Actuaries Institute.

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General Manager
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Dear Sir/Madam,

Consultation: Capital settings for longevity products

The Actuaries Institute (the 'Institute') welcomes the opportunity to provide feedback to the Australian Prudential Regulation Authority ('APRA') response paper titled 'Adjustments to the capital settings for longevity products' issued on 29 October 2025 ('Response Paper') and accompanying draft standards ('Draft Standards'). This follows our earlier submission dated 25 July 2025 in response to the APRA Consultation Paper outlining proposals designed to improve the capital framework for annuity products ('Consultation Paper').

The Institute is the peak professional body for actuaries in Australia. Our members work in a wide range of fields including insurance, superannuation, investments and retirement incomes, banking, enterprise risk management, data science and AI, climate change impacts and government services. The Institute has a longstanding commitment to contribute to public policy discussions where our members have relevant expertise. The comments made in this submission are guided by the Institute's 'Public Policy Principles' that any policy measures or changes should promote public wellbeing, consider potential impacts on equity, be evidence-based and support effectively regulated systems.

The Institute believes that many Australian retirees could enjoy higher standards of living if lifetime income products such as annuities played a larger role in the retirement system. When considered among the mix of product solutions for funding retirement, annuities distinctly deliver a guaranteed income stream. We therefore see annuities as an effective option for retirees wanting to increase confidence and manage the risk of exhausting their own financial resources during retirement (longevity risk).

Summary Comments

Our overall view is that APRA's revised proposals represent a significant step towards removing some of the excess conservatism inherent in the current standards, and in improving the capital framework for longevity products overall.

We specifically support APRA's revised proposals set out in the Response Paper and Draft Standards, notably:

- The addition and design of the Advanced Illiquidity Premium ('Advanced ILP') as a risk-sensitive spread less a risk allowance. We welcome the introduction of an appropriate reference portfolio which is intended to be more reflective of an insurer's liabilities and investment strategy.

- The level of risk controls being more proportionate to the capital relief available compared to the current standards.
- The application of the Advanced ILP, including adjustment of the long-term rate implementation period, increase of the long-term ultimate rate and removal of the cap that may otherwise apply to the Advanced ILP.
- The principles-based approach for determining longevity product eligibility, which we view as appropriate in the context of enabling innovation in the market for longevity products.
- The additional risk controls and attestations, including the proposed cashflow matching test and the Advanced ILP declaration by the Appointed Actuary ('AA').
- The closer alignment to comparable peer jurisdictions.

Notwithstanding the above, we believe there remain some areas of excess conservatism in the calibration of certain parameters in the Advanced ILP calculation and the application of stress scenarios to the Advanced ILP under LPS114.

We suggest:

- **A risk allowance of 35% or lower of the long-term average spreads ('LTAS') on the reference portfolio should be adopted**.

  We agree with APRA's aim of improving alignment with comparable peer jurisdictions. However, we note the following:

  - The proposed 45% risk allowance is high in comparison to other international jurisdictions. We note that the fundamental spread under Solvency II, broadly equivalent to APRA's proposed 'risk allowance', is calibrated to 35% of LTAS on a reference portfolio. In a matching adjustment environment such as Solvency II, materially all of the illiquidity premium inherent in the insurer's asset portfolio is recognised within the insurer's capital base. Given that the asset portfolio backing a book of lifetime annuities is highly likely to include a proportion of illiquid assets, it follows that an insurer in a matching adjustment environment will have a higher capital base than an identical insurer in a reference portfolio environment. As such, we consider 35% should represent a ceiling for the risk allowance adopted by APRA.
  - We estimate that in setting the risk adjustment at 45%, there are likely to be (potentially lengthy) periods where the floor of the Standard ILP will apply, limiting the intended capital relief benefits of the Advanced ILP, particularly for higher quality reference portfolios and in periods of tight credit spreads (as is the case currently/recently). As a consequence, all else equal the pricing of lifetime income products will be higher than otherwise. We note that the 45% factor may also have the unintended consequence of industry participants seeking lower quality reference portfolios with higher long-term spreads in order to attract a higher ILP. This would be contrary to APRA's desired outcome of introducing a degree of prudence in the risk allowance.

  Our overall suggestion is to ensure the risk allowance is a suitably prudent but not overly conservative parameter that is comparable to international jurisdictions, and we view 35% as an appropriate ceiling in this context.

- **APRA should consider increasing the proposed "Adjustment Factors" to 100% in LPS114 due to a prudent allowance for defaults within the Advanced Illiquidity Premium and a framework of control and stress testing by the Appointed Actuary to manage any basis risk.**

The proposed Adjustment Factors applied to the Advanced ILP for the purposes of LPS114 serve to overly dampen the capital relief for insurers, by increasing the level of capital required to be held against spread widening. LPS112 already includes a risk allowance within the calculation of adjusted policy liabilities which reflects a prudent allowance for long term defaults. In the Response Paper APRA sets out that the Adjustment Factors also serve to compensate for potential basis risk between the insurer's selected reference portfolio and actual asset portfolio. However we also note the additional risk controls to be introduced provide for management of risks including basis risk.

Lastly, LPS114 includes a default stress component for fixed income assets which is calibrated to a 99.5% level of sufficiency and is sensitive to counterparty credit rating. Given the levels of prudence included within the proposed framework more broadly, we view the application of the proposed Adjustment Factors as excessively conservative.

- **Additional restrictions on unrated and privately-rated assets are removed, as the controls framework within the Draft Standards can be expected to provide sufficient management of the risks posed by an insurer's investment strategy.**

  APRA's focus on these assets reflects their anticipated growth in supporting longevity products due to their potential to offer higher yields, diversification benefits and longer durations for asset liability matching.

  All asset classes pose unique risks to a life insurer and require a focused risk management and governance framework commensurate to those risks. The introduction of additional restrictions specifically on unrated and/or privately-rated assets may capture a wide range of both publicly traded, semi-liquid and privately negotiated debt instruments with varying terms and structures. A restriction on these assets is inconsistent with comparable jurisdictions and may represent a material constraint for an insurer seeking to access certain markets or sub-asset classes which offer useful characteristics for hedging long term longevity liabilities, such as infrastructure debt, or issuance through the US Private Placement market. In our view the proposed restrictions will not be an effective way of improving the risk management of an asset portfolio, and instead APRA should expect life insurers to have a strong framework of risk management across the whole asset portfolio. We suggest this be managed through appropriate risk controls and included within the Advanced ILP declaration process.

- **Certain components of the Draft Standards relating to the AA discretion and cash flow testing requirements be made more explicit, or additional guidance provided to avoid potential ambiguity in interpretation and implementation.**

  The key items are noted below with more detail covered in the Attachment.

  - Cashflow matching tests be explicit around the use of derivatives being permissible from a risk management perspective, and the level of granularity being established at the same level as used to determine the Advanced ILP.
  - We observe the specification of a 3% limit for the accumulated shortfall in the cash flow matching test may be more appropriate for large portfolios of longevity liabilities which represent a material proportional exposure for an insurer, however may be impractical for smaller, less material portfolios. We suggest a more nuanced approach that recognises portfolio differences, such as adopting the larger of 3% or a fixed dollar amount with the AA's discretion and attestation requirements extended to the application of the cash flow matching and accumulated shortfall test.

- The standards be more consistent in noting insurers may use multiple Advanced ILP in a statutory fund for different product groups, with granularity at the discretion of the AA.

- **Additional points:**
  - Acknowledging and notwithstanding APRA's current focus on longevity products, product eligibility should eventually be expanded to capture all illiquid liabilities (e.g. the disability income outstanding claims reserves) to be more in line with the Insurance Capital Standard ('ICS') of the International Association of Insurance Supervisors ('IAIS').
  - As the retirement income market evolves, APRA should continue to monitor developments in capital standards in other markets to ensure the Australian framework remains consistent to other jurisdictions, and we suggest APRA review these standards in 3-5 years.

We set out in the Attachment our specific responses to the questions in the Response Paper, together with a number of suggested clarifications in the wording of the Draft Standards to align terminology across standards and avoid ambiguity in interpretation.

Finally, APRA's proposals would, in ensuring appropriate risk controls, expand the potential responsibilities and role of the Appointed Actuary in relation to the issue and management of longevity products. The Institute will consider how best to support relevant members and AAs as part of the implementation process.

The Institute may be contacted to discuss this submission. If you would like to do so, please contact the Institute via (02) 9239 6100 or public_policy@actuaries.asn.au.

Yours sincerely

(Signed) Elayne Grace

Chief Executive Officer

Attachment: Detailed Responses

1. Responses to Questions in Consultation Paper from 'Consultation Paper questions'

Area	Question	Response
Proposed changes to the illiquidity premium	1. APRA seeks feedback on the advanced illiquidity premium approach.	1. The Institute welcomes the principles-based nature of the framing of the Advanced ILP approach, in particular: • The availability of a wide range of reference indices including overseas indices, noting the requirement that the reference portfolio "*must reflect the nature and duration of liabilities and align with the life company's investment strategy*" • The framing of the Advanced ILP in terms of 100% of the spread on the reference portfolio, less a risk allowance expressed as a percentage of the LTAS on that index; and • The Advanced ILP declaration from the AA in the Financial Condition Report ('FCR'). Notwithstanding this, as set out below in Table 2, we consider that in totality, the updated basis contains a level of conservatism that is in excess of the aim set out in LPS110 of 99.5% sufficiency, and remains somewhat more conservative than peer jurisdictions overseas. A number of these jurisdictions operate a full matching adjustment approach, and therefore allow a calculation of regulatory policy liabilities that includes the illiquidity premium within their asset portfolios. Capital standards are an evolving area worldwide, and consequently APRA will need to continue to monitor developments in peer jurisdictions to ensure alignment with overseas jurisdictions is maintained over time.
	2. APRA seeks specific feedback on the proposed cashflow matching test, particularly the impact of the proposed maximum accumulated shortfall on the illiquidity premium cut-off point.	2. The Institute welcomes the proposed cashflow matching test, which will improve alignment with peer jurisdictions. We suggest changes in four specific areas. • **3% threshold for maximum accumulated shortall** – we believe that a proportionate threshold (such as the 3% suggested by APRA) may be suitable for large, material portfolios that are tightly managed and closely matched. However, we suggest a more nuanced approach that recognises portfolio differences. For example for smaller portfolios, a more lenient threshold could be appropriate given their materiality, such as adopting the larger of 3% or a fixed dollar amount to better address rollover risk, where the AA calibrates this fixed dollar amount based on the proportion of aggregate assets (e.g. the level of materiality could be determined relative to total assets in the statutory fund) and be added to the AA's attestation requirements. Such an approach would provide an appropriate level of flexibility and materiality to ensure that asset/liability mismatch risk on smaller portfolios is appropriate. • **Use of derivatives** – as set out in our earlier submission, given the limitations of the Australian bond market, an appropriate asset portfolio to match a book of lifetime annuities will require a significant allocation to overseas markets that have deeper and longer duration bond markets (with appropriate hedging of the currency mismatch). The use of derivatives is therefore likely to be an intrinsic component of a cashflow matched asset-liability portfolio. For the avoidance of doubt, we suggest that the ability to include derivatives be clearly stated so it can be used in the cashflow test. This is consistent with APRA's inclusion of overseas indices as a possible reference portfolio.

Area	Question	Response
		• **"Severe but plausible"** – with reference to earning a spread at least equal to the illiquidity premium under "*severe but plausible scenarios*"[1], if APRA has expectations around how severe or extreme such scenarios should be (e.g. reflect a 1 in 10 or 1 in 20 year event calibrated over the average expected duration of the liability cash flows) or seeks consistency from insurers, we believe that this phrase would benefit from further clarity or guidance being provided. Otherwise, if APRA is comfortable with discretion being left to the AA to determine this, the existing wording without further additions would remain appropriate. • **Asset rebalancing** – under LPS 112 Attachment F, Paragraph 11(c), the phrase *"aligned to a hold-to-maturity bias with limited reasons under which assets are rebalanced or replaced"* is used to describe circumstances where rebalancing may occur. We note that CPS 320 Attachment B, Paragraph 2(e) uses different wording to describe a similar concept: *"in only limited circumstances, such as severe market dislocation or disruption. The circumstances must be well defined by the insurer in its risk management framework"*. We suggest consideration be given to aligning the wording, if the concepts are consistent under APRA's intentions.
	3. APRA seeks specific feedback on the proposed approach that the advanced illiquidity premium used for prudential purposes must not exceed the corresponding illiquidity premium determined under the accounting standard, ensuring consistency and reasonableness across insurers.	3. The concept of illiquidity exists under the relevant accounting standard (*AASB 17 Insurance Contracts)* however it is not precisely defined. As a mechanism that largely reflects the timing of profit recognition, we are satisfied that life insurers can deal with this as a part of their internal accounting policies and in consultation with their Appointed Auditor. The concept of illiquidity for prudential (capital) purposes is a different proposition which instead is intended to reflect the insurer's ability to demonstrate that they can earn the assumed yield. This is appropriate as it is required for the insurer to continue making guaranteed payments to policyholders. This necessarily places a higher burden on the life insurer to demonstrate, with support from a range of controls, the suitability of the illiquidity premium for prudential purposes. It may reasonably result in a higher illiquidity premium than what might be determined under AASB 17. Given the potential for justifiable differences in views between accounting and capital due to the views being formed for different purposes, we do not consider this proposal necessary and note it could add complexity to the management of such a portfolio.
Proposed risk controls	4. APRA seeks feedback on the introduction of the proposed risk controls.	4. The Institute supports APRA's proposal for an Advanced ILP declaration in the FCR. **a. Appointed Actuary attestation** We support APRA's principles-based approach to determining the appropriate level that attestations are made. Attestation levels might be at a higher level than the underlying granularity of analysis and methodologies may evolve over time.

[1] Referenced in the proposed mark ups to LPS 112 Attachment F paragraphs 7(d) and 12(b), as well as CPS 320 Attachment B, Paragraph 2(i)(ii).

Area	Question	Response
		We suggest notional allocation methods explicitly be recognised as acceptable, provided they are consistently applied, well documented and prevent any material cross subsidisation. We suggest that APRA reflect that there are products which do not have longevity risk, e.g. term certain annuities, where so long as the liability is illiquid, the same principles in setting the illiquidity premium should equally apply. We also note that the Advanced ILP declaration includes that: "*stress scenario analysis and back-testing has been undertaken as part of ICAAP that considers all key risks to at a minimum verify that:* *(i) the assets backing adjusted policy liabilities and PCR attributable to longevity products are separately identifiable and sufficient to meet the liabilities; and* *(ii) based on the assets backing adjusted policy liabilities and PCR attributable to longevity products, the insurer is able to earn a spread above the risk-free discount rate at least equal to the Advanced Illiquidity Premium under severe but plausible scenarios*." During a market stress event the Advanced ILP could change rapidly, and the concept of earning a spread on assets at least equal to the Advanced ILP will become difficult to measure. We therefore suggest that the points (i) and (ii) be merged to say "*the assets backing adjusted policy liabilities and PCR attributable to illiquid products are separately identifiable and sufficient to meet the liabilities under severe but plausible scenarios"* which we believe satisfies the intent of this section. We note that the proposed changes to LPS112 set out that "*A life company is considered to be cashflow matched where it can demonstrate that the maximum accumulated shortfall is less than 3 per cent of the present value of future liabilities discounted at the risk-free discount rate*", aligned with Matching Test 1 (the accumulated cash-flow shortfall test) adopted by the UK Prudential Regulation Authority ('PRA') for matching adjustment portfolios. For clarity, APRA could consider an explicit statement that the present value of liabilities (to which the 3% maximum is applied) is calculated at the valuation date, consistent with how this is specified within the UK PRA test. We also note that the proposed changes to LPS112 specify that: • "*a life company is considered to be cashflow matched when …*" which implies that cashflow matching is considered at the entity level, rather than a lower level (such as product level), noting that LPS112 also sets out that "*different illiquidity premiums may be applied to different products*". We suggest that the wording be changed, such as to *"An illiquid liability portfolio is considered to be cashflow matched when…*". • "*The life company must project on a risk-adjusted basis, at least on annual timesteps, the longevity liability cashflows and assets backing longevity liability cashflows on a best estimate basis*." For better clarity we suggest this be re-ordered to say "*The life company must project on at least on annual timesteps, the longevity liability cashflows on a best estimate basis, and assets backing longevity liability cashflows on a risk-adjusted basis*" which we believe matches APRA's intent here. More generally, to make more explicit and consistent in the standards that insurers may use multiple Advanced ILP in a statutory fund for different product groups, with granularity at the discretion of the AA, we suggest adding

Area	Question	Response
		at the end of CPS320 Attachment B, Paragraph 2 words to the effect of *"For any product groups where the Advanced illiquidity premium is applied".* **b. Restriction on assets** Please see responses to Q11-13 for a discussion on proposed restrictions on private assets. We suggest APRA explicitly state that derivatives are permissible for cashflow matching purposes.
Impact	5. What impact will the proposed changes to the illiquidity premium have on your measurement of capital (i.e. capital base before versus after the proposed reforms)? 6. What impact will the proposed changes to the illiquidity premium have on your capital requirements (i.e. PCA and Target Capital before versus after the proposed reforms) 7. Taking into consideration the totality of change APRA is proposing and the likely responses of insurers to these changes, what change in annuity pricing do you view as reasonable to expect as a result? 8. What impact will the change in the illiquidity premium have on your entity's asset allocation? 9. What are the estimated incremental costs you expect to incur in implementing and complying with the proposed changes to the longevity capital framework?	Responses to Q5 - Q9. This is a commercial matter for insurers and the Institute can provide only a general comment. At a high level, we consider moves towards a more risk sensitive illiquidity premium, which brings Australia more into line with other jurisdictions, will contribute to a more dynamic industry with a greater capacity to develop innovative and effective risk solutions to support the Australian community. We fully support this objective.
Scope of products eligible for the illiquidity premium	10. APRA seeks feedback on the proposed product eligibility approach for the advanced illiquidity premium?	10. We support APRA's proposed principles-based product eligibility approach for the Advanced ILP. We note the following points of feedback in relation to the updates to the Draft Standards: • LPS 112, Attachment F, Paragraph 7(d): the phrase "*products with material longevity risk*" is not defined. We assume the intention is for this to include products that the AA considers has material longevity risk. If so, we suggest adjusting the wording of the paragraph for clarity, for example changing to:

Area	Question	Response
		*(d) other types of products where the **Appointed Actuary** has determined based on its product features has material longevity risk and where the liabilities are illiquid under normal and severe but plausible scenarios;* (noting our comments on the phrase "*severe but plausible scenarios"* under Question 2 above). • LPS 112, Attachment F, Paragraph 7(e), 7(f) and 9: we suggest clarifying that a life company can use the Standard illiquidity Premium for some products that it issues, and the Advanced ILP for others. For example, by inserting the words "for this business" at the end of Paragraph 7(e) and 7(f), and the words "applied to each type of business" after the words "The illiquidity premium" in Paragraph 9. • CPS 001 and CPS 320 both make reference to the phrase "*longevity products*", and CPS 001 and LPS 112 make reference to the phrase "*longevity liability*". There is no definition of these phrases provided, and we understand the intention is that these phrases include certain products/liabilities which may not have longevity risk (e.g. term-certain annuities). We suggest defining these phrases to provide clarity on what they are referring to (e.g. by referencing LPS 112, Attachment F, Paragraph 7 – such as how LPS 360 Paragraph 10(d) makes reference to this), and utilising consistent phrases throughout the prudential standards. For example, the phrase *"Assets backing longevity liability cashflows"* in CPS 001 could be changed to "Assets backing illiquid liability cashflows", and the corresponding definition changed to: *means the assets required to meet best estimate liability cashflows for products where the adjusted policy liability is calculated using the Advanced Illiquidity Premium (as defined in LPS112), after allowing for all material risks associated with generating the asset cashflows including default and reinvestment risk.* It may also help to add to the definition of fixed term/rate business in CPS001 that this business is not exposed to material longevity risk. We acknowledge APRA's statement in the Response Paper that extending the illiquidity premium to liabilities beyond those related to longevity products is currently out of scope. We continue to believe a broader, principles-based approach to determine product eligibility for applying an illiquidity premium under the capital framework is appropriate, including those that are not related to longevity products but are classified as being highly illiquid (e.g. Disability Income Disabled Lives Reserves), noting other capital regimes including the ICS, have a broader application of the illiquidity premium than LAGIC.
Alternative (unrated) assets and privately rated assets	11. APRA seeks feedback on the proposed treatment of alternative (unrated) assets and / or privately rated assets used to back longevity products?	11. Private and privately rated assets have become an increasingly critical component of the asset portfolios of global insurers to support their exposure to long dated liabilities like annuities. These types of assets hold appeal for annuity writers as (amongst other reasons): • There are limited opportunities to buy sufficiently long dated instruments in public markets; and • The yields available on private assets – driven in part by the illiquidity of the market – enable life insurers to support higher annuity rates offered to customers. Private assets carry a different risk profile to public assets. In particular, private assets tend to carry increased illiquidity risk and in stressed situations may be sold at a large discount to resolve liquidity issues. There is also less

Area	Question	Response
		transparency as to the nature of the underlying agreements for these instruments, and different levels of price-discovery / availability. However, as set out above, they also present opportunities for insurers to access longer dated assets to match long duration liabilities and therefore present a trade-off of risk and opportunity. While introducing new risks for a debt portfolio, they may help manage risk faced by insurers holding shorter dated public assets (particularly reinvestment risk when shorter dated bonds mature). It is our view that this difference in risk profile is manageable and should align with good risk management practices over the whole investment portfolio. It is our expectation that the AA will assess the risk exposures of an insurer as a part of the Advanced ILP declaration framework proposed in this consultation (and could be included explicitly in the CPS320 requirements) and in the regular capital management processes of the insurer. Importantly this assessment should be applied to all asset classes. In this light we view a cap on a single class of assets to be unnecessary, and that APRA's proposed control framework without this cap is sufficient to manage the risks posed by private and privately rated assets, as well as all other assets held within the life insurer's investment portfolio. We also note that by creating the limits with reference to the Prescribed Capital Amount, the insurer would be required to perform an allocation of Prescribed Capital Amount to longevity products. Such an allocation can be highly subjective, particularly with respect to allocation of diversification benefits.
	12. APRA seeks insurers' views on examples of sophisticated risk management approaches in managing assets and longevity products for consideration of higher limits for alternative (unrated) assets and / or privately rated assets.	12. There are a range of approaches that we would expect an insurer to employ if private assets were a material component of their asset portfolio: • A wide recognition of the unique risks of private assets evidenced by strong internal governance processes, including appropriately senior and accountable people within the organisation performing regular reviews of private asset valuations, ongoing appropriateness of assumed credit rating, performance of private assets against expected income payment characteristics, and enforceability of covenants. • Evidence of a cultural recognition of the importance of risk management of these assets within an organisation at all levels (including the Board). • Regular stress testing across a broad spectrum of risks posed by the assets, including illiquidity (considering the extent to which the product structure dis-incentivises policyholders from surrendering products and the consequent need for asset liquidity) and ongoing credit-worthiness of the issuers across the portfolio. • A robust liquidity and capital management policy that is calibrated to consider the illiquidity risks posed by private assets and shows that the insurer is sufficiently supported by its portfolio of liquid assets in stressed markets and should not be forced into selling illiquid assets at a large discount. • Regular and robust analysis on portfolio diversification, identifying concentration to various lenders, industries, geographies, credit-worthiness of lenders and other risk factors.
	13. Which types of additional credit ratings — such as private ratings from APRA-recognised rating agencies, ratings from non-APRA-recognised rating agencies, or insurers' internal	13. This is a commercial matter for insurers and the Institute can provide only a general comment. We expect that insurers developing internal credit ratings would:

Area	Question	Response
	ratings — would have the greatest impact in supporting life insurers in investing assets backing longevity products? Please respond in the order of impact	• help insurers source assets that align with their risk profile more readily given the transparent understanding of how the credit ratings are determined; and • require regular internal and external review over the suitability and adequacy of the data, assumptions and models used to determine the internal ratings.

2. Further details on response to Consultation Question 1 'APRA seeks feedback on the advanced illiquidity premium approach'

Component of the Advanced Illiquidity Premium Approach	Feedback Response
Illiquidity Premium Formula	We support APRA's proposed Advanced ILP formula being defined as the Spread on 'Advanced Illiquidity Premium reference portfolio' less 'risk allowance'. Further comments on the components are provided below.
Factor Applied to Spread / Risk Allowance	APRA has proposed a *"risk allowance floor which is 45 per cent of the long-term average spread on the 'Advanced Illiquidity Premium reference portfolio'"*. While there are arguments that no such floor is required and the allowance should be set on a 'fundamentals basis', we note that: • **Comparisons to other jurisdictions suggest a floor on the risk allowance of less than 35%**: Other jurisdictions that have a matching adjustment or equivalent approach for regulatory valuation of annuity liabilities set a floor for their risk allowance. In particular the "fundamental spread" under the Solvency II construct is set at 35% of a reference portfolio. If we take this as a starting point, we consider that the most material difference between the Solvency II regime and the proposed Advanced ILP approach is that Solvency II is a full matching adjustment framework. Therefore under Solvency II, the regulatory value of the policy liabilities includes the entire illiquidity premium inherent in the backing assets. In our view and allowing for differences between the regimes in terms of risk controls, the higher quantum of capital requirements under the proposed Advanced ILP approach would justify a risk allowance that is consistent with the Solvency II regime (as an example of a peer overseas jurisdiction) of less than 35% of LTAS. • **There may be unintended consequences of setting a floor that is too conservative:** For example, an overly conservative floor may incentivise insurers to pursue investment behaviours and strategies which result in holding assets whose theoretical default risk is closer to the conservative floor that is set (i.e. higher) because of the limited benefit received in determining the illiquidity premium under the Advanced ILP approach where lower risk investment strategies are utilised. As such, we suggest setting a floor that balances these considerations. For example, we would consider a floor that is no greater than 35% as more appropriate.
Benchmark / Reference Portfolio	We support APRA's proposal, in particular the removal of the restrictions contemplated in the Consultation Paper around limiting the reference index to be Australian and with tenor of up to 10 years. However, we note there is inherent conservatism remaining in the restrictions; in particular the restriction of indices being at least investment grade places a constraint on an insurer's ability to invest in non-investment grade credit. Also, the requirement that it is available daily will generally mean that the assets within these indices will be more liquid than the liabilities they are supporting, and potentially materially more liquid. While we note that there are practical difficulties that any fit for purpose reference bond index for the Advanced ILP must by definition be more liquid than a lifetime annuity portfolio, this conservatism and its relativity to peer overseas jurisdictions should be considered by APRA as part of the overall design and calibration of the framework. We suggest clarifying that multiple benchmarks be allowed to cater for the durations and liquidity profiles of the different products. For example, lifetime vs fixed term vs deferred annuities of different durations, which may also have some form of death or surrender benefit.
Long-term Rate Implementation Period	We support APRA's proposed long-term rate implementation period being the period from the reporting date until the cut-off point where the "*long term illiquidity premium implementation*" comes into effect.

Component of the Advanced Illiquidity Premium Approach	Feedback Response
	• We note the phrase "*long term illiquidity premium implementation*" is used in LPS 112, Attachment F, Paragraph 11(a), but not elsewhere. We suggest adjusting the wording of the paragraph for clarity, for example changing to: *(a) 'n years' is the period from the reporting date until the last point in time that a life company can achieve 'cashflow matching' for the products for which the Advanced Illiquidity Premium applies, as determined by the Appointed Actuary;*
Long-term (Ultimate) Rate	We support APRA's proposal to increase the long-term (ultimate) rate to 50bps on the basis that this applies only after the last point in time that a life company can achieve "*cashflow matching*". As noted in our earlier submission: • Any long-term (ultimate) rate should be data-based and utilise long-term historical data (both related to Australia and other jurisdictions), wherever possible. • For example, consideration of the levels of prevailing spreads observed historically – their minimum, standard deviation, percentiles and other statistical aspects. This may indicate that a long-term (ultimate) rate higher than 50 bps could be appropriate, even on a prudent basis. As an illustration referencing the historical U.S. Treasuries market, the average 10-year spread rarely falls below 50 bps (after making allowance for downgrade and default risks). While the long-term (ultimate) rate should be prudent, the level of prudence needs to be considered as part of the illiquidity premium proposal as a whole and should not be overly conservative.
Cap on Illiquidity Premium	We support APRA's removal of the proposed cap on the illiquidity premium, noting the comments above on the factor applied to spread / risk allowance.
Asset Risk Charge – Credit Spread Stress **(LPS 114 change)**	In Table 2 of the updated LPS114, APRA sets out a framework of haircuts to be applied to the Advanced ILP to be used when calculating the policy liability adjustment within the credit spread stress component in the Asset Risk Charge. For example, in the hypothetical scenario where a reference portfolio is 100% in A-rated bonds, the credit spread shock applied when calculating the stressed value of policy liabilities is 70% of the credit spread shock applied when calculating the stressed value of the insurer's A-rated bond assets. This would mean that 30% of the spread shock would be held as capital requirements in respect of misestimation of the spread on these instruments. In the Response Paper APRA states that it considers that "*during a stress scenario, increases in credit spreads may be partly driven by increases in default premia, leading to overstatement of the illiquidity premium. This risk could be exacerbated by basis risk between the reference portfolio and the insurer's assets and may be more severe for lower quality assets*." We consider that the majority of these risks are adequately managed within other parts of the updated standards, including the inclusion of stress scenario analysis and back-testing within the Advanced ILP declaration. The proposed changes to LPS114 retain the existing default stress component for fixed income assets which is sensitive to counterparty credit rating. Draft LPS112 also includes a risk allowance within the calculation of adjusted policy liabilities which is a further margin of prudence for the regulated entity. We suggest therefore that APRA should increase the factors in Table 2 of LPS114

Component of the Advanced Illiquidity Premium Approach	Feedback Response
	to 100%, reflecting that default risk, even in stressed circumstances, is adequately covered within other areas of the updated standards. An increase in the factors in Table 2 would mean that LPS114 no longer requires an insurer to hold capital in respect of the basis risk between its asset portfolio and the reference index. As such this risk is expected to be identified and managed via: • AA attestations that the reference portfolio is aligned with the life insurer's investment portfolio; and • the required stress scenario analysis and back testing.

3. Other areas of feedback related to updated drafted versions of the prudential standards attached to the Consultation Paper

Area	Feedback Response
LPS 112 Attachment F, Paragraph 16 Notification Period and Wording	For the proposed LPS 112 Attachment F, Paragraph 16, we: • Suggest the notification period to APRA be changed from "10 days" to "10 business days", noting this would be consistent with other notification periods in the prudential standards (e.g. CPS 220, Paragraphs 52 to 55). • We believe the requirement to notify APRA if a life company using an Advanced ILP *'fails at any point to meet the requirements of the Advanced Illiquidity Premium Declaration'* may, in various circumstances, be administratively onerous for insurers relative to the materiality of the failure. We note our suggestion in response to Question 2 further above, that a more nuanced approach to the 3% threshold that recognises portfolio differences (including for example for smaller portfolios, a more lenient threshold), may address this.
Transitional arrangements	We agree with APRA's assumption that transitional arrangements will not be required as: • The proposal in the Response Paper is to introduce an additional option for the use of the Advanced ILP, given the existing calculation ('the standard illiquidity premium') remains available to insurers. • While the proposed changes to the prudential standards require an Advanced Illiquidity Premium Declaration to be included in the FCR of insurers who elect to use the Advanced ILP, this declaration can be separately provided to APRA (to fulfil the requirements of LPS 112 Attachment F, Paragraph 15) before the first FCR issued after 1 July 2026 gets submitted, which will allow insurers to utilise the Advanced ILP (subject to satisfying the relevant requirements) regardless of their financial statement balance date.
Post-implementation review	We note APRA's Response Paper does not include any explicit plans to perform a post-implementation review. As the longevity product market in Australia continues to evolve, regulations in other jurisdictions continue to change and other developments unfold, we see value in APRA setting out the approach for reviewing the illiquidity premium allowances after a period of time (e.g. no later five years after implementation). We note that overseas jurisdictions continue to monitor this closely, in the context of ageing populations globally. For example the UK Treasury indicated in their November 2022 response to the Review of Solvency II that they would "*review whether the calibration of the fundamental spread remains appropriate in 5 years' time*"[2]. We would strongly welcome a similar commitment from APRA as part of finalising these changes for 2026.
Changes in the reference portfolio	We note that the Response Paper sets out that "*APRA expects changes to the reference portfolio only in limited circumstances, such as a material shift in asset or liability profiles. Any such changes should be detailed in the Actuarial Valuation Report (AVR), including the reasons for modifying the reference portfolio or its associated adjustments*." It is not clear where this is picked up within the Draft Standards. We suggest it may be appropriate to include an appropriate statement within the Advanced ILP declaration in the FCR, with more detail in the AVR in the event the reference portfolio has changed from the prior period.

[2] https://assets.publishing.service.gov.uk/media/6375529fe90e072852140498/Consultation_Response_-_Review_of_Solvency_II_.pdf