

Health Insurance (prudential standard) determinations No. 5 of 2023

REPLACEMENT EXPLANATORY STATEMENT

Prepared by the Australian Prudential Regulation Authority (APRA)

Private Health Insurance (Prudential Supervision) Act 2015, section 92

Under subsection 92(1) of the *Private Health Insurance (Prudential Supervision) Act 2015* (the Act), APRA has power to determine 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 that applies to private health insurers.

On 24 May 2023, APRA made Health Insurance (prudential standard) determination No. 5 of 2023, which determines *Prudential Standard HPS 115 Capital Adequacy: Insurance Risk Charge* (HPS 115).

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

HPS 115 sets out the method for calculating the Insurance Risk Charge, the minimum amount of capital a private health insurer must hold against the insurance risks associated with its activities.

The Insurance Risk Charge is one of the components of the prescribed capital amount and relates to the risk that the value of the net insurance liabilities is greater than the value determined by the Appointed Actuary.

Exercise of discretion by APRA

Under subsection 92(4) of the Act, a prudential standard may provide for APRA to exercise powers and discretions under the standard, including (but not limited to) discretions to approve, impose, adjust or exclude specific prudential requirements in relation to a particular private health insurer.

HPS 115 includes powers to adjust or exclude a provision of the standard, which may be exercised by APRA that involve an element of discretion.

APRA considers a wide range of factors when exercising its discretion under prudential standards, including the considerations set out in the Act and the *Australian Prudential Regulation Authority Act 1998*. The need to apply discretion is driven by entity specific issues and circumstances which are not adequately addressed by the generally applicable provisions of the prudential standards.

Adjust and exclude powers

Paragraph 39 of HPS 115 provides for APRA to adjust or exclude a specific prudential requirement in relation to a particular private health insurer. APRA will exercise this power if it is satisfied that the exclusion or adjustment of the specific requirement will achieve a better prudential outcome than if it remained in its original form. In other cases, an adjustment or exclusion may be necessary to give APRA comfort that the prudential requirements apply appropriately to protect policy holders (for example when action may need to be taken urgently and with certainty that the insurer will comply with the adjusted requirements). Other considerations include efficiency, competition, contestability, competitive neutrality and regulatory burden, including comparisons with the entity's peer group.

A decision to exercise the powers under a prudential standard is subject to a robust decision-making framework which is documented in APRA's internal policies. This framework supports APRA in fulfilling its mandate by limiting decision making to those senior APRA officers with the appropriate experience and skill to exercise prudent judgement. The framework also requires decision makers to seek advice from internal experts.

The adjust and exclude power is exercised following discussion with the relevant private health insurer about its appropriateness and the impact it may have on the entity.

Review of decisions

Decisions made by APRA exercising its powers under the Act 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.

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 92(1) of the Act; and
- Reporting Standards determined by APRA under subsection 13(1) of the *Financial Sector (Collection of Data) Act 2001*;

which are available on the Federal Register of Legislation at www.legislation.gov.au.

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

In making the new prudential standards, including HPS 115, 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 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 to this Explanatory Statement.

ATTACHMENT

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 determine *Prudential Standard HPS 115 Capital Adequacy: Insurance Risk Charge*.

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 legislative instrument is compatible with human rights.

Conclusion

This legislative instrument is compatible with human rights as it does not raise any human rights issues.