Prudential Standard GPS 115

Capital Adequacy: Insurance Risk Charge

Objective and key requirements of this Prudential Standard

This Prudential Standard aims to ensure that general insurers and Level 2 insurance groups maintain adequate capital against the insurance risks associated with their activities. This Prudential Standard forms part of a comprehensive set of prudential standards that deal with the measurement of the capital adequacy of a general insurer and a Level 2 insurance group.

This Prudential Standard applies to all general insurers and Level 2 insurance groups.

The Insurance Risk Charge is the minimum amount of capital required to be held against insurance risks. The Insurance Risk Charge relates to the risk that the value of the net insurance liabilities is greater than the value determined by the Appointed Actuary.

This Prudential Standard sets out the method for calculating the Insurance Risk Charge. This charge is one of the components of the Standard Method for calculating the Prudential Capital Requirement for general insurers and Level 2 insurance groups.

Authority

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

Application

2. This Prudential Standard applies to each:

   (a) **general insurer** authorised under the Act (**insurer**); and

   (b) **Level 2 insurance group** as defined in *Prudential Standard GPS 001 Definitions* (**GPS 001**).

   Where a requirement is made in respect of a Level 2 insurance group, the requirement is imposed on the **parent entity** of the Level 2 insurance group.

3. Subject to any specific transition rules, this Prudential Standard applies to insurers and Level 2 insurance groups (**regulated institutions**) from 1 January 2013 (effective date).

Interpretation

4. Unless otherwise defined in this Prudential Standard, expressions in bold are defined in GPS 001.

Insurance Risk Charge

5. This Prudential Standard sets out the method for calculating the **Insurance Risk Charge** for a regulated institution using the **Standard Method** to determine its **prescribed capital amount**.

6. The Insurance Risk Charge relates to the risk that the value of net insurance liabilities is greater than the value determined in accordance with *Prudential Standard GPS 320 Actuarial and Related Matters* (**GPS 320**). It has two components:

   (a) a risk charge in respect of Outstanding Claims Risk; and

   (b) a risk charge in respect of Premiums Liability Risk.

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

Outstanding Claims Risk

7. The risk charge for Outstanding Claims Risk relates to the risk that the value of the net outstanding claims liabilities is greater than the value determined in accordance with GPS 320.

8. For the purposes of the Standard Method, the risk charge for each **class of business** is calculated by multiplying the net outstanding claims liabilities for

that class (as determined in accordance with GPS 320) by the relevant Outstanding Claim**s** Risk Capital Factor in Attachment A. The total risk charge for outstanding claims risk is the sum of the risk charges for each class of business.

Premiums Liability Risk

9. The risk charge for Premiums Liability Risk relates to the risk that the value of the net premiums liabilities is greater than the value determined in accordance with GPS 320. It also relates to the risk that **material net written premium** will be insufficient to fund the liabilities arising from that business.

10. For the purposes of the Standard Method, the risk charge for each class of business is calculated by multiplying the sum of:

    (a) net premiums liabilities as determined in accordance with GPS 320; and

    (b) material net written premiums

    by the relevant Premiums Liability Risk Capital Factor in Attachment A. The total risk charge for Premiums Liability Risk is the sum of the risk charges for Premiums Liability Risk for each class of business.

Classes of business

11. For the purposes of the Outstanding Claims Risk Capital Factor and Premiums Liability Risk Capital Factor, all but the **'other' direct class of business**[1] and **'**other' **reinsurance class of business** have been classified into different categories in Attachment A (Table 1 and Table 2 respectively). The 'other' class of business must be allocated to a category by the Appointed Actuary, in accordance with paragraph 12.

12. For the purpose of calculating the Insurance Risk Charge in respect of any 'other' business (whether it is direct business or reinsuance), the Appointed Actuary or Group Actuary (as appropriate) is required to determine the most appropriate category (i.e. category A, B or C) in Table 1 and Table 2 of Attachment A. The choice must be based on the underlying risk characteristics of the business being written. The regulated institution must then apply the corresponding Outstanding Claims Risk Capital Factor and Premiums Liability Risk Capital Factor listed in Attachment A in determining the Insurance Risk Charge.

13. If the 'other' class of business includes multiple risks with differing risk profiles, the Appointed Actuary or Group Actuary (as appropriate) may subdivide the net outstanding claims liabilities, net premiums liabilities and material net written premiums into more than one category.

14. The reasons for selecting the specific risk category or categories to which the 'other' class of business is assigned must be documented in the **Insurance Liability Valuation Report**.

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[1] The other class of business is as defined in paragraph 1(k) of Attachment B of GPS 001.

Business covering multiple classes

15. Where a regulated institution underwrites an inwards reinsurance contract which spans multiple 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 on a pro rata basis to each of the relevant categories; or

    (b) allocate the contract to the category which represents the greatest exposure; or

    (c) allocate the contract to the category representing the greatest premium income.

Securitisation

16. If a regulated institution securitises insurance liabilities, the net insurance liabilities may reduce. The regulated institution must consult APRA prior to entering into the securitisation transaction in order to be able to reduce the Insurance Risk Charge.

Adjustments and exclusions

17. APRA may, by notice in writing to a regulated institution, adjust or exclude a specific requirement in this Prudential Standard in relation to that regulated institution.

Transition

18. On application by a regulated institution, APRA may grant transitional relief from the obligation for the regulated institution to comply with any requirement in this Prudential Standard up until 31 December 2014.

Attachment A

Table 1: Direct insurance business

Category	Class of business	Outstanding Claims Risk Capital Factor	Premiums Liability Risk Capital Factor
A	Householders Commercial Motor Domestic Motor	9.0%	13.5%
B	Travel Fire and ISR Marine and Aviation Consumer Credit Other Accident	11.0%	16.5%
C	Mortgage CTP Public and Product Liability Professional Indemnity Employers' Liability	14.0%	21.0%

Table 2: Inwards reinsurance business

Category	Class of business	Reinsurance type	Outstanding Claims Risk Capital Factor	Premiums Liability Risk Capital Factor
A	Householders Commercial Motor Domestic Motor	Proportional	10.0%	15.0%
		Non-proportional	12.0%	18.0%
B	Travel Fire and ISR Marine and Aviation Consumer Credit Other Accident	Proportional	12.0%	18.0%
		Non-proportional	14.0%	21.0%
C	Mortgage CTP Public and Product Liability Professional Indemnity Employers' Liability	Proportional	15.0%	22.5%
		Non-proportional	17.0%	25.5%