



Prudential Standard GPS 118

Capital Adequacy: Operational Risk Charge

Objectives 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 operational 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 Operational Risk Charge is the minimum amount of capital required to be held against operational risks. The Operational Risk Charge relates to the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

This Prudential Standard sets out the method for calculating the Operational 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.

Operational Risk Charge

5. This Prudential Standard sets out the method for calculating the **Operational Risk Charge** for a regulated institution using the **Standard Method** to determine its **prescribed capital amount**.
6. The Operational Risk Charge is the minimum amount of capital a regulated institution must hold against the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

Calculation of the Operational Risk Charge

7. The Operational Risk Charge for a regulated institution is calculated as the sum of:
 - (a) the Operational Risk Charge for inwards reinsurance business (**ORCI**) defined in paragraph 9; and
 - (b) the Operational Risk Charge for business that is not inwards reinsurance business (**ORCNI**) defined in paragraph 10.

The Operational Risk Charge for a Level 2 insurance group is calculated after consolidation of intra-group exposures.

8. For the purposes of paragraphs 9 and 10:
- (a) GP_1 is written premium revenue (gross of reinsurance) for the 12 months ending on the **reporting date**;
 - (b) GP_0 is written premium revenue (gross of reinsurance) for the 12 months ending on the date 12 months prior to the reporting date;
 - (c) Written premium revenue includes fire services levy, other levies imposed by state and territory governments, and revenue relating to portfolio transfers and unclosed business;
 - (d) NL is the central estimate of insurance liabilities (net of reinsurance) at the reporting date;
 - (e) $|GP_1 - GP_0|$ is the absolute value of the difference between GP_1 and GP_0 .

All of the values determined under this paragraph should correspond to the value in the regulated institution's **statutory accounts**.

9. The ORCI is calculated as follows:

$$\text{ORCI} = 2\% \times \{\text{maximum}(GP_1, NL) + \text{maximum}(0, |GP_1 - GP_0| - 0.2 \times GP_0)\}$$

10. The ORCNI is calculated as follows:

$$\text{ORCNI} = 3\% \times \{\text{maximum}(GP_1, NL) + \text{maximum}(0, |GP_1 - GP_0| - 0.2 \times GP_0)\}$$

Adjustments and exclusions

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

Transition

12. 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.