

Balancing protection and affordability: APRA's prospective capital requirements

AIA Australia has called for super funds and group insurers to embrace foreshadowed capital requirement changes but has asked the industry to consider the balance between increased reserves with affordability for consumers.

Group insurer AIA Australia's Damien Mu supported "pro-active engagement" with the prudential regulatory authority on its draft requirements for capital adequacy.

Mu, AIA Australia's chief distribution and marketing officer, said "it is an important issue for the industry", which he encouraged to "communicate and engage" on the issue, in the ultimate interests of consumers who relied on insurance. "Group insurance offers a great platform to afford millions of Australian's necessary life insurance in a cost-efficient manner," he noted.

"Strong prudential regulation is a key stabiliser and something we all rely on. Australia should be proud of its financial services regulatory framework which stood the test during the recent GFC."

"What we all seek is an optimal balance between robust consumer protection and cost to industry, which can also affect the consumer. Group insurance is particularly sensitive to the latter which, by virtue of its scale and distribution method, is not a high-margin product. This segment of the industry is therefore watching with keen interest to see how APRA's review of the capital requirements will strike this balance," he said.

Last year, APRA published a discussion paper, followed by a number of technical papers, outlining its proposed overhaul of the capital regime for life and general insurers in Australia.

The proposed changes aimed to



Damien Mu

improve the risk-sensitivity of the requirements and to align capital standards, where appropriate, across the different industries for which APRA was responsible.

"The industry's role is to accept the offer to engage with APRA to provide a full picture of the issue, and to provide input to APRA on the impacts of any proposed changes to the regulatory capital requirements to ensure a fair and reasonable outcome for all parties," he said.

As part of the development of the standards during last year, the industry was asked to complete a Quantitative Impact Study (QIS). This was completed by industry participants in November last year.

Mu said that the results of the QIS raised some concerns across the industry about a potential significant increase in the overall level of required capital.

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Tim Chambers, chief actuary of AIA Australia, commented that "the QIS, in its current form, would represent a significant shift from the current regulatory capital requirements".

"First," he said, "the proposed capital calculations look at introducing a number of new risk factors which necessarily increase the current capital requirements. These include reserves for a potential pandemic event, as well as for operational risks, and additional credit spread and default risks."

Second, the mechanics of the calculations "reduce the diversification benefit of having a range of products and premium structures", he said.

There were two clear potential implications from the current form of the proposed new standards, Mu said. The present proposal indicated that the overall level of capital within the industry would need to be significantly increased. The QIS results also implied that risk products were going to be more significantly impacted by the new proposals than investment products.

"Applied across the board, this has the potential to increase life insurance

Quantitative Impact Study

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premium rates, disadvantaging a segment of the population where under-insurance remains a real problem," Mu said.

While he supported APRA's mandate to protect individuals and the insurance industry against insolvency, Mu also wants to ensure that the cost of insurance did not become prohibitive. The key is to ensure sustainability," he said.

"Insurers also have to work on new products that keep on delivering value to super funds' members. This extends far beyond competitive pricing by looking at other ways to assist clients, such as service and accessibility."

"Life insurance, both through individual and group insurance, is an efficient and vital platform for protecting millions of Australians. As an industry, we should seek to protect and continually enhance the value to consumers. This means both embracing regulatory change and also engaging proactively to help inform and influence the direction of regulation, to the ultimate benefit of the consumer as well as the industry."

APRA was due to release its response to the first set of QIS submissions this month, and there would be a second round of QIS in May through to July. The draft prudential standards were not due to be released until October. ■

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