



Australian Government

Private Health Insurance Administration Council

Application for conversion to for profit

Practice note

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*Regulatory
Framework*

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Related forms

- ◇ [cgests003 - Application for conversion to for-profit status](#)
- ◇ [cgests004 - Supporting documentation requirements](#)

This Practice Note applies to applications made under section 126-42 of the *Private Health Insurance Act 2007* (the Act).

The application for conversion to for profit status

An application by the insurer under section 126-42(1) of the Act is required for Council approval. Applications must be:

- ◇ in the approved form **cgests003**
- ◇ provide information as detailed in the approved form **cgests004**
- ◇ include a conversion scheme in the approved form
- ◇ be accompanied by such further information as is specified in the *Private Health Insurance (Registration) Rules 2007*¹

The application must be given to the Council at least 90 days before the day on which the insurer proposes to become a for-profit insurer.

It is advisable to start discussions with PHIAC as early as possible, to ensure that timelines, Federal Court hearings and member meeting dates are achievable against the Council's legislative requirements. Ideally, consultation should start prior to making a full application. This will ensure a smooth process and allow Council time for full consideration of the application.

PHIAC does not recommend that dates for the Federal Court and member meetings be arranged until PHIAC has advised if the application is complete and likely dates for Council consideration of the application.

It should be noted that if the Council requires additional information post receipt of the initial application or following policy holder consultation period as required in section 126-42(4)(a) of the Act, there may be changes as to when Council finalises its consideration of the application.

Assessment of the application

An application for conversion to for-profit is to include all information required in approved form cgests003.

1. Does the proposal involve a demutualisation?

The Council must first determine whether the conversion scheme, in substance, involves the demutualisation of the insurer. The Council has 30 days in which to take this decision.

In taking this decision, the Council considers whether the application involves a process, or series of processes, wherein a corporation with a mutual structure, usually limited by guarantee, becomes a corporation limited by shares, with its dominant purposes being to generate profit and yield returns to shareholders.

The processes through which an insurer may demutualise are varied. There is no single defining factor, but often the process involves a scheme of arrangement approved by a Court under part 5.1 of the *Corporations Act 2001* and constitutional amendments.

If the applicant does not believe that the conversion involves a demutualisation, the reasons must be outlined in the Reason for Change Statement.

¹ There are no relevant rules at the time of preparing this practice note. Insurers should check for any amendments to the Rules before completing their application.

2. Applications that do not in substance involve a demutualisation

If the Council is satisfied that the conversion scheme does not in substance involve a demutualisation of the insurer, the Council must approve the application within 30 days provided the insurer has provided all information required by the Council in the initial application and any subsequent requests (section 126-42(3) of the Act).

3. Approving the application if the application for conversion to for-profit involves a demutualisation

If, the Council is satisfied of the matters set out in section 126-42(5) of the Act, the Council must approve the application. These matters are reproduced below:

- a) the insurer has complied with section 126-42(2) in relation to the application, and given to the Council such further information as the Council has required under paragraph (4)(b); and
- b) the Council is satisfied that the conversion scheme would not result in a financial benefit to any person who is not a policy holder of, or another person insured through, a health benefits fund conducted by the insurer; and
- c) the Council is satisfied that the conversion scheme would not result in financial benefits from the scheme being distributed inequitably between such policy holders and insured persons.

If the Council is not satisfied the application for approval to convert to being registered as a for-profit insurer meets the above criteria, the application may be denied or the Council may require further information from the applicant.

The matters that the Council needs to be satisfied include:²

- ◇ Has the insurer provided a full and complete application in the approved form?
- ◇ Has the insurer provided further information as the Council has requested under subsection 126-42(4)(b)?
- ◇ Does the conversion scheme result in a financial benefit to any person who is not a policy holder of, or another person insured through, a health benefits fund conducted by the insurer?
- ◇ Does the conversion scheme result in financial benefits from the scheme being distributed inequitably between such policy holders and insured persons?
- ◇ Are financial benefits being distributed to other parties or stakeholders, other than policyholders as a result of the conversion?

Questions and Answers

These questions and answers have been provided to assist the insurer in the preparation of an application to the Council, under section 126-42 of the Act.

What should the Conversion Scheme cover?

A central concept of section 126-42(5) of the Act is the concept of conversion. A private health insurer applies to convert to being registered as a for-profit insurer, and must lodge with the Council a conversion scheme in the approved form, whether or not the conversion scheme would in substance, involve a demutualisation.

The conversion scheme is considered to be a plan or design to effect a change in registration status and should include information relating to the proposed restructure.

² This list is not exhaustive

The conversion scheme should identify whether the change of status involves a demutualisation of the insurer. Where the scheme involves a demutualisation, the insurer should demonstrate that the conversion scheme:

- ◇ would not result in a financial benefit to any person who is not a policy holder of, or another person insured through a health benefits fund conducted by the insurer; and
- ◇ would not result in financial benefits from the scheme being distributed inequitably between such policy holders and insured persons.

Where the proposal by a private health insurer to change from operating on a not-for-profit basis to a for-profit basis involves restructuring of the private health insurer by way of a Scheme of Arrangement under Chapter 5.1 of the *Corporations Act 2001*, the conversion scheme in its approved form must include reference to the Scheme of Arrangement and a copy of the Scheme of Arrangement. This enables the Council to determine whether post the change in registration status, benefits may be provided through the scheme to members of the company or senior executives or staff in a way which might breach the Act.

Where the Council identifies such an instance, the Council has the power under section 126-42(4) of the Act to require the insurer to give the Council additional information relating to the application for approval to convert to being registered as a for-profit insurer, to ensure the intent of the legislation is not circumvented if the event is considered to be part of the conversion scheme or integral to the conversion scheme.

What is a financial benefit under the scheme?

Section 264–5 of the Act requires the Council, in performing its functions and exercising its powers, to take all reasonable steps to achieve an appropriate balance between the following objectives:

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

In consideration and assessment of all applications under section 126-42(5) of the Act the Council needs to be satisfied that the conversion scheme:

- ◇ would not result in a financial benefit to any person who is not a policy holder of, or another person insured through a health benefits fund conducted by the insurer; and
- ◇ would not result in financial benefits from the scheme being distributed inequitably between such policy holders and insured persons.

Financial benefits resulting from the conversion scheme include, but are not limited to:

- ◇ Additional directors fees, retention and retirement payments arising from the | conversion
- ◇ Officers and staff retention and retirement payments arising from the conversion
- ◇ Fees and success retainers paid to experts and other consultants employed for the conversion
- ◇ Large donations resulting from the scheme (if any)

The above list is not exhaustive, but is an indication of what the Council considers are also part of the conversion scheme, as these transactions would not have been entered into unless there was a conversion scheme.

Who are policy holders or insured persons and why is this important?

Sub-sections 126-42(5)(b) and 5(c) of the Act requires the Council to consider the financial interest of all individuals who are covered by an insurance policy of the insurer, to be satisfied that the distribution of financial benefits is only to policy holders or insured persons, and that the distribution is not inequitable between policy holders and other insured persons.

The Act nominates policy holders and insured persons as the only stakeholders that may benefit financially from a conversion scheme including a demutualisation:

- ◇ A policy holder of a health benefits fund is the holder of a policy that is referable to the fund.
- ◇ The holder of an insurance policy is a person which is insured under the policy and who is not a dependent child.

The Council has separately determined that insured persons are any persons whose treatment may give rise to a claim under a policy.

What factors does the Council consider in assessing the share allocation proposed?

The Council is not required to identify the best share allocation, or to identify alternative share allocations. The Council's task is to make an assessment on whether the share allocation proposal nominated by the insurer is not inequitable between policy holders and insured persons.

In taking a decision on the share allocation methodology proposed by the applicant, the Council considers a number of principles to satisfy itself that the conversion scheme will not result in financial benefits being distributed inequitably between policy holders and insured persons. These include, but are not restricted to:

Value and Rights

The share allocation should recognize the past value contributed, the future value given up by policy holders and insured persons in the demutualisation and rights given up.

Equality

Policy holders and insured persons should be treated equally as far as possible. There should be minimal discrimination against groups or individuals, unless it can be demonstrated that they have forfeited a financial benefit:

- ◇ Persons should not receive a financial benefit from the conversion scheme unless the person is either a policy holder or person insured through the health benefits fund conducted by the insurer.
- ◇ Persons that are neither policy holders nor insured, regardless of their role in the demutualisation may not receive any additional share allocation.
- ◇ Shares should generally be allocated only to the insured persons who have the primary contractual relationship with the insurer.
- ◇ Eligible policy holders should be allocated a specified number of shares in proportion to length of membership.

Transparency

The allocation basis should be understandable, readily calculated and verifiable as accurate.

Efficiency

The allocation should not waste resources that would otherwise have been distributed to members.

Process

The process giving rise to the allocation decision should:

- ◇ Be performed without bias by those in control
- ◇ Include consideration of possible alternatives and rationale why those alternatives were not chosen
- ◇ Have some consistency with other demutualisations
- ◇ Be compliant with laws, regulation and the company's constitution
- ◇ Ensure that every affected person has a means to be heard.

Reasonable Benefit Expectations

To the extent that policy holder expectations cannot be protected in the demutualisation, they may be compensated for by a share allocation.

Needs

The allocation must satisfy stakeholder needs – for example, policy holders should understand the basis, process and have a say in the distribution – e.g. via a vote.

Access

It should be easy for policy holders to access their entitlement. It would be inequitable if participants had to go through a difficult or unnecessary process or administration in order to receive their entitlement.

What does the Council consider when determining the scheme may be inequitable?

The Council has determined that inequitable has its ordinary meaning of unfair or unequal.

What additional information should be provided with the application?

The information to be provided by the applicant is set out on the approved form **cgests003** and the supporting documentation form **cgests004**. Section 126-42(2)(b) of the Act requires the conversion scheme with the application in the approved form. The Council has detailed in the approved form and the supporting documentation requirements form, additional information to assist its early consideration of the application. Provision of this additional information (if available) with the initial application will greatly assist Council's consideration of the application.

Can the Council ask for more information?

The Council is able, under subsection 126-42(4)(b) of the Act, to require an insurer to give the Council additional information relating to the application. This power gives the Council scope to investigate the detail of the conversion scheme and to identify matters which may have been insufficiently disclosed in the conversion scheme or obtain information regarding transactions that may circumvent the legislation.

Additional information that has historically been requested by the Council includes details regarding payments and transactions around financial benefits arising from the conversion scheme. For further information – see “What is a financial benefit under the scheme” on page 4 of this practice note.

The Council may require additional information past receipt of the initial application or following policy holder consultation as presented in section 126-42(4)(a) of the Act.

Why does the Council need to advertise?

Where the conversion includes a demutualisation the Council is required to advertise under subsection 126-42(4)(a) of the Act. Advertising provides interested parties with an opportunity to submit comment on the conversion scheme to the Council. In particular, advertising provides an opportunity to inform the Council of whether the policy holders believe they are being treated inequitably.

The purpose of the advertisement is to allow the Council to reach an informed decision on the application, taking into consideration any comments arising from the notice(s). Accordingly, the insurer must ensure that the public are able to readily access details of the proposed conversion scheme during the consultation period.

What additional information needs to be available when the Council is required to advertise?

To advertise, relevant information regarding the proposed conversion must be available for members and to the public (hard and soft copies).

Will the Council obtain expert advice in relation to this application?

The Council may seek independent expert advice. This may be legal and/or actuarial advice. The Council will also liaise with other relevant government departments in assessing applications under section 126-42 of the Act.

What if the insurer is a restricted private health insurer?

The conversion to for-profit registration does not affect whether the private health insurer is a restricted or open private health insurer.

In the event that the conversion to for-profit involves a change in the restricted or open access status of the health insurer, the insurer will also need notify PHIAC of this intended change in registration in accordance with section 126-40 of the Act.

Are there certain critical timings with the application that a private health insurer should be aware of?

Yes – the Council needs to make certain decisions in certain timeframes, as outlined in section 126-42 of the Act. In particular:

- ◇ Determine if the proposal involves, in substance, a demutualisation
 - within 30 days of the receipt of the complete application

- ◇ Advertise to provide interested parties with an opportunity to submit comment on the conversion scheme to the Council (if the proposal involves, in substance, a demutualisation):
 - At least 45 days before the day specified in the application as the day on which the insurer proposes that it become registered as a for-profit insurer

It is recommended that a timeline is provided to PHIAC as early as possible to ensure that key milestones are achievable. Timelines should consider other regulatory reviews or approvals.

In determining the timeline, how should a private insurer advise other stakeholders in the process and ensure that their deadlines are met?

The private health insurer needs to ensure that all legislative requirements are met. The private health insurer needs to ensure that each government agency that plays a regulatory role in the conversion scheme is provided with sufficient time in order to make their assessment of the application.

The Australian Securities and Investments Commission (ASIC) has issued *Regulatory Guide 142: Schemes of arrangement and ASIC review* that they will provide their comments within 14 days, subject to the complexity of the scheme of arrangement. ASIC's role is different to PHIAC's role. However, ASIC seeks PHIAC's view on the scheme of arrangement. This means that PHIAC needs to have access to the same version of the scheme of arrangement, at the same time that it is provided to ASIC.

Can the conversion date be changed?

The particulars of the conversion date may be changed, especially if there are any slippages in managing the conversion process. Any changes to the conversion date will not stop Council's consideration of the application, however, it is important to notify the Council if the conversion date needs to be changed, and also the reasons for this change.