

AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY

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GEOFF SUMMERHAYES

Member

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Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
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Dear Secretary

Inquiry into the life insurance industry: APRA submission

The Australian Prudential Regulation Authority (APRA) welcomes the opportunity to make a submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into the life insurance industry (the Inquiry).

APRA's mandate is to undertake prudential supervision of regulated institutions. In undertaking this mandate, APRA is required to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality, and, in balancing these objectives, to promote financial system stability in Australia¹.

APRA seeks to fulfil its mandate through three key capabilities:

- Policy - which establishes the minimum prudential standards that all insurers must meet;
- Supervision - which involves day-to-day oversight of insurers to ensure they are not at risk of breaching minimum prudential standards; and
- Resolution and enforcement - which provides means for APRA to intervene in the affairs of an insurer should it be at material risk of breach or failure.

In short, APRA has a graduated set of responses in its toolkit to use in pursuit of its mandate.

The issues being considered by the Inquiry are directly relevant to APRA's mandate. The life insurance industry is characterised by complexity, driven by a complex legacy of long term contracts and outdated systems. Operational complexity and poor consumer

¹ Refer to section 8(2) of the *Australian Prudential Regulation Authority Act 1998*.

outcomes have the potential to lead to lack of confidence in the life insurance industry, can cause financial losses to institutions operating in the industry and can, in extreme cases, damage the stability of the financial system. APRA continues to undertake a range of policy and supervision initiatives to improve the sustainability of the life insurance industry. These responses are discussed in the attached Submission.

The contract between a life insurer and a policyholder is very long term; it is difficult to renegotiate the terms of the product and the insurer must be ready and able, in some cases, for decades, to fulfil its obligations under the contract. APRA therefore continues to support the Financial System Inquiry (FSI) recommendation regarding the rationalisation of legacy life products. Legacy products become more complex and expensive to administer over time and are prone to problems such as the use of outdated medical definitions. There are a range of legal, consumer and tax issues that inhibit an insurer's ability to update legacy products. Introducing a rationalisation mechanism, as recommended by the FSI, would help address this issue; this, however, requires legislative change.

Without in any way undermining the need for legislation to solve this problem, APRA's view is that industry can do more in relation to legacy products. In particular, life insurers need robust systems and processes capable of fairly and accurately administering their books of legacy business and have not always invested enough in these systems and processes.

While there has been progress by industry in recent years, more needs to be done. APRA will continue to increase the pressure on insurers to invest more in this area, so that their systems and processes are more capable of meeting community and policyholder expectations.

More generally, sustainability is a key theme underpinning APRA's recent activity in the life insurance industry. Insurers must operate on a sustainable basis in order to be financially and operationally viable into the future. A sustainable market serves the interests of consumers as well, through having insurers that are able to meet their financial promises over the long term, and through avoiding a recurrence of the significant price discontinuities experienced in recent years. To this end, APRA has strengthened the life insurance prudential framework and heightened its supervisory intensity of life insurers.

I look forward to assisting the Inquiry and considering its recommendations.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Geoff Summerhayes', written in a cursive style.

Geoff Summerhayes
Member