



# Discussion Paper

## **Prudential Supervision of Life Companies**

3 October 2006

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## Preamble

This discussion paper follows a review, by the Australian Prudential Regulation Authority (APRA), of aspects of the prudential framework applicable to life companies.

The review has been guided by APRA's aim of moving towards consistency of the principles underpinning the prudential frameworks of APRA-regulated industries. While differences in detail are necessary in recognition of the differing structures of the various industries, principles should, ordinarily, be consistent so that like risks are regulated in a like manner.

As a result of this review, a number of areas have been identified in which improvements could be made to the framework to the benefit of industry, policy owners and APRA. Accordingly, a package of prudential standards and prudential practice guides (PPGs) has been prepared. The resulting package, applicable to all life companies including friendly societies, proposes a set of minimum requirements which APRA sees as essential to the prudent management of life companies and provides guidance on meeting these minimum requirements.

The key benefits of the proposed changes are:

- further ensuring the protection of the interests of policy owners;
- flexibility for life companies to conduct their operations in the way that best suits their business needs, subject to meeting minimum standards of prudent practice;
- for friendly societies, the removal of a series of existing, dated and detailed prudential standards, with consequent reductions in the amount of prescription; and
- consistent regulatory principles across APRA-regulated industries, reducing costs and complexity for entities which are part of corporate groups operating across multiple regulated industries.

The package has been drafted according to APRA's desired structure of:

- mandatory prudential standards with principles-based requirements; and

- PPGs which provide non-mandatory guidance on ways to comply with the minimum requirements of the prudential standard, and which communicate APRA's view of good practice.

The prudential standards have been drafted, as far as possible, in a principles-based way. This gives companies maximum flexibility to configure their operations in the way that suits their objectives, subject to meeting the minimum requirements of the prudential standard.

This discussion paper is accompanied by:

- draft *Prudential Standard LPS 220 Risk Management*;
- a number of associated draft PPGs:
  - *Prudential Practice Guide LPG 200 Risk Management*;
  - *Prudential Practice Guide LPG 230 Operational Risk*;
  - *Prudential Practice Guide LPG 240 Life Insurance Risk and Life Reinsurance Management*;
  - *Prudential Practice Guide LPG 250 Asset and Liability Management Risk*; and
  - *Prudential Practice Guide LPG 260 Conflicts of Interest under Section 48*;
- draft *Prudential Standard LPS 232 Business Continuity Management*; and
- an associated draft PPG:
  - *Prudential Practice Guide LPG 232 Business Continuity Management*.

These draft prudential standards and PPGs are available on the APRA website at [www.apra.gov.au/policy](http://www.apra.gov.au/policy).

APRA proposes to finalise and issue the prudential standards and PPGs discussed in this paper in the first quarter of 2007, for implementation on 1 July 2007.

Written submissions on these proposals should be forwarded via email by 31 December 2006 to:

Mr Keith Chapman  
General Manager  
Policy Development  
Australian Prudential Regulation Authority  
Email: [lifeproposals@apra.gov.au](mailto:lifeproposals@apra.gov.au)

# Introduction

APRA has identified a range of areas in which the prudential framework applicable to life companies including friendly societies (collectively referred to herein as life companies unless expressly noted otherwise) could be improved, with the potential to benefit industry, policy owners and APRA. The key changes proposed are:

- setting minimum standards for risk management; and
- setting minimum standards for business continuity management.

## Expected benefits of the proposals

APRA expects that the benefits of introducing minimum risk management and business continuity management standards for life companies will be:

- for policy owners, further protection of their interests, as risk management systems reduce the risk of loss by, or failure of, a company;
- for friendly societies, the removal of a series of existing, dated and detailed, prudential standards, with consequent reductions in the amount of prescription and increases in the flexibility available to friendly societies;
- for all life companies, clarity about APRA's minimum expectations for risk management, including business continuity management;
- for life companies which are part of corporate groups operating across multiple regulated industries, reduced cost and complexity due to the consistent regulatory principles across industries; and
- for all life companies, maximum flexibility to conduct their operations in the way that best suits their business needs, subject to meeting minimum standards of prudent practice, due to a principles-based approach to the prudential standards and the use of PPGs.

The package of prudential standards and PPGs will advance APRA's aim of moving towards a set of principles which apply consistently across APRA-regulated industries. While differences between the requirements will continue to be necessary, due to differences in industry structure, the principles underpinning the requirements will be more consistent. Both industry and APRA benefit from such an approach through simplification of the regulatory framework, given the increasing conglomeration of the financial sector.

The proposed requirements for the life insurance industry are structured in a two-tiered fashion. The basic structure is the combination of two types of instruments – prudential standards, which set out minimum standards with which all life companies must comply, and PPGs, which are non-mandatory and offer guidance only. The prudential standards are drafted, wherever possible, in a principles-based, flexible manner which recognises the diversity in the regulated population and minimises the cost of complying.

In this proposal, *Prudential Standard LPS 220 Risk Management* and *Prudential Standard LPS 232 Business Continuity Management* set out APRA's minimum requirements of life companies.

In support of these prudential standards, APRA proposes a series of PPGs which will provide additional guidance to life companies to assist them to comply with the minimum requirements in the prudential standards. The PPGs will also contain material on APRA's views of good practice in the risk management area, including business continuity management. The PPGs will contain only guidance material – they will be non-mandatory. Life companies will have the flexibility to configure their risk management and business continuity structures in the way that best suits their business objectives, while meeting the minimum requirements of the prudential standards. One of the proposed PPGs, *Prudential Practice Guide LPG 260 Conflicts of Interest under Section 48*, draws directors' attention to their duty to policy owners under section 48 of the *Life Insurance Act 1995* (the Life Act).

## Structure of this paper

This paper is divided into three chapters:

- Chapter one deals with APRA's proposals in relation to *Prudential Standard LPS 220 Risk Management*.
- Chapter two deals with the proposed series of PPGs related to *Prudential Standard LPS 220 Risk Management*, specifically:
  - *LPG 200 Risk Management*;
  - *LPG 230 Operational Risk*;
  - *LPG 240 Life Insurance Risk and Life Reinsurance Management*;
  - *LPG 250 Asset and Liability Management Risk*; and
  - *LPG 260 Conflicts of Interest under Section 48*.
- Chapter three deals with APRA's proposals for *LPS 232 Business Continuity Management* and the associated PPG *LPG 232 Business Continuity Management*.

## Proposed commencement and transitional arrangements

APRA intends to release the final prudential standards and PPGs in advance of their effective date to enable industry to meet the requirements in an orderly way. The need for further specific transitional arrangements will be assessed based on the responses to this discussion paper.

Further details of commencement and transitional requirements will be released in due course. However, the proposed release date for the final prudential standards and PPGs discussed in this paper is the first quarter of 2007, with the prudential standards taking effect from 1 July 2007. A 12-month transition period is proposed in relation to the requirements of *LPS 232 Business Continuity Management*. During this transitional period, it is proposed that life companies will be required to report on their compliance with *LPS 232 Business Continuity Management* and submit a plan and timetable for rectifying areas of non-compliance prior to the end of the transitional period.

## Measuring the economic impact of this proposal

### Assessing the costs

As part of developing prudential requirements, APRA undertakes an assessment of costs and benefits to stakeholders likely to be affected by any proposals. These assessments are published by APRA as Regulation Impact Statements. (These are available for viewing at [www.apra.gov.au](http://www.apra.gov.au).)

In keeping with *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business* (the Banks report), APRA is further enhancing its approach to cost-benefit analysis. These enhancements will generally focus on obtaining more granular cost data from the affected stakeholders, in particular the affected industry. The Business Cost Calculator (BCC) developed by the Office of Small Business (OSB) is the preferred tool of the Commonwealth Government in calculating business compliance costs. To ensure APRA gathers such data in a uniform manner, respondents are asked to use the BCC to calculate their assessment of compliance costs of the proposals in this paper. Costs of the proposals that are not covered by cost categories in the BCC are to be advised to APRA separately along with the assumptions underlying the calculation. Attachment A further outlines APRA's approach to measuring the economic impact of the proposal.

### Assessing the benefits

The introduction of the proposed policy will strengthen the prudential framework in the Australian life insurance market. The expected benefits of the proposed changes have been outlined above.

APRA requests that respondents provide commentary on these benefits and would be interested to be advised of additional benefits that are foreseen.

# Chapter 1

## LPS 220 Risk Management

At this time, APRA does not have prudential standards setting out minimum requirements for risk management for the whole life insurance industry (refer to 'Other matters' below for information on existing friendly society risk management requirements). The proposal to introduce such standards follows the successful introduction of similar reforms in the general insurance and superannuation industries.

Comprehensive and robust risk management systems increase the resilience of a life company to internal or external events and thereby reduce the risk of loss to policy owners and shareholders, and failure of the company. Effective risk management is recognised as being essential to the prudent operation of financial institutions and effective business continuity management is an essential component of risk management.

The Board of Directors (Board)<sup>1</sup> of a life company is charged with prime responsibility for the risk management of the company. This includes establishing a culture within the life company whereby risk issues are proactively identified, assessed, mitigated and monitored. The proposed changes to the life industry prudential framework do not affect the responsibility of the Board for risk issues. APRA does not propose to dictate a detailed approach to risk management in life companies. Instead, a series of principles-based requirements will be introduced, leaving the individual approach to risk management in the hands of each company. Indeed, devising an approach suited to the individual life company is an important aspect of developing an effective risk management framework.

*LPS 220 Risk Management* sets out APRA's minimum expectations for risk management in life companies. The prudential standard is broadly harmonised with the equivalent general insurance prudential standard *GPS 220 Risk Management* except where departures from this approach are justified by genuine differences between the industries. The principles underpinning *LPS 220 Risk Management* are also broadly consistent with those applying to the superannuation industry. The key requirements are set out below.

## Risk management framework

*LPS 220 Risk Management* requires a life company to maintain a risk management framework to identify, assess, monitor, report on and mitigate all material risks likely to be faced by the company. The risk management framework is the totality of the life company's systems, structures, policies, processes and people for managing risk. The Board of the life company is responsible for ensuring that the life company has a risk management framework adequate to prudently manage the risks faced by the company.

A life company's risk management framework must include a written business plan and a Risk Management Strategy (RMS), as well as clearly defined managerial responsibilities and controls for risk management, and a review process to ensure that the risk management framework remains effective.

It is APRA's expectation that all life companies will already have some form of risk management framework in place. Existing frameworks will go some way towards meeting the requirements of the proposed prudential standard. The risk management framework of a well-managed life company is likely to need only minimal adjustment to comply with *LPS 220 Risk Management*.

## Business plan

*LPS 220 Risk Management* includes a requirement for a life company to have a written business plan approved by the Board. A business plan sets out the broad strategy of the life company, describes its business and identifies its goals and objectives. A business plan assists a life company in managing the future development of its business in a prudent manner. APRA expects that life companies will be already undertaking business planning. This requirement will simply establish a minimum standard of practice which will assist APRA in enforcing prudent practice for those cases where a life company is not operating prudently.

<sup>1</sup> In this discussion paper, for an eligible foreign life insurance company the term Board should be taken to be a reference to the Compliance Committee of that life company, as required by section 16ZF of the Life Act. See *LPS 510 Governance* for further details.

## Risk Management Strategy

The RMS of a life company is a high-level document which outlines the life company's risk appetite and its strategy for managing risk, and which documents the key elements of the risk management framework. Its purpose is therefore two-fold:

- it acts as a strategic driver of the life company, by documenting the risk appetite; and
- it acts as a 'roadmap' to the risk management framework, enabling the reader to obtain an understanding of how the life company manages risk.

The RMS must be approved by the Board of the life company.

The prudential standard sets out the minimum content to be included in an RMS.

## Review of the risk management framework

*LPS 220 Risk Management* requires that the risk management framework be subject to review by operationally independent, appropriately trained and competent persons. These persons may include the Appointed Actuary and the Approved Auditor. It is up to the individual life company to decide the frequency and scope of review that is appropriate to its operations.

In line with this requirement for review of the risk management framework:

- the Appointed Actuary of the life company must assess the suitability and adequacy of the risk management framework in the Financial Condition Report required under section 113 of the Life Act; and
- a life company must implement audit arrangements to ensure compliance with, and the effectiveness of, the risk management framework. These audit arrangements could be internal to the life company, external or a combination of the two.

Finally, APRA is proposing that life companies be required to notify APRA in the event that:

- the life company is aware of a material breach of, or departure from, the risk management framework; or
- the life company discovers that the risk management framework did not adequately address a material risk.

These arrangements will together help to ensure adequate oversight of risk management practices by the life company, auditors, Appointed Actuaries and APRA. They will assist in ensuring that the risk management framework is comprehensive and effective.

## Risk Management Declaration

*LPS 220 Risk Management* introduces a requirement for the Board of the life company to provide APRA with an annual declaration on risk management. This requirement is modelled on a similar requirement already applicable to general insurers.

Under the Risk Management Declaration, the Board of a life company must attest to certain risk management factors:

- that the life company has systems in place for the purpose of ensuring compliance with all APRA requirements;
- that the Board is satisfied with the efficacy of the processes and systems for the production of financial information;
- that the life company has in place an RMS that complies with *LPS 220 Risk Management*; and
- that the systems for managing and monitoring risks and the risk management framework are appropriate to the life company.

The requirement to attest to these matters reflects the prime responsibility of the Board of a life company in relation to risk management. The Board will be required, under *LPS 220 Risk Management*, to ensure that the life company has a risk management framework to prudently manage the risks arising in the life company. The Risk Management Declaration will encourage or reinforce a culture under which the Board exercises proper oversight of management in relation to risk management.

## Other matters

For friendly societies, the introduction of new requirements on risk management will enable the removal of a series of existing prescriptive prudential requirements. These are the following preserved transitional prudential standards which had been in force under the Australian Financial Institutions Commission (AFIC) Code:

- *PS 6.1 Risk Management;*
- *PS 6.3C Audit;*
- *PS 6.4A Subsidiaries;*
- *PS 6.4C Guarantees;*
- *PS 6.4D Service Contracts;*
- *PS 6.4E Overseas Trading;* and
- *PS 6.7 Non-Benefit Fund Based Funds Management and Associated Market Activities.*

The removal of these historical requirements will reduce the level of prescription applying to friendly societies. The resulting framework will be more flexible and compliance costs should be reduced. As a result of these proposals, the prudential requirements applicable to life companies and friendly societies will be significantly harmonised and modernised, and APRA will be able to tailor supervision approaches more flexibly to the circumstances of individual entities.

APRA would welcome comment from friendly societies and other interested parties about whether the removal of any of these preserved transitional prudential standards would be problematic for the friendly society industry.

## Chapter 2

### Prudential practice guides

*LPS 220 Risk Management* requires that a life company address a number of material risks:

- strategic and tactical risks that arise out of the life company's business plan;
- operational risk;
- life insurance risk, including risks arising out of reinsurance arrangements; and
- asset and liability management risk.

The proposed PPGs address one or more of these risks by providing additional guidance on methods by which a life company could manage them.

### LPG 200 Risk Management

*LPG 200 Risk Management* provides guidance to life companies on possible ways of complying with *LPS 220 Risk Management*, as well as providing general guidance on good practice in risk management. To this end, it indicates a number of considerations that may be relevant and suggests some approaches that may be considered to comply with various requirements of *LPS 220 Risk Management*.

Guidance is provided on:

- the process of risk identification and assessment;
- methods of risk mitigation and control;
- monitoring risk profiles and material exposures to loss;
- processes for escalation and communication of risk issues within the life company;
- information systems;
- review of the risk management framework and audit arrangements;
- the use of dedicated risk management functions; and
- business planning and capital management planning.

### LPG 230 Operational Risk

*LPG 230 Operational Risk* provides additional guidance on a number of matters in relation to operational risk. Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. It includes legal risk but excludes strategic and reputational risk.

*LPG 230 Operational Risk* describes some approaches to managing operational risk and offers some general guidance on APRA's view of good practice in the area of operational risk management. These matters include:

- general operational risk issues;
- operational risk issues associated with information technology;
- operational risk issues related to human resources;
- risks related to fraud;
- project management issues; and
- guidance around the role of information systems.

The PPG also draws specific attention to operational risks that can arise through legacy products, and refers to the APRA and ASIC publication, *Unit Pricing – Guide to good practice*.

### LPG 240 Life Insurance Risk and Life Reinsurance Management

Life insurance risk may be defined as the risk that inadequate or inappropriate product design, pricing, underwriting, claims management or reinsurance management will expose a life company to financial loss and, consequently, the potential inability to meet its liabilities. Life companies will face life insurance risk to varying extents, depending on their product mix.

*LPG 240 Life Insurance Risk and Life Reinsurance Management* provides further guidance to life companies on certain issues related to the management and control life insurance risk.

It also includes guidance on reinsurance management. Specifically, *LPG 240 Life Insurance Risk and Life Reinsurance Management* provides guidance on management of risks associated with:

- product design;
- pricing;
- the underwriting process;
- claims management; and
- reinsurance.

In addition, *LPG 240 Life Insurance Risk and Life Reinsurance Management* indicates that an RMS would ordinarily include a statement of the life company's approach to the use of reinsurance, including its approach to the use of limited risk transfer arrangements (or finite risk reinsurance). The aim of this is to communicate the intended use of such arrangements to APRA through the RMS.

The approach of combining insurance risk and reinsurance management is different from the equivalent general insurance arrangements. This difference in approach has been driven by:

- the longer-term nature of reinsurance contracts in the life insurance industry and the relative infrequency of renegotiation; and
- the statutory role of the actuary under section 116 of the Life Act under which a life company must not enter into a reinsurance arrangement unless its Appointed Actuary has given the company written advice about the likely consequences of the proposed arrangement.

### **LPG 250 Asset and Liability Management Risk**

Asset and liability management risk is a key risk faced by life companies. The risk is inherent in the long-term nature of life insurance business and it is essential to the safety and soundness of the life company that the risk is prudently managed.

Asset and liability management risk is defined in this PPG to include:

- investment risk – the possibility of adverse movement in the value of assets derived from market risk, credit risk and investment concentration risk;

- asset-liability mismatch risk – the risk of adverse movements in the relative value of assets and liabilities; and
- liquidity management risk – the risk that a life company will not have sufficient liquid assets to meet all cash outflow commitments when they fall due.

The PPG gives particular consideration to:

- risks associated with the use of derivatives;
- credit risk – the risk of default by transactional counterparties as well as the loss of value of assets due to deterioration in credit quality; and
- asset concentration risk – the risk that the assets of the life company are insufficiently diversified.

*LPG 250 Asset and Liability Management Risk* addresses each of these aspects of asset and liability management risk and provides additional guidance on how they can be prudently managed.

On derivatives management, it is proposed that *Circular to Life Companies C.1.1 Derivatives – Use, Management and Control* will be superseded by the combination of *LPS 220 Risk Management* and *LPG 250 Asset and Liability Management Risk*. Management of the risks associated with derivatives usage is a subset of risk management more generally. APRA would welcome comment from interested parties as to whether the removal of this circular would be problematic for the life industry.

### **LPG 260 Conflicts of Interest under Section 48**

The Life Act requires directors to be mindful of any conflicts and to give priority, where there is a conflict, to the interests of policy owners referable to each statutory fund. APRA expects that life companies would have systems and processes for ensuring that the requirements of the Life Act are met. *LPS 220 Risk Management* requires a life company to have systems in place to manage all material risks likely to be faced by a life company. One such material risk is the risk associated with conflicts of interest.

The effective management of conflicts of interest is an important component of a good corporate governance culture. The *Corporations Act 2001* (the *Corporations Act*) imposes conflicts of interest

obligations on directors. In addition to these obligations, life company directors are also subject to specific obligations under section 48 of the Life Act. Section 48 addresses a distinct area of conflicts of interest that can occur between the interests of policy owners and the interests of shareholders. In that instance, the directors of a life company, and the life company itself, are under particular duties to give priority to the interests of policy owners within a particular statutory fund. *LPG 260 Conflicts of Interest under Section 48* draws the attention of directors of life companies to their duties under section 48.

*LPG 260 Conflicts of Interest under Section 48* does not impose any additional obligations on a life company or its directors beyond those already imposed under the Life Act. The PPG discusses some situations where conflicts of interest may be present but does not dictate the action a life company should take in any of those situations. The question of how to identify and assess the interests of policy owners and shareholders is one that involves individual judgement.

## Chapter 3

### Business Continuity Management

*LPS 232 Business Continuity Management* sets out APRA's minimum expectations of life companies in relation to business continuity management. APRA considers business continuity management to be an important component of a life company's risk management framework.

The proposed *LPS 232 Business Continuity Management* is broadly harmonised with the existing *APS 232 Business Continuity Management* and *GPS 222 Business Continuity Management*. APRA-regulated life companies were consulted on a draft business continuity management prudential standard in July 2004. That proposal did not proceed at that time in relation to life companies as APRA wished to present a more coherent range of risk management proposals to the life industry, rather than introducing business continuity management requirements in advance of other risk management requirements. The current proposal is similar in principle to the July 2004 proposal, and to the current ADI and general insurance requirements, but adopts APRA's new structure of prudential standards and PPGs.

Effective business continuity management helps ensure that a life company can continue to meet financial and service obligations to policy owners in the event of a business disruption. A life company can incur substantial losses (both in financial and reputational terms), and may even fail, as a result of not being able to recover from business disruptions and restore critical business operations in a timely manner.

Business continuity management is an aspect of risk management which is recognised, both in Australia and overseas, as requiring specific attention. The seriousness of business continuity management risks and the need for effective business continuity management practices are apparent. The introduction of *LPS 232 Business Continuity Management* will improve the compliance of Australia's life insurance regulatory framework with the *Insurance Core Principles and Methodology*, published by the International Association of Insurance Supervisors in October 2003, and which are applicable to supervisors of life and non-life insurance companies.

*LPS 232 Business Continuity Management* recognises that the ultimate responsibility for the business continuity of the life company lies with the Board. The key elements of the prudential standard are:

- **Business Continuity Management** – defines business continuity management and sets out its minimum components;
- **Business Continuity Management Policy** – a life company must have a policy, approved by the Board, setting out its approach to business continuity management;
- **Critical business operations** – defined as the business functions, resources and infrastructure that have the potential, if disrupted, to impact materially on the business functions, beneficiaries, reputation or profitability of the life company;
- **Business Impact Analysis** – a life company must conduct a business impact analysis to identify and measure the business impact or loss from a disruption of critical business operations;
- **Recovery objectives and strategies** – a life company must identify and document appropriate recovery objectives, including recovery levels and recovery times, as well as implementation strategies, for each critical business operation;
- **Business Continuity Plan** – a life company must have a Business Continuity Plan which documents procedures and information to enable the life company to manage a business disruption and recover critical business operations;
- **review and testing of the Business Continuity Plan** – sets out the requirements for frequency of review and testing of the Business Continuity Plan; and
- **notification requirements** – A life company must notify APRA as soon as possible after a major disruption that has the potential to materially affect the life company's ability to meet obligations to its beneficiaries or its financial soundness.

*LPG 232 Business Continuity Management* provides additional non-mandatory guidance on methods of compliance with *LPS 232 Business Continuity Management* along with information on APRA's views of good practice in the area of business continuity management.

The PPG includes sections on:

- Business Continuity Management;
- Business Continuity Management Policy;
- critical business operations;
- Business Impact Analysis;
- recovery objectives and strategies;
- Business Continuity Plans, including documentation of responsibilities and authorities for business continuity management, and guidance on alternate sites, communication plans and outsourcing;
- review and testing of the Business Continuity Plan; and
- notification requirements.

## Conclusion

APRA welcomes comment by 31 December 2006 on any of the proposals discussed in this paper:

- draft *Prudential Standard LPS 220 Risk Management* and associated draft PPGs; and
- draft *Prudential Standard LPS 220 Risk Management* and the associated draft *Prudential Practice Guide LPG 232 Business Continuity Management*.

APRA would welcome the submission of data relating to the costs and benefits of the proposed prudential standards (refer Attachment A). APRA would also welcome comment on any specific transitional requirements which may be necessary to allow industry to meet the new requirements in an orderly way.

# Attachment A

## Cost benefit analysis

### Entities affected by the policy

APRA's assessment is that, based on the current structure of the life insurance industry, a total of 35 life companies and 27 friendly societies will be potentially impacted by the proposals in this paper.

### The approach to assessing benefits

The benefits attaching to this proposal will flow from the reduced probability that life companies will fail, with consequent flow-on impacts on their policy owners. There are also benefits to life companies in having a clear and consistent set of principles-based prudential standards and PPGs, as noted in the discussion paper.

Specifically, APRA expects that the key benefits of the proposed changes will be:

- further ensuring the protection of the interests of policy owners;
- flexibility for life companies to conduct their operations in the way that best suits their business needs, subject to meeting minimum standards of prudent practice;
- for friendly societies, the removal of a series of existing, dated and detailed prudential standards, with consequent reductions in the amount of prescription; and
- consistent regulatory principles across APRA-regulated industries, reducing costs and complexity for entities which are part of corporate groups operating across multiple regulated industries.

A calculated or market observable proxy is often needed to estimate the value of benefits. APRA is currently investigating ways in which benefits may be better estimated. Respondents to this paper are requested to consider the 'willingness to pay' model of assessing benefits and any appropriate proxies for 'willingness to pay'. Further details on this methodology are available in Australian Government guides to cost-benefit analysis: *Introduction to Cost-*

*Benefit Analysis and Alternative Evaluation Methodologies* and *Handbook of Cost Benefit Analysis* which are published by the Commonwealth Department of Finance. These publications are available online at:

[http://www.finance.gov.au/finframework/fc\\_2006\\_01.html](http://www.finance.gov.au/finframework/fc_2006_01.html) .

Submissions regarding benefits identified, where the analysis is suitably robust, will be used in formulating the Regulation Impact Statement for the introduction of the proposals.

### The approach to assessing costs

While the publications noted above provide information on the process of assessing costs, more specific guidance on assessing costs is also available. In the Commonwealth Government's interim response to the Banks report it indicated that the BCC would be used to measure the regulatory and compliance cost of proposed regulation. The BCC is used to calculate compliance costs incurred by business but does not capture all other costs such as the costs of restructuring a group or the costs of additional capital necessary to meet new requirements. In order to perform a comprehensive cost-benefit analysis, APRA needs data from stakeholders, particularly industry participants. As part of the consultation process on the proposals contained in this paper, APRA requests all respondents to provide APRA with an assessment of the impact of the proposed changes contained in this paper.

Respondents are requested to use the BCC to estimate costs to ensure that the data supplied to APRA can be aggregated and used in an industry wide assessment. APRA would appreciate being provided with the input to the BCC as well as the final result.

The BCC can be accessed at <http://online.industry.gov.au/costingmodel>. A guide is available to the cost categories used in the model. There are nine cost categories in the BCC and costs should be split into initial and ongoing costs.

The outcomes of the analysis of costs will be used, where adequately robust, in the Regulation Impact Statement for the introduction of the proposals.



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