

Development of  
Corporate  
Governance  
Guidelines for the  
Private Health  
Insurance Industry

A Discussion Paper

22 June 2006

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## Key Recommendations of the Discussion Paper:

<p><b>The Board</b></p> <ul style="list-style-type: none"> <li>• be proactive and appropriately skilled to understand the major risks faced by the fund</li> <li>• have a sound understanding of the industry, the financial, commercial, legal and prudential obligations of the fund</li> <li>• be aware of the potential outcomes of all decisions taken by the board</li> <li>• ensure the fund is conducted in the best interests of contributors at all times</li> <li>• meet regularly with senior management</li> </ul>	Sections 1-3
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<p><b>Tenure</b></p> <ul style="list-style-type: none"> <li>• every board to develop a policy on board renewal; in particular, how the board will remain open to new ideas and independent thinking, while retaining adequate expertise</li> </ul>	2.2
<p><b>Succession Planning</b></p> <ul style="list-style-type: none"> <li>• all boards to implement a formal succession planning policy so an orderly replacement of board skills occurs and board stability is maintained</li> <li>• a fit and proper assessment process be developed to ensure all directors and executives are ethical and comply with the fund's code of conduct</li> <li>• there should be an annual assessment of all directors and senior management against the fund's fit and proper policy</li> <li>• formal letters of appointment be provided to all new directors/ executives setting out key terms and conditions and a description of core duties</li> </ul>	2.3 – 2.5
<p><b>Performance</b></p> <ul style="list-style-type: none"> <li>• there should be a regular review of the performance of the board and individual directors against measurable and qualitative indicators</li> </ul>	2.6
<p><b>Board Meetings</b></p> <ul style="list-style-type: none"> <li>• need for planning and structure, regular meetings, distribution of papers a week in advance of board day, sufficient time to research and discuss issues, an annual agenda and standing items for every meeting</li> </ul>	3.1
<p><b>Compliance Register</b></p> <ul style="list-style-type: none"> <li>• a fund's compliance framework must be subject to regular review, with periodic reporting to the board and/or audit committee</li> </ul>	3.2
<p><b>Code of Conduct</b></p> <ul style="list-style-type: none"> <li>• boards to clarify the standard of ethical behaviour required of directors, management and staff through a corporate code of conduct</li> <li>• funds to develop a system for detecting, recording and dealing with breaches of the code</li> </ul>	3.3
<p><b>Conflicts of Interest</b></p> <ul style="list-style-type: none"> <li>• boards must ensure all decisions are made without bias and are free from any interests, influences or perceived conflicts</li> </ul>	3.4

<p><b>Board Committees</b></p> <ul style="list-style-type: none"> <li>• no committee to be given broad decision making powers</li> <li>• all funds must have an audit committee</li> <li>• a risk management committee facilitates the establishment of a formal process of risk review and risk oversight</li> <li>• a formal induction program should be developed for each committee</li> </ul>	4
<p><b>Financial Integrity</b></p> <ul style="list-style-type: none"> <li>• there needs to be a structure in place which independently verifies and safeguards financial reporting to the board</li> <li>• financial forecasts must have clear links to the business and strategic plans</li> <li>• all boards must develop a capability to understand their risks at the product level by undertaking product profitability analysis</li> <li>• investment decisions should be subject to an agreed due diligence process to ensure they are based on sound information and performance is monitored</li> </ul>	5
<p><b>Risk Management</b></p> <ul style="list-style-type: none"> <li>• all funds to have a comprehensive risk management structure in place</li> <li>• the risk management plan to have direct links to the strategic and business plans</li> <li>• there needs to be appropriate training of staff in their responsibilities, accountabilities and contingency planning</li> </ul>	6.1
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<p><b>Interests of Contributors</b></p> <ul style="list-style-type: none"> <li>• in making any decision or taking any action relating to the application, investment or management of the assets of the fund, the board must give priority to the interests of the contributors</li> </ul>	7
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<p><b>Public Disclosure / Annual Reporting</b></p> <ul style="list-style-type: none"> <li>• from June 2007, every fund to disclose its governance policies, processes and practices</li> </ul>	

## **Section 1: Background to the Development of Corporate Governance Guidelines for the Private Health Insurance Industry**

These guidelines are being developed in recognition of the need for a corporate governance framework specific to the needs of the private health insurance sector. Whilst Standards Australia, the Australian Prudential Regulation Authority and the Australian Stock Exchange have developed excellent generic corporate governance guidelines and standards, they are not responsive to the needs of the private health insurance sector. Accordingly, many private health insurance fund boards have failed to develop comprehensive governance policies.

PHIAC's four year fund review program has provided an excellent insight into areas of common governance concerns across the industry. The guidelines being developed by PHIAC will provide an industry base line. They will assist boards to identify and to understand factors which may contribute to poor governance. They will provide guidance in areas such as board responsibilities, strategic planning, decision making, program evaluation, risk management and internal controls and will include recommendations relating to the composition of boards, effective use of sub-committees, managing conflicts of interest and use of external advisers.

PHIAC's objectives in developing industry specific governance guidelines are four-fold:

- 1) to raise awareness within the industry of PHIAC's governance expectations
- 2) to create more disciplined thinking by boards on governance issues and facilitate more robust systems of governance
- 3) to encourage boards to benchmark their performance, upgrade standards of decision making and increase accountability and transparency, and
- 4) to assist boards to evaluate whether the fund is being managed prudently.

Subject to the outcomes of the ongoing industry consultation process and industry workshops in October 2006, PHIAC aims to publish the guidelines by the end of the year. If this is achieved, PHIAC will recommend that from June 2007, all funds make available in written form, or on their website, their governance policies, processes and practices. These actions will contribute to increased transparency and accountability across the industry.

In instances where a fund chooses not to implement one or more of the guidelines, the fund may be required to provide an explanation to PHIAC. This will ensure consistency of issues across the industry whilst enabling individual funds to implement governance programs appropriate and tailored to their needs.

PHIAC recognises that the range in size and diversity of private health insurance organisations is significant and that the smaller health funds may face difficulties in attaining all PHIAC recommendations from the outset. These funds will be encouraged to prioritise their needs and to develop a time frame for meeting PHIAC's governance guidelines.

## **Section 2: Legislative Context**

PHIAC was established in 1989 under section 82B of *the National Health Act 1953* as a specialised prudential regulator for Australia's private health insurance industry. The National Health Act requires PHIAC to ensure a financially sound, efficient, competitive and innovative industry, that all private health insurance funds comply with the legislative requirements of the National Health Act, that they remain prudentially sound and that they conduct their business in the best interests of consumers.

The National Health Act gives PHIAC powers to monitor, investigate and supervise health funds and to take action on issues of non-compliance. PHIAC applies its monitoring procedures to all funds equally, but has authority to examine the affairs of individual funds and to require compliance by any fund under investigation, to ensure that the interests of contributors are not compromised by actions of the board or management.

PHIAC takes its monitoring of governance issues as seriously as it does financial compliance. PHIAC has demonstrated a strong commitment in recent years to raising the industry's awareness of governance issues through seminars, fund reviews, investigations of non-compliance with the National Health Act and regular consultation with the industry throughout the development of these draft guidelines.

PHIAC is committed to fostering a regulatory environment which encourages high standards of practice and ethics. PHIAC will formally review the impact of the governance guidelines in 2008 to ensure they remain relevant and continue to take account of local and international developments. Should uptake of the guidelines prove problematic, PHIAC may establish industry rules, backed by the National Health Act.

## **Section 3: Response to Industry Concerns**

In March 2005, PHIAC circulated draft corporate governance principles to the industry for comment. The principles were based on the results of four years of fund reviews and were aligned to existing national and international corporate governance standards, including concepts espoused by:

- Standards Australia
- the Australian Stock Exchange
- the Australian Prudential Regulation Authority
- the Organisation for Economic Co-operation and Development and
- the International Association of Insurance Supervisors.

The revised discussion draft incorporates feedback which PHIAC has received from the industry in the intervening twelve months. It incorporates written comments from health funds on the initial draft guidelines and verbal feedback from the industry at meetings attended by PHIAC staff during the year.

Following is a summary of the industry concerns which warrant more discussion during the next three months of industry consultation and workshops, together with

PHIAC's rationale for not adopting, or only partially adopting these recommendations in the revised discussion paper:

**1. The industry not be subjected to higher governance standards than those for publicly listed companies**

There seems to be an assumption within the industry that because many funds are not-for-profit, are not subject to shareholder disciplines and lack the market pressures faced by publicly listed companies, that health funds should not be subject to the same high standards of governance as publicly listed companies.

PHIAC strongly refutes this view, noting that health funds should be subject to the same (or higher) level of governance as publicly listed companies. The absence of market pressures, the support of the government, in particular through the 30% rebate, and the statutory requirement to give priority to the best interests of contributors in any key decisions of the fund, point to the industry being reliant on more robust internal governance structures than publicly listed companies.

**2. Governance standards should only be promulgated when there is a compelling issue which requires a departure from the principles of the Australian Stock Exchange**

After four years of in-depth fund reviews, PHIAC has compiled sufficient data to provide a detailed analysis of common governance failings in the industry.

PHIAC's framework will assist boards to identify and understand factors which may contribute to poor governance. The guidelines will facilitate more disciplined thinking, assist boards to develop more robust systems of governance, upgrade standards of decision making, increase accountability and transparency, and assist boards and management to identify more readily issues which have the potential to cause long term harm to a fund.

**3. The guidelines should not place an additional administrative burden on the industry. In particular, there was opposition to a governance check list and for funds to annually report on their compliance with the guidelines.**

The checklist provided in the March 2005 discussion paper was intended as a summary to capture key discussion points. The check list has since been expanded into the attached governance guidelines document.

PHIAC's expectation is that boards will discuss the guidelines and tailor them to meet the needs of their health fund. Where a board does not implement one or more of the guidelines, it will need to give serious consideration as to why not, given the guidelines have been developed based on issues consistently arising in Australia's private health insurance sector over the last four years.

Inclusion of a section in all future annual reports on compliance with the guidelines will provide a trigger for funds to undertake an annual review of the effective implementation of the guidelines. If the review is undertaken at the same time as a fund's review of its strategic, business, operational and risk management plans, this

requirement will formalise a process which should already be undertaken annually by every health fund.

**4. The guidelines should not specify the frequency of board reviews. It should be left to each board to determine.**

The initial discussion paper recommended an annual (internal) review of the performance of the board as a whole and the performance of individual directors; with an independent review every 3-5 years. PHIAC stands by this recommendation noting that there are a variety of ways board evaluations may be conducted, and that internal reviews conducted to an agreed set of performance indicators, should be as effective as external ones.

The suggestion of an external review every 3-5 years is to bring a level of independent peer review to the board, particularly as the board builds up its internal competencies and experience in the review process over time.

**5. PHIAC's initial guidelines recommended greater interaction between the board and senior management. Some funds expressed concern that this greater dialogue might undermine the chief executive officer's authority and accountability.**

PHIAC cautions against the chief executive officer/managing director being responsible at all board meetings for every management issue. Ownership of issues by senior management is important, as is direct feedback on reports prepared for the board. This will always be a balancing act, but the health fund's charter should clarify accountabilities for specific issues and include some provision for contact between board members and senior management both inside and outside the board room.

From a succession planning point of view, it is important that the board has the opportunity to meet frequently with the senior management of the fund and to understand the capabilities and strengths and weaknesses of the management team.

This recommendation is not intended to undermine the position of the chief executive officer/managing director. Rather, it should enable this officer to focus more on strategic issues, and, by inviting senior management to present to the board, enable a more rigorous discussion of issues against the fund's strategic direction.

**6. Whilst there was general agreement amongst funds that the chair of the board should not also chair the audit committee, a number of funds felt there should be scope in the guidelines for the chair to be a member of the audit committee.**

To preserve the independence and objectivity of the audit committee, PHIAC recommends that the chair of the board not also chair the audit committee. There have been a number of instances where combining these two roles has contributed to significant health fund governance failure.

PHIAC notes that the chair of the board may be a *member* of the audit committee provided the chair of that committee has relevant skills, and the other members of the committee are all independent directors.

## **7. The framework content should not be mandatory**

PHIAC is not advocating a “one size fits all” approach to corporate governance in this discussion paper. PHIAC’s goal is to provide the industry with guidelines which are practical to implement and relevant to the operation of all funds. Whilst not expecting all funds to implement all recommendations, PHIAC expects all funds to provide greater accountability in the future on corporate governance.

If a fund considers a recommendation is inappropriate to its particular circumstances, it has the flexibility not to adopt it – a flexibility tempered by the requirement to explain why not. This will ensure consistency of issues across the industry, will enable individual organisations to implement a governance program which is appropriate and tailored to their needs and will enable fund contributors to decide, on the basis of their fund’s approach to governance, whether to stay with that fund or to select another fund.

## **8. The Guidelines should not set mandatory tenure limits for directors, or advocate regular rotation of directors**

PHIAC does not seek to define a limit on tenure for directors of private health insurance funds, but the guidelines note that there is merit in regular refreshment of a board. Membership is changing and the market is changing. It is therefore healthy for the board of a health fund to keep abreast of change by attracting new members on a regular basis.

The guidelines recommend board’s develop a formal policy on renewal. The policy should provide details of how the board intends to renew itself in order to ensure it remains open to new ideas and independent thinking, while retaining adequate expertise.

The guidelines note that there needs to be a balance between long standing directors and a policy of regular refreshment of the board.

## **Section 4. Draft Private Health Insurance Governance Guidelines:**

### **1. Leadership**

**The board has the ultimate responsibility for the strategy and annual performance of the fund. All directors must take an active role in providing strategic guidance to the fund, effective oversight of management and the risk management practices of the organisation.**

#### ***1.1 Responsibilities of Board Members***

Responsibility for the sound management of health funds rests with the board of directors and senior management of the fund. This requires that all boards are proactive and appropriately skilled to understand the major risks faced by the fund, that the directors have a sound understanding of the industry, the financial, legal and prudential obligations of the fund, and are aware of the potential outcomes of all actions taken by the board, in particular the impact of major decisions on contributors.

In its industry review program, PHIAC identified several health fund boards which did not challenge management sufficiently, and who accepted management's recommendations without effective questioning, or independent testing of the information provided through external advisers such as the external auditor or appointed actuary. PHIAC expects there to be a lively interchange between board members and management that extends to regular contact with senior managers, not just the chief executive officer or managing director. This will enable the board to rigorously assess the recommendations of senior management against the fund's strategic direction.

PHIAC does not support boards restricting themselves to the passive role of reviewing and endorsing management's actions retrospectively. This presents risks including poor accountability and compliance risk. Boards have an obligation to satisfy themselves that recommendations from management are well thought through and that management has considered all risks and opportunities. This obliges directors to ask challenging questions.

All boards should be aware that regardless of any powers or duties delegated to sub-committees or to management, the board remains fully accountable at all times for the operations of the health fund. This requires that all directors be fully cognisant of their statutory responsibilities under the *National Health Act 1953*, in particular the duty to ensure that the management of the fund is conducted in the best interests of contributors at all times.<sup>1</sup>

PHIAC considers it essential that the roles and responsibilities of all board members and senior executives are clarified to ensure an appropriate balance of authority and to facilitate accountability to the fund and its contributors. The absence of clearly designated roles can weaken accountabilities between the board and management and the achievement of fund goals. Accordingly PHIAC expects all health funds to have a board charter which clearly sets out the powers reserved for the board, sub-committees and management and which provides a structure for how key decisions are taken.

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<sup>1</sup> National Health Act 1953 section 73AAC refers

Based on good practice principles, the responsibilities of the boards of all health funds should include:

- input into and approval of the fund's vision and mission statements, and strategic, business and operational plans
- regular monitoring of the strategic plan, annual budget and business plan
- approval of policies, processes and practices to ensure efficient and effective operation of the fund
- review and ratification of the fund's risk assessment, code of conduct and legal compliance documents
- approval of the annual budget and all major capital expenditures
- regular monitoring of the product profitability, investment and membership trends
- ensuring the board collectively has the full range of skills needed for the effective operation of the fund
- annual evaluations of the effectiveness of the board against established key performance indicators
- consideration of the interests of contributors when setting policies and taking major decisions
- monitoring the performance of senior management, including appointments, succession planning and performance against key performance indicators
- establishment of sub-committees and their terms of reference
- annual review of the delegations policy
- facilitation of director induction and training
- compliance with applicable laws and regulatory requirements

## **1.2      *Management***

In contrast to the board's oversight role, management is charged with the day-to-day administration of the fund. Management must ensure the strategic, business and operational plans approved by the board are implemented in a timely fashion, that the fund's performance against key performance indicators is closely monitored, that the board receives regular briefs on environmental threats and opportunities, and that board papers clearly address achievement of the fund's strategic objectives.

Management is also responsible for ensuring internal controls are in place and are regularly reviewed, that all issues identified by the internal and external auditors are fully addressed, and that reports to the board are detailed and accurate so as to permit the board to have a complete picture of all significant issues facing the fund.

Management should provide the board with balance sheet and profit and loss details as a standing item at every board meeting. It is important that the financial statements not be limited to recent performance of the fund (current month, previous month, year to date and prior year comparison month). The financial statement should also include progress against the fund's business plan, cash flow forecasts and longer term trends or performance history. As the forecasts are changed, management needs to provide the board with commentary on the expected impact these changes may have on the fund's prudential position and budgetary performance.

Between annual reviews, management should formally document and monitor the policies of the health fund<sup>2</sup> to ensure the policies continue to be appropriate, are being adhered to, and advise the board of any infractions as they arise.

There is also an obligation on management's part to be completely open and transparent in all of its dealings with the board – even when it has bad news to report.

### **1.3 Delegations of Authority Policy**

To minimise risk, PHIAC requires all health funds to have a documented delegations of authority policy from the board to senior management. The delegations policy should formalise the delineation of responsibility and authority between management and the board and cover all transactions, approvals and exercising of authority in the operations of the fund, including investment activities. The delegations policy should be communicated to all relevant staff to ensure delegations are clearly understood and to allow the practical operation of the fund within established limits.

The delegations policy should be annually reviewed by the board to ensure the delegations continue to be appropriate, are up to date and are being adhered to. Between annual reviews, management should monitor the delegations manual and advise the board of any infractions of the policy.

### **1.4 The Strategic Plan**

Every board needs to develop its own sense of fund priorities and the matters that are most important to the ongoing success of the fund. Doing so enables the board to provide management with meaningful guidance and support in refining the fund's strategic plan each year and in monitoring its effectiveness during the year. Involvement in the strategic planning process also helps the board to focus its attention, to determine its own agenda and to identify the information it needs to make objective judgements.

PHIAC considers it essential that the full board work with the senior executive to develop the fund's strategic plan. The planning process should include a discussion of the key issues facing the fund, the identification of past successes and potential opportunities. The strategic plan should set clear objectives to ensure the ongoing viability of the fund and identify key performance indicators to monitor achievement of the fund's long run strategic objectives (both financial and operational). The absence of these benchmarks will prevent the board from performing an effective oversight role over management and the fund.

PHIAC recommends all board and senior management teams undertake a formal strategic planning process every year to ensure both have a clear and precise idea of where the fund is, where it intends to be, its strategic intent and business objectives. Once the strategic plan is refreshed, it should be formally endorsed by the board. A copy should be provided to the fund's external auditor and to all staff and relevant stakeholders. It then becomes management's responsibility to monitor the fund's performance against the key performance indicators during the year and to ensure board papers clearly address the achievement of the strategic objectives of the fund.

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<sup>2</sup> Appendix A provides an indicative list of policy documentation which PHIAC recommends all health fund boards consider developing

## **1.5 The Business Plan**

The fund's strategic plan should be complemented by an annual business plan, prepared by management and approved by the board. There should be a clear connection between the two documents. A strategic plan's success of implementation hinges on the cascading of broader strategic objectives into smaller achievable units of work at the business level. In the absence of clear links between the two plans, there is a significant risk the fund's strategic objectives and milestones will not be achieved due to a mismatch of management and board objectives.

The business plan should restate the fund's key objectives and goals, but also include time frames and key performance indicators to ensure the fund's objectives are achieved and are reviewed on a regular basis.

The business plan should be signed off annually by the board.

In a number of the smaller health funds, a separate business plan does not exist, with the business plan encompassed in the strategic plan and complemented by an annual budget, broken down into operational budgets for each business unit. This can be an effective solution provided there is formal review of fund performance against the strategic plan at every board meeting.

Good practice suggests that a fund's business plan should include such items as:

- clearly identified organisational goals, objectives and annual budgets
- direction for the year, assigning specific goals and strategies to the business units responsible for each function
- identify the risks associated with the fund's operating environment
- provide a list of directions to ensure that the objectives are collectively achieved
- include the fund's solvency and capital adequacy ratio objectives
- membership information
- marketing strategies
- product review
- computer systems and information technology.

## **2. Board Structure**

**All health funds must conduct their businesses with due skill, care and diligence; with a balance of skills and expertise appropriate to the size of the fund and the nature of the business conducted.**

### **2.1 Mix of skills and experience on the board**

Because the private health insurance industry carries significant commercial risk, in particular that funds compete in an environment of ever increasing costs, small profit margins and price sensitivities, the importance of directors fully understanding the business they are governing cannot be overstated. It is particularly important that directors understand reports in relation to the prudential standards, risk identification and mitigation processes, are aware of the market forces within the industry and are able to effectively deal with actuarial advice and recommendations.

Recent failures within the private health insurance industry have illustrated the importance of boards regularly reviewing their composition, size, mix of skills, commitment and level of oversight. As regulator of the private health insurance industry, PHIAC has an interest in ensuring all health funds are conducted by persons who are commercially capable and focussed, appropriately skilled, whose conduct is consistent with their legal obligations, and that an environment to support sound decision making is present.

PHIAC recommends all health fund boards strive to include a mix of financial, commercial, management, marketing, legal and industry knowledge on the board. PHIAC recognises that funds with restricted or regional memberships may have a limited pool of professional skills and expertise from which to appoint directors. But PHIAC notes that it is the responsibility of the board to identify skills gaps and to develop strategies to attract directors with the requisite skills.

In most instances, health funds have been able to source the range of skills recommended by PHIAC from within their existing membership. In some restricted membership funds, family members have been targeted as nominees with the requisite skill backgrounds. Where a fund is unable to source a specific skill from within its membership, consideration should be given to amending the fund's constitution to enable it to approach potential directors, rather than relying on external advisors as a substitute for board members.

## **2.2 Tenure**

There are many examples in the private health insurance industry of long serving directors. A direct application of the Australian Stock Exchange guidelines regarding length of tenure<sup>3</sup> would disqualify a number of private health insurance directors. This is not a preferred PHIAC outcome as it would lead to the resignation of many effective directors who are dedicated to serving their organisations, and it could also result in instability on some boards.

PHIAC does not seek to define a limit on tenure for directors of private health insurance funds, but PHIAC notes that there is merit in regular refreshment of a board. Membership profiles are changing and the market is changing. It is therefore healthy for the board of a health fund to keep abreast of change by attracting new members on a regular basis.

Where PHIAC might have a concern is when a board has a majority of directors who have served very long periods on the board. In these instances, it is recommended the fund undertake an independent review of its board structure (in particular the composition, skills mix and individual performance) and, if change is not warranted, develop a clearly articulated rationale for retaining the longer serving board members. Such a policy should provide details of how the board intends to renew itself in order to ensure it remains open to new ideas and independent thinking, while retaining expertise.

Equally, PHIAC does not consider it sufficient for the smaller restricted membership funds to remain complacent about the composition of their boards and to argue the difficulties of attracting appropriately qualified directors. PHIAC's experience has

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<sup>3</sup> ASX guidelines recommend a maximum 10 year tenure for Board members

been that if a board clearly identifies the skills and expertise required of its new directors, and advertises the vacancies amongst its membership, in most instances a number of suitably qualified candidates will express interest.

### **2.3 Succession Planning**

All boards should implement a formal succession planning policy so that the board is able to target people with the necessary skills and experience, that an orderly rotation and replacement of board skills takes place, and board stability is maintained.

In order to ensure health fund members have an opportunity to make an informed decision in relation to the election of new directors, detailed and transparent information on all potential directors should be provided to members prior to the annual general meeting, clearly demonstrating that candidates have the potential to meet the skills shortages identified on the board.

By ensuring candidates have the skills and experience to efficiently discharge the duties imposed on them by law, a health fund's board will ensure it continues to adequately guide the operation of the organisation after the election of new members.

### **2.4 Fit and Proper**

As part of their commitment towards strategic succession planning, boards should give consideration to developing processes for assessing and ensuring the fitness and propriety of potential directors and senior executives, to ensure the fund attracts members who are ethical, responsible and will be able to comply with the fund's code of conduct.

Once a fund's fit and proper policy has been endorsed by the board, all existing members of the board and senior management should be assessed annually against the criteria to help reduce the risk of potential misconduct against the fund.

### **2.5 New Appointees**

It is important that new directors clearly understand the fund's expectations as soon as possible after appointment to the board. Formal letters of appointment setting out the key terms and conditions and a description of the duties of new directors are useful in this regard. These letters should include the date and length of the appointment, remuneration and expenses, duties and expectations, code of ethics and a copy of the health fund's constitution and charter.

The chair of the board should also conduct an informal meeting with all new directors to advise them of their rights as a director, including access to independent external advice, and the types of issues they can expect to contend with.

To further assist new directors to contribute to the board's performance, all boards should develop tailored induction programs to ensure that new appointees are given a comprehensive and consistent introduction to the fund and the board. In particular, the induction program should give new directors an understanding of the fund's

financial, strategic, operational and risk management positions, and the role of all board sub-committees.

It is important that new management executives also undergo a similar induction program, given the technical nature of the business and the importance placed on having the right people and the right training.

## **2.6 Performance Appraisal**

As part of the commitment to continuous improvement of the board and individual directors, there should be a regular review of performance and the independence of each director in light of the interests disclosed by them. These reviews will help ensure the board is populated with a mix of skills and experience relevant to the conduct of the health benefits fund and determine whether all directors are able to devote the requisite time to attend to the full range of health fund business.

As part of the annual performance review, PHIAC recommends directors consider the length and frequency of board meetings and whether the board meets sufficiently regularly for directors to engage in detailed discussions of significant issues, make sound and informed decisions, exercise appropriate oversight and exercise their fiduciary duties.

It will often be useful for the performance reviews to be conducted using a facilitator or advisor independent of the board.

## **2.7 Remuneration**

Remuneration of staff should be high enough to attract and to retain appropriately skilled and qualified executives, but not so high as to cause unnecessarily high management costs. PHIAC requires that there be a clear relationship between remuneration and annual performance and that the performance of key executives be regularly reviewed against both measurable and qualitative indicators.

# **3. Commitment:**

**There should be a philosophy and strategy of continuous improvement in the corporate governance of the health fund from the board, the chief executive officer and senior management, to all levels of staff in the fund.**

## **3.1 Board Meetings**

In its program of review, PHIAC has identified several boards who meet infrequently, whose meetings mostly run for no more than two hours, and who receive their papers only one or two days in advance of a meeting. Whilst PHIAC does not have in mind an appropriate number of board meetings per year, or a recommended duration for these meetings, PHIAC believes it unlikely that private health insurance boards can adequately fulfil their obligations to their contributors and the Corporations Act 2001, when meetings are infrequent and of short duration.

A practical tool for planning board meetings throughout the year is to develop an annual agenda. If monitored correctly, this tool will ensure that all matters requiring the board's attention in any one year are attended to.

To further facilitate the running of board meetings, it is desirable there be a number of standing items for all meetings to ensure compliance issues are not overlooked. Some of the standing items PHIAC recommends health funds include, are:

- endorsement of the minutes of the previous meeting
- conflict of interest declarations
- chief executive report
- management report
  - monitoring the implementation of the strategic plan against key performance indicators
  - compliance and risk management reports
- financial reports:
  - a report on the solvency and capital adequacy position of the fund
  - product pricing and profitability analysis
  - membership performance
  - a budget to actual variance analysis, including actions for rectification where necessary
  - a report of actual asset allocation against the fund's benchmark allocation, and performance of equities
- actuary's forecasts on the fund's ability to maintain above the capital adequacy requirement

PHIAC is also of the view that board papers should be provided to members at least one week before scheduled meetings. This allows directors time to review the issues and prepare for the meetings.

### **3.2      *Legislative Compliance***

All boards should develop and implement a formal process to identify, systematise and review the fund's legislative requirements and changes to those requirements. A comprehensive compliance checklist will ensure that the fund is not in breach of any legislation, regulation, codes or organisational standards.

The compliance process should provide directors with sufficient information to allow them to attest to certain statements (eg PHIAC's annual reporting requirements) and to verify the fund's compliance with various legislative and regulatory requirements.

To remain effective, the compliance framework should be subject to regular review, with periodic reporting made available to the board and or the audit and compliance committee.

### **3.3      *Code of Conduct***

Sound corporate governance requires people of integrity. The development of a corporate code of conduct is an effective way to guide directors, the chief executive officer and staff to the practices necessary to maintain confidence in the health fund's integrity and the responsibility and accountability of individuals for reporting and investigating reports of dishonest or unethical practices. The board has a

responsibility to set the tone and standards of the fund and to oversee adherence to the code. To this end, all boards should clarify the standards of ethical behaviour required of directors, management and staff by endorsing a corporate code of conduct and publicising it on the fund's web site.

A fund's code of conduct should covers items such as:

- ensuring there are no conflicts of interest
- directors and management do not take advantage of corporate opportunities for their personal gain
- corporate and personal information is not divulged inappropriately
- the fund's employees, contributors and suppliers are treated fairly
- the fund's assets are protected and only used for legitimate purposes
- there is active promotion of compliance with laws, regulations and ethics; and
- there is encouragement of the reporting of unlawful or unethical behaviour

It is important that a health fund's code of conduct has measurable expectations, both quantitative and qualitative, so that the board can be satisfied the directors and senior management are adhering to the code. It is also important that funds develop a system for detecting, recording and dealing with breaches of the code, to reduce the chance of recurrence.

Upon commencement with the health fund, all staff and directors should be required to sign an agreement which ensures that they are aware of the appropriate level of ethics required by the fund.

### **3.4 *Managing Conflicts of Interest***

Under the Corporations Act 2001, all directors are bound by duties of confidentiality, must give priority to the interests of the fund on whose board they sit and must notify other directors when a conflict of interest arises. A director who breaches any one of these duties can be subject to civil and criminal penalties.

Examples of conflicts of interest experienced by health fund directors have included:

- when the health fund has been seen as an internal business unit of a much larger corporation. In a number of these instances the board of directors has run the fund as a benefit, not as a separate business, and therefore not applied a commercial focus to the operations of the fund, or adequately documented policies and procedures.
- when board members nominated by an employer, union or other external organisation, have been pressured to represent the interests of the third party, rather than acting in the interests of the fund.

All boards should establish a process for directors to declare their interests, and all potential conflicts must be recorded in a board conflicts of interest register. Each board meeting should have a declaration of interest as a standing agenda item. This provides a reminder and an opportunity for directors to consider whether a conflict of interest exists, to seek advice where necessary, and to make declarations where appropriate. It is also good practice for all members of the board to refresh their directors' disclosure statement every year.

## **4. Decision Making**

**Sound committee structures can make the work of a board more effective by allowing board members to review issues relevant to their expertise in detail. Boards should be aware, however, that regardless of the powers, responsibilities and duties delegated to a committee, it is the full board, not individual committees, that remains fully accountable for the operations of the fund.**

Committees are an effective tool to ensure a rigorous assessment of critical issues which will ultimately require board endorsement. PHIAC promotes the use of charters to outline the roles and responsibilities of each committee. The charter should be approved by the board and document:

- the committee's terms of office
- the required skill set of committee members
- who may participate on the committee
- the extent of decision making powers of the committee
- how often each committee should report its findings and recommendations to the full board, and
- how often the committee should meet.

It is the full board which is responsible for the activities of each committee. No committee should be given broad decision making powers.

All health funds should have at least one committee – the audit committee. Other common committees include the risk management, nomination and remuneration committees. If these committees do not exist, their issues must be addressed by the full board.

### **4.1 *The Audit Committee***

All health fund boards must have an audit committee, responsible for safeguarding the integrity of the fund's financial reporting. Audit committee actions may include:

- overseeing the financial reporting processes to ensure accuracy, timeliness and appropriate disclosures
- responsibility for the fund's risk management framework – both financial and operational<sup>4</sup>
- ensuring effective accounting and financial operations
- monitoring the performance of the internal and external auditors and controls
- monitoring the fund's compliance and statutory requirements
- reviewing the delegations exercised by management
- reviewing and reporting on any special investigations deemed necessary by the board
- overseeing the fund's relations with the external auditor and approving their fees
- ensuring the health fund complies with all regulatory standards
- providing an annual report to the board on the committee's conduct and performance against its charter

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<sup>4</sup> Alternatively risk management compliance may be covered by a separate committee; either option is acceptable

- requiring the external auditor to prepare an annual report documenting all recommendations made throughout the year and management's responses
- assisting the full board to understand and to sign the annual accounts

It is desirable that all members of the audit committee are financially literate and are non-executive directors. The audit committee must include a director with financial expertise. Other desirable backgrounds include an accounting or other financial professional, a director with detailed knowledge of the private health insurance industry and at least one other director with experience in risk assessment or a compliance/legal background.

This committee should be able to seek independent expert financial advice. It is also important that the audit committee's composition should ensure its independence from management, thereby eliminating the possibility for conflict wherein a person whose work is subject to extensive audit, is in a position to select an external auditor.

Good practice suggests that in order to carry out its responsibilities for internal control effectively, the audit committee should require reports from and discussions with the appointed actuary, the external auditor, the internal auditor and senior management. It is also desirable that there be a formal induction process for new members of this committee given its highly specialised nature.

#### **4.2 The Risk Management Committee<sup>5</sup>**

Establishing a risk management committee will ensure a fund establishes a formal process of risk review and oversight which clearly defines the risk appetite of the fund. This committee should identify, prioritise and document all potential regulatory, business, financial and operational risks and ensure these risks are assessed in terms of likelihood and impact on the fund. Business continuity and disaster recovery plans should also be developed by this committee to reduce or otherwise manage the more significant risks identified by the fund. This committee has responsibility for taking to the full board of directors each year for signature a risk management certification as part of PHIAC's annual reporting requirements<sup>6</sup>.

For this committee to be effective, there needs to be a clear understanding between the board and senior management of the role, objectives and responsibilities of the committee, clarity in what issues are board worthy, in what time frame, and under what circumstances the board should be informed of an emerging issue.

Risk management should be a separate standing agenda item at every board meeting. The committee should require management to report regularly to the board against key industry and fund specific risks and activities to reduce the likelihood of a risk occurring. The directors of this committee should question management on risk management processes and give appropriate priority to discussion, action and regular re-evaluation of the organisation's exposure to risk.

As with the audit committee, the risk management committee should have access to the internal auditor and the external auditor.

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<sup>5</sup> Note: Section 6 deals with the issue of risk management in more detail

<sup>6</sup> PHIAC's suggested reporting format is at Attachment 2 to the PHIAC guidelines document – Risk Management Practices in the Private Health Insurance Industry (March 2004); copies of which are available on the PHIAC website: [www.phiac.gov.au](http://www.phiac.gov.au)

Many of the smaller funds have combined the roles of the audit and the risk management committees. This can be a satisfactory outcome provided there is a clear governance statement/charter to guide the committee's activities and relationships with management and the internal and external auditors.

### **4.3 The Nomination and Remuneration Committee**

For transparency purposes, it is desirable that healthy funds establish a nomination and/or remuneration committee to ensure appropriately skilled staff and directors, and that the level of remuneration for directors and senior management is balanced.

This committee can also provide a point of reference for substantive policy matters relating to employment in the fund. The committee can have a broad range of duties including

- determining the skills and experience required of directors and senior managers
- identifying the skills not currently adequately represented and the options for obtaining those skills
- evaluating the performance of directors and senior management
- determining the amount of remuneration to be paid to directors and senior managers
- providing the framework for the performance of and overseeing the evaluation of board committees
- formalising and documenting the fund's succession planning process
- developing and monitoring the fund's policy for director education, induction and development

External recruitment consultants can provide advice on comparable director fees and senior executive salary packages and key performance indicators, so that the committee can gauge what payments are current in the market and assist the annual evaluation of performance.

This committee should comprise exclusively non-executive directors who are free from any conflict. It is inappropriate for any members of management to form part of this committee.

### **4.4 The Corporate Governance Committee**

A number of funds have established corporate governance committees primarily as a result of the increased regulatory focus on their corporate governance operations and concern at their inadequate reporting and disclosure procedures. Some of the functions this committee takes on include: providing advice to the board on structure, process and procedures, strategic planning, delegation of authority, legislative compliance, the annual report and the conduct of the annual general meeting.

## **5. Financial Integrity**

**The board of each registered organisation is accountable for the financial stability and effective operation of its fund. The importance of health fund boards fully understanding reports in relation to the prudential standards, of appreciating risk identification and mitigation processes, of being aware of the market forces within the private health insurance market and being able to effectively deal with actuarial advice and recommendations, cannot be overstated.**

It is important that every board ensure that there is a structure in place which independently verifies and safeguards financial reporting to the board, so that there is no doubt about the accurate financial position of the fund at all times. This structure should involve the chief executive officer and the chief finance officer certifying that all financial reports are true and that the financial records are in accord with the relevant accounting standards.

The Capital Adequacy Standard and the Prudential Standard require a board to be informed and involved in decisions concerning the operations of their funds. These standards impose on the board the responsibility for determining business forecasts and understanding the assumptions and methodologies underlying them. The financial forecasts must have clear links to the business and strategic plans. The board must regularly monitor the financial and prudential circumstances of the fund and ensure that it has all information that will enable it to understand and make informed decisions about those positions.

Every board of directors must sign an annual statement in relation to the capital adequacy margin, the loss ratio and risk management procedures of the fund. These are not minor compliance issues. Board members need to understand the content of these reports.

Directors are responsible under the Corporations Act 2001 for the accuracy of the health fund's financial statistics. A director can be charged under the legislation if found to be negligent on any financial decision or on the content of the financial statements provided to PHIAC. A director's best defence is good due diligence. That is, that the director has done what can be reasonably expected to confirm that the data in the reports is accurate. For example, PHIAC expects the chief finance officer to be present during the board's review of the financial reports and the board should meet regularly with the internal auditor and actuary so that the board can be fully satisfied that any issues identified have been fully addressed by management.

### **5.1 *Profitability Analysis***

PHIAC views product pricing and profitability analysis as critical tools which allow a fund to understand its risks at the product level and allow the fund to make informed pricing decisions. A fund's pricing and profitability analysis reports should categorise the fund's profit by product, track each product's performance over time and include data relating to membership trends. PHIAC considers this level of detail is vital to the effective management and governance of an organisation operating in this industry.

PHIAC advocates boards develop a capability to understand their risks at the product level by undertaking product profitability analysis as part of their monitoring of the financial affairs of the fund. Management should provide the board with reports of product profitability analysis at all board meetings.

## **5.2 Investment strategy**

Regardless of the size of a fund, even when it is small and invests only in cash and term deposits, the board needs to have a clearly articulated investment policy against which the fund's performance can be monitored. Elements of the investment policy should include:

- a description of all fund assets. This includes any assets used in the conduct of the business, including owner occupied premises, hospitals, clinics; not just financial assets
- be approved and adopted by the board. The board should set the risk tolerances for the health fund, with investment risk being the most important asset risk
- be subject to regular review by the board or an appropriate sub-committee and clearly outline the investment type and mandate to be considered before an investment decision is made, the diversification of investments and the process for reviewing strategic asset allocation
- address rules and limits relating to allowable institutions and types of securities
- address counterparty and credit risks, and tolerances for exposure
- impose ranges or maximum levels of exposure to various asset classes
- address liquidity requirements of the fund and take into account the cash flow requirements of the fund
- include structured delegations that relate to the placement, rollover and redemption of investments.

Whilst the board may develop the fund's investment policy, in most circumstances it should not be involved in deciding where funds should be invested. It is the board's responsibility to ensure that the investment decisions of the fund align with its investment policy, that management is at all times acting in the best interests of contributors, and that investment decisions are made without bias and are free from any interest or influence.

The fund's investment decisions should be subject to an agreed due diligence process to ensure they are based on sound information. The board should test the market periodically to confirm that the fund's investments are attracting the best possible return and that the risk to return relationship has not changed significantly.

Where a fund has international investments, the investment policy statement should include a currency hedging policy which documents the fund's tolerance for currency risk and its approach to managing or accepting this risk.

The board should receive a report of actual asset allocation against the fund's strategic / benchmark allocation and performance of equities at every board meeting.

## **6. Management and Control**

**A fund must take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems in place**

### **6.1 Risk Management Practices**

PHIAC expects all funds to have a comprehensive risk management structure in place involving internal compliance and control systems, internal and external audits and a risk management committee. Risk management practices are important for protecting the assets of the fund. It is essential that all boards view risk management as a requirement for sound business practice rather than as a compliance issue for PHIAC's annual and quarterly returns.

In 2001 PHIAC developed a set of risk management guidelines for the industry with the aim of ensuring all funds establish appropriate risk management policies.<sup>7</sup> Each fund's risk management statement needs to be written to the prudential standards, the strategic framework of the fund, and include all forms of identifiable risk. Adoption of generic risk management statements is a very real danger to a fund's ongoing commercial viability.<sup>8</sup>

Ideally, a fund's risk management plan should include as a minimum, a risk register, risk profile, risk action plan and identification of the manager responsible for managing each risk. The risk management policy needs to be well integrated into other key governance policies of the fund and the organisation as a whole, have direct links to the fund's strategic and business plans, and there needs to be ongoing review by management and the audit/risk management committee of the risk management program.

All staff need to be aware of the health fund's risk management strategy and there needs to be appropriate training of staff in their responsibilities and accountabilities.

It is important that directors explicitly determine the risk appetite of their fund. They must determine acceptable levels of risk for each risk item identified, and aggregate exposure limits. By doing so they influence the fund's investment policies, liability valuations and risk margins.

Directors should require management to report monthly against key industry and fund specific risks to ensure that the identified risks and risk ratings remain relevant. This will involve questioning management on risk management processes and giving priority to discussion, action and regularly re-evaluating the organisation's exposure to risk.

The funds' risk management policies should establish clear lines of responsibility, provide for regular assessment and include contingency plans. The fund should also give consideration to engaging a dedicated risk management officer.

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<sup>7</sup> PHIAC: Risk Management Practices in the Private Health Insurance Industry – Guidelines (March 2004); available on the PHIAC website: [www.phiac.gov.au](http://www.phiac.gov.au)

<sup>8</sup> The Australian/New Zealand (AS/NZS 4360:1999) can provide basic guidance for development of risk management plans

Sound risk management not only contributes to good governance, it also provides some protection for directors and office holders. In the event the fund experiences an adverse outcome, a comprehensive risk management plan will demonstrate that the board and management have exercised a proper level of diligence.

## **6.2 Business Continuity and Disaster Recovery Plans**

All health funds need to develop comprehensive business continuity and disaster recovery plans as part of their overall risk management processes.

The business continuity plan should detail, step by step, the procedures to be followed in the event of a disaster or loss of IT capability. It should include a crisis management plan, emergency response and action plans, back up procedures, system specifications and operating requirements.

The disaster recovery plan is a vital component of the fund's risk management plan and should relate to the fund exclusively. It should include IT capabilities such as the fund's accounting system, other office systems and the fund's infrastructure. It should incorporate rigorous policies and procedures to mitigate operational risks associated with the IT system. It is not sufficient to rely on the disaster recovery program/s of external IT service providers. Every fund must have a back up program in place and regular testing to ensure the fund's assets are not at risk.

A fund's disaster recovery plan should be clearly structured, documented, subject to regular review, testing and maintenance. It should be well communicated so that the whole organisation is well aware of the disaster recovery procedures. Routine review of the plan is essential to its effectiveness. There should be an annual testing and a full disaster simulation every five years.

Offsite copies of the disaster recovery plan should be kept by a number of responsible managers. All staff must undertake disaster recovery training, and each fund should establish a fully operational hot site within close proximity of the fund.

## **6.3 Internal Audit**

All funds need to have an internal audit function to enable internal controls to be tested and improved so that directors and senior management are confident that the risk management control systems are operating effectively, to assist the board in discharging its fiduciary duties and to safeguard contributor's interests. The internal audit group should have a direct line to the audit committee and to management.

The internal audit process offers independent, impartial advice that objectives, policies, plans, procedures and controls are being appropriately implemented. The internal audit function provides independent review of activities as well as assessing and reporting on the effectiveness and efficiency of internal controls. It is therefore important that funds do not combine the internal audit function with that of the finance manager – this would be contrary to the concept of independence.

PHIAC recommends that the internal audit process be carried out on a periodic basis, be clearly documented and subject to regular review. Failure to conduct a regular and formal review may lead to areas of weakness. Not having an effective internal audit function can lead to issues such as fraud, inaccuracies in internal

financial reporting, inaccuracies in statutory reporting, compliance risks, inefficient use of resources and lack of ability to meet objectives in a timely manner.

Whilst PHIAC understands that some of the smaller funds may not be able to afford a full time internal auditor, good practice suggests that some form of internal audit program should exist to test the adequacy of internal controls. Alternative mechanisms such as the audit committee, or the external auditor being employed to also undertake the internal audit function are acceptable options, provided the fund can demonstrate that under either option, it still maintains a robust system for monitoring the effectiveness of the funds risk management and internal controls.

In those instances where an external company takes on the dual audit functions, PHIAC recommends that different audit partners be engaged for the internal and external audit functions and the board of directors reassess the independence of the auditor on an annual basis.

The endorsement of an internal audit function not only provides assurance to management and the audit committee on the adequacy of the organisation's internal controls and risk management processes, but also demonstrates to PHIAC the fund's commitment to ensure that funds are adequately protected, accounted for and applied.

#### **6.4 External Auditors**

The primary role of an external auditor is to express an opinion as to whether the financial accounts of the health fund have been prepared in accordance with the financial reporting framework. This opinion helps to establish the credibility of the financial statements.

There have however, been a number of instances in the industry where it has become apparent to PHIAC that the quality of the external audit review of a registered organisation has been poor.

Cases of major failure have included:

- significant reinsurance miscalculations
- a failure to identify the complete absence of financial controls in a fund
- a failure to identify valuation and payment irregularities in the accounts of the health fund
- poorly audited financial statements.

Other examples that have given rise to concern have included:

- auditors who have derived a large proportion of their audit service revenue from a health fund client
- lack of knowledge about the industry
- auditors unaware of the AelFRS changes affecting their clients and the industry
- lack of awareness of PHIAC's audit requirements for PHIAC 1 and PHIAC 2
- long term relationships between individual auditors and health fund clients
- audit services being seen by the board as a management process, not requiring review by the board.

It is a concern to PHIAC that some audit committees have never met with their external auditor, relying instead on advice from management as to the soundness of the advice provided by the external auditor. As part of maintaining a good awareness of the financial state of the fund, PHIAC recommends all fund's external auditors have direct access to the board and the audit committee, and for the board and audit committee to meet from time to time with the external auditor without the presence of management. These meetings will enable the board to be fully satisfied that any issues identified with internal processes have been fully addressed by management.

PHIAC recommends all boards undertake market testing of their external auditor every three to five years to ensure the advice received by the board is up to date, is commercially competitive and independent, and that no relationships have developed between the external auditor and the organisation during the period of association, which could give the perception of non-independence.

A number of funds have had an ongoing relationship with their external auditor for an extended period of time. Whilst in most cases this has arisen because the fund has not been able to find another audit firm with experience in health insurance, PHIAC believes it is sound governance for boards to change external auditors from time to time.

PHIAC has not determined an ideal period after which external auditors should be changed, however, PHIAC would be concerned in instances where the same external auditor has been used for over a decade. After such a long period of association, there is a risk that the advice received is not truly independent. PHIAC believes the benefits achieved from having a fresh review by a newly appointed external auditor will outweigh the short period of time it would take for a newly appointed auditor to familiarise him/herself with the business of the fund.

PHIAC also notes that as part of good practice, a fund's audit/risk management committee should have very clear procedures for the selection and rotation of external audit partners, and require the audit partner to confirm in writing every year that independence is maintained.

## **6.5 Appointed Actuary**

In 2004, PHIAC took the decision to require all health funds to appoint an actuary to ensure that appropriate independent and objective financial advice is available to support the board and management. Whilst the board of a private health insurer has the primary responsibility for prudential management of the health fund, the appointed actuary can assist the board with this function.

The appointed actuary should be involved in:

- the annual pricing applications to the Department of Health and Ageing
- development of the business case for new product development applications and new product pricing. In particular, providing commentary on the claims assumptions, reinsurance effect and anticipated financial outcome of the product
- informing the board that the fund is meeting the solvency standard and that the fund has a reasonable likelihood of remaining solvent in the future
- involvement in the assessment of risk in the health fund

- as part of the annual financial audit, providing advice in relation to the risk margin related to the mis-estimation of technical liabilities<sup>9</sup> (outstanding claims, contributions); and
- preparing the health fund's annual financial conditions report to PHIAC.

The appointed actuary should have involvement with the fund at least quarterly, for example, reviewing the preparation of the PHIAC 2 quarterly returns. Regular interaction enables the actuary to understand changes in the fund and issues encountered throughout the year, rather than simply reviewing the position of the fund at year-end.

It is also important that the actuary have direct access to the board and audit committee, not just indirect access through management. This is particularly important when the appointed actuary is an internal role, when the actuary is employed directly by the fund and when the actuary reports to management on a day-to-day basis. If the appointment is external, it is equally important to ensure that the actuary is independent of the auditor of the fund.

A common failing of some of the smaller funds has been to place a heavy reliance on the actuary for preparing and interpreting financial statements. Directors need to remember that it is the board, not the appointed actuary who will wear the responsibility if data is wrong.

## **6.6 Key Person Risk**

Regardless of size, all funds should give careful consideration to cross skilling, to minimise the impact on the fund in the event of staff absences and to provide staff with opportunities to advance within the organisation.

Key person risk can be a significant issue in the smaller health funds, which if not addressed, can contribute to poor corporate governance and increase the risk that the fund will not perform optimally following staff losses.

As a minimum, all funds should develop succession planning policies for their chief executive officer and any other employees identified as a key risk to the fund. Development and regular monitoring of these policies by management will ensure continuity of knowledge and skills, and that stability is maintained.

To further reduce key person risk, the board should be regularly briefed on the adequacy of staffing levels and recruitment policies.

## **7. Relationship with Contributors**

**All decisions taken by the board must give priority to the interests of contributors. The board should inform contributors of all major developments affecting the fund**

Conducting the fund in the interests of contributors is a critically important governance issue for all private health insurance funds. It is a condition of

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<sup>9</sup> PHIAC require this advice to also be included with the PHIAC annual returns. Australian Accounting standards AASB 1023 and AASB 104 refer

registration that “...in making any decision or taking any action relating to the application, investment or management of the assets of the health benefits fund conducted by it, a registered organisation must give priority to the interests of the contributors to the fund...”<sup>10</sup>....

Boards which fail to take into account the interests of contributors in all major decisions which have the potential to impact on the fund, may find themselves subject to penalties under the National Health Act.

Considering the interests of contributors includes:

- overseeing the management of the organisation and ensuring the fund remains financially solvent and able to meet the claims of all contributors over time.
- that the fund is properly managed and constantly improved
- acquiring knowledge of the business of the organisation and the statutory and regulatory requirements affecting directors in the discharge of their duties
- ensuring that there are reasonable systems in place to provide the board, on a regular and timely basis, with the necessary data to enable it to make sound, informed decisions
- providing contributors with appropriate premium levels, a range of products and services, adequate product coverage, exclusions lists, preconditions for payments, claims management (for example, does the fund assess and process claims promptly and fairly), the risk ratings of fund investments and liquidity of assets

PHIAC acknowledges that there may be some trade-off between some of these factors – for example, it may be that the lower the premium at which the fund provides health insurance, the less financial resources there may be behind the fund to guarantee ability to pay benefits over time. What is important is that when the board considers issues which have the potential to impact on the interests of contributors, the board consider not only the interests of the fund, but also how the interests of contributors are likely to be affected.

Consideration of the best interests of contributors is therefore likely to involve some balancing and a qualitative assessment.

If PHIAC has reason to suspect the affairs of a fund are being, or are about to be carried on in a manner that is not in the best interests of contributors, for example, financial mismanagement, the fund may not have complied with a provision of the National Health Act, there is a question concerning the competence of persons carrying on the affairs of the organisation, or there has been a breach of one, or more of the corporate governance guidelines contained in this report, PHIAC will intervene and request an independent examination of the fund.

Following this examination, if directors or other officers of the fund are found to be not acting in the best interests of contributors, or are pursuing purposes other than the best interests of contributors, PHIAC may appoint an inspector to assess the fund.<sup>11</sup> PHIAC considers each case on its own merits, taking into account the individual circumstances.

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<sup>10</sup> National Health Act 1953 section 73AAC(1) and 73AAD refer

<sup>11</sup> PHIAC’s *Managing Supervision and Intervention* guidelines, details PHIAC’s powers of supervision under the National Health Act, and its intended regulatory response to breaches of the Act and other issues where there is cause for concern. Copies of this document are available on the PHIAC web site at [www.phiac.gov.au](http://www.phiac.gov.au)

## **8. Relations with Regulators**

**A fund must deal with PHIAC and any other regulator in an open and cooperative way and must disclose anything relating to the fund which a regulator would reasonably expect notice of**

Members of the board and senior management must be available to meet with PHIAC on request and to meet PHIAC's annual and quarterly reporting requirements. PHIAC also encourages funds to keep PHIAC informed of the status of their health fund on a regular basis, rather than approach PHIAC only when the fund is experiencing financial difficulties. Such regular dialogue assists PHIAC to meet its objective of ensuring a financially sound, efficient, competitive and innovative industry which conducts its business in the best interests of consumers.

### **8.1 Reporting Requirements**

Each registered organisation is responsible for ensuring it meets PHIAC's regulatory requirements. Section 82L of the *National Health Act 1953* requires each health fund to provide the following information to PHIAC:

- a copy of any report made to its contributors, within one month of release
- financial accounts and statements as required by PHIAC for use in preparing PHIAC's annual report to the Minister for Health and Ageing on the Operations of Registered Organisations during the financial year. The statements required include:
  - contributions payable to the fund
  - other amounts payable to the fund
  - fund benefits payable out of the fund
  - management expenses
  - other amounts payable out of the fund
  - the balance of the fund as at the end of that year
  - details of how the reserves of the fund have been invested
  - such other information as the Minister requires to be included
- All registered health funds must also provide quarterly reports to PHIAC on the financial affairs of the organisation. This includes:
  - the operation of gap cover schemes
  - the incentive payments scheme
  - the premium reductions scheme

### **8.2 Compliance Register**

Every health fund is responsible for ensuring it meets PHIAC's regulatory requirements. To assist funds in meeting these requirements, PHIAC recommends management develop structured approaches to regulatory and statutory compliance. A compliance register can be an effective tool in this regard. It can provide a systematic process to monitor the fund's compliance with legislative requirements. It can help to prevent breaches of relevant legislation/regulations and lessen the risk of missing important compliance dates.

Once established, management can use the compliance register at every meeting of the board and the audit and compliance committee to provide an update of the fund's

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compliance. If used correctly, the register will ensure that all staff are aware of the fund's reporting requirements and lessen the risk of the fund missing important compliance dates.

### ***8.3 Relations with Other Regulators***

A number of private health insurance funds are regulated by more than one body. PHIAC works closely with other regulators, in particular the Australian Prudential Regulation Authority (APRA), to minimise duplication of regulatory functions.

**A Checklist of Policy Documentation which PHIAC Recommends All Funds Develop:**

	<b>Reference</b>
Board Charter	1.1
Delegations of Authority Policy	1.3
Strategic Plan	1.4
Business Plan	1.5
Succession Plan	2.2 & 2.3
Fit and Proper Person Policy	2.4
Induction Programs - a general program for new directors and senior managers - a program for new members of the audit and risk management committees	2.5 & 4.5
Performance Evaluation Policy	2.6
Remuneration Policy	2.7
Compliance Registers – regulatory and statutory	3.2 & 8.2
Code of Conduct Policy	3.3
Conflict of Interest - Statement and Register	3.4
Terms of Reference for all Board Committees	4
Risk Management Plan - must include a risk register, risk profile, risk action plan and managers responsible for managing each risk	4.2 and 6
Business Continuity Plan	6.2
Disaster Recovery Plan	6.2
Financial Statements - Product profitability analysis - Investment policy - Currency hedging policy	5 5.1 5.2 5.2