The Auditor-General
Audit Report No.20 2005–06
Performance Audit

Regulation of Private Health Insurance by the Private Health Insurance Administration Council

Australian National Audit Office

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Australian National
Audit Office

Canberra ACT
6 December 2005

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit in the Private Health Insurance Administration Council in accordance with the authority contained in the *Auditor-General Act 1997*. I present the report of this audit and the accompanying brochure to the Parliament. The report is titled *Regulation of Private Health Insurance by the Private Health Insurance Administration Council.*

Following its tabling in Parliament, the report will be placed on the Australian National Audit Office's Homepage—http://www.anao.gov.au.

Yours sincerely

Steve Chapman
Acting Auditor-General

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
Canberra ACT

AUDITING FOR AUSTRALIA

The Auditor-General is head of the Australian National Audit Office. The ANAO assists the Auditor-General to carry out his duties under the *Auditor-General Act 1997* to undertake performance audits and financial statement audits of Commonwealth public sector bodies and to provide independent reports and advice for the Parliament, the Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

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Abbreviations

AAT	Administrative Appeals Tribunal
AEIFRS	Australian Equivalents to International Financial Reporting Standards
ACCC	Australian Competition and Consumer Commission
AHIA	Australian Health Insurance Association
AHSA	Australian Health Services Alliance
ANAO	Australian National Audit Office
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
CAC Act	*Commonwealth Authorities and Companies Act 1997*
CEO	Chief Executive Officer
Finance	Department of Finance and Administration
GMF	Goldfields Medical Fund (Inc.)
HBRTF	Health Benefits Reinsurance Trust Fund
HCP	Hospital Casemix Protocol
Health Act	*National Health Act 1953*
Health	Department of Health and Ageing
HIRMAA	Health Insurance Restricted Membership Association of Australia
IOR	I.O.R. (Australia) Pty. Ltd.
KRAs	Key Result Areas
The Minister	Minister for Health and Ageing

MoU	Memorandum of Understanding
OECD	Organisation for Economic Cooperation and Development
PBS	Portfolio Budget Statements
PHIAC	Private Health Insurance Administration Council
PHIO	Private Health Insurance Ombudsman
RHBOs	Registered Health Benefits Organisations
Secretary	Secretary of the Department of Health and Ageing
SEU	Single Equivalent Unit
TUH	Queensland Teachers' Union Health Fund Ltd

Glossary

Community rating	The principle, adopted by the Australian Government, that persons should not be discriminated against in obtaining health insurance on the basis of their health risks. Insurers must accept all qualified applicants and, in setting premiums or paying benefits, cannot discriminate on the basis of health status, age (other than under Lifetime Health Cover), race, gender, sexuality, use of hospital, medical or ancillary services, or general claiming history. Premiums, however, may vary between insurers.
PHIAC1	A quarterly form submitted to PHIAC by RHBOs for each State in which they are based, that provides membership and benefits data used to calculate the reinsurance payments due by or to each fund. It also provides data for several statistical summaries published by PHIAC.
PHIAC2	A form submitted quarterly and annually to PHIAC by RHBOs, that provides financial information enabling both the RHBOs and PHIAC to monitor the prudential well-being of each insurer.
Reinsurance	In the context of private health insurance, the means to fulfil the legislative requirement that all private health insurers share in the costs of hospital treatment for high-risk groups, which include people aged 65 years and over, or people with more than 35 days of hospitalisation in any twelve month period.
Single Equivalent Unit (SEU)	A standard measure for the number of persons covered under a contributor's private health insurance policy. A single contributor is counted as one SEU, while all other categories of membership (family, couple and single parent) are counted as two SEUs.

Summary and Recommendations

Summary and Key Findings

This audit

1. The objective of this audit was to assess the Private Health Insurance Administration Council's (PHIAC's) administrative effectiveness as a regulator of private health insurance. In making this assessment, the Australian National Audit Office (ANAO) addressed the following criteria:

- whether PHIAC monitored compliance with its legislative requirements and analysed related data;
- whether PHIAC addressed and managed non-compliance with its legislative requirements; and
- whether PHIAC's governance and organisation supported the performance of its legislative functions.

2. Although the Department of Health and Ageing (Health) also has a role in the regulation of the private health insurance industry under the *National Health Act 1953* (Health Act), Health's regulatory activities were outside the scope of this audit.

Overall audit conclusion

3. Overall, PHIAC's administrative effectiveness as a regulator of private health insurance was sound. In performing its functions, PHIAC maintained an appropriate balance between its objectives of fostering an efficient and effective health insurance industry; protecting the interests of consumers; minimising the level of health insurance premiums; and ensuring the prudential safety of individual Registered Health Benefits Organisations (RHBOs). PHIAC monitored the RHBOs' compliance with requirements and analysed related data, and it addressed and managed non-compliance by taking enforcement action when necessary.

4. PHIAC's governance and organisation supported the performance of its legislative functions.

5. ANAO has made four recommendations and a number of suggestions to enhance PHIAC's regulation and governance. PHIAC has agreed to all recommendations.

Agency response

6. PHIAC provided the following summary response to the audit:

> PHIAC welcomed this audit of its functions. As a small organisation, it can be difficult to find the resources for an objective assessment of our activities and to ensure that we are both efficient and effective. The audit provided useful information to PHIAC to enable ongoing improvement of our operations.
>
> PHIAC fully accepts the recommendations. Recommendations 1 to 3 have already been implemented and the implementation of Recommendation 4 is in progress.

About PHIAC

7. PHIAC is the independent prudential regulator established under the Health Act to oversee the operations of the RHBOs. It is a body corporate within the Health and Ageing portfolio.

8. PHIAC's primary role is to ensure that the RHBOs comply with legislative requirements, that they retain a sound financial position, and that they conduct their businesses in the best interests of consumers. In carrying out its role, the legislation requires PHIAC to achieve an appropriate balance between the following four main objectives:

- fostering an efficient and effective health insurance industry;
- protecting the interests of consumers;
- minimising the level of health insurance premiums; and
- ensuring the prudential safety of individual registered organisations.

9. PHIAC has been given extensive powers to monitor, investigate and supervise the RHBOs, and to take action on issues of non-compliance. However, private health insurance policy matters and other regulatory activities related to products and contribution rates, are the responsibility of the Minister for Health and Ageing (the Minister) and Health.

10. PHIAC's general administrative costs are funded through levies on the RHBOs, based on their membership. In 2004–05, PHIAC's revenue was $4.2 million and its budget for 2005–06 is $4.4 million. PHIAC is located in Canberra, and comprises a five-member Board and a Secretariat of 16 staff.

11. PHIAC maintained close relationships with a number of stakeholders other than the RHBOs which it regulates. These included the Minister, Health, the Private Health Insurance Ombudsman (PHIO), the private health insurance industry bodies, the Australian Government Actuary, other government agencies, and other corporate regulators such as the Australian Prudential Regulation Authority (APRA).

About the industry

12. Since 1984, private health insurance has co-existed with Australia's universal public insurance scheme, Medicare. For those insured, private health insurance is designed to provide such benefits as choice of doctor in hospital, choice of hospital and choice of timing for a procedure. It can also assist with the costs of ancillary services, such as dental and optical, which are not covered by Medicare. Private health insurance is an important component of health care funding, with members' premiums and the Australian Government's Private Health Insurance Rebate accounting for over ten per cent of the total.

13. After a steady decline during the 1990s, the number of persons covered by private hospital insurance grew significantly in 2000, but has since remained relatively stable. The increase followed the introduction by the Australian Government of measures designed to increase the take-up of private health insurance, including the Medicare Levy Surcharge, the Private Health Insurance Rebate and Lifetime Health Cover.

14. At 30 June 2005, almost ten million Australians (or 49 per cent of the population) were covered by some form of private health insurance. Some 8.7 million persons (43 per cent) had hospital coverage—7.1 million with combined private hospital and ancillary insurance and 1.6 million with hospital only insurance. A further 1.3 million persons (six per cent) had ancillary cover only.

15. RHBOs provide private health insurance. In 2003–04, these organisations collected $8.6 billion in members' contributions and paid out $7.6 billion in benefits. The industry is volatile in that it operates on small profit margins and is price sensitive in terms of whether or not people take out or retain a private health insurance policy. Six of the 40 RHBOs operating at 30 June 2005 had around 77 per cent of the hospital cover business and received 76 per cent of the total premium income, which meant that the other 34 funds shared only around 23 per cent of the market.

16. The Health Act is the main legislation governing private health insurance in Australia. It provides that organisations must be registered in order to carry on the business of health insurance; it specifies the types of services which may be offered and the way the business is conducted; and it allows conditions to be set in relation to any fund's registration. It also sets out the regulatory framework for the industry.

Key findings

Regulatory monitoring (Chapter 2)

17. PHIAC was carrying out the range of activities expected of a regulator, including promoting its legislative requirements to members of the industry, monitoring and surveillance of the industry, taking enforcement action in cases of non-compliance, and providing information to, and educating, the industry.

18. ANAO found that PHIAC was performing its functions as specified in the Health Act, with one exception. Rather than obtaining hospital casemix data from Health for modelling, evaluation and research, PHIAC was using data from its own collections because it considered that these were more timely and up-to-date. ANAO considers that if PHIAC believes that this function is no longer relevant, it should seek an amendment to the legislation to remove the requirement.

19. PHIAC's prudential supervision of the private health insurance industry under the Health Act requires it to establish solvency and capital adequacy standards, impose uniform reporting requirements, require actuarial assessments for RHBOs, and monitor and analyse financial and other data provided by the RHBOs to confirm their prudential viability.

20. PHIAC developed Solvency and Capital Adequacy Standards, together with an Interpretation Standard, and implemented these in January 2001. After appropriate review and consultation, PHIAC recently revised these standards to take account of the introduction of Australian Equivalents to International Financial Reporting Standards (AEIFRS).

21. PHIAC follows appropriate monitoring and analytical processes in reviewing the prudential well-being of RHBOs, in line with the requirements established by the prudential standards.

22. PHIAC implemented Appointed Actuary requirements for RHBOs with effect from 1 July 2004. This was an effective and far-reaching initiative as it strengthened decision-making within RHBOs and reinforced governance, as directors of RHBOs are required to certify that they have appropriate risk management and business plans in place. It also ensured that RHBOs were obtaining appropriate actuarial advice. ANAO noted that all RHBOs had complied with PHIAC's requirement by 31 July 2004.

23. PHIAC also administers the Health Benefits Reinsurance Trust Fund (HBRTF), through the quarterly calculation and redistribution among RHBOs of the costs of hospital treatment for high-risk groups. In 2004–05, this involved the transfer of $163 million between the RHBOs. PHIAC expected this to increase to $180 million in 2005–06.

24. ANAO found that PHIAC had established and communicated to RHBOs policies and guidance on the reinsurance data collection process. PHIAC had implemented appropriate monitoring and analytical processes in administering reinsurance, including validation checks on the data.

25. ANAO noted that a key risk to the reinsurance calculation was the accuracy of data submitted by the RHBOs. PHIAC recognised this risk and addressed it. Despite assurances given by the RHBOs, the validation checks carried out by PHIAC found inaccuracies. ANAO observed that PHIAC queried discrepancies with the relevant RHBO and required it to correct any errors prior to processing the returns.

26. From time to time, Health requests PHIAC's advice on whether any increase in contribution rates requested by an RHBO might adversely affect the financial stability of that RHBO by failing to cover anticipated increases in the cost of providing services, or being excessive and so reducing the number of contributors. ANAO found that PHIAC had developed appropriate procedures to assess and advise on the impact of such changes.

27. ANAO found that PHIAC produced and disseminated a range of financial and statistical reports and other publications about the industry, which provided relevant information to the industry, other stakeholders and to consumers. ANAO noted PHIAC's efforts to improve the quality of reports and the services provided.

Regulatory action (Chapter 3)

28. PHIAC used a range of surveillance mechanisms to identify cases of non-compliance. Along with its regular monitoring and analysis, PHIAC had initiated a program of fund reviews aimed at gaining a better understanding of the RHBOs' administration and financial operations.

29. However, ANAO's analysis of the time taken by PHIAC to produce reports on the outcome of these reviews found the average was five months, with some taking much longer. ANAO considered that PHIAC needed to ensure more timely advice to RHBOs on the results of these reviews to enable better monitoring of issues raised, and made a recommendation that PHIAC improve its reporting on the review program.

30. If RHBOs failed to meet either the Solvency or Capital Adequacy Standard, or breached the Health Act, PHIAC took regulatory action. It had established appropriate procedures and guidelines for its management of non-compliance, using a seven-step process, and had provided these guidelines to RHBOs. ANAO found that PHIAC was effectively applying these procedures when investigating and supervising fund performance.

31. ANAO found instances where PHIAC had used the enforcement actions available to it as the regulator, when required. These included appointing inspectors and administrators to RHBOs. Where it did not have jurisdiction to take action itself, it had passed the responsibility for action to the appropriate authority—the Minister, Health or another regulator.

32. PHIAC used a number of mechanisms to assist RHBOs understand its requirements and to inform them of better practices. PHIAC developed procedures, guidelines and instructions setting out its requirements and provided these to RHBOs. ANAO noted that PHIAC has also introduced other measures to educate RHBOs and improve their operations and reporting, to maximise their compliance with PHIAC's requirements.

33. PHIAC set out its objectives and functions in its annual report and in a number of documents on its website. It had also developed clear procedures and guidelines for carrying out its monitoring and analysis of prudential standards and management of non-compliance by the RHBOs. However, ANAO considered that PHIAC could improve promotion of its role and responsibilities to members of the industry, and made a recommendation that PHIAC develop a clear statement that set out its intentions as the regulator and identified the reciprocal responsibilities of the RHBOs.

Governance and organisation (Chapter 4)

34. ANAO assessed PHIAC's governance and organisation, and found that it provided sound support for its regulatory activities. PHIAC's structure is appropriate to its regulatory functions and it has a logical division of duties and appropriate reporting lines. PHIAC had clearly defined the roles and responsibilities of the Chief Executive Officer (CEO) and staff. ANAO noted that PHIAC was reviewing its structure, as part of its current strategic planning, to identify the best organisational design for the next three to five years.

35. PHIAC was meeting its responsibilities under the *Commonwealth Authorities and Companies Act 1997* (CAC Act). It had developed operating procedures for the conduct of Board business, including a Board Charter, and it provided induction and training for Board members. It also assessed Board performance through regular Board reviews.

36. PHIAC had relevant internal controls, including an Audit and Compliance Committee, and well-documented compliance instructions, such as an Employee Manual and CEO's Instructions, which included a fraud control plan.

37. PHIAC had established a comprehensive and effective strategic and operational planning framework to guide the performance of its legislative functions, which included a Corporate Plan, a Business Plan and a Risk Management Plan. It had sound regular annual strategic and operational planning processes. It set strategies and monitored its performance using a risk management approach. However, ANAO recommended that PHIAC could improve this process by conducting more regular reviews of its risk register and extending its risk management reporting to incorporate those risks categorised as 'significant'.

38. ANAO found that PHIAC had a performance management and reporting framework that identified the extent to which PHIAC achieved the operational goals established in its Corporate Plan. However, ANAO recommended that improvements could be made in order to better demonstrate the extent to which PHIAC achieved its stated outcome. These would include linking actions in its Business Plan to the performance indicators set out in the Portfolio Budget Statements (PBS), and developing more measurable indicators for public reporting.

39. PHIAC met its legislative reporting requirements by preparing an annual report on its activities (as required under s. 9 of the CAC Act) and the annual report on the operations of the RHBOs, and notifying the Minister of significant events. PHIAC's annual report included its audited financial statements.

Recommendations

Recommendation No.1 Para 3.25

ANAO recommends that PHIAC set specific and realistic targets for the conduct of and reporting on fund reviews, in order to ensure timely advice to RHBOs and monitoring of issues raised in the reviews.

PHIAC's response: *Agreed.*

Recommendation No.2 Para 3.71

ANAO recommends that PHIAC develop a clear statement of its role in regulation of the private health insurance industry, which distinguishes between its functions and responsibilities under the legislation and those of other regulators, and identifies the reciprocal responsibilities of the RHBOs.

PHIAC's response: *Agreed.*

Recommendation No.3 Para 4.50

ANAO recommends that:

(a) PHIAC's Board and senior management review its risk register at least annually to ensure that its risk profiles and risk ratings remained valid over time; and

(b) PHIAC extend its risk management reporting to incorporate those risks categorised as 'significant', as well as 'high' and 'very high', to ensure that their impact on PHIAC's operations are understood, monitored, and acted upon by PHIAC's Board and senior management.

PHIAC's response: *Agreed.*

Recommendation No.4 Para 4.73

ANAO recommends that PHIAC develop performance information in its Business Plan that is closely aligned with the performance information in the Portfolio Budget Statements, in order to better measure the extent to which PHIAC achieves its stated outcome, and develop more measurable indicators for public reporting.

PHIAC's response: *Agreed.*

Audit Findings and Conclusions

1. Introduction

This Chapter provides a background to the audit by describing the private health insurance industry and its regulation. It also outlines the audit objective and approach.

Background

1.1 Private health insurance is an important component of funding health care in Australia, with members' premiums and the Australian Government's Private Health Insurance Rebate providing over 10 per cent of total national health care funding. Since 1984, private health insurance has co-existed with the universal public insurance scheme, Medicare. For those insured, private health insurance is designed to provide such benefits as choice of doctor in hospital, choice of hospital and choice of timing for a procedure. It can also assist with the costs of ancillary services, such as dental and optical, which are not covered by Medicare.

Legislation – the National Health Act

1.2 The *National Health Act 1953* (Health Act) is the main legislation governing private health insurance in Australia. The Health Act provides that organisations must be registered in order to carry on the business of health insurance; it specifies the types of services which may be offered and the way the business is conducted; and it allows conditions to be set in relation to any fund's registration. It also sets out the regulatory framework for the private health insurance industry.

The Private Health Insurance Administration Council

1.3 The Private Health Insurance Administration Council (PHIAC) is the independent prudential regulator established under the Health Act to oversee the operations of the Registered Health Benefits Organisations (RHBOs). PHIAC's primary role is to ensure that the RHBOs comply with legislative requirements, that they retain a sound financial position, and that they conduct their businesses in the best interests of consumers.

1.4 In carrying out its role, the legislation requires PHIAC to achieve an appropriate balance between the following four main objectives:

- fostering an efficient and effective health insurance industry;
- protecting the interests of consumers;

- minimising the level of health insurance premiums; and
- ensuring the prudential safety of individual registered organisations.

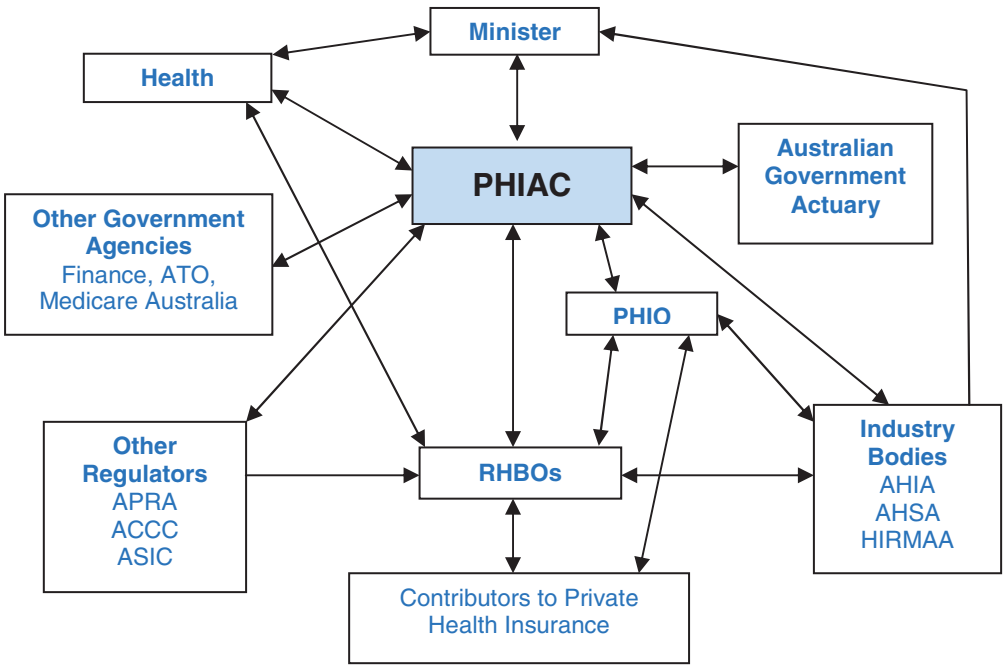
1.5 PHIAC has been given extensive powers to monitor, investigate and supervise RHBOs, and to take action on issues of non-compliance. However, private health insurance policy matters and other regulatory activities are the responsibility of the Minister for Health and Ageing (the Minister) and the Department of Health and Ageing (Health).

PHIAC's stakeholders

1.6 While PHIAC considers that its principal stakeholders are the Minister, Health, the RHBOs and contributors to RHBOs, it also has relationships with a number of other parties, as shown in Figure 1.1. These include the Private Health Insurance Ombudsman (PHIO), the private health insurance industry bodies, the Australian Government Actuary, other government agencies, and other corporate regulators.

Figure 1.1

PHIAC's stakeholders



Source: ANAO.

The Department of Health and Ageing

1.7 The Private Health Insurance Branch within Health develops private health insurance policy and provides policy advice to the Minister on private health insurance matters. It also advises the Minister and Secretary about their powers under the Health Act—which include the regulation of RHBO products, premium pricing and rules.

1.8 PHIAC regularly provides a range of statistical information to Health as required under the legislation, and they exchange information on issues arising with the RHBOs. They both have a role in the annual round of RHBO premium increases, and on the Registration Committee, which examines and reports on applications from organisations for registration as a RHBO. PHIAC also provides advice to Health on the prudential regulation framework and amendments to the Health Act to improve its implementation.

The Private Health Insurance Ombudsman

1.9 The PHIO handles consumer complaints about matters associated with private health insurance, and makes recommendations to the Minister and Health on regulatory and industry practices. The PHIO publishes an annual *State of the Health Funds Report* for the benefit of consumers. This compares the RHBOs based on financial and other data provided mainly by PHIAC.

The Australian Government Actuary

1.10 PHIAC consults the Australian Government Actuary for actuarial advice when developing and reviewing the prudential standards, and in analysing applications from RHBOs for premium increases. The Australian Government Actuary is also a member of the Registration Committee.

Other regulators

1.11 PHIAC cooperates with the Australian Prudential Regulation Authority (APRA), the Australian Securities and Investments Commission (ASIC), and the Australian Competition and Consumer Commission (ACCC), on matters affecting RHBOs and the industry generally. PHIAC and APRA have a Memorandum of Understanding (MoU) that sets out a framework for coordination and cooperation between the agencies in the regulation of the four RHBOs that are run by friendly societies regulated by APRA under the *Life Insurance Act 1995* and the *Corporations Act 2001*.

The private health insurance industry

1.12 Private health insurance is provided by the RHBOs, most of which are incorporated mutual associations.[1] They are not permitted to conduct other business within the fund and must be registered with the Australian Government. The role and size of the private health insurance industry has varied over time in response to government decisions on the mix of public and private funding of health services, and as a result of some rationalisation of health funds.

1.13 The Australian Government introduced a range of measures over recent years aimed at improving the usage of private health insurance. These included the Medicare Levy Surcharge, the 30 per cent Private Health Insurance Rebate (increased in 2005 to 35 per cent and 40 per cent for people aged 65 to 69 and 70 and over, respectively), and Lifetime Health Cover.[2]

1.14 In 2003–04, the private health insurance industry collected $8.6 billion in members' contributions and paid out $7.6 billion in benefits, as shown in Table 1.1. Industry management expenses totalled $852 million, which accounted for almost ten per cent of contribution income.[3]

Table 1.1

Industry overview 2003–04

	$ million
Total benefit income	8 636
Other income	296
Benefit outlays	(7 630)
Management expenses	(852)
Other expenses	(3)
Industry surplus before tax	447

Source: PHIAC, *Operations of the Registered Health Benefits Organisations 2003–04 Annual Report*.

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1 The Health Act requires that a registered health fund be incorporated under a law of the Commonwealth, State or Territory (s. 73AA). The majority of health funds are incorporated under the Commonwealth's *Corporations Act 2001*. However, five funds are incorporated under State legislation and two funds are registered under the *Life Insurance Act 1995*.

2 More detail about these measures is available in *Insure? Not Sure?* on PHIAC's website at <www.phiac.gov.au/insurenotsure>.

3 Industry data for 2004–05 was not available at the time of the audit. This data will be included in PHIAC's *Operations of the Registered Health Benefits Organisations 2004–05 Annual Report,* which is expected to be tabled in early 2006.

1.15 The industry, however, remains potentially volatile. It operates on small profit margins and is price sensitive in terms of whether or not people take out or retain a private health insurance policy. Table 1.2 shows that the net operating surplus derived from insurance activities in 2003–04 was $151 million—a net margin result of 1.8 per cent.

Table 1.2

Industry surplus 2003–04

	$ million
Surplus from other business activities and investment income	296
Surplus from core insurance operations	151
Industry surplus before tax	447

Source: PHIAC, *Operations of the Registered Health Benefits Organisations 2003–04 Annual Report*.

Registered Health Benefits Organisations

1.16 Over the past ten years, the number of RHBOs has decreased by almost 20 per cent, from 48 in June 1995 to 39 in July 2005.[4] Of these, 25 were open membership organisations—available to the public generally—and 14 were restricted membership organisations—available only to members of specific employment groups, professional associations or unions, and their dependants. The RHBOs operating during 2004–05 are listed in Appendix 1.

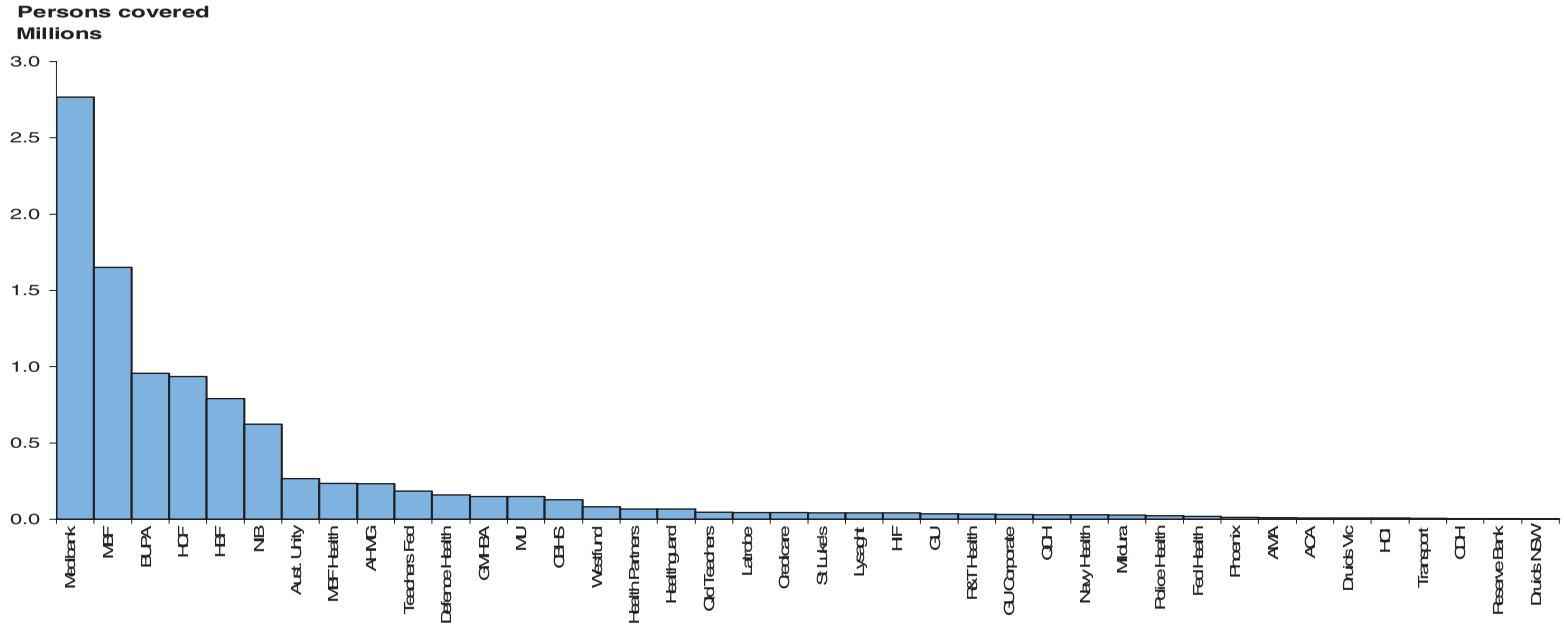
1.17 Most RHBOs (34) operated on a 'not-for-profit' basis, where any surplus generated from the organisation's business remains in the fund to be used for the benefit of contributors. The five organisations that operated on a 'for-profit' basis may use monies in excess of the prudential requirements for payments to shareholders.

1.18 Figure 1.2 shows that the private health insurance industry is unevenly balanced, with a significant range in the size of RHBOs based on the number of persons covered by each fund's membership.

[4] There were 40 at 30 June 2005. In July 2005, Federation Health advised its members that it had merged with Latrobe Health (see <www.fedhealth.com.au/Changes/>).

Figure 1.2

Number of persons covered by RHBO – 30 June 2005



Source: PHIAC.

1.19 The 40 RHBOs at 30 June 2005 had 4.7 million members. The six largest RHBOs (Medibank, MBF, BUPA, HCF, HBF and NIB)[5] covered some 77 per cent of privately insured persons and received 76 per cent of the total premium income. The other 34 RHBOs at that time covered the remaining 23 per cent of privately insured persons. Of these, 26 individual funds each covered less than one per cent of persons with coverage, received less than one per cent of total premium income, and when combined, comprised only eight per cent of the market.

1.20 RHBOs belong to one or more of the health insurance industry bodies. These are the Australian Health Insurance Association (AHIA), the Australian Health Services Alliance (AHSA) and the Health Insurance Restricted Membership Association of Australia (HIRMAA). These bodies represent the interests of RHBOs in their role of helping to shape both the overall regulatory environment and public perceptions of private health insurance.

Private health insurance coverage

1.21 Health funds follow a principle known as 'community rating', which is based on the underlying premise that persons should not be discriminated against in obtaining health insurance on the basis of their health risks. Under the Health Act, RHBOs must accept all qualified applicants, and, in setting premiums or paying benefits, they cannot discriminate (in relation to the contributor or their dependants) on the basis of health status, age (other than age at entry, under Lifetime Health Cover), race, gender, sexuality, use of hospital, medical or ancillary services, or general claiming history.

1.22 There are three basic types of health insurance coverage: hospital insurance only; a combination of hospital and ancillary insurance; or ancillary insurance only.[6] At 30 June 2005, almost ten million Australians (or 49 per cent of the population) were covered by some form of private health insurance.

1.23 Some 8.7 million persons (43 per cent of the population) had hospital coverage at 30 June 2005—7.1 million with combined private hospital and ancillary insurance and 1.6 million with hospital only insurance. A further 1.3 million persons (six per cent) had ancillary cover only.

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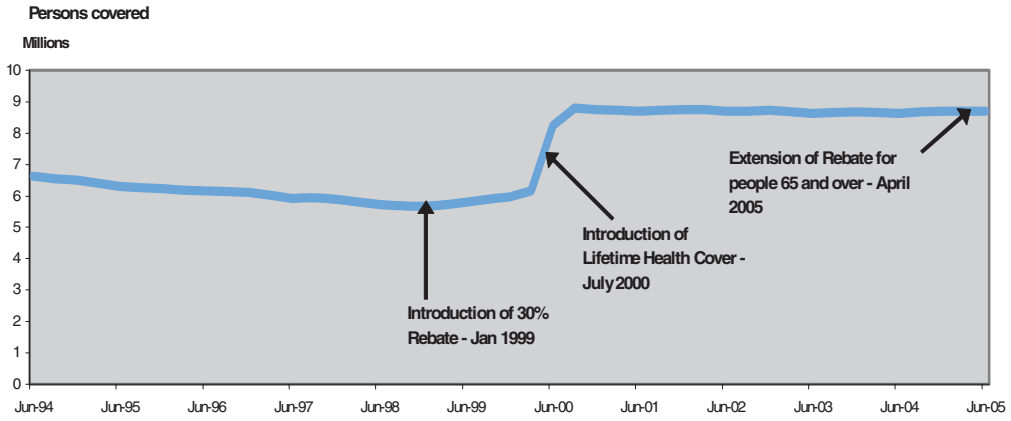
5 Appendix 1 provides a list of the RHBOs operating during 2004–05 and their abbreviated names.

6 Ancillary insurance can be purchased to cover extra services such as physiotherapy, podiatry, dental treatment and glasses or contact lenses.

1.24 After a steady decline during the 1990s, the number of persons covered by private hospital insurance increased significantly in 2000 following the introduction of the Government's measures outlined above. The number since has remained relatively stable—see Figure 1.3.

Figure 1.3

Persons covered by hospital insurance - 1994 to 2005



Source: PHIAC, *Operations of the Registered Health Benefits Organisations Annual Reports*, 1993–94 to 2003–04.

International comparisons

1.25 A recent OECD study found that private health insurance arrangements across member countries are diverse in terms of market size (population covered or share of total health expenditure), functions within the health system, types of insurers and their market conduct, regulatory frameworks and fiscal environments. On average, private health insurance represented only a small share of total health funding in OECD member countries (around six per cent in 2000), and covered at least 30 per cent of the population in only a third of the member countries[7].

1.26 At September 2002, Australia was grouped within the cluster of OECD countries where private health insurance had a relatively significant role in total health expenditure. Australia ranked fifth among the small group of

[7] F Colombo and N Tapay, *Private Health Insurance in OECD Countries: The Benefits and Costs for Individuals and Health Systems*, Organisation for Economic Cooperation and Development Health Working Papers No.15, OECD, 2004, pp.7-8.

countries with the highest percentages of private hospital coverage, with 44 per cent; after France (86 per cent), the United States (70 per cent), Canada (70 per cent) and Ireland (48 per cent)[8].

Audit approach

1.27 ANAO conducted the audit because PHIAC was a small agency with important responsibilities in regulating private health insurance, and ANAO had not previously conducted a performance audit of PHIAC.

Audit objective and criteria

1.28 The objective of this audit was to assess PHIAC's administrative effectiveness as a regulator of private health insurance. In making this assessment, ANAO addressed the following criteria:

- whether PHIAC monitored compliance with its legislative requirements and analysed related data;
- whether PHIAC addressed and managed non-compliance with its legislative requirements; and
- whether PHIAC's governance and organisation supported the performance of its legislative functions.

1.29 As noted earlier, Health also has a role in the regulation of the private health insurance industry under the Health Act. However, Health's regulatory activities were outside the scope of this audit.

Audit methodology

1.30 In conducting the audit, ANAO reviewed the Health Act and other legislation, and literature and prior studies relevant to private health insurance and its regulation.

1.31 ANAO undertook fieldwork at PHIAC's office in Canberra. This involved interviews with Council members and officers of PHIAC, and the examination of PHIAC's records, files, operational documents and publications. ANAO also performed checks on PHIAC's reinsurance calculations, verified the accuracy of the computer program used to make the calculations, and analysed other data.

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[8] F Colombo and N Tapay, *Private Health Insurance in Australia: A Case Study*, Organisation for Economic Cooperation and Development Health Working Papers No.8, OECD, 2003, p.8.

1.32 ANAO interviewed various key stakeholders of PHIAC to obtain their perspectives on its operations. These included Board members, Chief Executive Officers (CEOs) and other officers of a small number of RHBOs across Australia; Health officers; the PHIO; the Australian Government Actuary; and representatives of industry associations and other relevant Commonwealth regulators.

1.33 The audit was conducted in accordance with ANAO Auditing Standards at a cost of $418 000.

Report structure

1.34 The remainder of this report is structured as follows:

- Chapter 2 considers PHIAC's regulatory activities and assesses how well PHIAC monitors the industry to secure compliance with the legislation;
- Chapter 3 discusses how PHIAC addresses and manages non-compliance by RHBOs with its requirements and assesses how PHIAC informs and educates the industry; and
- Chapter 4 considers whether PHIAC's governance and organisation support its legislative functions.

2. Regulatory Monitoring

In this Chapter, ANAO considers PHIAC's regulatory activities and assesses how well PHIAC monitors the industry to secure compliance with the legislation.

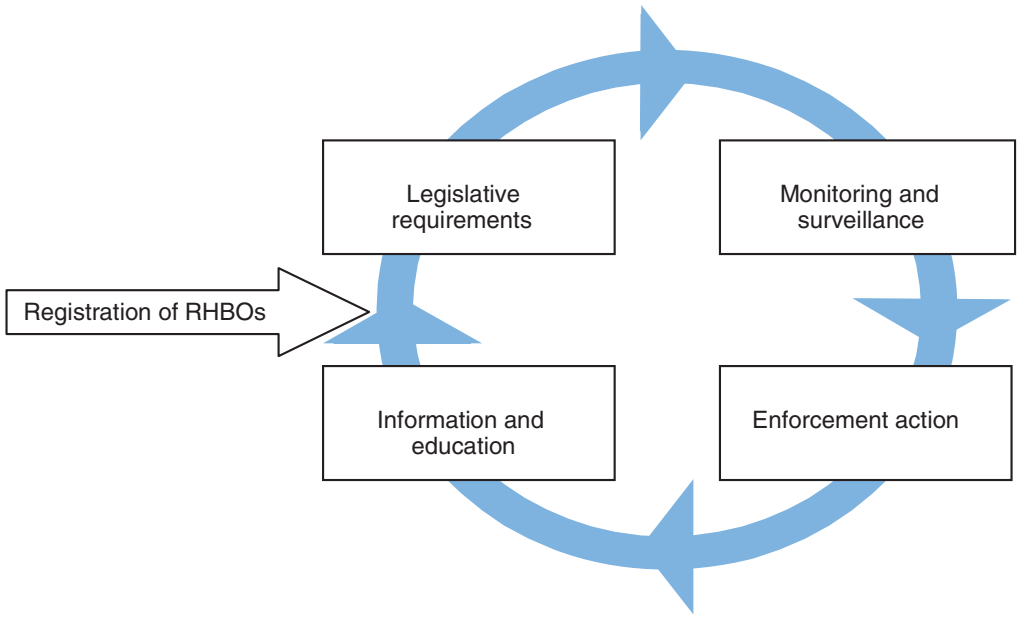
Introduction

2.1 In general terms, ANAO would expect that, in carrying out its regulatory functions and powers, an authority would perform a specific range of activities as part of the regulatory cycle. These include promoting legislative requirements to members of the industry, operational surveillance and monitoring of the industry to ensure that its requirements were met, taking enforcement action in cases of non-compliance with its requirements, and providing information to, and educating, the industry.

2.2 ANAO found that PHIAC carried out the full range of these activities in performing its regulatory role, as shown in Figure 2.1.

Figure 2.1

PHIAC's regulatory activities



Source: ANAO.

2.3 After considering whether PHIAC was performing its functions as set out in the Health Act, in this Chapter ANAO covers PHIAC's promotion of its requirements to the industry, and its monitoring and surveillance activity in relation to these requirements, particularly with respect to the RHBOs' prudential adequacy. Chapter 3 then covers PHIAC's enforcement action when requirements are not complied with, and the extent and means by which PHIAC informs and educates the industry.

Functions

2.4 ANAO noted that the Health Act (under s. 82G(1)) outlines 28 functions that PHIAC is required to perform in its regulatory role. These are listed in Appendix 2. They mostly relate to PHIAC's regulatory monitoring and analysis, and its supervision and intervention activities. PHIAC also performs certain other functions that are set out in other sections of the legislation. For example, ss. 68-73 of the Health Act specifies PHIAC's functions relating to the registration of RHBOs.[9]

2.5 ANAO found that PHIAC was performing the legislative functions listed in Appendix 2, with one exception. PHIAC was not obtaining from Health, for the purposes of modelling, evaluation and research, aggregated data derived from information referred to in the Hospital Casemix Protocol (HCP) as specified under s. 82G(1)(ba).

2.6 PHIAC advised that it does not currently use the aggregate HCP data because this largely duplicates information PHIAC already receives through its own statistical collections. In addition, the availability of the HCP dataset can be up to a year behind the PHIAC quarterly collection and, therefore, PHIAC prefers to use the more up-to-date dataset. ANAO noted that the PHIAC dataset is audited as part of the industry reporting requirements for reinsurance. PHIAC stated that it had confidence in both the quality and timeliness of its own collection, and the HCP dataset could not provide PHIAC with better information in a timely manner.

2.7 ANAO considers that PHIAC should comply with its legislation. If, as is apparent in this case, PHIAC believes that a function is no longer relevant, PHIAC should seek amendment to the legislation to remove the requirement.

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[9] These functions include accepting applications from organisations for registration as RHBOs, referring these to the Registration Committee (of which PHIAC is a member) for examination and report, and, after consideration of the Committee's report, grant or refuse the application. PHIAC is also responsible for keeping a 'Register of Health Benefit Organisations'. There were no registrations in 2004–05.

Prudential supervision

2.8 The Health Act requires PHIAC to monitor and analyse the RHBOs' financial and other data to ensure their prudential adequacy. Prudential supervision by PHIAC of the private health insurance industry is varied. It includes establishing and updating solvency and capital adequacy standards for the industry; imposing uniform reporting requirements to facilitate the collection and comparison of data from RHBOs; requiring actuarial assessments for RHBOs; publishing guidance for the RHBOs and their auditors; and requesting quarterly and annual reports from the RHBOs and monitoring this data against the prudential standards.

2.9 PHIAC is also required to administer the reinsurance calculation, provide advice to Health on contribution rates, and publish statistical and other reports. These are covered in separate sections later in this Chapter.

Solvency and capital adequacy standards

2.10 The Health Act required PHIAC to develop a solvency standard and a capital adequacy standard as integral components of the prudential reporting and management regime for RHBOs under the Act. PHIAC established the Solvency Standard to ensure the basic solvency of RHBOs, while the Capital Adequacy Standard was designed to secure the financial soundness of RHBOs in a 'going concern' sense. In most circumstances, this second tier provides an additional buffer of capital above the minimum solvency requirement. PHIAC first implemented these standards in January 2001.

2.11 In addition, to assist RHBOs, PHIAC developed an Interpretation Standard setting out the terminology used in the Solvency Standard and Capital Adequacy Standard, and detailing the requirements for determining their various components. All standards are available on PHIAC's website.

2.12 The standards provide a measure of the financial position of the RHBO. The management of the RHBO and PHIAC are required to focus on the risks to which the fund is exposed, and the need to manage those risks by either mitigating them or setting aside an amount of capital commensurate with those risks.

2.13 RHBOs are obliged under the Health Act to comply with the requirements of the legislative standards at all times. The standards provide some of the trigger points for regulatory action. If an organisation fails to meet either the capital adequacy or the solvency standard, PHIAC may carry out a

range of regulatory actions, including the imposition of solvency or capital adequacy directions.

Solvency Standard

2.14 The purpose of the Solvency Standard is to ensure that at any time the financial position of a health benefits fund is such that, in the circumstances of its being run-off or wound up, it should be able to reliably meet its existing liabilities to members and other creditors out of the assets of the fund.

2.15 This solvency requirement is the sum of the RHBO's existing liabilities, costs associated with concluding the fund and prudential reserves for risk, less appropriate debts and calls on new capital. Each RHBO's total assets must be greater than the solvency requirement.

Capital Adequacy Standard

2.16 The Capital Adequacy Standard prescribes the capital requirement of a RHBO to ensure that there are sufficient assets in the fund to meet the obligations to, and reasonable expectations of, contributors and creditors, fund its business plans and absorb short-term set-backs in the context of a viable ongoing operation.

2.17 This capital adequacy requirement is the sum of the RHBO's existing liabilities, future capital needs of the fund and prudential reserves for risk, less appropriate debts and calls on new capital. Each RHBO's total assets must be greater than the capital adequacy requirement.

Review of standards

2.18 PHIAC reviewed the standards after one year of operation and implemented revised standards from 1 July 2003. Further revisions were necessary in 2005 to take account of the introduction of Australian Equivalents to International Financial Reporting Standards (AEIFRS). PHIAC developed the revised standards in consultation with the industry and other stakeholders, including obtaining advice from the Australian Government Actuary. These were issued from 1 July 2005.

2.19 These revisions demonstrated that PHIAC was aware of the need to keep standards' requirements up-to-date, and was regularly reviewing them for accuracy. Communicating this to the industry ensured that it too was aware of such developments.

Uniform reporting requirements

2.20 Under s. 82M of the Health Act, it is a condition of the registration of a RHBO that it complies with such reporting requirements that PHIAC, in the performance of its functions under s. 82G(1)(c), sets for the RHBO. This was necessary to ensure uniform reporting standards (to facilitate comparisons) where there may otherwise have been an inconsistency between the reporting requirements of the Health Act, the *Corporations Act 2001* and Australian Accounting Standards.

2.21 ANAO noted that PHIAC revised and issued to RHBOs periodically (usually annually), the PHIAC Reporting Requirements, which detailed its requirements for all reports provided to PHIAC. This covered the interpretation of various terms; the records of the RHBOs; specific requirements in relation to income, expenses, liabilities and assets for the industry, reinsurance account transactions and audit reports. The requirements first applied for all reports to PHIAC for periods commencing after 1 July 2001.

Actuarial assessments

2.22 PHIAC advised it had found, through its monitoring and fund review processes, that not all RHBOs obtained actuarial advice for product pricing, fund reserves and other matters. This was despite the fact that directors were required to certify that they had appropriate risk management and business plans in place. PHIAC was concerned that this meant appropriate financial advice was not available to support the Board and management of RHBOs.

2.23 As a consequence, PHIAC implemented Appointed Actuary requirements for RHBOs from 1 July 2004. These required RHBOs to appoint an actuary, either in-house or a consulting actuary, who met the professional standards and Code of Conduct of the Institute of Actuaries of Australia. RHBOs were required to notify PHIAC of the name and contact details of the appointee. ANAO noted that all RHBOs had complied with PHIAC's requirement by 31 July 2004.

2.24 The role of these appointed actuaries is to provide independent expert analysis which will assist RHBOs in their pricing reviews and the development and costing of new health insurance products. They will also provide advice on the solvency and capital adequacy standards and the Australian accounting standards.

2.25 To ensure RHBOs are obtaining appropriate actuarial advice, PHIAC requested from RHBOs, for the first time, a Financial Condition Report as at 30 June 2005 prepared by each RHBO's appointed actuary. The reports were to be prepared in accordance with the Guidance Note on Financial Condition Reports provided by the Institute of Actuaries of Australia. PHIAC advised in October 2005 that it had received a Financial Condition Report from each RHBO. These reports provide PHIAC with additional assurance on the RHBOs' viability.

Monitoring and analysis processes

Collection of data

2.26 The Health Act requires PHIAC to obtain from each RHBO regular reports about the financial affairs of the organisation, including reports supported by actuarial certification. Consequently, PHIAC requires each RHBO to provide a quarterly return with financial data that PHIAC uses to assess and monitor the RHBO's prudential adequacy and solvency against the solvency and capital adequacy standards.

2.27 PHIAC issues a standard reporting template, the PHIAC 2 Return (PHIAC2), which requires RHBOs to provide detailed statements of financial performance, financial position and standards calculations. These are submitted for the quarters ending March, June, September and December, unless more frequent reporting has been instigated by PHIAC as a monitoring measure.

2.28 The RHBO's public officer[10] signs the PHIAC2 certifying the truth and fairness of the return. This demonstrates that the RHBO can meet the solvency and capital adequacy standards.

2.29 PHIAC requires an additional return from each RHBO for the full financial year in the form of a PHIAC2 certified by the fund's auditors. PHIAC issues a protected template for this purpose. This is the only audited PHIAC2 and the auditors are required to state that the information contained in this fifth return is accurate. Discrepancies between the quarterly and annual returns are due to changes in assumptions supported by the audit certificate.

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[10] Under s. 74 of the Health Act, RHBOs must appoint a person (usually the CEO) to be the public officer of the RHBO for the purposes of the Act. The public officer performs, on behalf of the RHBO, all acts which are required or permitted to be performed by the RHBO by or under the Act. Anything done by the public officer in this capacity is deemed to be done by the RHBO.

2.30 The annual return also includes a statement from the directors of each RHBO regarding risk management, which provides PHIAC with assurance that risk management systems were in place.

Guidance

2.31 PHIAC issued an Audit Programme Guidance for PHIAC 2 Annual Returns each year to inform the audit process. The latest version was dated May 2005. PHIAC also notified RHBOs by way of a circular. PHIAC's standards, audit guidance and circulars are published on its website.

Processing

2.32 ANAO noted that PHIAC had developed a comprehensive checklist that it used each quarter to analyse the returns and monitor the prudential safety of each RHBO. PHIAC checked the consistency of return data between schedules, and reviewed the completeness and consistency over time of the statements of financial performance and financial position. It also reviewed various ratios and margins; the attribution of inadmissible assets; reserves, projections and other components of the financial statements.

2.33 Each quarter, PHIAC reviewed the PHIAC2 for each RHBO to ensure that not only was there an excess of assets over the solvency and capital adequacy requirements, but that assets were at least 100 per cent of the solvency requirement and 110 per cent of the capital adequacy requirement. In its review, PHIAC also checked to ensure that the capital adequacy coverage ratio was increasing or stable over time, or that the decline in the ratio was no more than 7.5 per cent per annum.

2.34 PHIAC utilised a Financial Statistical Report generated from the database created from the PHIAC2 returns to compare components of each return over time, with peer groups and the industry. This statistical report also provided graphs and bar charts to facilitate its quarterly review. Membership, age profile and benefits data gathered from the reinsurance process (as detailed later in this Chapter) also informed the review.

2.35 Where PHIAC had queries about the accuracy of information provided, or concerns about an RHBO's capital adequacy or solvency as a result of this monitoring, it raised the issue with the RHBO and requested an explanation. If PHIAC identified a breach by a RHBO of the capital adequacy or solvency standards, the process for supervision and intervention commenced.

2.36 At the time of the audit, PHIAC filed all quarterly PHIAC2 returns with Financial Statistical Reports and correspondence. PHIAC stated that, from September 2005, all checking of PHIAC2 returns would be subject to a 'sign-off' process to indicate that they had been satisfactorily completed and reviewed by a senior manager. The introduction of this additional control by PHIAC should improve the audit trail and provide further assurance that RHBOs are meeting their prudential requirements.

Review of fund management expenses

2.37 From information provided on the PHIAC2, PHIAC introduced in 2004 a process of monitoring management expenses incurred by the RHBOs. This was a means to further PHIAC's objective of fostering an efficient and competitive health insurance industry. ANAO noted that PHIAC focused on higher than average expenses incurred by some RHBOs and looked for improvements over time. PHIAC reported on management expenses in the *Operations of the Registered Health Benefits Organisations Annual Report*, so that consumers were aware of how their health fund compared with other funds.

2.38 PHIAC defined RHBO management expenses as all expenses incurred in managing the business (such as rent and salaries) other than the benefits paid to contributors. PHIAC does not assess a further breakdown of these management expenses into subcategories, as different interpretations by RHBOs would make comparisons difficult.

2.39 As noted in Chapter 1, management expenses for the industry totalled $852 million in 2003–04. This was an average of 9.9 per cent of contribution income, reduced from 10.5 per cent the previous year. However, individual RHBOs' management expense ratios varied markedly from the industry average, from a low of 1.2 per cent to a high of 22.6 per cent of contribution income.

2.40 Although RHBOs interviewed by ANAO during the audit generally felt that PHIAC maintained an appropriate monitoring regime, some expressed dissatisfaction over this review of management expenses. RHBOs considered that there were reasonable explanations for high management costs within some RHBOs. For example, management costs taken as a percentage of revenues may be high because contribution rates were kept low, or a greater number of local offices and clinics may provide a higher level of service to members.

2.41 ANAO noted, however, that PHIAC looked at the wider picture and considered cost per contributor as well as cost as a proportion of contribution income. PHIAC also considered industry and peer group averages. PHIAC found that RHBOs could not always adequately explain why their costs were considerably higher than the industry average. ANAO noted that PHIAC has placed increased scrutiny on those RHBOs with abnormally high management expenses, resulting in several funds implementing plans to reduce these. PHIAC informed ANAO that this process of review will continue.

2.42 ANAO found that PHIAC had used appropriate processes to review RHBOs' management expenses, and it was appropriate for PHIAC to review management expenses as part of its monitoring regime.

Future developments in prudential supervision

Industry model

2.43 ANAO noted that PHIAC had been developing an Industry Model that aimed to predict with reasonable accuracy the forward prudential position of RHBOs. The model would use a combination of historical and prospective data coming primarily from the RHBOs' quarterly reports. PHIAC also aimed to enhance the model's usefulness by accommodating changes in RHBOs' assumptions, such as increasing benefits or usage rates, and reviewing the impact of policy proposals.

2.44 PHIAC considered that the development of such a model would further its aims to continuously improve its monitoring and analysis tools, as well as facilitate decisions on rate increases during pricing rounds. The benefits of this would be greater efficiency and improved accuracy of monitoring. PHIAC could discuss fund issues before they occurred rather than after the event. Whole-of-industry information would also be enhanced.

2.45 However, ANAO noted that this task was put on hold until PHIAC found a replacement for the Industry Analyst responsible for its development, who had left PHIAC in January 2005 (staff turnover is discussed later in this report). Consequently, this model was not available for review at the time ANAO conducted the audit.

Reinsurance

2.46 In the context of private health insurance, 'reinsurance' refers to the legislative requirement that all RHBOs share in the costs of hospital treatment for high-risk groups. This is done under the principle of 'community rating' (defined in Chapter 1), which ensures that persons are not discriminated against in obtaining or retaining health insurance for hospital cover.

2.47 Reinsurance is a form of supervision that ensures that the prudential safety of an individual RHBO is not jeopardised by the RHBO having to pay excessive benefits in comparison with its contribution income, so that it becomes insolvent. Reinsurance also protects the interests of consumers by ensuring that rates are kept at a reasonable level despite the amount of care needed.

2.48 PHIAC administers the reinsurance arrangements by making quarterly payments that redistribute relevant costs among RHBOs under the Health Benefits Reinsurance Trust Fund (HBRTF) scheme. PHIAC transferred $163 million through the HBRTF in 2004–05. PHIAC expected this to increase to $180 million in 2005–06.

2.49 The reinsurance calculations relate to profile and usage based equalisation, where RHBOs paying benefits above their state or territory[11] average for hospital services to people aged 65 years and over, or to fund memberships with more than 35 days of hospitalisation in any twelve-month period, receive payments from the HBRTF. Those RHBOs paying less than the state or territory average in benefits contribute to the pool. Payments into and out of the HBRTF are equal so that the net result each quarter is always a nil balance. Generally, organisations with a younger and healthier membership make payments to the HBRTF, and organisations with an older and less healthy membership receive monies from the HBRTF.

2.50 As outlined in Chapter 1, the industry operates on small profit margins, and the volatility of benefits payments can have a significant impact on smaller funds. Some funds rely on the receipt of investment revenues to offset planned premium deficiencies. Reinsurance allows all RHBOs to be competitive on price. ANAO observed for the March 2005 quarter that net payments by

[11] The Northern Territory is considered separately while the Australian Capital Territory is considered with New South Wales.

individual RHBOs into the HBRTF ranged from $97 000 to $9 million, while net receipts from the HBRTF ranged from $70 000 to $18.4 million.

2.51 Requirements for the reinsurance calculations were legislated in the *Health Benefits Reinsurance (Trust Fund Principles) Determination 1998* and the *Health Benefits Reinsurance (Records of Organisations) Determination 1998*. These Determinations detail the method of, and the matters to be taken into account in, calculating the amounts to be paid into the HBRTF by RHBOs.

2.52 The Determinations also set out a Form PHIAC 1 Template (PHIAC1), and information about how this is to be prepared and presented (both electronically and as a printed record) for acceptance by PHIAC. As with the PHIAC2, RHBOs are required to submit a PHIAC1 return for the quarters ending March, June, September and December each year.

Policies and guidance

2.53 ANAO noted that PHIAC published Guidelines and Audit Programs for PHIAC 1 Returns to clarify the requirements of the Determinations, assist organisations with their auditing processes and to help encourage uniform procedures for reporting and auditing. This was updated annually, with the latest version dated June 2005. PHIAC stated that these guidelines were not binding rules. PHIAC advised the RHBOs of the updated guidelines each year by way of a circular and published the guidelines on its website.

Monitoring and analysis processes

2.54 ANAO found that PHIAC's task of allocating monies to and from the reinsurance pool involved a range of activities, including the collection and verification of data from quarterly PHIAC1 returns; error resolution; the calculation of payments under the pooling system; and the collection and distribution of monies.

2.55 PHIAC required a quarterly PHIAC1 from RHBOs for each state or territory in which they operated where more than 500 Single Equivalent Units (SEUs) resided.[12] The returns provided membership and benefits data for the reinsurance calculation. The RHBO's public officer (usually the CEO) signed the quarterly PHIAC1 returns to affirm the truth and fairness of information

[12] A SEU is the measure of the number of people covered by each fund. A single member is counted as one SEU, while all other categories of membership (family, couple and single parent) are counted as two SEUs. Where a RHBO has less than 500 SEUs in a state or territory, those members and their benefits are included in the statistics for that RHBO's majority state or territory.

provided. Each quarter, PHIAC calculated the average benefits paid per single member (or equivalent) for reinsurance categories by state.

2.56 ANAO noted that PHIAC had documented the procedures involved in processing the PHIAC1 returns in its internal publication PHIAC 1 Processing & Reinsurance Calculations Manual. Figure 2.2 describes this process and timeline. As well as informing the reinsurance calculation, data obtained from the PHIAC1 is included in statistical reports provided to stakeholders, as discussed later in this Chapter.

2.57 In processing the returns, PHIAC carried out a range of validation checks to confirm the reasonableness and accuracy of the data submitted by RHBOs. These included comparing the figures against returns from previous quarters, as well as against other sources of information, such as its annual survey of the number of persons covered by private health insurance.[13] They also involved checking the relationships between data in the various fields of each return, such as ensuring that figures matched where appropriate, and ratios were reasonable.

2.58 Despite the assurance given by the RHBOs' public officers, the validation checks carried out by PHIAC did find inaccuracies. These ranged from small discrepancies to large errors. PHIAC queried these with the relevant RHBO prior to processing the return, and required the RHBO to correct any errors and resubmit amended data to ensure that the calculations were accurate. PHIAC also provided the reinsurance calculations to each RHBO every quarter, which enabled them to complete their own checks on the outcomes.

2.59 PHIAC, or the RHBOs, also occasionally discovered errors after the determination of the quarterly reinsurance pool and distribution of monies between RHBOs was completed, as the result of new information becoming available. For example, PHIAC had to make adjustments to the reinsurance pool in 2003–04 of over $6.9 million against Medibank Private as the result of errors detected in 2002–03 that had accumulated over a number of years.[14]

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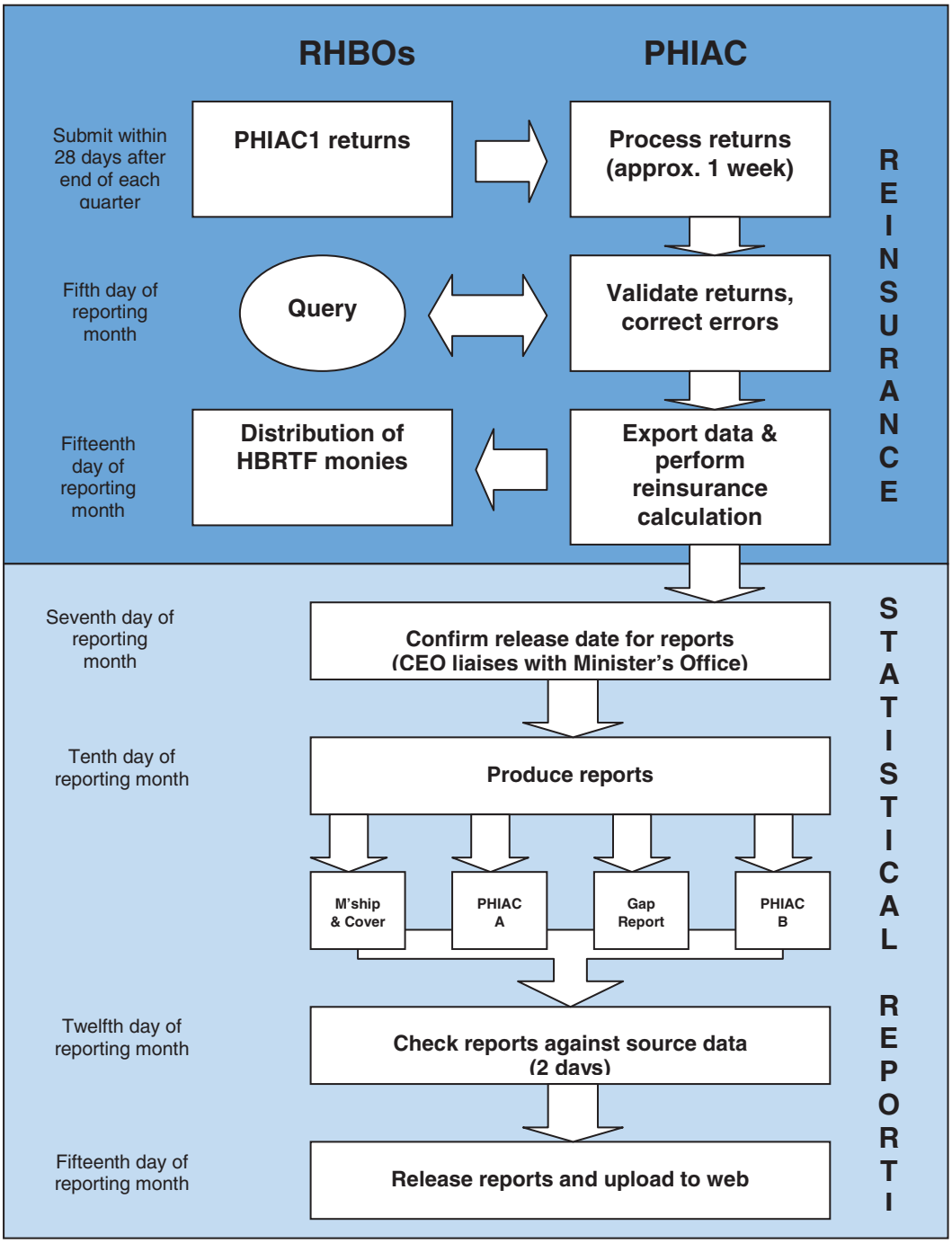
[13] PHIAC conducts an Annual December Coverage Survey of RHBOs that collects information about the number of people with private health cover as at 31 December each year.

[14] PHIAC, *Operations of the Registered Health Benefits Organisations 2003–04 Annual Report*, PHIAC, 2004, p.37.

Figure 2.2

PHIAC1 reinsurance and statistical return processing



Source: ANAO.

2.60 ANAO assessed the appropriateness and effectiveness of PHIAC's processes in relation to the quarterly reinsurance calculations by observing PHIAC's processing of the March 2005 returns and calculations, and verifying the computer programming relating to the reinsurance calculation to ensure that it agreed with the formula set out in the legislative Determinations.

2.61 ANAO checked the accuracy of PHIAC's processing of data submitted by RHBOs for the December 2004 and March 2005 quarters. ANAO reconciled the data from RHBOs' printed returns with the data in PHIAC's electronic database, and manually re-performed PHIAC's March 2005 calculations.

2.62 ANAO found that, for the two quarters checked, the figures in PHIAC's electronic database matched those provided in the RHBOs' PHIAC1 returns, and PHIAC's processing followed established procedures and incorporated appropriate controls. ANAO confirmed that the computer programming of the calculation conformed to the formula in the legislation. ANAO also found that the reinsurance calculation for the March 2005 quarter was correct and the allocation of monies to and from the HBRTF was accurate.

2.63 ANAO noted that a key risk to the reinsurance calculation was the accuracy of data submitted by the RHBOs. Inaccurate returns meant that the calculation would be incorrect, resulting in RHBOs contributing or receiving incorrect amounts. However, ANAO found that PHIAC recognised this risk and took steps to minimise inaccuracies, or make adjustments when necessary.

2.64 RHBOs also submit to PHIAC (under s. 82L(2) of the Health Act) a PHIAC1 audit certificate for the four quarters ending 30 June, by 30 September each year. These audits are informed by the guidance produced by PHIAC, although the guidelines make it clear that auditors are responsible for their own audit programs and processes. The audit opinions provided additional assurance to PHIAC that the returns fairly stated the:

- number of contributors in each category (single, family, couple and single parent);
- number of persons covered by policies held by contributors; and
- reinsurance benefits and total benefits paid during the quarterly periods.

2.65 ANAO also noted that, as part of the validation process to determine data accuracy, PHIAC was developing new checks. For example, during the March 2005 quarter processing, PHIAC introduced the following new check:

New validation check in PHIAC1 processing introduced March quarter 2005

PHIAC's analysis of PHIAC1 historical medical services data revealed that some RHBOs were paying benefits in excess of 25 per cent of the schedule fee where there was no agreement with the health care provider. The Health Act does not allow funds to do this.

To investigate this issue, and determine the extent and reasons behind it, PHIAC introduced a new validation check. The check identified funds that were submitting data with benefits paid in excess of 25 per cent of the schedule fee where there was no agreement with the provider.

Nine RHBOs were found to breach the test and were asked for explanations. Of these, seven were found to result from timing issues, software problems or minor errors that are being investigated and corrected. These had no effect on the calculation and PHIAC will monitor future returns to ensure that they do not remain an issue.

However, the issues for the remaining two RHBOs were of more concern to PHIAC:

- PHIAC was informed that one RHBO had products where, for an additional premium, the contributor was paid a 'benefit' where the charge was above the schedule fee. It was PHIAC's belief that the RHBO was acting contrary to the Health Act. PHIAC sought clarification from Health (which is responsible for approving products) and advised the RHBO that the amounts paid to their contributors in this case should not be included in the PHIAC1. PHIAC believed this could affect the reinsurance calculation, depending on whether the contributors were over 65 or had more than 35 days in hospital, and asked the RHBO to provide details of all such amounts paid in previous periods.
- Another RHBO offered a product for non-Australian residents that provided benefits equivalent to the Medicare benefit for medical services that would normally attract a Medicare benefit. As a result this affected the 'No Agreement' figures in the low membership states. PHIAC advised the RHBO that non-Australian residents, and benefits paid on their behalf, should not be counted as members for PHIAC1 reporting purposes. This issue did affect the reinsurance calculation but was detrimental to the RHBO by counting the non-Australian residents as members.

In the cases where reinsurance was affected, the monetary discrepancy was not expected to be material. It was impossible to tell from the data the amount that had been incorrectly counted as reinsurable benefits by the two RHBOs. It was most likely that including non-Australian residents as contributors for the purpose of reinsurance had disadvantaged one RHBO. Including benefits that should not have been included may have advantaged the other RHBO.

PHIAC advised that it will continue to monitor these matters.

2.66 In addition, ANAO's annual financial audit of the HBRTF provides further assurance that the calculations of amounts payable to and from the HBRTF have been made in accordance with the Minister's Determination under the Health Act.

Advice on contribution rate increases

2.67 As noted in Chapter 1, the private health insurance industry operates on very tight margins. As RHBOs annually face increases in benefits due to increases in the costs of medical services, pharmaceuticals and prosthetics, they need to use their reserves or increase the price of their products (that is, contribution rates) in order to remain prudentially solvent.

2.68 RHBOs are required under the Health Act to notify Health of changes to contribution rates normally no later than 14 days before the change is to come into effect. This is customarily done by all RHBOs at the same time each year. If a fund was in prudential difficulties, it may notify Health of a contribution rate rise outside the annual round.

2.69 From time to time, Health requests PHIAC's advice on whether proposed increases in contribution rates (or other rule changes) requested by an RHBO might adversely affect the financial stability of that RHBO. Where the Minister is of the opinion, having regard to PHIAC's advice, that the financial stability of a RHBO might be adversely affected, the Minister may disallow the change.

Rate increase assessment process

2.70 ANAO reviewed a sample of PHIAC files that documented the rate increase assessment process for 2005. ANAO found that this commenced with Health providing detailed information justifying the increases to PHIAC together with the RHBO's notification, including endorsement by an independent actuary. Where PHIAC considered it necessary, further justification was requested from RHBOs.

2.71 ANAO noted that PHIAC considered each RHBO's submission in the light of PHIAC's own monitoring of prudential well-being, together with the information provided by the RHBOs and PHIAC's fund reviews. In providing its advice, the Health Act requires PHIAC to maintain a balance between its stated objectives of ensuring the prudential safety of organisations while keeping rate increases to a minimum, in order to protect the interests of

consumers. ANAO considered that, in documenting its consideration of each submission, PHIAC was aware of and complied with this requirement.

2.72 In March 2005, PHIAC announced that contribution rates for private health insurance policies would increase by an average of 7.96 per cent in 2005. The actual increase varied from fund to fund, from product to product, and between states.

Statistical reporting

2.73 PHIAC's functions under the Health Act include:

- making statistics and other financial information about RHBOs publicly available; and
- advising the Minister about the financial operations and affairs of RHBOs .

2.74 The PHIAC1 and PHIAC2 returns collected a range of data that enabled PHIAC to monitor the industry and calculate membership statistics for the industry. These informed the advice provided to the Minister and the statistical reports published on PHIAC's website. PHIAC includes these statistics in its annual report and in the *Operations of the Registered Health Benefits Organisations Annual Report*—which reviewed the annual operations of the health funds, and contained an industry overview and tables of statistics for each individual fund.

2.75 ANAO noted that PHIAC produced and disseminated a number of statistical reports, based on data obtained from PHIAC1 returns as shown earlier in Figure 2.2. These are outlined below:

- *Membership Statistics*—a publication that details (by state or territory) the number of persons covered by private health insurance for hospital cover and ancillary cover and the proportion of the population these persons represent. The tables are on both a quarterly and an annual basis and include hospital coverage by age group;
- *PHIAC A Report*—a quarterly publication similar to the PHIAC1 return which details in total, by state or territory, the membership and benefits paid by registered organisations for the period. These reports are available on PHIAC's website;

- *PHIAC B Report*—a quarterly publication that provides the information contained in the *PHIAC A Report* by individual RHBO, and which is distributed to registered organisations only;
- *Statistical Trends in Membership and Benefits*—two separate publications that detail trends since September 1997 in private health insurance membership and coverage, and benefits paid for hospital and ancillary services. PHIAC plans to issue in the 2005–06 financial year a quarterly report that combines both financial and membership statistics in a timely manner in the one document; and
- *Medical Gap Information*—a quarterly publication on in-hospital medical services, which shows the proportion of services for which there was 'no gap' or a 'known gap' and the average gap payment for each state.

2.76 In addition, PHIAC collected information from each RHBO covering the numbers of persons with private health cover as at 31 December each year, by age group within each state and territory. These statistics are included in the *Annual December Coverage Survey*, accessible from the PHIAC website.

Conclusion

2.77 PHIAC was carrying out the range of activities expected of a regulator and performing its functions as specified in the Health Act, with one exception. ANAO considers that if PHIAC believes that this function is no longer relevant, it should seek an amendment to the legislation to remove the requirement.

2.78 PHIAC was effectively monitoring RHBOs to ensure their prudential safety, the best interests of members of those funds and a competitive level of private health insurance premiums. PHIAC also collected data which allowed it to inform and accurately administer the reinsurance calculation and provide reports to stakeholders.

2.79 PHIAC's monitoring and analysis activities were consistent with its internal monitoring policy and program, which, in turn, was consistent with its legislation. Monitoring and data analyses were comprehensive, rigorous and consistent with a risk management approach. PHIAC effectively communicated the results of its monitoring and analysis to stakeholders.

3. Regulatory Action

This Chapter discusses how PHIAC addresses and manages non-compliance by RHBOs with its requirements. It also assesses how PHIAC informs and educates the industry.

Introduction

3.1 PHIAC has legislative powers to investigate and supervise the performance of RHBOs in order to verify compliance and identify non-compliance with its requirements. PHIAC is also empowered to intervene and take regulatory action when RHBOs have been non-compliant with its requirements or have breached the Health Act.

3.2 As well as implementing these legislative requirements, PHIAC's regulatory role has been evolving. ANAO found that, in recent years, PHIAC has been increasing its development of approaches that focus on educating the RHBOs in order to promote self-regulation and prevent non-compliance.

Supervision and intervention

Procedures for managing supervision and intervention

3.3 PHIAC developed Managing Supervision and Intervention guidelines in 2000–01 to inform RHBOs about the way in which PHIAC intended to regulate the industry following the introduction of the solvency and capital adequacy standards. These guidelines set out its principles and procedures for addressing non-compliance with its requirements. The guidelines were provided to the RHBOs, and are available on PHIAC's website.

3.4 PHIAC outlined in these guidelines that its role (supported by legislation) was to intervene where there was cause for concern about the affairs of a RHBO or where there had been a breach of the prudential standards or the Health Act. It stated that its decision to intervene would be based on the individual circumstances facing each RHBO, and the appropriate regulatory response would depend on the nature and severity of the breach. The guidelines also stated that PHIAC would adopt a 'no surprises' approach and work closely with industry in the management of risk and financial stability.

3.5 However, PHIAC made it clear in these guidelines how it considered that the Board of each registered organisation was accountable for the financial soundness and effective operation of the RHBO. This included the RHBO's management of risk, and responsibility for ensuring that the RHBO met regulatory requirements.

Review of procedures

3.6 PHIAC reported that it had reviewed the Managing Supervision and Intervention guidelines during 2003–04.[15] However, the guidelines provided to ANAO during fieldwork for the audit, and those available on PHIAC's website in June 2005, were still dated March 2001. PHIAC explained that the review of the guidelines had not resulted in any major revisions to the document, so the date had not been amended.

3.7 ANAO suggested that to minimise confusion among users of its guidance and procedures documents, PHIAC should clearly identify any revised versions. PHIAC consequently revised the date on the guidelines posted on its website to 'reviewed March 2004'.

Surveillance

Identifying non-compliance

3.8 In its Managing Supervision and Intervention guidelines, PHIAC set out the general circumstances that may give rise to PHIAC exercising its regulatory powers. These were RHBO:

- failing to meet solvency and capital adequacy margins;
- failing to operate in accordance with industry experience and trends;
- failing to meet reporting and accountability requirements;
- failing to contribute to the HBRTF;
- breaching registration conditions; and
- any change to the company as a result of an external takeover, company restructure or insolvency of a parent company.

[15] PHIAC, *Private Health Insurance Administration Council 2003–04 Annual Report*, PHIAC, Canberra, 2004, p.4.

3.9 ANAO found that PHIAC used a range of surveillance mechanisms to identify cases of non-compliance. The main mechanisms were through its monitoring and analysis of the financial and statistical information provided by the RHBOs (which were discussed in Chapter 2), and its fund review program, which is discussed in the following section. It also used its analysis of industry developments, and its investigations of media reports or allegations coming from whistleblowers within the RHBOs, to identify non-compliance.

3.10 The Industry Analysts in PHIAC monitored the RHBOs' financial operations. As part of their duties, they are required to maintain an up-to-date knowledge of issues and developments that may affect the industry. PHIAC relied on their knowledge and experience to identify and investigate any emerging issues or concerns with each RHBO, and to analyse the impact on funds of rule amendments and other industry developments.

3.11 These monitoring and analysis activities enabled PHIAC to become quickly alerted to problems in the capital adequacy and solvency of RHBOs, and to other instances of non-compliance with its requirements. If one of the Industry Analysts leaves (as discussed later in Chapter 4), this exposes PHIAC to a higher risk of delays in identifying such problems within RHBOs.

Fund reviews

3.12 In response to the failure of two RHBOs during 2002 (Goldfields Medical Fund and IOR (Australia)—discussed later in this Chapter), PHIAC instigated in 2002–03 a program of fund reviews as an additional means of industry surveillance. ANAO noted that PHIAC is able to conduct such reviews as it has the legislative authority to examine the financial affairs of RHBOs by inspecting and analysing their records, books, accounts and any other relevant information (under s. 82G(1)(d)).

3.13 PHIAC considered that such reviews enabled it to gain a better understanding of the funds' administration and financial operations than was available from the financial statements, and to take corrective action, where necessary and appropriate, in the interests of contributors. The primary focus of the reviews was the RHBOs' governance and risk management arrangements. The reviews pointed out areas requiring improvement, which PHIAC could monitor, that assisted the RHBOs.

3.14 PHIAC's objective was to review every RHBO each three years and it scheduled a rolling program commencing in late 2002. ANAO noted that to achieve this aim, PHIAC must conduct at least 13 reviews each year. ANAO found that PHIAC had completed 28 fund reviews to June 2005—eight in 2002–03, 12 in 2003–04 and eight in 2004–05—mainly in the smaller RHBOs.

3.15 ANAO found that while most fund reviews had been conducted when originally scheduled in the program, PHIAC had brought forward some reviews when alerted to a likely problem within a particular fund, and in cases where RHBOs had volunteered for early reviews in order to gain assurance. However, PHIAC also delayed some reviews in 2004–05 while recruiting replacements for two Industry Analysts who left PHIAC in early 2005.

3.16 PHIAC scheduled the reviews of the four largest RHBOs later in the program, as it considered that these had lower risk profiles. PHIAC made this assessment on the basis that these funds had adopted appropriate practices—such as actuarial assessment—and PHIAC had more frequent contact and a good working relationship with them.

3.17 When it reviewed the first of the larger RHBOs, PHIAC found that its existing methodology was not totally appropriate to reviewing a fund of that size, and that it lacked the resources necessary for the review. To overcome this, PHIAC seconded an APRA officer to work with it, utilising APRA's methodology for reviewing similar organisations. ANAO noted that PHIAC was liaising with APRA in planning its future fund review process for the larger funds. It was also negotiating access to APRA's regulatory framework, with a view to harmonising the regulatory processes that apply to the health insurance industry with those of other financial services industries, where practicable.

Review process

3.18 PHIAC used an external consultant to assist it to develop its review methodology in late 2002. This included questionnaires for interviewing key personnel and better practice guidance. PHIAC progressively improved the methodology with each completed review. The process of the fund review involved PHIAC requesting from the RHBO a range of relevant corporate and financial documents. Once these were obtained, PHIAC staff visited for interviews and to inspect and/or obtain other documents.

3.19 PHIAC produced a report on the outcome of the review for its Board, including recommendations for improvement. PHIAC then issued the report to the RHBO as a guide (for both PHIAC and the RHBO) to PHIAC's concerns about the RHBO's operations, to enable monitoring of any issues raised.

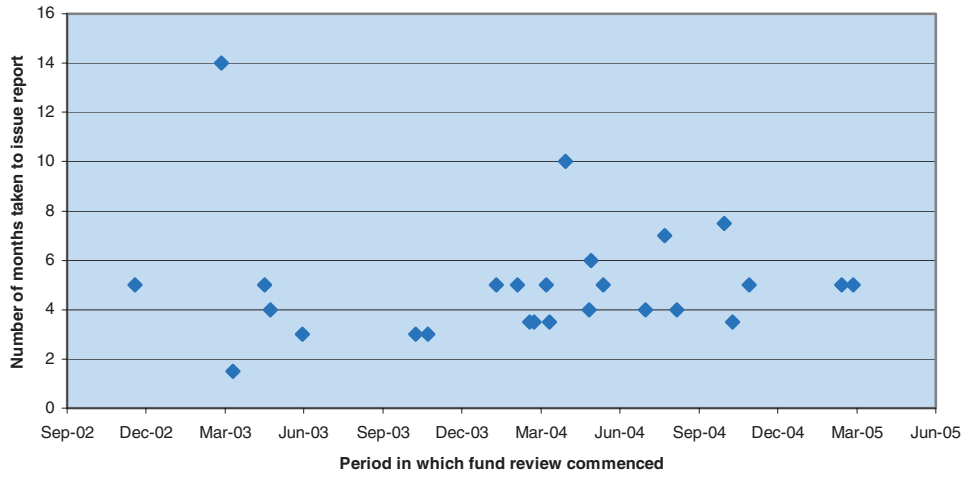
3.20 PHIAC used the results from its fund review program to consult with the RHBO, or to take corrective action if a breach was found. If, following its review, PHIAC had significant concerns, PHIAC acted on them immediately, using its procedures for managing non-compliance rather than waiting for the next review. PHIAC also used the findings to inform its assessment of the review process and to identify lessons learned.

Production of review reports

3.21 For the fund review program, ANAO noted that PHIAC had no systematic reporting arrangements which set targets for the production of review reports to RHBOs. ANAO analysed the time taken between PHIAC conducting the completed reviews and issuing the reports to the RHBOs. The results are shown in Figure 3.1.

Figure 3.1

Time between conduct of fund reviews and issue of reports



Source: ANAO.

Note: No report was issued for two early reviews completed when PHIAC and its consultant were developing the review methodology.

3.22 ANAO found that the average time taken between conducting the reviews and issuing the reports was five months. However, in some cases the period was much longer, as shown in the following examples.

- PHIAC conducted a fund review in March 2003 but the report was not sent to the RHBO until May 2004—14 months after the review; and
- PHIAC conducted a fund review in April 2004. In November 2004, the report had not been completed and PHIAC needed to revisit the RHBO to refresh the information gathered due to the time that had elapsed since the review. The report was provided to the fund in February 2005—ten months after the review.

3.23 PHIAC advised that the times taken to produce the earlier reports, including the two noted above, had been the result of PHIAC developing the new process as the reviews progressed, and attempting a larger number of reviews than it had sufficient resources for early in the program. It also advised that the time taken to produce reports during late 2004 and early 2005 had been longer due to the loss of key staff.

3.24 ANAO considers that PHIAC should set a target for the time taken to conduct a review, produce the review report and provide the review outcomes to the RHBO. It could then monitor progress against this target to measure its performance. This would assist in ensuring that reports were produced in a timely manner. In situations where PHIAC made recommendations designed to improve the RHBO's operations, it would enable the fund to begin implementing those improvements sooner. It would also be more efficient for PHIAC as it would reduce the need for additional work to update information prior to finalising delayed reports.

Recommendation No.1

3.25 ANAO recommends that PHIAC set specific and realistic targets for the conduct of and reporting on fund reviews, in order to ensure timely advice to RHBOs and monitoring of issues raised in the reviews.

PHIAC's response: Accepted and implemented.

Enforcement

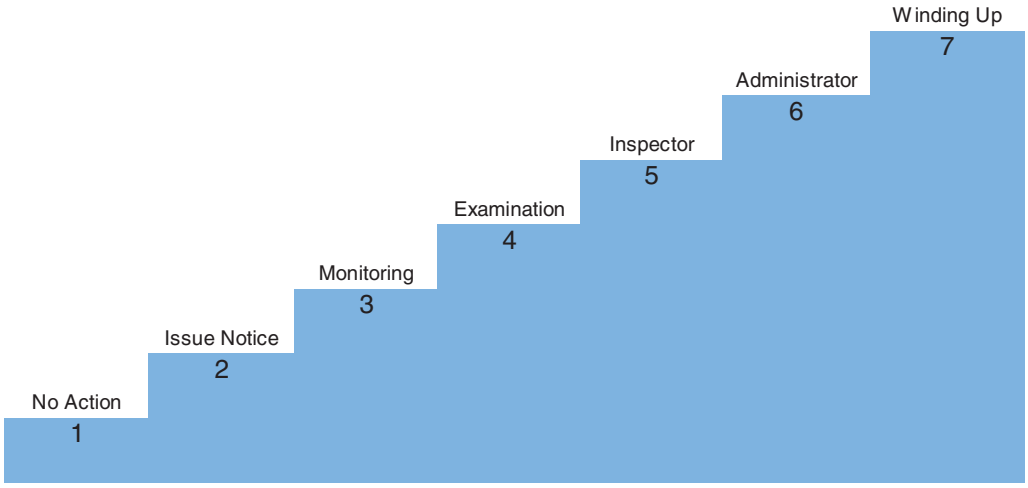
Managing non-compliance

3.26 In developing the Managing Supervision and Intervention guidelines, PHIAC conducted a risk analysis that identified the likelihood of particular breaches of its requirements. Using this, PHIAC adopted a graduated approach to the risks from non-compliance.

3.27 The guidelines specify the seven-step process PHIAC uses to manage cases of non-compliance, as shown in Figure 3.2. PHIAC's procedures throughout the seven-step process are described in more detail in Appendix 3.

Figure 3.2

PHIAC's process for managing non-compliance



Source: ANAO, using PHIAC's Managing Supervision and Intervention guidelines.

3.28 The nature and severity of PHIAC's concern, together with the RHBO's response and actions as a result of PHIAC's requests, determined whether it is necessary for PHIAC to proceed to a subsequent step, or return to an earlier stage. Steps one to three involved working cooperatively with the RHBO to resolve issues. ANAO noted that there was a clear difference in PHIAC's approach after step three, with steps four to seven requiring a greater level of intervention in accordance with the Health Act. If PHIAC proceeded to step four, this indicated that a more severe breach had occurred which the RHBO could not solve or the RHBO was not cooperating in resolving its problems.

3.29 ANAO found examples of situations where PHIAC had used the seven-step process to supervise RHBOs, and to intervene and take action

where it found breaches. These steps are discussed in the section on enforcement action later in this Chapter.

Addressing non-compliance

3.30 PHIAC has the power to issue directions on capital adequacy or solvency, and to amend the registration conditions of a RHBO. If PHIAC determines that a serious breach has occurred, at step two it issues a notice ('the Notice') advising the RHBO of the breach and makes recommendations that must be addressed within a set time. At that point, the RHBO is put on PHIAC's Regulatory Action and Watch List, which means that PHIAC closely monitors the fund's performance and capital position, and provides monthly reports to the Board. Such monitoring continues until PHIAC is convinced that the problem has been corrected.

3.31 In situations where the RHBO failed to carry out the agreed strategy for improvement, or when the breach was found to be more severe, PHIAC escalated its action to step four. This involved PHIAC (or its consultant) examining the RHBO's books and accounts, followed, if necessary, by the appointment of an inspector who assessed the financial and operational position of the RHBO. If the inspector's report so recommended, PHIAC then appointed an administrator to manage the RHBO's affairs and suggest future options.

Punitive action

3.32 ANAO found that, while PHIAC had specific enforcement powers as the prudential regulator of private health insurance, its ability under the legislation to undertake punitive action or impose sanctions on RHBOs was restricted. PHIAC can only take action to a certain point before it has to refer the breach to another regulator or authority.

3.33 In addition, PHIAC currently has no power to intervene or take action where a RHBO did not appear to be acting in the best interest of its contributors, but where there were no identified breaches of the Health Act.

3.34 PHIAC is able to approve the voluntary winding up of RHBOs and apply to a court for the winding up of insolvent RHBOs. PHIAC also has the power to cancel the registration of a RHBO (under s. 79(7) of the Health Act), if PHIAC is satisfied that:

- the RHBO had repeatedly contravened an obligation imposed on it by or under the Act, or had contravened a number of such obligations; or

- a contravention of such an obligation had serious implications for the interests of contributors to the RHBO.

3.35 Although PHIAC had the power to cancel the registration of a RHBO, and had done so where the fund had been voluntarily wound up, PHIAC was yet to deregister a RHBO. PHIAC stated that it would be difficult to take such action as a sanction for non-compliance, as this would be seen as not being in the best interest of contributors. Rather, in all circumstances to date, where PHIAC was alerted to a possible contravention, it has followed the seven-step process outlined above to try to resolve the situation with the RHBO.

3.36 PHIAC can apply direct to the Federal Court for a fund or a registered organisation to be wound up, as the last step in its seven-step process. These applications would ordinarily be supported by appropriate evidence of insolvency. However, PHIAC considered this to be an option of 'last resort', as it resulted in the loss of contributors' reserves, and has not so far taken this action (other than where a registered organisation was wound up after the fund was transferred to another RHBO following a merger).

3.37 In situations where PHIAC does not have legislative powers to act itself, such as through providing legal or policy advice or taking legal action against RHBOs, it refers such matters to the Minister, Health, or the other regulatory authorities, which have legislative powers that enable them to take punitive action in these areas.

Penalties

3.38 Under s. 82G(1)(k) of the Health Act, PHIAC may impose a fee on a RHBO where high costs were incurred in making an examination of that RHBO's financial situation in taking enforcement actions. ANAO found that in 2004–05, PHIAC collected such fees from one RHBO, totalling $142 088.

3.39 Breaches of particular sections of the Health Act relating to the regulation of private health insurance can attract penalties. One example is where RHBOs provided false or misleading information, documents or statements to PHIAC. Penalties ranged from fines of $1 000 to $10 000, to terms of imprisonment. PHIAC has no legislative power to impose such penalties, so it has to refer matters to the Australian Federal Police to take action. PHIAC advised that it had not referred any such matters in recent years.

Enforcement action

3.40 ANAO found that PHIAC had used all the enforcement actions available to it as the regulator, when required, in order to protect the interests of consumers. Where it did not have the legislative powers to take action itself, it had passed the responsibility for action to the appropriate authority—the Minister, Health or another regulator.

3.41 Over the past five years, PHIAC had exercised its enforcement powers on a number of occasions. First, it had put a number of RHBOs on monthly reporting against the solvency and capital adequacy standards until it was satisfied that each remained financially solvent. The total number of RHBOs on PHIAC's Regulatory Action and Watch List for at least one month in 2000–01 to 2004–05 is shown in Table 3.1.

Table 3.1

RHBOs on PHIAC's Regulatory Action and Watch List

Year	Number of RHBOs on monthly reporting
2000–01	15
2001–02	17
2002–03	18
2003–04	13
2004–05	7

Source: PHIAC.

3.42 The total time that any RHBO remained continuously on the list on any occasion ranged from one month to over two years, although those that remained on the list for long periods were where PHIAC had escalated its actions to examination, inspection and administration.

3.43 At the time of audit fieldwork, PHIAC was monitoring two RHBOs on its Regulatory Action and Watch List:

- Federation Health continued on monthly reporting while the appointed administrator prepared and implemented a scheme to transfer the fund to Latrobe Health (which occurred on 1 July 2005); and
- another RHBO was on monthly reporting, with independent auditor and actuarial oversight of its technical liabilities, due to PHIAC's concerns about the RHBO's mid to long-term viability.

3.44 PHIAC or its consultant had examined the books and records of six RHBOs during the past five years. On four occasions, PHIAC appointed an inspector to further investigate and assess the financial state of an RHBO and to provide independent advice on the fund's solvency. ANAO noted that, on each of those four instances, PHIAC had then appointed an administrator to the RHBO as a result of findings reported by the inspector. An outline of the regulatory actions taken by PHIAC in these four cases is provided in Table 3.2.

3.45 In the first three cases outlined, PHIAC took action after it had identified a breach of the prudential standards by the RHBOs concerned. PHIAC moved quickly to appoint inspectors to investigate the financial situations of these RHBOs due to the immediate likelihood of fund failure and the consequent impact on contributors. In the other case, PHIAC proceeded through its seven-step process after it was alerted to possible financial and corporate governance problems in Federation Health. ANAO noted that, in each case, PHIAC had used the procedures for regulatory action specified in its guidelines, which are supported by legislation.

3.46 ANAO found that where PHIAC did not have the power to act itself on the findings of the independent inspector and administrator, it had referred the cases to other regulators. For example, PHIAC had referred the case relating to TUH in Queensland to ASIC for further investigation. ASIC has since commenced legal action against the former CEO under the *Corporations Act 2001* and the *Friendly Societies (Queensland) Act 1997*.

3.47 In three of the cases, PHIAC's appointed administrator negotiated a merger of the fund's membership with another RHBO, prior to transferring the fund and winding up the registered organisation. In these cases, the regulator acted to ensure that fund members' benefits were protected and would continue to be paid. In the TUH case, PHIAC's actions enabled the RHBO to continue its operations after changes to its Board and management.

3.48 ANAO found that PHIAC's regulatory actions were directed at ensuring the viability of the industry as a whole, through ensuring the viability of all funds. It strived to turn any particular fund around if it was in financial difficulties before taking further action, in order to protect the contributors. In this respect, PHIAC maintained a balance in its operations in determining whether it should continue to assist poorly run funds rather than allowing them to fail, while protecting the contributors.

Table 3.2

Recent enforcement action by PHIAC

RHBO	PHIAC Action
Goldfields Medical Fund (Inc.) (GMF)	November 2001—appointed inspector to investigate and assess GMF's financial situation, after closely monitoring its performance. December 2001—appointed administrator to GMF, after receipt of the inspector's report, when it became apparent that the fund was in breach of the prudential standards. September 2002—endorsed the administrator's recommendation that GMF merge with Healthguard Health Benefits Fund Ltd.
I.O.R. (Australia) Pty. Ltd. (IOR)	February 2002—appointed inspector to IOR when it failed to meet its solvency requirement. July 2002—appointed administrator to IOR, directed only at its health insurance arm, not its friendly society membership. November 2002—approved the sale of the health fund conducted by IOR to the Hospitals Contribution Fund of Australia Limited.
Queensland Teachers' Union Health Fund Ltd (TUH)	February 2003—appointed inspector to investigate TUH when it failed to meet the prudential standards required as a result of breaches of the Health Act, which resulted in the loss of a significant proportion of the fund's reserves. June 2003—appointed an administrator, as a result of corporate governance issues; and imposed a number of conditions of registration upon TUH. August 2004—reached a settlement with TUH, after it sought an AAT review of PHIAC's conditions, with agreement to change the constitution to allow for an independent chairperson and directors. February 2005—publicly announced that the findings of the independent inspector and the administrator appointed to TUH led to PHIAC referring matters to other regulators for further investigation. March 2005—ASIC then took legal action against the former CEO.
Federation Health	June 2004—appointed a consultant to review the books, records and accounts of Federation Health after receiving allegations from a Federation Health 'whistleblower' that the fund's management and Board were not acting in members' interests. November 2004—appointed inspector to investigate a number of issues related to Federation Health's financial and reporting arrangements. December 2004—appointed an administrator to Federation Health. March 2005—following a recommendation from the administrator, announced that Federation Health was seeking Federal Court approval to merge with Latrobe Health Services Inc. July 2005—Federation Health merged with Latrobe Health.

Source: PHIAC Media Releases and Annual Reports 2001–02 to 2003–04.

Due process and natural justice in enforcement practices

3.49 As noted earlier, one of PHIAC's objectives under the legislation is protecting the interests of consumers. PHIAC must take action against a RHBO where a breach of the Health Act occurs. PHIAC has to balance the protection of contributors with the requirement for natural justice to the managers and Board of the RHBO.

3.50 ANAO found that PHIAC addressed this natural justice issue by:

- publishing the Managing Supervision and Intervention guidelines, so that all RHBOs were aware of the actions that PHIAC would take when necessary; and
- keeping any RHBO that breached the Health Act informed of PHIAC's actions when taking preliminary steps and throughout the process.

3.51 PHIAC included a number of principles in its guidelines. These set out how it will operate efficiently to ensure regulatory requirements are not imposed in an unnecessarily onerous manner; and that it will regulate actions in a timely manner.

3.52 ANAO noted that PHIAC worked cooperatively with a RHBO as far as possible up to step three of its seven-step process, in order to resolve issues before proceeding to enforcement action. PHIAC also established a communications protocol with the RHBO early in the process to manage its supervision and intervention.

Impact of inspection/administration

3.53 ANAO noted that the costs of inspection and administration are borne by the RHBO and its members, so any lengthy and continuing investigations were likely to be costly to an organisation that was already in financial trouble.

3.54 The Health Act specifies that an administrator must provide a report to PHIAC within three months of being appointed, unless PHIAC's Board approved an extension of this period where special circumstances existed.[16] While PHIAC's guidelines did not specify any times for appointed consultants' or inspectors' examinations of RHBOs or for their reporting back to PHIAC, ANAO noted that when PHIAC's actions included appointment of a consultant, the dates for reporting were detailed in the terms of reference of the appointment.

[16] Under s. 82XZC of the Health Act.

3.55 A further matter considered by ANAO was the length of time spent by the administrator in implementing the decision made by PHIAC following receipt of the administrator's report. This involved either implementing adequate processes to allow the RHBO to be returned for management to its own Board, or in negotiating the merger of the RHBO with another fund and making arrangements for the organisation to be wound up. ANAO noted that the administrator's report advised the Board of completed and proposed actions, and made recommendations for their implementation for PHIAC's approval.

3.56 PHIAC advised that its decision to appoint an administrator was not taken lightly and the administrator stayed in place only as long as necessary, until removed by PHIAC or the Federal Court. ANAO noted that while the cost of the administrator was met by the RHBO under investigation, in three of the four appointments of administrators made by PHIAC, the management costs of the fund had actually decreased while the administration was in place.

Education and prevention

3.57 ANAO noted that, in the past two years, PHIAC had introduced measures to educate RHBOs and improve their operations and reporting, in order to maximise their compliance with PHIAC's requirements.

Education mechanisms

3.58 PHIAC states in its Corporate Plan 2005–07 that its intention is to educate and encourage the industry to operate more effectively. Its aim is to achieve a financially sound, innovative industry that is professionally managed and governed, and that acts in the best interests of its contributors.

3.59 ANAO found that PHIAC used a number of mechanisms to assist RHBOs understand its requirements and to inform them of better corporate practices. PHIAC provided education and information for the directors and management of the RHBOs on changing industry requirements, such as accounting standards and changes in reinsurance. It conducted seminars for RHBOs on improving their corporate governance. It also developed a number of principles and guidelines for RHBOs, some of which required the RHBOs to affirm that they had implemented the practices recommended by PHIAC.

Risk management guidelines

3.60 In 2001, PHIAC developed its Risk Management Practices in the Private Health Insurance Industry guidelines with the aim of ensuring that all RHBOs established appropriate risk management policies. These guidelines required RHBOs to have adequate systems in place to manage and reduce risks, and advised on the nature and management of financial risks (asset and liability risks) and operational risks in the industry. PHIAC reviewed and updated the guidelines in March 2004.

3.61 The guidelines also introduced new reporting requirements for RHBOs, which allowed PHIAC to monitor and regulate corporate governance and risk management processes within the industry with greater accuracy and effect. Since 30 June 2002, PHIAC has required the directors of RHBOs to annually certify that they have appropriate risk management systems in place.

Corporate governance seminars and checklist

3.62 According to PHIAC, poor corporate governance, rather than prudential failure, caused most fund failures and poor performance issues. Therefore PHIAC had placed particular emphasis on improving corporate governance in the industry. ANAO noted that, since 1998, PHIAC had provided occasional seminars for the RHBOs on corporate governance. In July 2004, it held a half-day conference on corporate governance issues for the health insurance industry. During 2005, PHIAC developed an education course on corporate governance for RHBO directors, and conducted the first course in September 2005.

3.63 In early 2005, PHIAC also commenced consultations with the RHBOs and other key industry stakeholders aimed at developing a corporate governance framework applicable to the health insurance industry. As a first step, PHIAC developed a Corporate Governance Checklist and provided it to the industry for comments in March 2005.

Communication with RHBOs

3.64 In order to be effective, PHIAC must promote its role and legislative requirements by providing adequate information to members of the industry and advising members on their responsibilities.

3.65 ANAO found much evidence showing that PHIAC's communication with the RHBOs is frequent and varied. PHIAC corresponded and spoke to the CEOs and public officers of RHBOs regularly, particularly about PHIAC1 and

PHIAC2 returns. PHIAC staff visited many RHBOs, either during the fund review process or through the CEO's schedule of visits to funds. PHIAC consulted with the industry and the industry associations on proposed changes to the prudential standards and improvements to regulation of the industry (such as the Appointed Actuary requirement).

3.66 As noted earlier, PHIAC developed procedures and guidelines setting out its requirements, and provided these to RHBOs. It also issued circulars on various issues concerning the industry, which were available on its website.

3.67 PHIAC conducted seminars on relevant issues for RHBOs, and attended and made presentations to relevant industry meetings and conferences. Representatives of RHBOs, industry associations and other stakeholders that ANAO interviewed during the audit all considered that PHIAC communicated well.

Policies and procedures

3.68 ANAO found that PHIAC set out its objectives and functions in its annual report and in a number of documents available on its website. ANAO also found that PHIAC had developed clear internal procedures and guidelines for carrying out its monitoring and analysis of prudential standards and management of non-compliance by the RHBOs.

3.69 ANAO observed during the audit that a small number of RHBOs held misconceptions about what PHIAC could legally do as the regulator and what it expected of a RHBO. ANAO considered it would benefit PHIAC if it developed and promulgated a document which clearly stated its role and intent as the regulator, and which identified the reciprocal responsibilities of the RHBOs. Such a document would draw together information setting out PHIAC's interpretation of the legislation, how it will apply it, what is expected from the RHBOs, and when PHIAC will hand over to other regulators.

3.70 PHIAC providing such a document to the RHBOs would reduce the need to reiterate its policies and its right to assert its authority under the legislation on a case-by-case basis. It would enable PHIAC to communicate more effectively to stakeholders its interpretation of its functions and responsibilities under the legislation, and how it will apply these (particularly as the legislation is complex). This would also assist the RHBOs to have a clearer understanding of their responsibilities and PHIAC's role. In addition, as PHIAC is funded by levies on the RHBOs, it has an obligation to clearly inform the RHBOs of its regulatory intentions.

Recommendation No.2

3.71 ANAO recommends that PHIAC develop a clear statement of its role in regulation of the private health insurance industry, which distinguishes between its functions and responsibilities under the legislation and those of other regulators, and identifies the reciprocal responsibilities of the RHBOs.

PHIAC's response: Accepted and implemented.

Communication with the public

3.72 The Health Act requires PHIAC to collect and disseminate information that enables people to make informed choices about private health insurance. ANAO noted that, in satisfying this requirement, PHIAC:

- produces, and regularly reviews, a booklet *Insure? Not Sure?*, that explains the Australian health system in simple terms for consumers, and provides the booklet on its website;
- provides details of gap cover schemes approved by the Minister, which were supplied by RHBOs, on its website; and
- makes available to the public, copies of the *Private Patients' Hospital Charter* issued by Health, and publicises the Charter's availability from Health's website on its website, in its annual report and in *Insure? Not Sure?*.

Balancing education and punitive action

3.73 PHIAC advised that, in its regulatory role, it has focussed on achieving a balance between educating RHBOs and promoting preventative measures, and taking punitive action. As noted above, PHIAC was providing a range of educational and guidance tools to assist the Board of each registered organisation meet PHIAC's requirements as outlined in its guidelines. However, as described earlier, PHIAC was also taking the enforcement actions available to it as the regulator when RHBOs did not meet its requirements, in order to protect the interests of consumers.

3.74 In this regard, PHIAC's regulatory approach is similar to a model outlined in the Australian Law Reform Commission report on penalties in Australian regulation.[17] This model states that a regulator should have access to severe punishments but should rarely use them in practice.[18] Rather, the initial response to breaches should be to persuade and educate as to the appropriate behaviour, as this approach promotes self-regulation.

Lessons learned

3.75 PHIAC documented the lessons learned from its regulatory actions taken in relation to IOR, GMF, TUH and Federation Health for its Board's consideration in addressing improvements in its regulatory practices. This internal paper highlighted the issues of concern surrounding the above named RHBOs, particularly the importance of receiving and acting upon actuarial advice about the RHBOs, prudential reviews and improving the governance practices and procedures of RHBOs. ANAO noted that PHIAC had acted on these lessons in implementing its requirement for RHBOs to have appointed actuaries, and its educational initiatives.

3.76 In March 2005, PHIAC provided to all RHBOs a paper setting out the lessons learned from its fund review program and through its regulation of several health funds. The paper identified corporate governance issues within RHBOs, such as board composition and performance, board and management interaction, risk management processes (including internal audit), and board relationships with external auditors and appointed actuaries.

Conclusion

3.77 ANAO found that PHIAC used a range of surveillance mechanisms to identify cases of non-compliance, including a program of fund reviews aimed at gaining a better understanding of the RHBOs' administration and financial operations. If RHBOs failed to meet either the solvency or capital adequacy standard, or breached the Health Act, PHIAC took regulatory action.

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[17] Australian Law Reform Commission, *Principled Regulation: Civil and Administrative Penalties in Australian Federal Regulation*, ALRC, 1995, pp.111–112.

[18] The model is the 'enforcement pyramid' by which regulators use coercive sanctions only when less interventionist measures had failed to produce compliance This model was first put forward by Braithwaite in J Braithwaite, *To Punish or Persuade: Enforcement of Coal Mine Safety*, State University of New York Press, Albany, New York, 1985.

3.78 PHIAC had established appropriate procedures and guidelines for its management of non-compliance, using a seven-step process, and had provided these guidelines to RHBOs. ANAO found that PHIAC was effectively applying these procedures when investigating and supervising fund performance.

3.79 PHIAC used the enforcement actions available to it as the regulator, when required, in order to protect the interests of consumers. Where it did not have jurisdiction to take action itself, it passed the responsibility for action to the appropriate authority—the Minister, Health or another regulator.

3.80 PHIAC used a number of mechanisms to assist RHBOs understand its requirements and to inform them of better corporate practices. PHIAC developed procedures, guidelines and instructions setting out its requirements and provided these to RHBOs. ANAO noted that PHIAC has also introduced other measures to educate RHBOs and improve their operations and reporting, in order to maximise their compliance with PHIAC's requirements. However, ANAO considered that PHIAC could improve promotion of its role and responsibilities to members of the industry to ensure that they were adequately informed of PHIAC's intentions as the regulator.

3.81 ANAO made a number of suggestions and two recommendations to improve the effectiveness of PHIAC's management of non-compliance with its requirements.

4. Governance and Organisation

This Chapter considers whether PHIAC's governance and organisation support its legislative functions.

Introduction

4.1 PHIAC is one of the large number of statutory bodies which are subject to the *Commonwealth Authorities and Companies Act 1997* (CAC Act), but which also operate under specific legislation. The Health Act dictates PHIAC's structure, composition, appointment arrangements, and planning and reporting for the entity, its Board and its CEO.

4.2 To be as effective a regulator as possible, PHIAC must be efficient in its use of resources and processes. It needs to have competent systems in place that enable it to operate effectively with its resource base. As the segregation of duties is difficult because of the small numbers of staff, it must rely on compensating controls. PHIAC must also demonstrate to the industry appropriate internal governance and sound financial arrangements when expecting the same of the RHBOs it regulates.

PHIAC's governance

4.3 Corporate governance commonly refers to the processes by which organisations are directed, controlled and held to account. The ANAO's Better Practice Guide defined public sector governance as covering how an organisation is managed, its corporate and other structures, its culture, its policies and strategies, and the way it deals with its various stakeholders.[19]

4.4 In assessing whether PHIAC had a sound public sector governance framework to support the performance of its legislative functions, ANAO considered its:

- organisational structure and resourcing, and how roles, responsibilities and delegations were defined under this structure;
- financial arrangements;
- risk management processes and internal controls;
- strategic and operational planning framework; and
- performance management and reporting.

[19] ANAO Better Practice Guide–*Public Sector Governance Volumes 1 & 2*, July 2003.

Organisation

The Council

4.5 PHIAC consists of a Commissioner and four other members appointed for three-year terms by the Minister, as specified in the Health Act. One member has been appointed Deputy Commissioner. For the purposes of the CAC Act, the Commissioner and members hold office on a part-time basis as non-executive directors of the PHIAC Board. The current Commissioner has served in the position since July 1998.

4.6 ANAO noted that Board members were appointed at different times, meaning that only two were replaced at any one time. This ensures the continuity of experience and skills in what is a complex regulatory area.

4.7 The Commissioner determines the number of meetings required each year and sets the Board calendar. The Board normally meets ten times a year and holds an annual planning day, usually in June.

Roles and responsibilities

4.8 PHIAC is accountable to the Minister and to the Parliament. As described in Chapter 1, the Health Act specifies the purpose of the Council as the regulator of private health insurance, as well as its functions and powers. The CAC Act also prescribes certain functions and responsibilities of PHIAC and its Directors, and their role in PHIAC's governance.

4.9 In 1998–99, following enactment of the CAC Act, the Board Secretary reviewed PHIAC's accountability, control and administrative systems in line with this Act, and governance best practice. As a result of this review, PHIAC developed Board Operating Procedures, which took account of its requirements under the CAC Act as well as the Health Act. ANAO noted that these procedures set out a clear protocol for the conduct of Board business and for identifying and handling conflicts of interest.

4.10 PHIAC has a Mission Statement and Customer Service Charter, and specifies its objectives and functions in its annual report. PHIAC also developed a Board Charter in early 2005, following a recommendation of the Board review (discussed below). The Charter summarises PHIAC's objectives, functions and powers, and sets out the roles and responsibilities of, and a code of conduct for, Board members.

Skills

4.11 A 1997 review identified particular gaps in the then skill mix of the Board. Since that time, PHIAC has asked Health to satisfy a particular mix of skills and experience in the selection of Board members, including accounting, actuarial and legal skills. ANAO noted that Health, the Board and the Minister's Office worked together in the selection of new members and assessed their skills, experience and independence prior to appointment.

Induction and training

4.12 ANAO found that PHIAC provided an Induction Manual to new Board members. This contained comprehensive information about the health industry and legislation, and PHIAC's structure, responsibilities, activities and requirements. It also included the Board Operating Procedures, Audit and Compliance Committee Charter, Anti-Fraud Plan, Customer Service Charter, and PHIAC's reports. However, while ANAO noted that the Induction Manual provided to new Board members in April 2005 contained up-to-date information, it did not contain the Board Charter. PHIAC advised that this was an oversight and that it had later provided the Charter to members.

4.13 PHIAC made funding available for continuing education and professional development programs to Council members. The CEO regularly informed the Board of any relevant conferences and seminars.

Board Review

4.14 In May 2004, PHIAC commissioned an external consultant to review the Council's operations, with the objective of considering its performance as a group and as individuals. In conducting the review, the consultant interviewed the Board, CEO and management team of PHIAC, and sought comments from RHBOs, the industry associations, Health and the Minister's Office.

4.15 While the review was positive overall and found no deficiencies of particular concern, the consultant made some recommendations for improvement, as follows:

- the Board could take on a more strategic role now that PHIAC had grown in size;
- PHIAC should more specifically define the role of the Board, develop an agreed role for non-executive members, and clarify its expectations of directors over and above attendance at Board meetings; and

- PHIAC should give greater attention to succession planning by developing the management team.

4.16 ANAO found that PHIAC was addressing these recommendations through its development of a Corporate Plan for 2005–07, which outlined key strategies determined by the Board for the next two years, and a Board Charter, which defined the roles and responsibilities of Board members. PHIAC had also increased its establishment, which enabled better development of its management team to assist with succession planning.

The Secretariat

4.17 The Council appointed a CEO to manage the affairs of the Council, and employed as many other staff in the Secretariat as it considered necessary to assist in the performance of its functions and the exercise of its powers. The Secretariat is responsible to the CEO. All staff are employed on a full-time basis, with the exception of the Council Secretary who is employed part-time.

4.18 The Board and CEO defined the organisational structure for the Secretariat, which shows the distribution and management of operational responsibilities.[20]

Roles and responsibilities

4.19 The CEO is accountable to the Council and manages the affairs of PHIAC in accordance with the policy and directions given by the Council. The CEO attended Board meetings in an executive capacity. The role of the CEO is well documented and this documentation forms part of the recruitment and selection documentation for the position, and the performance management procedures used by the Board. The current CEO was appointed in 1995.

4.20 Under the Health Act, the Council is able to delegate any of its functions and powers to the CEO or another staff member. ANAO noted that the Board had delegated certain powers to the CEO. These included the power to incur expenditure, authorise payments, sign bank accounts and cheques, and employ staff and consultants.

4.21 The structure of the Secretariat reflects the regulatory responsibilities of PHIAC, by including a Prudential Supervision Section, a Reinsurance and Statistics Section, and a Manager of Policy and Projects. There is also a Finance

[20] These are set out in PHIAC's organisational chart, which is included in its Corporate Plan available from its website <www.phiac.gov.au>.

and Administration Section, which is responsible for PHIAC's financial reporting and internal administrative functions. ANAO noted that the division of duties appeared logical and there were clear reporting lines.

4.22 PHIAC has developed job descriptions for its CEO and staff, which specify the role and responsibilities of each of the positions in the current structure. They also identify the skills needed for these functions.

Resources

4.23 At the commencement of ANAO's audit, the Secretariat had a total establishment of 13 positions. PHIAC considered six of these to be key specialist positions, as they required the expertise and experience to manage PHIAC's industry and government relationships, manage the HBRTF, conduct in-depth analysis of RHBO and industry performance and compliance, and meet PHIAC's statutory reporting requirements.

4.24 PHIAC faced the problems of many small organisations in that staff departures meant a skills shortage, which was exacerbated if the person leaving was one of the identified key staff. In addition, PHIAC advised that it took around ten months to train a new key staff member to be fully operative.

4.25 ANAO noted that this had happened in early 2005, when two of PHIAC's three Industry Analysts, and its Manager Projects and Policy, all left within a short period. The loss of these staff meant that PHIAC deferred development of its new Industry Model and delayed its fund review program (although in the short term, it seconded an officer from APRA to assist with one fund review).

4.26 PHIAC implemented a number of strategies to reduce the risk posed by future staff losses. The Board decided in early 2005 to increase PHIAC's staff establishment to 16 to provide greater backup and capacity to cope, and to enable better succession planning.[21] The Board also determined that PHIAC would strengthen its relationship with APRA, in order to share regulatory methodologies, and would continue to contract suitable resources where necessary.

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[21] One of the new positions was in the Prudential Supervision Section. Another was the additional position of Data Manager, which would take on the information and database management role that had been previously carried by the Manager, Reinsurance and Statistics, as well as assisting both Sections with statistical analysis.

4.27 During the audit, PHIAC recruited to fill the two new positions as well as those that had been vacant, and commenced training and development of the officers selected. ANAO noted that the CEO was training the Secretariat staff to ensure that more than one person had the skills and experience to enable them to undertake tasks of other positions. Building a larger team also enabled the CEO to delegate some tasks to the Manager Prudential Supervision, in a 'Deputy CEO' role.

Skills

4.28 As with any organisation, PHIAC relies on having competent staff with appropriate skills. ANAO found that the qualifications of the Secretariat staff were commensurate with those specified in job descriptions. ANAO observed that in recruiting staff, PHIAC used the job descriptions and duty statements specifically developed for each position, and matched the skills of prospective applicants to those required in the selection criteria in making selections.

4.29 ANAO found that PHIAC also sought external professional advice and services where it was not cost-effective for permanent staffing of the PHIAC Secretariat with such expertise. This expertise included legal advice, actuarial advice and industry modelling assistance, reinsurance process audits, recruitment of staff, and communications advice and support. PHIAC also brought in consultants for Board reviews and risk management assessments, and to carry out inspections of RHBOs.

Financial arrangements

Funding

4.30 PHIAC is industry funded under the *Private Health Insurance (Council Administration Levy) Act 2003*. This Act enables PHIAC to impose levies on the RHBOs, based on their membership, to meet its general administrative costs as approved by the Board in the annual budget. In addition, this Act allows the Minister to determine up to two supplementary levies within any financial year, having obtained and taken into account advice from PHIAC.

4.31 PHIAC also has the power, under *The Private Health Insurance (Collapsed Organisation Levy) Act 2003*, to impose an additional levy on the industry in the event that any RHBO is unable to meet its liabilities.

4.32 These levy Acts, which took effect from 1 July 2004, repealed provisions of the Health Act under which PHIAC had previously imposed levies. Since

2004–05, monies collected have been placed into the Consolidated Revenue Fund and appropriated for the purposes of each levy. PHIAC continues to administer these levies directly.

4.33 PHIAC determines the industry levy annually on the basis of its estimated administrative costs and the number of contributors to each RHBO. Therefore RHBOs with larger numbers of contributors pay higher levies[22]. The total levies imposed on the RHBOs during 2003–04 were $2.8 million. The 2004–05 levies on RHBOs totalled $4.2 million and those for 2005–06 will be $4.4 million.

4.34 Each RHBO sends its quarterly levy to PHIAC, which deposits the funds into Consolidated Revenue and then draws down the funds it requires for each quarter.

Budget

4.35 An overview of PHIAC's revenue and associated expenditure since 1997–98, together with appropriations for 2004–05 and 2005–06, is shown in Figure 4.1.

4.36 ANAO noted that PHIAC's budgeted expenditure had increased significantly to $4.3 million in 2004–05 when compared with the previous years. PHIAC stated that this was due to planned increases in staff numbers and anticipated litigation costs. Council had also decided PHIAC should build up an amount equivalent to around six months operating expenditure, to be used to meet future contingencies. It determined in 2004 that the level to be built up would amount to $250 000 per year for four years. This resulted in a corresponding increase in the amount of the annual levies on RHBOs so that, in addition to the anticipated litigation costs and staff increases, the levies for 2004–05 increased by around 49 per cent over those for 2003–04.

4.37 PHIAC advised that it had recorded a significant surplus of $1.3 million in funds for 2004–05 as a result of underspending relative to its budget, which had been based on previous experience. The surplus in 2004–05 was due to the settlement of a large case and no major emerging issues.

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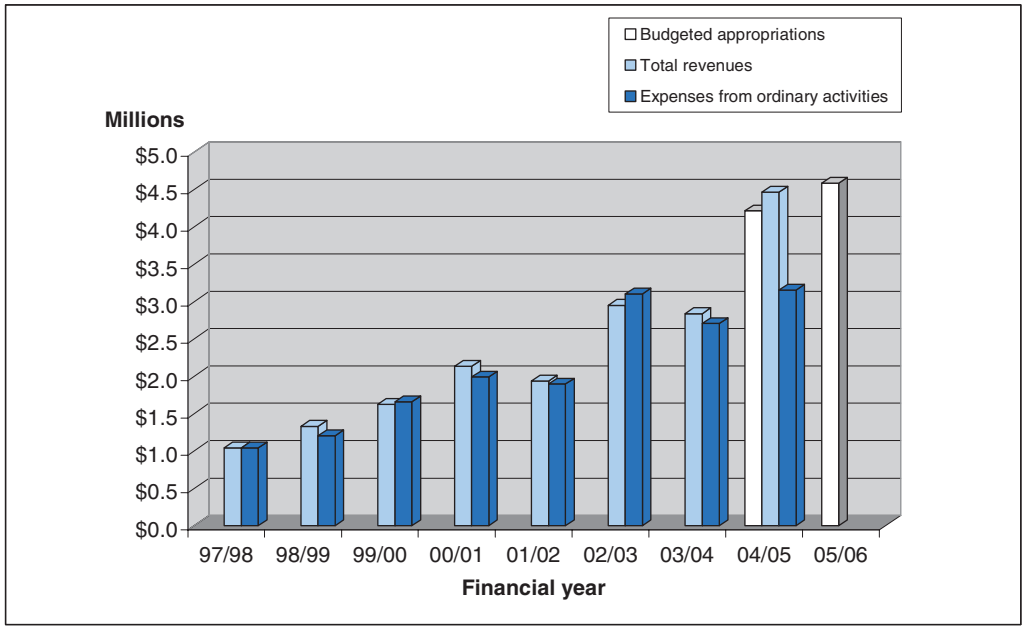
[22] The formula for calculating levies is set out in the Regulations to the *Private Health Insurance (Council Administration Levy) Act 2003*. Paragraph 7(2)(c) of this Act sets annual maximum amounts for the levy ($2 for a single contributor and $4 for those who contribute in respect of more than one person).

Figure 4.1

PHIAC revenues and expenses—1997–98 to 2005–06



Source: PHIAC, Annual Reports 1997–98 to 2003–04 and Department of Health and Ageing Portfolio Budget Statements 2004–05 and 2005–06.

4.38 ANAO also noted that the appropriation for 2005–06 was at a similar level to the previous year ($4.4 million). PHIAC advised that it believed the maintenance of appropriate reserves to smooth out fluctuations in costs from year to year was prudent and responsible, because there remained uncertainty on the need and expense of regulatory action.

4.39 ANAO noted that the amount that PHIAC is building up is more than the amount that it determined in 2004, which was the equivalent of $250 000 per year.

Financial monitoring and reporting

4.40 PHIAC monitors its revenue and expenditure on a monthly basis, with monthly reporting of financial information to the Board for consideration and approval. These reports included the operating statement, cash flow statement and balance sheet for the month immediately prior to the Board meeting, and the month's accounts set out in the Budget Estimates Framework Review format required by Finance. They also included a summary of revenue and expenditure adjustments to the total year's forecasts.

4.41 PHIAC prepares an annual report on its activities as required under s. 9 of the CAC Act, which includes its financial statements as audited by ANAO. No adverse audit opinion has been given in recent years.

Risk management

4.42 Risk management is a process of identifying, analysing, treating, monitoring and communicating the risks affecting an organisation. These risks could prevent an organisation from achieving its business objectives or hinder the opportunity for extra benefits to be realised.[23] Risk management encourages a greater emphasis on outcomes, as well as concentrating on resource priorities and performance assessment as part of management decision-making.

4.43 ANAO reviewed PHIAC's operational risk management procedures against ANAO's better practice principles. This involved determining whether PHIAC:

- gave detailed consideration to the risks facing the organisation as a whole;
- established appropriate risk management processes and practices;
- regularly analysed and reviewed risk management approaches; and
- actively involved everyone in the organisation in risk management.

Consideration of risk and development of a risk register

4.44 PHIAC employed consultants in March 2000 to assist it to identify the risks to which PHIAC was exposed in carrying out its functions, and to formulate a risk profile and risk register. Consultants were again employed in 2003 to assist with the revision of the operational risk profile and the development of a risk management plan to enable ongoing management and control of risk. ANAO considered that obtaining such outside advice and assistance was an effective means for PHIAC to develop expertise and establish a risk management process.

4.45 These documents identified a number of likely risks to PHIAC in the areas of fund monitoring, reinsurance and statistics, operations, governance, communication, finance, information technology and human resources. Thirty

[23] ANAO Better Practice Guide–*Public Sector Governance Volumes 1 & 2*, July 2003, Vol. 1 p. 19.

risks were described, with assessed risk ratings ranging from 'low' to 'very high'. These ratings were determined on the basis of the likelihood and consequences of the risk event.

4.46 PHIAC plans to review these risk profiles and assessments every three years. However, as PHIAC's operating environment is constantly changing, ANAO considers that a review of its risks and risk ratings should be part of PHIAC's annual strategy and planning processes. PHIAC's annual strategic planning day would provide an opportunity for the Board to carry out this review.

Risk management and review

4.47 From this risk assessment, PHIAC adopted a Key Risks Plan addressing those risks rated as 'high' or 'very high'. This involved determining appropriate actions for each risk; the officer responsible; agreeing on the timing of the actions, either as specific deadlines or ongoing; establishing review dates; and reporting on progress to PHIAC's Audit and Compliance Committee.

4.48 ANAO considered that it was not sufficient for PHIAC to include only those risks rated as 'high' or 'very high' in this plan. Risks rated as 'significant' were also in need of careful management, as their impact on PHIAC's operations could be considerable. These 'significant' risks included risks both to PHIAC's regulatory functions and internal operations, such as:

- failure to detect breaches in capital adequacy;
- errors in the existing reinsurance computer application;
- inadequate expertise base/skills;
- prolonged absence of a staff member; and
- trust funds invested in unauthorised investments.

4.49 If these risks were not monitored more frequently, necessary changes in their rating may go unmeasured as PHIAC's circumstances altered. Furthermore, such risks as staff absence or lack of expertise may have an impact on more serious potential problems such as the detection of breaches in solvency or the provision of advice to the Minister.

Recommendation No.3

4.50 ANAO recommends that:

(a) PHIAC's Board and senior management review its risk register at least annually to ensure that its risk profiles and risk ratings remained valid over time; and

(b) PHIAC extend its risk management reporting to incorporate those risks categorised as 'significant', as well as 'high' and 'very high', to ensure that their impact on PHIAC's operations are understood, monitored, and acted upon by PHIAC's Board and senior management.

PHIAC's response: Accepted and implemented.

Ownership of risk management

4.51 While risk management was ultimately the responsibility of the directors, all managers and staff had a responsibility to manage risk. ANAO noted that PHIAC's risk management plan identified the individuals or groups responsible for controlling each risk. These were described as 'owners' of that risk management strategy. Staff manuals addressed specific risks as part of a multi-level approach to managing and mitigating risks.

4.52 PHIAC reported regularly against its risk management plan to the Audit and Compliance Committee for consideration at its quarterly meetings. This report included against each risk the proposed action, the timeframe for action, a review date, and progress. The Committee informed the Board through exception-based reporting of all instances where action was required to address a specific risk, such as a breach of security.

4.53 ANAO considers that in a small organisation such as PHIAC, where it may not be feasible to employ a dedicated risk manager, making all staff accountable for risk management is an effective administrative tool. Staff are in the best position to monitor and manage risk within their own areas of responsibility, with oversight by the Audit and Compliance Committee.

Internal controls

Audit and Compliance Committee

4.54 A sub-committee consisting of all Board members except the Commissioner forms PHIAC's Audit and Compliance Committee. The Committee's charter defines its functions and role. The Committee has no executive powers or decision–making authority in relation to the day-to-day operations of PHIAC.

4.55 The aim of the Committee is to assist PHIAC and the Council by ensuring that due care and diligence is applied to internal control systems, risk management and the financial management processes adopted by PHIAC. This complies with ANAO's better practice principles for governance. ANAO noted that the Committee was performing its specified functions.

4.56 PHIAC has a Compliance Officer who reports to and assists the Audit and Compliance Committee. This Officer's role is to ensure that PHIAC complies with reporting requirements under the CAC Act, and to report performance against targets such as publication dates. ANAO noted that PHIAC complied with its CAC Act reporting requirements.

Internal audit

4.57 ANAO found that PHIAC had not implemented a regular internal audit program. Systems of internal controls were designed and implemented by PHIAC staff to incorporate appropriate segregation of duties and delegations of authority. The Board and staff conducted risk management reviews of any changes to internal systems prior to implementation.

Procedures and instructions

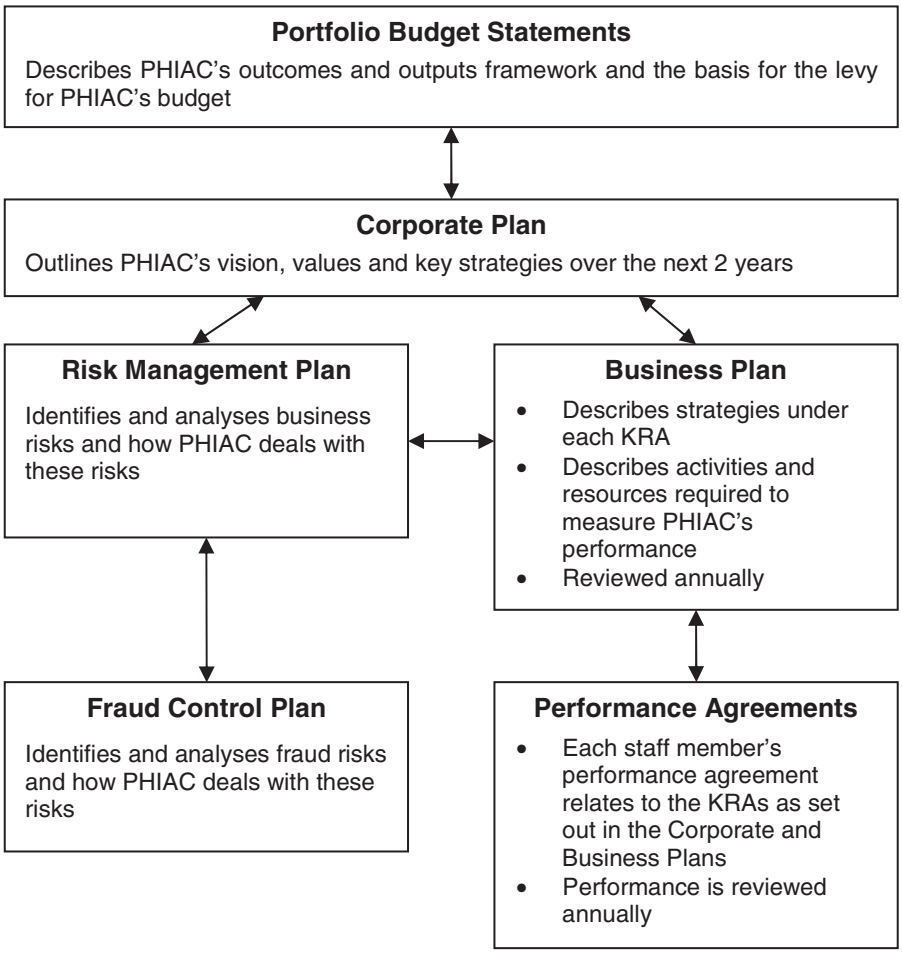
4.58 ANAO noted that PHIAC has an Employee Manual and CEO's Instructions, which is provided to all staff. This was last updated in March 2005. The manual establishes internal controls for PHIAC's operations and sets out procedures to be followed by staff in their work. This is important in an organisation where it is difficult to have a strict separation of functions. PHIAC's manual also includes an Anti-Fraud Plan. Compliance with this plan was part of each individual's performance review.

Strategic and operational planning

4.59 ANAO found that PHIAC had established corporate and business plans to guide the performance of its legislative functions. PHIAC's strategic planning framework is shown in Figure 4.2.

Figure 4.2

PHIAC's strategic planning framework



Source: ANAO, from PHIAC's Corporate Plan 2005–07.

4.60 PHIAC held annual strategic planning days to review and revise these plans, the most recent being held in June 2005. These involved both the Board and PHIAC management with an independent facilitator. PHIAC's strategic planning considered the environment in which PHIAC will operate over the

following two to three years, with particular emphasis on the first twelve months. It sought to identify major issues that may impact on the private health insurance industry.

Corporate Plan

4.61 In 2005, PHIAC developed a Corporate Plan for the period 2005–07 (which succeeded its Strategic Plan 2004–06). The Corporate Plan was provided to the Minister and Health. A summary was provided to all RHBOs and published on PHIAC's website. The plan covers such matters as PHIAC's core functions, values and behaviours; PHIAC's vision statement; risk management framework and key risks; how PHIAC will undertake its task and achieve key result areas. It is aligned with PHIAC's risk management plan, and will be reviewed annually.

4.62 The Plan identifies four Key Result Areas (KRAs), which inform PHIAC's strategic planning process. These are:

- KRA 1–ensure that health insurance regulation in Australia is best practice;
- KRA 2–strengthen industry governance;
- KRA 3–develop effective industry information to support strengthened governance; and
- KRA 4–build capacity in staff skills and management.

Business Plan

4.63 PHIAC's Business Plan identifies strategies, actions and related target dates to achieve the KRAs defined in the Corporate Plan. It is reviewed annually. The CEO reports progress against these actions at each Board meeting.

4.64 Using this Business Plan, the CEO and staff develop operational business plans, including budgets, and submit them to the Board for approval. These plans for each operational area (such as the Prudential Supervision Section) specify the particular actions, responsible officers, supervisor and target dates required to achieve the strategies. The business plans are also linked to the performance criteria in each staff member's performance agreement, and informed their performance appraisals.

Performance management and reporting

Portfolio Budget Statements

4.65 As stated in the 2005–06 Portfolio Budget Statements (PBS), PHIAC works to achieve a single outcome specified by government:

> The prudential safety of registered private health insurance funds, the best interests of members of those funds, and a competitive level of private health insurance premiums, are efficiently regulated to support a viable industry.

4.66 This outcome is closely aligned with PHIAC's legislative objectives. 2005–06 will be the first year in which PHIAC will report under its own outcome.

4.67 Two output groups are associated with this outcome: information to Government and other stakeholders relevant to private health insurance; and regulatory activity. ANAO found that these output groups are encompassed within the KRAs defined in the Corporate Plan, with their emphasis on regulation and information.

4.68 The 2005–06 PBS listed specific actions for each of PHIAC's output groups and set out the key performance indicators for measuring whether these actions were achieved. For example, output group 2 (regulatory activity) included the action 'monitoring the financial status of the private health insurance industry' for which key performance indicators included 'collection of financial returns from each RHBO on a quarterly basis and on a more frequent basis where necessary'.

4.69 Performance indicators established for PHIAC in the PBS for 2005–06 related to the 'quality' of PHIAC services. Such indicators should, where possible, relate to tangible, objective attributes of how well an agency output has been delivered. Less tangible, but nonetheless significant, criteria such as client satisfaction, peer review and public perception can also be used but these require sound methodologies for collecting the information.[24]

4.70 ANAO found that some qualitative outputs described in PHIAC's PBS did not have measurable attributes at the time of our audit. For example, in relation to regulatory activity, PHIAC was required to achieve a 'high level of customer satisfaction with services provided'. However, no measure of customer satisfaction had yet been provided.

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[24] ANAO Better Practice Guide-*Performance Information in Portfolio Budget Statements*, May 2002, p.21.

4.71 ANAO considers it important that performance information used for such external reporting requirements is consistent with, and integral to, internal planning, budgets, analysis, and other internal performance reporting.[25] This means using consistent basic indicators and measures for internal and external use.

4.72 ANAO considered that the actions set out by PHIAC in the Business Plan to meet the KRAs were operational goals (for the most part one-off objectives) rather than measurable key performance indicators. While useful and necessary actions in themselves, they gave no indication as to how they contributed to the successful achievement of the KRAs on an ongoing basis. They were not linked to the performance information published in the PBS. Target dates were set in the Business Plan for their achievement and, once completed, no further action or monitoring in relation to these tasks was expected.

Recommendation No.4

4.73 ANAO recommends that PHIAC develop performance information in its Business Plan that is closely aligned with the performance information in the Portfolio Budget Statements, in order to better measure the extent to which PHIAC achieves its stated outcome, and develop more measurable indicators for public reporting.

PHIAC's response: Accepted and will be implemented for PHIAC's next budget year, 2006–07.

Reporting

4.74 ANAO found that PHIAC management produced relevant, timely financial and operational reports within the limitations identified above, such as the lack of benchmarking.

4.75 PHIAC monitored the performance of specific tasks against actions and target dates in its planning framework. Progress against each Business Plan action is monitored and reported to the CEO, and informs the report on the Corporate Plan. The status of each action is highlighted, with alerts (such as 'caution', 'danger') for those actions where progress has been unsatisfactory. The CEO reported on progress against the plan each month to the Board.

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[25] ANAO Better Practice Guide-*Public Sector Governance*, Volume 1, July 2003.

4.76 PHIAC produced two annual reports that contained information about its activities, as well as statistics on PHIAC's operations and the operations of the RHBOs. PHIAC's annual report submitted under the CAC Act included details of activities against each PBS output group.

Records management

4.77 Recordkeeping is a key component of any organisation's governance and critical to its accountability and performance. Good recordkeeping supports communication and decision-making and is fundamental to the successful achievement of an organisation's objectives. An effective regulatory system has sound records management, including documentary records of key regulatory decisions and the reasons underpinning them.

4.78 During the fieldwork for the audit, ANAO accessed a broad range of PHIAC's files and records. In doing so, ANAO assessed whether PHIAC had an appropriate records management system in place.

4.79 ANAO had some concerns about PHIAC's recordkeeping. PHIAC kept files and records in both traditional (paper) and electronic format. ANAO found that many of PHIAC's paper files were poorly compiled, in that documents were not folioed or chronologically maintained. This meant that important records could be removed without detection and PHIAC could have difficulty in locating documents related to key regulatory decisions and actions when required.

4.80 Of additional concern to ANAO were instances where some documents marked 'confidential' or 'in-confidence', which contained personal information, were filed on unclassified files that were accessible to all staff. This was a breach of PHIAC's procedures as set out in the CEO's Instructions, and a breach of the Privacy legislation.

4.81 ANAO noted that Board and Audit and Compliance Committee papers and minutes, personal files and other confidential files (including those related to security, CEO contracts and Board appointments) were kept securely. PHIAC also secured, and kept confidential, information it collected from and about RHBOs.

4.82 ANAO suggests that PHIAC takes action to appropriately maintain its records in order to ensure that important records were not lost, and documents related to key regulatory decisions and actions were easily located when required. ANAO noted that when these issues were brought to PHIAC's attention during the audit, PHIAC had immediately responded in a positive way to addressing the discrepancies found.

Conclusion

4.83 ANAO found that PHIAC had established an appropriate organisational structure for the performance of its duties as the regulator of private health insurance, with a logical division of duties and appropriate reporting lines.

4.84 PHIAC was meeting its responsibilities under the CAC Act. It had developed operating procedures for the conduct of Board business, including a Board Charter, and it provided induction and training for Board members. It also assessed Board performance by undertaking regular Board reviews. PHIAC had relevant internal controls, including an Audit and Compliance Committee and well-documented compliance instructions.

4.85 PHIAC met its reporting requirements by preparing its annual report and the annual report on operations of the RHBOs, and notifying the Minister of significant events. PHIAC had its financial statements annually audited by ANAO.

4.86 PHIAC had established a comprehensive strategic and operational planning framework to guide the performance of its legislative functions, which included a Corporate Plan, a Business Plan and a Risk Management Plan. It had sound regular annual strategic and operational planning processes. It set strategies and monitored its performance using a risk management approach. However, ANAO recommends that PHIAC could improve this process by conducting more regular reviews of its risk register and extending its risk management reporting to incorporate those risks categorised as 'significant'.

4.87 ANAO found that PHIAC had a performance management and reporting framework that identified the extent to which PHIAC achieved the KRAs established in its Corporate Plan. However, ANAO recommends that PHIAC could improve these to better demonstrate the extent to which it achieved its outcome. These improvements would include linking actions to the performance indicators set out in the PBS, and developing more measurable indicators for public reporting.

Steve Chapman
Acting Auditor-General

Canberra ACT
6 December 2005

Appendices

Appendix 1: Registered Health Benefits Organisations – 2004–05

Abbreviated Name	Registered Name	Open/ Restricted	For Profit
ACA	A.C.A. Health Benefits Fund	R	No
AHMG	Australian Health Management Group Limited	O	No
AMA	A.M.A. Health Fund Limited	R	No
Aust. Unity	Australian Unity Health Limited	O	Yes
BUPA	BUPA Australia Health Pty Ltd	O	Yes
CBHS	CBHS Friendly Society Limited	R	No
CDH	Cessnock District Health Benefits Fund Limited	O	No
Credicare	Credicare Health Fund Limited	O	No
Defence Health	Defence Health Limited	R	No
Druids NSW	United Ancient Order of Druids Registered Friendly Society Grand Lodge of New South Wales	O	No
Druids Vic	United Ancient Order of Druids Friendly Society Limited	O	No
Fed Health	Federation Health	O	No
GMHBA	GMHBA Limited	O	No
GU	Grand United Health Fund Pty Limited	O	Yes
GU Corporate	Grand United Corporate Health Limited	O	Yes
HBF	HBF Health Funds Inc	O	No
HCF	The Hospitals Contribution Fund of Australia Limited	O	No
HCI	Health Care Insurance Ltd.	R	No
Healthguard	Healthguard Health Benefits Fund Limited	O	No
Health Partners	Health–Partners Inc	O	No
HIF	Health Insurance Fund of W.A.	O	No
Latrobe	Latrobe Health Services Inc.	O	No
Lysaght	Lysaght Peoplecare	R	No
MBF	Medical Benefits Fund of Australia Ltd	O	No

Abbreviated Name	Registered Name	Open/ Restricted	For Profit
MBF Health	MBF Health Pty Limited	O	Yes
Medibank	Medibank Private Limited	O	No
Mildura	Mildura District Hospital Fund Limited	O	No
MU	Manchester Unity Australia Ltd	O	No
Navy Health	Navy Health Limited	R	No
NIB	N.I.B. Health Funds Limited	O	No
Phoenix	Phoenix Health Fund Limited	R	No
Police Health	South Australian Police Employees' Health Fund Inc	R	No
QCH	Queensland Country Health Limited	O	No
Qld Teachers	Queensland Teachers' Union Health Fund Ltd	R	No
R&T Health	Railway & Transport Employees' Friendly Society Health Fund Ltd	R	No
Reserve Bank	Reserve Bank Health Society Ltd	R	No
St Luke's	St Luke's Medical & Hospital Benefits Association Limited	O	No
Teachers Fed	Teachers Federation Health Ltd	R	No
Transport	Transport Friendly Society Ltd	R	No
Westfund	Western District Health Fund Ltd	O	No

Source: PHIAC.

Appendix 2: PHIAC's legislative functions

PHIAC's functions under Section 82G(1) of the Health Act

	Function
(a)	To administer the Health Benefits Reinsurance Trust Fund.
(b)	To obtain from each registered organisation regular reports about the financial affairs of the organisation, including reports supported by actuarial certification.
(ba)	To obtain from the Department, for the purposes of modelling, evaluation and research, aggregated data derived from information referred to in the Hospital Casemix Protocol, being information of a kind determined in writing by the Minister for the purposes of this paragraph.
(bb)	To obtain regular reports from registered organisations about matters relating to the incentives scheme within the meaning of the *Private Health Insurance Incentives Act 1997* or the incentive payments scheme, or the premiums reduction scheme, within the meaning of the *Private Health Insurance Incentives Act 1998*, including reports supported by actuarial certification.
(bc)	To obtain regular reports from registered organisations about matters relating to the operation of gap cover schemes and to provide advice to the Minister on the operation of those schemes with particular reference to the extent to which the schemes genuinely reduce or eliminate the cost to consumers of hospital treatment and associated professional attention.
(bd)	To publish on the Internet, and make available for inspection at its offices, details of all gap cover schemes approved by the Minister under section 73BDD, including details of any terms and conditions that apply to the relationship between a registered organisation and individual medical providers.
(c)	To establish standards of the following kinds to be complied with by registered organisations: (i) solvency standards; (ii) capital adequacy standards; (iii) uniform standards for reporting to the Council.
(d)	To examine, from time to time, the financial affairs of registered organisations, by means of the inspection and analysis of the records, books and accounts of the organisations and any other relevant information.
(db)	To appoint, under section 82R, inspectors for the purpose of investigating the affairs of registered organisations under Part VIA and to exercise other related powers and functions under that Part.
(e)	To review, by carrying out independent actuarial assessment, the value of the assets of each health benefits fund.
(f)	To appoint, on the basis of a report of an inspector or otherwise, persons as administrators of health benefits funds or of registered organisations and to terminate such appointments.
(g)	To receive, under section 82XZC, reports of administrators of health benefits funds or registered organisations concerning the administration of those funds or organisations and to deal with such reports in accordance with section 82XZD.

	Function
(ga)	To give approvals related to the voluntary winding up of health benefit funds or registered organisations in the circumstances set out in Subdivision 3 or 4 of Division 4 of Part VIA, as the case requires.
(gb)	To apply to a court for the winding up of insolvent health benefits funds or insolvent registered organisations in accordance with Subdivision 5 or 6 of Division 4 of Part VIA, as the case requires.
(k)	Where it is necessary, for the purpose of making a proper examination of the financial affairs of a registered organisation, for the Council to incur unusually high costs—to impose an appropriate fee on the organisation concerned.
(l)	To distribute copies of the Private Patients' Hospital Charter issued under section 73F to registered organisations for distribution and display by the organisations.
(la)	To make copies of the Charter available to members of the public on request at each of its offices accessible to the public.
(lb)	Where appropriate, to publicise the existence and availability of the Charter in its brochures and other documents, concerning health insurance, made available to the public.
(m)	To make statistics, and other financial information, relating to a registered organisation or registered organisations, publicly available in accordance with the Council's rules.
(ma)	To collect and disseminate information about private health insurance, for the purpose of enabling people to make informed choices about private health insurance.
(n)	To receive applications from registered organisations for review of certificates given under subsection 3B(1) of the *Health Insurance Act 1973* and to refer the applications to the Secretary.
(p)	To impose fees in relation to applications for review of certificates given under subsection 3B(1) of the *Health Insurance Act 1973*.
(r)	To make rules, not inconsistent with this Act, for the purpose of the performance of its functions and the exercise of its powers.
(s)	To advise the Minister about the financial operations and affairs of registered organisations.
(sa)	To cooperate with other regulatory agencies on matters affecting registered organisations and the private health insurance industry generally.
(sb)	To provide the Private Health Insurance Ombudsman, from time to time, with information in the possession of the Council that is, in the view of the Council, likely to be of use in the production, after the end of each financial year, of the State of the Health Funds Report referred to in paragraph 82ZRC(ba).
(t)	Functions incidental to any other functions of the Council.
(u)	Any other functions conferred on the Council by this, or any other, Act.

Source: *National Health Act 1953*.

Appendix 3: PHIAC's management of non-compliance

PHIAC's seven-step process for intervention

Step	Regulatory Action
1 - No action	Initially, PHIAC will take no action if, after discussion with the RHBO, the breach is found to be of a minor and temporary nature. In this situation, PHIAC advised the RHBO that a minor breach was identified, informed the organisation that no further action would be taken, and documented its decision not to act.
2 - Issue notice	This is the initial step for all matters where PHIAC had concerns about an issue that does not appear to be minor or temporary. In such cases, PHIAC identified and defined the breach, requested information from the RHBO, and established a communication protocol in order to seek agreement on the nature of the problem. Following receipt of the requested information from the RHBO and discussions with its management, PHIAC could: • take no further action (thus returning to step one); or • issue a supplementary request for information; or • move to step three, by issuing a Notice to the RHBO which made recommendations that must be addressed within a specific time.
3 - Monitoring	At this step, PHIAC required the RHBO to take corrective actions in response to the Notice issued at step two. This included immediately correcting the cause of the problem and developing a turnaround strategy, which included monitoring and reporting requirements against milestones and within timeframes. PHIAC reviewed the fund's strategy and requested further information if required for approval of the strategy. It then established and implemented a monitoring and reporting protocol.
4 - Examination	If the RHBO and PHIAC were unable to establish the exact nature of the breach, or if the RHBO failed to report to PHIAC on its strategy, PHIAC advised the RHBO that it would exercise its power to examine the company's books, records and accounts. Following the examination, and depending on the severity of identified breaches, PHIAC may issue another Notice, or escalate the investigation by appointing an inspector.
5 - Appoint Inspector	Where the breach was severe, and in PHIAC's opinion after its examination of the RHBO's financial situation, the appointment was considered to be in the best interests of contributors, PHIAC appointed an inspector. The inspector undertook a quick and detailed assessment of the financial and operational position of the RHBO by examining its books and records. This was in order to determine its solvency position and to provide a report to PHIAC recommending future action.

Step	Regulatory Action
6 - Appoint Administrator	The next step for a severe breach was for PHIAC to appoint an administrator to the RHBO. This enabled an independent party to assess the financial position of the RHBO to determine its solvency and to suggest options for its future. The administrator reported back to PHIAC on the RHBO's financial position and could make one of three recommendations, as follows: • the RHBO be returned to the directors and the administration cease; • the RHBO be placed into liquidation; or • the RHBO's contributors and creditors enter into a deed or scheme of arrangement.
7 - Winding up	For a company with severe 'going concern' problems and where, after due process, in PHIAC's opinion, liquidation was in the best interests of contributors, PHIAC would petition the Court to wind up the fund or the registered organisation, as the circumstances required. In making application, PHIAC would apply directly to the Court. PHIAC entered into a reporting arrangement with the Official Liquidator, once appointed, to monitor the progress of the liquidation.

Source: PHIAC, Managing Supervision and Intervention guidelines, reviewed March 2004.

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