



Prudential Standard HPS 110

Capital Adequacy

Objective and key requirements of this Prudential Standard

~~The purpose of this~~ This Prudential Standard ~~is to ensure, as far as practicable, that there are sufficient assets in a health benefits fund conducted by~~ requires a private health insurer to ~~provide~~ maintain adequate capital ~~for the conduct of the health benefits fund in accordance with~~ against the risks associated with its activities.

The ultimate responsibility for the prudent management of capital of a private health insurer rests with its Board of directors. The Board must ensure that the **Act** private health insurer maintains an adequate level and ~~in~~ quality of capital commensurate with the **interests of the policy holders of the fund** scale, nature and complexity of its business and risk profile, such that it is able to meet its obligations under a wide range of circumstances.

This Prudential Standard requires the private health insurer to demonstrate that the assets of its health benefits fund will be able to meet the liabilities of the fund after a 12-month period, allowing for the future business plans of the fund and adverse circumstances.

The health benefits fund's compliance with this Prudential Standard is an indication of its future financial strength, on a going concern basis.

The key requirements of this Prudential Standard are that a private health insurer must:

- ~~that a health benefits fund must have an Internal Capital Adequacy Assessment Process;~~
- maintain required levels of capital within each of its funds and for the private health insurer;
- ~~that a private health insurer must have, and comply with, a written, board endorsed, capital management policy for each health benefits fund it conducts, and provide this to APRA as soon as is practicable after it has been endorsed; and~~
- ~~that the board must review~~ determine each fund's prescribed capital amount having regard to a range of risk factors that may adversely impact the private health insurer's ability to meet its obligations. These factors include insurance risk, asset risk, asset concentration risk and operational risk;
- comply with any supervisory adjustment to capital imposed by APRA;
- make certain public disclosures about the capital management policy at least every two years and as part adequacy position of each review, consider fund and

~~the insurers access to internal and external capital and the impact on premiums of holding more or less private health insurer;~~

- ~~seek APRA's consent for certain planned capital~~ seek APRA's consent for certain planned capital ~~that~~ reductions of the private health insurer; and
- ~~inform APRA of any significant adverse changes in the amount determined capital position of the private health insurer as a whole or any of its funds.~~

Authority

1. This Prudential Standard is made under subsection 92(1) of the *Private Health Insurance (Prudential Supervision) Act 2015* (the Act).

Application

2. This Prudential Standard applies to all **private health insurers**⁺, except where expressly noted otherwise.
3. A private health insurer must apply this Prudential Standard separately to each of its **health benefits funds** and its **general fund**, in addition to the private health insurer as a whole, unless otherwise noted. The term 'private health insurer' refers to the private health insurer as a whole. The term 'fund' refers to each health benefits fund and the general fund, unless otherwise noted.
4. This Prudential Standard ~~takes effect on the day the *Private Health Insurance (Prudential Supervision) Act 2015* commences.~~ applies to private health insurers from 1 July 2023.

Interpretation

5. Terms that are defined in *Prudential Standard HPS 001 Definitions* (~~HPS 001~~) appear in bold the first time they are used in this Prudential Standard.
6. ~~Where this Prudential Standard provides for APRA to exercise a power or discretion, the power or discretion is to be exercised in writing.~~

~~Unless otherwise indicated, the term **health benefits fund** will be used to refer to a health benefits fund.~~ **Responsibility for capital management**

7. ~~Capital is the cornerstone of a private health insurer, as relevant.~~

The role of the board

8. ~~The **board** of a private health insurer must ensure that insurer's financial strength. It supports a private health insurer's operations by providing a buffer to absorb unanticipated losses from its activities and, in the event of such losses, enables the private health insurer is compliant with this Prudential Standard.~~

Capital Adequacy requirement

9. ~~The private health insurer must ensure that, at all times, the value of the assets of its health benefits fund is not less than the amount calculated under subparagraph (a) and also not less than the second amount calculated under subparagraph (b), where:~~
 - (a) ~~the amount is the sum of that fund's:~~

⁺ ~~Refer to subsection 92(1) of the Act.~~

- (i) ~~prudent liabilities amount (see paragraphs 12 to 18); and~~
 - (ii) ~~stress test amount (see paragraphs 19 to 25); and~~
 - (iii) ~~operational risk amount (see paragraph 26); and~~
 - (iv) ~~any capital adequacy supervisory adjustment amount (see paragraphs 27 to 30); and~~
 - (v) ~~less any **subordinated debt**; and~~
- (b) ~~the second amount is the sum of that fund's:~~
- (i) ~~prudent liabilities amount; and~~
 - (ii) ~~capital adequacy maximum default loss amount (see paragraphs 31 to 32); and~~
 - (iii) ~~any capital adequacy supervisory adjustment amount; and~~
 - (iv) ~~less any subordinated debt.~~
10. ~~Any amount or value that is required to be calculated for the purposes of this Prudential Standard must be calculated in accordance with **Australian Accounting Standards**, unless otherwise indicated.~~
11. ~~All estimates, forecasts and calculations in this Prudential Standard must:~~
- (a) ~~be made having regard to reasonably available statistics and other relevant information; and~~
 - (b) ~~not be deliberately or carelessly overstated or understated.~~

Prudent Liabilities Amount

12. ~~Prudent liabilities amount of a health benefits fund, means the sum, on the **relevant day** of the:~~
- (a) ~~outstanding claims liability amount; and~~
 - (b) ~~future claims liability amount; and~~
 - (c) ~~risk equalisation special account accrued liability amount; and~~
 - (d) ~~other liabilities amount.~~
13. ~~Outstanding claims liability amount of a health benefits fund is calculated in accordance with the following formula:~~
- ~~Outstanding claims liability \times (1 + **size margin**)~~
14. ~~Outstanding claims liability has the meaning given by the *Australian Accounting Standard Board Standard 1023*, where:~~

- ~~(a) the risk margin applied produces a 75 per cent probability of adequacy; and~~
 - ~~(b) discounting is not applied; and~~
 - ~~(c) any outstanding claims liabilities from health-related business are incorporated; and~~
 - ~~(d) receipts from the risk equalisation special account are incorporated.~~
- ~~15. Future claims liability amount of a health benefits fund is calculated in accordance with the following formula:~~
- ~~Future claims liability \times (1 + size margin)~~
- ~~16. Future claims liability of a health benefits fund, is the amount calculated, at a 75 per cent probability of adequacy, in accordance with the following calculation:~~
- ~~(a) the sum of:~~
 - ~~(i) future cash flows from future claims under current policies; and~~
 - ~~(ii) the additional risk margin; and~~
 - ~~(iii) the sum of related intangible assets and related deferred acquisition costs;~~
- ~~where all elements of the future claims liability calculation are defined in a manner consistent with the definitions contained in the liability adequacy test set out in the *Australian Accounting Standard Board Standard 1023*, except that discounting is not applied and the constructive obligation component is not included.~~
- ~~17. Risk equalisation special account accrued liability amount of a health benefits fund is the greater of:~~
- ~~(a) $0.1 \times$ unbilled calculated deficit; and~~
 - ~~(b) $(1.1 \times$ unbilled calculated deficit) — unbilled gross deficit + billed risk equalisation special account liability.~~

~~Where:~~

~~Billed risk equalisation special account liability means the amount of risk equalisation special account payments, on the relevant day, for which an invoice from the APRA has been received by the insurer but that have not yet been paid by the insurer.~~

~~Risk equalisation special account has the same meaning as in the Act.~~

~~Unbilled calculated deficit means the central estimate of the sum of all the amounts calculated for each risk equalisation jurisdiction, and under the following conditions:~~

- ~~(a) in accordance with Part 2, Rule 11(1)(e) of the *Private Health Insurance (Risk Equalisation Policy) Rules 2007*;~~
- ~~(b) over the period up to the relevant day;~~
- ~~(c) where the risk equalisation special account payments or receipts have accrued but have not yet been paid; and~~
- ~~(d) where an invoice, notice or receipt from APRA has not yet been received by the private health insurer, for that period.~~

~~Unbilled gross deficit means the central estimate of the sum of the eligible benefits notionally allocated to the aged-based pool and the high cost claimants pool, calculated for each risk equalisation jurisdiction, and under the following conditions:~~

- ~~(a) in accordance with Part 2, Rule 11(1)(a) of the *Private Health Insurance (Risk Equalisation Policy) Rules 2007*;~~
- ~~(b) over the period up to the relevant day;~~
- ~~(c) where the risk equalisation special account payments or receipts have accrued but have not yet been paid; and~~
- ~~(d) where an invoice, notice or receipt from APRA has not yet been received by the private health insurer, for that period.~~

~~18. Other liabilities amount of a health benefits fund, means the sum of any other liabilities not included in the outstanding claims liability amount, future claims liability amount, or risk equalisation special account accrued liability amount, valued as follows:~~

- ~~(a) individually, at a 98 per cent probability of adequacy, where the balance sheet value of the liability is not less than 2 per cent of the total value of balance sheet liabilities; and~~
- ~~(b) collectively, at least at a 98 per cent probability of adequacy, where the balance sheet value of the liability is less than 2 per cent of the total value of balance sheet liabilities.~~

Stress Test Amount

~~19. The stress test amount of a health benefits fund on the relevant day is the greater of:~~

- ~~(a) \$0; and~~
- ~~(b) the amount calculated using the following formula:~~

$$\text{—N—I—O+T}$$

~~Where:~~

~~N is the health benefits fund's stressed net margin estimate, calculated in accordance with paragraph 20.~~

~~I is the health benefits fund's stressed investment income estimate, on the relevant day, calculated in accordance with paragraph 23.~~

~~O is the health benefits fund's stressed other income estimate, on the relevant day, calculated in accordance with paragraph 24.~~

~~T is the amount of tax that may be attributable to the health benefits fund (which may be a negative amount to reflect future income tax credits), if it achieved its:~~

- ~~(i) ——— stressed net margin estimate; and~~
- ~~(ii) ——— stressed investment income estimate; and~~
- ~~(iii) — stressed other income estimate;~~

~~for the 12 months after the relevant day.~~

~~20. The stressed net margin estimate (N) of the health benefits fund is calculated in accordance with the following formula:~~

$$~~P \times NM\%~~$$

~~Where:~~

~~P is the premium income estimate of the health benefits fund on the relevant day.~~

~~21.6. NM% is the private health insurer's estimate of its health benefits fund's xth percentile net margin percentage for the health to continue to meet its insurance business for 12 months after the relevant day calculated: obligations.~~

- ~~(a) — applying the same premium increases as those assumed in calculating the premium income estimate; and~~
- ~~(b) — excluding any possible changes in the unexpired risk liability or constructive obligation during that period.~~

~~7. Unexpired risk liability As a consequence of the key role played by capital in the financial strength of a private health insurer, the **Board** of a private health insurer must ensure that:~~

- ~~(a) the private health insurer as a whole; and~~
- ~~(b) each fund~~

~~22. has the meaning given in the liability adequacy test in the relevant *Australian Accounting Standards Board Standard 1023*.~~

~~23. In calculating NM% the following must be taken into account:~~

- (a) ~~historical variability in net margins; capital that is adequate for the scale, nature and~~
 - (b) ~~changes in the fund's policy holder growth rate; and~~
 - (c) ~~expansion into new complying health insurance product(s); and~~
 - (d) ~~expansion into new markets.~~
24. ~~The stressed investment income estimate (I) of the health benefits fund is the private health insurer's estimate of its health benefits fund's xth percentile investment income for the 12 months after the relevant day, taking into account all significant risks including:~~
- (a) ~~market risk; and~~
 - (b) ~~credit risk; and~~
 - (c) ~~the risk of incorrect asset valuation on the balance sheet.~~
25. ~~The stressed other income estimate (O) of the health benefits fund is the private health insurer's estimate of its health benefits fund's xth percentile of its health related business and all other income, less associated expenses for the 12 months after the relevant day.~~
26. ~~xth percentile means the percentile with which the:~~
- (a) ~~net margin for the health insurance business; and~~
 - (b) ~~investment income; and~~
 - (c) ~~health related business income and all other income, less associated expenses,~~
- ~~must be measured at, in order its risk profile, such that it is able to achieve a second percentile profit margin, incorporating allowance for correlation between (a), (b) and (c) of this paragraph meet its obligations under a wide range of circumstances.~~

Operational risk amount

27. ~~Operational risk amount of a health benefits fund means the amount calculated in accordance with the sum of:~~
- (a) ~~0.5% of its health business revenue estimate, on the relevant day; and~~
 - (b) ~~\$1,000,000 × 1.025[^] (the calendar year of the relevant day minus 2014).~~

Internal Capital adequacy supervisory adjustment amount Adequacy Assessment Process

28. ~~Capital adequacy supervisory adjustment amount means, on the relevant day:~~

- ~~(a) — an amount expressed in dollars; or~~
- ~~(b) — a percentage figure; or~~
- ~~(c) — a factor; or~~
- ~~(d) — an amount, or a description of an amount, derived through another basis for calculating the capital adequacy supervisory adjustment amount;~~

~~which is not less than 0, and would not result in a negative amount, determined by APRA (including by the application of specified methodology), upon reasonable grounds.~~

~~29. In making a determination about a capital adequacy supervisory adjustment amount, APRA may consider the following examples as being examples of reasonable grounds for the determination of the capital adequacy supervisory adjustment but APRA is not limited in its considerations to those examples:~~

- ~~(a) — there is a less than 98 per cent probability that the health benefits fund will meet its prudent liabilities in 12 months' time; and/or~~
- ~~(b) — the health benefits fund's stress test amount does not make adequate allowance for:~~
 - ~~(i) — growth in policy holders, including in new markets; and/or~~
 - ~~(ii) — changes to the fund's products, including the launch of new products; and/or~~
 - ~~(iii) — a lack of asset diversification; and/or~~
 - ~~(iv) — market risk; and/or~~
 - ~~(v) — mismeasurement of asset values; and/or~~
 - ~~(vi) — credit risk.~~
- ~~(c) — the health benefits fund's prudent liabilities amount does not make adequate allowance for inherent uncertainty; and/or~~
- ~~(d) — the health benefits fund's operational risk amount does not make adequate allowance for inherent uncertainty; and/or~~
- ~~(e) — the health benefits fund's assets are not valued appropriately; and/or~~
- ~~(f) — the private health insurer conducting the health benefits fund does not have adequate data to assess the risks of the fund; and/or~~
- ~~(g) — the health benefits fund is exposed to contagion risks from a related party, and the private health insurer has not appropriately considered these risks for the purpose of its obligation under this prudential standard; and/or~~

- (h) ~~the health benefits fund's capital adequacy maximum default loss has not been appropriately calculated.~~
30. ~~APRA may determine the same or different capital adequacy supervisory adjustment amounts for the purposes of paragraphs 9(a) and 9(b) of this Prudential Standard.~~
31. ~~If APRA is satisfied that there are reasonable grounds to make a determination of the capital adequacy supervisory adjustment, APRA must, as soon as practicable after making the determination in relation to the health benefits fund, notify the private health insurer, in writing, of:~~
- (a) ~~the amount, factor or figure determined and the calculation methodology used to determine this amount; and~~
- (b) ~~the reasons for the decision to make a determination including which of paragraphs 9(a) and 9(b) of this Prudential Standard the capital adequacy supervisory adjustment amount applies to.~~

Capital adequacy maximum default loss amount

32. ~~Capital adequacy maximum default loss amount of a health benefits fund means, on the relevant day, a prudent estimate of the maximum default loss of a health benefits fund, calculated in accordance with the following:~~
- (a) ~~the capital adequacy maximum default loss amount must be at least as large as the maximum default loss; and~~
- (b) ~~the capital adequacy maximum default loss amount must be less than the maximum default loss plus 10% × (value of assets in the fund — prudent liabilities amount).~~
33. ~~Maximum default loss means the largest uncompensated loss of the health benefits fund arising from any loss, other than losses arising from assets held with an Australian Government counterparty or deposits held with an **authorised deposit-taking institution**, in relation to:~~
- (a) ~~any asset or any group of related assets of the health benefits fund; and~~
- (b) ~~any individual counterparty or group of related counterparties.~~

~~Where:~~

~~Uncompensated loss means the likely net loss after insurance, derivative, recoveries, and compensation.~~

Capital Management Policy

- 34.8. ~~A private health insurer must have, and comply with, a written, board endorsed, capital management policy for each health benefits fund it conducts. in place an **Internal Capital Adequacy Assessment Process (ICAAP)** that considers each fund as well as the private health insurer as a whole. The ICAAP must:~~

- (a) be adequately documented, with the documentation made available to APRA on request; and
 - (b) be approved by the Board initially, and when significant changes are made.
- 9. A private health insurer's ICAAP must be appropriate to the private health insurer's size, business mix and the complexity of its operations.
- 10. A private health insurer that is part of a group may rely on the ICAAP of the group provided that the Board of the private health insurer is satisfied that the group ICAAP meets the criteria in paragraph 11 in respect of the private health insurer.
- 11. The ICAAP must include at a minimum:
 - (a) adequate policies, procedures, systems, controls and personnel to identify, measure, monitor and manage the risks arising from the private health insurer's activities on a continuous basis, and the capital held against such risks;
 - (b) a strategy for ensuring adequate capital is maintained over time, including specific capital targets set in the context of the private health insurer's risk profile, the Board's risk appetite and regulatory capital requirements. This includes plans for how target levels of capital are to be met and the means available for sourcing additional capital where required;
 - ~~(a)(c) actions and procedures for monitoring the private health insurer's compliance with its regulatory capital requirements and capital targets. This includes the setting of triggers to alert management policy must include, but is not limited to: to, and specified actions to avert and rectify, potential breaches of the regulatory capital requirements;~~
 - ~~(a) — a capital management plan that must contain:~~
 - ~~(i) — a description of the board's risk appetite as it relates to capital needs and the process used to determine that appetite; and~~
 - ~~(ii) — capital target levels which have regard to paragraph 37, and details of how they are calculated; and~~
 - ~~(iii) — clearly defined capital trigger points, which have regard to paragraph 37; and~~
 - ~~(iv) — corrective action options, for each trigger point identified specifying actions and timeframes, for those actions, which a private health insurer may utilise to return capital to capital target levels (identified in subparagraph 34(a)(ii)).~~
 - ~~(b) — a pricing philosophy, which must include:~~
 - ~~(i) — profitability targets; and~~

- (ii) ~~direct and explicit consideration of the capital implications of particular profitability levels; and~~
 - (iii) ~~guidelines on the speed of correction of deviations from these profitability targets.~~
 - (c) ~~investment rules, which must include:~~
 - (i) ~~clear objectives; and~~
 - (ii) ~~asset allocation limits; and~~
 - (iii) ~~asset concentration limits; and~~
 - (iv) ~~a consideration of capital strength.~~
 - (d) ~~rules stipulating circumstances under which the capital management policy is to be reviewed, which must include changes in:~~
 - (i) ~~policy holder growth rates; and~~
 - (ii) ~~registration status; and~~
 - (iii) ~~net margin; and~~
 - (iv) ~~broader economic conditions.~~
35. ~~The private health insurer must provide APRA with a copy of the capital management policy as soon as practicable after it has been endorsed.~~
- (d) The board must stress testing and scenario analysis relating to potential risk exposures and available capital resources;
 - (e) processes for reporting on the ICAAP and its outcomes to the Board and senior management of the private health insurer, and for ensuring that the ICAAP is taken into account in making business decisions;
 - (f) policies to address the capital impact of material risks not covered by explicit regulatory capital requirements; and
 - (g) an 'ICAAP summary statement' as defined in paragraph 12.
12. The ICAAP summary statement is a high level document that describes and summarises the capital assessment and management processes of the private health insurer. It must outline at a minimum the aspects of the ICAAP listed in paragraphs 11(a) to (f) and this paragraph. The ICAAP summary statement must also include:
- (a) a statement of the objectives of the ICAAP, the expected level of financial soundness associated with the capital targets and the time horizon over which the ICAAP applies;

- (b) a description of the key assumptions and methodologies utilised by the private health insurer in its ICAAP, including stress testing and scenario analysis;
- (c) triggers for reviewing the ICAAP in light of changes to business operations, regulatory, economic and financial market conditions, and other factors affecting the private health insurer's risk profile and capital resources;
- (d) a summary of the private health insurer's policy for reviewing its ICAAP, including who is responsible for the review, the details of the frequency and scope of the review, and mechanisms for reporting on the review and its outcomes to the Board and senior management;
- (e) a description of the basis of measurement of capital used in the ICAAP, and an explanation of the differences where this basis differs from that used for regulatory capital; and
- (f) references to supporting documentation and analysis, as relevant.

~~36-13.~~ A private health insurer must ensure its ICAAP is subject to regular and robust review by appropriately qualified persons who are operationally independent of the conduct of capital management policy. The frequency and scope of the review must be appropriate to the private health insurer, having regard to its size, business mix, complexity of its operations, and the nature and extent of any changes that have occurred or are likely to occur in its business profile or its risk appetite. A review must be conducted at least every two years and either three years. The review must be sufficient to reach a view on whether the ICAAP is adequate and effective.

- ~~(a) — re-endorse the existing capital management policy; or~~
- ~~(b) — endorse a new capital management policy.~~

~~37. — In meeting the requirements in subparagraphs 34(a)(ii) and 34(a)(iii) a private health insurer must use methods designed to protect the health benefits fund and which consider:~~

- ~~(a) — access to internal and external capital; and~~

~~38-14.~~ the impact, on premiums an annual basis, provide a report on the implementation of holding more or less capital its ICAAP to APRA (ICAAP report). A copy of the ICAAP report must be provided to APRA no later than the amount determined three months from the end of the reporting period to which it relates.

Transition

~~39. — On the commencement of this Prudential Standard, a private health insurer that has any previously approved subordinated debt may treat it as having its full value for the purposes of this Prudential Standard, subject to paragraph 39.~~

~~40. — From the earlier of:~~

~~(a) five years after the commencement of the capital adequacy standard made as Part 6 of the *Private Health Insurance (Health Benefits Fund Administration) Rules 2007* on 31 March 2014; and~~

~~(b) four years before the maturity date of the subordinated debt;—~~

15. the value of previously approved subordinated debt, for The ICAAP report must include:

(a) detailed information on current and three-year projected capital levels relative to minimum regulatory capital requirements and target levels for the private health insurer and each fund;

(b) detailed information on the actual outcomes of applying the ICAAP over the period, relative to the planned outcomes in the previous ICAAP report (including analysis of the private health insurer's actual capital position relative to minimum regulatory capital requirements and capital targets and actual-versus-planned capital management actions);

(c) description of material changes to the ICAAP since the previous ICAAP report;

(d) detail and outcomes of stress testing and scenario analysis used in undertaking the ICAAP;

(e) a breakdown of capital usage over the planning horizon, as relevant, by material:

(i) business activity;

(ii) geographic spread of exposures; and

(iii) risk types;

(f) an assessment of anticipated changes in the private health insurer's risk profile or capital management processes over the planning horizon;

(g) details of any review of the ICAAP since the previous ICAAP report, including any recommendations for change and how those recommendations have been, or are being, addressed; and

(h) references to supporting documentation and analysis as relevant.

16. The ICAAP report submitted to APRA by the private health insurer must be accompanied by a declaration approved by the Board and signed by the CEO stating whether:
- (a) capital management has been undertaken by the private health insurer in accordance with the ICAAP over the period and, if not, a description of, and explanation for, deviations;
 - (b) the private health insurer has assessed the capital targets contained in its ICAAP to be adequate given the size, business mix and complexity of its operations; and
 - (c) the information included in the ICAAP report is accurate in all material respects.

Capital base

17. In assessing the adequacy of a fund's or a private health insurer's **capital base**, attention must be paid not only to the risks it is likely to face, but also the quality of the support provided by various forms of capital. In assessing the quality of support provided by a particular form of capital, regard must be had to the extent to which it:
- (a) provides a permanent and unrestricted commitment of funds;
 - (b) is freely available to absorb losses;
 - (c) does not impose any unavoidable servicing charges against earnings; and
 - (d) ranks behind the claims of **policy holders** and creditors in the event of the winding-up of the private health insurer.
18. Not all forms of capital meet these criteria equally. Due to the need to ensure that the capital base of a private health insurer provides adequate support for its activities, APRA imposes some restrictions on the composition of the capital base. The forms of capital deemed eligible for inclusion in the capital base, and the conditions as to their inclusion, are specified in *Prudential Standard HPS 112 Capital Adequacy: Measurement of Capital* (HPS 112). HPS 112 defines the different categories and components of the capital base and the restrictions on the quality of the capital that is used to meet the required level of capital for regulatory purposes.
19. A fund's or private health insurer's balance sheet may contain certain assets (such as deferred tax assets, goodwill and other intangibles) that are acceptable from an accounting perspective. However, for supervisory purposes ~~of~~, such assets are either generally not available, or of questionable value, should the fund or private health insurer encounter difficulties. A private health insurer is therefore required to make certain adjustments in determining the capital base. Details of these adjustments are specified in HPS 112.

Prudential Capital Requirement

20. This Prudential Standard establishes a risk-based approach for measuring the capital adequacy of a private health insurer or its funds. This required level of capital for regulatory purposes is referred to as the **Prudential Capital Requirement** (PCR). The PCR is intended to take account of the full range of risks to which a fund or private health insurer is exposed.
21. A private health insurer must ensure that the private health insurer and each of its funds have a capital base, at all times, in excess of its PCR.
22. The PCR of a fund equals:
- (a) a **prescribed capital amount** as determined by this Prudential Standard, linearly decreases to zero over 48 months; and
 - (b) any **supervisory adjustment** determined by APRA under paragraph 41.
23. The prescribed capital amount for a private health insurer is the sum of the prescribed capital amounts of each of its funds.
24. The prescribed capital amount for a health benefits fund of a private health insurer cannot be less than \$5 million. There is no minimum prescribed capital amount applicable to the general fund.
25. The PCR for a private health insurer is the sum of the PCRs of each of its funds (or such higher amount as determined by APRA under paragraph 41).

Prescribed Capital Amount

26. The prescribed capital amount is determined as:
- (a) the **Insurance Risk Charge**; plus
 - (b) the **Asset Risk Charge**; plus
 - (c) the **Asset Concentration Risk Charge**; plus
 - (d) the **Operational Risk Charge**; less
 - (e) an ‘aggregation benefit’ as defined in paragraph 32 to 34; less
 - (f) tax benefits.
27. The prescribed capital amount is intended to be sufficient, such that if a fund was to start the year with a capital base equal to the prescribed capital amount, and losses occurred at the 99.5 per cent confidence level then the assets remaining would be at least sufficient to provide for the **central estimate** of insurance liabilities and other liabilities at the end of the year. The other liabilities to be provided for exclude those liabilities that satisfy the criteria for inclusion in the capital base.

Insurance Risk Charge

28. The Insurance Risk Charge relates to the risk of adverse financial impacts due to movements in existing and future claims, expenses, and other insurance risks such as adverse events. The method for determining the Insurance Risk Charge is set out in *Prudential Standard HPS 115 Capital Adequacy: Insurance Risk Charge* (HPS 115).

Asset Risk Charge

29. The Asset Risk Charge relates to the risk of adverse movements in the value of on-balance sheet and off-balance sheet exposures. The method for determining the Asset Risk Charge is set out in *Prudential Standard HPS 114 Capital Adequacy: Asset Risk Charge* (HPS 114). Asset risk can be derived from a number of sources, including market risk and credit risk. For the purposes of this Prudential Standard and HPS 114, assets and exposures must be valued in accordance with the relevant reporting standards made under the *Financial Sector (Collection of Data) Act 2001* (FSCODA).

Asset Concentration Risk Charge

30. The Asset Concentration Risk Charge relates to the risk resulting from concentrations in individual assets or large exposures to individual counterparties or groups of related counterparties. The method for determining the Asset Concentration Risk Charge is set out in *Prudential Standard HPS 117 Capital Adequacy: Asset Concentration Risk Charge*.

Operational Risk Charge

31. The Operational Risk Charge relates to the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The method for determining the Operational Risk Charge is set out in *Prudential Standard HPS 118 Capital Adequacy: Operational Risk Charge*.

Aggregation benefit

32. The aggregation benefit makes an explicit allowance for diversification between asset and insurance risks in the calculation of the prescribed capital amount.
33. The aggregation benefit formula is:

$$\text{Aggregation benefit} = (A + I) - \sqrt{A^2 + I^2 + 2 \times \text{correlation} \times A \times I}$$

where:

- (a) ‘A’ is the Asset Risk Charge;
- (b) ‘I’ is the Insurance Risk Charge; and
- (c) ‘correlation’ is 20 per cent.

34. The Asset Concentration Risk Charge and the Operational Risk Charge are not included in the calculation of the aggregation benefit.

Tax benefits

35. Recognition is able to be made for future shareholder tax benefits arising from losses occurring within the Insurance Risk Charge and Asset Risk Charge of a fund. A private health insurer may reduce the prescribed capital amount by the aggregate amount of any tax benefits that can be netted against deferred tax liabilities as specified in HPS 112.

36. The tax benefits from the Asset Risk Charge are the tax benefits resulting from scenarios modelled by the stress tests in HPS 114, reduced to allow for the reduction in Asset Risk Charge due to the asset risk aggregation formula. The tax benefits are therefore calculated as:

$$\text{tax benefits from asset stress tests} \times \frac{\text{aggregated asset risk charge component}}{\text{sum of asset risk charge components}}$$

37. The tax benefits from the Insurance Risk Charge are the tax benefits resulting from losses in the Insurance Risk Charge in HPS 115.

38. Overall tax benefits are to be reduced to allow for aggregation between the Asset Risk Charge and Insurance Risk Charge. Tax benefit aggregation reduction is calculated as:

$$\begin{aligned} &\text{Tax benefit aggregation reduction} \\ &= (TA + TI) - \sqrt{TA^2 + TI^2 + 2 \times \text{correlation} \times TA \times TI} \end{aligned}$$

where:

- (a) ‘TA’ is the tax benefits from Asset Risk Charge in Paragraph 36;
- (b) ‘TI’ is the tax benefits from Insurance Risk Charge in Paragraph 37; and
- (c) ‘correlation’ is 20 per cent.
39. Tax benefits must only be recognised as a deduction from the prescribed capital amount if tax legislation allows them to be absorbed by the existing deferred tax liabilities. For this purpose, the deferred tax liabilities are those liabilities (if any) that remain after netting off the deferred tax assets and liabilities in the calculation of the deductions from **Common Equity Tier 1 Capital** in HPS 112.

APRA may adjust the Prescribed Capital Amount for calculating the prescribed capital amount

40. If APRA is of the view that the prescribed capital amount does not produce an appropriate outcome in respect of a particular fund, or a private health insurer has used inappropriate judgement or estimation in calculating the prescribed capital amount, APRA may, in writing, adjust any aspect of the prescribed capital

amount calculation for that fund. If such an adjustment is applied to a fund under this paragraph, a private health insurer must comply with the adjusted calculation.

Supervisory adjustment

41. APRA recognises that any measure of the adequacy of a fund or private health insurer's capital involves judgement and estimation, including quantification of risks that may be difficult to quantify. If APRA is of the view that there are prudential reasons for doing so, APRA may, in writing, determine a supervisory adjustment to be included in the PCR of a fund or private health insurer.

Disclosure

42. To improve the understanding of its capital adequacy position by policy holders and other market participants, a private health insurer must publish, at least annually, the following items for the private health insurer:

- (a) the amount of Common Equity Tier 1 Capital;
- (b) the aggregate amount of any regulatory adjustments applied in the calculation of Common Equity Tier 1 Capital;
- (c) the amount of **Additional Tier 1 Capital**;
- (d) the aggregate amount of any regulatory adjustments applied in the calculation of Additional Tier 1 Capital;
- (e) the amount of **Tier 2 Capital**;
- (f) the aggregate amount of any regulatory adjustments applied in the calculation of Tier 2 Capital;
- (g) the total capital base of the private health insurer derived from the items (a) to (f);
- (h) the prescribed capital amount; and
- (i) the capital adequacy multiple (item (g) divided by item (h)).

43. A private health insurer must also publish, at least annually, the following items for each of its funds:

- (a) the amount of the fund's 'net assets', after applying any regulatory adjustments;
- (b) the aggregate amount of any regulatory adjustments applied to the fund's net assets;
- (c) the amount of Tier 2 Capital held by the fund;
- (d) the aggregate amount of any regulatory adjustments applied in the calculation of the fund's Tier 2 Capital;

- (e) the total capital base of the fund derived from the items (a) to (d);
 - (f) the fund's prescribed capital amount;
 - (g) the components of the fund's prescribed capital amount² specified in paragraph 26; and
 - (h) the capital adequacy multiple of the fund (item (e) divided by item (f)).
44. A private health insurer must publish the information specified in paragraphs 42 and 43 so that it is readily accessible to both policy holders and other market participants.
45. A private health insurer must not disclose any supervisory adjustment determined by APRA in accordance with paragraph 41.

Reductions in capital base

46. A private health insurer must obtain APRA's written approval prior to making any planned reduction in its capital base.
47. A reduction in a private health insurer's capital base includes:
- (a) a share buyback or the redemption, repurchase or repayment of any qualifying Common Equity Tier 1 Capital, Additional Tier 1 Capital and Tier 2 Capital instruments issued by the company;
 - (b) trading in the private health insurer's own shares or capital instruments outside of any arrangement agreed upon with APRA in accordance with HPS 112; and
 - (c) the aggregate amount of dividend payments on ordinary shares that exceeds a private health insurer's after-tax earnings³ (as reported to APRA in the private health insurer's **statutory accounts**) after taking into account any payments on more senior capital instruments, in the financial year⁴ to which they relate.
48. A private health insurer proposing a capital reduction must provide APRA with a forecast showing the projected future capital position (including PCR) after the proposed capital reductions. The forecast should extend for at least two years.
49. A private health insurer must satisfy APRA that its capital base will remain adequate for its future needs after a proposed reduction.

² This item must separately identify any transition amount approved by APRA under the **capital standards**.

³ If the sum of a private health insurer's 'change in **fair value** of financial assets' through other comprehensive income and 'net insurance financial result' through other comprehensive income is negative, then the insurer must reduce its after-tax earnings by this sum.

⁴ 'Financial year' means the last four quarters for which the private health insurer was required to submit quarterly returns in accordance with reporting standards made under FSCODA to APRA preceding the date of the proposed dividend.

Materiality

~~41-50. A private health insurer may take into account materiality when calculating its capital base and prescribed capital amount or the capital base and prescribed capital amount of each of its funds. Particular values or components are considered material to the overall result of a calculation if misstating or omitting them would produce results likely to be misleading to the users of the information.~~

Notification requirements

~~51. Under section 95A a private health insurer must inform APRA as soon as practicable of:-~~

- ~~(a) any breach or prospective breach of its PCR or the PCR of any of its funds;~~
- ~~(b) any significant departure from its ICAAP;~~
- ~~(c) any significant adverse changes in the capital base or PCR of the private health insurer or any of its funds; or~~
- ~~(d) other necessary notification events under the Act.~~

~~The notice must include any remedial actions taken or planned to be taken to address the situation and the timing of these actions.~~

Pricing philosophy

~~52. In addition to the requirements under *Prudential Standards CPS 220 Risk Management*, a private health insurer has obligations to notify APRA of certain breaches of this Prudential Standard as well as other matters relating to the financial position of the insurer or its must have a written, Board approved pricing philosophy, which includes:~~

- ~~(iv)(i) target profitability for each health benefits funds.fund and major product groups;~~

Transition arrangements

~~42. Any approval, determination or other exercise of discretion by PHIAC under Schedule 3—Capital Adequacy Standard (the PHIAC capital adequacy standard) of the *Private Health Insurance (Health Benefits Fund Administration) Rules 2007* as they existed prior to 1 July 2015 will continue to have effect following 1 July 2015 as though exercised pursuant to a corresponding power under this Prudential Standard. In particular:~~

- ~~(a) a capital adequacy supervisory adjustment amount determined by PHIAC under subclause 12(1) of the PHIAC capital adequacy standard, and in force immediately before 1 July 2015, continues in effect as if determined under paragraph 27 of this Prudential Standard; and~~
- ~~(b) any methodology determined by PHIAC under paragraph (b) of the definition of premium income estimate in rule 3 of the *Private Health*~~

~~Insurance (Health Benefits Fund Administration) Rules 2007, and in effect immediately before 1 July 2015, has effect as if determined by APRA under subparagraph (b) of the definition of premium income estimate in HPS 001.~~

- (ii) tolerances for profitability for each health benefits fund and major product groups; and
 - (iii) the party responsible for monitoring adherence to the pricing philosophy and the party with authority to approve remedial action.
53. The Board must conduct a review of the pricing philosophy at least every two years. The review must be sufficient to reach a view on whether the pricing philosophy is adequate and effective.
54. A private health insurer must provide APRA with a copy of the pricing philosophy within one month following approval by the Board.

Adjustments and exclusions

55. APRA may, by notice in writing to a private health insurer, adjust or exclude a specific requirement in this Prudential Standard in relation to that private health insurer.

Transition

56. On application by a private health insurer, APRA may grant transitional relief from the obligation for the private health insurer to comply with any requirement in this Prudential Standard. Any relief granted by APRA under this paragraph will have effect until no later than 30 June 2025.

Previous discretions

57. A private health insurer must contact APRA if it seeks to place reliance, for the purposes of complying with this Prudential Standard, on a previous exemption or other exercise of discretion made by APRA under a previous Prudential Standard.