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Better Cover. Better Access. Better Care.

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SUBMISSION: GOVERNANCE, FIT AND PROPER, AUDIT AND DISCLOSURE REQUIREMENTS

Private Healthcare Australia (PHA) appreciates the opportunity to provide feedback in response to APRA's proposal 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.

PHA accepts in principle that the above proposals are appropriate for the PHI industry and understands APRA's preference for a consistent approach to prudential standards across the various industries it regulates. This is partly a result of APRA's extensive consultation and engagement with the industry since beginning the process of assuming regulatory power from PHIAC in 2014, and also because many insurers are already managing their risk in ways that comply with the proposed new requirements.

When considering harmonising regulation, PHA urges APRA to keep in mind that the PHI industry is relatively heterogeneous in comparison to other financial services sectors. The differences between individual insurers in terms of number of customers, complexity and profitability are likely to be greater than in other APRA-regulated industries, particularly general insurance and banking. The risk inventory for a private health insurer is materially different to a bank (i.e., there is different credit

risk, conduct risk and global payments risk) or to a general insurer (due to the requirements of community rating and risk equalisation).

The significant discrepancies in the risk profile, size and scope, and operational complexity between PHIs should be recognised by APRA by allowing insurers to apply for alternative arrangements to those established in the prudential framework where it can be demonstrated the aim of the requirement can be achieved.

PHA has two specific comments in relation to the Discussion Paper and Draft Standards:

1. <u>Board performance, assessment and renewal</u>

In addition to the draft Prudential Standard CPS 510, APRA has issued a draft Prudential Practice Guide HPG 510. 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.

As a legislative instrument, it is our understanding that the proposed CPS 510 is governed by the requirements of the *Legislative Instruments Act 2003 (Cth)*, meaning that is it must be laid before the Parliament and be subject to a possible motion of disallowance within 15 sitting days after it has been tabled in the House of Representatives. On the other hand, a Prudential Practice Guide (in this case HPG 510) is not a legislative instrument and therefore not subject to Parliamentary scrutiny.

PHA supports the establishment of consistent processes for assessing, appointing, re-appointing and removing directors and the requirement that these be documented. We are concerned, however, with HPG 510 which states that APRA would consider "there would be limited circumstances in which maximum tenure limits exceeding 12 years would be appropriate" (paragraph 35) and "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" (paragraph 37). In our view this proposed guidance:

- Effectively amounts to a prudential mandate of a maximum term of 12 years for Board directors of private health insurers.
- Appears to give APRA powers not contemplated by Parliament and could be construed as being constructed to avoid Parliamentary scrutiny; and
- Is not mentioned in the Discussion Paper, which merely emphasises the issue of independence rather than renewal.

Health insurers operate in a highly complex regulatory and competitive environment. The PHI industry includes a number of insurers which are: restricted-access insurers representing a particular demographic sub-set of the community such as teachers, defence personnel, medical doctors, or employees of particular organisations; or regionally-based insurers with membership predominantly derived from the local area.

The practice of appointing Board directors with particular attributes or experience is common in membership organisations. When appropriate Board performance assessment systems are in place (as established elsewhere within CPS 510) there are likely to be benefits to insurers and their members from retaining long serving, highly competent Board Directors with extensive industry experience and knowledge.

We are not aware of any intention by APRA to impose a maximum period of tenure for Board directors on other APRA-regulated industries. In our view this matter is of such importance that it should have been included within the terms the proposed CPS 510 and not within a guidance document exempt from Parliamentary scrutiny.

CPS 510 applies to all APRA-regulated institutions and refers to tenure in relation to Director independence only once, in Attachment A, 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.

This reference is out of date. The ASX Corporate Governance Council has 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 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 specific period of tenure after which independence may be in doubt.

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."*

It is our view, the approach of the ASX is sensible. It does not prevent any entity from adopting maximum tenure if they so wish. We also note that the Federal Parliament abolished the compulsory retirement age for company directors nearly 20 years ago.

There are extensive requirements within the draft CPS 510 relating to director performance assessment, nomination processes and independence and the requirements of CPS 520 relating to fit and proper. We therefore submit that there is therefore no reason to introduce maximum term limits for Board directors, either through the Standard or via guidance material.

2. Standards for Appointed Auditors

The requirement in the draft Standard HPS 310 for an Appointed Auditor to have five years specific PHI experience (section 4.2 of the Discussion Paper) appears to be at odds with the general move towards the harmonisation of standards across APRA-regulated industries. It would be unreasonable, for example, that an auditor with 20 years' experience in APRA-regulated industries, but only four years in PHI, that person would be ineligible to be the Appointed Auditor of a private health insurer. Consultation with PHA members indicates this type of scenario is more likely to affect insurers based in regional areas.

Two possible alternatives considered by PHA include:

- Amend the requirement so that an Appointed Auditor must have at least five years' experience in APRA-regulated industries, or five years' experience in APRA-regulated industries including at least two years in private health insurance.

- Provide a framework for consideration of alternative arrangements in cases where an insurer wishes to appoint a person as the Appointed Auditor who does not meet the experience requirements of the Standard.

Please contact me if further information is required.

Yours sincerely

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