



Australian Government

Private Health Insurance Administration Council

Discussion Paper

**Disclosure Standard
for Private Health Insurers
September 2010**

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Foreword

Following an initial round of industry consultation on the proposed disclosure framework, the Private Health Insurance Administration Council (**PHIAC**) is now seeking comments on the attached draft disclosure standard (**the Standard**) from industry stakeholders by **Friday 8 October 2010**.

The first consultation period ended on 16 July 2010 and PHIAC received 16 submissions, twelve from insurers, two from industry bodies and two from other interested parties. The Standard builds on the feedback and input PHIAC received from the industry. In the main, submissions were supportive of the proposed Standard and noted PHIAC's primary role in ensuring the prudential safety of the industry. The proposed routine disclosure requirements were broadly accepted, while some responses had specific comments and suggestions regarding the scope and application of the unusual events notification. Others noted that there will be limited compliance costs with implementing the Standard.

On the basis of the first consultation round, the findings of the Council's ongoing program of fund reviews and regulatory interventions, PHIAC has amended the framework in a number of areas, and drafted the Standard accordingly.

A second round of industry consultation is appropriate and PHIAC again invites industry comment on the proposed Standard. This discussion paper and the attached draft Standard provide the industry with revised documents for review and comment.

When made, the Standard will appear as a schedule to the *Private Health Insurance (Insurer Obligations) Rules 2009* (**the Rules**). Insurers will be required to disclose certain information which accords with the expectations of PHIAC and the requirements set out in the *Private Health Insurance Act 2007* (**the PHI Act**). The Standard, to be located at Schedule 3 of the Rules, will set out the minimum requirements that all registered private health insurers will need to comply with once the Standard is endorsed.

The Australian Government, in an effort to improve the efficiency of regulation, requires new policy proposals to undertake a preliminary assessment to establish the extent of compliance costs on industry. As part of the consultation process, PHIAC again requests that respondents indicate the impact, specifically compliance costs, the proposed Standard is likely to have on their operations.

PHIAC invites written submission on the content and regulatory impact of the Standard. Submissions should be addressed to:

The Manager – Prudential Standards
Private Health Insurance Administration Council
PO Box 4549
KINGSTON ACT 2604

Or by email: phiac@phiac.gov.au marked 'Disclosure Standard'. Written submissions must be received by close of business, **Friday 8 October 2010**.

Submissions may be the subject of a request for access made under the *Freedom of Information Act 1982* (**FOI Act**). Submissions will be treated as public unless clearly marked as confidential and the confidential information contained in the submission is identified.

PHIAC will deal with any FOI Act requests in accordance with the provisions of the FOI Act and the PHI Act.

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Key abbreviations used in this paper

ACCC	Australian Competition and Consumer Commission
ASIC	Australian Securities and Investments Commission
APRA	Australian Prudential Regulation Authority
Board	the board of directors of a private health insurer
Corps Act	<i>Corporations Act 2001</i>
FOI Act	<i>Freedom of Information Act 1982</i>
insurer	a private health insurer registered under the <i>Private Health Insurance Act 2007</i>
PHIAC	Private Health Insurance Administration Council
PHI Act	<i>Private Health Insurance Act 2007</i>
the Rules	<i>Private Health Insurance (Insurer Obligations) Rules 2009</i>
the Standard	PHIAC's proposed disclosure standard which, when made, will appear as Schedule 1 to the <i>Private Health Insurance (Insurer Obligations) Rules 2009</i>
TPA	<i>Trade Practices Act 1974</i>

1. About PHIAC

PHIAC is an independent Statutory Authority primarily responsible for ensuring that insurers in Australia are well-run and prudentially sound. PHIAC was established in 1989 as a body corporate under section 82B of the *National Health Act 1953* and continues in existence by force of section 264-1 of the *Private Health Insurance Act 2007* (**the PHI Act**).

PHIAC's functions are set out in section 264-10 of the PHI Act (see **Attachment A**). These include monitoring and regulating the private health insurance industry and providing information to Government and other stakeholders on private health insurance membership and utilisation, risk equalisation and gap cover. The performance of its functions requires the collection of financial and statistical returns from each registered private health insurer on a monthly, quarterly and an annual basis.

For further information regarding PHIAC's functions and publications refer to www.phiac.gov.au

2. Structure of this paper

This paper is structured to outline and respond to the common concerns raised in the first round of consultation with the private health insurance industry and reaffirms PHIAC's goals in relation to disclosure:

- the **Objectives** section outlines PHIAC's key intentions and targets in relation to the disclosure of certain information by private health insurers
- the **Requirements** section discusses the workings of, and the changes made to, the Standard in response to recent industry consultation and internal PHIAC consideration.

3. Objectives

Key objectives of the disclosure standard

PHIAC is proposing to introduce the Standard to ensure it is better placed to discharge of its legislative responsibilities. Under the PHI Act, PHIAC must take all reasonable steps to achieve an appropriate balance between the following objectives:

- fostering an efficient and competitive health insurance industry
- protecting the interests of consumers
- ensuring the prudential safety of individual private health insurers.¹

By making a disclosure standard that requires insurers to provide certain information, PHIAC will be informed in a timely and appropriate manner when issues of potential prudential risk arise. In receiving the additional information identified in the Standard, PHIAC will be better able to identify issues of potential prudential concern and respond more quickly to such issues and any changes in the industry.

Broadly, PHIAC's objectives are to:

- promote a culture of transparency and disclosure with insurers which will support greater integrity in decision making
- ensure that PHIAC is better informed about unusual events in an insurer and interactions with other regulators, members and key stakeholders

¹ *Private Health Insurance Act 2007*, section 264-5

- increase the protection provided to consumers and the beneficiaries of private health insurance policies through better and more timely prudential supervision of private health insurance
- ensure PHIAC is able to intervene in a timely manner on a preventative basis and reduce the risk of an insurer failing.

Problem identification

With the introduction of the PHI Act, PHIAC was given a range of information collection functions, namely sections 172-1, 264-10(2) and 264-20 of the PHI Act, which PHIAC exercises on an “as needs” basis, usually during fund reviews. Insurers are also required, under the PHI Act, to provide PHIAC with periodic financial reports to demonstrate that they are compliant with PHIAC’s capital adequacy and solvency standards. PHIAC also receives regular statistical updates relating to membership and benefits. Using this information, the fund review process and other documents voluntarily provided by insurers, PHIAC is generally able to assess the prudential risks of insurers, particularly relating to financial risk.

However, industry failures² and corporate collapses both within Australia and abroad have strengthened the case for:

- increased transparency and accountability
- increased provision of non-financial information to assist in identifying possible governance issues
- improved capacity of regulators to protect the interests of consumers.

More recent experiences have also shown that the information received by PHIAC relating to unusual governance events or potential prudential risk is not always timely or adequate.

Policy development

In forming the proposed disclosure requirements, PHIAC has been influenced by the following events and concepts:

PHIAC’s supervisory experience

In recent years, a number of governance issues have taken place within insurers and in some instances PHIAC was only made aware of the issues through third party dialogue. Ultimately the issues were resolved by the insurers, with some regulatory oversight.

Enactment of the PHI Act

The PHI Act was enacted in 2007. As noted above, the legislation contains provisions which encourage proactive supervision such as PHIAC’s directions powers. Timely and appropriate information is required to support PHIAC’s legislated preventative powers.

The Standard operates, in part, cognisant of the preventative role of PHIAC. The PHI Act, in Division 163 also specifically empowers PHIAC to make prudential standards addressing “the conduct by private health insurers of any of their affairs with integrity, prudence and professional skill”. This is the power that PHIAC proposes to employ when making this Standard.

Other regulators’ requirements

Throughout the consultation and development process, PHIAC will ensure that the Standard is developed to be no more onerous than the disclosure requirements of other regulators, most notably APRA, ASIC and the ACCC.

² Between 2001 and 2004 PHIAC was required to intervene on four separate occasions by appointing administrators to conduct the affairs of insurers which had run into difficulties. More information about these interventions is available on the PHIAC website at www.phiac.gov.au/media-releases

The benefits of transparency and integrity

Effective corporations strive to keep their processes as transparent as circumstances permit. This does not mean that a corporation's affairs should be conducted as an "open book". Rather, the commitment should be to avoid unnecessary secrecy and instead to consider whether information can properly be shared with customers, staff and relevant regulators.

4. Requirements

Draft Standard

PHIAC recognises that consultation is a vital part of the development of effective prudential standards. Based on industry comments and the broad endorsement by the Australian Securities and Investments Commission (**ASIC**) of PHIAC's proposed approach to routine disclosure, the proposed requirements have not altered from the framework outlined in the first consultation paper.

However, the notification requirements relating to unusual events received the most consideration and comment by the industry, and on review this is where PHAIC has proposed the majority of the changes to the Standard.

PHIAC engaged the Office of Legislative Drafting and Publishing (**OLDP**) of the Attorney General's Department to draft the Standard as an additional schedule to the *Private Health Insurance (Insurer Obligations) Rules 2009*. The OLDP have produced a consultation draft, attached to this paper, based on PHIAC's disclosure framework and the industry submissions.

Summary of changes

For ease of reference, the titles used in the attached Standard have been used.

1 Insurers must give copies of certain forms lodged with ASIC to Council

Two additional ASIC forms have been added to the required list as a result of a review of PHIAC information requirements, bringing the total number of ASIC forms to five. The additional requirements will not substantially increase the compliance burden on the industry. The two additional forms are:

- **ASIC Form 315 - Resignation, removal or cessation of an auditor**, will provide PHIAC with timely notification of a change in an insurers' auditor.
- **ASIC Form 388 – Copy of financial statements or reports**, is used by companies to submit annual reports to ASIC. PHIAC acknowledges that many insurers already provide annual reports as a matter of courtesy, but this requirement will standardise their provision across the industry.

2 Insurers to give copies of notice of meetings of members to Council

This provision drew very little commentary and has not been changed from the initial disclosure framework.

3 Insurers to notify Council of resolution to remove director

While this requirement remains as it did in the first consultation round and drew some industry comments as to its application, PHIAC decided to retain the requirement. PHIAC's interest in being notified is twofold. Firstly, being made aware of such resolutions will allow PHIAC to consider whether the composition of an insurer's board will still meet the requirements set out in the Governance Standard.³ Secondly, instability at board level can be a key indicator of prudential risk. Early notification of such issues will allow PHIAC to better consider its position as to whether to seek additional information from the insurer.

³ The Governance Standard is at Schedule 1 of the *Private Health Insurance (Insurer Obligations) Rules 2009*

This notification requirement will not apply to resignations or the end of terms for directors, as PHIAC should be notified under the requirements of the Governance Standard⁴ when there is a routine change in board composition.

4 Insurers to notify Council of termination of a person's complying private health insurance policy

This requirement also drew some comments from the industry, but remains as it did in the first consultation round because PHIAC has a legislated role⁵ in protecting the interests of consumers (including seeking an injunction under section 84-10 of the Act), and obtaining a better understanding of the numbers and reasons for policy terminations. Notification of termination of a person's complying private health insurance policy will assist PHIAC in satisfying this requirement.

Recent experience has shown that, depending on the context, some policy terminations may be sufficiently important for PHIAC, the Minister for Health and Ageing and/or the Private Health Insurance Ombudsman to be informed of such action.

PHIAC is not looking for information that is legally privileged, or for the release of information that may be personal or would prejudice an ongoing investigation. PHIAC acknowledges that there often will be valid reasons for terminating a person's policy, and will welcome what information can be provided on the reasons behind such terminations.

PHIAC also notes that some insurers, due to the number of persons they insure, may have to report to PHIAC more often. While this may be the case, PHIAC considers that the larger insurers have greater capacity to comply with this provision.

5 Insurers to notify Council of complaint or investigation of insurer or officer of insurer

Comments on the proposed requirement for insurers to notify PHIAC regarding investigations or complaints centred around how broadly the provision could be interpreted, privacy issues and concerns as to whether an insurer could be held accountable if an officer did not disclose an investigation.

PHIAC is interested to receive notification of a complaint or investigation into an insurer or an officer of an insurer as it may be an indicator of prudential instability of the insurer. This information will also assist Council in ensuring disqualified persons do not act as directors.

PHIAC acknowledges that the preliminary framework for the disclosure standard may have required insurers to report on investigations and events that were possibly unrelated to the role of an officer of a private health insurer.

Accordingly, the provision has been drafted to reflect the disqualified person criteria in the PHI Act⁶ and has been limited to investigations of proceedings regarding contraventions under the PHI Act, the *Corporations Act 2001* (**the Corps Act**), or dishonest conduct relating to a financial sector company or other regulatory authority. An insurer offering a written undertaking to the ACCC under the *Trade Practices Act 1997* (**TPA**) will also be a notifiable circumstance.

PHIAC must also be informed at the commencement of the investigation and of any outcomes of the investigations, for example, if civil or criminal charges are laid.

⁴ Section 1(6) of the Governance Standard requires insurers to notify PHIAC within 28 days, using an approved form, about a change in board membership.

⁵ *Private Health Insurance Act 2007*, section 264-5(b)

⁶ *Private Health Insurance Act 2007*, section 166-15 – **Who is a disqualified person?**

6 Insurers must notify Council of unusual incidents or circumstances

This requirement was the most commented on in submissions, with responses noting that the term 'unusual event' needed greater clarification.

Accordingly, the draft Standard now limits the requirement for insurers to notify Council of unusual incidents or circumstances to impacts on the insurer's health benefits fund that are **prudential matters**,⁷ as defined by the PHI Act in Section 163-1(2). As Division 163 is the enabling power in the PHI Act for the establishment of prudential standards, it is appropriate to restrict notification of unusual events to those relating to **prudential matters**.

The provision goes on to provide a non-exhaustive list of examples that PHIAC may consider to be an unusual event or circumstance. The examples provided set the threshold for what is a notifiable incident or circumstance at a level that PHIAC consider to be major impacts on the operations of the insurer.

Examples include events such as serious damage to infrastructure, death, serious personal injury or incapacitation of a substantial proportion of officers of the insurer or other similar event resulting in substantial loss of operational capacity are unusual, and have the potential to adversely impact the insurer's stability and policy holders if not managed well.

7 Exemptions and modifications by Council

In addition to the transitional arrangements identified in the first discussion paper, PHIAC has included an additional power that allows PHIAC to grant exemptions or modify to the disclosure requirements of the standard in its application to a particular insurer. Upon written application, or on its own initiative, the Council may modify the requirements or exempt an insurer from specified provisions of the disclosure standard. This power allows the Council greater flexibility in administering the requirements, and will go some way to providing comfort to the industry when there are instances where an insurer is unable to fully comply.

8 Transitional arrangements

This provision drew no comments from the industry and has been drafted in line with the initial disclosure framework.

5. Next steps

After comments on the draft Standard are received and assessed by PHIAC, further amendments to the Standard may be made, before final consideration of the Standard will occur, planned to be at the Council's 12 November 2010 meeting. Should the Council resolve to make the Standard into law at that time, the date of effect for the Standard is planned to be 1 January 2011.

When made, the Standard will be subject to the usual 10 year sun-setting rules of the *Legislative Instruments Act 2003*. The Standard will also be reviewed after 24 months and again after five years to ensure it continues to reflect good practice, remains relevant, effective and meets the Government's five yearly review process. PHIAC will also liaise with other regulatory bodies to ensure that its disclosure requirements remain relevant.

⁷ *Private Health Insurance Act 2007*, section 163-1(2) – **Prudential matters** are matters relating to:

(a) the conduct by private health insurers of any of their affairs in such a way as:

(i) to keep themselves in a sound financial position; or

(ii) not to cause or promote instability in the Australian private health insurance system; or

(b) the conduct by private health insurers of any of their affairs with integrity, prudence and professional skill;

but does not include matters relating to the solvency or capital adequacy of *health benefits funds.

Attachment A - PHI Act extract

Section 264-10 of the PHI Act includes the following:

Functions of the Council

General

- (1) The functions of the Council are:
- (a) to administer the *Risk Equalisation Trust Fund; and
 - (b) to administer the registration of private health insurers under Part 4-3; and
 - (c) the information collection function under subsection (2); and
 - (d) the compliance functions under subsection (3); and
 - (e) the enforcement functions under subsection (4); and
 - (f) the public information functions under subsection (5); and
 - (g) the agency cooperation functions under subsection (6); and
 - (h) to advise the Minister about the financial operations and affairs of private health insurers; and
 - (i) functions incidental to any other functions of the Council; and
 - (j) any other functions conferred on the Council by this, or any other, Act.

Information collection function

- (2) The information collection function of the Council is to obtain from each private health insurer regular reports about the insurer's operations, including reports supported by actuarial certification.

Compliance functions

- (3) The compliance functions of the Council are:
- (a) to establish a *solvency standard and a *capital adequacy standard to be complied with by private health insurers, and to give *solvency directions and *capital adequacy directions to private health insurers; and

Note: The solvency standard and the capital adequacy standard are established by the *Private Health Insurance (Health Benefits Administration) Rules*.
 - (b) to exercise powers and discretions under the *prudential standards, and to give directions to private health insurers relating to compliance with the prudential standards; and

Note: The prudential standards are established by the *Private Health Insurance (Insurer Obligations) Rules*.
 - (c) to consider, in accordance with Division 160, whether persons should, or should not, be *appointed actuaries; and
 - (d) to consider, in accordance with Division 166, whether persons should, or should not, be *disqualified persons; and
 - (e) to examine, from time to time, the financial affairs of private health insurers, by the inspection and analysis of the records, books and accounts of the insurers and any other relevant information; and
 - (f) to review, by carrying out independent actuarial assessment, the value of the assets and liabilities of each *health benefits fund; and
 - (g) if it is necessary, for the purpose of making a proper examination of the financial affairs of a private health insurer, for the Council to incur unusually high costs—to impose an appropriate fee on the private health insurer concerned.

Enforcement functions

- (4) The enforcement functions of the Council are:

- (a) to take action under Part 5-2 to monitor compliance with, and to encourage or compel compliance with, *Council-supervised obligations; and
- (b) to appoint, under section 214-1, *inspectors for the purpose of investigating the affairs of private health insurers under Division 214, and to exercise other related powers and functions of the Council under that Division; and
- (c) to appoint, under Subdivision 217-B, persons as *external managers of *health benefits funds, and to exercise other related powers and functions of the Council under Division 217 and 220

Public information functions

- (5) The public information functions of the Council are:
- (a) to make statistics, and other financial information, relating to a private health insurer or private health insurers, publicly available in accordance with the Private Health Insurance (Council) Rules; and
 - (b) to collect and disseminate information about private health insurance, for the purpose of enabling people to make informed choices about private health insurance.

Agency cooperation functions

- (6) The agency cooperation functions of the Council are:
- (a) to cooperate with other regulatory agencies on matters affecting private health insurers and the private health insurance industry generally; and
 - (b) to provide the Private Health Insurance Ombudsman, from time to time, with information in the Council's possession that the Council considers likely to be of use in production of the State of the Health Funds Reports referred to in paragraph 238-5(c).