We are hirmaa

Manager
Insurance and Superannuation Unit
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The Treasury
Langton Crescent
PARKES ACT 2600

28 January 2015

Dear Sir/Madam

Exposure Draft – Private Health Insurance (Prudential Supervision) Bill 2015

Thank you for the opportunity to comment on the Exposure Draft of the *Private Health Insurance (Prudential Supervision) Bill 2015* (Cth) (the **Exposure Draft**).

hirmaa represents 17 community-based private health insurers, comprising both industry or employer focused "restricted access" insurers and "open" insurers serving particular regions. hirmaa constituents are predominantly not-for-profit and generally identify as mutuals. One of hirmaa's constituent members is a for-profit insurer owned by a mutual, not-for-profit organisation.

A full list of hirmaa members is included as Annexure A.

Summary of hirmaa's position on prudential regulation

hirmaa considers that a vibrant, competitive private health insurance industry is vital to ensuring Australians have access to quality healthcare services representing the best value for money. To that end, hirmaa considers that regulation of private health insurers – including prudential supervision – should not impact the capacity or capability of its member organisations to continue to serve their communities. In particular, regulation should not disadvantage smaller private health insurers or disproportionately affect their ability to compete with larger insurers.

hirmaa considers that its members provide, primarily, a service to assist individuals and families to provide for and manage their healthcare expenditure. Whilst hirmaa supports effective prudential supervision of private health insurers, it considers private health insurance a functionally different service to general insurance carrying a fundamentally different risk profile. Whilst hirmaa does not necessarily object to harmonisation of regulatory approaches between private health insurance, general insurance and other APRA supervised financial services, it does not consider harmonisation alone is necessarily a sufficient reason to justify changes in regulation.

hirmaa supports the Australian Government's deregulation agenda and acknowledges the Government's commitment to budget savings by reducing duplication, improving coordination and increasing efficiency in government bodies. With respect to the transition of prudential supervision from PHIAC to APRA, hirmaa is keen to ensure that:

- Firstly, the transition does not affect the capacity or capability of its member organisations to serve their communities by imposing additional costs or regulatory burdens disproportional to the prudential risks of its members' businesses.
- Secondly, the transition does not result in a "one-size-fits-all" approach to prudential supervision of private health insurers, general insurers and other APRA supervised entities. Differences in the nature of the services and their risk profile must be reflected in the supervisory approach.

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- Thirdly, the overall effectiveness of prudential supervision of private health insurers is maintained through the transition (particularly by ensuring that there is not a loss of "corporate memory" and regulatory expertise as a result of discontinuity of personnel).

The private health insurance industry has had a specialist prudential regulator for approximately 25 years. Private health insurers – including hirmaa's members – rely on the stable administration of laws and regulations day-to-day. Although the Exposure Draft introduces few wholly new legislative provisions, changes in the way laws and regulations are administered can impact significantly on business certainty (this might include, for example, changes in interpretation of existing rules or changes in enforcement policies). Assuming the Exposure Draft is enacted in its current form, it is important that any changes in the day-to-day administration of prudential supervision laws and regulations applicable to private health insurers are made only with adequate notice and consultation.

hirmaa's members include some of the longest-standing private health insurers operating in Australia and a number of hirmaa's members are led by some of the longest-serving health insurance executives in Australia. In that respect, hirmaa would encourage APRA, as a new prudential regulator of private health insurers, to recognise the experience of its members in approaching its regulatory and supervisory functions.

Commentary on the Exposure Draft

hirmaa has sought the advice of Maddocks legal services and has reviewed and considered the implications of the Exposure Draft. As an overarching comment, hirmaa recognises that the Exposure Draft replicates many of the prudential supervision provisions currently set out in the *Private Health Insurance Act 2007* (Cth) and introduces few wholly new legislative provisions.

However, the impact of the Exposure Draft on private health insurers is substantially dependent on whether existing PHIAC-made standards continue to apply (specifically, the solvency, capital adequacy and other prudential standards). hirmaa notes that the explanatory material indicates that "it is likely that APRA will replace [the PHIAC-made] standards, in substantially the same form as the PHIAC standards, effective 1 July 2015"). Generally speaking, the content and administration of prudential standards will have greater day-to-day impact than the underlying legislative provisions from which they are derived and enforced.

Importantly, the PHIAC-made capital adequacy and solvency standards have only recently been subject to significant revision (effective 1 July 2014). That revision required private health insurers to incur a range of extraordinary costs in implementation (such as actuarial consulting fees, changes to internal processes and staff training). Those additional costs are less easily borne by smaller private health insurers. APRA has indicated to the market that it does not intend to make any changes to the existing capital adequacy and solvency standards before 1 July 2016.[1] As noted above, assuming the Exposure Draft is enacted in its current form, it is important that any changes to prudential standards are made only with adequate notice and consultation and only where there is a compelling prudential reason for any proposed change.

The Explanatory Material to the Exposure Draft indicates that, amongst other things, the collection of returns and data from private health insurers will be governed by the *Financial Sector (Collection of Data) Act 2001* (Cth). Whilst the source of powers to collect returns and data is of less importance, substantive changes to the way in which returns and data are provided has the potential to significantly impact day-to-day operations of private health insurers and impose significant additional costs (including information technology costs).

hirmaa notes that the Exposure Draft forms part of a four bill package (that is, the *Private Health Insurance Amendment Bill 2015* (Cth); the relevant transitional and consequential amendment bill; and the bill effecting changes to the private health insurance levies). hirmaa looks forward to the opportunity to consult on the balance of the legislative package in due course.

In the commentary table below, **PHIA** refers to the current *Private Health Insurance Act 2007* (Cth).

[1] Medibank Private Prospectus, page 99.

Part	Comments
Part 1 – Introduction	No comments.
Part 2 – Registration of Private Health Insurers	**Section 15(4) and (5)** of the Exposure Draft substantially reflects section 126-20(7) and (8) of the PHIA. However, each of hirmaa's restricted access members are reliant on rules made under section 126-20(8) to define their restricted access group (specifically, the *Private Health Insurance (Registration) Rules*) and not on the groupings in section 126-20(7). It is critically important that the continued operation of these rules be provided for in transitional arrangements.
Part 3 – Health benefits funds	**Div. 1 – Introduction** No comments.
	Div. 2 – The requirement to have health benefits funds No comments.
	Div. 3 – The operation of health benefits funds No comments.
	Div. 4 – Restructure, merger and acquisition of health benefits funds No comments.
	Div. 5 – Termination of health benefits funds **Section 39** of the Exposure Draft makes Part 3, Div. 5 the exclusive mechanism for winding up or terminating a health benefits fund. hirmaa supports this approach. **Section 45** of the Exposure Draft substantially reflects section 149-45 of the PHIA. However, it is unclear to hirmaa why on completion of a winding-up of the health benefits fund of a not-for-profit insurer surplus assets are effectively forfeited to APRA when a for profit insurer is free to apply surplus assets as it sees fit. By comparison, if a not-for-profit insurer were to convert to for profit status by demutualisation, APRA is required to be satisfied that only policy holders will benefit financially and financial benefits will be distributed to policy holders equitably (section 20(5) of the Exposure Draft). **Section 46** of the Exposure Draft substantially reflects section 149-50 of the PHIA and makes officers jointly and severally liable for a loss to the health benefits fund (where there has been a contravention of the Act resulting in a loss to a subsequently terminated fund). Although hirmaa acknowledges the due diligence defence in section 46(2), hirmaa does not support the imposition of officers' liability for loss. Joint and several liability for loss is qualitatively different from other forms of sanction (civil penalty, disqualification etc.) and there is uncertainty in other legal contexts of how a "due diligence" defence applies where an officer did not participate in a relevant process or decision. A middle ground may be to provide a general exculpatory provision, similar to that in **section 165** of the Exposure Draft, providing a discretion for relief from liability where a person has acted honestly and, having regard to all the circumstances of the case, ought fairly to be excused. In order to remain viable and competitive, it is important that hirmaa members be able to recruit capable and effective directors and officers. The negative impact of onerous liability provisions on the recruitment and retention of directors is well documented.[2]

[2] Australian Institute of Company Directors, *Impact of Legislation on Directors* (November 2010).

	Div. 6 – External management of health benefits funds **Section 50** of the Exposure Draft makes Part 3, Div. 6 the exclusive mechanism for external administration of a health benefits fund. hirmaa supports this approach.
	Div. 7 – Ordering the termination of health benefits funds No comments.
	Div. 8 – External managers and terminating managers No comments.
	Div. 9 – Duties and liabilities of directors **Section 88** of the Exposure Draft substantially reflects section 152-10 of the PHIA and makes directors jointly and severally liable for a loss to a health benefits fund (where there has been a failure to comply with an APRA notice in respect of a contravention of Part 3 resulting in a loss to a health benefits fund). Although hirmaa acknowledges the due diligence defence in section 88(2), hirmaa does not support the imposition of directors' liability for loss. Joint and several liability for loss is qualitatively different from other forms of sanction (civil penalty, disqualification etc.) and there is uncertainty in other legal contexts of how a "due diligence" defence applies where a director did not participate in a relevant process or decision. A middle ground may be to provide a general exculpatory provision, similar to that in **section 165** of the Exposure Draft, providing a discretion for relief from liability where a person has acted honestly and, having regard to all the circumstances of the case, ought fairly to be excused. In order to remain viable and competitive, it is important that hirmaa members be able to recruit capable and effective directors and officers. The negative impact of onerous liability provisions on the recruitment and retention of directors is well documented.[3]
Part 4 – Prudential standards and directions	**Div. 1 – Introduction** No comments.
	Div. 2 – Prudential standards Div. 2 of the Exposure Draft consolidates the existing standard-making powers with respect to solvency standards, capital adequacy standards and prudential standards. hirmaa supports this approach.
	Div. 3 – Directions **Section 103** of the Exposure Draft introduces a strict liability offence for failing to comply with an APRA direction. Both an insurer (corporately) and an officer of an insurer are subject to strict liability. The explanatory material notes that a strict liability approach is necessary because requiring proof of fault would "undermine deterrence". Whilst hirmaa acknowledges the harmonisation of these powers with other APRA supervisory regimes, hirmaa queries whether the prudential risk associated with the operation of private health insurers necessarily justifies a strict liability approach (that is, an approach where officers are liable irrespective of proof of fault).
Part 5 – Other obligations of	**Div. 1 – Introduction** No comments.

[3] Australian Institute of Company Directors, *Impact of Legislation on Directors* (November 2010).

private health insurers	**Div 2 – Appointed actuaries** hirmaa recognises and values the key role of appointed actuaries in the prudential supervision of private health insurers and, subject to our comments below, hirmaa supports the approach in the Exposure Draft. **Section 111** of the Exposure Draft makes it an offence for an appointed actuary to fail to comply with a notice to give APRA information or produce books, accounts or documents about a private health insurer. Section 111 includes both a fault-based and strict liability offence (sub-section (2) and (3), respectively). Whilst hirmaa acknowledges the harmonisation of these powers with other APRA supervisory regimes, a particular feature of private health insurers is that they hold significant quantities of highly-sensitive personal information (eg. fund members' health information). This provision should include a relevant limitation in relation to personal information (similar to that appearing in **section 94** of the Exposure Draft).
	Div 3 – Disqualified persons **Section 119** of the Exposure Draft requires APRA to obtain an order of the Federal Court in respect of disqualification (other than where a person is automatically disqualified). hirmaa supports having an administrative disqualification regime and supports the additional procedural oversight of having the disqualification power exercised by the Federal Court (rather than APRA itself).
	Div 4 – Miscellaneous No comments.
Part 6 – Monitoring and investigation	**Div. 1 – Introduction** No comments.
	Div. 2 – Monitoring **Sections 127 and 128** give APRA the explicit power to require a private health insurer to provide information or documents for "routine" monitoring (ie. without suspecting contravention of an enforceable obligation). Whilst hirmaa acknowledges the harmonisation of these powers with other APRA supervisory regimes, a particular feature of private health insurers is that they hold significant quantities of highly-sensitive personal information (eg. fund members' health information). This provision should include a relevant limitation in relation to personal information (similar to that appearing in **section 94** of the Exposure Draft).
	Div. 3 – Investigation No comments.
	Div. 4 – Other matters No comments.
Part 7 – Enforceable undertakings	hirmaa supports the use of enforceable undertakings as an administrative mechanism to improve regulatory compliance as a more flexible and less costly process than formal enforcement mechanisms (eg. legal proceedings).
Part 8 – Remedies in the Federal Court	No comments.
Part 9 – Miscellaneous	**Section 167, item 8** provides that a decision to make, vary or revoke a prudential standard in respect of a particular private health insurer a reviewable decision. hirmaa supports this approach.

In the first instance, questions about this submission may be directed to:

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Yours faithfully

MATTHEW KOCE
Chief Executive Officer

ANNEXURE A
hirmaa members

ACA Health Benefits Fund Ltd

Defence Health Ltd

Health Care Insurance Ltd

Health Partners Ltd

Lysaght Peoplecare Ltd

Mildura Health Fund Ltd

Navy Health Ltd

Phoenix Health Fund Ltd

Police Health Ltd

Queensland Country Heath Ltd

Queensland Teachers' Union Health Fund Ltd

Railway and Transport Health Fund Ltd

Reserve Bank Health Society Ltd

St Luke's Medical & Hospital Benefits Association Ltd

Teachers Federation Health Ltd

The Doctors' Health Fund Ltd

Westfund Ltd