RESPONSE PAPER

Finalising the review of the Private Health Insurance Capital Framework

September 2022

Disclaimer Text

Contents

Executive summary

The finalisation of a revised private health insurance (PHI) capital framework represents a key milestone, and the final stage of APRA's updates to the PHI prudential policy framework, following APRA assuming prudential regulatory responsibility for the industry in 2015.

The new capital framework seeks to ensure there is an appropriate level of financial resilience and protection for policyholders through:

- improved risk sensitivity of the capital standards to better reflect the risks faced by private health insurers;
- reduced discretion available to private health insurers to determine their capital requirement, so as to narrow the differences between insurers with similar business models and profiles; and
- alignment with the structure of the life and general insurance capital (LAGIC) framework, where appropriate. This reflects APRA's overall approach to capital quality and adequacy and is consistent with international best practice.

This Response Paper sets out APRA's response to feedback received in the December 2021 consultation on the draft prudential and reporting standards; discusses changes made to the final capital framework; and covers a range of issues relating to the design and impact of the new requirements. The Response Paper should be read in conjunction with the final PHI prudential and reporting standards, as well as the information paper *A New Capital Framework for Private Health Insurance*.

Policy development and consultation

In December 2021, APRA released a Response to Submissions Paper, draft prudential standards, and a full Quantitative Impact Study (QIS). APRA received 11 written submissions on the draft prudential standards and 29 QIS workbooks.

Key areas of feedback on the draft standards included the treatment of the deferred claims liability (DCL) within the capital framework, the allowance for management actions, and the design of the insurance risk charge (IRC). Insurers also raised the scale of the increase in minimum regulatory capital requirements and the impact this may have on premiums.

APRA has made a number of changes following consideration of the feedback received, including:

- introducing an aggregation benefit between the DCL and other components of the IRC to reduce the capital charge associated with the DCL and to address concerns regarding over-conservativism;
- technical changes to the design of the IRC, including reducing the prescribed benefit stress and permitting discounting for insurance liabilities and the Future Exposure Risk Charge (FER). These changes contribute to a reduction in the Prescribed Capital Amount (PCA);

- removing the requirement for private health insurers to maintain a standalone pricing philosophy;
- providing a two-year transition period to meet the new PCA and capital base requirements; and
- providing a two-year exemption from the new Internal Capital Adequacy Assessment Process (ICAAP) requirements for smaller insurers.

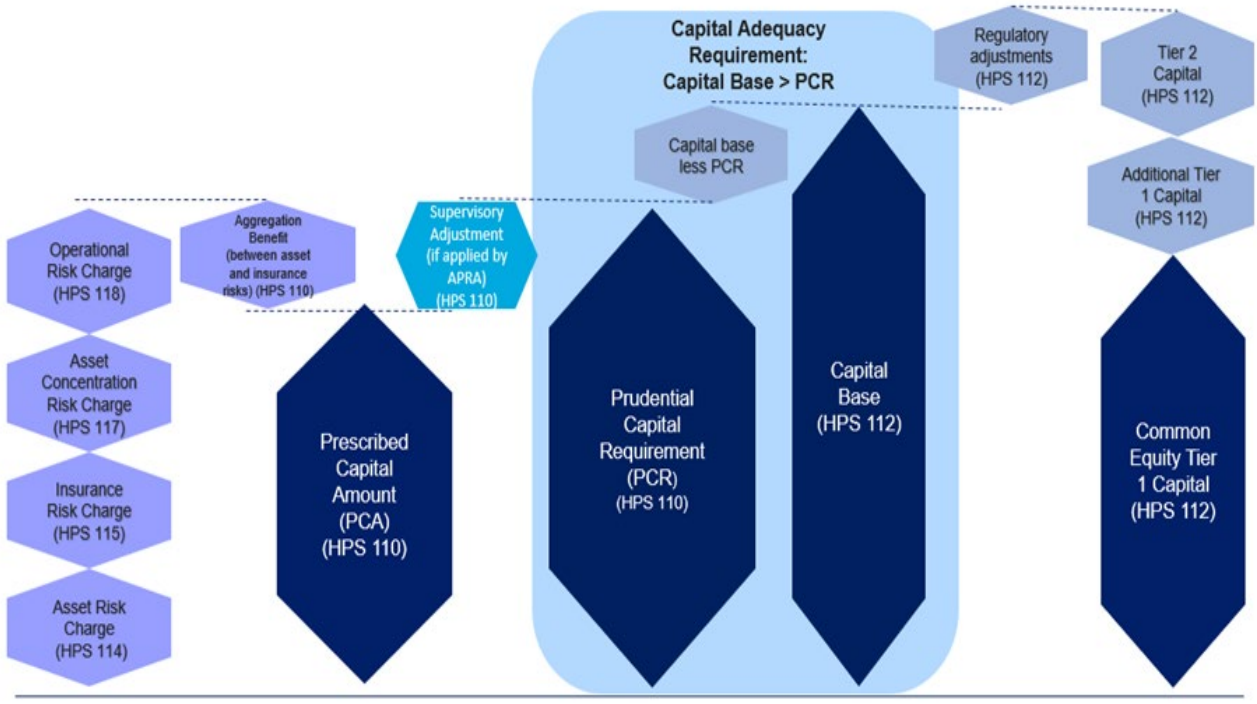
Further detail on each of these changes is provided in Chapter 3.

Overview of the new capital framework

Figure 1 provides an illustration of the new capital framework which:

- includes a separate charge for insurance risk, asset risk, asset concentration risk and operational risk;
- includes provision for supervisory adjustments, whereby APRA can determine adjustments to the required capital of an insurer;
- introduces an ICAAP requirement for PHIs;
- aligns with the commencement of AASB 17 for prudential purposes; and
- improves coverage of risk outside the health benefits fund by applying a capital charge on asset risk and asset concentration risk outside the health benefits fund and managing risks related to non-insurance businesses via the ICAAP.

Figure 1. PHI Capital Framework



As at 30 June 2021, and excluding the DCL, the total industry PCA equated to approximately $2.4bn. Under the final standards, it is expected that the total industry PCA will be around $3.5bn and the capital base around $8.6bn. Because the industry is already well capitalised, premiums are not expected to need to increase to meet the new minimum capital requirements. Further detail on the impact of the new capital standards and APRA's expectations is set out in Chapter 2.

Reporting standard development and consultation

APRA released draft PHI reporting standards for consultation in December 2021 and April 2022. APRA received seven written submissions on the reporting standards. Submissions discussed regulatory burden of the proposed data collection for private health insurers. In particular submissions noted specific items that would be collected at a more granular level than private health insurers use internally. Some submissions also requested additional clarity in the reporting instructions. In response to industry feedback, APRA has simplified elements of the data collection and has clarified some areas of the reporting standards and instructions.

Further detail on the reporting standards is provided in Chapter 5.

AASB 17 and LAGIC updates, revisions, and consequential amendments

APRA will align the commencement of the PHI capital framework with the implementation of AASB 17 for prudential purposes from 1 July 2023.

In December 2021, APRA released a response paper, *Integrating AASB 17 into the capital and reporting for insurers and updates to the LAGIC framework* (*AASB 17 and LAGIC updates* response paper). This included proposals relevant to private health insurers, which were included in the draft PHI capital standards for consultation.

APRA has considered the feedback from stakeholders across all insurance industries in relation to the implementation of AASB 17 and updates to the LAGIC framework and has subsequently made revisions. Details of these revisions can be found in the *AASB 17 and LAGIC updates* response paper.

Implementation: next steps

The new prudential and reporting standards for private health insurers will come into effect from 1 July 2023. The new framework will represent a significant change for industry. To assist insurers with implementation, the following transitional arrangements are available:

- Non-Significant Financial Institutions[1], unless notified by APRA, will have a two-year exemption from the new ICAAP requirements.
- Non-Significant Financial Institutions, unless notified by APRA, will also have a two-year exemption from the new reporting requirements under *Reporting Standard HRS 104 – Forecasts and Targets* (HRS 104).
- A transition period of up to two-years is available for an insurer that may require further time to meet the PCA and capital base requirements under the new standards. An insurer that wishes to utilise this transitional arrangement must notify APRA by 30 June 2023.

Further detail on the transitional arrangements and APRA's expectations during this period can be found in Chapter 6 –Implementation.

[1] A Significant Financial Institution means a private health insurer that either: (a) has total assets in excess of AUD $3 billion; or (b) is determined as such by APRA, having regard to matters such as complexity in its operations or its membership of a group.

Glossary

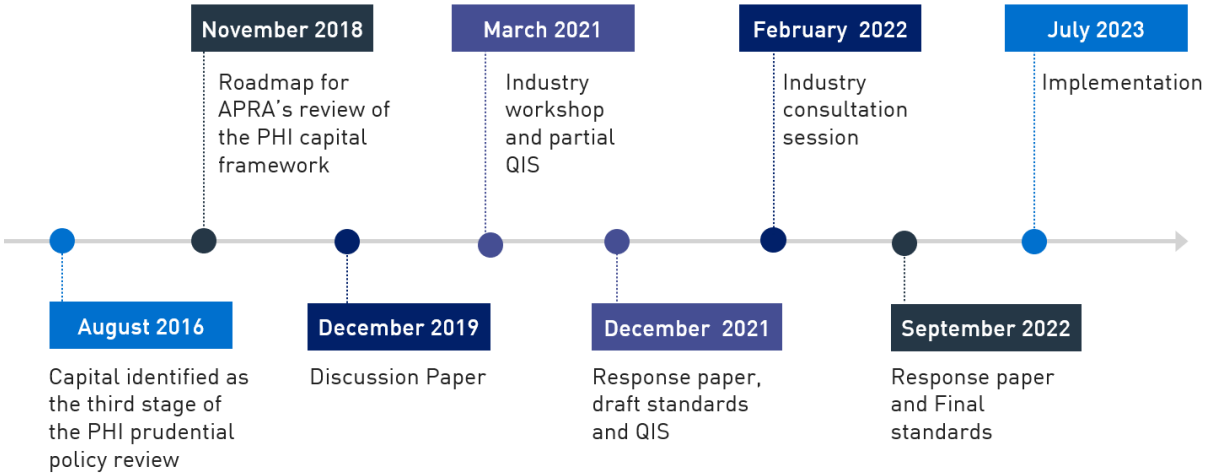
AASB	Australian Accounting Standards Board
AASB 17	AASB 17 Insurance Contracts
APRA	Australian Prudential Regulation Authority
APRA Act	Australian Prudential Regulation Authority Act 1998
ARC	Asset Risk Charge
ACRC	Asset Concentration Risk Charge
CMP	Capital Management Plan
Corporations Act	Corporations Act 2001
DCL	Deferred Claims Liability
FER	Future Exposure Risk Charge
FOIA	Freedom of Information Act 1982
FSCODA	Financial Sector (Collection of Data) Act 2001
HBF	The health benefits fund (HBF) is established in the private health insurer for the purposes of operating health insurance business and, where relevant, health related business in accordance with the Private Health Insurance Act 2007
HPS 100	*Prudential Standard HPS 100 Solvency Standard*
HPS 110	*Prudential Standard HPS 110 Capital Adequacy*
HPS 112	*Prudential Standard HPS 112 Capital Adequacy: Measurement of Capital*
HPS 115	*Prudential Standard HPS 115 Insurance Risk*
HRS 104	*Reporting Standard HRS 104 – Forecasts and Targets*
ICAAP	Internal Capital Adequacy Assessment Process
IRC	Insurance Risk Charge
LAGIC	Life and General Insurance Capital Standard
MEI	Mutual Equity Interest
Non-SFI	Non-Significant Financial Institution
PCA	Prescribed Capital Amount
PHI	Private Health Insurance
Risk Equalisation	A system of sharing hospital treatment costs of high-risk groups and high cost claimants between insurers.
SFI	Significant Financial Institution

Chapter 1 - Introduction

This chapter summarises APRA's approach to developing the new PHI capital framework, outlines the extensive consultation that has taken place, and provides a high-level summary of findings from the December 2021 Quantitative Impact Study (QIS). This chapter also details the process undertaken to ensure the new capital standards reflect risks specific to private health insurers.

As detailed below, the finalisation of the PHI capital framework has been an iterative process, involving extensive industry engagement which commenced in August 2016.

Figure 2. Development of the PHI Capital Framework



PHI Prudential Policy Outlook – August 2016

In August 2016, following industry and stakeholder consultation, APRA issued a letter to private health insurers advising them of the three stages for the review of the PHI prudential framework.[2] This letter notified industry that the capital review would be the third and final stage.

APRA then announced its intention in November 2018 to commence the review by issuing a review roadmap.[3] To ensure the review was guided by expert opinion from inception, APRA engaged the Actuaries Institute to provide early feedback and inform APRA on the specific characteristics of private health insurers that are relevant to insurance risk.

[2] https://www.apra.gov.au/private-health-insurance-prudential-policy-outlook.

[3] https://www.apra.gov.au/sites/default/files/phi_capital_roadmap_letter_0.pdf

Industry consultation

APRA has undertaken several rounds of consultation with industry to ensure adequate opportunity has been provided for input and comment by insurers. A discussion paper was released in December 2019 which described APRA's proposed high level structure for revisions to the PHI capital framework.[4] Industry feedback to this paper helped shape key aspects of the capital review.

Following a policy pause due to the COVID-19 pandemic, APRA issued a partial- QIS in March 2021. The partial-QIS focused on the aspects of the standards most tailored to the characteristics of private health insurance, being insurance risk and operational risk. APRA also held an industry workshop to discuss the partial-QIS, and to provide insurers with an update on the review.

After consideration of the partial-QIS results, APRA released the draft standards in December 2021 along with a response paper. The response paper detailed a number of changes made by APRA to the capital framework proposals in response to industry feedback. It was accompanied by a full QIS.

An industry consultation session in February 2022 provided insurers with further opportunity to raise issues and provide preliminary feedback on the draft standards ahead of the consultation close date. Following analysis of all feedback received, the final PHI capital framework is being released. Attachment B provides a summary of the changes that have been made to the final the prudential standards.

QIS analysis summary

When adjusted for changes made to the final standards, QIS submissions revealed that the draft standards:

- resulted in an increase in the Asset Risk Charge (ARC), up from 4% of premiums in the current standards to 6.5% of premiums in the draft standards;
- produced an industry Insurance Risk Charge (IRC) of 9.2% of premiums;
- led to a reduction in the capital base that equated to approximately 3.3% of premiums ($0.83bn), primarily due to removing the recognition of goodwill and deferred tax assets;
- produced an industry Prescribed Capital Amount (PCA) of 14.5% of premiums;
- did not require any insurer to need additional capital to meet the PCA; and
- resulted in most insurers having reasonable capital buffers above the PCA.

[4] Review of the private health insurance capital framework | APRA

Chapter 2 - Impact of the new capital framework

This chapter sets out the key areas of impact from the new standards. It outlines APRA's views on the expected impact on premiums following implementation of the new capital standards, and expectations with respect to capital management and planning under the new framework.

Premiums and the new capital standards

Some not-for profit insurers submitted concerns that the new capital standards may result in higher premiums for policyholders. They noted that they may have to reduce the amount of growth assets held as these will attract a higher capital charge in the ARC. This may have a premium impact as the investment income from these portfolios is used to subsidise low margins and reduce premiums.

Some insurers also submitted that the new capital requirements will likely increase target capital levels. This increase in capital would be sourced through net profits, which is ultimately sourced from premium income.

As the industry remains well capitalised, APRA does not consider that the increase in minimum regulatory capital requirements provides a basis for increasing premiums. Nor does APRA consider that it would necessitate a change in investment strategies. Based on the results of the QIS, no insurer will need to hold more capital to meet the minimum capital requirements.

The QIS results also showed that most insurers have a reasonable capital buffer above the minimum requirements. This is particularly the case for most smaller, not-for-profit entities, who, on existing investment portfolios, have an average capital base that is 2.7 times the PCA. A review of capital targets and capital management, together with the transition arrangements, should assist insurers to readily meet the new minimum requirements.

Target capital requirements under the new framework

The new capital standards will require insurers to undertake an ICAAP that has been board approved. APRA expects boards will undertake a thorough assessment of the insurer's risks, risk appetite and strategy in revising capital targets and developing the ICAAP. This should include robustly reviewing and challenging the assumptions and methodologies behind the ICAAP, and being able to understand and be in a position to explain why their ICAAP is considered appropriate for their business. In particular APRA will expect boards to consider and articulate an insurer's appetite for the possibility of breaching regulatory capital.

APRA encourages insurers to familiarise themselves with APRA's ICAAP expectations as detailed in *CPG 110 - Internal Capital Adequacy Assessment Process and Supervisory Review* (CPG 110).

For those insurers who will have a two-year transition to meet the new ICAAP requirements, APRA encourages those boards to use this period to review their capital management needs in light of the new capital requirements, and not simply rely on current capital targets. Further details on this transition, and the timeframes for producing ICAAPs, are outlined in Chapter 6 - Implementation.

Competition and the new capital standards

When developing policy proposals, APRA's mandate requires APRA to balance the objectives of financial safety and efficiency, competition and contestability and competitive neutrality.

Some submissions raised concern that the revised framework had the potential to hinder competition in the industry.

While acknowledging changes made by APRA from the original discussion paper, smaller insurers raised concern with the design of the Future Exposure Risk Charge (FER) and the misestimation factor, which takes into account the additional uncertainty related to growth. While agreeing that growth has been a key area of risk, it was suggested that more could be done to consider how an insurer has managed past growth and the adequacy of its mechanisms to monitor growth.

APRA's view is that making further adjustments to the misestimation factor will introduce undue levels of complexity for minimal benefit. A range of adjustments were made from APRA's original proposal. These included: reflecting positive growth only; reducing the level of the charge; focusing the charge on risks that are above the trend levels for the industry; and calculating the growth rate as a proportion of total current membership, to better reflect the extent of membership which has a less certain claiming profile.

APRA considers that an appropriate balance has been struck, to ensure the heightened risk of misestimating future claims following periods of growth is captured in the capital framework while limiting the potential for adverse competition impacts. APRA's position has been informed by broader stakeholder feedback, including the ACCC.

Chapter 3 - Revisions after consultation

This chapter provides detail on APRA's response to issues raised in submissions on the December 2021 draft PHI capital standards. It outlines areas where revisions have been made following consideration of feedback from industry.

3.1 Deferred claims liability

The draft standards added the risk charge for the DCL to the other components of the IRC. This implied that the 1-in-200 year insurance risk event included the DCL materialising in the same period as the FER and other insurance liability risks.

Comments received

A number of insurers questioned the treatment of the DCL under the revised capital framework and submitted that APRA's approach to the DCL was overly conservative. Concern was raised that the capital charge associated with the DCL was excessive, with some insurers expressing the view that if the IRC is calibrated to a 1-in-200 year level there should be enough capital captured by the IRC to mitigate against a COVID claims recovery scenario, or an event of similar impact, therefore removing the need for a specific DCL related charge.

Insurers also suggested that capturing the DCL at the 99.5th percentile, combined with an industry wide stress, and an insurer specific stress, potentially results in an outcome that is more conservative than a 1-in-200 year event.

Not permitting the DCL's deferred tax asset in the capital base also received strong feedback. Insurers submitted that this exemption creates an excessively punitive aggregated charge. While insurers generally agreed that deferred tax assets should not be included in the capital base, some called for an exception to be made for the DCL.

APRA response

APRA has now amended *Prudential Standard HPS 115* (HPS 115) to treat the DCL differently to other insurance liabilities by including a 20% correlation factor. This will reflect an expected positive correlation between the DCL and other components of the IRC at the 99.5% level and seeks to mitigate over-conservativism in the calibration of this component of the framework.

While the new standards will still capture any DCL, it is estimated that the correlation factor will reduce the size of the capital associated with the DCL by around 65% from that submitted in the QIS submissions. APRA recognises that the DCL has the potential to be both significant and uncertain, and therefore considers it important that some level of capital is held against this liability.

APRA does not support the recognition of deferred tax assets in the capital base, as the asset is not available to meet claims costs. Not permitting intangible assets to meet regulatory capital is consistent with international best practice and LAGIC. The DCL's deferred tax asset will be excluded from the capital base under the new standards, similar to the treatment of other intangible assets. However, APRA is affording those insurers who wish to incrementally adjust their capital base to the new standards a two-year transition period to do so.

3.2 Future exposure risk charge – prescribed benefit stress and investment income

The FER relates to the risk that the financial performance of insurance business is materially worse than expected over the 12-month period following the reporting date.

Comments received

Some insurers submitted that the IRC is 1 to 2 percentage points of premiums too high and adjustments should be made to reduce the FER. Comments were received that there may be overlap between components of the IRC and some of the historic volatility used in designing the FER which do not reflect current risks.

Insurers also submitted that the revised capital framework should allow for investment and other income to offset the FER.

APRA response

APRA has reduced the health insurance prescribed benefit stress by 1 percentage point of benefits/expenses. Following industry feedback, the data and approach to calibrating the prescribed benefit stress has been re-examined. A small number of data points have had a material impact on the risk margin and a 1 percentage point benefits/expenses reduction in the size of the stress is justifiable and reasonable.

APRA will also allow discounting at the Government yield curve for insurance liabilities and for the FER to reflect that investment income can be expected at the 99.5th percentile for risk free assets.

An allowance for investment income from other assets at the 99.5th level is not supported as this income is uncertain and captured by the ARC. Such a feature would be inconsistent with the principles of LAGIC and would introduce significant discretion through insurers determining expected investment earnings.

3.3 Pricing philosophy

Under the current standards insurers must have a board endorsed capital management policy which includes a capital management plan (CMP) and a pricing philosophy. The pricing philosophy must include: profitability targets, capital implications of the targets, and guidelines on the speed of correction of deviations from targets. APRA proposed under the draft standards that insurers implement an ICAAP and also maintain a pricing philosophy to ensure sound governance of pricing risk.

Comments received

Some not-for-profit insurers suggested that the requirement for a pricing philosophy could be removed as the objectives behind the pricing philosophy can be appropriately considered as part of the ICAAP. These insurers also noted that the requirement for to undertake a pricing philosophy is not required and hence that this places an additional burden on the industry that is disproportionate to the risks the industry faces and is over and above requirements for general and life insurers.

APRA response

The requirement for insurers to produce a standalone pricing philosophy has been removed from the final standards.

APRA agrees that an insurer's approach to pricing risk can be appropriately considered as part of the ICAAP. This will enable insurers to detail the impact of both pricing targets and tolerances on capital while reducing the number of documents required.

APRA maintains that pricing risk is critical in the prudential management of private health insurers. APRA expects insurers to consider pricing risk as part of broader risk management obligations as articulated in *Prudential Standard CPS 220 Risk Management*.

While the requirement for a standalone pricing philosophy has been removed, APRA will maintain oversight as to how pricing risk is being managed via data submitted under HRS 104. As detailed in Chapter 5, in response to industry feedback this form has been greatly simplified but will still provide APRA with useful supervisory insights.

3.4 Mutual equity interests

The proposal to introduce Mutual Equity Interests (MEIs) into the revised capital framework was removed from the draft standards due to the interaction between MEIs, tax provisions, and the not-for-profit status of several mutual insurers.

Comments received

One submission specifically focused on APRA's approach to MEIs and called on APRA to amend the standards so that they are recognised in the new capital framework. This submission suggested that not including MEIs in the standards would prevent mutual PHIs from being able to effectively plan for and carry out an issuance of MEIs to raise Common Equity Tier 1 (CET1) capital.

APRA response

HPS 112 has been amended to incorporate provisions comparable with those in the ADI standards to allow mutually owned insurers to issue MEIs.

It is noted that previous submissions have commented that MEI requirements may be inconsistent with the not-for-profit structure and tax-exempt status of mutual insurers. These submissions requested that APRA draft provisions to ensure that the not-for-profit status of insurers is protected.

The MEI requirements in the PHI capital framework will align with the ADI requirements as well as the new MEI provisions for life and general insurers. APRA is not able to give advice or comment on tax laws and regulations administered by other government agencies. Insurers seeking to issue MEIs should make their own inquiries to ensure their proposals comply with relevant regulatory requirements.

3.5 Implementation

APRA has advised industry that the standards would commence on 1 July 2023 to align the commencement of the PHI capital framework with the implementation of AASB 17 for prudential purposes.

Comments received

Submissions from some smaller insurers raised concern with a 2023 implementation date. A key cause for concern included some of the reporting forms, the impact of the COVID-19 pandemic on resources and operations, and the uncertainty associated with the DCL. It was also suggested that there may be insufficient synergy between AASB 17 and the new PHI capital standards to warrant them being introduced at the same time.

Insurers that submitted concerns with the implementation date recommended a 12-month delay.

APRA response

APRA will maintain a 1 July 2023 implementation date to align the implementation of the new capital standards to the changes in AASB 17; however, support will be provided to smaller insures to assist them with implementation. It is recognised that implementation may pose a greater challenge for smaller insurers due to resource and operational constraints. Using the Significant Financial Institution (SFI)/Non-SFI distinction in the prudential standards, APRA is offering smaller insurers a two-year transition period to meet the new ICAAP requirements, as well as a two-year exemption from the reporting requirements under HRS 104. A two-year transition to meet the new PCA and capital base requirements is also available for all insurers. (Chapter 6 has full details of the transitional arrangements under the new standards.)

It is APRA's view that appropriate transitional arrangements provide a more proportionate solution than delaying implementation of the new standards by 12 months as many insurers are well placed for a 1 July 2023 implementation. APRA's intention is to reduce regulatory burden by aligning implementation of the new capital standards with AASB 17. The final capital standards therefore incorporate AASB 17 to avoid the need for dual reporting from 1 July 2023.

With regard to the feedback that the standards should be delayed until the DCL is no longer required, this proposal is not supported. APRA acknowledges that the DCL is likely transitory and somewhat uncertain. Relying on the DCL not being required before the standards can be implemented would inject a similar level of uncertainty into the commencement date of the new standards and would inhibit appropriate planning for implementation by the industry.

Chapter 4 - Further industry feedback

This chapter sets out APRA's response to other issues raised in the December 2021 consultation on the draft standards. While no further changes have been made to the final standards on these matters, APRA notes that many of the issues below were introduced or amended at earlier points of the review process following consideration of feedback in previous consultation with insurers.

4.1 Management actions

The draft standards included an allowance for insurer-specific management actions to partially offset the FER. This is intended to reflect the ability of private health insurers to take actions to address deterioration in experience.

Comments received

Almost all submissions commented on the design of management actions within the draft capital framework. For some insurers, the primary areas of concern were with APRA being too restrictive by applying a nine-month timeframe before management actions can come into effect. This was particularly commented on in the context of the adverse event stress, where it was submitted that it would not take nine months to respond to an immediate industry-wide lapse in membership.

Some submissions suggested that APRA should remove the prescription around management actions and instead adopt a more tailored approach, whereby insurers would detail the management actions they would undertake in their ICAAPs and recovery plans. APRA could then assess these plans to determine if the actions assumed are reasonable.

A further issue raised in regard to management actions was APRA's proposal that profits expected after management action cannot be offset against prior losses and reduce the FER. Insurers submitted that this cap on profitability should either be removed, or instead constrained to their central estimate or target net margins.

Conversely to the above, other insurers submitted that management actions added complexity to the framework and further increased insurer discretion. Some insurers suggested that APRA remove management actions altogether, and instead assume that a level of management actions would take place across the industry, which could then be applied as a deduction to the IRC.

APRA response

APRA has considered the feedback received on management actions and, after reviewing the parameters and prescription in the draft standards, determined that these will be maintained. The operation of management actions will however be reviewed when a post-implementation review of the framework is undertaken.

In response to the view that management actions should not be incorporated into the standards, APRA's position is that management actions should be permitted to reflect appropriate and justifiable actions that would be taken. This increases insurer responsiveness to insurance risks and encourages insurers to consider how they would respond in a stressed scenario. By allowing for management actions within tightly defined parameters, APRA believes a balance between risk sensitivity, insurer discretion, and prudential outcomes can be achieved.

For the same reason, APRA does not agree with the suggestion that management actions should be permitted without any restrictions in the standards. This could encourage allowance for actions that are not realistic and result in an inappropriate calculation of insurance risk.

While some insurers submitted that the nine-month timeframe is too restrictive, particularly in the context of the industry wide adverse event scenario, it should be noted the adverse event scenario is one example of a 1-in-200-year shock. Such a shock could manifest in a variety of scenarios and the timeliness and availability of management action will differ accordingly. The nine-month timeframe is a reasonable reflection of when management action could be effective for a 1-in-200-year event.

With regard to profitability after management actions, if there were no constraints insurers would be able to reduce the PCA by forecast profits after the action takes effect. This would mean that future profits could offset current losses in a 1-in-200-year event. It would also mean that the FER could be reduced to an unreasonably low amount if the insurer assumed they would be sufficiently profitable post management action. This is not considered prudent given future profits in a 1-in-200-year event are likely to be very uncertain. This is also inconsistent with the LAGIC restrictions for management actions in life insurance.

APRA has committed to undertake a post-implementation review of the revised capital framework and will consider at that time whether any changes are needed to management actions in the capital framework.

4.2 Misestimation factor

Following stakeholder feedback, the draft standards included a recalibration of the growth charge. The charge was revised to focus on risks above trend levels for the industry, reduce the impact of the charge and minimise any disincentives on growth arising from mergers.

Comments received

While acknowledging the adjustments made in the draft standards, some insurers remained concerned that the design of the misestimation factor could still adversely impact competition through failing to consider stable and well-managed growth.

Submissions from smaller insurers called on APRA to further enhance the risk sensitivity of the charge and to not inadvertently disincentivise growth above the industry average where that is undertaken in a controlled manner. Some insurers called on APRA to better differentiate between high-risk and low-risk growth. One insurer suggested that the growth charge be tailored for different types of growth, for example growth outside of a historical market should carry additional risk to growth within historical market.

APRA response

No further changes have been made to the misestimation factor in the final standards. Attempting to introduce a distinction between different types of growth would introduce significant complexity and discretion. It would also move away from the central purpose of the mis-estimation charge, which is to recognise that the claiming profile for new members is unknown.

As noted in the December 2021 response paper, the risk of misestimating future claims has been reflected within capital standards for the PHI industry since 2001. It was a feature of the Private Health Insurance Administration Council's standards prior to 2014 in the 'additional qualitative margin' and is reflected in the current Capital Adequacy Requirement. This reflects that growth has been, and remains, a key contributor to uncertainty in future claims.

4.3 Asset risk charge

The draft standards adopted the LAGIC treatment of asset risk and asset concentration risk.

Comments received

Several insurers submitted that their expected level of investment income should be incorporated into the PCA. This would allow for their expected returns to be received and subjected to a stress, which would reflect their position in 12 months and be more aligned with the current standards.

Some insurers submitted that the Asset Risk Charge (ARC) should only apply to the assets backing the PCA or stressed liabilities. This would allow assets above the PCA to be exempt from an ARC, meaning insurers with high levels of assets would not need a higher PCA. It was suggested that APRA implement a mechanism in the ARC to recognise when investment assets exceed a defined minimum threshold.

Smaller, not-for-profit insurers noted that the new ARC may result in divestment of growth assets. Some insurers rely on investment income to grow their capital base or to subsidise low margins on the health insurance business. Limiting growth assets may limit not-for-profit insurers from being able to increase their capital base without increasing premiums.

APRA response

The final standards do not include any changes to the design of the ARC. Incorporating an insurer's view of the investment earnings directly into the standards would introduce a significant amount of discretion and subjectivity. It would also compromise consistency, as insurers could have different views of the expected returns for the same investment portfolio. One of the aims of the new standards is to reduce the amount of discretion in the PCA. Incorporating insurers' expected investment earnings would be contrary to this objective.

Having reviewed the original design of the ARC for LAGIC, APRA is satisfied that the approach allowing for earnings from high-risk assets is consistent with APRA's proposal. That is, earnings are already allowed for in the calibration of ARC stresses applied. To reflect expected earnings for risk-free assets, the final standards permit discounting of insurance liabilities and cash flows in the FER.

Regarding a mechanism to not apply an ARC to assets above the PCA, the standards reflect an insurer's position at the end of the year should losses occur at the 99.5 per cent level. Differentiating the ARC into those assets backing the PCA would be contrary to the purpose of the standards and inconsistent with the ARC applied to life and general insurers.

Regarding insurers divesting growth assets, the appropriate growth/defensive investment strategy is an issue for each insurer. Insurers may make a strategic decision that holding risky assets is beneficial in the long term even if it means a higher PCA. APRA expects insurers to consider their strategic objectives when conducting their ICAAP and determining their investment strategy and capital targets.

Based on QIS results, APRA's analysis suggests that no insurer requires additional capital to meet the PCA. QIS submissions did not provide a rationale that would justify not-for-profit insurers needing to amend their investment portfolio due to the ARC. Additional commentary on this matter can be found in Chapter 2.

4.4 Adverse event stress

The draft standards included a mass lapse scenario of an immediate 20 per cent reduction of the whole fund due to lapses from under 65-year-old policyholders across the industry. The stress assumes that 25 per cent of each insurer's policyholders below the age of 65 lapse, which is equivalent to an overall 20 per cent lapse at an industry level

Comments received

Some insurers commented on the design and appropriateness of the adverse event stress within the draft standards. For some insurers, this was in the context of management actions which, when combined, resulted in an overly conservative IRC.

Other insurers challenged the conceptual basis for the adverse event stress, stating that there is no example of an extreme adverse event that would impact insurers beyond government intervention.

APRA response

The rationale behind incorporating the adverse event stress into the IRC was documented in the December 2021 response paper. As noted at the time, APRA is of the view that it is prudent for the capital standards to include the requirement for industry to hold capital against an industry wide adverse event.

While changes in government policy have typically led to major shifts in industry membership, APRA maintains that a mass lapse event not associated with a change in government policy remains a plausible risk at a 1-in-200-year level. APRA notes that affordability and value are recognised as leading risks within industry risk registers and insurer strategies. Further, there is the potential for new products that are outside of the traditional private health insurance industry to emerge that may appeal to younger policyholders.

APRA views the adverse event stress as a proxy for a 1-in-200-year industry-wide stress. By its nature, such a stress cannot be fully predicted, and it is not APRA's intention to suggest that the stress would occur exactly as detailed in the standards. Instead, APRA has designed

the new framework to ensure insurers hold adequate capital against this risk, noting it may eventuate in a variety of forms.

4.5 Going concern and gone concern

The December 2019 discussion paper proposed that the probability of sufficiency apply on a gone concern basis. This proposal seeks to ensure that insurers have prudent capital to meet the needs of policyholders, without relying on potential future business revenue or profit which may not eventuate if the insurer experiences extreme stress.

Comments received

Several insurers commented on APRA's adoption of gone concern versus going concern, as applied in the draft prudential standards, submitting that there was inconsistency of use. For example, some insurers submitted that the ARC is applied to investments on a gone concern basis, while the FER is determined on a going concern basis. Some insurers also submitted that the LAGIC standards are on a gone concern basis while the FER in the proposed PHI standards is on a going concern basis. Broadly, insurers submitted that this inconsistency of use led to a potential double counting of risks and an overly punitive approach.

APRA response

APRA recognises that the terms gone concern and going concern have created confusion. These terms are not used in the life or general insurance standards and feedback indicated different interpretations of the terms, particularly with regard to renewing business, accepting new business, and whether cover would be immediately cancelled.

To clarify, APRA's position is that the PCA under the new capital standards should ensure that the liabilities of the insurer can be met in 12 months at the 99.5 per cent level of sufficiency. The PCA should be sufficient, based on the time required to take corrective action. It should also be sufficient if the insurer is unable to generate future profits. *Prudential Standard HPS 110 Capital Adequacy* (HPS 110) addresses this:

> *'The prescribed capital amount is intended to be sufficient, such that if a fund was to start the year with a capital base equal to the prescribed capital amount, and losses occurred at the 99.5 per cent confidence level then the assets remaining would be at least sufficient to provide for the* ***central estimate*** *of insurance liabilities and other liabilities at the end of the year. The other liabilities to be provided for exclude those liabilities that satisfy the criteria for inclusion in the capital base.'*

Chapter 5 - Reporting standards

As part of the release of the PHI capital and AASB 17 response packages, APRA released draft PHI reporting standards for consultation in December 2021 and April 2022.

This chapter outlines APRA's response to issues raised in the December 2021 and April 2022 consultations on the draft PHI reporting standards, and the December 2021 QIS. It also provides clarification on reporting via APRA Connect for private health insurers.

Updates to the reporting standards include those necessary to reflect prudential standard design changes; incorporation of reporting design feedback; consistency with relevant LAGIC updates; and definition and instruction clarifications. A summary of the changes made to the reporting standards for private health insurers since the December 2021 and April 2022 consultations can be found in Appendix B.

Where applicable, APRA has also made changes to reflect AASB 17 implementation. APRA's response paper *Finalisation of the integration of AASB 17 into the capital and reporting frameworks for insurers and updates to the LAGIC framework* contain details of these changes.

5.1 Key feedback and revisions to reporting standards

HRS 101.0 Regulatory Income Statement – Supplementary Information

Comments received

Feedback received from private health insurers flagged the regulatory burden relative to that currently imposed in HRF 602_3 and HRF 602_4. In particular insurers noted challenges in obtaining reasonable assurance from auditors on some of the new items. Primary concerns related to:

- the collection of Gold, Silver, Bronze, Basic (GSBB) data by state;
- collecting Overseas Visitors Cover (OVC) and Overseas Student Health Cover (OSHC) performance split by hospital treatment and general treatment;
- splitting Risk Equalisation results into calculated deficit and gross deficit; and
- state levies not captured in the hospital category field.

APRA response

APRA has considered the feedback and simplified HRS 101.0 by:

- removing the collection of GSBB by state, with GSBB performance to instead be collected at a national level only. Insurers will also be able to use 'approximate methods' to allocate liability valuations and other estimates between hospital categories where they are not individually calculated as part of general business practice;

- no longer collecting the split between hospital and general treatment for OVC and OSHC data; and

- reverting to 'Net Risk Equalisation Trust Fund', as is provided in existing reporting, rather than splitting risk equalisation data into components.

Following the removal of GSBB performance data from HRS 101.0 no changes to the state levies data collection were required.

HRS 104.0 Forecasts and Targets

Comments received

A small number of submissions raised concerns regarding the level of granularity in the draft reporting standards. Concerns were raised on reporting gross margins targets by GSBB category as some insurers structure targets differently and this may not be readily available. Similarly, targets on OVC and OSHC may not be readily available depending on how the insurer manages health related insurance business.

Some comments also outlined that forecasts by month would be difficult to provide and suggested a less frequent basis.

APRA response

The collection of forecasts and targets will provide valuable supervision insights to APRA for monitoring an insurer's capital position and gross margin performance relative to forecasts and targets in a timely way. To reduce the burden on insurers, APRA is taking various steps in line with, and in addition to, feedback received:

- APRA has removed the request for target gross margins by GSBB and split by OVC and OSHC.

- Annual gross margin targets will be summarised to only be collected at health insurance business and health-related insurance business levels.

- Forecasts by month have been amended to forecasts by quarter.

APRA is further assisting the reduction of reporting burden through removing the quarterly reporting requirement for this reporting standard, to instead be required for annual reporting only.

Further, APRA is offering smaller insurers a two-year exemption from meeting the requirements under this reporting standard. This will be achieved using the SFI/Non-SFI distinction in the prudential standards.

A limited audit assurance is to be required for this reporting standard, which is a lower level of assurance than is required for the remainder of the reporting standards being implemented as part of this package.

5.2 Reporting via APRA Connect and direction of future data collections

As outlined in previous industry communications and in the Discussion Paper – *Direction for Data Collections*[5], APRA has introduced a new data collection solution, APRA Connect, to progressively replace Direct to APRA (D2A) and facilitate entities meeting other reporting obligations. APRA Connect will enable APRA to improve the way data is collected into the future, strengthening its data-enabled decision-making and enabling enhanced data submission capabilities.

From 1 July 2023, APRA's revised data collection, incorporating changes due to the PHI capital reforms, will be collected through APRA Connect. For the affected reporting standards, quarterly, semi-annual, and annual data for periods ending up to 30 June 2023 will continue to be submitted in D2A.

APRA notes that there are private health insurance reporting standards that are not impacted by updates to the PHI capital framework. Data under these reporting standards will continue to be submitted to APRA via D2A:

- *Reporting Standard HRS 601.1 Statistical Data by State*
- *Reporting Standard HRS 603.0 Statistical Data on Prosthetic Benefits*
- *Reporting Standard HRS 604.0 Medical Speciality Block Grouping Information*

APRA expects to migrate any remaining D2A insurance collections in 2024, after which regulated insurers will submit all data to APRA using APRA Connect. The migration exercise is deliberately limited in scope and will not significantly increase the breath or depth of insurance data collected.

In parallel, APRA will work with stakeholders to scope ways to enhance the insurance data collections in the longer term. These enhancements are intended to enable exploration of strategic issues within each insurance industry, such as product affordability, accessibility and sustainability.

[5] Refer to the discussion paper - Direction for data collections (apra.gov.au)

Chapter 6 - Implementation

6.1 Implementation and transition arrangements

The new capital standards for private health insurers will come into effect from 1 July 2023.

APRA understands that the introduction of a new capital framework represents a significant change for the industry. As a result, transition arrangements will be provided as outlined below. Any insurer who requires additional assistance beyond these transitional arrangements should contact their APRA supervisor.

PCA and capital base transition arrangements

To assist industry, APRA will be offering insurers a two-year transition period to meet the new PCA and capital base requirements. This will provide insurers with the option to gradually adjust to the new capital requirements if they choose.

If adopted, the transition would adjust the PCA and capital base such that the change from the existing standards to the new capital standards occurs over a two-year period on an incremental and proportional basis. The adjustments are capped to ensure that they cannot be used to support a lower PCA, or higher capital base, than those calculated at 30 June 2023.

To be eligible for the transitional arrangements, a private health insurer must notify APRA by 30 June 2023 and provide the requested data as detailed in HPS 110 and HPS 112 by 30 September 2023.

ICAAP and HRS 104 transition arrangements and timings

APRA will also be providing Non-SFIs, unless APRA has notified an insurer otherwise, with a two-year transition to meet the new ICAAP requirements as well as a two-year exemption from the reporting requirements under HRS 104.

To assist transitioning insurers with preparing for ICAAP requirements, APRA will expect these insurers to provide an ICAAP implementation plan by 1 July 2024. The plan should detail progress achieved to date, and how insurers expect to complete the transition from the current CMP requirements to the ICAAP.

APRA notes that transitioning insurers will not be required to provide a full ICAAP report until September 2026. Until this time, at a minimum, APRA would expect transitioning insurers to maintain current CMP requirements which include:

- a description of the board's risk appetite as it relates to capital needs and the process used to determine that appetite;
- capital target levels and details of how they are calculated;
- clearly defined capital trigger points; and

- corrective action options for each trigger point identified specifying actions, and timeframes for those actions, which an insurer may utilise to return capital to target levels.

SFIs and any insurer that APRA deems not eligible for ICAAP transition will be required to meet the new ICAAP requirements from 1 July 2023.

Insurers are encouraged to refer to CPG 110 which sets out APRA expectations regarding ICAAPs and is designed to assist insurers with the development of their ICAAP approach.

Table 2 details APRA's expectations for the first submissions of ICAAP documentation.

Table 1. ICAAP documentation timing

	ICAAP Transition Plan	ICAAP Summary Statement	ICAAP Report
SFIs and insurers deemed by APRA not eligible for ICAAP transition	n/a	1 July 2023	September 2024
All other insurers	By 1 July 2024	1 July 2025	September 2026

6.2 Post-implementation review

To ensure the PHI capital reforms are achieving their intended objectives, APRA will review the capital framework at the earliest of three years following implementation.

Attachment A: Regulatory Impact Analysis

This attachment sets out APRA's regulatory impact analysis. Consistent with the Australian Government Guide to Regulation, APRA has followed a similar process to that required for a Regulation Impact Statement (RIS). APRA's evaluation of the impact of policy changes to the PHI capital framework is summarised below.

In its December 2019 discussion paper, *Private Health Insurance Capital Standards Review,* APRA set out in detail the problem that required attention and why regulatory action was needed to solve it. APRA views the existing PHI capital framework to be less robust than the capital requirements that apply in other insurance sectors in Australia.

In APRA's view, the current PHI capital framework does not appropriately reflect the risks faced by insurers, with inadequate consideration of extreme adverse events. Capital standards are a critical foundation to support the objectives of APRA's prudential framework, and in turn deliver better outcomes for the Australian community. APRA's standards ensure that private health insurers hold sufficient capital, maintaining an appropriate level of resilience so that they can survive periods of stress and continue to provide protection for policy holders.

APRA's review set out to make enhancements to the PHI capital framework, including:

- improving the risk sensitivity of the capital standards to better reflect the nature of risks faced by private health insurers;
- limiting differences in capital requirements due to insurer discretion, improving consistency and comparability between insurers in the adequacy of capital held; and
- alignment with the life and general insurance (LAGIC) capital framework, which reflects APRA's overall approach to insurer capital and is consistent with international best practice.

APRA's 2019 discussion paper also identified the need to address the interaction between the PHI capital standards, and the introduction of the Australian Accounting Board's new standard AASB 17, which adjusts the accounting treatment of insurance contracts. APRA's capital and reporting framework is based on the existing accounting standard. The introduction of the new accounting standard means APRA will need to update its capital and reporting framework. APRA's objective in doing so has been to align the treatment of capital and reporting requirements with the new standard, with departures as needed to ensure sound prudential outcomes. This will assist in minimising the regulatory burden on industry by reducing the mismatch between the new accounting standard and APRA's requirements.

APRA has undertaken two rounds of public consultation in reviewing the PHI capital framework and has engaged with a variety of stakeholders, including private health insurers,

industry bodies and other regulators.[6] The consultation commenced with the release of APRA's December 2019 discussion paper which described APRA's proposed high level structure for revisions to the PHI capital framework. Industry feedback to this paper helped shape the capital review.

In APRA's response paper in December 2021, *A proposed new capital framework for Private Health Insurance*, APRA clarified and amended its proposals in a number of areas, following the consideration of issues raised by stakeholders. An industry consultation session in February 2022 provided insurers with further opportunity to raise issues and provide preliminary feedback on the draft standards. The finalised framework includes a number of additional changes as a result of incorporating industry feedback.

Summary of policy options

APRA has considered three broad policy options for the reforms to the PHI capital framework. These policy options are set out in the table below. Within Option 3 APRA considered a range of specific approaches, including a number that were raised by stakeholders through the consultation process.

Option 1: No change to existing capital framework	Make no revisions to prudential requirements nor provide additional guidance to address weaknesses in the existing framework or incorporate updates driven by the introduction of AASB 17.
Option 2: Refreshing the existing capital framework	Incorporate changes driven by the new accounting standard, AASB 17 and update the existing capital framework in isolation, without reference to APRA's approach in other sectors.
Option 3: Consider greater alignment with the capital requirements of the life and general insurance industries and incorporate AASB 17 where appropriate	Align APRA's capital framework for private health insurance with other insurance sectors where appropriate and incorporate changes driven by the new accounting standard AASB 17.

Assessment of regulatory costs

As part of the consultation process, APRA invited submissions on additional regulatory costs that could be incurred as a result of the three policy options under consideration. Respondents were invited to use the Australian Government's Burden Measurement Tool to assess regulatory costs. APRA has considered all relevant compliance and administration costs, including both upfront and ongoing costs, in estimating the regulatory cost of each option.

[6] APRA's consultation on revisions to the PHI capital framework, along with non-confidential industry submissions can be found here: Review of the private health insurance capital framework | APRA

Option 1: No change to existing framework

Under Option 1, there would be no change to APRA's existing prudential requirements, and no revisions would be made to incorporate the introduction of the new accounting standard AASB 17. If this option were adopted, it is likely that private health insurers would be more financially vulnerable to stress events and adverse financial impacts, with capital requirements that are not fully reflective of their risk profile.

This option would not give rise to any additional compliance costs associated with implementing revised requirements. However, capital requirements are a core component of APRA's supervision, and taking no action to address weaknesses observed in the current PHI capital framework would detract from insurer resilience and compromise policy holder protection.

Failing to incorporate changes driven by the introduction of AASB 17 would also create additional regulatory burden for insurers, as it would require them to maintain multiple sets of accounts to satisfy both accounting and prudential needs. This would increase compliance costs for private health insurers in the medium and long term when the new accounting standard comes into effect in 2023.

On balance, APRA considers there to be a long-term net cost associated with Option 1. While there are no upfront compliance costs associated with this option, not making these enhancements and failing to incorporate updates driven by the introduction of AASB 17 would result in a heightened compliance burden for industry on an ongoing basis. This is primarily driven by the need for insurers to maintain dual reporting systems to satisfy both prudential capital and accounting requirements.

Option 2: Refreshing the existing capital framework

Under this option, APRA would incorporate the changes driven by the new accounting standard AASB 17, and update the existing capital framework in isolation without reference to the capital frameworks applied in the other insurance sectors regulated by APRA. This option could remove outdated provisions in *Prudential Standard HPS 100 Solvency Standard* (HPS 100) and *Prudential Standard HPS 110 Capital Adequacy* (HPS 110), but would still set lower minimum capital requirements than other APRA regulated sectors.

This option is expected to involve implementation costs for insurers, as material changes to the framework would need to be made to address APRA's concerns. Implementation costs would include the cost of management time needed to adopt the changes, system updates, and time to develop internal policies and enhance internal capital management processes. However, it is expected that private health insurers would still have lower minimum capital requirements than other APRA regulated sectors as the standards would not require private health insurers to meet the 99.5% probability of sufficiency set as a baseline for capital standards for other insurance industries.

While this approach may address some deficiencies with the current framework and provide for alignment with AASB 17, it would not fully address APRA's objectives. The treatment of capital for private health insurers would not align with the approach in other APRA regulated insurance industries, and therefore provide a less robust level of protection for PHI policy holders. This approach would also present ongoing comparability issues for insurers

operating across different insurance sectors within group structures and leave APRA's capital standards for private health insurers out of step with international best practice.

While APRA would incorporate changes to reflect the introduction of AASB 17, the approach taken would be inconsistent with other industries. It would introduce additional complexity for key stakeholders in understanding and comparing insurer results.

Annual regulatory costs, averaged over 10 years				
Change in costs	Business	Community organisations	Individuals	Total change in costs
Total, by sector ($m)	1.3	Nil	Nil	1.3

Option 3: Consider greater alignment with the capital requirements of the life and general insurance industries and incorporate AASB 17 where appropriate

Under Option 3, prudential requirements for private health insurers would be revised to respond to the weaknesses identified in the current framework and align with other insurance sectors where appropriate. This would also bring PHI capital standards into line with international best practice.

Under this approach, the revisions to prudential requirements would significantly enhance insurer resilience and policy holder protection. This would be achieved by enhancing the risk sensitivity of the capital standards and enable private health insurers to optimise their business and capital management strategies. Introducing greater alignment in the capital frameworks across insurance industries will also facilitate improved comparability and the use of consistent terminology and accounting standards.

Option 3 is expected to have similar costs, yet slightly higher, to Option 2 with a higher net benefit. APRA would be directly addressing the weaknesses observed in the current capital framework with reference to a proven prudent and risk sensitive approach, aligned to international standards. This would ensure the PHI capital standards are fit for purpose and appropriate for the longer term by applying a demonstrated robust capital framework, which has operated successfully over a long period.

APRA anticipates that this option will also reduce the likelihood of future changes being needed to address issues not identified at implementation, as APRA's existing LAGIC framework is tried and tested.

Using the Significant Financial Institution and Non-Significant Financial Institution distinction in the prudential standards, APRA is offering smaller insurers a two-year transition to meet the new International Capital Adequacy Assessment Process (ICAAP) requirements, as well as a two-year exemption from the reporting requirements under *Reporting Standard HRS 104 – Forecasts and Targets* (HRS 104). A two-year transition to meet the new Prescribed Capital Amount (PCA) and capital base requirements is also available for all insurers. These

transitional arrangements will enable the implementation costs to be spread over a longer period of time.

Annual regulatory costs, averaged over 10 years				
Change in costs	Business	Community organisations	Individuals	Total change in costs
Total, by sector ($m)	1.8	Nil	Nil	1.8

Assessment of net benefit

As outlined in APRA's 2019 discussion paper, and 2021 response paper, there are a range of net benefits in APRA's approach to revising the PHI capital framework with reference to the existing LAGIC framework (Option 3):

- The existing capital framework for life and general insurers reflects APRA's overall approach to capital. By starting with this approach, APRA aims to improve the resilience of the PHI industry to financial stresses and promote a prudentially sound industry over the long term. This will also directly address APRA's concerns that the current PHI capital framework is less robust than the capital requirements that apply in other insurance sectors.

- Adopting the LAGIC framework will strengthen prudential outcomes for PHI policy holders, and provide for a consistent level of protection for policy holders across APRA-regulated insurance industries.

- Consistency of capital frameworks across the insurance sectors allows for a common language for capital and supports discussions about capital between APRA and insurers, and within groups that contain multiple APRA-regulated insurers across different insurance sectors.

- Introducing an aligned approach and principles to incorporate the new accounting standard AASB 17 will make regulatory requirements more comparable and clearer, enabling capital requirements to be more easily understood by external stakeholders.

- Aligning APRA's requirements with AASB 17, where appropriate, will also reduce regulatory burden on insurers by removing the need for dual reporting for accounting and capital purposes.

Conclusion: comparison of policy options

When developing policy, APRA is required to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality, while promoting financial system stability in Australia. APRA considers that, on balance, Option 3 will enhance prudential outcomes and improve financial system safety and stability in Australia.

While Option 3 has a marginally higher compliance cost, the prudential benefits associated with addressing prudential concerns arising from the deficiencies in the current PHI capital framework are materially higher.

	Option 1	Option 2	Option 3
Regulatory costs	No change	Low to moderate	Moderate
Increases the risk sensitivity of standards	Does not meet this criterion	Partly meets this criterion	Meets this criterion
Limits inappropriate insurer discretion	Does not meet this criterion	Partly meets this criterion	Meets this criterion
Alignment with LAGIC and international best practice	Does not meet this criterion	Does not meet this criterion	Meets this criterion
Comparability	Does not meet this criterion	Does not meet this criterion	Meets this criterion
Alignment with AASB 17 where appropriate	Does not meet this criterion	Meets this criterion	Meets this criterion
Overall	Net cost	Moderate net benefit	Material net benefit

Implementation and review

As delegated legislation, prudential standards impose enforceable obligations on APRA-regulated institutions. APRA monitors ongoing compliance with its prudential framework as part of its supervisory activities. APRA has a range of remedial powers available for non-compliance with a prudential standard, including a direction requiring compliance, the breach of which is a criminal offence. Other actions include imposing a condition on an APRA-regulated institution's authority to carry on its business or increasing regulatory capital requirements.

Under APRA's policy development process, reviews of new measures are typically scheduled following implementation. Such a review would consider whether the requirements continue to reflect good practice, remain consistent with international standards, and remain relevant and effective in facilitating sound risk management practices. To ensure the PHI capital reforms are achieving their intended objectives, APRA will review the capital framework at the earliest of three years after implementation. APRA will act within a shorter timeframe where there is a demonstrable need to amend a prudential requirement.

Attachment B: Summary of changes to Prudential Standards

Prudential standard	Key APRA proposals
HPS 110	• Added in opt-in transitional arrangements for PCA to Attachment A. • Added in ICAAP transitional arrangements for non-SFIs. • Removed pricing philosophy requirements.
HPS 112	• Added in provisions for mutual equity interests. • Added in opt-in transitional arrangements for capital base to Attachment G. • Added additional capital requirements to ensure APRA's point of supervisory intervention remains appropriate.
HPS 114	• Updated the real interest rate stress to clarify that nominal risk-free interest rates and real yields may be negative after applying the downward stress adjustment.
HPS 115	• Added in an aggregation benefit between DCL and other components of the IRC. • Reduced the prescribed benefit stress by 1% of benefits/expenses. • Changes made to allow for discounting of insurance liabilities and the FERC. • Clarification of the wording for which management expenses are to be reduced following the Adverse Event Stress.
HPS 310	• Updated reporting standard names and reporting numbers in Attachment A.
HPS 340	• Separated the deferred claims liability from other insurance liabilities to accommodate the DCL aggregation benefit • Changes to introduce the ability to discount insurance liabilities. • Updated treatment of reinsurance expenses in line with GPS 340.

Attachment C: Summary of changes to Reporting Standards

This attachment sets out the changes made to the private health insurance reporting standards since consultation in December 2021 and April 2022.

Reporting standard	Key APRA proposals
Various	• Updated boilerplates on all reporting standards, to apply consistency where applicable.
HRS 101.0	• Separated insurance revenue and insurance claims tables by state and by hospital category (i.e. GSBB). • Allowed approximate methods to be used in apportioning data by hospital category. • Simplified gross deficit and calculated deficit to be "net RETF" in line with current reporting. • Combined insurance claims tables for claims incurred, net RETF and state ambulance levies. • Added "Private Health Insurer Fund Type" to Table 8, for consistency in structure with other tables. • Simplified OVC/OSHC reporting to no longer request insurance revenue and insurance claims by HT/GT. • Added "Other retained earnings movements" in Table 13, to capture retained earnings that are not captured by other categories.
HRS 104.0	• Deferred reporting commencement to 1 July 2025 for non-SFI and insurers not subject to an APRA determination. • Reduced reporting frequency from quarterly lodgement to annual. • Changed reporting for HRB Non-Insurance and Capital Forecasts and Target Capital from 12 individual months to four quarters. • Updated forecast data item from Prescribed Capital Requirement (PCR) to Prescribed Capital Amount (PCA). • Updated Target Capital table to collect a single target, rather than a target range. Updated "Target Capital Amount" definition to reflect this change. • Updated Hospital Category Gross Margin Forecasts table to collect gross margin percentage by hospital category only. • Removed collection of HRIB gross margin forecast percentages by OVC and OSHC. • Simplified gross margin target information to collect health insurance business and health-related insurance business only, rather than by hospital category.
HRS 109.0	N/A

Reporting standard	Key APRA proposals
HRS 110.0	• Added table to capture information related to the private health insurer's prescribed capital amount. • Added Deferred Claims Liability Risk Charge item to align with the change to HRS 115.0. • Updated instructions to clarify that the $5m Prescribed Capital Amount minimum for each health benefits fund will be automatically applied where the sum of risk charge components is less than this amount.
HRS 111.0	• Added adjustment item for Deferred Claims Liability Risk Charge to align with the change in HPS 115. • Added clarifications regarding the method for reporting prescribed capital amount transitional arrangements introduced in HPS 110.
HRS 112.0	• Added data items relating to mutual equity interest to reflect the update in HPS 112. • Added data items and clarifications to capture transitional arrangements to reflect the updated HPS 112. • Added core capital related ratios. • Added data metrics to reflect the proposed capital requirements aimed at ensuring that APRA's point of supervisory intervention remains appropriate. • Clarification of "Insurance liabilities surplus / (deficit)" definition, including to reference deferred claims liability. • Added "cost of reinsurance for future business not written" as an explicit regulatory adjustment item under the net surplus / (deficit) relating to insurance liabilities. This is aligned with General Insurance, where it is a replacement item for deferred reinsurance expense for future business not yet written. • Revised the data labels and definitions of regulatory receivables and payables to improve clarity.
HRS 112.3	• Added country list at Appendix 1. • Combined the reporting of ACN / ABN / ARBN to align with the structure in HRS 117.0.
HRS 114.0	• Added item for HPS 340 deferred claims liability to reflect the updated HPS 340. • Clarified instructions for "HPS 340 risk equalisation transfers" so receivables are reported as a negative value for the pre-stress liability amount. • Aligned the data labels and definitions of regulatory receivables and payables with HRS 112.0. • Changed the ordering of data items and playback layout to be more aligned with general insurance reporting. • Changed the structure of the table on yields to be consistent with other tables.
HRS 115.0	• Added reporting requirements and attribute definitions for DCL risk charge to align with the update to HPS 115.

Reporting standard	Key APRA proposals
	• Added reporting requirements and attribute definitions for discounting insurance liabilities and the Future Exposure Risk Charge to align with the update to HPS 115. • Added "Insurance profits forecast after management action". This captures the insurance profits after management action for the constraint that this can not offset prior losses for the PCA, per HPS 115. This replaces the derived calculation within FER playback. • Revised Future Exposure Risk Charge derived playback calculations to align with HRS 115 workbook changes issued in February 2022. • Added "Billed Risk Equalisation Special Account Liability amount". • All tables to include fund type field, even where table is applicable to health benefits funds only. This is to create consistency in table structure.
HRS 117.0	N/A
HRS 118.0	N/A
HRS 300.0	• Clarified the reporting of deferred tax assets in circumstances when the insurer does not have sufficient information on unused tax losses. • Added instructions to specify when the insurance/reinsurance finance reserve is relevant for an insurer. • Added additional splits to insurance contract assets/liabilities to collect amounts receivable/payable under the Risk Equalisation scheme; and other insurance contract assets/liabilities (including deferred claims liability and loyalty bonuses).
HRS 310.0	• Clarified reporting of reversals of recoveries of losses from the reinsurance contracts; expenses recognised under AASB 17.59 (a); and "effect of changes in non-performance risk of reinsurers". • Removed split of impairment losses and impairment loss reversals on insurance acquisition cash flows assets. • Introduced requirements for insurers to present "allocation of reinsurance premiums" separately from "amounts recoverable from reinsurers" because APRA requires this level of granularity for its analysis.
HRS 320.0	• In Part B (disclosures for reinsurance contracts held): added an additional column for assets for insurance acquisition cash flows; and revised the labels for certain cash flow items, to ensure consistency with Part A (disclosures for insurance contracts issued). • Removed signage instructions and introduced cross form validation rules to help ensure that closing balances for insurance contract assets/liabilities and reinsurance contract assets/liabilities reconcile to amounts reported on the Statement of Financial Position (HRS 300.0).

APRA