Risk based Supervision including Off-site analysis and On-site inspection

FSI Regional Seminar for Supervisors in Africa on Risk Based Supervision

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Australian Prudential Regulation Authority
Australian Regulators

Four distinct regulators, each aligned to different potential sources of market failure

ACCC
- Anti-competitive behaviour

ASIC
- Disclosure
- Market integrity
- Consumer protection
- Corporations

APRA
- Prudential regulation of financial institutions - banks, life insurers, non-life insurers, superannuation

RBA
- Monetary policy
- Stability of banking system
- Payments system
APRA’s Structure

Executive Group

Management Group

Supervision

Diversified Institutions

Specialised Institutions

Supervisory Support

PRS

Policy

Research

Statistics

APRA brochure
Structure in the Context of Supervision

- Executive Members
  - Diversified
  - Specialised
  - Support
  - Policy
  - Corporate

- Front-line Supervision
- Technical Experts
- Integrated Supervision
• APRA’s mission is to:
  - Establish and enforce prudential standards and practices designed to ensure that, under all reasonable circumstances, financial promises made by the institutions APRA supervises are met within a stable, efficient and competitive financial system
Objectives of Supervision

- Ensuring the ability to meet financial promises
- Minimise failure - but do not guarantee zero failure
- Financial promises vary from industry to industry
- Must be prepared to intervene to protect beneficiaries’ interests
- Financial compensation schemes and government guarantees
Our supervision approach
APRA’s Supervisory Framework (ASF)

Our supervisory approach is

- Forward-looking
- Risk based
- Consultative
- Consistent
- In line with international best practice

• This approach also recognises that management and boards of supervised institutions are primarily responsible for financial soundness

• Our supervision is conducted under the APRA Framework for Prudential Supervision
APRA’s Framework for Prudential Supervision

- All activities, supporting procedures, processes, systems and guidelines that are used in forming risk assessments and supervision strategies

- Central to supervision is entity risk assessment and appropriate supervisory outcomes

- Form these views by undertaking:
  - APRA-initiated supervisory activities
  - Institution-initiated requests
  - Overall assessments of industries and the financial sector
Supervision Cycle

Supervisory activities

Prudential Reviews, Prudential Consultations, financial and other offsite analysis, ongoing interaction, industry analysis, requests, licensing, enforcement

Supervision outcomes and responses

Entity risk assessment

SOARS - Supervisory response
Normal
Oversight
Mandated Improvement
Restructure

PAIRS
Assessment of probability of failure
Measurement of impact
Appropriate supervisory action plan
Probability and Impact Rating System (PAIRS)

- Dynamic risk assessment tool
- Determine the probability of failure, by rating
  - Quality assessment
  - Significance weight
- Measure the impact of potential consequences of failure
- Drives supervisory action
Probability and Impact Rating System (PAIRS) - (continued)

• Assessments of:
  – Inherent risks
  – Management and control
  – Capital

• All types of supervisory analysis and assessment have the potential to result in a revision to PAIRS
Supervisory Oversight and Response System (SOARS)

- A result of the PAIRS assessment
- Determines the ‘supervisory stance’ for a regulated entity as:

<table>
<thead>
<tr>
<th>Impact Rating</th>
<th>GI assets</th>
<th>Low</th>
<th>Lower Medium</th>
<th>Upper Medium</th>
<th>High</th>
<th>Extreme</th>
</tr>
</thead>
<tbody>
<tr>
<td>Extreme</td>
<td>&gt;13 bil</td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>High</td>
<td>&lt;13 bil</td>
<td></td>
<td></td>
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<td></td>
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</tr>
<tr>
<td>Medium</td>
<td>&lt;1.3 bil</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Low</td>
<td>&lt;133 mil</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- Ensure we take sufficient supervisory action based on our assessment of the likelihood and potential impact of failure
Levels of Supervision

- **Normal Supervision**
  Work in line with ASF and baseline supervision

- **Oversight Supervision**
  Institution not considered likely to fail
  Supervision focuses towards risk areas

- **Mandated Improvement**
  Not a permanent classification
  Management still in charge
  Defined action plan

- **Restructure**
  Use full enforcement powers available to protect beneficiary interests
  Legal entity may or may not continue
  Possible disqualification of individuals
Data Collection Requirements

- Level 1 insurers have quarterly and annual statistical reporting requirements under the Financial Sector (Collection of Data) Act 2001.
- Level 2 insurance groups now have half-yearly and annual statistical reporting requirements under the same Act.
- Both sets of data are submitted to APRA electronically, via our system Data 2 APRA (D2A).
- Data collected includes (inter alia):
  - Capital base and minimum capital requirements
  - Profit & Loss
  - Balance Sheet

- APRA publishes data on a quarterly basis; and half-yearly basis: www.apra.gov.au/Statistics/General-Insurers-Statistics.cfm
Prudential Reviews of Insurers

- Prudential reviews of insurers are a cornerstone of APRA’s assessment
- APRA reviews and assesses:
  - Reinsurance
  - Pricing
  - Underwriting
  - Claims
  - Independent review
  - Liability valuation
  - Product design
  - IT and business continuity management
  - Operational risk
  - Investment risk
Key Documentation under standards

- Prudential standards require insurers to provide a number of key documents typically linked to timing of the submission to or approval by the Board.
- APRA reviews and assesses:
  - Reinsurance Management Strategy
  - Reinsurance Arrangements Statement
  - Reinsurance Declaration
  - Actuary’s Insurance Liability Report
  - Actuary’s Financial Condition report
  - Risk Management Framework and Strategy
  - Three year Business plan
  - Material Outsourcing notification and summary of risk evaluation
Major supervision activities

- Prudential Review - On-site
- Prudential Review - Off-site
- Prudential Review - On-site with Supervisory support technical experts
- Prudential Review - Commissioned Expert
- Quarterly Analysis
- Annual Analysis
- Off-site review of documentation required under prudential standards
- Additional reporting and meetings (Board)
- External Party Liaison - auditors, actuaries
# Supervisory Action Plans

**Entity details**

<table>
<thead>
<tr>
<th>Entity Name</th>
<th>Probability Rating</th>
<th>Impact Rating</th>
<th>SOMARS Score</th>
<th>Total Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>ABC Bank Ltd</td>
<td>Lower/Medium</td>
<td>Extreme</td>
<td>Oversight</td>
<td>$123 456 789</td>
</tr>
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</table>

**Planned supervisory actions**

<table>
<thead>
<tr>
<th>Key Risk/Issue</th>
<th>Activity</th>
<th>Scoping</th>
<th>Timing</th>
<th>Additional resources</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk-based</td>
<td>Prudential review</td>
<td>Review problem asset management</td>
<td>Mar 09</td>
<td>$200 - credit risk</td>
</tr>
<tr>
<td>Internal management report - impaired assets</td>
<td>Quarterly discussion with CRO</td>
<td>Ensure regular discussion with relevant senior executives to track issues</td>
<td>Quarterly untill advised</td>
<td></td>
</tr>
<tr>
<td>SME credit deterioration (industry risk)</td>
<td>Offsite analysis - review loan portfolio composition and management reports</td>
<td>Jul 09</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Sign-offs consistent with PAIRS**

**Developed in the context of most recent supervision activities**

**Clear scope for assessment**

**Activity targeted to risk/issue type**

**Focus on risk/issue**
Structure in the Context of Supervision

- Executive Members
  - Diversified
  - Specialised
  - Support
  - Policy
  - Corporate
    - Front-line Supervision
    - Technical Experts
    - Integrated Supervision
## Baseline Supervision Requirements

<table>
<thead>
<tr>
<th>PAIRS Impact rating Activity</th>
<th>Extreme</th>
<th>High</th>
<th>Medium</th>
<th>Low</th>
<th>Other</th>
<th>Tolerance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Review PAIRS and supervisory action plan</td>
<td></td>
<td></td>
<td></td>
<td>12 months</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prudential review</td>
<td>12 months</td>
<td>24 months</td>
<td>36 months</td>
<td>Not mandated</td>
<td></td>
<td>3 months</td>
</tr>
<tr>
<td>Prudential consultation (excluding super)</td>
<td>12 months</td>
<td>24 months</td>
<td>36 months</td>
<td>36 months</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial analysis</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>3 months</td>
</tr>
<tr>
<td>Information mandated by Prudential Standards</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>As submitted</td>
</tr>
</tbody>
</table>


# PAIRS model

<table>
<thead>
<tr>
<th>PAIRS Category</th>
<th>Inherent Risk</th>
<th>Management and Control</th>
<th>Net Risk</th>
<th>Significance Weight</th>
</tr>
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<tbody>
<tr>
<td>Board</td>
<td></td>
<td></td>
<td>(0-4)</td>
<td>%</td>
</tr>
<tr>
<td>Management</td>
<td></td>
<td>SW applied to ‘Net Risk’</td>
<td>(0-4)</td>
<td>%</td>
</tr>
<tr>
<td>Risk Governance</td>
<td></td>
<td></td>
<td>(0-4)</td>
<td>%</td>
</tr>
<tr>
<td>Strategy and Planning</td>
<td>(0-4)</td>
<td>(0-4)</td>
<td>(0-4)</td>
<td>%</td>
</tr>
<tr>
<td>Liquidity Risk</td>
<td>(0-4)</td>
<td>(0-4)</td>
<td>(0-4)</td>
<td>%</td>
</tr>
<tr>
<td>Operational Risk</td>
<td>(0-4)</td>
<td>(0-4)</td>
<td>(0-4)</td>
<td>%</td>
</tr>
<tr>
<td>Credit Risk</td>
<td>(0-4)</td>
<td>(0-4)</td>
<td>(0-4)</td>
<td>%</td>
</tr>
<tr>
<td>Market and Investment Risk</td>
<td>(0-4)</td>
<td>(0-4)</td>
<td>(0-4)</td>
<td>%</td>
</tr>
<tr>
<td>Insurance Risk</td>
<td>(0-4)</td>
<td>(0-4)</td>
<td>(0-4)</td>
<td>%</td>
</tr>
<tr>
<td><strong>Net Risk Total</strong></td>
<td></td>
<td></td>
<td>(0-4)</td>
<td>100%</td>
</tr>
<tr>
<td>Coverage/ Surplus</td>
<td></td>
<td></td>
<td>(0-4)</td>
<td>%</td>
</tr>
<tr>
<td>Earnings</td>
<td></td>
<td></td>
<td>(0-4)</td>
<td>%</td>
</tr>
<tr>
<td>Access to Additional Capital</td>
<td></td>
<td></td>
<td>(0-4)</td>
<td>%</td>
</tr>
<tr>
<td><strong>Capital Support Total</strong></td>
<td></td>
<td></td>
<td>(0-4)</td>
<td>100%</td>
</tr>
<tr>
<td>Overall Risk of Failure</td>
<td></td>
<td></td>
<td>(0-4)</td>
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</table>
Modules and PAIRS are aligned

**PAIRS**
- Board
- Management
- Risk Governance
- Strategy & Planning
- Liquidity Risk
- Operational Risk
- Credit Risk
- Mk & Investment Risk
- Insurance Risk
- Capital - Coverage
- Capital - Earnings
- Capital – Access to Add

**APRA Supervision Framework Modules**
- Board
- Management
- Risk Governance
- Strategy & Planning
- Liquidity Risk
- Operational Risk
- Credit Risk
- Mkt & Investment Risk
- Insurance Risk
- Capital
<table>
<thead>
<tr>
<th>Modules and Topics</th>
<th>Module 1 Board</th>
<th>Module 2 Management</th>
<th>Module 3 Risk Governance</th>
<th>Module 4 Strategy &amp; Planning</th>
<th>Module 5 Capital</th>
<th>Module 6 Liquidity Risk</th>
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</thead>
<tbody>
<tr>
<td>Board Composition</td>
<td>Board Composition</td>
<td>Management Structure</td>
<td>Role of Board</td>
<td>Compliance Framework</td>
<td>Coverage / Surplus</td>
<td>Liquidity Risk</td>
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<tr>
<td>Fit and Proper</td>
<td>Fit and Proper</td>
<td>Fit and Proper</td>
<td>Risk Governance of Board</td>
<td>Management Information System</td>
<td>Earnings</td>
<td>Board and Management Awareness</td>
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<td>Board Committees</td>
<td>Independent Review</td>
<td>Access to Additional Capital</td>
<td>Liquidity Risk Management</td>
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<td>Decision Making Process</td>
<td>- Internal Audit (IA)</td>
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<td>Risk Management</td>
<td>- Independent Review</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>- External Audit (EA)</td>
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<tr>
<td>Module 4 Strategy &amp; Planning</td>
<td>Strategic Risk</td>
<td>Module 5 Capital</td>
<td>Module 6 Liquidity Risk</td>
<td>Implementation &amp; Execution</td>
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<tr>
<td></td>
<td>Strategic Planning</td>
<td></td>
<td></td>
<td>Monitoring its own progress</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Business Plan</td>
<td></td>
<td></td>
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</tbody>
</table>
## Modules and Topics

| Module 7 Op Risk | • Nature and Complexity  
• Internal & External Fraud  
• IT Systems  
• Business Disruption  
• Board and Mgt Awareness  
• Operational Risk Mgt Framework  
• Outsourcing Arrangements | • Administration  
• Information Technology  
• Business Continuity Management  
• Project Management (IT)  
• New & Varied Products  
• Independent Review of Operational Risk | Module 8 Credit Risk (reinsurer focus)  
• Credit rating / financial standing of reinsurers  
• Concentration and large exposures  
• Impact of downgrade or default on insurer | • Credit policy  
• Concentration and large exposures  
• Payment and collections |
| --- | --- | --- | --- |
| Module 9 Market and Investment Risk (MIR) | • Asset Liability Mismatch Risk  
• Investment Risk  
• Risk of Asset Valuation | • Board and Mgt Awareness  
• Asset and Liability Risk Mgt  
• Invest. Risk Mgt  
• Controls on Asset Valuation  
• Independent Review of Market Investment Risk | Module 10 Insurance Risk  
• Insurance Risk  
• Credit Risk  
• Board and Management  
• Product Design  
• Pricing  
• Underwriting | • Claims  
• Liability Valuation  
• Reinsurance  
• Distribution  
• Independent Review of Insurance Risk |
## Language of PAIRS Rating

<table>
<thead>
<tr>
<th>Rating Band</th>
<th>Inherent Risk (ignoring any controls)</th>
<th>Management and Controls</th>
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<tbody>
<tr>
<td>0 - 0.5</td>
<td>Very Low</td>
<td>Strong</td>
</tr>
<tr>
<td>0.6 - 1.0</td>
<td>Low</td>
<td>Sound</td>
</tr>
<tr>
<td>1.1 - 1.5</td>
<td>Low Medium</td>
<td>Adequate</td>
</tr>
<tr>
<td>1.6 - 2.0</td>
<td>High Medium</td>
<td>Vulnerable</td>
</tr>
<tr>
<td>2.1 - 3.0</td>
<td>High</td>
<td>Weak</td>
</tr>
<tr>
<td>3.1 - 4.0</td>
<td>Extreme</td>
<td>Extremely Weak</td>
</tr>
</tbody>
</table>
Probability of failure

![Fourth Power Conversion Graph](image)

- **Probability Index**
- **Overall Risk of Failure and Probability Rating**
  - Low
  - Lower medium
  - Upper medium
  - High
  - Extreme
Quality and control

- Education and training
- Sign off protocols
- System validations
- Reporting and monitoring
- Benchmarking sessions
- Peer reviews
Supporting prudential framework
General Insurance Prudential Regulation Framework

- Prudential framework it comprises:
  - Amended Insurance Act 1973;
  - GI Prudential Standards;
  - Prudential Practice Guides (PPGs);
  - GI Reporting Standards

- commenced on 1 July 2002, introducing risk based capital regime when requirements in relation to governance, financial soundness and risk management were either introduced or significantly strengthened

- Additional requirements in 2006 relating to governance and fit & proper and outsourcing
Refinements in 2006 relating to risk, financial management, reinsurance and FCR

In 2007 Prudential Practice Guides replaced GI Guidance Notes (GN);

Refinements in 2008 relating to categories of insurers and capital charges on reinsurance & equity/property

Introduction in 2009 of requirements for Level 2 insurance groups

New remuneration requirements, effective on 1 April 2010

New performance reporting introduced, effective 1 July 2010
Policy Development

- Capital review (Life & general insurance)
- Level 3 conglomerates framework
Prudential Framework

Insurance Act & Regulations

Prudential Standards

- GPS 110  Capital Adequacy
- GPS 120  Assets in Australia
- GPS 220  Risk Management
- GPS 222  Business Continuity Management
- GPS 230  Reinsurance Management
- GPS 310  Audit & Actuarial Valuation
- GPS 410  Transfer and Amalgamation of insurance Business
- GPS 510  Governance
- GPS 520  Fit and Proper

- Guidelines on Authorisation
- Prudential Practice Guides
Prudential Practice Guides (PPG’s)

PPGs are recommended better practices rather than PS requirements. PPGs are not legally enforceable.

- GPG 200: Risk Management
- GPG 220: Credit Risk
- GPG 230: Operational Risk
- PPG 231: Outsourcing
- GPG 232: Custody Arrangements
- PPG 233: Pandemic Planning and Risk Management
- GPG 240: Insurance Risk
- GPG 245: Reinsurance Management Strategy
- GPG 250: Balance sheet & Market Risk
- GPG 510: Governance
- GPG 520: Fit and Proper
Risk Management

• A general insurer must have:
  – A risk management framework, which is documented in a risk management strategy
  – Dedicated risk management function
  – Three year business plan
  – Submit a risk management and financial information declaration
Reinsurance Management

• A general insurer must:
  – Have a reinsurance management framework, which is documented in a reinsurance management strategy
  – Have a process for documenting reinsurance arrangements
  – Submit a reinsurance arrangements statement
  – Submit a reinsurance declaration
  – Submit Limited Risk Transfer Arrangement details to APRA for prior approval
The Board must appoint an actuary and auditor to ensure that the Board and senior management of an insurer are provided with impartial advice in relation to its operations, financial condition and insurance liabilities.

The Appointed Auditor’s primary role is to:

- provide an independent and objective view on the truth and fairness of the insurer’s financial statements; and
- assess the insurer’s systems, procedures and controls used to address compliance with prudential requirements.
The Appointed Actuary’s primary role is to:
- Provide advice on the insurer’s insurance liability valuation (note that this includes discounting of insurance liabilities)
- Provide an impartial assessment of the overall financial condition of the insurer

The Reviewing Actuary’s primary role is to undertake a peer review of the Appointed Actuary’s ILVR
This Prudential Standard sets out minimum foundations for good governance of regulated institutions. It aims to ensure that regulated institutions are managed in a sound and prudent manner by a competent Board of Directors, which is capable of making reasonable and impartial business judgements in the best interests of the regulated institution and which gives due consideration to the impact of its decisions on policyholders.

This standard has applied to Authorised Non-Operating Holding Companies since October 2006

The standard allows some concessions for insurers whose parents are prudentially regulated
Governance (continued)

- **Main requirements**
  - Board size of at least 5 directors; majority independents and independent chair
  - a Board Audit Committee must be established
  - regulated institutions must have a dedicated internal audit function
  - certain provisions dealing with independence requirements for auditors
  - the Board must have a policy on Board renewal and procedures for assessing Board performance
The Insurance Act requires all insurers (both subsidiaries and branches) to maintain assets in Australia to the value that equals or exceeds the total amount of the insurer’s liabilities in Australia. This requirement ensures that the total value of assets held within the jurisdictional reach of APRA and the Australian courts is sufficient to meet a general insurer’s liabilities in Australia.

The objective of GPS 120 Assets in Australia, is to specify certain assets that are excluded as “assets in Australia”.

The assets excluded are those which would otherwise fall within the definition of “assets in Australia” but which APRA considers to have doubtful or no value to policy holders in Australia in the event of a general insurer becoming insolvent.
• BCM Prudential Standard ensure that the general insurer implements a whole of business approach to Business Continuity Management (BCM) appropriate to the nature and scale of its operations. BCM increases an insurer’s resilience to business disruption arising from internal and external events and reduces the impact on the insurer’s operations, reputation, profitability, policyholders and other stakeholders.

• Outsourcing Prudential Standard aims to ensure that all outsourcing arrangements involving material business activities entered into by a general insurer are subject to appropriate due diligence, approval and on-going monitoring. All risks arising from outsourcing material business activities must be appropriately managed to ensure that the general insurer is able to meet both its financial and service obligations to its policyholders.
Questions
Appendix: Fit & Proper

• Fit and Proper Prudential Standard sets out minimum requirements for these institutions in determining the fitness and propriety of individuals to hold positions of responsibility (Responsible Person).

• Key requirements
  – Fit and Proper Policy
  – Assess responsible person prior to initial appointment and then re-assessed annually (or as close to annually as practicable);
  – take all prudent steps to ensure that a person is not appointed to, or does not continue to hold, a responsible person position for which they are not fit and proper;
  – additional requirements must be met for certain auditors and actuaries; and
  – certain information disclosures to APRA
Appendix: Capital Adequacy

- An insurer must maintain a capital base in excess of its Minimum Capital Requirement (MCR).
- Capital base:
  - Defined in GPS 112
  - Tier 1 includes ordinary shares, retained earnings and innovative instruments)
  - Tier 2 includes preference shares, convertible notes and subordinated debt.
  - deductions to be made from the eligible capital (goodwill, intangibles, expected dividends)
  - insurance liabilities held on the balance sheet at a probability of sufficiency greater than 75% count as Tier 1 capital (net of tax)
Appendix: Minimum Capital Requirements

- Prescribed Method or Internal Model Based Method (or combination)

- Prescribed Method sets risk based capital requirements based on three main categories
  - **Insurance risk** - actual value of net insurance liabilities could be greater than the estimated amount
  - Calculated by applying a capital factor to the net outstanding claims provision and net premium liabilities (at 75% probability of sufficiency)

<table>
<thead>
<tr>
<th>Direct Classes of Business</th>
<th>OCP</th>
<th>PL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Houseowners / Householders</td>
<td>9.0%</td>
<td>13.5%</td>
</tr>
<tr>
<td>Commercial Motor Vehicle</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Domestic Motor Vehicle</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Travel</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fire and ISR</td>
<td>11.0%</td>
<td>16.5%</td>
</tr>
<tr>
<td>Marine</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Aviation</td>
<td></td>
<td></td>
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<tr>
<td>Consumer Credit</td>
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<td></td>
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<tr>
<td>Mortgage</td>
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<td></td>
</tr>
<tr>
<td>Other Accident</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
</tr>
<tr>
<td>CTP motor vehicle</td>
<td>15.0%</td>
<td>22.5%</td>
</tr>
<tr>
<td>Public and Product Liability</td>
<td></td>
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<td>Professional Indemnity</td>
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<td>Employers Liability</td>
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Appendix: Minimum Capital Requirements 2

- **Investment risk** - the risk of an adverse movement in the value of an insurer’s assets and/or off-balance sheet exposures due to credit risk, market/mismatch risk and liquidity risk
- Calculated by applying a capital factor to the quality of the assets on the balance sheet, including investments and reinsurance recoverables
- For example,
  - Cash is 0.5%
  - AA- reinsurance recoveries from APRA authorised reinsurers is 2%
  - AA- reinsurance recoveries from non-APRA authorised reinsurers is 3%
  - Fixed interest security issued by A rated bank is 4%
  - Listed Equities is 16%
− **Concentration risk** - accumulation of exposures to a single catastrophic event or single cause (net of reinsurance).
− Firstly, the insurer calculates the Probable Maximum Loss (PML), the largest gross loss due to a concentration of risk exposures, set to be a 1 in 250 year event.
− The insurer then calculates potential reinsurance assets to derive the Maximum Event Retention (MER)
− The risk charge is equal to the MER plus the cost of one reinstatement of the catastrophe reinsurance program.
− Lenders Mortgage Insurers have a prescribed MER scenario, based on a three year economic downturn