Health Insurance (prudential standard) determination No. 7 of 2023

Prudential Standard HPS 118 Capital Adequacy: Operational Risk Charge

Private Health Insurance (Prudential Supervision) Act 2015

I, Helen Rowell, a delegate of APRA, under subsection 92(1) of the *Private Health Insurance (Prudential Supervision) Act 2015* determine *Prudential Standard HPS 118 Capital Adequacy: Operational Risk Charge*, in the form set out in the Schedule, which applies to all private health insurers.

This instrument commences on 1 July 2023.

Dated: 24 May 2023

[Signed]

Helen Rowell
Deputy Chair

Interpretation

In this instrument:

APRA means the Australian Prudential Regulation Authority.
private health insurer has the meaning given in section 4 of the Act.

Schedule

Prudential Standard HPS 118 Capital Adequacy: Operational Risk Charge, comprises the document commencing on the following page.

Prudential Standard HPS 118

Capital Adequacy: Operational Risk Charge

Objectives and key requirements of this Prudential Standard

This Prudential Standard requires a private health insurer to maintain adequate capital against the operational risks associated with its activities.

The ultimate responsibility for the prudent management of capital of a private health insurer rests with its Board of directors. The Board must ensure that the private health insurer maintains an adequate level and quality of capital commensurate with the scale, nature and complexity of its business and risk profile, such that it is able to meet its obligations under a wide range of circumstances.

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 prescribed capital amount for private health insurers.

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Authority

1.   This Prudential Standard is made under subsection 92(1) of the *Private Health Insurance (Prudential Supervision) Act 2015* (the Act).

Application and commencement

2.   This Prudential Standard applies to all private health insurers except where expressly noted otherwise.

3.   A private health insurer must apply this Prudential Standard separately to each of its health benefits funds and its general fund, unless otherwise noted. The term 'private health insurer' refers to the private health insurer as a whole. The term 'fund' refers to each health benefits fund and general fund, unless otherwise noted.

4.   This Prudential Standard applies to private health insurers from 1 July 2023.

Interpretation

5.   Terms that are defined in *Prudential Standard HPS 001 Definitions* appear in bold the first time they are used in this Prudential Standard.

Operational Risk Charge

6.   The **Operational Risk Charge** is the minimum amount of capital a fund is required to hold against the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events within the **health insurance business** and **health related insurance business**.

Calculation of the Operational Risk Charge

7.   The Operational Risk Charge (ORC) is calculated as follows:

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

Where:

(a) GP_1 is **accrued premium** (gross of **reinsurance**) for the 12 months ending on the **reporting date**;

(b) GP_0 is accrued premium (gross of reinsurance) for the 12 months ending on the date 12 months prior to the reporting date;

(c)   NL is the **central estimate** of insurance liabilities (net of reinsurance) determined in accordance with *Prudential Standard HPS 340 Insurance Liability Valuation* at the reporting date; and

(d) $|GP_1 - GP_0|$ is the absolute value of the difference between GP_1 and GP_0.

8. For the purposes of paragraph 7, 'accrued premium' includes all premiums from Health Insurance Business and Health Related Insurance Business. Accrued premium is calculated as follows:

$$\textbf{Accrued premium} = \textbf{Premiums received} - \textbf{A} + \textbf{B}$$

Where:

(a) A = Premiums in advance at the end of the specified period - Premiums in advance at the start of the specified period;

(b) B = **Unpaid premiums** at the end of the specified period – Unpaid premiums at the start of the specified period; and

(c) Premiums must be inclusive of relevant levies, loadings and discounts.

Adjustments and exclusions

9. APRA may, by notice in writing to a private health insurer, adjust or exclude a specific requirement in this Prudential Standard in relation to that private health insurer.