

Life Insurance (prudential standard) determination No. 10 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.

On 24 May 2023, APRA made Insurance (prudential standard) determination No. 10 of 2023 (the instrument), which revokes *Prudential Standard LPS 118 Capital Adequacy: Operational Risk Charge* made under Life Insurance determination No. 7 of 2012 and determines a new *Prudential Standard LPS 118 Capital Adequacy: Operational Risk Charge* (LPS 118).

The instrument commences on 1 July 2023.

1. Background

On 24 May 2023, APRA determined 19 general insurance and life insurance prudential standards with amendments that relate to the new accounting standard Australian Accounting Standards Board (AASB) 17 Insurance Contracts (AASB 17) and minor updates to the Life and General Insurance Capital (LAGIC) Framework.

Based on International Financial Reporting Standard 17 Insurance Contracts, AASB 17 will see all insurance contracts accounted for in a consistent manner, thereby facilitating comparisons across similar insurance companies. The requirements are designed to help users of financial statements better understand an insurer's exposure, profitability and financial position.

APRA's capital and reporting frameworks have close linkages with the accounting standards previously relied upon to determine the accounting treatment of insurance liabilities. As a result, APRA's capital and reporting frameworks required substantial updates to ensure compatibility with AASB 17.

Not making adjustments to APRA's capital and reporting frameworks may have resulted in unintended changes to reported capital levels across the insurance industries. It may have also significantly increased regulatory burden due to the need for insurers to maintain dual valuation, actuarial, accounting and reporting systems to meet the different requirements of AASB 17 and APRA's prudential framework.

In addition to this, although the LAGIC framework continues to achieve its objectives, APRA has taken the opportunity to make a number of updates to LAGIC to ensure it remains fit-for-purpose. The key changes include:

- removing the ability of insurers to use Internal Capital Models for regulatory capital purposes;
- aligning the measurement of capital instruments for ADIs and Insurers; and
- clarifying and strengthening APRA’s position on the use of offshore reinsurers (these proposals were initially consulted on separately but have since been subsumed into the AASB 17 and LAGIC updates project).

2. Purpose and operation of the instrument

The purpose of this instrument is to revoke LPS 118 and replace it with the corresponding new versions of the prudential standard incorporating the amendments.

This instrument makes changes to better align APRA’s prudential requirements with accounting concepts, as well as make a small number of other amendments to address minor prudential matters. The fundamental components or purpose of each standard has not changed.

LPS 118 sets out the method for calculating the Operational Risk Charge, the minimum amount of capital a life company must hold against operational risks. The Operational Risk Charge is one of the components of the Standard Method for calculating the prescribed capital amount for life company statutory funds and general funds and relates to the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

Documents incorporated by reference

Under paragraph 14(1)(a) of the *Legislation Act 2003*, the prudential standard incorporates by reference as in force from time to time:

- Acts of Parliament and associated delegated legislation;
- Prudential Standards determined by APRA under:
 - subsection 11AF(1) of the *Banking Act 1959*;
 - subsection 32(1) of the *Insurance Act 1973*;
 - subsection 230A(1) of the *Life Insurance Act 1995*; and
 - subsection 92(1) of the *Private Health Insurance (Prudential Supervision) Act 2015*; and
- Reporting Standards determined by APRA under subsection 13(1) of the Act;
- the Australian Accounting Standards determined by the Australian Accounting Standards Board under section 334 of the *Corporations Act 2001* (Cth); and
- the Australian Auditing Standards determined by the Auditing and Assurance Standards Board under section 336 of the *Corporations Act 2001* (Cth).

These documents may be freely obtained at www.legislation.gov.au (all documents listed above except for Australian Accounting and Auditing Standards),

<https://www.aasb.gov.au/pronouncements/accounting-standards/> (Australian Accounting Standards) and <https://auasb.gov.au/standards-guidance/auasb-standards/auditing-standards/> (Australian Auditing Standards).

Review of decisions

There are several powers that may be exercised by APRA in prudential standards that involve an element of discretion, and which may impact the interests of a life company to which the prudential standards apply.

Decisions made by APRA exercising those powers are not subject to merits review. APRA considers decisions made by APRA exercising discretions under its prudential standards should not be subject to merits review as they are financial decisions with a significant public interest element.

A breach of a prudential standard is also a breach of the Act, as the Act provides that a life company must comply with the prudential standard. However, there are no penalties prescribed for such breaches. Instead, a life company's breach of a provision in the Act is grounds for APRA to make further, substantive decisions under the Act.

3. Consultation

APRA began its engagement with industry on AASB 17 in 2017, subsequent engagement has taken a range of forms including letters to industry, information requests, quantitative impact studies, and four rounds of consultation:

- September 2019 – Letter issued outlining APRA's proposed directions and information request on preparedness;
- November 2020 – Discussion paper 'Integrating AASB 17 into the capital and reporting frameworks for insurers and updates to the LAGIC framework';
- December 2021 – Response paper 'Integrating AASB 17 into the capital and reporting framework for insurers and updates to the LAGIC framework'; and
- September 2022 – Response paper 'Finalisation and the integration of AASB 17 into the capital and reporting frameworks for insurers and updates to the LAGIC framework'.

Amendments to *Prudential Standard LPS 117 Capital Adequacy: Asset Concentration Risk Charge* (LPS 117) were initially part of a separate consultation related to responding to prudential concerns from the increased use of offshore reinsurers. As the standard was also affected by AASB 17 changes, it was later subsumed into the AASB 17 project.

APRA is satisfied the consultation was appropriate and reasonably practicable.

4. Impact Analysis (IA)

The Office of Impact Analysis advised that no Regulation Impact Statement was required for the consequential amendments as the changes to the prudential standards are minor and machinery.

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 118 Capital Adequacy: Operational Risk Charge* and replace it with a new version of the corresponding prudential standards with the appropriate amendments.

This instrument ensures insurers are not subject to undue regulatory burden with the introduction of AASB 17 and sets up the insurance prudential framework to remain fit for purpose into the future.

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 Instrument is compatible with human rights.

Conclusion

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