Prudential Standard LPS 117

Capital Adequacy: Asset Concentration Risk Charge

Objectives and key requirements of this Prudential Standard

This Prudential Standard requires a life company to maintain adequate capital against the asset concentration risks associated with its activities.

The ultimate responsibility for the prudent management of capital of a life company rests with its board of directors. The board must ensure that the life company maintains an adequate level and quality of capital commensurate with the 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.

The Asset Concentration Risk Charge is the minimum amount of capital required to be held against asset concentration risks. The Asset Concentration Risk Charge relates to the risk of a life company's concentration in particular assets resulting in adverse movements in the life company's capital base.

This Prudential Standard sets out the method for calculating the Asset Concentration Risk Charge. This charge is one of the components of the Standard Method for calculating the prescribed capital amount for life company statutory funds and general funds.

Table of Contents

Authority

1. This Prudential Standard is made under paragraph 230A(1)(a) of the *Life Insurance Act 1995* (the Act).

Application and commencement

2. This Prudential Standard applies to all life companies including **friendly societies** (together referred to as **life companies**) registered under the Act[1], except where expressly noted otherwise.

3. A life company must apply this Prudential Standard separately:

   (a) for a life company other than a friendly society: to each of its statutory funds and its shareholders' fund; and

   (b) for a friendly society: to each of its approved benefit funds and its management fund.

4. This Prudential Standard only applies to the business of an **Eligible Foreign Life Insurance Company** which is carried on through its Australian statutory funds but not otherwise.[2]

5. This Prudential Standard applies to life companies from 1 July 2023.

Interpretation

6. Terms that are defined in *Prudential Standard LPS 001 Definitions* appear in bold the first time they are used in this Prudential Standard.

7. Unless otherwise indicated:

   (a) the term **statutory fund** will be used to refer to a statutory fund of a life company other than a friendly society, or an approved benefit fund of a friendly society, as relevant;

   (b) the term **general fund** is used to refer to the shareholders' fund of a life company other than a friendly society, or the management fund of a friendly society, as relevant;

   (c) the term 'fund' will be used to refer to a statutory fund or a general fund, as relevant; and

   (d) the term 'insurance policy receivables' will be used to refer to premiums and other accounts receivable that have been recognised within the **net life contract liabilities** derived from the insurance and reinsurance contract liabilities and assets reported on the balance sheet under *AASB 17 Insurance Contracts.*

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[1] Refer to subsection 21(1) of the Act.

[2] Refer to section 16ZD of the Act.

8. Eligible Collateral Items are cash, government securities, or debt obligations (i.e. loans, deposits, placements, interest rate securities and other receivables) where the counterparty has a **counterparty grade** of 1, 2 or 3 and there is no currency mismatch between the collateral item and the asset.

9. An affiliated entity of a life company is an overseas parent, an associated company, or a subsidiary company of the life company.

Asset Concentration Risk Charge

10. This Prudential Standard sets out the method for calculating the **Asset Concentration Risk Charge** for a life company's statutory funds and its general fund.

11. The method for calculating the **Asset Risk Charge** is set out in *Prudential Standard LPS 114 Asset Risk Charge* (LPS 114). It is calibrated for funds whose investments in each asset class are well diversified. Additional capital is therefore required if there are excessive concentrations of investments in individual assets or in exposures to single counterparties (or groups of related counterparties).

12. The Asset Concentration Risk Charge is the amount by which the values of individual asset and credit exposures (or groups of related exposures) exceed certain limits. The limits, by type of asset exposure, are set out in Attachment A. Modifications to the limits that apply to **specialist reinsurers** are set out in paragraph 46.

13. The prescribed limits are expressed as percentages of the value of assets of the statutory fund or general fund (VAF), as percentages of the **capital base** of the fund, or as fixed dollar limits.

14. For the purpose of calculating the Asset Concentration Risk Charge in respect of reinsurance assets:

    (a) the value of the reinsurance asset must be its stressed value (determined in accordance with paragraph 17); and

    (b) the prescribed limits use the modified definition of VAF in paragraph 20.

15. Where individual assets are exposed to common risks (e.g. strata titles in the same property, or exposures to a single creditor) their values must be aggregated and the Asset Concentration Risk Charge determined as the amount by which the aggregated value exceeds the relevant limit.

Determining VAF for asset concentration limits that apply to non-reinsurance assets

16. For the purpose of determining the asset concentration limits for non-reinsurance assets, VAF is determined as:

    (a) the sum of the:

(i) total assets of the fund reported in the life company's **statutory accounts**;

(ii) value of adjusted reinsurance assets of the fund; and

(iii) value of insurance policy receivables of the fund; less

(b) the value of insurance and reinsurance contract assets of the fund reported in the life company's statutory accounts.

The value of adjusted reinsurance assets must be determined by calculating the adjusted policy liabilities gross of reinsurance, and deducting the corresponding net of reinsurance values. Where a life company has entered into deferred premiums, deposit backs or funds withheld arrangements, the value of adjusted reinsurance assets must be reduced by the value of assets held in the statutory fund under these arrangements (regardless of whether they meet the requirements for netting under paragraph 28).

Determining the stressed value of a reinsurance asset

17. Reinsurance assets must be valued on a stressed basis for the purpose of determining their asset concentration limits. If a reinsurance asset would increase in value when one or more of the equity, property, credit spreads, currency or default stresses specified in LPS 114 are applied to the fund's other assets, the stressed value of the reinsurance asset must be determined as the greater of the amount determined in accordance with the method described in paragraph 18 (the insurance-stress method) or the amount determined in accordance with the method described in paragraph 19 (the combination-stress method). Otherwise the stressed value of the reinsurance asset must be determined in accordance with the insurance-stress method.

18. The stressed value of a reinsurance asset under the insurance-stress method is the amount by which the stressed policy liabilities determined under *Prudential Standard LPS 115 Insurance Risk Charge* (LPS 115) would increase, if the stressed policy liabilities were determined gross of reinsurance. When determining the stressed policy liabilities gross of reinsurance, the stress margins and diversification factor used to derive the adjusted stress margins must be recalculated.

19. The stressed value of a reinsurance asset under the combination-stress method is the amount by which net of reinsurance stressed policy liabilities determined under a combination asset and insurance stress would increase if they were to be determined gross of reinsurance. The combination stress must be determined by applying equity, property, credit spreads, currency and default stresses simultaneously with adjusted insurance stress margins:

(a) The five asset stresses are as specified in LPS 114 (excluding the default stress that applies to the reinsurance asset) except that they are multiplied by the asset risk diversification factor (ARDF) and the aggregation diversification factor (ADF) that are used in calculating the combined stress scenario adjustment as specified in Attachment B of *Prudential Standard LPS 110 Capital Adequacy*.

(b) The adjusted insurance stress margins are the relevant net or gross of reinsurance adjusted stress margins (as defined in LPS 115) multiplied by the ADF.

(c) Life companies must not recalculate the ARDF based on the five asset stresses included for the combination stress.

(d) Life companies must not recalculate the ADF to account for a different value for the aggregation benefit (either net or gross of reinsurance).

(e) The direction of the currency stress is the same as used in calculating the combined stress scenario adjustment.

(f) For the purposes of this paragraph, the ARDF and ADF must be calculated assuming paragraph 18(b) of LPS 114 does not apply to the reinsurance asset.

Determining VAF for asset concentration limits that apply to reinsurance assets

20. For the purpose of determining the asset concentration limits for reinsurance assets, VAF is determined as in paragraph 16 but with the following modifications:

(a) the stressed value of reinsurance assets is added to VAF in place of the value of adjusted reinsurance assets of the fund; and

(b) VAF excludes assets allocated to support:

(i) participating **traditional business** and participating **unbundled investment business** (gross policy liabilities, policy owners' retained profits, and shareholders' retained profits);

(ii) **non-participating benefits** with entitlement to **discretionary additions** (gross policy liabilities only).

The stressed value of reinsurance assets must be determined in accordance with paragraph 17. For the purposes of paragraph 20(a), where a life company has entered into deferred premiums, deposit backs or funds withheld arrangements, the stressed value of reinsurance assets must be reduced by the value of assets held in the statutory fund under these arrangements (regardless of whether they meet the requirements for netting under paragraph 28).

Exposures

21. All exposures to a reinsurer or reinsurance group are to be considered a single counterparty exposure (for the purposes of applying the relevant limits in Attachment A).

22. Exposures must be the effective exposures of the fund to each asset or counterparty, including both on-balance sheet and off-balance sheet exposures. If collateral or a third party guarantee has been used in place of an asset under LPS 114, the collateral or exposure to the guarantor must also be used in place of the asset for the purposes of this Prudential Standard. If a look-through basis has been used for assets under LPS 114, the same look-through basis must be used for the purposes of this Prudential Standard.

23. Where the fund has a significant cumulative exposure through different classes of assets to a single counterparty or related counterparties, the limit for that counterparty in respect of any particular asset class must be reduced by the lesser of the actual exposure or the exposure limit to that same counterparty in respect of all asset classes with lower limits in Attachment A. This requirement does not apply to the aggregate limits for other reinsurance arrangements specified in paragraph 3 of Attachment A.

24. Where the policy liabilities are in respect of investment-linked benefits linked to the asset or credit exposure in question and there has been full disclosure to policy owners of the risks to which they are exposed, no asset concentration limits apply.

25. Where the asset or credit exposure is in respect of bank bills, bank deposits, bank guarantees or letters of credit issued by a bank, bank for this purpose means:

    (a) an **authorised deposit-taking institution** (ADI); and

    (b) in the case of overseas business, a bank in the same country as that in which the business is written, provided that country has capital requirements in respect of banking business comparable to those determined under the *Banking Act 1959*.

26. The value of an asset can be offset by deferred tax provisions or other liabilities related to the asset, if those provisions/liabilities would be realised if the asset was sold.

27. The value of an asset can be reduced by any amounts that have been treated as deductions from the capital base, as determined under *Prudential Standard LPS 112 Capital Adequacy: Measurement of Capital*.

Netting of reinsurance exposures

28. Subject to paragraphs 29 and 30, assets and liabilities arising from arrangements with a reinsurer may be netted (i.e. taken as a single net exposure) to the extent they are subject to a legally enforceable right of offset in circumstances including the default, liquidation, bankruptcy or winding-up of the life company, the reinsurer or both.

29. Where a life company has entered into deferred premiums, deposit backs and funds withheld arrangements:

    (a) it must set aside assets equal in value to its liabilities to the reinsurer under each arrangement;

(b) the assets must either be held in a custody account established for this purpose or be otherwise identifiable in the books and records of the life company as comprising assets of the statutory fund in respect of which the arrangement applies;

(c) under the terms of the reinsurance contract, assets held in support of such arrangements must be available to satisfy the reinsurer's obligations under the relevant reinsurance contract(s) in the event the reinsurer fails to meet its obligations under the relevant reinsurance contract(s); and

(d) the arrangement should also specify the investment policies and governance arrangements that are to apply in managing the assets set aside under each arrangement and set out whether the arrangement is to be for a set period or until such time as liabilities under the relevant reinsurance contracts have been extinguished.

30. The life company's **Internal Capital Adequacy Assessment Process (ICAAP)** must include systems and controls for monitoring roll-off risk. Roll-off risk is the risk of a sudden material increase in net exposures if short-term liabilities are no longer available to offset longer-term assets.

Treatment of collateral and guarantees as risk mitigants

31. A fund that holds certain types of collateral against an asset, or where the asset has been guaranteed, as a means of reducing risk, may apply a different approach to determining the Asset Concentration Risk Charge for that asset.

Collateral

32. Where a fund possesses eligible collateral against an asset, it may treat the underlying asset as an exposure to the Eligible Collateral Item. This means that the asset is subject to the limits in Attachment A with respect to the collateral, rather than the underlying counterparty.

33. For the purposes of paragraph 32, collateral held against an asset can be recognised to the extent that it takes the form of a registered charge, registered mortgage or other legally enforceable security interest in, or over, an Eligible Collateral Item. The Eligible Collateral Item must also be held for the period for which the asset is held.

34. If the asset is a reinsurance asset, collateral can also be recognised if it satisfies the requirements of paragraphs 35 and 36.

35. For the purposes of paragraph 32, collateral held against a reinsurance asset will be recognised if the following conditions are satisfied:

(a) the collateral must take the form of:

(i) assets held in Australia which form part of a trust fund maintained by a trustee resident in Australia for the benefit of the life company;

(ii) assets held in Australia under the control of a custodian resident in Australia where the assets are held for the benefit of the life company;

(iii) deposits under the control of the life company held by an ADI in Australia; or

(iv) a combination of two or more forms of collateral specified above;

(b) the law of the collateral agreement must be the law of an Australian state or territory and the parties must submit to the exclusive jurisdiction of the Courts therein;

(c) where an agreement provides for arbitration, the seat of arbitration must be a capital city of a state or territory of Australia and the arbitral proceedings must be conducted in accordance with the arbitration law applicable in that jurisdiction;

(d) the assets held under the collateral arrangement must be available for drawdown at any time the life company is satisfied that the reinsurer has failed to make a payment required under the related reinsurance arrangements;

(e) the right of the life company to draw upon the collateral to meet the reinsurer's obligations must be enforceable in the winding-up of the life company regardless of whether or not claims have been paid by the life company;

(f) the collateral must be available to meet the liabilities of the reinsurer under contracts of reinsurance to which the life company and the reinsurer are parties until such time as the obligations of the reinsurer have been discharged under the contracts of reinsurance. It must not be available for distribution to the reinsurer other than where:

(i) the reinsurer has discharged its obligations under the reinsurance contract; or

(ii) the reinsurer requests that excess assets under the collateral arrangement be released and the reinsurance contract provides for such releases.

(g) the collateral arrangement must specify:

(i) the types of Eligible Collateral Items that may be held and apply limits to exposures to particular asset classes (quality and counterparty exposure limits);

(ii) a method for determining the value of assets to be held under the arrangement and must specify how any shortfall or excess is to be dealt with. The Appointed Actuary of the life company must be responsible for determining the value of the reinsured liabilities and any adjustments to the required collateral amount;

(iii) what is to happen to cash flows arising from assets or deposits, including but not limited to interest, dividends and maturity proceeds;

(iv) that where an asset held under the collateral arrangement ceases to be an Eligible Collateral Item, it will no longer be recognised as an Eligible Collateral Item for the purposes of paragraph 32.

36. Where a life company conducts life insurance business in an overseas jurisdiction, collateral with respect to reinsurance of that business held in the overseas jurisdiction may also qualify for the treatment in paragraph 32. It will do so where:

(a) the collateral arrangement is subject to the laws of that jurisdiction;

(b) the seat of arbitration under the arrangement is located in a capital city in that jurisdiction;

(c) any deposits under the arrangement are held for and are under the control of the life company with a bank, as defined in paragraph 25, in that jurisdiction; and

(d) the requirements of paragraph 35 are otherwise met.

37. Where the **fair value** of the collateral does not cover the full value of the asset, the collateral can only replace part of the asset. The remaining portion of the asset must be treated as an exposure to the underlying counterparty.

38. Given a provider of collateral may fail to or not be required to post additional collateral in response to falls in the value of the collateral or, for a collateralised reinsurance asset, increases in the value of the reinsurance asset, a material increase may occur in the Asset Concentration Risk Charge. This risk must be addressed in the life company's ICAAP.

39. If a collateral arrangement includes requirements for the poster of collateral to post additional collateral in response to falls in the value of the collateral or increases in the value of the collateralised asset, the collateral agreement must address the following matters:

(a) the method for determining the initial amount to be held under the collateral arrangement;

(b) the method for adjusting the amount to be held as collateral and the timing of such adjustments;

(c) in the case of a collateralised reinsurance asset, valuation of the asset must be made by the Appointed Actuary of the life company;

(d) the monitoring and reporting of the value of the collateral and the value of the collateralised asset; and

(e) the method for addressing any shortfall or excess between the value of the collateral and the value of the collateralised asset. In the case of a collateralised reinsurance asset, the Appointed Actuary of the life company must be responsible for determining adjustments to the required collateral amount.

Guarantees

40. Where a fund possesses a non-reinsurance asset that has been explicitly, unconditionally and irrevocably guaranteed for its remaining term to maturity by a guarantor with a counterparty rating (or for governments, the long-term foreign currency credit rating) of grade 1, 2 or 3, it may treat the underlying asset as an exposure to the guarantor. This means that the asset is subject to the limits in Attachment A as an exposure to the guarantor, rather than an exposure to the underlying counterparty.

41. Guarantees provided to a fund by the life company's own parent or a **related entity** are not eligible for the treatment provided for in paragraph 40.

42. Where a statutory fund possesses a guarantee or letter of credit in respect of amounts payable by a reinsurer under a reinsurance contract (a reinsurance asset), it may treat the reinsurance asset as an exposure to the guarantor or the issuer of the letter of credit. This means that the asset is subject to the limits in Attachment A with respect to the guarantor or issuer of the letter of credit, rather than the underlying reinsurer. This paragraph applies only if:

(a) the guarantor or issuer of the letter of credit is a bank (as defined in paragraph 25) with a counterparty grade of 1, 2 or 3 and is not the life company's parent entity or a related entity;

(b) the guarantee or letter of credit is explicit, unconditional and irrevocable but may provide for the assignment of a claim under a reinsurance contract to the guarantor where a draw-down occurs under the guarantee or letter of credit in relation to the claim. The guarantor's assigned claim must be subordinate to the claims of the reinsurer's policyholders in the winding up of the reinsurer;

(c) the guarantee or letter of credit (the instrument) must be effective for:

(i) the period of the reinsurance asset; or

(ii) where that is impractical a period of at least three years with the term of the letter of credit or guarantee being extended each year on the anniversary of its commencement (the extension date) for a further term of 12 months until such time as the issuer or the life company serves notice on the other party that the term of the letter of credit or guarantee will not be so extended for a further 12 month period (notice being required to be served on the other party at least 30 days before the extension date);

(d) the guarantee or letter of credit must specify the circumstances, if any, under which the fee charged by the bank can be increased and the maximum fee that can be charged. No adjustment to the fee is to apply should the life company or reinsurer breach its registration conditions or an external manager be appointed to either the life company or the reinsurer;

(e) the guarantor or issuer of the letter of credit is obliged to pay the statutory fund in Australia;

(f) the guarantee or letter of credit must specify the reinsurance arrangements (the relevant reinsurance contracts) between the life company and the reinsurer to which the guarantee relates;

(g) the guarantee or letter of credit must provide that in the event of the reinsurer being subject to external administration (including through the appointment of a liquidator, provisional liquidator, a judicial manager or a statutory manager), the guarantor or the issuer of the letter of credit must pay the life company an amount not less than the discounted present value of reinsurance claims incurred but not yet paid and unearned reinsurance premiums, but subject to a limit of the face amount of the guarantee or letter of credit (less any prior draw-downs);

(h) the guarantee or letter of credit must specify the statutory fund of the life company in respect of which the guarantee or letter of credit is to apply;

(i) the guarantee or letter of credit must allow draw-downs until such time as the guarantee or letter of credit is exhausted;

(j) the guarantee or letter of credit must specify the date it commences and the date it expires;

(k) the guarantor or issuer of the letter of credit must be required to make payments to a nominated account of the life company with a bank as defined in paragraph 25. The nominated bank account must be used exclusively for money that constitutes assets of the statutory fund;

(l) upon presentation by the life company of a notice to the guarantor or issuer of the letter of credit specifying that an amount is due and payable under one or more specified contracts of reinsurance and has not been paid, the guarantor or issuer of the letter of credit is required to pay the amount due to the life company without further enquiry and within five business days;

(m) a pro forma sight draft must be attached to the letter of credit or the guarantee which sets out the wording to be used by the life company in making a demand under the arrangement (which must include a reference to the non-payment of an amount due under the relevant reinsurance contracts covered under the arrangement).

Limitation on recognition of risk mitigants

43. Where a statutory fund has a reinsurance arrangement with a reinsurer that is not a registered life company, a maximum of 50% of the stressed reinsurance assets held in respect of that reinsurer (after applying netting according to paragraph 28) can be treated as an exposure to eligible collateral, guarantors or issuers of letters of credit. If APRA is of the view that the stressed reinsurance assets do not adequately reflect a fund's overall risk exposure to reinsurers that are not registered life companies, APRA may, in writing, adjust the asset concentration risk charge calculation for that fund. If such an adjustment is applied to a fund under this paragraph, a life company must comply with the adjusted calculation. Such an adjustment could be made to a fund whose stressed reinsurance assets are reduced through the use of netting arrangements.

44. Where a statutory fund has a reinsurance arrangement with a reinsurer that is:

    (a) an affiliated entity of the life company that APRA has approved for the purposes of item 1(g) of Attachment A; or

    (b) an overseas parent, associated, or subsidiary company which, with APRA's agreement, has been identified as an appropriate retrocessionaire for the purposes of paragraph 46;

    if APRA is of the view that there are prudential reasons for doing so, APRA may, in writing, waive the requirements of paragraph 43 and determine an alternative maximum percentage of the stressed reinsurance assets held in respect of that reinsurer (after applying netting according to paragraph 28) that can be treated as an exposure to eligible collateral, guarantors or issuer of letters of credit.

APRA-specified treatment of risk mitigants

45. APRA may require a life company to apply a specified treatment to reinsurance assets supported by collateral, guarantees or letters of credit, rather than the treatment that would otherwise apply under paragraphs 31 to 42.

Specialist reinsurers

46. In the case of a specialist reinsurer, the following asset concentration limits apply in respect of retrocessions by that specialist reinsurer to an overseas parent, associated, or subsidiary company which, with APRA's agreement, has been identified as an appropriate retrocessionaire for the purposes of this paragraph:

    (a) where the retrocessionaire has a current counterparty grade of 1, 2 or 3 – 50 per cent of VAF;

    (b) where the retrocessionaire does not have a current counterparty grade of 1, 2 or 3, but had such a grade at the time the retrocession arrangement was entered into;

(i) within the first three months after the downgrade below Grade 3 – 50 per cent of VAF;

(ii) within the next nine months – 33 per cent of VAF;

(iii) within the second 12 months after the downgrade – 17 per cent of VAF; and

(iv) thereafter, the retrocession arrangements do not qualify for the concessional treatment afforded to specialist reinsurers;

(c) in all other circumstances, the retrocession arrangements do not qualify for the concessional treatment afforded to specialist reinsurers.

47. Item 1(g) of Attachment A does not apply to a specialist reinsurer.

Adjustments and exclusions

48. APRA may, by notice in writing to a life company, adjust or exclude a specific requirement in this Prudential Standard in relation to that life company.

Transition

49. On application by a life company, APRA may grant transitional relief from the obligation for the life company to comply with any requirement in this Prudential Standard. Any relief granted by APRA under this paragraph will have effect until no later than two years after the commencement date of this standard.

Attachment A - Asset exposure limits

1. The limits by type of asset exposure are:

	Asset exposure	**Limit**
(a)	Assets guaranteed by an Australian State or Federal government or by the national government of the country in whose currency the liabilities of the statutory fund or general fund are denominated:	No limit
(b)	A life insurance policy issued to the life company by a registered life company which is a related entity of the life company:	No limit
(c)	Bank bills, bank guarantees and letters of credit issued by a bank; or Assets guaranteed by an overseas provincial government (equivalent in status to an Australian State government), in the country in whose currency the liabilities of a statutory fund or a general fund are denominated:	The greater of: i) 25% of VAF; and ii) AUD 22 million.
(d)	Bank deposits	The greatest of: i) 50% of VAF less the value of the assets of the fund secured by bank bills, bank guarantees and letters of credit issued by a bank; ii) 25% of VAF; and iii) AUD 22 million.
(e)	A reinsurance arrangement with a registered life company with a counterparty grade of 1, 2 or 3 that is not a related entity of the life company; or With APRA's written approval, a reinsurance arrangement in respect of overseas business, with a related entity with a counterparty grade of 1, 2 or 3 of a registered life company that has a statutory fund which is a specialist reinsurer:	The greatest of: i) 25% of VAF; ii) 125% of capital base; and iii) AUD 22 million.

(f)	Outstanding premiums receivable by a reinsurer under a reinsurance policy with a registered life company with a counterparty grade of 1, 2 or 3:	The greatest of: i) 25% of VAF; ii) 125% of capital base; and iii) AUD 22 million.
(g)	A reinsurance arrangement with an APRA approved affiliated entity of the life company that is not a registered life company, where the related entity has a counterparty grade of 1, 2 or 3:	The greater of: i) 12.5% of VAF; and ii) 62.5% of capital base.
(h)	i) any other actively traded security; ii) a non-traded security, loan, or reinsurance arrangement with a counterparty grade of 1, 2 or 3; iii) real estate; or iv) other income producing real property asset:	The greater of: i) 5% of VAF; and ii) 25% of capital base.
(i)	Any asset not covered by any of the above categories:	The greater of: i) 2.5% of VAF; and ii) 12.5% of capital base.

2. For reinsurance arrangements that were included in item (e) or (g) at the time the reinsurance arrangement was entered into but which no longer have a counterparty grade of 1, 2 or 3:

   (a) within the first 3 months of the downgrade below Grade 3 the arrangement continues to have the limit specified in (e) or (g);

   (b) within the next 9 months the limit specified in (e) or (g) is reduced by 34 per cent;

   (c) within the second 12 months after the downgrade the limit specified in (e) or (g) is reduced by 66 per cent;

   (d) thereafter, the reinsurance arrangement is included in item (i).

3. For reinsurance arrangements included in items (g), (h) and (i) which are not with a registered life company or appropriate retrocessionaire, an aggregate limit for all such arrangements applies, equal to the greater of:

   (a) 12.5 per cent of VAF; and

   (b) 62.5 per cent of capital base.

To avoid double counting of excess exposures, for the purposes of this paragraph the asset value for each reinsurance arrangement is subject to a maximum of the individual limit for the arrangement.

If the asset value of a reinsurance arrangement is negative it must not be included in the aggregate value.

4. For the purpose of calculating the Asset Risk Charge according to LPS 114, any Asset Concentration Risk Charge that results from applying the aggregate limit must be allocated across reinsurance arrangements which are not with a registered life company or appropriate retrocessionaire in proportion to the exposure amount for the arrangement that is being assessed against the aggregate limit.