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Via email: policydevelopment@apra.gov.au

RE: Adjustments to the capital settings for longevity products

The FSC welcomes the opportunity to provide specific feedback on APRA's updated proposals around the capital settings for longevity products and the accompanying draft prudential standards.

The FSC supports the proposed changes and considers them a positive step toward improving the supply and competitiveness of retirement income products, ultimately supporting better retirement income outcomes for members. While current uptake of longevity products remains modest, these reforms lay important foundations for deeper market development by helping to ensure product availability is not unduly affected by short-term market conditions and by supporting members' access to more stable and predictable income in retirement.

We also appreciate that several of the recommendations from our first submission are reflected in these updated proposals. In particular, we welcome APRA's decision to embed the Appointed Actuary's attestations within existing reporting processes, preventing duplication. We also acknowledge the refinements to the cashflow matching and hold-to-maturity expectations, which now better reflect industry practice. In addition, we support the proposal of a principles-based approach for determining a longevity product's eligibility for the illiquidity premium, which will allow innovation in product design while maintaining strong actuarial oversight.

Our members have identified a couple of suggested adjustments to further enhance the impact of these changes, described overleaf.

About the Financial Services Council

The FSC is a peak body which sets mandatory standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services. Our full members represent Australia's retail and wholesale funds management businesses, superannuation funds, financial advice licensees and investment platforms.

The financial services industry is responsible for investing more than \$3 trillion on behalf of over 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is one of the largest pools of managed funds in the world.

We appreciate APRA's efforts to progress reforms that promote a more competitive and sustainable market for longevity products. If you would like to discuss this matter further, please contact [REDACTED], [REDACTED], [REDACTED], on [REDACTED] or email [REDACTED].

Yours sincerely,

[REDACTED]
[REDACTED]

Overview of feedback on APRA's updated proposals around the capital settings for longevity products

Overall, the FSC considers APRA's proposed changes to be a positive and meaningful step toward improving the retirement income landscape. We support the reforms and believe they will assist in expanding the supply and competitiveness of retirement income products. These improvements are best realised where capital settings appropriately balance incentives for product provision with strong expectations around insurers' governance, controls and ongoing management of credit risk. At the same time, there is an opportunity for some targeted refinements that would improve the effectiveness of the framework without compromising prudential outcomes.

Action in this area is increasingly important. By the mid-2030s, more than 300,000 Australians are expected enter retirement each year, yet access to affordable personal financial advice remains limited.¹ As a result, most retirees are unadvised and under-informed at the point of making critical decisions. Approximately 1.4 million Australians aged over 65 remain in accumulation phase and continue to pay unnecessary tax, and behavioural research consistently shows retirees tend to underspend out of caution in the absence of clear, trusted guidance.² A well-functioning market for retirement income products is therefore essential to ensuring retirees can access sustainable, predictable income throughout later life.

Against this backdrop, we recommend two targeted adjustments to APRA's proposals that would enhance their effectiveness while remaining fully aligned with prudential objectives:

Recommendation #1: Adjust the long-term average spread floor to 35%

APRA's proposed 45% floor on the long-term average spread (LTAS) floor is more conservative than necessary and exceeds comparable international benchmarks. In similar prudential frameworks overseas, including the Solvency II Matching Adjustment, the LTAS floor is set at 35%. This level is widely regarded as appropriately prudent, recognising both long-term credit experience and the need to avoid overstating default risk within the illiquidity premium.

A 45% floor would materially reduce the benefits of the advanced illiquidity premium by increasing the risk allowance beyond what underlying risk fundamentals justify. This could unnecessarily constrain the capital relief available to longevity products and diminish the pricing and competitiveness improvements that APRA is seeking to enable.

Moving to a 35% floor would:

- remain conservative from a prudential standpoint,
- be more closely aligned with international practice,
- avoid embedding undue conservatism that could dampen product innovation; and,
- better support the Retirement Income Covenant's objective of enabling retirees to draw down their savings with confidence.

We therefore recommend adjusting the LTAS floor to 35% or allowing a range where 35% represents the benchmark default.

Recommendation #2: Remove the limitation on the proportion of the illiquidity premium increase recognised in the credit spread stress charge

The updated LPS 114 proposals introduce an adjustment factor that limits how much of the increase

¹ Super Members Council, *Retirement revolution: Simpler smarter retirement*, p.1.

² Keith Ford, Lack of advice hurting over 65s in accumulation phase, Independent Financial Adviser, 15 September, 2023.

in the advanced illiquidity premium can flow through to the credit spread stress charge. While we understand APRA's intention to address potential misestimation risk, this mechanism effectively acts as an additional buffer that may unintentionally double-count default and downgrade risk.

Under the advanced illiquidity premium, insurers must already incorporate:

- conservative long-term default assumptions,
- downgrade risk,
- currency and other relevant risk allowances; and,
- a prudential LTAS floor (even at 35%).

These elements collectively provide a robust and conservative allowance for severe-but-plausible credit deterioration. In stressed conditions, the residual portion of credit-spread widening is predominantly attributable to illiquidity premia, not incremental default expectations. Limiting the recognition of this component risks misrepresenting economic reality.

Introducing a further constraint within the credit spread stress charge therefore results in:

- double-counting of default risk already captured in the risk allowance,
- reduced risk sensitivity, particularly for higher-quality portfolios,
- weaker countercyclicality, as the capital framework would be less responsive to genuine spread movements; and,
- unnecessary conservatism that may diminish the intended benefit and viability uplift for longevity products.

Removing this limitation would create a more coherent and proportionate framework that relies on the already substantial existing safeguards embedded in the advanced illiquidity premium methodology.

Accordingly, we recommend that APRA remove the adjustment factor that limits the proportion of the illiquidity premium increase recognised in the credit spread stress charge, and instead rely on the default, downgrade and risk-allowance components that already conservatively address credit risk.