



Health Insurance (prudential standard) determination No. 6 of 2023

Prudential Standard HPS 117 Capital Adequacy: Asset Concentration 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 117 Capital Adequacy: Asset Concentration 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 117 Capital Adequacy: Asset Concentration Risk Charge, comprises the document commencing on the following page.



Prudential Standard HPS 117

Capital Adequacy: Asset Concentration Risk Charge

Objectives and key requirements of this Prudential Standard

This Prudential Standard requires a private health insurer to maintain adequate capital against the risks associated with asset concentration in 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 operations under a wide range of circumstances.

The Asset Concentration Risk Charge is the minimum amount of capital required to be held against asset concentration risks. The Asset Concentration Risk Charge relates to the risk of a concentration in exposures to a particular asset, counterparty or group of related counterparties resulting in adverse movements in the private health insurer's capital base.

This Prudential Standard sets out the method for calculating the Asset Concentration 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 the 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.
6. For the purposes of this Prudential Standard:
 - (a) ‘Eligible Collateral Items’ are **cash**, government securities or **debt obligations** (i.e. loans, deposits, placements, interest rate securities and other receivables) where the counterparty has a **counterparty grade** of 1, 2 or 3 as defined in Attachment A of HPS 001;
 - (b) ‘non-reinsurance exposures’ are the on- and off-balance sheet exposures of a fund other than exposures to a reinsurer;
 - (c) ‘reinsurance exposures’ are the on- and off- balance sheet exposures of a fund to **reinsurance assets**; and
 - (d) ‘residual maturity’ is the remaining time until the expiration or the repayment of a financial instrument.
7. Where this Prudential Standard provides for APRA to exercise a power or discretion, this power or discretion is to be exercised in writing.

Asset Concentration Risk Charge

8. This Prudential Standard sets out the method for calculating the **Asset Concentration Risk Charge** for each fund of a private health insurer. The Asset Concentration Risk Charge relates to the risk of a fund’s concentrations in exposures to a particular asset, counterparty or group of related counterparties resulting in adverse movements in the fund’s **capital base**.
9. For the purposes of the Asset Concentration Risk Charge, exposures include all on- and off-balance sheet exposures of each fund within the private health

insurer. On-balance sheet exposures of each fund should be net of any regulatory adjustments expressly related to the items that are required under *Prudential Standard HPS 112 Capital Adequacy: Measurement of Capital*.

10. All exposures should be converted to Australian dollars (AUD) as at the **reporting date**.
11. The portion of any exposure which is subject to the Asset Concentration Risk Charge must not be subject to the **Asset Risk Charge** as defined in *Prudential Standard HPS 114 Capital Adequacy: Asset Risk Charge* (HPS 114). The portion of any exposure which is not subject to the Asset Concentration Risk Charge must be subject to the Asset Risk Charge.
12. If a look-through basis has been used for assets under HPS 114, the same look-through basis must be used for the purposes of this Prudential Standard.

Definitions

13. Two or more counterparties will form a ‘group of related counterparties’ if they are linked by:
 - (a) cross guarantees;
 - (b) common ownership or management;
 - (c) the ability of a counterparty to exercise control (defined in accordance with the **Australian Accounting Standards**) over the other(s), whether direct or indirect;
 - (d) financial interdependency such that the financial soundness of any of them may affect the financial soundness of the other(s); or
 - (e) other connections or relationships that exist between counterparties, that in the private health insurer’s assessment, constitute exposure to the counterparties as a single risk.
14. For the purpose of determining the asset concentration risk charge, liabilities ceded under reinsurance (reinsurance assets) are to be treated as an asset of the fund.
15. For the purposes of the limits in respect of non-reinsurance exposures in Attachment A, exposures are classified depending on whether or not the counterparty is APRA-regulated or part of an APRA-regulated group. A counterparty meets this requirement if the specific counterparty or its ultimate parent is:
 - (a) authorised by APRA under the Act as a private health insurer; or
 - (b) authorised by APRA under the *Insurance Act 1973* as a general insurer or authorised **non-operating holding company** (NOHC); or

- (c) authorised by APRA under the *Banking Act 1959* as an **authorised deposit-taking institution** (ADI) or authorised NOHC of an ADI; or
 - (d) registered by APRA under the *Life Insurance Act 1995* as a life company or authorised NOHC of a life company.
16. For the purposes of the limits in Table 2(c) of Attachment A, exposures are classified as either short-term or long-term. ‘Short-term’ means a residual maturity of less than or equal to one year. ‘Long-term’ means perpetual or a residual maturity of greater than one year.

Asset Concentration Risk Charge calculation

17. The Asset Concentration Risk Charge for each exposure of a fund to a particular asset, counterparty or group of related counterparties is the amount by which this exposure exceeds the limits set out in Attachment A. Separate treatment applies for reinsurance exposures and non-reinsurance exposures. A differing treatment also applies for collateral, guarantees and **reinsurance recoverables** due from **non APRA-authorised reinsurers** as set out in paragraphs 22 to 34.
18. For non-reinsurance exposures to unrelated parties that are part of an APRA-regulated group (Table 2(c) of Attachment A), the Asset Concentration Risk Charge of a fund is calculated as the maximum amount after applying each of the sub-limits to the relevant exposures.
19. In the case of reinsurance exposures (both on-balance and off-balance sheet) to a group of related counterparties, exposures of a fund need to be compared and aggregated against each of the limits in Table 1 of Attachment A. This means that:
- (a) reinsurance exposures within the group that have a counterparty grade of 5 or below are compared to the limit (Table 1(c)) and an amount is determined;
 - (b) reinsurance exposures of grade 5 and below that are not part of the calculation in sub-paragraph (a) are then added with those with a counterparty grade of 4 and compared to the limit (Table 1(b)), and a further amount is determined; and
 - (c) reinsurance exposures of grade 4 and below that are not part of the calculation in sub-paragraphs (a) or (b) are then added to those with a counterparty grade above 4 and compared to the limit (Table 1(a)).
20. The total Asset Concentration Risk Charge for the reinsurance exposure is the sum of the amounts from each sub-paragraph in paragraph 19.
21. The total Asset Concentration Risk Charge is the sum of each resulting risk charge for each exposure of the private health insurer.

Treatment of collateral and guarantees as risk mitigants

22. A private health insurer that holds certain types of collateral against an asset of a fund, or where the asset has been guaranteed, as a means of reducing risk may apply a different approach to determining the Asset Concentration Risk Charge for that asset. Where the assets in question are reinsurance recoverables due from non-APRA-authorized reinsurers, different rules regarding treatment of collateral and guarantees apply (refer to paragraphs 28 to 34).

Collateral

23. Subject to paragraph 24, where a private health insurer possesses eligible collateral against an asset of a fund (other than reinsurance recoverables due from non-APRA-authorized reinsurers), it may treat the underlying asset as an exposure to the Eligible Collateral Item. This means that the asset is included in the limits in Attachment A with respect to the collateral, rather than the underlying counterparty.
24. For the purposes of paragraph 23, collateral is recognised only to the extent that it takes the form of a registered charge, registered mortgage or other legally enforceable security interest in, or over, an Eligible Collateral Item. Eligible Collateral Items are cash, government securities, or debt obligations (i.e. loans, deposits, placements, interest rate securities and other receivables) where the counterparty has a counterparty grade of 1, 2 or 3. The Eligible Collateral Item must be held for a period not less than that for which the asset is held.
25. Where the **fair value** of the collateral does not cover the full value of the asset, the collateral counterparty rating can only replace that part of the asset that is covered by the collateral. The remaining portion of the asset must be treated as an exposure to the underlying counterparty.

Guarantees

26. Subject to paragraph 27, where a private health insurer possesses an asset in a fund (other than reinsurance recoverables due from non-APRA-authorized reinsurers) that has been explicitly, unconditionally and irrevocably guaranteed for its remaining term to maturity by a guarantor with a counterparty rating (or for governments, the long-term foreign currency credit rating) of grade 1, 2 or 3, it may treat the underlying asset as an exposure to the counterparty providing the guarantee. This means that the asset is included in the limits in Attachment A with respect to the guarantee, rather than the underlying counterparty.
27. Guarantees provided to a private health insurer by its own parent or a related entity are not eligible for the treatment provided for in paragraph 26.

Reinsurance recoverables due from non-APRA-authorized reinsurers

Collateral

28. Subject to paragraphs 29, 30 and 33, where a private health insurer possesses eligible collateral in Australia against reinsurance recoverables due to a fund

from a non-APRA-authorized reinsurer, it may elect to treat the reinsurance recoverable as an exposure to the eligible collateral. This means that the asset is included in the limits in Attachment A with respect to the collateral, rather than the underlying reinsurer.

29. For the purposes of paragraph 28, eligible collateral is recognised only:
- (a) to the extent that it takes the form of:
 - (i) assets held in Australia which form part of a trust fund maintained by a trustee resident in Australia;
 - (ii) deposits held by the private health insurer or its fund in Australia made by the non-APRA-authorized reinsurer;
 - (iii) a combination of the two forms of collateral specified in sub-paragraphs (i) and (ii); or
 - (iv) any other form of collateral as may be approved by APRA in a particular case;
 - (b) if it provides effective security against liabilities arising under the reinsurance contract; and
 - (c) if it is not available for distribution to creditors of the reinsurer other than the private health insurer or its fund in the event of insolvency of the reinsurer.
30. Where the fair value of the collateral does not cover the full value of the reinsurance recoverables, only the part of the value of the reinsurance recoverables that is covered by collateral may be assigned the counterparty grade of the collateral. The remaining portion of the reinsurance recoverable must be treated as an exposure to the underlying reinsurer.

Guarantees

31. Subject to paragraph 33, where a private health insurer possesses a guarantee or letter of credit in respect of the reinsurance recoverables due to a fund from a non-APRA-authorized reinsurer, it may elect to treat the reinsurance recoverables as an exposure to the guarantor or the issuer of the letter of credit (as applicable). This means that the asset is included in the limits in Attachment A with respect to the guarantor or issuer of the letter of credit, rather than the underlying reinsurer. This paragraph applies only if:
- (a) the guarantor or issuer of the letter of credit is an ADI;
 - (b) the guarantee or letter of credit is explicit, unconditional and irrevocable;
 - (c) the guarantor or issuer of the letter of credit is obliged to pay the private health insurer in Australia; and

- (d) the obligation of the guarantor or issuer of the letter of credit to pay the private health insurer is specifically linked to performance of the reinsurance contract or contracts under which the reinsurance recoverables arise.
- 32. A guarantee or letter of credit provided to a private health insurer by its parent entity or other related entity is not eligible for the treatment provided for in paragraph 31.
- 33. The collateral, guarantee or letter of credit referred to in paragraphs 28 and 31 must be effective for the expected period for payment of claims under the reinsurance contract under which the reinsurance recoverables arise. If this is impractical, the collateral, guarantee or letter of credit must be effective for a period of at least 24 months but be renegotiable each year to allow at least 12 months to identify alternative arrangements if the collateral, guarantee or letter of credit cannot be renegotiated.
- 34. A private health insurer may elect to not apply the treatment for reinsurance recoverables from non-APRA-authorized reinsurers in paragraphs 28 and 31 to any of its funds and instead apply the counterparty grade of the non-APRA-authorized reinsurer in order to determine the Asset Concentration Risk Charge. APRA may require a private health insurer to apply to a fund, a specified treatment to reinsurance recoverables from non-APRA-authorized reinsurers supported by collateral, guarantee or letter of credit, rather than the treatment that would otherwise apply under this paragraph.

Adjustments and exclusions

- 35. A private health insurer may apply to APRA to vary the application of the limits in Attachment A. In deciding whether to grant the application, APRA will have regard to the type of exposure, the term of the exposure, the ability for the institution to mitigate the Asset Concentration Risk Charge by other means and any other matters which APRA considers relevant. APRA may grant approval for such variation subject to conditions and may specify any period of time for such variation.
- 36. APRA may, by notice in writing to a private health insurer, adjust or exclude a specific requirement in this Prudential Standard in relation to a private health insurer.

Attachment A – Asset exposure limits

1. This attachment sets out the Asset Concentration Risk Charge limits for exposures to single assets, counterparties and groups of related counterparties.

Table 1: Reinsurance exposures

| | Exposure – reinsurance counterparty or group of counterparties | AUD limit |
|-----|---|---------------------|
| (a) | Exposures to reinsurers with a counterparty grade of 1, 2 or 3 | No limit |
| (b) | Exposures to reinsurers with a counterparty grade of 4 | 50% of capital base |
| (c) | Exposures to reinsurers with a counterparty grade of 5, 6 or 7 | 25% of capital base |

Table 2: Non-reinsurance exposures

| | Exposure – asset, counterparty or group of counterparties | AUD limit |
|-----|--|---|
| (a) | Governments with a counterparty grade 1 or 2 ¹ | No limit |
| (b) | Related parties that are APRA-regulated or part of an APRA-regulated group ² | Greater of \$22.5 million and 100% of capital base |
| (c) | Unrelated parties that are APRA-regulated or part of an APRA-regulated group ³ : <ul style="list-style-type: none"> (i) Short-term exposures⁴ (ii) Long-term exposures⁵ (iii) Total exposure | Greater of \$22.5 million and 100% of capital base Greater of \$11.2 million and 50% of capital base Greater of \$22.5 million and 100% of capital base |
| (d) | All other exposures | 25% of capital base |

¹ This includes assets with a counterparty grade 1 or 2 that are guaranteed by the Commonwealth Government, Australian state and territory governments and foreign governments.

² As defined in paragraph 15 of this Prudential Standard.

³ As defined in paragraph 15 of this Prudential Standard.

⁴ As defined in paragraph 16 of this Prudential Standard.

⁵ As defined in paragraph 16 of this Prudential Standard.