

EXPLANATORY STATEMENT

Issued by the Authority of the Private Health Insurance Administration Council

Private Health Insurance Act 2007

Private Health Insurance (Insurer Obligations) Amendment Rule 2012 (No. 1)

Authority

The Private Health Insurance Administration Council (the **Council**) is empowered by section 163-1 of the *Private Health Insurance Act 2007* (the **Act**) and under item 2 of the table in section 333-25 of the Act to make the *Private Health Insurance (Insurer Obligations) Rules*.

Section 163-1 of the Act provides that:

- (1) The Private Health Insurance (Insurer Obligations) Rules may establish prudential standards relating to *prudential matters for private health insurers.
- (2) **Prudential matters** are matters relating to:
 - (a) the conduct by private health insurers of any of their affairs in such a way as:
 - (i) to keep themselves in a sound financial position; or
 - (ii) not to cause or promote instability in the Australian private health insurance system; or
 - (b) the conduct by private health insurers of any of their affairs with integrity, prudence and professional skill; but does not include matters relating to the solvency or capital adequacy of *health benefits funds.
- (3) A *prudential standard may impose different requirements to be complied with:
 - (a) by different classes of private health insurers; or
 - (b) in different situations; or
 - (c) in respect of different activities.
- (4) A *prudential standard may provide for the Council to exercise powers and discretions under the standard, including but not limited to discretions to approve, impose, adjust or exclude specific prudential requirements in relation to a particular private health insurer or a particular class of private health insurers.
- (5) A *prudential standard takes effect on the day on which it is established in the Private Health Insurance (Insurer Obligations) Rules, or on such later day as is specified in the Private Health Insurance (Insurer Obligations) Rules.

The *Private Health Insurance (Insurer Obligations) Amendment Rule 2012 (No. 1)* (**the Amendment Rule**) amend the *Private Health Insurance (Insurer Obligations) Rules 2009* (**the Rules**), which commenced on 1 January 2010.

The Amendment Rule is a legislative instrument for the purposes of the *Legislative Instruments Act 2003*.

All legal and other requirements for making the Amendment Rule have been met.

Purpose

The purpose of the Amendment Rule is to establish an Outsourcing Standard which requires private health insurers to comply with minimum requirements if entering into, renewing or renegotiating an outsourcing arrangement. These minimum requirements focus on effective risk management, in order to prevent or minimise the financial, and informational risks associated with insurers entrusting unrelated entities with their core business operations.

The Amendment Rule also inserts an exemption or modification mechanism into the existing Appointed Actuaries Standard.

Further details on the Amendment Rule are set out in the **Attachment**.

Summary of impact

This Amendment Rule was prepared under RIS ID 12860.

The likely impact of the changes to the Appointed Actuaries Standard contained in the Rule is very small, as the provisions in question merely add an exemption or modification mechanism for provisions which have been in place since 2007 and which largely replace requirements and processes that were in place under the *National Health Act 1953* (the **National Health Act**). The Council has required for the past six years private health insurers to appoint an actuary, who was required to provide a financial condition report to the insurer.

The Outsourcing Standard will have a moderate impact on private health insurers, in that it will enforce the need for insurers to have a board-endorsed policy specific to risk management of outsourcing activities, and in that it will require any new, renewed or renegotiated outsourcing arrangements to be subject to comprehensive review and planning. These impositions are necessary, and will ensure in the long term that risks currently outside of PHIAC's regulatory reach are assessed and minimised.

Consultation

Both the Outsourcing Standard and the changes to the Appointed Actuaries Standard underwent two rounds of industry and other major stakeholder consultations, first in August 2011 and again in February 2012.

Both consultation rounds resulted in substantial stakeholder feedback, with 38 submissions received from private health insurers and other industry stakeholders. The comments provided as part of these consultation processes were assessed and taken into account by the Council in finalising this Rule.

Documents incorporated by reference

The Amendment Rule incorporates no other documents by reference.

ATTACHMENT

DETAILS OF THE *PRIVATE HEALTH INSURANCE (INSURER OBLIGATIONS) RULE 2012 (No. 1)*

1. Name of Rule

Rule 1 provides that the title of the Rule is the *Private Health Insurance (Insurer Obligations) Amendment Rule 2012 (No. 1)* (the **Amendment Rule**).

2. Commencement

The Amendment Rule commence in two-stages:

- (a) Sections 1 to 3 and Item [4] of the Standard apply from the day after it is registered. These sections outline amendments to the Appointed Actuaries Standard only.
- (b) The remainder of the Amendment Rule have effect from the later of:
 - (i) The day after registration of the instrument; and
 - (ii) 1 October 2012.

As detailed in Part 5, Section 8 of this Attachment, the Amendment Rule does not have retrospective application, in that they do not apply to outsourcing arrangements existing at the commencement of this Standard.

3. Amendment of *Private Health Insurance (Insurer Obligations) Rule 2009*

Schedule 1 amends the *Private Health Insurance (Insurer Obligations) Rule 2009*.

SCHEDULE 1 - AMENDMENTS

[1] Rule 4, after definitions of notifiable circumstance

Rule 4 defines terms used in the Amendment Rule.

[2] After rule 4

Insertion of section 4A

4A Outsourcing arrangements

Subsection (1) introduces what “outsourcing arrangement” means under the Standard, being an arrangement between a private health insurer and another party. This blanket term “another party” includes an entity within the insurer’s corporate group. The “arrangement” referred to means an agreement wherein a provider agrees to perform a material business activity which is currently or could be undertaken by the insurer itself.

Subsection (2) outlines the criterion which an activity must meet in order to be termed “material”. This criterion centres on the idea of the activity being a vital or crucial component of the insurer’s business operations, and one which, if disabled, would result in a significant impact on the insurer’s business operations, including its risk management.

Subsection (3) outlines the factors which insurers must consider in deciding whether an activity meets the criterion outlined in subsection (2). Subsection (3) also then provides examples of material business activities, with reference to this list of factors. The factors focus on the financial, operational and reputational impact of failure of an activity, with regard to issues of reinstatement of failed activities, and potential regulatory, financial and informational risks associated with this hypothetical failure. They do so as follows:

- (a) By describing a material business activity as being an activity which would cause financial, operational, regulatory, or reputational impact of a significant nature, if disrupted. This provision looks specifically at the potential financial and business costs associated with a failure in performance of a particular activity, and also the potential impact such failure could have on the regulatory compliance of the insurer, and the damage failure could cause to the goodwill or esteem of the insurer. These considerations are important ones insurers should make in determining the materiality of any activity they plan to outsource.
- (b) By encouraging insurers to consider the potential costs of the proposed outsourcing of a particular activity, and how this would – due to the nature of the activity – impact on the overall management expenses of their health insurance business.
- (c) By encouraging insurers to consider, before outsourcing a particular activity, the potential difficulty in making alternative arrangements for performance of that activity, should the planned arrangement fail. This consideration is most relevant for a specialised activity, which can only be performed by a unique or niche market of service providers.
- (d) By encouraging insurers to consider the potential losses to their policyholders and other affected parties, (including the Australian Government, other insurers and service providers) which could be caused by performance failure. For example, if an activity carries with it the risk of significant financial losses, and relies on interdependencies amongst stakeholders, it could potentially be defined as a “material business” activity.

[3] After rule 12

Insertion of

13 Outsourcing Standard

This provision introduces Schedule 4, and how it sets out the substantive provisions of the Outsourcing Standard.

[4] Schedule 2, after section 10

Insertion of

PART 3 Exemptions and modifications by Council

11 Exemptions and modifications by Council

This section implements exemptions as part of the Appointed Actuaries Standard, providing that:

- (a) The Council may exempt an insurer from particular provisions of the Standard; or
- (b) Modify the application of particular provisions of the Standard

upon written application of the private health insurer, or if the Council – on its own initiative – considers this appropriate.

[5] After Schedule 13

Insertion of

SCHEDULE 4 – OUTSOURCING STANDARD

(rule 13)

PART 1 Outsourcing policy

1 Outsourcing policy

Subsection (1) outlines the need under the Standard for private health insurers to have a policy specifically dedicated to outsourcing activities.

Subsection (2) details the specific information that an insurer's Outsourcing Policy must contain, and that it must be known by and endorsed by the insurer's management. This subsection explains:

- (a) That the Outsourcing Policy must be endorsed by the insurer's board;
- (b) That the policy must comply with Subsection (3) (outlined below) for use in a situation where the insurer is assessing options to outsource a material business activity to a third party outside of its corporate group; and
- (c) That the policy must comply with Subsection (4) for use in a situation where the insurer is assessing options to outsource a material business activity to a third party inside its corporate group.

Subsection (3) requires that when looking at options to potentially outsource a material business activity outside of its own corporate group, a private health insurer must do the following:

- (a) Prepare a business case. This task is established as a requirement for all insurers assessing options to outsource a material business activity, as it is a reflective task which compels insurers to capture the reasoning for initiating a project or task. The intention of this requirement is to ensure that insurers take the time to assess, through a merits-based process, whether outsourcing is necessary, efficient and appropriate to their overall business operations.
- (b) Undertake a due diligence review. This provision is aimed at ensuring insurers investigate the operations of the business to which they plan on outsourcing material business activities to in order to make an informed decision about the risks of the third party failing to provide the service.
- (c) Undertake a selection process for potential service providers. This provision is intended to ensure that insurers choose their outsourced service providers in a transparent, economical, merits manner.
- (d) Involve the board in selection processes. This provision looks to make sure that those in control of the insurer, and with the appropriate authority, expertise and knowledge of the insurer, are involved in decisions directly affecting the insurer's core business. The use of the word "involve" may be interpreted as meaning "consult on or with", "collaborate with", "inform" or "notify". Insurers need to be wary of these possible interpretations in designing their selection processes, to ensure that individuals making decisions with regard to outsourcing are adequately included in the process.

- (e) Develop evaluation processes. The aim of this provision is to encourage insurers to develop standards by which they wish outsourced service providers to conform, and for the purposes of evaluated service providers' performance generally.
- (f) Establish dispute resolution processes. This provision compels insurers to include in their management planning, the ability to foresee and minimise the impact of potential disagreements arising within outsourcing arrangements.
- (g) Develop contingency planning. This provision encourages insurers to have alternative planning in place, in order to avoid potential operation failure and financial and informational losses resulting from the breakdown of an outsourcing arrangement.
- (h) Set the terms of the outsourcing arrangement in writing. This provision aims to ensure that terms of service between insurers and outsourced service providers are clearly articulated, agreed and binding.

Subsection (4) sets out factors insurers should consider when looking at options to potentially outsource a material business activity within its own corporate group. These include:

- (a) Whether the outsourced service provider can perform under the outsourcing arrangement in an economical and on an ongoing basis.
- (b) Whether any risks which may accompany the outsourcing activity may change the risk profile of the insurer as a whole. This analysis process should include planning with a focus on attending to these potential changes.
- (c) Whether there are sufficient monitoring procedures in place with regard to the insurer's outsourcing arrangements. If not, insurers are encouraged to adopt this measure, in order to avoid risk creep.
- (d) Consideration of how defective performance by the outsourced service provider would be addressed by the insurer. This forward thinking provision encourages insurers to be mindful of the potential effects of disruption or collapse of an outsourcing arrangement, and how such disruption could be minimised.

PART 2 Outsourcing monitoring processes

2 Risk management

Subsection (1) requires private health insurers to do a number of things in an effort to manage risks associated with the outsourcing process. These include:

- (a) Conducting a risk assessment; and
- (b) Establish and instigate risk controls in an effort to minimise or prevent the impact of identified risks; and
- (c) Report regularly to the insurer's board on the effectiveness of the risk control system required in subsection 1(b).

Subsection (2) is a blanket provision aimed at ensuring information sharing within an insurer's business units about the insurer's outsourcing policy and processes, and the risk profile associated with these.

3 Monitoring arrangements

Subsection (1) requires insurers to effectively monitor its outsourcing activities.

Subsection (2) outlines the specifics of what the Standard requires of an insurer's outsourcing monitoring. These include:

- (a) That the insurer has regular contact with the outsourced service provider, for the purpose of monitoring the associated outsourcing arrangement; and
- (b) That any monitoring of outsourcing activities is done so based on assessment against measurable service level criterion, as required under Part 1, Section 1 (3)(e) of the Standard.

4 Council access to information held by outsourced service providers

Subsection (1) provides that any outsourcing arrangement must require that the outsourced service provider allows Council's access to the private health insurer's documentation and information related to that arrangement.

Subsection (2) provides that Council may request an outsourced service provider for the information and access outlined in subsection 4(1).

Subsection (3) placed restrictions on Council's ability to request access and information, as outlined in subsection 4(2) by providing that the Council cannot make such a request of the outsourced service provider unless:

- (a) The Council has already made the same request of the insurer; and
- (b) The insurer has not complied with this request.

Subsection (4) stipulates that if a legitimate request, complying with the rest of Section 4 is made of an outsourced service provider, that outsourced service provider must comply with the request.

Subsection (5) requires that if Council seeks access to the information or premises of an insurer's outsourced service provider in accordance with Section 4, the insurer engaged in the associated outsourcing arrangement must ensure that their outsourced service provider keeps this confidential, except to the extent necessary to conduct business with another insurer for which the outsourced service provider works.

PART 3 Notifications

5 Offshore outsourcing

Subsection (1) requires two things of insurers who plan to enter into an outsourcing arrangement which is to be conducted outside of Australia:

- (a) Notify the Council in writing of this intention; and
- (b) Provide the Council with a copy of the risk assessment and associated risk controls devised by the insurer in order to minimise or prevent losses, as described in Section 2.

It is important to note here that under this provision, paired with Part 3, Section 6 of the Rule, the insurer would be obliged to:

- Notify PHIAC of its proposed entry into the arrangement; and then
- Notify PHIAC of the eventual entry into the arrangement (if or when this occurs); and then
- Notify PHIAC of the termination of this arrangement (if or when this occurs).

Subsection (2) provides that if Council is not satisfied that the risk assessment and controls provided by the insurer are adequate, it is able to direct that the insurer must make suitable arrangements for performance of the activity that it is attempting to outsource.

Instances in which Council may impose a requirement on an insurer to make other suitable arrangements may include:

- Council requiring the insurer to break an existing outsourcing arrangement and make an outsourcing arrangement with an alternative service provider; or
- Council requiring the insurer to reinforce an existing outsourcing arrangement with a specific policy or schedule outlining further terms and / or conditions; or
- Council requiring the insurer to reconsider its risk management analysis and control framework in relation to a particular outsourcing arrangement.

Council will have regard to the privacy implications in relation to the personal information of consumers of private health insurance, in its appraisal. If a potential breach of privacy law is identified, Council will make all efforts to refer this to the appropriate authority.

6 Disclosure requirements

Subsection (1) requires private health insurers to notify the Council in writing of its intention to enter into an outsourcing arrangement, within 28 days of the intended commencement of that arrangement.

Subsection (2) requires insurers to do two things within 28 days of any termination of an outsourcing arrangement:

- (a) Notify Council in writing, of the termination;
- (b) Provide the Council with written details of the transition arrangements and future strategies the insurer has in action, for carrying out the activity which was the basis of the outsourcing arrangement.

It is important to note here that if the relevant outsourcing arrangement was to an offshore outsourced service provider, as defined in the Rule, the insurer would be obliged to:

- Notify PHIAC of its proposed entry into the arrangement; and then
- Notify PHIAC of the eventual entry into the arrangement (if or when this occurs); and then
- Notify PHIAC of the termination of this arrangement (if or when this occurs).

Subsection (3) enforces that if the termination of the outsourcing arrangement in question may result in a unexpected or significant disruption to a material business activity, that notification requirements specified under the Disclosure Standard, articulated in Schedule 3 of the Rule, apply in addition to the obligations under Section 6.

PART 4 Exemptions and modifications by Council

7 Exemptions and modifications by Council

This section implements an exemptions provision as part of the Appointed Actuaries Standard, providing that:

- (a) The Council may exempt an insurer from particular provisions of the Standard; or
- (b) Modify the application of particular provisions of the Standard

upon written application of the private health insurer, or if the Council, on its own initiative, considers this appropriate.

PART 5 Transitional arrangements

8 Transitional arrangements

Subsection (1) outlines that subject to subsection 8(3), on commencement of the Standard all non-compliant private health insurers must notify the Council in writing of their non-compliance, and in doing so, must:

- (a) Identify the specific provisions of the Standard with which they currently cannot comply; and
- (b) Specify a date by which the Council can expect the insurer to be fully compliant with the Standard.

Subsection (2) of this provision places an onus on Council to respond to any notification in accordance with subsection 8(1), to tell the insurer in writing a date the Council has set for that insurer's compliance.

Subsection (3) stipulates that the Standard does not have retrospective effect – that is, any outsourcing arrangement entered into before the commencement of the Standard, does not have to comply with the Standard until it is renewed or renegotiated.

A note included in Section 8 explains that the date set by the Council under subsection 8(2) does not need to be the same as the date specified by the insurer under paragraph subsection 8(1)(b).

STATEMENT OF COMPATABILITY WITH HUMAN RIGHTS

Issued by the Authority of the Private Health Insurance Administration Council

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

Private Health Insurance (Insurer Obligations) Amendment Rule 2012 (No. 1)

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*.

Overview of the Legislative Instrument

The *Private Health Insurance (Insurer Obligations) Amendment Rule 2012 (No. 1)* comprises two amendments to the *Private Health Insurance (Insurer Obligations) Rule 2009* (the Rule):

- a) Outsourcing Standard (Schedule 4): articulation of a prudential standard which sets out the minimum requirements that a private health insurer must comply with if it enters into an outsourcing arrangement. The Outsourcing Standard requires an insurer that enters into, renews or renegotiates an outsourcing arrangement to manage effectively any risks associated with the arrangement.
- b) Amendment to the existing Appointed Actuaries Standard (Schedule 2): this amendment will introduce an exemptions provision to the current Standard, which will allow the Private Health Insurance Administration Council ('PHIAC' or 'the Council') to vary the requirements articulated within the Appointed Actuaries Standard, on written application from an insurer, or by its own initiative.

Outsourcing Standard

The instigation of a prudential standard dedicated to the practice of outsourcing will work to ensure that private health insurers plan for, develop and execute their outsourcing practices in a sound and economical manner.

This prudential standard forms part of the broader regulatory framework PHIAC uses to achieve an appropriate balance between the following objectives:

- Fostering an efficient and competitive health insurance industry;
- Protecting the interests of consumers of private health insurance; and
- Ensuring the prudential safety of individual private health insurers.

Appointed Actuaries Standard

The legislative instrument also provides for insertion into the Appointed Actuaries standard, of a provision which provides PHIAC with the ability to exempt a particular insurer from parts of the legislation, in limited circumstances. The provision may be enacted upon application of an insurer, or by the Council's own initiative.

This amendment to the Rule will increase PHIAC's regulatory efficiency, as it will provide the Council with reasonable and necessary regulatory flexibility.

Human rights implications

The Outsourcing Standard and amendment to the Appointed Actuaries Standard will place restrictions and requirements on private health insurer businesses. All of these businesses are, subject to the registration provisions of the *Private Health Insurance Act 2007* (Cth),¹ companies or constitutional corporations.² As human rights are inherent in human beings, as opposed to corporate entities, this part of the instrument will not directly engage human rights.

The Outsourcing Standard does however; indirectly promote the human rights of private health insurance consumers.

Right to health

The 1948 Universal Declaration of Human Rights mentions health as being a part of the right to an adequate standard of living (Article 25) and since 1948, the right to health has been most notably recognised as a human right in Article 12 of the 1966 International Covenant on Economic, Social and Cultural Rights. This is articulated as: “the right of everyone to the enjoyment of the highest attainable standard of physical and mental health”.³

By placing particular restrictions and obligations on insurers to ensure that they act with prudence in conducting business operations such as outsourcing, PHIAC aims to protect the private health insurance industry and its consumers from potential financial and information losses.

In providing this consumer protection in a strong and stable industry, the Outsourcing Standard will work to indirectly promote the right to health of private health insurance consumers. The Standard will do this by ensuring that the systems through which consumers of private health insurance access the Australian health system are financially sound and efficient.

The Office of the United Nations High Commissioner for Human Rights explains that some key freedoms and entitlements comprised in the right to health are:

- the right to a system of health protection providing equality of opportunity for everyone to enjoy the highest attainable level of health;
- access to essential medicines;
- equal and timely access to basic health services;
- the provision of health-related education and information;
- participation of the population in health-related decision-making at the national and community levels; and

¹ S 126-10 *Private Health Insurance Act 2007* (Cth).

² As defined in the *Private Health Insurance Act 2007* (Cth).

³ Article 12, International Covenant on Economic, Social and Cultural Rights, done at New York on 16 December 1966 ([1976] ATS 5).

- all health services, goods and facilities must be available, accessible, acceptable and of good quality.⁴

The Outsourcing Standard will promote these key aspects of the right to health by making sure private health insurers effectively manage the risks associated with their outsourcing practices. In turn, this practice provides people who choose to access the health system with the assistance of a private health insurer, with financial protections.

In the exemption provisions it adds to the Appointed Actuaries standard, the instrument will also remove potential challenges to market efficiency and competition, by reasonably adjusting regulation where it may be considered burdensome or a hindrance to business practices. Arguably, this will assist consumers of private health insurance to source cover from within a competitive industry, and accordingly, obtain better value for money.

Conclusion

The *Private Health Insurance (Insurer Obligations) Amendment Rule 2012 (No. 1)* is compatible with human rights because:

- it does not directly engage human rights, as it applies substantively only to companies and constitutional corporations; and
- where it indirectly engages with the human rights of consumers of private health insurance, it does so in a positive way.

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⁴ Office of the United Nations High Commissioner for Human Rights and World Health Organisation, *The Right To Health – Fact Sheet No. 31*, <http://www.ohchr.org/Documents/Publications/Factsheet31.pdf>