



4 August 2016

To: All private health insurers and other interested parties

Private health insurance (PHI): prudential policy outlook

In May/June 2016, APRA commenced consultation with the industry and other stakeholders on APRA's medium term PHI policy agenda. This letter confirms the key points discussed in those meetings and sets out APRA's initial priorities. It also sets out the policy development process to be followed, including opportunities for insurers and other interested parties to contribute their views.

The matters discussed in this letter represent APRA's current intentions in relation to PHI prudential policy. Changes in the external environment or material prudential concerns, should they arise, may mean that those intentions get reviewed. In addition, if operational amendments to rules or standards become necessary to ensure that the prudential framework operates as intended and adapts to changing circumstances, APRA will consult as appropriate.¹

Background

From 1 July 2015, APRA assumed responsibility for the prudential supervision of the PHI industry. As part of that process, APRA undertook not to make any substantive regulatory changes during its first year of supervision. APRA's priority was to maintain continuity of the prudential framework while integration progressed.

As APRA enters its second year of supervising the industry, it has commenced consultation on future policy development priorities and intends to systematically review the PHI prudential framework over the medium term.

APRA's observations of the industry so far do not indicate any significant prudential concerns or an urgent need to modify the PHI prudential framework. Accordingly, APRA will review the current arrangements at a measured pace with the aim of maintaining quality and effectiveness, implementing appropriate changes over time to strengthen the prudential framework and ensure its ongoing relevance.

Principles underpinning APRA's review

APRA's mandate is set out in the *Australian Prudential Regulation Authority Act 1998*, which states that we are to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality and, in balancing these objectives, to promote financial system stability in Australia. APRA fulfils this mandate through establishing and enforcing prudential standards and practices designed to ensure that, under all reasonable

¹ For example, will shortly write to industry proposing to streamline the process for an insurer to vary its restricted access group.

circumstances, financial promises made by institutions to customers are met within a stable, efficient and competitive financial system.

APRA's key objective in reviewing the PHI prudential framework is to ensure that it remains fit for purpose in supporting the achievement of APRA's mandate. In particular, that it supports appropriately high standards of risk management, governance and capital adequacy in the industry.

In undertaking the review, APRA intends to use as a starting point the prudential framework it applies in other industries. The prudential framework for other APRA regulated industries reflects APRA's expectations of sound prudential practice. These expectations have been informed by experience in supervising entities in multiple industries over a number of years, observations of better practice and domestic and international developments.

APRA will carefully consider whether, in each particular case, a cross industry requirement is appropriate for the PHI industry. Where differences exist that warrant different requirements for the PHI industry, APRA will consider appropriate PHI specific requirements to ensure the framework remains fit for purpose for the PHI industry. Submissions to consultation will assist APRA in its consideration.

Harmonisation with the requirements applying in other industries is not APRA's main goal, but it has benefits, such as treating like risks in a like manner, creating a common language and simplifying compliance, particularly for entities that operate across APRA regulated industries. Harmonisation also provides a level of comfort to policyholders that their interests are protected across all industries regulated by APRA.

APRA's policy development process

Before introducing any changed or new requirements, APRA will follow its normal policy development process. This will include:

- one or more discussion papers, accompanied where appropriate by draft standards and prudential practice guides (PPGs) outlining APRA's proposals and how insurers can meet their obligations;
- up to 12 week consultation periods depending on the complexity and materiality of the proposals - for material proposals, the full 12 weeks will be provided; and
- release of a paper setting out APRA's response to submissions and any changes to the proposed approach, accompanied by final prudential standards and PPGs.

APRA will ensure that appropriate transition arrangements are put in place, to facilitate implementation of new or revised requirements. This will include:

- sufficient time between release of final requirements and their implementation; and
- consideration on a case-by-case basis of whether additional entity-specific transition arrangements are necessary.

APRA will undertake analysis of the costs and benefits of all proposals, and will publish a regulation impact statement where required in line with Government requirements.

The three phases of the review

Broadly the program for the review of the prudential framework will be conducted in three phases: risk management, governance and capital. Each phase is outlined in more detail in Attachment A.

Summary

Publishing the prudential policy outlook for the next three years provides transparency and identifies opportunities for the industry to participate in consultations with APRA. APRA's objective is to ensure that the prudential framework remains fit for purpose. APRA will carefully consider the specific circumstances of the PHI industry so that they are appropriately reflected in the PHI prudential framework.

APRA welcomes the opportunity to discuss any of the matters in this letter. Please feel free to contact Peter Kohlhagen (02 9210 3363, peter.kohlhagen@apra.gov.au) or your responsible supervisor if you want to discuss any of the issues raised above further.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Geoff Summerhayes'. The signature is stylized with a large 'G' and 'S'.

Geoff Summerhayes

Member

Attachment A - the three phases of the review

Phase 1: Risk management

Risk Management

Consultation on the development of a PHI risk management prudential standard will commence in the second half of 2016 with the release of a discussion paper setting out APRA's proposed requirements for risk management in the PHI industry. The paper will be accompanied by a draft prudential standard and prudential practice guide. The paper will draw heavily on the research undertaken by PHIAC between 2013 and 2015 in assessing the risk management practices of individual insurers and industry submissions to PHIAC on risk management. It will also be informed by the findings of the risk management thematic review currently underway and the requirements of *Prudential Standard CPS 220 Risk Management* (CPS 220).

APRA has not yet determined whether CPS 220 will be applied to PHIs or a separate PHI-specific standard developed. The current in-depth thematic review program will aid APRA in addressing this question. While APRA anticipates that the core principles of CPS 220 will be appropriate for the PHI industry, where a requirement of CPS 220 is found to not be relevant, APRA will consider a modified requirement.

For example, when implementing CPS 220 for other industries, APRA considered on a case-by-case basis entity-specific alternative arrangements in cases where particular requirements were impracticable for certain insurers. Most significantly, APRA agreed alternative arrangements for a number of smaller and less complex insurers for whom the requirement to have a designated chief risk officer was not practical. APRA anticipates adopting a similar approach in the PHI industry.

In preparation for this consultation, insurers may find it helpful to familiarise themselves with CPS 220 and the related prudential practice guide *CPG 220 Risk Management*. These are available on the APRA website: www.apra.gov.au.

Outsourcing / Business Continuity Management and related matters

Outsourcing, business continuity management and related areas are key areas of material risk within an insurer's approach to risk management. APRA will be separately reviewing its expectations of these matters for other regulated industries during the coming year. As part of that review process, APRA will consider the PHI industry and apply common expectations to private health insurers and other regulated industries, unless sound reasons are identified for different treatment.

Insurers will have the opportunity to make submissions on these prudential standards in due course through APRA's consultation process.

The role of the appointed actuary

APRA is currently undertaking a holistic review of its expectations of the role of the appointed actuary and actuarial advice in the life and general insurance industries to ensure the existing prudential standards *GPS 320 Actuarial and Related Matters* (GPS 320) and *LPS 320 Actuarial and Related Matters* (LPS 320) remain fit for purpose. This review is being undertaken with the aim of improving prudential outcomes and streamlining requirements without compromising prudential outcomes.

As it is likely that many of the principles to be considered in this broader review may be relevant to the PHI industry, PHI insurers and their actuaries may find it useful to follow and to contribute to the broader review. The discussion paper is available on the APRA website at <http://apra.gov.au/CrossIndustry/Pages/Review-of-the-Appointed-Actuary-June-2016.aspx>.

Later in the year, APRA will write separately to the PHI industry about the key outcomes of the LPS 320 and GPS 320 reviews and how relevant principles from the broader review will be applied in the PHI industry.

Phase 2: Governance

When APRA's consultations on risk management are well advanced, APRA intends to commence the consultation process on four aspects of governance in the PHI industry.

Governance

Given industry and international developments since the introduction of *Prudential Standard HPS 510 Governance* (HPS 510) in 2009, APRA plans to review this standard in 2017/18. Through consultation, APRA will form a view as to whether the additional provisions of *Prudential Standard CPS 510 Governance* should apply to the PHI industry. This will include consideration of such issues as the independence of directors, tenure, assessment and appointment processes and board engagement with APRA.

Audit and related matters

APRA also proposes to consult on establishing a separate standard regarding the prudential functions of the auditor, or expanding the auditor requirements of HPS 510. Separate audit standards exist for all other industries regulated by APRA and provide for independent assurance of prudential matters by an appropriately qualified auditor. *LPS 310 Audit and Related Matters* and *GPS 310 Audit and Related Matters* articulate APRA's approach in other industries.

Fit and Proper

APRA also proposes to consult on establishing a PHI fit and proper prudential standard for directors, senior managers, auditors and appointed actuaries aligned with *Prudential Standard CPS 520 Fit and Proper* (CPS 520). Such a standard would have the objective of ensuring that insurers undertake sufficient inquiry to determine that these key persons have the appropriate skills, experience and knowledge, and act with honesty and integrity in performing their roles.

In undertaking this review, APRA will consider the disqualification provisions contained in the *Private Health Insurance (Prudential Supervision) Act 2015* and APRA Rules to determine whether CPS 520, or a separate PHI prudential standard on fit and proper is more appropriate.

Disclosure

During 2014/15, as part of the initial remake of the PHI standards prior to transition, some insurers provided commentary to APRA on the ongoing effectiveness of the PHI disclosure standard (now *HPS 350 Disclosure*). It is anticipated that parts of this standard may be made redundant as APRA conducts the risk management and governance reviews outlined above. Accordingly, following conclusion of those reviews, APRA will consult on the merits of retaining any elements of this standard in a stand-alone document, or revoking it.²

² HPS 350 relates to disclosure to APRA. Separately, APRA is considering matters relating to public disclosure for prudential purposes in the life insurance and general insurance industries. APRA will consider in due course whether this work should be applied to PHI.

Phase 3: Capital

APRA does not propose to review *Prudential Standards HPS 100 Solvency* or *HPS 110 Capital Adequacy* in the short term unless a prudential issue or other change arises which warrants an earlier review. At the earliest, it is envisaged a review of these standards may occur in 2018/2019, by which time both the industry and APRA will have had a more substantial period of experience with the current requirements.