

***Insurance, Life Insurance and Health Insurance (prudential standards)
determination 1 of 2023***

EXPLANATORY STATEMENT

Prepared by the Australian Prudential Regulation Authority (APRA)

Insurance Act 1973, section 32

Life Insurance Act 1995, section 230A

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

APRA may, in writing, determine vary or revoke a prudential standard that applies to an APRA-regulated institution under:

- (1) subsections 32(1) and (4) of the *Insurance Act 1973* (Insurance Act), in relation to general insurers, authorised non-operating holding companies (authorised insurance NOHCs), and subsidiaries of general insurers and authorised insurance NOHCs;
- (2) subsections 230A(1) and (5) of the *Life Insurance Act 1995* (Life Insurance Act), in relation to life companies (including friendly societies), registered non-operating holding companies (registered life NOHCs), and subsidiaries of life companies and registered life NOHCs; and
- (3) subsections 92(1) and (5) of the *Private Health Insurance (Prudential Supervision) Act 2015* (PHIPS Act), in relation to registered private health insurers.

On 21 November 2023, APRA made *Insurance, Life Insurance and Health Insurance (prudential standards) determination No. 1 of 2023* (the instrument), which revokes *Prudential Standard CPS 320 Actuarial and Related Matters* (CPS 320) made under *Insurance, Life Insurance and Health Insurance (prudential standard) determination No. 1 of 2018*.

The instruments commence on 1 January 2024.

1. Background

APRA's mandate is to ensure the safety and soundness of prudentially regulated financial institutions so that they can meet their financial promises to depositors, policyholders and fund members within a stable, efficient and competitive financial system.

APRA carries out this mandate through a multi-layered prudential framework that encompasses licensing and supervision of institutions. APRA is empowered under the Insurance Act, Life Insurance Act and PHI Act to issue legally binding prudential standards that set out specific prudential requirements with which APRA-regulated institutions in each industry must comply. These standards are supported by

prudential practice guides which clarify APRA's expectations with regard to prudential requirements.

APRA regularly reviews its regulatory regime and amends its prudential requirements as a result of a number of factors including:

- international developments;
- changes in financial market conditions;
- changes in risk management practices, in response to identified weaknesses in the prudential framework; and
- to reduce potential negative impacts of emerging industry issues.

When amending its prudential requirements APRA has regard to, amongst others, the impact on industry in terms of both industry burden and matters of proportionality.

Between 2016 and 2018, APRA consulted with the general insurance, life insurance and private health insurance industries to review and reform the prudential requirements relating to the role of the Appointed Actuary. In 2018, CPS 320 was introduced for general insurers, life insurers and private health insurers to establish appropriate frameworks to allow the Appointed Actuary to focus on the matters most material to the sound and prudent operation of the insurer's business.

CPS 320 remakes the previous version of the prudential standard which came into effect on 1 July 2019, with minor revisions to terminology to accommodate the revised private health insurance capital framework which took effect on 1 July 2023.

2. Purpose and operation of the instruments

The purpose of this instrument is to revoke the previous CPS 320 and to replace it with a new version, incorporating minor updates.

CPS 320 set out prudential requirements for general insurers, life insurers and private health insurers to maintain appropriate actuarial advice. This advice is designed to assist the board and senior management in carrying out their responsibilities for the sound and prudent management of the insurer.

The key requirements of CPS 320 are:

- an insurer must establish an actuarial advice framework;
- an insurer must provide the Appointed Actuary with sufficient information, and access to the board and senior management, to allow the Appointed Actuary to fulfil specified roles and functions;
- the Appointed Actuary must provide advice to the insurer on the valuation of the insurance liabilities, the insurer's financial condition, and matters specified

under the insurer's actuarial advice framework, consistent with the insurer's materiality policy;

- the Appointed Actuary must assess the insurer's financial condition and prepare a Financial Condition Report;
- an insurer must submit a copy of the Financial Condition Report to APRA;
- the Appointed Actuary must provide advice on the valuation of insurance liabilities, and Appointed Actuaries of general insurers and life companies must prepare an Actuarial Valuation Report; and
- a general insurer or life company must submit a copy of the Actuarial Valuation Report to APRA.

Exercise of discretion by APRA

CPS 320 provides for APRA to exercise various discretions. Decisions made by APRA in 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 Insurance Act, Life Insurance Act and PHIPS Act, a breach of a prudential standard is a breach of the enabling legislation, as each enabling Act provides that regulated entities must comply with the standard. However, there are no penalties prescribed for breach of the prudential standards under any of these Acts. 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 104 of the Insurance Act, section 230B of the Life Insurance Act); and a direction to comply with all, or specified obligations, which includes prudential standards (section 96 of the PHIPS Act); or
- (b) to revoke an authority to carry on insurance business (section 15 of the Insurance Act); an insurance NOHC authorisation (section 21 of the Insurance Act); registration of life insurance business (section 26 of the Life Insurance Act); or a life NOHC authorisation (section 28C of the Life Insurance 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 (50 penalty units each day under section 108 of the Insurance Act, and section 230F of the Life Insurance Act; and 30 penalty units each day under section 104 of the PHIPS Act). In nearly all cases,¹ the

¹ The Insurance Act and Life Insurance Act specifically provide that 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 national interest (subsection 15(4) of the Insurance Act), or contrary to the public interest (subsection 26(5) of the Life Insurance Act), respectively.

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 104 of the Insurance Act, section 236 of the Life Insurance Act, and section 168 of the PHIPS Act), which is appropriately available at the point where an entity could be exposed to a penalty.

All decisions to revoke authorisations/registrations under the Insurance Act and Life Insurance Act are subject to merits review, unless specifically excluded by the enabling legislation.

Revocation of an authorisation to carry on insurance business or an insurance NOHC authorisation is subject to merits review (sections 15 and 21 of the Insurance Act).

Revocation of registration as a life insurance company or a life NOHC authorisation is subject to merits review (section 236 of the Life Insurance Act).

The situation in relation to cancellation of registration under the PHIPS Act is different to the other enabling legislation.

Adjust and exclude powers

CPS 320 gives APRA the discretion to adjust or exclude a provision of the prudential standard (paragraph 41). The power to create such a discretion is provided for under subsections 32(3D) of the Insurance Act, 230A(4) of the Life Insurance Act and 92(4) of the PHIPS Act.

APRA may exercise this power when it is satisfied that the adjustment or exclusion of a specific requirement for one or more specified regulated entities will better support APRA in meeting its objectives. For example, the adjustment or exclusion may be necessary to obtain a better prudential outcome than would be the case if the prudential requirement were applied unaltered to a particular regulated entity. A tailored approach would give APRA comfort that the prudential requirements apply appropriately to protect the interests of depositors, policyholders and fund members. APRA will also take into account other considerations, such as efficiency, competition, contestability, competitive neutrality and regulatory burden, including comparisons with the entity's peer group.

The exercise of APRA's powers is governed by 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 technical experts.

Incorporation 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 laws;
- Prudential Standards determined by APRA under:
 - 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 *Financial Sector (Collection of Data) Act 2001*;
- 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).

3. Consultation

APRA undertook consultations on its review of the role of the Appointed Actuary between June 2016 and December 2017. Submissions were received from, and discussions held with, numerous insurers, industry bodies, and the professional body.

In June 2016, APRA released for public consultation a discussion paper, *The role of the Appointed Actuary and actuarial advice within insurers*. APRA received 26 written submissions in response to the discussion paper and presented the proposed reforms via a wide range of industry forums.

In September 2017, APRA released for public consultation a response to submissions paper which included two new draft prudential standards and a draft prudential practice guide. In the response, APRA outlined the significant issues raised in the submissions and APRA's response to them. APRA received 10 submissions in relation to the response paper.

All submissions to the response paper were generally supportive of the proposed changes and mainly sought minor clarifications to the draft CPS 320. The key issue of concern related to the date of implementation with some stakeholders noting that given other concurrent regulatory changes, a later implementation date would be preferred.

In June 2023, APRA released for public consultation minor prudential framework updates to several prudential standards and guidance documents. For CPS 320, APRA consulted on replacing the stress test amount references relating to private health insurance as this is no longer applicable after the revised private health insurance capital framework took effect on 1 July 2023. APRA also proposed some other minor corrections to references. Five submissions were received on the proposed minor

amendments. Submissions did not raise any objections to the proposed updates to CPS 320.

4. Impact Analysis (IA)

The Office of Impact Analysis has confirmed that IA is not required as the remaking of CPS 320 is unlikely to have more than a minor regulatory impact.

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 Instruments

The purpose of *Insurance, Life Insurance and Health Insurance (prudential standard) determination 1 of 2023* is to revoke the existing requirements under *Prudential Standard CPS 320 Actuarial and Related Matters* (CPS 320) for general insurers, life insurers and private health insurers and replace it with the new CPS 320 which sets out prudential requirements for general insurers, life insurers and private health insurers to maintain appropriate actuarial advice. This advice is designed to assist the board and senior management in carrying out their responsibilities for the sound and prudent management of the insurer.

CPS 320 is designed to protect policyholder interests and ensure sound prudential outcomes by improving the functioning of the Appointed Actuary role.

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 instruments is compatible with human rights as it does not raise any human rights issues.