Directors. As was noted earlier, additional clarification from APRA as to what would constitute an 'independent Director' would be welcomed by Members Health.

- **'Senior Management' – Extend APRA's expectations of good governance to senior managers and, implications for robustness of appointment and review process**

Members Health does not object to the extensions of APRA's expectations of good governance as mandated by the final updated version of CPS 510 to senior managers within a health fund.

- **'Remuneration' – Require a formal policy linked to the risk management framework.**

Members Health does not object to the requirement that health funds develop a formal Remuneration Policy linked to the risk management framework as described in the Draft Prudential Standards.

- **'Internal audit' – Expands the internal audit function beyond quarterly reports and includes independent review of risks, controls and processes.**

Members Health does not object to the requirement that internal audit functions be expanded to incorporate additional reporting requirement. However, we note the practical impacts of this standard with respect to cost and resourcing and believe that APRA should seek to be flexible and broadly supportive of any fund seeking an extensions in the implementation timeframe or seeking either exemptions, or special consideration with respect to the new obligations.

- **'Communications with APRA' – Contracts/policies may not constrain employees from raising issues with, or providing information to APRA.**

Members Health does not object to the requirement that the employee contracts or internal policies of health funds prohibit constraints on employees from raising issues with, or providing information to APRA.

Item 2: Extend the cross industry *Prudential Standard CPS 520 Fit and Proper* (CPS 520) to private health insurers.

Areas of change and key requirements

- **Every insurer to establish a written fit and proper policy to manage responsible person risk.**

Members Health does not object to the requirement that a health fund develop a fit and propert policy to manage the appointment, oversight and expectations of responsible persons.

- **Responsible persons include those individuals which have the potential to materially affect the financial soundness and stability of an institution such as Directors, Chief Executive Officer, Senior Managers, Appointed Actuary, Appointed Auditors etc.**

Members Health does not object to the definition of 'responsible persons' nominated by APRA. Members Health acknowledges the fact that "A private health insurer may seek guidance from APRA if it is unsure whether a particular person meets the definition of a responsible person".

- **'Assessment processes' – Apply the criteria contained in CPS 520 to every responsible person with additional criteria for Appointed Actuaries and Auditors.**

Members Health does not object to the application of criteria contained in CPS 520 to every responsible person, namely, criteria requiring that a person:

- possesses the necessary skills, knowledge, expertise, diligence and soundness of judgement to undertake and fulfil the particular duties and responsibilities of the role in question; and
- has demonstrated the appropriate competence and integrity in fulfilling occupational, managerial or professional responsibilities previously and/or in the conduct of his or her current duties; and
- has no history of untoward professional behaviour.

However, we do have some concern about the application of some standards, specifically, we note that Clause 99 of CPS 510 requires:

> *An individual who plays a significant role21 in the audit of an APRA-regulated institution in relation to the Prudential Acts, prudential standards or reporting standards, for five successive years, or for more than five years out of seven successive years, cannot continue to play a significant role in the audit until at least a further two years have passed, except with an exemption from APRA.*

Clause 32B of CPS 520 requires an auditor to have a minimum of five years' relevant experience in the audit of APRA regulated institutions in the industry within which they are working to be classified fit and proper.

35D of this standard also requires that an Appointed Actuary has a minimum of five years' *relevant experience in the provision of actuarial services to entities carrying on private health insurance that is sufficiently relevant and recent to provide reasonable assurance that the person is familiar with current issues in the provision of actuarial services to such institutions.*

The combination of these requirements is likely to be of some consequence to funds which are located in rural and regional communities. Such funds may have limited options for changing key individuals at regular intervals or identifying individuals with 5 years specific experience within the private health insurance industry.

While it is acknowledged that exemptions can be obtained by APRA we do not believe that these funds should be required to undergo formal exemption processes for identifying otherise qualified individuals for engagement, or for maintaining the services of individuals with proven capabilities in order to meet this requirement.

- **'Whistleblowing protections' – Ensure that Fit and Proper Policy does not restrict or discourage persons from disclosing information.**

Members Health does not object to the clear incorporation of whistleblowing protection within an organisation's Fit and Proper Policy.

Item 3: 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.

Areas of change and key requirements

- **'Appointment' – Each insurers is required to appoint an auditor and ensure that they are able to fulful the role.**

Members Health does not object to the formalisation of the requirement that health funds appoint a suitably qualified and experienced auditor and we note that this is already required under the requirements of the *Corporations Act 2001*.

- **'Independence and skills' – Reinforces the eligibility requirements in the governance standard, the fit and proper standard and the Corporations Act.**

Members Health does not object to the requirement that a private health insurer must ensure that an Appointed Auditor:

  - is a fit and proper person in accordance with the private health insurer's fit and proper policy as required by Prudential Standard CPS 520 Fit and Proper, including those requirements that apply specifically to the Appointed Auditor; and
  - satisfies the Auditor independence requirements in Prudential Standard CPS 510 Governance; and
  - satisfies the eligibility and independence criteria in the Corporations Act 2001.

- **'Terms of engagement' – Insurers are required to include various prudential obligations on the auditor in a binding contract.**

Members Health does not object to the requirement that a private health insurer be required to ensure that the terms of engagement of an Appointed Auditor are set out in a legally binding contract obliging the said Appointed Auditor to fulfil those roles and responsibilities specified in the Prudential Standard, in the manner specified in this Prudential Standard.

Nor does Members Health object to the requirement that the legally binding contract requires the Appointed Auditor, in meeting its role and responsibilities to comply with the relevant

Standards and Guidance issued from time to time by the AUASB (AUASB standards and guidance) to the extent they are not inconsistent with this Prudential Standard.

- **'Special purpose engagement' – APRA may require an insurer to engage an approved auditor to prepare a report on a particular aspect of the insurer's operations.**

Members Health does not object to the allowace of 'special purpose engagement' arrangement but warns that caution is warranted.

The standard allows APRA to direct a fund to engage its Appointed Auditor to undertake a special purpose engagement and to prepare a report, to the satisfaction of APRA.

The fact that any direction must be provided to a fund in writing is acknowledged, however given the potential for a substantial cost impact to health funds we believe that it is imperative that an appeals process be established for funds to challenge such a request.

A genuine internal appeals process, or another low cost option should be considered as an alternative to expensive external (legal) options.

- **'Review of systems, processes and internal controls' – Audit function beyond financial reporting to be expanded to include an annual independent review of risks, controls and processes for the entity's Board and APRA.**

Members Health has some concern that funds may be required to engage the Appointed Auditor to prepare an annual report.

The requirement that the detailed review be undertaken on an annual basis is onerous. We strongly believe that a tri-annual review is more appropriate given the relative stability of health fund systems as well as the significant cost that would be associated with an annual 'root and branch' review of all internal systems, processes and internal controls.

Members Health believes that a tri-annual review of the nature proposed would ensure that funds, their Boards and APRA could be satisfied that no significant systematic failures were in effect. If additional assurances were required we would not object to consideration being given to a formal assurance regime in the intervening years whereby an appointed actuary provided sign off to an internal audit.

Item 4: Revoke *Prudential Standard HPS 350 Disclosure to APRA* (HPS 350).

Members Health strongly supports the proposal to revoke *Prudential Standard HPS 350 Disclosure to APRA* (HPS 350).

With the introduction of CPS 220, HPS 350 is considered to be obsolete and an unnecessary compliance cost for health funds.

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Item 5: Update *Prudential Standard HPS 001 Definitions* (HPS 001) to include terminology referenced in CPS 510, CPS 520 and HPS 310.

Members Health does not object to the proposal to update *Prudential Standard HPS 001 Definitions* (HPS 001) to include terminology referenced in CPS 510, CPS 520 and HPS 310. This proposal is recognised as a consequential administrative change based on the substantive reforms outlined in the Discussion Paper.

However, we take the opportunity to reiterate those substantive observations and comments raised by Members Health earlier in this submission.