

**Banking, Insurance, Life Insurance and Health Insurance (prudential standard)  
determination No. 1 of 2018**

**EXPLANATORY STATEMENT**

**Prepared by the Australian Prudential Regulation Authority (APRA)**

*Banking Act 1959*, section 11AF

*Insurance Act 1973*, section 32

*Life Insurance Act 1995*, section 230A

*Private Health Insurance (Prudential Supervision) Act 2015*, section 92

APRA may, in writing, determine, vary or revoke a prudential standard that applies to an institution regulated by APRA under:

- (1) subsections 11AF(1) and (3) of the *Banking Act 1959* (Banking Act), in relation to authorised deposit-taking institutions (ADIs) and authorised non-operating holding companies (authorised banking NOHCs);
- (2) subsections 32(1) and (4) of the *Insurance Act 1973* (Insurance Act), in relation to general insurers, authorised non-operating holding companies (authorised insurance NOHCs), and subsidiaries of general insurers and authorised insurance NOHCs;
- (3) subsections 230A(1) and (5) of the *Life Insurance Act 1995* (Life Insurance Act), in relation to life companies, friendly societies, registered non-operating holding companies (registered life NOHCs), and subsidiaries of life companies and registered life NOHCs; and
- (4) subsections 92(1) and (5) of the *Private Health Insurance (Prudential Supervision) Act 2015* (PHIPS Act), in relation to registered private health insurers.

On 14 September 2018, APRA made the following determination (the instrument):

Banking, Insurance, Life Insurance and Health Insurance (prudential standard) determination No. 1 of 2018, which revokes *Prudential Standard CPS 510 Governance* (CPS 510) made under Banking, Insurance and Life Insurance (prudential standard) determination No. 8 of 2016 and *Health Prudential Standard HPS 510 Governance* (HPS 510) made under Health (prudential standard) determination No. 7 of 2015, and determines CPS 510.

The instrument commences on 1 July 2019.

## **1. Background**

APRA's mandate is to ensure the safety and soundness of prudentially regulated financial institutions so that they can meet their financial promises to depositors, policyholders and

fund members within a stable, efficient and competitive financial system.

APRA carries out this mandate through a multi-layered prudential framework that encompasses licensing and supervision of institutions. APRA is empowered under the Banking Act, the Insurance Act, the Life Insurance Act and the PHIPS Act to issue legally binding prudential standards that set out specific prudential requirements with which APRA-regulated institutions in each industry must comply. These standards are supported by prudential practice guides which clarify APRA's expectations with regard to prudential requirements.

In addition to improvements in financial strength and asset quality, it's also critical to the long run health of the financial system that the Australian community has a high degree of confidence that individual financial institutions are well governed and prudently managed. Robust governance practices that support sound decision-making are essential to ensure regulated institutions remain resilient and able to adapt quickly to changes in the broader operating environment, while remaining prudentially sound.

Following an extensive consultation with the private health insurance industry, this instrument extends coverage of the cross industry governance prudential standard to private health insurers. The instrument does not impose new prudential requirements on general insurers, life companies, ADIs or groups.

## **2. Purpose of the instrument**

The purpose of the instrument is to update the requirements in HPS 510 to reflect the latest experience in developing sound governance frameworks and to harmonise the prudential requirements with other APRA-regulated sectors, by extending the application of CPS 510 to private health insurers.

The new cross industry prudential framework is expected to improve resilience in the private health insurance sector by increasing the likelihood that Boards, senior management, auditors and actuaries will identify and take proactive action on emerging issues. Policyholders are expected to benefit from a strengthening of the overall quality of governance of private health insurers through a reduction in the risk of failure arising from fraud, mismanagement, or other undesirable practices.

## **3. Operation of the instrument**

Key aspects of CPS 510 which will now apply to private health insurers are:

### **Board and senior management**

CPS 510 recognises the important role that senior managers play in the governance of an institution and requires the Board to be satisfied that the skills of senior managers are appropriate to the positions they hold. It also requires directors to constructively challenge senior management proposals and decisions on all aspects of risk management arising from the institution's activities.

## **Independence and Board composition**

CPS 510 broadens independence requirements for PHI Board members. For example, it enables independent directors on the Board of a parent company, or another subsidiary in a group, to sit as independent directors on other subsidiary Boards. The standard also enables senior managers of the parent company, or other subsidiaries to sit as non-executive directors on other subsidiary Boards.

CPS 510 may require a larger number of independent directors, depending on the size of the Board, as it requires all locally incorporated regulated institutions to have a majority of independent directors at all times.

## **Board committees**

Reflecting APRA's experience in supervising financial institutions as well as international standards and best practice, CPS 510 mandates a Board Risk Committee separate from the Board Audit Committee, along with a Board Remuneration Committee.

## **Board performance, assessment and renewal**

CPS 510 contains performance assessment and renewal provisions that require regulated institutions to establish processes for assessing, appointing, re-appointing and removing directors.

## **Remuneration policy**

CPS 510 requires regulated institutions to establish a written remuneration policy to align remuneration outcomes with prudent risk-taking. APRA does not have a view on the level of executive remuneration. The remuneration requirements in the standard are principles-based and focussed on promoting effective governance, ensuring executive directors are not placed in a position of actual or perceived conflict of interest, and managing risk incentives associated with remuneration.

The remuneration requirements of CPS 510 and the guidance contained in Prudential Practice Guide PPG 511 Remuneration will assist private health insurers to put in place procedures, controls and performance measures, and to ensure prudent remuneration decisions, particularly in adverse circumstances.

## **Internal audit**

CPS 510 expands the internal audit functions to include an evaluation of the adequacy and effectiveness of the financial and risk management framework of the institution prescribed by *Prudential Standard CPS 220 Risk Management* (CPS 220).

To fulfil its functions, the internal auditor must, at all times, have unfettered access to the institution's business lines and support functions.

## **Communications with APRA**

With a view to ensuring regulated institutions do not attempt to prevent the provision of relevant prudential information to APRA, CPS 510 requires corporate policies to not constrain employees or contractors from discussing issues with APRA of relevance to the prudential supervision of the institution, or from providing documents under their control to APRA.

The standard also requires directors and senior managers to be available to meet with APRA on request. Such meetings provide the regulated institution with an opportunity to raise matters directly with APRA and to hear APRA's views on emerging issues.

## **Relevance to other APRA-regulated industries**

The instrument makes no material changes to CPS 510 for general insurers, life companies and ADIs.

In CPS 510, unless the contrary intention appears, a reference to an Act, Regulations or prudential standard is a reference to the Act, Regulations or Prudential Standard as in force from time to time.

## **4. Consultation**

Since assuming responsibility for the prudential regulation of private health insurance in 2015, APRA has progressively reviewed the prudential framework applying to private health insurers to ensure it remains fit for purpose. In August 2016, APRA released a three stage Prudential Policy Roadmap for the private health insurance industry. Stage two of the Roadmap contained a proposal for extending the application of CPS 510 to include private health insurers.

In February 2018, APRA released for public consultation *Discussion Paper: Governance, Fit and Proper, Audit and Disclosure Requirements*. This document outlined the proposed requirements for private health insurers from the existing cross-industry prudential standard CPS 510 and provided a twelve week consultation period.

APRA presented the reforms via a wide range of industry forums and held round table discussions with the relevant external actuarial and auditing firms on the proposed requirements.

CPS 510 is accompanied by guidance for private health insurers. The guidance is not legally enforceable, but sets out APRA's expectations of better practice and aims to assist private health insurers to understand the standard. The guidance notes APRA's view that long periods of tenure can affect a person's capacity to exercise independent judgement. The guidance notes APRA's expectation that there would be limited circumstances in which maximum tenure limits exceeding 12 years would be appropriate and that circumstances where a person is re-appointed as a director at the end of the private health insurer's maximum tenure period would be exceptional.

All nine written submissions in response to the Discussion Paper were supportive of the goal to strengthen the overall quality of governance in private health insurers. Some submissions

noted concerns in relation to the guidance on director tenure. APRA issued a letter to the industry responding to the key issues.

In relation to feedback on proposed guidance on director tenure, APRA confirmed there is no requirement in the governance standard for fixed tenure for PHI directors. The standard includes a principles-based requirement for all APRA regulated entities to have a Board renewal policy that sets out how the Board intends to renew itself in order to ensure it remains open to new ideas and independent thinking, while retaining adequate expertise.

## **5. Regulation Impact Statement**

The Office of Best Practice Regulation advised that a Regulation Impact Statement was not required for this determination.

## **6. Statement of compatibility prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.**

A Statement of compatibility prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* is provided at Attachment A to this Explanatory Statement.

## ATTACHMENT A

### Statement of Compatibility with Human Rights

*Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011*

#### **Banking, Insurance, Life Insurance and Health Insurance (prudential standard determination No 1 of 2018)**

This Legislative Instrument is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011 (HRPS Act)*.

#### **Overview of the Legislative Instrument**

This Legislative Instrument revokes *Prudential Standard CPS 510 Governance (CPS 510)* made under Banking, Insurance and Life Insurance (prudential standard) determination No. 8 of 2016 and *Health Prudential Standard HPS 510* made under Health (prudential standard) determination No. 7 of 2015 and determines a new CPS 510.

The instrument extends the coverage of CPS 510 to private health insurers under the *Private Health Insurance (Prudential Supervision) Act 2015*.

The prudential framework contained in CPS 510 supports sound decision-making to ensure regulated institutions remain resilient and able to adapt quickly to changes in the broader operating environment, while remaining prudentially sound.

The instrument does not impose new prudential requirements on existing APRA-regulated institutions previously covered by the CPS 510 determination made under Banking, Insurance and Life Insurance (prudential standard) determination No. 8 of 2016.

#### **Human rights implications**

APRA has assessed this Legislative Instrument and is of the view that it does not engage any of the applicable rights or freedoms recognised or declared in the international instruments listed in section 3 of the HRPS Act. Accordingly, in APRA's assessment, the instrument is compatible with human rights.

#### **Conclusion**

This Legislative Instrument is compatible with human rights as it does not raise any human rights issues.