

All substantive changes are highlighted in yellow



## Prudential Standard GPS 115

# Capital Adequacy: Insurance Risk Capital Charge

### Objective and key requirements of this Prudential Standard

This Prudential Standard sets out the calculation of the Insurance Risk Capital Charge under the Prescribed Method of calculating the Minimum Capital Requirement applicable to a general insurer.

A general insurer is required to calculate its insurance liabilities in accordance with the requirements of *Prudential Standard GPS 310 Audit and Actuarial Reporting and Valuation*. The Insurance Risk Capital Charge relates to the risk that the value of the net insurance liabilities is greater than the value determined under *Prudential Standard GPS 310 Audit and Actuarial Reporting and Valuation*. There are two components to the Insurance Risk Capital Charge:

- the charge with respect to Outstanding Claims;
- the charge with respect to Premium Liabilities (or unexpired risk).

The prescribed charges with respect to particular classes of business are set out in Attachment A.

This Prudential Standard forms part of a comprehensive set of prudential standards that deal with the measurement of a general insurer's capital adequacy.

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### Authority

1. This Prudential Standard is made under section 32 of the *Insurance Act 1973* (**the Act**).

### Application

2. This Prudential Standard applies to **general insurers (insurers)** authorised under the Act.<sup>1</sup>
3. Subject to any specific transition rules:
  - (a) an insurer that is authorised under the Act as at the of determination of this Prudential Standard must:
    - (i) comply with this Prudential Standard from 1 July 2008 (**effective date**); and
    - (ii) continue to comply with *Prudential Standard GPS 110 Capital Adequacy* made on 26 September 2007 until the effective date; and
  - (b) an insurer that is authorised under the Act after the date of determination of this Prudential Standard must comply with this Prudential Standard from [*date of release of standard*].
4. As a consequence of the key role played by capital in the financial health of an insurer, every insurer must maintain sufficient capital to enable its insurance obligations to be met under a wide range of circumstances. This required level of capital for regulatory purposes is referred to as the Minimum Capital Requirement (**MCR**).

### Interpretation

5. Unless otherwise defined in this Prudential Standard, expressions in bold are defined in *Prudential Standard GPS 001 Definitions*.

### Insurance Risk Capital Charge

6. This Prudential Standard details the calculation of the Insurance Risk Capital Charge for an insurer using the Prescribed Method to determine its MCR.
7. The Insurance Risk Capital Charge relates to the risk that the value of net insurance liabilities is greater than the value determined under *Prudential Standard GPS 310 Audit and Actuarial Reporting and Valuation (GPS 310)*. It has two components:
  - (a) a charge in respect of Outstanding Claims Risk; and
  - (b) a charge in respect of Premiums Liability Risk.

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<sup>1</sup> Refer to sections 32 and 35 of the Act.

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The total Insurance Risk Capital Charge is the sum of the capital charge for each of the two components.

**Outstanding Claims Risk**

8. The capital charge for Outstanding Claims Risk relates to the risk that the value of the net outstanding claims liabilities is greater than the value determined under GPS 310.
9. For the purposes of the Prescribed Method, Outstanding Claims Risk is to be measured as a percentage of the value of the net outstanding claims liabilities. Because Outstanding Claims Risk will vary by class of business, different capital charges for Outstanding Claims Risk must be calculated for each class of business.
10. The capital charge for each class of business is calculated by multiplying the net outstanding claims liabilities for that class (as determined under GPS 310) by the relevant Outstanding Claims Risk Capital Factor. For these purposes, APRA classes of business have been divided into three categories with respect to direct insurance business and a matrix of three classes with four types of business with respect to inwards reinsurance business (as set out in the tables at Attachment A). Classes of business within the same category are regarded as having broadly similar levels of Outstanding Claims Risk. The total capital charge for Outstanding Claims Risk is the sum of the capital charges for each class of business.

**Premiums Liability Risk**

11. The capital charge for Premiums Liability Risk relates to the risk that premiums relating to post calculation date exposures, including premiums written before but incepting after the calculation date, will be insufficient to fund the liabilities arising from that business.
12. The value of the net premiums liabilities, as determined under GPS 310, is taken as the base value for the liabilities upon which the capital charge for Premiums Liability Risk is calculated.
13. For the purposes of the Prescribed Method, Premiums Liability Risk is to be measured as a percentage of the value of the net premiums liabilities. As for Outstanding Claims Risk, the extent of Premiums Liability Risk will vary by class of business. However, in a stable portfolio, Premiums Liability Risk is likely to be greater than Outstanding Claims Risk for the same class of business. A separate capital charge for Premiums Liability Risk needs to be calculated for each class of business.
14. The capital charge for each class of business is calculated by multiplying the net premiums liabilities for that class (as determined by GPS 310) by the relevant Premiums Liability Risk Capital Factor (using the same categories as for Outstanding Claims Risk – see the tables at Attachment A). The total capital

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charge for Premiums Liability Risk is the sum of the capital charges for Premiums Liability Risk for each class of business.

**Business covering multiple classes**

15. Where an insurer underwrites an inwards reinsurance contract and is unable to split this business into the classes and types listed below, it must use the highest factors in Table 2<sup>2</sup> at Attachment A on its outstanding claims liabilities and its premiums liabilities.
16. Where an insurer underwrites an inwards reinsurance contract which spans multiple classes and the insurer cannot readily split the contract between classes, the contract must be allocated by using an appropriate method (provided the same method is used for all contracts and all subsequent periods), including the following methods:
  - (a) allocate the contract to the category which represents the greatest exposure; or
  - (b) allocate the contract to the category representing the greatest premium income.

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<sup>2</sup> That is, those set for casualty business.

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## Attachment A

**Table 1: Direct insurance business**

<b>Class of business</b>	<b>Outstanding Claims Risk Capital Factor</b>	<b>Premiums Liability Risk Capital Factor</b>
Householders Commercial Motor Domestic Motor Travel	9%	13.5%
Fire and ISR Marine and Aviation Consumer Credit Mortgage Other Accident Other	11%	16.5%
CTP Public and Product Liability Professional Indemnity Employers' Liability	15%	22.5%

**Table 2: Inwards reinsurance business**

<b>Class of business</b>	<b>Outstanding Claims Risk Capital Factor</b>	<b>Premiums Liability Risk Capital Factor</b>
<i>Property</i>		
- Facultative Proportional	9.0%	13.5%
- Treaty Proportional	10.0%	15.0%
- Facultative Excess of Loss	11.0%	16.5%
- Treaty Excess of Loss	12.0%	18.0%
<i>Marine &amp; Aviation</i>		
- Facultative Proportional	11.0%	16.5%
- Treaty Proportional	12.0%	18.0%
- Facultative Excess of Loss	13.0%	19.5%
- Treaty Excess of Loss	14.0%	21.0%
<i>Casualty</i>		
- Facultative Proportional	15.0%	22.5%
- Treaty Proportional	16.0%	24.0%
- Facultative Excess of Loss	17.0%	25.5%
- Treaty Excess of Loss	18.0%	27.0%