

Insurance (prudential standard) determinations No. 2 to 4 of 2022

SUPPLEMENTARY EXPLANATORY STATEMENT

Prepared by the Australian Prudential Regulation Authority (APRA)

Insurance Act 1973, section 32

APRA may, in writing, determine, vary or revoke a prudential standard that applies to an APRA-regulated institution under subsections 32(1) and (4) of the *Insurance Act 1973* (the Act), in relation to general insurers, authorised non-operating holding companies (authorised insurance NOHCs), and subsidiaries of general insurers and authorised insurance NOHCs.

On 22 June 2022, APRA made the following determinations (the instruments):

- (1) Insurance (prudential standard) determination No. 2 of 2022 which revokes *Prudential Standard GPS 114 Capital Adequacy: Asset Risk Charge* made under Insurance determination No. 4 of 2019 and determines a new *Prudential Standard GPS 114 Capital Adequacy: Asset Risk Charge*;
- (2) Insurance (prudential standard) determination No. 3 of 2022 which revokes *Prudential Standard GPS 116 Capital Adequacy: Insurance Concentration Risk Charge* made under Insurance determination No. 13 of 2019 and determines a new *Prudential Standard GPS 116: Capital Adequacy: Insurance Concentration Risk Charge*; and
- (3) Insurance (prudential standard) determination No. 4 of 2022 which revokes *Prudential Standard GPS 117 Capital Adequacy: Asset Concentration Risk Charge* made under Insurance determination No. 2 of 2017 and determines a new *Prudential Standard GPS 117 Capital Adequacy: Asset Concentration Risk Charge*.

The instruments commenced on 1 July 2022.

1. Background

To incorporate minor consequential amendments to the prudential framework to support the operation of the Australian Government's cyclone and related flood damage reinsurance pool APRA has made changes to the following insurance prudential standards:

- Prudential Standard GPS 114 Capital Adequacy: Asset Risk Charge;
- Prudential Standard GPS 116 Capital Adequacy: Insurance Concentration Risk Charge; and
- Prudential Standard GPS 117 Capital Adequacy: Asset Concentration Risk Charge.

The minor amendments clarify that reinsurance provided by the Australian Reinsurance Pool Corporation (ARPC) are not subject to a capital charge in recognition of the Australian Government guarantee that supports the reinsurance pool.

2. Purpose and operation of the instruments

The prudential standards, that have been amended, currently impose requirements on a general insurer or Level 2 insurance group to maintain adequate capital against the asset risks associated with its activities, namely:

- *Prudential Standard GPS 114 Capital Adequacy: Asset Risk Charge:*

(this prudential standard sets out the method for calculating the Asset Risk Charge. This charge is one of the components of the Standard Method for calculating the prescribed capital amount for general insurers and Level 2 insurance groups.)

- *Prudential Standard GPS 116 Capital Adequacy: Insurance Concentration Risk Charge:*

(this prudential standard sets out the method for calculating the Insurance Concentration Risk Charge. This charge is one of the components of the Standard Method for calculating the prescribed capital amount for general insurers and Level 2 insurance groups.)

- *Prudential Standard GPS 117 Capital Adequacy: Asset Concentration Risk Charge:*

(this prudential standard sets out the method for calculating the Asset Concentration Risk Charge. This charge is one of the components of the Standard Method for calculating the prescribed capital amount for general insurers and Level 2 insurance groups.)

The purpose of each of the instruments is to revoke the existing prudential standard that requires minor consequential amendments and replace it with a corresponding standard that incorporates the appropriate amendment.

The minor consequential amendments only:

- remove footnotes made redundant by the change to the definition of an APRA-authorised reinsurer; and
- add footnotes to clarify the treatment of reinsurance cover provided by the ARPC.

Following the minor consequential amendments, the ARPC will be recognised as a high-grade APRA-authorised reinsurer to ensure that reinsurance recoverables from the ARPC are not subject to a capital charge in recognition of the Australian Government guarantee that supports the pool.

Each prudential standard provides for APRA to exercise various discretions. Decisions made by APRA exercising those discretions are not subject to merits review. This is because these decisions are preliminary decisions that may facilitate or lead to substantive decisions which are subject to merits review.

Under the Act, a breach of a prudential standard is a breach of the enabling legislation, as the Act provides that regulated entities must comply with the standard. However, there are no penalties prescribed for breach a prudential standard under the Act. Instead, an entity's breach of the enabling legislation is grounds for APRA to make further, substantive decisions under the relevant enabling legislation in relation to the entity. Those decisions may include the decision:

- (a) to issue a direction to the regulated entity, including a direction to comply with the whole or part of a prudential standard (section 104 of the Act); and

- (b) to revoke an authority to carry on insurance business (section 15 of the Act) or to revoke an insurance NOHC authorisation (section 21 of the Act).

It is only at this stage that an entity is exposed to a penalty: loss of licence or imposition of a penalty if it breaches the direction (section 108 of the Act). In nearly all cases,¹ the decisions are preceded by a full consultation with the regulated entity to raise any concerns they may have in relation to the decision.

The decisions of APRA to impose a direction are subject to merits review (section 104 of the Act) which is appropriately available at the point where an entity could be exposed to a penalty. All decisions to revoke authorisations under Act are subject to merits review, unless specifically excluded by the enabling legislation.

Revocation of an authorisation to carry on insurance business or an insurance NOHC authorisation is subject to merits review (ss 15 and 21 of the Act).

Where these standards refer to an Act, Regulation or Prudential Standard, this is a reference to the document as it exists from time to time, and which is available on the Federal Register of Legislation at www.legislation.gov.au.

In setting out the method for calculating the Asset Risk Charge for general insurers and Level 2 insurance groups under Prudential Standard GPS 114 Capital Adequacy: Asset Risk Charge (GPS 114), reference is made to the “Consumer Price Index (CPI)” and to the “ASX 200 index”.

The content underpinning the referenced matters are not incorporated into GPS 114. There is no application of the content underpinning the matters as requirements under GPS 114. The matters provide background for the ‘expected’ inflation stress test and the ‘equity’ stress test. The matters do not impose any obligations on regulated entities and are included for scenario setting in relation to measuring stress measures on the capital base under GPS 114.

3. Consultation

On 28 April 2022, APRA undertook consultation with all general insurers in relation to its proposed minor amendments to the prudential framework to support the operation of the Australian Government’s cyclone and related flood damage reinsurance pool.

As part of the consultation, APRA requested written submissions by 1 June 2022 on its proposal to recognise the ARPC as a high-grade APRA-authorized reinsurance and its proposal that reinsurance recoverables from the ARPC are not subject to a capital charge in recognition of the Australian Government guarantee that supports the pool.

No submissions were received. APRA is satisfied the consultation was appropriate and reasonably practicable as the consequential amendments can be regarded as minor and machinery.

4. Regulation Impact Statement

¹ APRA does not need to consult where APRA is satisfied that doing so could result in a delay in revocation that would be contrary to the national interest: subsection 15(4) of the Act.

The OBPR confirmed that a Regulation Impact Statement was not required for the changes described in this explanatory statement as they were considered minor and machinery.

5. 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.

ATTACHMENT A

Statement of Compatibility with Human Rights

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

Insurance (prudential standard) determination No. 2 of 2022

Insurance (prudential standard) determination No. 3 of 2022

Insurance (prudential standard) determination No. 4 of 2022

The above Legislative Instruments are compatible with the human rights and freedoms recognised or declared in the international instrument listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* (HRPS Act).

Overview of the Legislative Instruments

The purpose of the above Legislative Instruments is to make minor consequential changes to Prudential Standard GPS 114 Capital Adequacy: Asset Risk Charge, Prudential Standard GPS 116 Capital Adequacy: Insurance Concentration Risk Charge and Prudential Standard GPS 117 Capital Adequacy: Asset Concentration Risk Charge to recognise the Australian Reinsurance Pool Corporation (ARPC) as a high-grade APRA-authorized reinsurer and to ensure that reinsurance recoverables from the ARPC are not subject to a capital charge in recognition of the Australian Government guarantee that supports the scheme.

Human rights implications

APRA has assessed the above Legislative Instruments and is of the view that they do not engage any of the applicable rights or freedoms recognised or declared in the international instruments listed in section 3 of the HRPS Act. Accordingly, in APRA's assessment, the above Legislative Instruments are compatible with human rights.

Conclusion

These Legislative Instruments are compatible with human rights as they do not raise any human rights issues.