Australian Prudential Regulation Authority

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MEMBER

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To all CEOs (or equivalent) of life insurers

Solvency standard requirements under the *Life Insurance Act 1995*

As you know, APRA has substantially completed a review of its capital standards for general insurers and life insurers.

One of the changes that will be implemented following the review is to replace the two existing requirements for solvency and capital adequacy for life insurers with a single measure of required capital. In order to achieve this, amendments to the *Life Insurance Act 1995* (the Act) are required as the Act in its current form refers to separate prudential standards in relation to solvency and capital adequacy. As a result, section 9.3.2 of the consultation paper 'Strengthening APRA's Crisis Management Powers', released by the Government on 12 September 2012[1], proposes amendments to the Act to implement a single capital requirement. Consultation on the Government's proposals ends on 14 December 2012.

Until the Act is amended, it is necessary to have separate solvency and capital adequacy standards for life insurance statutory funds. APRA proposes that for the purposes of the Act, with effect from 1 January 2013 the capital adequacy standards will be the suite of capital prudential standards, *Prudential Standard LPS 110 Capital Adequacy* through to *Prudential Standard LPS 118 Capital Adequacy: Operational Risk Charge*.

APRA proposes the solvency standard would be an additional prudential standard (*Prudential Standard LPS 100 Solvency Standard* (LPS 100)). LPS 100 would require the capital base (as measured under *Prudential Standard LPS 112 Capital Adequacy: Measurement of Capital*) of each statutory fund to exceed 90 per cent of the fund's prescribed capital amount under the capital adequacy standards. The factor of 90 per cent is proposed so as to ensure that there is a modest but material difference between the levels of capital required to be held under the solvency and capital adequacy standards. The proposed basis would require minimal effort for a life company to calculate and minimal effort for APRA to monitor compliance.

There will be no APRA reporting or disclosure requirements in respect of the solvency standard. It is proposed that the solvency standard cease to have effect from the time the changes to the Act (as foreshadowed above) become effective.

Draft LPS 100 is attached to this letter. In addition, the definition of 'capital standards' in *Prudential Standard LPS 001 Definitions* (LPS 001) is proposed to be changed to 'capital adequacy standards' and the definition would include reference to the Act in order to improve its clarity. A definition of 'solvency standard' is also proposed to be added to LPS 001.

[1] http://www.treasury.gov.au/ConsultationsandReviews/Submissions/2012/APRA

APRA welcomes feedback in relation to the proposals in this letter and draft LPS 100 by 12 October 2012. Submissions should be sent to InsuranceCapital@apra.gov.au. Subject to feedback received, APRA expects to finalise and issue LPS 100 by the end of October 2012, to come into effect from 1 January 2013.

Yours sincerely

Important Disclosure Notice - Publication of Submissions

All information in submissions will be made available to the public on the APRA website unless a respondent expressly requests that all or part of the submission is to remain in confidence. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain in confidence should provide this information marked as confidential in a separate attachment.

Submissions may be the subject of a request for access made under the Freedom of Information Act 1982 (FOIA). APRA will determine such requests, if any, in accordance with the provisions of the FOIA. Information in the submission about any APRA regulated entity which is not in the public domain and which is identified as confidential will be protected by section 56 of the *Australian Prudential Regulation Authority Act 1998* and therefore will ordinarily be exempt from production under the FOIA.

Prudential Standard LPS 100

Solvency Standard

Objective and key requirements of this Prudential Standard

This Prudential Standard is made for the purposes of the *Life Insurance Act 1995*.

The *Life Insurance Act 1995* makes provision for prudential standards in relation to the solvency of statutory funds.

This standard is a prudential standard in relation to solvency for the purposes of sections 3, 52, 62, 63 and 159 of the *Life Insurance Act 1995*. This Prudential Standard is satisfied in relation to a statutory fund if the capital base of the fund exceeds 90 per cent of the fund's prescribed capital amount.

Authority

1. This Prudential Standard is made under paragraph 230A(1)(a) of the *Life Insurance Act 1995* (the Act).

Application

2. This Prudential Standard applies to all life companies including **friendly societies** (together referred to as life companies) registered under the Act[2], except where expressly noted otherwise.

3. A life company must apply this Prudential Standard separately:

   (a) for a life company other than a friendly society: to each of its statutory funds; and

   (b) for a friendly society: to each of its approved benefit funds.

4. This Prudential Standard only applies to the business of an **Eligible Foreign Life Insurance Company** (EFLIC) which is carried on through its Australian statutory funds but not otherwise.[3]

5. This Prudential Standard applies to life companies from 1 January 2013 (effective date).

6. This Prudential Standard applies only for the purposes of sections 3, 52, 62, 63 and 159 of the Act. Should these sections cease to contain references to prudential standards in relation to solvency, this Prudential Standard will cease to have effect.

Interpretation

7. Unless otherwise defined in this Prudential Standard, expressions in bold are defined in *Prudential Standard LPS 001 Definitions*.

8. Unless otherwise indicated, the term statutory fund will be used to refer to a statutory fund of a life company other than a friendly society, or an approved benefit fund of a friendly society, as relevant.

9. This Prudential Standard is a prudential standard in relation to solvency for the purposes of sections 52, 62, 63 and 159 of the Act. A direction given to a life company under section 230B of the Act to comply with a requirement of this Prudential Standard is a direction in relation to solvency for the purposes of sections 62, 63 and 159 of the Act.

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[2] Refer to subsection 21(1) of the Act.

[3] Refer to section 16ZD of the Act.

Solvency requirement

10. A statutory fund satisfies the requirements of this Prudential Standard if the **capital base** of the fund exceeds 90 per cent of the fund's **prescribed capital amount**.

Adjustments and exclusions

11. APRA may, by notice in writing to a life company, adjust or exclude a specific requirement in this Prudential Standard in relation to that life company.