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Dear General Manager, Policy Development

APRA's Review of the Private Health Insurance Capital Framework

Police Health welcomes the opportunity to comment on the review of the Private Health Insurance (PHI) capital standards framework and offers the following feedback in relation to the proposed Standards.

Regulatory Burden

Whilst understanding APRA's desire to harmonise Standards across the industries it regulates, Police Health believes that any new Standards should avoid unnecessary complexity, be tailored as appropriate to PHI, have sufficient implementation timelines/transition periods, and address issues within the current framework.

Police Health does not believe the current capital framework is such that more prescriptive Standards are required. APRA itself notes that the industry is well capitalised, and that failures within the industry under the current Standards have not occurred and that the current standards delivered against their intent. Therefore, the requirement for more prescriptive Standards does not appear to be addressing any gap in the current framework, rather it will increase both cost and regulatory burden causing disruption across the industry.

In addition, there will be higher costs of compliance with the revised Standards, requiring more input from Appointed Actuaries and other parties, including but not limited to Investment Advisors and Consultants, along with implementation costs, all of which will increase the regulatory burden on the industry. It is difficult to understand APRA's rationale as to why this is necessary given there have been no failures under the current Standards, and that APRA believes the industry to be well capitalised.

Overall in relation to regulatory burden, Police Health believes that the revised Standards are overly complex given the level of ongoing capital stability within the industry.

Impact on Premiums

Police Health notes that APRA does not expect any change in minimum capital requirements as a result of the revised Standards to drive an increase in premiums. Not for profit insurers are limited in the ways in which they can raise capital, and therefore it is likely that any increase in capital requirements will ultimately have to be sourced through net profits. The largest contributors to the net results of an insurer are premium income and claims costs. Therefore, if an insurer requires increased net profit to hold increased capital, it is most likely to be driven by an increase in premiums or a reduction in claims costs. Whilst any premium increases must be approved by the Department of Health, some insurers may decide to decrease product offerings in order to reduce claims costs if an increase in premiums is not possible or desirable. Neither of these options will assist in the ongoing affordability issues being faced by the Industry. In fact, a reduction in the product offering across the industry will lead to a reduction in the perception of value of PHI, which is at odds with the Government's agenda for the PHI industry to improve its value proposition to attract new members and retain the younger market.

Police Health believes this is likely to be a more material issue for smaller insurers. Should some of these smaller insurers cease to exist as a result, competition and therefore customer choice within the industry will be compromised.

Many insurers use their investment portfolio to supplement premium income and manage net profits. This has a positive overall impact on premiums. Whilst Police Health does not seek to utilise investment income to subsidise poor margins, we do use it to allow us to have consistently low premium increases, which is a benefit to our contributors. This has been managed over many years whilst maintaining a low risk, highly credit rated investment portfolio. Police Health is of the opinion that the Asset Risk Charge within the revised Standards may cause Insurers to change their already low risk portfolios, and lead to an increase in requested premium increases, as insurers are not able to utilise their investment portfolio to assist in the management of premium increases, in what is traditionally a low margin business. Given that investment portfolio's held by Insurers generally exist as a result of Insurers being required to hold a substantial amount of capital, it is prudent for Insurers to attempt to maximise the return on those portfolio's in a way which balances risk and contributor value.

Police Health also notes that average contribution income increases have been relatively stable whilst the current Standards have been in place. We believe that the revised Standards will lead to greater variability in capital requirements, particularly in relation to the Asset Risk Charge and Insurance Risk Charge, making them more difficult to forecast. This variability may ultimately lead to variability in premium increases each year, or higher premium increases in order to manage the variability, which will be challenging for consumers to understand, and for Insurers to manage.

Impact on Competition

Any increase in the minimum capital requirement or increased regulatory burden may ultimately lead to a reduction in competition, with smaller insurers finding it increasingly challenging to operate. Any resulting impact on premiums or detrimental changes to products as a result of managing an increase in capital requirements will further lead to a reduction in competition, as insurers exit the industry or reduce their product offering.

Beyond the impacts on competition outlined above, Police Health believes that the charge for growing insurers contained with the Operational Risk Charge may contribute to reduced competition. The Operational Risk Charge increases the minimum capital requirement for insurers experiencing growth, regardless of how well managed that growth is/has been. As a result, some insurers may actively choose not to grow, or to reduce the speed of growth, which ultimately does not benefit consumers or facilitate competition. The Standards appear to penalise growth without recognition or consideration of how an individual insurer has managed growth in the past or the monitoring mechanisms in place.

Alignment with AASB 17

Police Health does not believe there is sufficient synergy between the revised Standards and AASB 17 to necessitate the need to implement both at the same time. In fact, Police Health believes that attempting to implement both at the same time is making it more challenging to determine the forecast capital position of an insurer. This in turn may increase the risk of the Quantitative Impact Statement (QiS), whilst being completed on a best endeavours basis by insurers, containing inaccurate information, and therefore an inaccurate snapshot of the anticipated impact of the revised Standards on the capital position of insurers.

All insurers are at differing stages of their implementation of AASB 17 and continue to work through the impacts with their Appointed Auditor and Appointed Actuary. Therefore, the data included in the QiS for each insurer will reflect their current point of implementation, which will make comparison by APRA extremely difficult.

Police Health recommends that APRA allow insurers to implement AASB 17 prior to the commencement of the revised Standards. As APRA is not concerned about the level of capitalisation within the industry, this would be achievable. Alternatively, a significant transition phase should be allowed by APRA as insurers implement both and manage any variability in capital position as a result of the simultaneous implementation.

Impact of the Deferred Claims Liability

Whilst Police Health acknowledges the development of the revised Standards and associated timetable commenced prior to the COVID-19 pandemic, the ongoing impact of the pandemic and particularly the requirement for the Deferred Claims Liability (DCL) is further complicating the implementation of what is an already complex framework when coupled with the concurrent implementation of AASB 17. This is further complicated by the Australian Competition and Consumer Commission's current public commentary on the 'return of the Deferred Claims Liability to contributors'. Police Health recommends that the implementation of the Standards is delayed until such time as the Deferred Claims Liability is no longer an APRA requirement.

Reporting Framework

Police Health understands that the final reporting forms and framework cannot be finalised until the Standards themselves are finalised, however it is difficult to determine the impact of the reporting framework without the forms. If it is APRA's intention to utilise forms similar to the QiS, Police Health believes such forms are not fit for purpose, requiring increased effort, prone to error as duplication of effort is required as well as lacking clear instructions. All of these issues increase the overall regulatory burden for insurers, and in turn increase the cost of compliance. Police Health strongly recommends these forms be amended and anticipates that this will occur when APRA finalises the Standards.

Other areas for Consideration

Police Health considers that a likely reduction in the amount of surplus capital as a result of the revised Standards may lead some insurers to increase their risk appetite in relation to capital risk as an alternative to larger premium increases or detrimental changes to products into the future. Whilst the Standards themselves move from a 98% probability of sufficiency to a 99.5% probability of sufficiency, which inherently changes the risk appetite, Police Health considers that while it is not our intention, it is likely that some insurers may increase their risk appetite on a larger scale than the additional security afforded by the revised Standards. This would appear counter intuitive to APRA's intention in implementing the revised Standards.

Whilst Police Health does not currently have non-PHI (ie General Fund) activities, we believe the application of the revised Standards to these activities may stifle innovation and diversification within the industry. Whilst understanding that APRA is seeking to protect policyholders, the application of the Standards to non-PHI activities should be such that they are only applied to the extent that those non-PHI activities present a risk to the PHI business.

ICAAP

Police Health understands APRA's desire to align ICAAP requirements across its regulated industries, however, is of the opinion that the ICAAP requirements are overly onerous when considered in the context of PHI and will not provide the desired increase in understanding an Insurers capital adequacy position by external users. Police Health particularly believes this to be the case in relation to the disclosure requirements set out in paragraphs 42-45 of proposed Prudential Standard HPS 110 Capital Adequacy. Not for Profit Insurers such as Police Health have few interested parties who would find this information useful in their decision making. Therefore, the regulatory burden and related costs do not appear justified.

The PHI industry has current capital requirements, such as the Capital Management Policy, which are tailored to PHI, have served the industry well, incorporate risk assessments, are subject to regular review and are well understood. Police Health does not believe that the move to a materially more onerous and complicated ICAAP is addressing a gap in the current framework, nor reflective of the intricacies of PHI or working to ease Regulatory burden.

Police Health thanks APRA for the level of engagement to date on the review of the Capital Framework and looks forward to further participation as the Standards are finalised and implemented.

Yours sincerely

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Scott Williams
Chief Executive Officer
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