Insurance (prudential standard) determination No. 1 of 2014

EXPLANATORY STATEMENT

Prepared by the Australian Prudential Regulation Authority (APRA)

*Insurance Act 1973*, section 32

Under subsection 32(1) of the *Insurance Act 1973* (the Act), APRA has the power to determine standards (prudential standards), in writing, in relation to prudential matters to be complied with by general insurers and authorised non-operating holding companies (authorised NOHCs). Under subsection 32(4) of the Act, APRA may, in writing, vary or revoke a prudential standard.

On 17 June 2014, APRA made Insurance (prudential standard) determination No. 1 of 2014 (the instrument) which revokes *Prudential Standard GPS 117 Capital Adequacy: Asset Concentration Risk Charge* made under Insurance (prudential standard) determination No. 7 of 2012 and determines a new *Prudential Standard GPS 117 Capital Adequacy: Asset Concentration Risk Charge* (GPS 117).

The instrument commences on 1 July 2014.

1. Background

The Asset Concentration Risk Charge relates to the risk of an insurer’s concentrations in exposures to a particular asset, counterparty or group of related counterparties resulting in adverse movements in the regulated institution’s capital base. GPS 117, applicable to general insurers and Level 2 insurance groups, sets out the method for calculating the Asset Concentration Risk Charge.

The Asset Concentration Risk Charge for each exposure of an insurer 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 of GPS 117. Separate treatment applies for reinsurance exposures and non-reinsurance exposures.

1. Purpose and operation of the instrument

The purpose of this instrument is to revoke GPS 117 and determine a new GPS 117 to clarify the treatment of certain non-reinsurance exposures for the purposes of the Asset Concentration Risk Charge.

APRA has made minor amendments to the definition of APRA-regulated groups. The definition, provided in paragraph 16 of the new GPS 117, is used to determine the asset concentration limits for non-reinsurance exposures.

Under the now revoked version of GPS 117, the definition was drafted such that a counterparty is not part of an APRA-regulated group if the ultimate parent is not APRA-regulated. The application of this definition resulted in lower limits for exposures to counterparties that are APRA-regulated, but owned by an overseas parent. This was not APRA’s intention when drafting the Prudential Standard.

This instrument determines a new version of GPS 117 that makes minor amendments to clarify APRA’s intent. APRA has specifically included references to APRA-regulated counterparties in paragraph 16 of GPS 117. This ensures that exposures to counterparties that are APRA-regulated (but foreign owned) will be subject to the same asset concentration limits as exposures to counterparties where the ultimate parent is APRA-regulated.

This instrument will ensure the correct application of the Prudential Standard across the industry. This will ensure that general insurers and Level 2 insurance groups correctly calculate the Asset Concentration Risk Charge on non-reinsurance exposures to counterparties that are APRA-regulated, but owned by an overseas parent.

As the amendment increases the asset concentration limit of certain non-reinsurance exposures, there may also be a decrease in the Asset Concentration Risk Charge and therefore the prescribed capital amount for a small number of general insurers and Level 2 insurance groups.

1. Consultation

The instrument is minor or machinery in nature and does not substantially alter existing arrangements.

4. Regulation Impact Statement

The Office of Best Practice Regulation has advised that a Regulation Impact Statement is not required for this legislative instrument.

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. 1 of 2014

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**

This Legislative Instrument makes amendments to *Prudential Standard GPS 117 Capital Adequacy: Asset Concentration Risk Charge* to clarify the treatment of certain non-reinsurance exposures for the purposes of the Asset Concentration Risk Charge.

**Human rights implications**

APRA has assessed this Legislative Instrument and is of the view that it does 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 instruments are compatible with human rights.

**Conclusion**

This Legislative Instrument is compatible with human rights because it does not raise any human rights issues.