

Health Insurance (prudential standard) determinations No. 2 of 2023

EXPLANATORY STATEMENT

Prepared by the Australian Prudential Regulation Authority (APRA)

Private Health Insurance (Prudential Supervision) Act 2015, subsection 92(1)

Under subsection 92(1) of the *Private Health Insurance (Prudential Supervision) Act 2015* (the Act), APRA has power to determine standards (prudential standards), in writing, in relation to prudential matters to be complied with by private health insurers. Under subsection 92(5) of the Act, APRA may, in writing, vary or revoke a prudential standard.

On 24 May 2023, APRA made Health Insurance (prudential standard) determination No. 2 of 2023, which revokes *Prudential Standard HPS 110 Capital Adequacy* made under Health Insurance determination No. 3 of 2015 and determines a new *Prudential Standard HPS 110 Capital Adequacy* (HPS 110).

The instrument commences on 1 July 2023.

1. Background

Capital standards are an important tool to support the objectives of APRA's prudential framework. They are intended to ensure that an insurer has sufficient financial resources available to meet its financial promises to policy holders despite adverse conditions. APRA's capital standards determine the minimum regulatory capital requirement for an insurer, taking into account the nature of the risks an insurer is exposed to in its business.

Since assuming prudential regulatory responsibility for the private health insurance industry in 2015, APRA has progressively reviewed and updated the prudential policy framework. APRA's review of the capital framework represents the third and final phase of that systematic process.

The review of the private health insurance capital framework revealed that, in a number of respects, the former capital framework was less robust than the requirements applied to other Australian insurance sectors and did not appropriately reflect the risks faced by insurers.

The new private health insurance capital framework seeks to address these concerns by ensuring there is an appropriate level of financial resilience and protection for policyholders through:

- **improved risk sensitivity** of the capital standards to better reflect the risks faced by private health insurers;
- **reduced discretion** available to private health insurers to determine their capital requirements, so as to narrow the differences between insurers with similar business models and profiles; and
- **alignment** with the structure of the life and general insurance capital framework, where appropriate. This reflects APRA's overall approach to capital quality and adequacy and is consistent with international best practice.

The changes to the private health insurance capital framework also incorporate changes to APRA's insurance capital framework due to the new accounting standard AASB 17 Insurance Contracts (AASB 17). This ensures alignment between the prudential and

accounting requirements and reduces cost and complexity for industry from otherwise needing to manage and report on diverging frameworks.

2. Purpose and operation of the instrument

The purpose of this instrument is to revoke HPS 110 and replace it with a new version of HPS 110.

HPS 110 requires a private health insurer to maintain an adequate level and quality of capital commensurate with the scale, nature and complexity of its business and risk profile. A private health insurer is also required to have a documented Internal Capital Adequacy Assessment Process (ICAAP), comply with any supervisory adjustment to capital imposed by APRA, obtain APRA's written consent before reducing its capital, and inform APRA of any significant adverse changes to its capital position.

Under HPS 110, a private health insurer is required to maintain required levels of capital and determine its prescribed capital amount having regard to a range of risk factors that may adversely impact the insurer's ability to meet its obligations. These factors include insurance risk, asset risk, asset concentration risk and operational risk.

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 the private health insurers 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 private health insurer must comply with the prudential standard. However, there are no penalties prescribed for such breaches. Instead, a private health insurer's breach of a provision in the Act is grounds for APRA to make further, substantive decisions under the Act.

3. Consultation

This and other prudential standards, forming the new private health insurance capital framework, are the product of extensive consultation with the industry and other key stakeholders. Submissions were received from, and discussions held with, private health insurers, industry bodies and other government agencies.

Submissions were largely supportive of aligning the private health insurance capital framework with the requirements for life and general insurers. Key areas of feedback from submissions included the treatment of the deferred claims liability within the capital framework, the allowance for management actions, and the design of the insurance risk charge. Insurers also raised the scale of the increase in minimum regulatory capital requirements and the impact this could have on premiums.

A number of public discussion and response papers were released during and following the consultation periods with draft standards accompanying the December 2021 response paper:

- November 2018: Letter *Roadmap for APRA's review of the private health insurance capital framework*;
- December 2019: Discussion Paper *Private Health Insurance Capital Standards Review*;
- December 2021: Response Paper *A proposed new capital framework for Private Health Insurance*;
- December 2021: Quantitative Impact Study;
- December 2021: Response Paper *Integrating AASB 17 into the capital and reporting framework for insurers and updates to the LAGIC framework*;
- April 2022: Letter *Integrating AASB17 into the Capital and reporting framework for insurers and updates to private health insurer capital framework*;
- September 2022: Response paper *Finalising the review of the Private Health Insurance Capital Framework*; and
- September 2022: Response Paper *Finalisation of the integration of AASB 17 into the capital and reporting frameworks for insurers and updates to the LAGIC framework*.

APRA is satisfied the consultation was appropriate and reasonably practicable.

4. Impact Analysis (IA)

In making the new prudential standards, including HPS 110, APRA has followed a process which satisfies the requirements of the Office of Impact Analysis (OIA). APRA has followed a similar process to that required for a Regulation Impact Statement (RIS) which satisfies the OIA's requirements. APRA's policy development process is evidenced in Attachment A of the Response Paper *Finalising the review of the Private Health Insurance Capital Framework*. An extract of Attachment A has been lodged as supporting material.

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 HPS 110 Capital Adequacy* made under Health Insurance determination No. 3 of 2015 and determines a new Prudential Standard HPS 110 Capital Adequacy.

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.