

Health Insurance (prudential standard) determination No. 1 of 2024

EXPLANATORY STATEMENT

Prepared by the Australian Prudential Regulation Authority (APRA)

Health Insurance (Prudential Supervision) Act 2015, section 92

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

On 9 July 2024, APRA made Health Insurance (prudential standard) determination No. 1 of 2024 (the instrument), which revokes *Prudential Standard HPS 112 Capital Adequacy: Measurement of Capital* made under *Health Insurance (prudential standard) determination No. 3 of 2023* and determines a new *Prudential Standard HPS 112 Capital Adequacy: Measurement of Capital* (HPS 112).

The instrument commences on 1 October 2024.

1. Background

APRA's role is to protect the financial interests of Australians by maintaining the safety and soundness of financial institutions. To do this, APRA sets legal requirements and guidance for the entities it regulates (the prudential framework).

The prudential framework comprises:

- legally binding prudential standards;
- legally binding reporting standards; and
- supporting guidance (such as prudential practice guides).

HPS 112 is a legally binding prudential standard. It is part of a group of prudential standards relating to the capital that a private health insurer must hold as a buffer against unexpected losses.

HPS 112 remakes the previous version of the prudential standard with minor amendments.

2. Purpose and Operation

The purpose of the instrument is to revoke the previous HPS 112 and replace it with a new version. The new version makes a minor change to replace the term 'health fund', which is not a defined term, to 'fund', which is defined (in paragraph 3 of HPS 112).

Adequate capital is critical to protect policyholders. APRA sets requirements on minimum capital to ensure private health insurers can absorb unexpected losses in their business. This is a core tool of prudential regulation and supports system-level financial stability.

The overarching purpose of HPS 112 is to ensure a private health insurer holds adequate capital against the risks it faces. The standard specifies both the amount and type of capital that must be held.

The key requirements of HPS 112 are set out in Attachment A to this Explanatory Statement.

3. Consultation

On 4 April 2024, APRA consulted¹ on a set of minor updates to the prudential framework, including changes to HPS 112. APRA has previously consulted on the provisions in HPS 112 that were unchanged.

APRA did not receive any submissions for HPS 112 from private health insurers during the consultation.

4. Scope of administrative powers

Exercise of discretion by APRA

HPS 112 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 Act, a breach of a prudential standard is a breach of the Act, as the Act provides that regulated entities must comply with the 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 in relation to the insurer. Those decisions may include the decision to issue a direction to the regulated entity, including a direction to comply with all, or specified obligations, which includes prudential standards (section 96 of the Act).

It is only at this stage that an insurer is exposed to a penalty, loss of licence or imposition of a penalty if it breaches the direction (30 penalty units each day under section 104 of the Act). In nearly all cases, the decision is preceded by a full consultation with the insurer to raise any concerns it may have in relation to the decision.

A decision of APRA to impose a direction is subject to merits review under section 168 of the Act, which is appropriately available at the point where an insurer could be exposed to a penalty.

Cancellation of the registration of a private health insurer is subject to merits review (section 168 of the Act).

¹ See <https://www.apra.gov.au/prudential-framework-minor-updates-0>

Adjust and exclude discretion

HPS 112 gives APRA the discretion to adjust or exclude a provision of the prudential standard (paragraph 9). The power to create such a discretion is provided for under subsection 92(4) of the 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 policyholders. 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.

5. Incorporation by reference

Under section 14(1)(a) of the *Legislation Act 2003*, the 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 92(1) of the Act;
- 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 on the Federal Register of Legislation 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).

6. Impact Analysis (IA)

The Office of Impact Analysis has confirmed that an IA is not required as the remaking of HPS 112 is unlikely to have more than a minor regulatory impact.

7. 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 B to this Explanatory Statement.

ATTACHMENT A

Key requirements of HPS 112

1. Capital base of a private health insurer

The capital base must be assessed for the private health insurer as a whole and for each of its funds. Paragraphs 13 to 43 set out the requirements for the private health insurer as a whole.

The capital base of a private health insurer consists of Common Equity Tier 1 (CET1), Additional Tier 1 (AT1), paid-up mutual equity interests and Tier 2 (T2) Capital. Attachment A lists the criteria for an instrument to be classified as paid-up ordinary shares in CET1 Capital. Attachment C sets out the criteria for an instrument to be classified as AT1 Capital. Attachment D outlines the criteria for an instrument for inclusion in T2 Capital. Attachment F outlines the criteria for an instrument to be classified as a mutual equity interests.

Paragraphs 44-46 set out matters that APRA may consider in assessing capital strength of a private health insurer in relation to intra-group capital transactions.

2. Regulatory adjustments

Attachment B sets out regulatory adjustments required to be made to ensure the capital base is adequate to support the activities of the private health insurer.

3. Capital base of a health benefits fund and general fund

The capital base requirements for health benefit funds are specified in paragraphs 50 to 53. The requirements for general funds are specified in paragraphs 54 to 56.

ATTACHMENT B

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 instruments 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 112 Capital Adequacy: Measurement of Capital* made under *Health Insurance (prudential standard) determination No. 3 of 2023* and replace it with another version.

HPS 112 is designed to ensure private health insurers remain financially resilient by maintaining sufficient capital against the risks associated with its activities.

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.