

Australian Prudential Regulation Authority instrument fixing charges No. 5 of 2019

For assessing applications by general insurers to use the Internal Model-based Method for determining the prescribed capital amount

EXPLANATORY STATEMENT

Issued by the Australian Prudential Regulation Authority (APRA)

Australian Prudential Regulation Authority Act 1998, paragraphs 51(1)(a) and (b)

Acts Interpretation Act 1901, subsection 33(3)

This explanatory statement relates to Australian Prudential Regulation Authority instrument fixing charges No. 5 of 2019 which is made under paragraphs 51(1)(a) and (b) of the *Australian Prudential Regulation Act 1998* (the APRA Act) and dated 30 August 2019 (the instrument).

1. Background

Legislative framework

APRA has statutory responsibility for the prudential supervision of most of the superannuation industry, the life insurance, general insurance and private health insurance industries, and authorised deposit-taking institutions (ADIs). ADIs include banks, building societies and credit unions.

Subsection 51(1) of the APRA Act provides that APRA may, by legislative instrument, fix charges to be paid to it by persons in respect of:

- (a) services and facilities that APRA provides to such persons; and
- (b) applications or requests (however described) made to APRA under any law of the Commonwealth.

Subsection 51(2) of the APRA Act provides that a charge fixed under subsection 51(1) must be reasonably related to the costs and expenses incurred or to be incurred by APRA in relation to the matters to which the charge relates and must not be such as to amount to taxation.

Purpose and operation of the instrument

The instrument:

- (a) revokes the Australian Prudential Regulation Authority instrument fixing charges No. 1 of 2009; and
- (b) fixes charges for services provided by APRA relating to the assessment of applications from general insurers (including Level 2 insurance groups) that have sought to use the

Internal Model-based Method (IMB Method) approach for determining the prescribed capital amount (PCA).

General Insurance Internal Models-based Method

Under *Prudential Standard GPS 110 Capital Adequacy (GPS 110)*¹, general insurers may choose one of two methods for determining the PCA. These are the:

- (a) IMB Method; or
- (b) Standard Method.

The Standard Method is the ‘default’ method and is currently being used by most authorised general insurers.

General insurers seeking to use the IMB Method must have APRA’s approval to do so.

The IMB Method is expected to benefit those general insurers that seek to adopt it because it will align regulatory capital requirements more closely with the general insurer’s individual risk profiles and internal risk and capital management processes. This approach should also result in more efficient use of capital.

How the charge has been calculated

The charges set by the instrument are fixed on a cost recovery basis and in line with the *Australian Government Cost Recovery Guidelines July 2014 – Resource Management Guide No. 304*.

The charge is based on the need to recover APRA’s expected costs for carrying out the assessment of the expected applications for approval to use the IMB method. Those costs are based on an estimation of APRA staff time involved with an addition of direct overhead costs.

The costs incurred in monitoring the PCA of general insurers using the IMB Method and Standard Method are recovered through the Financial Institutions Supervisory Levies.

2. Operation of the instrument

Description of the charges

The charges fixed by the current instrument is based on a two-tiered structure:

- (a) \$400,000 plus GST (which totals \$440,000) imposed on each general insurer for the first application seeking approval to use the IMB Method made by the group; and / or
- (b) \$150,000 plus GST (which totals \$165,000) imposed for each second and onward application for approval from a general insurance group.

Charges must be reasonably related to the costs and expenses incurred

¹ Made by *Insurance (prudential standard) determination No. 12 of 2019*.

As indicated above, the charges fixed by the instrument are set on a cost recovery basis and related to the estimated time and effort involved in the discharge of APRA's responsibilities and in line with the *Australian Government Cost Recovery Guidelines July 2014*.

The charges do not amount to taxation

As the charges are reasonably related to the costs incurred by APRA in providing the services concerned, the charges do not constitute a tax.

The charges are not retrospective

The charges are fixed prospectively. They are payable 14 days after receipt of APRA's invoice.

Cost Recovery Implementation Statement

A Cost Recovery Implementation Statement (CRIS), which covers APRA's cost recovery model for the supervision of financial institutions, has been tabled in support of this Explanatory Statement and has been published on the APRA website².

3. Consultation

A consultation was not conducted for this instrument as there has been no change to the substance of the IMB Method approval process³, or to the relevant prudential standards⁴ or guidance relating to the IMB Method; only to the amounts being fixed as charges. The changes to the fixed charges is driven by updated effort and cost estimates in APRA's assessment of approvals to use the IMB Method.

As part of annual consultation regarding APRA's costs recovery, each industry sector is made aware of APRA's cost recovery process including the reduction of levies through direct user charging.

4. Statement of Compatibility prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

A Statement of Compatibility prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* is provided at Attachment A to this Explanatory Statement.

² APRA's 'Cost Recovery Implementation Statement – Prudential regulation of financial institutions' dated 3 July 2019 is available here:
https://www.apra.gov.au/sites/default/files/cost_recovery_implementation_statement_prudential_regulation_of_financial_institutions_2019-2020.pdf

³ See Australian Prudential Regulation Authority instrument fixing charges No. 1 of 2009.

⁴ See Insurance (prudential standard) determination No. 12 of 2019 Prudential Standard GPS 110 Capital Adequacy and Insurance (prudential standard) determination No. 3 of 2019 Prudential Standard GPS 113 Capital Adequacy: Internal Model-based Method.

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*

Australian Prudential Regulation Authority instrument fixing charges No. 5 of 2019

This Legislative Instrument is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* (HRPS Act).

Overview of the Legislative Instrument

The Legislative Instrument fixes charges to be paid to APRA by general insurers for APRA's assessment of general insurers' applications to use the Internal Model-based Method for determining their prescribed capital amount.

Human rights implications

APRA has assessed the Legislative Instrument against the international instruments listed in section 3 of the HRPS Act and determined that the Legislative Instrument does not engage any of the applicable rights or freedoms, as the charges payable by the general insurers will not have any direct or indirect effect on the rights of individual persons.

Conclusion

Australian Prudential Regulation Authority instrument fixing charges No. 5 of 2019 is compatible with human rights as it does not raise any human rights issues.