



# Building resilience in private health insurers

## ***Phase 2 of APRA's implementation of its prudential standards covering areas of Governance, Fit and Proper and Audit Requirements is open for consultation***

*The long-term stability of the financial system requires the community to have a high degree of trust and confidence that APRA regulated institutions do not just meet their financial requirements but are also well governed, prudently managed, and resilient to emerging risks<sup>1</sup>. APRA expects the release of their Phase 2 prudential standards for consultation to emulate what is likely to already be in place, but acknowledges that institutions with lower levels of scale and access to resources and technical sophistication may find these requirements challenging.*

*For some time these standards, or their equivalents, have been a requirement of other APRA regulated institutions.*

In February 2018, APRA released a consultation paper relating to proposed new Prudential Standards and Prudential Practice Guides: CPS 510 *Governance*, CPS 520 *Fit and Proper* and HPS 310 *Audit and Related Matters*. These standards represent the second phase of regulatory alignment with other APRA regulated institutions.

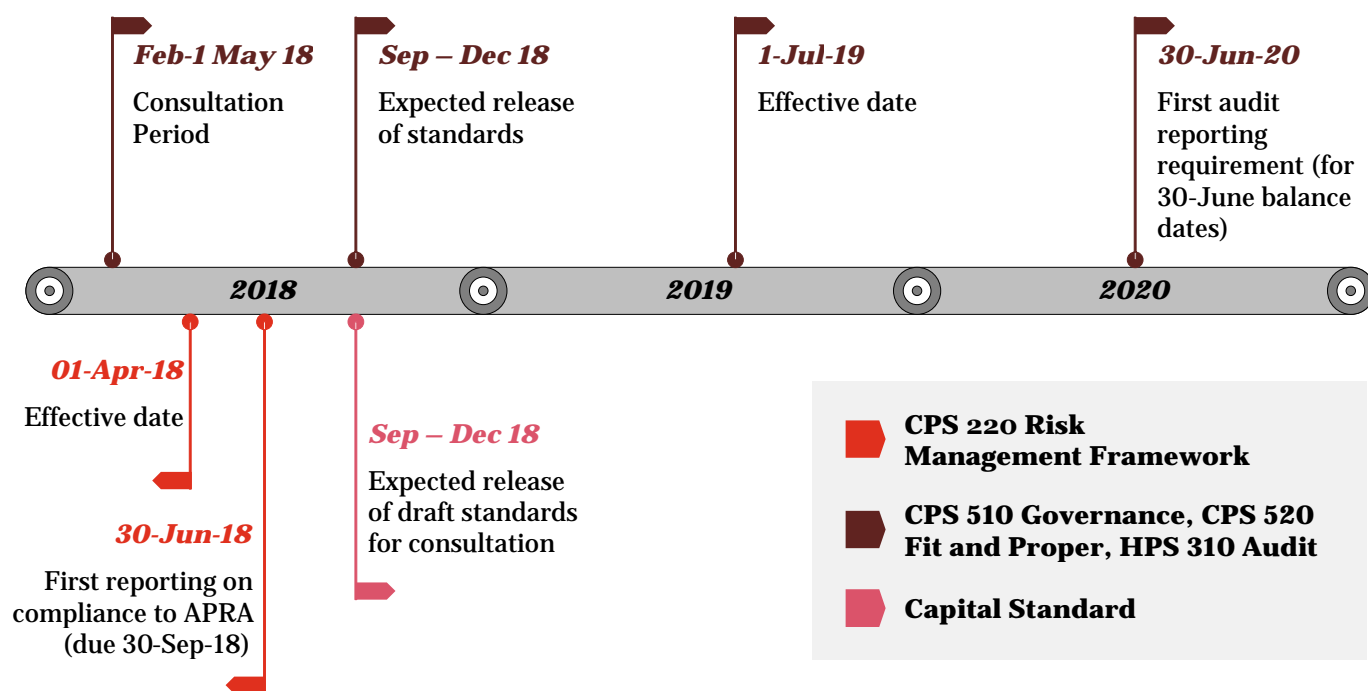
These new standards are cross industry standards and they have been tailored to some extent for banking, insurance, and superannuation as needed. This consultation is to consider if the PHI industry requires changes and what they should be.

This phase of implementation follows Phase 1 which covered CPS 220 *Risk Management*. That standard comes into effect on 1 April 2018.

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<sup>1</sup> APRA Discussion Paper *Governance, fit and proper, audit and disclosure requirements* for private health insurers, February 2018

## Timeframe



## Overview of the standards

### CPS 510 Governance

#### Role of the Board

- The Board must constructively challenge proposals and decisions by Executives on all aspects of risk management arising from the organisations activities
- There must be three separate committees:
  - Audit
  - Risk
  - Remuneration

#### Board composition

- There is a target size of the Board and its committees and a renewal policy to maintain this size
- Recommends at least one independent director and they be considered for the role of Chair
- Expects an external party assess the performance of the Board at least every three years
- Must have a documented policy on Board performance assessments
- Expects a Director tenure period to be less than 12 years

#### Remuneration

- The Board must prudently manage the risks that may arise from their remuneration arrangements and will be attested to by Directors in the annual Risk Management Declaration to APRA
- The organisation must manage or limit risk incentives associated with remuneration, specifically for those that are Responsible Managers, hold roles relating to risk and financial control and who receive a significant portion of bonuses/commissions
- It is expected poor performance on risk control measures or other behaviour not in keeping with the culture of the organisation should be reflected in remuneration outcomes

## ***CPS 520 Fit and Proper***

### **Responsible persons**

- A responsible person generally comprise Directors, the CEO, direct reports of the CEO, CRO, Head of Internal Audit and External Audit
- Position descriptions should be in place for these roles

### **Assessment criteria**

- There are a range of factors to be considered in assessing fitness and propriety including:
  - character, competence and experience;
  - has not complied, or demonstrated a lack of willingness to comply with legal or regulatory obligations;
  - has been reprimanded or disqualified or has been bankrupt;
  - independence and conflicts of interest

### **Assessment process**

- On initial assessment, an Australian criminal record check and evidence of material qualifications are a minimum expectation;
- Attestations from responsible persons is likely to satisfy the requirement to annually confirm fitness and propriety but this will not be enough for the initial assessment of fitness and propriety;
- Documentary evidence of this process is required

## ***HPS 310 Audit and related matters***

### **Audit requirements**

- An additional review of the organisations systems, procedures and internal controls that are designed to ensure that the private health insurer has complied with all applicable prudential requirements, is required annually by the External Auditor
- All other existing audit and review requirements remain
- APRA may request the auditor to perform additional audits, in consultation with the insurer

### **Auditor skills**

- The auditor must satisfy the fit and proper requirements of the organisation
- The auditor must have at least five years of experience in the PHI sector and be approved by the Board of the Insurer
- The appointed actuary and external auditor must not be from the same firm





## What these standards have meant for other APRA regulated institutions?

We have worked with many APRA regulated institutions both in the establishment of their framework to implement the prudential standards upon initial adoption but also in their ongoing management of the regulatory requirements. We have summarised some key learnings from other APRA regulated institutions:

*The benefit in the cross-functional standards is there are lessons from other organisations that can be considered by the PHI industry. It also allows an opportunity to gain greater insight into APRA's perspective on the detail of the application of the standard.*

1

### **Manage stakeholders**

The implementation of these prudential standards should not be considered a "compliance" only exercise. Engage early with the Board to help them understand the impact on their obligations. Implementing appropriate frameworks from the outset helps to get buy in throughout the organisation and, to do so requires input from Human Resources, Legal and Governance, Compliance, Risk and Business Unit leaders. Help your Responsible Managers understand the impact on them.

2

### **Formalise informal processes. Existing good practice needs to be formally documented for compliance purposes**

It is important to be able to evidence your compliance with the prudential standards. Our reviews have often seen good practice that is not reflected in documentation. Updates may be required to Board and Committee charters and Board policies, particularly relating to skills, performance assessments and tenure consideration. A board skill matrix should be in place. Evidence should be kept to demonstrate Board members' challenge of senior management decisions based on risk (i.e. extended Committee meeting minutes) as well as documentation of the Board assessment process. Ensure evidence is in place to satisfy your assessment of responsible managers' fit and proper and that any risk consequences are reflected in how you consider remuneration outcomes.

3

### **Plan in advance for completion of the Risk Management Declaration**

From 30 June 2018, Boards are required to sign a Risk Management Declaration to be submitted to APRA in accordance with CPS 220 *Risk Management*. The Declaration requires Boards to confirm, amongst other things, the Insurer has in place systems for ensuring compliance with all prudential requirements. Ensure that the framework to support your compliance with these standards is robust and that you have reasonable comfort over your compliance with that framework. This framework may then be used as the basis for your external audit of the systems, procedures and internal controls to determine whether you have complied with all prudential requirements as required by HPS 310 *Audit and related matters*.

## Setting your organisation up for success?

Here are some questions to consider in setting your organisation up for compliance:

- Have you performed a Gap Analysis against the new standards? Is there robust documentation for areas where you assess yourself as being compliant?
- Have you formed a working group to implement the new standards upon adoption and are the right people involved? (it's important to get representation from across the business; have you thought about HR, legal, compliance, company secretarial, key business heads for example?)
- Are you comfortable that you have the appropriate framework in place to comply with the new standards including governance, control, risk management, accountabilities and reporting and remediation procedures? If not, is the planned way forward appropriate?
- Are committee structures in place and are their terms of reference aligned with the new standards?
- Have you reviewed job descriptions and employment contracts to consider any impact on the fitness and proprietary obligations?
- Are your remuneration outcomes aligned to prudent risk taking?
- Have you communicated with the rest of the organisation about what the standards are, why it's important and what you're doing about it? Do they understand the requirements and purpose regarding APRA and external audits?
- Have you spoken to the key people that might be affected by the standards and do you have their buy-in (for example, your defined Responsible Managers)?
- Have you engaged with your Internal Auditor and External Auditor regarding your assurance needs both prior to and after the effective date of the new standards?



***To have a deeper conversation about how this subject may affect your business, please contact your PwC engagement partner or:***



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