

## **Life Insurance (prudential standard) determination No. 2 of 2023**

### **EXPLANATORY STATEMENT**

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

*Life Insurance Act 1995, section 230A*

Under subsection 230A(1) of the *Life Insurance Act 1995* (the Act), APRA has power to determine standards (prudential standards), in writing, in relation to prudential matters to be complied with by life companies, including friendly societies, registered non-operating holding companies (registered NOHCs) and subsidiaries of life companies and registered NOHCs. Under subsection 230A(5) of the Act, APRA may, in writing, vary or revoke a prudential standard.

#### **1. Background**

On 7 March 2023, APRA determined four life insurance prudential standards which would have otherwise sunset in accordance with the *Legislation Act 2003*.

Following internal and external consultation APRA determined that all four life insurance standards remain fit for purpose and there was potential for prudential risk to arise if they were allowed to sunset. The prudential standards re-made:

- Prudential Standard LPS 100 Solvency Standard;
- Prudential Standard LPS 115 Capital Adequacy: Insurance Risk Charge;
- Prudential Standard LPS 360 Termination Values, Minimum Surrender Values and Paid-up Values; and
- Prudential Standard LPS 370 Cost of Investment Performance Guarantees.

Each instrument revoked the existing prudential standard and replaced it with a corresponding prudential standard that commence on 29 March 2023.

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

The purpose of this instrument is to revoke Prudential Standard LPS 115 Capital Adequacy: Insurance Risk Charge and replace it with Prudential Standard LPS 115 Capital Adequacy: Insurance Risk Charge (LPS 115).

LPS 115 requires a life company to maintain adequate capital against the insurance risks associated with its activities. The ‘Insurance Risk Charge’ is the minimum amount of capital required to be held against insurance risks. The Insurance Risk Charge relates to the risk of adverse impacts due to movements in future mortality, morbidity, longevity, servicing expenses and lapses.

LPS 115 set out the method for calculating the Insurance Risk Charge. This charge is one of the components of the Standard Method for calculating the prescribed capital amount for life company statutory funds and general funds.

Each prudential standard provides for APRA to exercise various discretions. Decisions made by APRA exercising those discretions are not subject to merits review. This is because these decisions are preliminary decisions that may facilitate or lead to substantive decisions which are subject to merits review.

Under the Act, a breach of a prudential standard is a breach of the enabling legislation, as the Act provides that regulated entities must comply with the standard. However, there are no penalties prescribed for breach of a prudential standard under the Act. Instead, an entity's breach of the enabling legislation is grounds for APRA to make further, substantive decisions under the relevant enabling legislation in relation to the entity. Those decisions may include the decision:

- (a) to issue a direction to the regulated entity, including a direction to comply with the whole or part of a prudential standard (section 230B of the Act); and
- (b) to revoke the registration of a life company (section 26 of the Act) or NOHC registration (section 28C of the Act).

It is only at this stage that an entity is exposed to a penalty: loss of licence or imposition of a penalty if it breaches the direction (section 230F of the Act). In nearly all cases<sup>1</sup>, the decisions are preceded by a full consultation with the regulated entity to raise any concerns they may have in relation to the decision.

The decisions of APRA to impose a direction are subject to merits review (section 236 of the Act) which is appropriately available at the point where an entity could be exposed to a penalty. All decisions to revoke registrations under the Act are subject to merits review, unless specifically excluded by the enabling legislation. Revocation of registration as a life company or a NOHC registration is subject to merits review (section 236 of the Act).

Where this standard refers to an Act, Regulation or Prudential Standard, this is a reference to the document as it exists from time to time, and which is available on the Federal Register of Legislation at [www.legislation.gov.au](http://www.legislation.gov.au).

### **3. Consultation**

On 21 November 2022, APRA undertook consultation with all life insurers in relation to its proposal to remake four life insurance prudential standards without change, which included LPS 115. APRA invited feedback on the four prudential standards by 15 December 2022.

Two submissions were received during the consultation. The respondents agreed with APRA's assessment that the four standards remained broadly fit for purpose. Neither submission highlighted issue with LPS 115.

APRA is satisfied the consultation was appropriate and reasonably practicable.

### **4. Impact Analysis (IA)**

In remaking these four life insurance prudential standards as they are, APRA has followed a process which satisfies the requirements of the Office of Impact Analysis (OIA). APRA has prepared a letter for the OIA that certifies APRA's assessment that the prudential standards are operating efficiently and effectively. This self-assessment is in lieu of an Impact Analysis (IA) and is allowable by OIA in situations where consultation, with affected stakeholders, has been undertaken and the standards are to be remade with no change. This letter, as evidence of APRA's policy development process, has been lodged as supporting material

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<sup>1</sup> The Act specifically provides APRA does not need to consult where APRA is satisfied that doing so could result in a delay in revocation that would be contrary to the public interest (subsections 26(5) and 28(3) of the Act).

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

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

## ATTACHMENT A

### Statement of Compatibility with Human Rights

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

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

#### Overview of the Legislative Instrument

The purpose of the Legislative instrument is to revoke *Prudential Standard LPS 115 Capital Adequacy: Insurance Risk Charge* and replace it with another version.

LPS 115 requires a life company to maintain adequate capital against the insurance risks associated with its activities. The Insurance Risk Charge is the minimum amount of capital required to be held against insurance risks. The Insurance Risk Charge relates to the risk of adverse impacts due to movements in future mortality, morbidity, longevity, servicing expenses and lapses.

LPS 115 set out the method for calculating the Insurance Risk Charge. This charge is one of the components of the Standard Method for calculating the prescribed capital amount for life company statutory funds and general funds.

#### Human rights implications

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

#### Conclusion

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