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Health Insurance (prudential standard) determination No. 2 of 2015

Prudential Standard HPS 100 Solvency Standard

Private Health Insurance (Prudential Supervision) Act 2015

I, [*insert name of delegate*], delegate of APRA under subsection 91(1) of the *Private Health Insurance (Prudential Supervision) Act 2015* (the Act) DETERMINE *Prudential Standard HPS 100 Solvency Standard*, in the form set out in the Schedule, which applies to all private health insurers.

This instrument takes effect on 1 July 2015.

Dated: xx June 2015

[To be signed]

Interpretation

In this Determination:

APRA means the Australian Prudential Regulation Authority.

Private health insurer has the meaning given in the section 4 of the Act.

Schedule

Prudential Standard HPS 100 Solvency Standard comprises the 5 pages commencing on the following page.

Prudential Standard HPS 100

Solvency Standard

Objective and key requirements of this Prudential Standard

The purpose of this Prudential Standard is to ensure as far as practicable that at any time the financial position of a health benefits fund conducted by a private health insurer is such that the private health insurer will be able to meet, out of the fund's assets, all liabilities that are referrable to the fund, as those liabilities become due.

This Prudential Standard requires the private health insurer to demonstrate that it will be able to meet the liabilities of its health benefits fund, allowing for adverse circumstances.

A central pillar of a private health insurer's financial strength is that the assets of a health benefits fund are sufficiently liquid to meet its cash demands and unanticipated losses from its activities.

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

This Prudential Standard is satisfied in relation to a health benefits fund if:

- the value of the cash of its health benefits fund is not less than the sum of the cash management amount, plus any solvency supervisory adjustment amount; and

- A private health insurer has, and complies with, a board endorsed, liquidity management plan for each health benefits fund it conducts, and ensures that the plan has been designed with regard to the important factors included in this Prudential Standard, and is reviewed at least every two years.

Authority

1. This Prudential Standard is made under subsection 91(1) of the *Private Health Insurance (Prudential Supervision) Act 2015* (the Act).

Application

2. This Prudential Standard applies to all **private health insurers**[1], except where expressly noted otherwise.

3. A private health insurer must apply this Prudential Standard separately to each of its health benefits funds.

4. This Prudential Standard applies to private health insurers from 1 July 2015.

Interpretation

5. Terms that are defined in *Prudential Standard HPS 001 Definitions* 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.

7. Unless otherwise indicated, the term **health benefits fund** will be used to refer to a health benefits fund of a private health insurer, as relevant.

The role of the board

8. The **board** of a private health insurer must ensure that the private health insurer is compliant with this Prudential Standard.

Solvency requirement

9. The private health insurer must ensure that, at all times, the value of the cash of its health benefits fund is not less than the sum of the **cash management amount**, plus any **solvency supervisory adjustment amount** as defined in this Prudential Standard.

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.

[1] Refer to subsection 91(1) of the Act.

12. A private health insurer must have, and comply with, a board endorsed, liquidity management plan for each health benefits fund it conducts. The liquidity management plan must be designed to enable the health benefits fund to continue to comply with the solvency requirements set out in this section, including by setting minimum liquidity requirements and management action triggers, to ensure compliance.

13. When a board of a private health insurer endorses a liquidity management plan it must ensure that the plan has been designed with regard to:

    (a) the extent to which the assets of the health benefits fund could be readily converted to cash under stressed market conditions;

    (b) the concentration of exposures to related counterparties for the assets which may be required to be converted to cash under stressed market conditions;

    (c) the seasonality and variability in cash flows;

    (d) the potential size of cash outflows under stressed business conditions;

    (e) the potential that the health benefits fund may have to draw down its cash to repay borrowings; and

    (f) any other matter the board of the private health insurer considers relevant.

14. The board must review the liquidity management plan at least every two years and either:

    (a) re-endorse the existing liquidity management plan; or

    (b) endorse a new liquidity management plan.

Cash management amount

15. The cash management amount of a health benefits fund is the greater of:

    (a) the stressed net cash outflow amount defined in paragraph 16 of this Prudential Standard plus 1 per cent of the health business revenue estimate; and

    (b) 1 per cent of the health business revenue estimate.

16. Stressed net cash outflow amount of a health benefits fund means the 98th percentile estimate of the net cash outflows for a 30 day period from the **relevant day**, where:

    (a) net cash outflow means the cash outflows from the health benefits fund less cash inflows to the health benefits fund; and

    (b) cash outflows are limited to cash payments required to meet all liabilities that are, or might become, **referable** to the health benefits fund; and

(c) cash inflows represent cash receipts arising from:

(i) premiums payable under policies of insurance that are referable to the fund;

(ii) income from the investment of assets of the fund held on the relevant day including amounts receivable on maturity and excluding revenues from the sale of assets, except where a binding agreement for the sale has been entered into prior to the relevant day; and

(iii) any other money due to be received by the insurer in connection with its conduct of the business of the fund.

Solvency supervisory adjustment amount

17. The solvency supervisory adjustment amount of a health benefits fund, on the relevant day, is:

(a) an amount expressed in dollars;

(b) a percentage figure;

(c) a factor;

(d) an amount, or a description of an amount, derived through another basis for calculating the solvency supervisory adjustment amount; or

(e) a methodology to be applied that will result in an amount;

which is not less than 0, and would not result in a negative amount, determined by APRA, upon reasonable grounds.

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

(a) the health benefits fund's cash management amount does not make adequate allowance for inherent uncertainty;

(b) the health benefits fund's cash has not been classified appropriately;

(c) the private health insurer conducting the health benefits fund does not have adequate data to assess the risks of the fund; and/or

(d) 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.

19. If APRA is satisfied that there are reasonable grounds to make a determination of a solvency supervisory adjustment amount in relation to the health benefits

fund, APRA must, as soon as practicable after making the determination, notify the private health insurer, in writing, of:

(a) the amount, factor, figure or methodology determined; and

(b) the reasons for the decision to make a determination.

Notification requirements

20. Under section 94 of the Act, 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 health benefits funds.

Transition arrangements

21. Any approval, determination or other exercise of discretion by PHIAC under Schedule 2 – Solvency 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 solvency supervisory adjustment amount determined by PHIAC under section 6 of the PHIAC solvency standard, and in force immediately before 1 July 2015, continues in effect as if determined under paragraph 17 of this Prudential Standard.

Adjustments and exclusions

22. 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.