

Health Insurance (prudential standard) determination No. 2 of 2024

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 may, in writing, make standards (prudential standards) relating to prudential matters, that must be complied with by, or in relation to, private health insurers. Under subsection 92(5) of the Act, APRA may, in writing, vary or revoke a prudential standard.

On 27 November 2024, APRA made Health Insurance (prudential standard) determination No. 2 of 2024 (the instrument), which revokes *Prudential Standard HPS 110 Capital Adequacy* made under *Health Insurance (prudential standard) determination No.2 of 2023* and determines a new *Prudential Standard HPS 110 Capital Adequacy* (HPS 110).

The instrument commences on 1 January 2025.

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 110 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 110 remakes the previous version of the prudential standard with minor amendments.

2. Purpose and Operation

The purpose of the instrument is to revoke the existing version of HPS 110 and replace it with a new version. The new version makes minor amendments to the previous HPS 110 by:

1. replacing a reference to *Prudential Standard HPS 001 Definitions* with *Prudential standard CPS 001 Defined terms* (CPS 001). CPS 001 replaced HPS 001 on 1 October 2024, and
2. amending the prescribed capital amount for a transferor insurer's health benefits fund where APRA has approved an arrangement under section 33 of the Act for the merger of health benefits funds.

The amendment will address an inconsistency between:

- a) paragraph 33(3)(c) of the Act that requires the net asset position of the transferor insurer's health benefits fund immediately after the arrangement takes effect to not be greater than zero; and
- b) paragraph 24 of HPS 110 which requires that the prescribed capital amount for a health benefits fund of a private health insurer must not be less than \$5 million.

There will be no change in outcomes following the minor update, except private health insurers will no longer need to apply to APRA for regulatory relief from paragraph 24 of HPS 110.

The overarching purpose of HPS 110 is to ensure a private health insurer holds adequate capital against the risks it faces. Adequate capital is critical to protect policyholders and 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. Details of HPS 110 are set out in Attachment A to this Explanatory Statement.

3. Consultation

On 6 September 2024, APRA undertook public consultation¹ on a proposed set of minor amendments to the prudential framework, including amendments to HPS 110. APRA has previously consulted on the provisions in HPS 110 that remain unchanged.

APRA did not receive any submissions regarding HPS 110 during the consultation.

4. Scope of administrative powers

Exercise of discretion by APRA

HPS 110 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

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

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).

Adjust and exclude discretion

HPS 110 gives APRA the discretion to adjust or exclude a provision of the prudential standard (paragraph 52). 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 gives 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 paragraph 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 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*.

These documents may be freely obtained on the Federal Register of Legislation at www.legislation.gov.au.

6. Impact Analysis (IA)

The Office of Impact Analysis has confirmed that an IA is not required as the remaking of HPS 110 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

Details of HPS 110

1. Authority, application, commencement and interpretation

Under subsection 92(1) of the Act, APRA may determine prudential standards to be complied with by private health insurers.

Paragraphs 1 to 3 are the machinery provisions relating to the legal authority under which the instrument is made, and the requirement that a private health insurer must apply the standard separately to each of its health benefits funds and its general fund, as well as to the private health insurer as a whole.

Paragraphs 4 to 5 are machinery provisions relating to the commencement and interpretation of the standard, and relevant definitions used in the standard.

2. Responsibility for capital management

Paragraphs 6 and 7 require the private health insurer's Board to ensure that the private health insurer meets the capital adequacy requirements set out by HPS 110.

3. Internal Capital Adequacy Assessment Process (ICAAP)

A private health insurer must have in place an ICAAP detailing its capital assessment and management processes.

Paragraphs 8 to 16 set out what the ICAAP must incorporate, including: policies and procedures to identify, measure and monitor risks arising from the private health insurer's activities and the capital held against those risks; a strategy for maintaining adequate capital over time; stress testing of risks; an ICAAP Summary Statement and an annual ICAAP Report.

4. Minimum capital adequacy requirements

In assessing the adequacy of a private health insurer's capital base, the considerations needed to be given to risks it faces and the quality of the capital are set out in paragraphs 17 to 19.

The Prescribed Capital Requirement (PCR) is the minimum required level of capital for regulatory purposes and is intended to take account of the full range of risks to which a private health insurer is exposed to. Paragraphs 20 to 25 provide the requirements for the PCR.

The Prescribed Capital Amount (PCA) is a risk-based approach for measuring the capital adequacy of private health insurers. The PCA is determined by having regard to a range of risk factors set out in paragraphs 26 to 39, that may adversely impact the private health insurer's ability to meet its obligations.

Paragraphs 40 to 41 require private health insurers to comply with any supervisory adjustment to capital imposed by APRA.

5. Disclosure

Paragraphs 42 to 43 set out key capital metrics that private health insurers must publish at least annually. This published information must be widely accessible to both policy holders and other market participants per paragraph 44.

Paragraph 45 stipulates that a private health insurer must not disclose any supervisory adjustment determined by APRA.

6. Reductions in capital base

Paragraph 46 to 49 sets out the types of reductions in a private health insurer's capital base and APRA requirements that need to be satisfied before a reduction is made.

7. Materiality

Paragraph 50 provides that a private health insurer may take into account materiality when calculating its capital base and PCA.

8. Notification requirements

Paragraph 51 sets out incidents where a private health insurer must inform APRA, including any breach of its capital requirements and any significant adverse changes to its capital.

9. Adjustments and exclusions, determinations made under previous prudential standards

Paragraph 52 provides APRA the power to adjust or exclude a specific requirement in HPS 110 in relation to a private health insurer.

Paragraph 56 notes that an exercise of APRA's discretion given to a private health insurer under a previous version of the standard continues to have effect.

10. Transition

Paragraphs 53 to 55 detail the commence dates for which Significant Financial Institutions (SFIs) and non-SFIs must comply with the ICAAP requirements in paragraphs 8 to 16.

11. Attachment A – Transition Arrangements

Paragraphs 1 to 4 of Attachment A detail requirements relating to a private health insurer's transitional arrangement, which provides an adjustment to reduce the PCA that is phased out over a two-year period.

ATTACHMENT B

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*

Health Insurance (prudential standard) determination No. 2 of 2024

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 110 Capital Adequacy* made under *Health Insurance (prudential standard) determination No.2 of 2023* and replace it with another version.

HPS 110 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.

Conclusion

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