



# Prudential Standard LPS 001

## Definitions

### **Objectives and key requirements of this Prudential Standard**

This Prudential Standard defines key terms referred to in other prudential standards applicable to life companies. All prudential standards applicable to life companies must be read in conjunction with this Prudential Standard.

## Authority

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

## Application

2. This Prudential Standard commences on 1 July ~~2019~~2023.
3. Unless the contrary intention appears, definitions in this Prudential Standard apply to all prudential standards made under paragraph 230A(1)(a) of the Act (collectively 'LI Prudential Standards').

## Definitions

4. Key terms referred to in the LI Prudential Standards are defined as follows:

**AASB** means Australian Accounting Standards Board.

**Acquisition expenses** means the fixed and variable expenses of a life company to the extent they are, either directly or indirectly, referable to those activities of the company related to the acquiring of that new business expected to derive from the expenditure.

~~**Acquisition expense recovery carrier** means a financially measurable indicator of the element of a related product group designed or intended to recover acquisition expenses.~~

~~**Acquisition expense recovery component** means a uniform margin of an acquisition expense recovery carrier, determined in accordance with *Prudential Standard LPS 340 Valuation of Policy Liabilities (LPS 340)*.~~

**Actuarial Valuation Report (AVR)** is as defined in *Prudential Standard CPS 320 Actuarial and Related Matters (CPS 320)*.

**Actuary** means an actuary appointed under section 93 of the Act.

**Additional Tier 1 Capital** is as defined in *Prudential Standard LPS 112 Capital Adequacy: Measurement of Capital (LPS 112)*.

**Adequacy threshold** is the minimum value for ~~profit margins expected future profits of a subcategory<sup>1</sup> of a related product group~~ under LPS 340 - i.e. it is the level at which losses must be recognised.

**Adjusted policy liabilities** means the liabilities to policy owners as defined for the purpose of determining the capital base of a statutory fund in LPS 112.

**APRA product groups** means the product groups listed and defined in *Reporting Standard LRS 001 Reporting Requirements*. The product groups are to be used for the purpose of completing the information required under *Reporting Standard*

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<sup>1</sup> Subcategory is defined in the Act.

~~*LRS 200.0 Capital Adequacy Supplementary Information. a list of product groups applicable when completing the required information under Reporting Standard LRS 200.0 Capital Adequacy Supplementary Information. The product groups are listed and defined in Reporting Standard LRS 001 Reporting Requirements.*~~

**Appointed Actuary** means an actuary appointed under section 93 of the Act.

**Approved benefit funds** refers to friendly society benefit funds approved by APRA according to the provisions of *Prudential Standard LPS 700 Friendly Society Benefit Funds* (LPS 700) and the Act.

**Asset Concentration Risk Charge** means the risk charge determined under *Prudential Standard LPS 117 Capital Adequacy: Asset Concentration Risk Charge*.

**Asset Risk Charge** means the risk charge determined under *Prudential Standard LPS 114 Capital Adequacy: Asset Risk Charge*.

**Associate** means an associate as defined under *Australian Accounting Standard AASB 128 Investments in Associates and Joint Ventures*.

**Auditing and Assurance Standards** is a reference to the Auditing and Assurance Standards issued by the Auditing and Assurance Standards Board (AUASB) as may be amended from time to time.

**Australian Accounting Standards** is a reference to the Australian Accounting Standards issued by the ~~Australian Accounting Standards Board (AASB)~~ as may be amended from time to time.

**Authorised deposit-taking institution (ADI)** means a deposit-taking institution authorised by APRA under the *Banking Act 1959* (Banking Act). It includes foreign ADIs as defined in the Banking Act.

**Best estimate assumptions** means assumptions about future experience determined in accordance with LPS 340.

**Best estimate bonus** refers to the maximum level of **bonus** which (on best estimate assumptions and taking into account a life company's profit distribution philosophy, including shareholder entitlements) can be added to a **participating benefit** over its benefit life without supplementary income from other sources, including policy owner retained profits.

**Best estimate discretionary addition** means the level of **discretionary addition** which (on best estimate assumptions and taking into account a life company's crediting philosophy) can be added to a **non-participating benefit** over its benefit life without supplementary income from other sources, including policy owner retained profits.

**Best estimate liability** is calculated in accordance with LPS 340 and refers to the amount expected on best estimate assumptions to be required to the end of the benefit period to meet future benefits and expenses related to past transactions for the business in force. The calculation process will take into account all factors

which are known to be material, including future investment earnings, taxation, any options under the policies and future premiums, where relevant to the calculation.

**Best estimate shareholder profit** refers to the maximum level of **shareholder profit** which (on best estimate assumptions and taking into account a life company's profit distribution philosophy, including policy owner entitlements) can be attributed to shareholders without supplementary income from other sources, including shareholders' retained profits.

**Board** means the Board of directors and includes, for an **Eligible Foreign Life Insurance Company**, the Compliance Committee as required under subsection 16ZF(4) of the Act.

**Bonus** means an amount of profit added at the discretion of a life company (including additions in respect of investment experience) to the benefits due under a participating benefit, but excluding any guaranteed rate of addition also applicable to the benefit.

**Business plan** refers to a written business plan as part of a life company's **risk management framework** as required under *Prudential Standard CPS 220 Risk Management* (CPS 220).

**Capital adequacy standards** collectively refers to all prudential standards relating to the capital adequacy of life companies and falls within the meaning of prudential standards in relation to capital adequacy referred to under the Act.

**Capital base** is as defined in LPS 112.

**Commencement** means the time from which a life company is at risk under a policy and is the point from which profit margins or acquisition expense recovery components are, or would be, first determined.

**Common Equity Tier 1 Capital** is as defined in LPS 112.

**Corporate group** is a group of entities comprising two or more companies that are related bodies corporate within the meaning of section 50 of the *Corporations Act 2001*.

**Corporations Act** refers to the *Corporations Act 2001*.

**Counterparty grade** means the counterparty grade of an investment set out under the first column of Table 1 and Table 2 in Attachment A, which maps these grades to the equivalent Standard and Poor's, Moody's, AM Best and Fitch rating grades.

**Current termination value** refers to the **termination value** of a policy at the reporting date.

**Defined benefit fund** is as defined in LPS 700.

**Defined contribution fund** is as defined in LPS 700.

**Discretionary addition** means an amount added to a non-participating benefit, at the discretion of a life company, to reflect the investment experience of the assets backing the benefit, but excluding any guaranteed rate of addition also applicable to the benefit. For this definition an amount added to a benefit is defined to mean any change to the previously applying contractual conditions that is beneficial to the policy owner.

**Discretionary participation feature** means a contractual right to receive, as a supplement to guaranteed benefits, additional benefits:

- (a) that are likely to be a significant portion of the total contractual benefits;
- (b) whose amount or timing is contractually at the discretion of the issuer; and
- (c) that are contractually based on:
  - (i) the performance of a specified pool of contracts or a specified type of contract;
  - (ii) realised and/or unrealised investment returns on a specified pool of assets held by the issuer; or
  - (iii) the profit or loss of the company, fund or other entity that issues the contract.

A policy with a discretionary participation feature can provide benefits that are either participating benefits or non-participating benefits.

**Education bond business** means a form of **unbundled investment business** where the policies provide for the payment of a benefit ~~that is not investment-linked and is~~ for the specific purpose of contributing towards the expenses of, and incidental to, the education of the beneficiary.

**Eligible Foreign Life Insurance Company** has the meaning given in section 16ZD of the Act.

**Ensure** when used in relation to a responsibility of the board, means to take all reasonable steps and make all reasonable enquiries as are appropriate for a board so that the board can determine, to the best of its knowledge, that the stated matter has been properly addressed.

**Establishment fee** is a fee received at the commencement of a policy which is intended to, at least partially, cover acquisition expenses. It does not include contingent entitlement to exit fees or surrender penalties.

**Expense category** refers to a grouping of expenses directly or indirectly referable to life business. For the purposes of prudential standards, three categories of expense are defined: acquisition expenses, **maintenance expenses** and **investment management expenses**.

**Expense driver** means a quantifiable measure in relation to which the relevant expenses of a life company are expected to vary.

**Experience profit** means the profit arising in a period from the difference between actual experience during that period and expected experience on the basis of best estimate assumptions at the beginning of the period.

**Fair value** has the same meaning as it does in the Australian Accounting Standards and refers to the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

**Financial Condition Report** means a report on the financial condition of a life company by its Appointed Actuary to meet the requirements of CPS 320.

**Financial instrument element** means the activities and associated cash flows of a **life investment contract** that relate directly to the establishment of a financial asset or financial liability.

**Financial risk** refers to the risk of a possible future change in one or more specified economic variables - a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, a credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract.

**Fixed term/rate business** means policies which provide for guaranteed investment returns at a disclosed rate for a specified period. The guaranteed returns may be paid in the form of income or as capital at maturity. The specified period of the guarantee may be the full term of the policy, or may be to an interim point at which the option exists to 'roll' the policy for a further specified period at a new guaranteed return.

**Friendly society** has the meaning given in section 16C of the Act.

**Funeral bond business** means policies providing continuous insurance against the contingency of death on terms and conditions agreed at the commencement of the policy, where:

- (a) the primary purpose of the benefit is to meet the expenses of and incidental to the funeral of the policy owner, their spouse or children; and
- (b) the amount of the benefit (excluding any entitlement to bonus) is no greater than \$15,000.

**General fund** means the management fund for a friendly society or the shareholders' fund for a life company other than a friendly society.

**Gross policy liability** is as defined in LPS 340.

**ICAAP summary statement** is as described in LPS 110.

**ICAAP report** is as described in LPS 110.

**Illiquidity premium** is as defined in LPS 112.

**Immediate life annuity** is an annuity that is not unbundled investment business and is not a variable annuity, where the next annuity payment is due within 12 months and payments continue until the death of the life insured. This includes deferred annuities that have commenced payment.

**Insurance contract** means a contract under which one party (the insurer) accepts significant insurance risk from another party (the policy owner) by agreeing to compensate the policy owner if a specified uncertain future event (the insured event) adversely affects the policy owner.

**Insurance risk** refers to risk, other than financial risk, transferred from the holder of a contract to the issuer.

**Insurance Risk Charge** means the risk charge determined under *Prudential Standard LPS 115 Capital Adequacy: Insurance Risk Charge* (LPS 115).

**Internal Capital Adequacy Assessment Process** is as described in *Prudential Standard LPS 110 Capital Adequacy* (LPS 110).

**Investment account benefit** has the meaning given in the Dictionary to the Act.

**Investment account contract** has the meaning given in the Dictionary to the Act.

**Investment fluctuation reserve** means a reserve used for smoothing discretionary additions for non-participating benefits. For the purpose of the capital adequacy standards the investment fluctuation reserve is defined to be the difference between the value of the assets administered for the purpose of a subcategory and the aggregate value of the accounts under the policies belonging to that subcategory.

**Investment management expenses** means the fixed and variable expenses of a life company to the extent they are, either directly or indirectly, referable to managing the company's investment portfolio.

**Investment performance guarantee** means an investment performance guarantee in accordance with section 42 of the Act.

**Investment-linked benefit** has the meaning given in the Dictionary to the Act.

**Investment-linked contract** has the meaning given in the Dictionary to the Act.

**Life business** has the meaning given in the Dictionary to the Act.

**Life company** has the meaning given in the Dictionary to the Act.

**Life insurance contract** means an insurance contract or a financial instrument with a discretionary participation feature which is regulated under the Act.

**Life investment contract** means a contract other than a life insurance contract which is regulated under the Act.

~~**Life investment contract liability** is as defined in LPS 340.~~

**Long term risk business** refers to policies providing continuous insurance against the contingency of death, other than solely by accident, on terms and conditions agreed at the commencement of the policy, where:

- (a) a level premium is paid through the term of the policy;
- (b) the term of the policy is:
  - (i) greater than or equal to 15 years; and
  - (ii) such that the life insured is aged greater than 70 at the expiry of that term; and
- (c) the amount of insurance (excluding any entitlement to bonus) is greater than \$15,000.

**Maintenance expenses** means the fixed and variable expenses of a life company to the extent they are, either directly or indirectly, associated with:

- (a) the company's administration of policies subsequent to their sale, including policies subject to claim; and
- (b) the general operations, including maintenance of the overall health, of the company.

Maintenance expenses include all operating costs and expenses other than acquisition expenses and investment management expenses.

~~**Management services element** means all activities and cashflows arising from the full range of management services provided under a life investment contract, including investment management, financial planning and advice. This will equal all the activities and cashflows of the life investment contract excluding those in respect of the financial instrument element.~~

**Minimum paid-up value** is as defined in *Prudential Standard LPS 360 Termination Values, Minimum Surrender Values and Paid-up Values* (LPS 360).

**Minimum surrender value** is as defined in LPS 360.

**Minimum termination value** is as defined in LPS 360.

~~**Net life contract liabilities** equals the sum of the insurance, reinsurance and investment contract liabilities (net of insurance and reinsurance assets) disclosed in the statutory accounts.~~

~~**Net policy liability** means the policy liability calculated after allowing for outward reinsurance premiums as an expense and reinsurance recoveries as income.~~

**Non-operating holding company (NOHC)** has the same meaning as in the Dictionary of the Act.



**Non-participating benefit** has the meaning given in section 15 of the Act.

**Operating profit** has the same meaning as in section 58 of the Act.

**Operational Risk Charge** is the risk charge determined under *Prudential Standard LPS 118 Capital Adequacy: Operational Risk Charge*.

**Other liability** refers to a liability according to general accounting concepts, other than a policy liability or a liability in respect of an instrument that is eligible to be included in the capital base.

**Participating benefit** has the same meaning as in section 15 of the Act.

**Participating policy liability** is as defined in LPS 112.

**Policy liability** ~~has the same meaning as in the Dictionary to the Act. refers to a liability calculated in accordance with LPS 340.~~

**Policy owner profit share** means the entitlement of the policy owner to share in the profits emerging from the benefits.

**Prescribed capital amount** is as defined in LPS 110.

~~**Profit carrier** means a financially measurable indicator of the provision of a service or related income.~~

~~**Profit margin** means a percentage of a profit carrier, determined in accordance with the LPS 340.~~

**Prudential Capital Requirement** is as defined in LPS 110.

**Prudential requirements** include requirements imposed by the Act, the *Life Insurance Regulations 1995*, prudential standards determined under the Act, the *Financial Sector (Collection of Data) Act 2001* (~~FSCODA~~Collection of Data Act), reporting standards made under ~~FSCODA~~Collection of Data Act, conditions imposed under the Act on the life company's authorisation, directions issued by APRA pursuant to the Act and other requirements imposed by APRA in writing.

**Regular premium business** means business under life policies where:

- (a) there exists a contractual obligation on the policy owner to make subsequent premium payments after the first premium payment; or
- (b) the scale or level of charges levied against the policy distinguishes between first and subsequent premiums.

**Reinsurance** refers to all arrangements where some part of individual or aggregate insurance risks are ceded to another company or companies and include cessions of direct writing companies to reinsurance companies or other direct writing life companies and parent companies as well as retrocessions of **reinsurers** to their parent companies or other reinsurers.

**Reinsured best estimate liability** means the component of the **reinsured policy liability**, being the best estimate liability in respect of outwards reinsurance business.

**Reinsured policy liability** ~~is as defined in LPS 340 means the policy liability calculated by considering as premiums only reinsurance premiums and considering as benefits only reinsurance recoveries.~~

**Reinsurer** means any company providing reinsurance, whether a parent life company, direct writing company or reinsurance company.

**Related body corporate**, or **related company**, has the same meaning as in section 50 of the Corporations Act (Corporations Act).

**Related entity** means an entity which is a ‘related party’ within the meaning of the relevant Australian Accounting Standards.

~~**Related product group** refers to a grouping of products where the products are considered by the Actuary to exhibit benefit characteristics and pricing structures sufficiently similar as to justify their grouping for the purposes of profit margin calculation, loss recognition or reporting. A related product group must not extend over subcategories, where a subcategory is defined in the Act.~~

**Reporting period** is the period that the insurer is required to report under the relevant reporting standards made under the Collection of Data Act.

**Retail business** means life business which is not **wholesale business**.

**Risk business** refers to policies that only provide for benefits to be paid to policy owners on the death or disability of the life insured, or if the life insured is found to have a specific disease or injury. The policies must not provide participating benefits or discretionary additions to benefits and must not be traditional business or funeral bond business.

**Risk management declaration** is as defined in CPS 220.

**Risk management framework** is as defined in CPS 220.

**Risk management strategy** is as defined in CPS 220.

**Risk-free best estimate liability** is as defined in LPS 112.

**Risk-free discount rate** for liabilities denominated in Australian currency means the rate (or rates) based on the yields of Commonwealth Government Securities that relate to the term of the future liability cash flows. If the term of the liability cash flows exceeds the maximum available term of Commonwealth Government Securities, APRA expects other instruments with longer terms to be used as a reference point for the purpose of extrapolation unless the insurer can demonstrate there are no other suitable instruments. Adjustments must be made to remove any allowances for credit risk and illiquidity that are implicit in the yields on these instruments. For foreign liabilities, the rate (or rates) must be based on the yields of highly liquid sovereign risk securities in the currency of the policy liabilities

and with counterparty grade 1. If there are no securities satisfying these requirements, other instruments may be used as a reference point. Adjustments must be made to remove any allowances for credit risk and illiquidity that are implicit in the yields on these instruments.

**Seed capital** means an amount transferred, with the approval of APRA, from the management fund of a friendly society to one of its approved benefits funds for the purpose of meeting the capital standards for the benefit fund.

**Senior manager has the same meaning as in the Act.**

**Servicing expenses** refers to the combination of maintenance expenses and investment management expenses.

**Servicing expense reserve** is as defined in LPS 115.

**Shareholder profit** is the amount of profit attributable to the shareholders.

**Shareholder profit share** means the entitlement of the shareholder to share in the profit emerging from the benefits.

**Shareholders' retained profits (Australian participating)** has the meaning given in the Dictionary to the Act.

**Shareholders' retained profits (overseas and non-participating)** has the meaning given in the Dictionary to the Act.

**Single premium business** is life business which is not regular premium business.

**Solvency standard** refers to *Prudential Standard LPS 100 Solvency Standard* and falls within the meaning of prudential standards in relation to solvency referred to under the Act.

**Special purpose review** is a review relating to a life company's operations, risk management or financial affairs and is conducted by an Appointed Actuary or another actuary when requested to do so in writing by APRA, under CPS 320.

**Special Purpose Vehicle (SPV)** refers to an entity that is not a related entity and whose activities are restricted to the acquisition and financing of specific assets.

**Specialist reinsurer** refers to a statutory fund of a registered life company where all policies referable to the fund are reinsurance policies and none of the policies is owned by a related entity of the life company.

**Statutory accounts** means the reporting documents that a life company is required to lodge with APRA under section 13 of ~~FSCODA~~ Collection of Data Act.

**Statutory fund** means a statutory fund of a life company other than a friendly society, or an approved benefit fund of a friendly society.

**Stressed policy liabilities** is as defined in LPS 115.

**Superannuation business** is as defined in the Act.

**Supervisory adjustment** is as defined under LPS 110.

**Term certain annuity** is an annuity that is not unbundled investment business and is not a variable annuity, where the next annuity payment is due within 12 months and payments continue for a fixed term that is not dependent on the survival of the life insured.

**Termination value** is as defined in LPS 360.

**Tier 1 Capital** is as defined in LPS 112.

**Tier 2 Capital** is as defined in LPS 112.

**Traditional business** refers to whole of life and endowment policies with either a single premium or with regular premiums that are level throughout the term for which premiums are payable. Regular premiums are level if each premium is the same, or if the premium can only be increased due to indexation of the sum insured or policy fee, or because the life company increases its premium rates. Traditional business excludes funeral bond business, unbundled investment business, fixed term/rate business and annuity business.

**Unbundled investment business** refers to life business that is not risk business, where the costs of the investment and the other services provided under the policy are separately disclosed to policy owners. Unbundled investment business excludes variable annuities and funeral bond business, but includes all other types of investment account business and investment-linked business.

**Unpaid premium** means the value of premiums due but not received. Premiums ~~is~~are defined as gross of commissions and before profit share rebates (for example included in group insurance and reinsurance contracts issued). Premiums must also be inclusive of stamp duty, policy fees, loadings and discounts.

**Value of supporting assets** means the value of assets determined in accordance with Part C of LPS 340 as being available to support life insurer company's participating business ~~entitled to bonuses or discretionary additions~~.

**Variable annuity** means a policy with benefits calculated by reference to the value of the units allocated to the policy, but the benefits may exceed the value of those units in specified circumstances.

**Wholesale business** means superannuation business where the effective purchasing decision is made by a trustee or company except that where the number of members has always been less than five it is retail business.

## **Adjustments and exclusions**

5. 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.

**Determinations made under previous prudential standards**

6. An exercise of APRA's discretion (such as an approval, waiver or direction) under a previous version of this Prudential Standard continues to have effect as though exercised pursuant to a corresponding power (if any) exercisable by APRA under this Prudential Standard.

## Attachment A

### Counterparty grades

1. Assets subject to credit risk must be assigned a counterparty grade using one of the following methods:
  - (a) for publicly rated assets refer to paragraphs 2 and 3 of this Attachment;
  - (b) for non-publicly rated assets secured by a residential mortgage refer to paragraphs 7 to 11 of this Attachment. An asset secured by a residential mortgage comprises an investment held by way of a registered lien, charge or mortgage over residential property. The valuation must have been performed by a qualified valuer. The property cannot be a speculative construction or a property development;
  - (c) assets other than those referred to in (a) and (b) may be rated using private external ratings or a life company's own ratings, but only with the prior approval of APRA; or
  - (d) assets other than those referred to in (a) and (b) that have not been rated using methods approved by APRA must be assigned a counterparty grade of 5.
2. Publicly rated assets are assigned a counterparty grade based on the following tables. The short-term ratings in Table 1 are typically used for assets with original term to maturity of not more than 13 months. For other assets the long-term ratings in Table 2 apply. The credit ratings in Table 1 and Table 2 include structured finance ratings with the (sf) indicator.

**Table 1: Short-term ratings**

Grade	Standard & Poor's	Moody's	AM Best	Fitch
1	A1+		AMB-1+	F1+
2	A1	P1	AMB-1	F1
3	A2	P2	AMB-2	F2
4	A3	P3	AMB-3	F3
<u>5</u>	=	=	=	=
6	B	NP Vulnerable	AMB-4	B
7	C	NP Currently Vulnerable		C

**Table 2: Long-term ratings**

Grade	Standard & Poor's	Moody's	AM Best		Fitch
			Debt	FSR <sup>2</sup>	
1	AAA	Aaa	aaa	A++	AAA
2	AA+ AA AA-	Aa1 Aa2 Aa3	aa+ aa aa-	A+	AA+ AA AA-
3	A+ A A-	A1 A2 A3	a+ a a-	A A-	A+ A A-
4	BBB+ BBB BBB-	Baa1 Baa2 Baa3	bbb+ bbb bbb-	B++ B+	BBB+ BBB BBB-
5	BB+ BB BB-	Ba1 Ba2 Ba3	bb+ bb bb-	B B-	BB+ BB BB-
6	B+ B B-	B1 B2 B3	b+ b b-	C++, C+ C C-	B+ B B-
7	Below B-	Below B3	Below b-	Below C-	Below B-

3. Where investments are held via a trust that has itself been separately rated by a recognised rating agency, that rating may be applied to all the investments in the trust in lieu of the ratings of the individual trust assets, provided that the trust is treated as a single investment for asset concentration purposes and is not subject to 'look-through'. When a 'look-through' approach is adopted the underlying assets need to be individually rated. If the trust is separately rated, that overall trust rating cannot be applied to the individual underlying assets.
4. A life company must, in general, use the same rating agency for determining all counterparty grades. A life company may depart from this general rule where there are good reasons for doing so, such as under the following circumstances:
  - (a) where the rating agencies usually monitored by a life company do not issue a solicited credit rating<sup>3</sup> for a particular debt obligation and only one other rating agency issues a solicited credit rating for that debt obligation, a life company may use that solicited credit rating; or
  - (b) where the rating agencies usually monitored by the insurer do not issue a solicited credit rating for a particular debt obligation, the credit ratings issued by all other rating agencies listed in the table above must be reviewed and the rule in paragraph 5 of this Attachment must be used to determine which rating agency will be used to determine the counterparty grade and therefore the credit spreads or default factors to be applied; or

<sup>2</sup> 'FSR' refers to the Financial Strength Rating issued by AM Best.

<sup>3</sup> A solicited credit rating is a rating that has been initiated and paid for by the issuer or rated counterparty or a commercial associate of the issuer or rated counterparty.

- (c) the rule in paragraph 5 of this Attachment may also be applied where a life company monitors multiple rating agencies that provide different solicited credit ratings for a particular debt obligation.
5. For the purposes of paragraph 4 of this Attachment the following rule applies: where a counterparty or debt obligation has solicited credit ratings from multiple rating agencies, the following guidelines must be followed in determining the counterparty grade:
- (a) if there are two solicited ratings which correspond to different counterparty grades, the lower counterparty grade must be used for the debt obligation; or
- (b) if there are three or more solicited ratings that correspond to different counterparty grades, the ratings corresponding to the second-best of those counterparty grades must be used for the debt obligation.
6. APRA's written approval must be sought if a life company wishes to use the rating determined by a rating agency not included in the tables above.
7. The Counterparty Grade for assets secured by residential mortgages (as defined in paragraph 1(b) of this Attachment) is determined from the following table.

**Table 3: Assets secured by residential mortgages**

Counterparty Grade	Standard residential mortgages		Other residential mortgages	
	No LMI	>40% LMI	No LMI	>40% LMI
'Loan to value ratio'				
≤ 60%	2	2	3	2
> 60% but ≤ 80%	2	2	4	3
> 80% but ≤ 90%	3	2	5	4
> 90% but ≤ 100%	4	3	5	4
> 100%	5	4	5	5

8. 'Loan to value ratio' is the ratio of the value of the asset (i.e. loan) to the market value of the collateral. The market value of the collateral is the value at inception or, where a substantive valuation has subsequently been carried out, this subsequent valuation.
9. A standard residential mortgage is defined as a mortgage on an existing residential property where the life company has:
- (a) prior to loan approval and as part of the loan origination and approval process, documented, assessed and verified the ability of the borrowers to meet their repayment obligation;
- (b) valued any residential property offered as security;



- (c) established that any property offered as security for the loan is readily marketable; and
- (d) the life company has at all times unequivocal enforcement rights over the mortgaged property (including a power of sale and a right to possession) in the event of default by the borrower.

The life company must also revalue any property offered as security for such loans when it becomes aware of a material change in the market value of property in an area or region.

- 10. Loans that are secured by residential properties but fail to meet the criteria detailed in paragraph 9 of this Attachment must be classified as other residential mortgages. Such loans may be reclassified as standard residential mortgages where the borrowers have met their contractual loan repayments to the life company continuously over the previous 36 months.
- 11. LMI refers to lenders mortgage insurance. '>40% LMI' refers to mortgages where insurance cover has been obtained for all realised losses up to at least 40 per cent of the higher of the original loan amount and outstanding loan amount (if higher than the original loan amount). Such insurance must be with a lenders mortgage insurer that is regulated by APRA.