

**Banking, Insurance and Life Insurance (prudential standards) determination
Nos. 1 to 4 of 2012**

EXPLANATORY STATEMENT

Prepared by the Australian Prudential Regulation Authority

Banking Act 1959, subsections 11AF(1) and 11AF(3)

Insurance Act 1973, subsections 32(1) and 32(4)

Life Insurance Act 1995, subsections 230A(1) and 230A(5)

Legislative Instruments Act 2003, paragraph 6(d)

APRA may, in writing, vary or revoke a prudential standard that applies to an APRA-regulated institution under:

- subsection 11AF(3) of the *Banking Act 1959* (Banking Act), in relation to authorised deposit-taking institutions (ADIs) and authorised non-operating holding companies (authorised banking NOHCs);
- subsection 32(4) of the *Insurance Act 1973* (Insurance Act), in relation to general insurers and authorised non-operating holding companies (authorised insurance NOHCs); and
- subsection 230A(5) of the *Life Insurance Act 1995* (Life Insurance Act), in relation to life companies (including friendly societies) and registered non-operating holding companies (registered life NOHCs).

APRA may, in writing, determine a prudential standard that applies to an APRA-regulated institution under:

- subsection 11AF(1) of the Banking Act, in relation to ADIs and authorised banking NOHCs;
- subsection 32(1) of the Insurance Act, in relation to general insurers and authorised insurance NOHCs; and
- subsection 230A(1) of the Life Insurance Act, in relation to life companies (including friendly societies) and registered life NOHCs.

Pursuant to paragraph 6(d) of the *Legislative Instruments Act 2003* (the Legislative Instruments Act), such prudential standards are legislative instruments for the purposes of the Legislative Instruments Act.

1. Background

APRA commenced a review of the regulatory capital framework for general insurers and life companies (LAGIC review) in 2010. The broad aims of the review were to:

- improve the risk sensitivity and appropriateness of the capital standards in general insurance and life insurance (including friendly societies); and
- where appropriate, improve the alignment of the capital standards across the industries that APRA supervises.

APRA has made a range of amendments to its prudential framework to give effect to the findings of the review.

Changes in respect of cross-industry prudential standards are given effect through the instruments described in section 2 and comprise changes to prudential requirements concerning outsourcing, business continuity management, governance and fitness and propriety.

2. Purpose and operation of the instruments

The purpose of making the instruments is to introduce amended prudential standards and revoke existing prudential standards in order to implement the changes arising from the LAGIC review.

A small number of minor amendments to the cross-industry prudential standards have been made, to update footnotes that made reference to general insurance and life insurance prudential standards that will be amended as part of the LAGIC review. In conjunction with these updates, APRA has taken the opportunity to make a small number of other minor amendments to the cross-industry prudential standards to align the structure of these standards with the other prudential standards applicable to insurance, banking and superannuation. There has been no change to the substantive prudential requirements in these standards.

On 30 November 2012, APRA made the following determinations (the instruments) under the relevant provisions of the Banking Act, Insurance Act and Life Insurance Act:

1. Banking, Insurance and Life Insurance (prudential standards) determination No. 1 of 2012, which revokes *Prudential Standard CPS 231 Outsourcing* made on 9 September 2011 (the existing CPS 231) and determines a new *Prudential Standard CPS Outsourcing* (CPS 231);
2. Banking, Insurance and Life Insurance (prudential standards) determination No. 2 of 2012, which revokes *Prudential Standard CPS 232 Business Continuity Management* made on 9 September 2011 (the existing CPS 232) and determines a new *Prudential Standard CPS Business Continuity Management* (CPS 232);
3. Banking, Insurance and Life Insurance (prudential standards) determination No. 3 of 2012, which revokes *Prudential Standard CPS 510 Governance* made on 9 September 2011 (the existing CPS 510) and determines a new *Prudential Standard CPS 510 Governance* (CPS 510); and
4. Banking, Insurance and Life Insurance (prudential standards) determination No. 4 of 2012, which revokes *Prudential Standard CPS 520 Fit and Proper* made

on 9 September 2011 (the existing CPS 520) and determines a new *Prudential Standard CPS 520 Fit and Proper* (CPS 520).

The instruments will take effect on 1 January 2013.

3. Consultation

APRA undertook consultation on the LAGIC review between May 2010 and October 2012, including four rounds of industry consultation, three technical papers and two quantitative impact studies.

APRA released the following consultation materials:

- May 2010 – Discussion paper ‘Review of capital standards for general insurers and life insurers’¹;
- July 2010 – Technical papers ‘Review of capital standards for general insurers and life insurers – Asset risk capital charge’² and ‘Review of capital standards for general insurers and life insurers – Capital base and insurance risk capital charge for life insurers’³;
- September 2010 – Technical paper ‘Review of capital standards for general insurers and life insurers – Insurance concentration risk capital charge for general insurers’⁴;
- Late 2010 – APRA invited insurers to participate in the first quantitative impact study⁵;
- March 2011 – Response paper ‘Review of capital standards for general insurers and life insurers’⁶;
- April 2011 – APRA invited insurers to participate in the second quantitative impact study⁷;
- December 2011 – Response paper ‘Review of capital standards for general insurers and life insurers’⁸, draft prudential standards;
- March 2012 – Letter to all CEOs (or equivalent) and Appointed Actuaries of life insurers ‘Illiquidity premium’⁹;

¹ [http://www.apra.gov.au/CrossIndustry/Documents/GLI_DP_RCSGILI_032010_v7\[1\].pdf](http://www.apra.gov.au/CrossIndustry/Documents/GLI_DP_RCSGILI_032010_v7[1].pdf)

² http://apra.gov.au/CrossIndustry/Documents/GLI_TP_LGICR_062010_ex%5B1%5D.pdf

³ http://apra.gov.au/CrossIndustry/Documents/GLI_TP_CBIRCC_072010_v8%5B1%5D.pdf

⁴ <http://apra.gov.au/CrossIndustry/Documents/Insurance-Conc-Risk-charge%5B1%5D.pdf>

⁵ <http://www.apra.gov.au/GI/PrudentialFramework/Pages/Review-Cap-Stds-QIS1-QIS2-TechSpecs.aspx>

⁶ http://apra.gov.au/CrossIndustry/Documents/GLI_RS_RCSGILI_032011_ex_r%5B1%5D.pdf

⁷ <http://www.apra.gov.au/GI/PrudentialFramework/Pages/Review-Cap-Stds-QIS1-QIS2-TechSpecs.aspx>

⁸ <http://apra.gov.au/GI/PrudentialFramework/Pages/General-and-Life-Insurance-Capital-Review-Consultation-on-Draft-Prudential-Standards.aspx>

- May 2012 – Response paper ‘Review of capital standards for general insurers and life insurers’¹⁰, final versions of the capital adequacy standards, draft versions of the composition of the capital base and non-capital prudential standards containing amendments that are in the main consequential to the revised capital framework;
- June 2012 – Discussion paper ‘Review of capital standards for general insurers and life insurers – proposed revisions to reporting requirements’¹¹, draft versions of reporting forms and instructions, reporting standards and capital adequacy calculation workbooks and instructions;
- August 2012 – Letter to insurers ‘Additional proposed changes to the reporting standards’¹²;
- September 2012 – Letter to all CEOs (or equivalent) of life insurers ‘Solvency standard requirements under the *Life Insurance Act 1995*’¹³;
- September 2012 – Letter to insurers ‘Consultation on draft prudential practice guides and information paper’¹⁴, draft versions of prudential practice guides and an information paper¹⁵;
- October 2012 – Response paper ‘Review of capital standards for general insurers and life insurers’¹⁶, final versions of all prudential standards amended as a result of the LAGIC review; and
- October 2012 – Response paper ‘Review of capital standards for general insurers and life insurers – reporting requirements’¹⁷, final versions of all forms and instructions and reporting standards.

APRA has considered both formal and informal feedback from industry throughout the above multi-year process. APRA has also considered feedback from the authorised deposit-taking (ADI) industry in relation to requirements for the composition of the capital base which are common to insurers and ADIs.

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http://apra.gov.au/lifs/PrudentialFramework/Documents/120330_LTI_LAGIC_LI_illiquidity_premium_consultation.pdf

¹⁰ <http://apra.gov.au/CrossIndustry/Pages/Life-and-General-Insurance-Capital-Review-Consultation-May-2012.aspx>

¹¹ <http://www.apra.gov.au/CrossIndustry/Consultations/Pages/LAGIC-Reporting-Requirements-June-2012.aspx>

¹² <http://www.apra.gov.au/CrossIndustry/Consultations/Documents/120806-letter-to-industry-LAGIC-proposed-changes-to-reporting-standards.pdf>

¹³ http://apra.gov.au/CrossIndustry/Consultations/Documents/120912_LAGIC_letter_life_insurance_temporary_solvency_standard.pdf

¹⁴ <http://www.apra.gov.au/CrossIndustry/Consultations/Pages/LAGIC-Prudential-Practice-Guides-September-2012.aspx>

¹⁵ Final versions of the prudential practice guides and information paper will be released in 2013.

¹⁶ <http://www.apra.gov.au/CrossIndustry/Pages/Life-and-General-Insurance-Capital-Review-October-2012.aspx>

¹⁷ <http://www.apra.gov.au/lifs/ReportingFramework/Pages/LAGIC-final-reporting-requirements-LI-October-2012.aspx>

Submissions made by industry were broadly supportive of the changes. Issues considered to be significant or to have merit were incorporated into the revised capital framework.

4. Regulation Impact Statement

A Regulation Impact Statement is required for the life and general insurance capital review. It has been prepared and is attached as supporting material.

5. Statement of compatibility prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*

The legislative instruments the subject of this explanatory statement do not engage any of the applicable rights or freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*. Accordingly, in APRA's assessment, these legislative instruments are compatible with human rights.