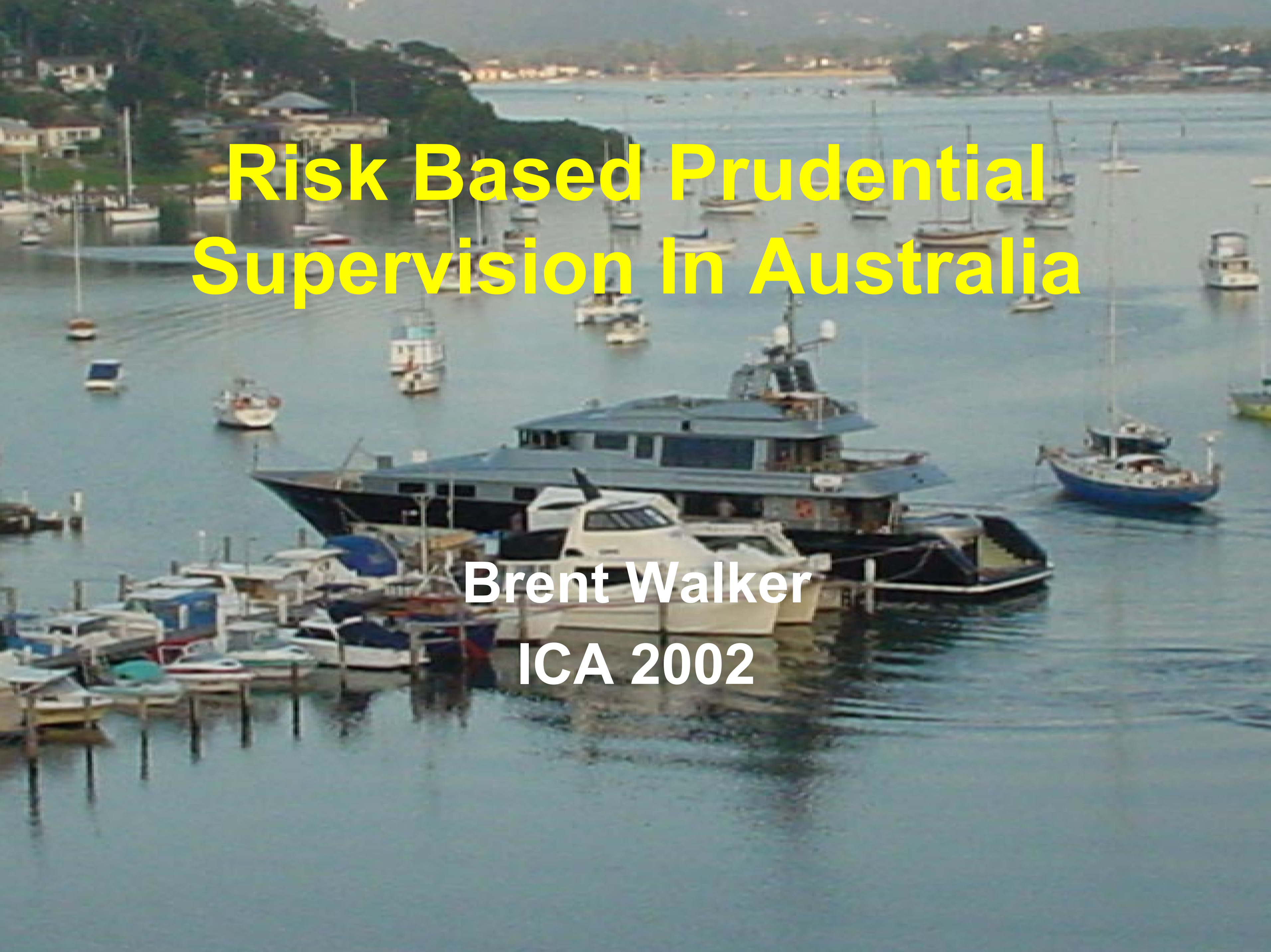
Risk Based Prudential Supervision In Australia



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Outline

- Brief History
- Solvency Standard
- Capital Adequacy Standard
- Actuarial Involvement

History

- 1953 National Health Act commenced – Dept of Health supervised health insurance industry.
- 1968 Small regional insurer bankrupt but major political consequences
- Reserve levels – political football
- 1982 Minimum solvency margin legislated – 2 breakeven contribution months.
- 1989 Private Health Insurance Administration Council formed to regulate industry

History Continued

- 1993 Actuarial report recommends risk based capital approach.
- 1997 Productivity Commission endorses recommendation
- 1999 Actuarial consultants appointed by PHIAC to develop standard
- January 2001 new solvency and capital adequacy standards commence

Liability Risks

- Reserve adequacy risk
  - Outstanding claims
  - Contributions in advance
  - Reinsurance recovery
  - Reinsurance liability
  - Other liabilities
- Catastrophe / reinsurance risk

Asset Risks

- Adverse systemic market movements
- Asset contagion risks / liquidity / realisation
- Holdings in entities, which are prudentially regulated.
- Asset Concentration & non-systemic risks
- General credit / liquidity risks

Operational Risks

- Administration and business operations risk

Solvency Standard

- *“The purpose of the solvency standard is to ensure, as far as practicable, that at any time the financial position of the health insurers conducted by a registered organisation is such that the organisation will be able, out of the assets of the insurer, to meet all liabilities referable to the health insurance business of the organisation as those liabilities become due.”*

Specific Solvency Reserves

- **Liabilities**
  - 10% of best estimates
- **Assets**
  - Inadmissible assets (includes conduct of business assets)
  - Resilience reserves (1.5% change in yields)
- **Operational**
  - 6 month's operational expenses (excludes new business expenses)

Capital Adequacy Standard

- *"The purpose of the capital adequacy standard is to ensure, as far as practicable, that there are sufficient assets in the health insurers conducted by each registered organisation to provide adequate capital for the conduct of the health insurance business in accordance with this Act and in the interests of the contributors to the insurer."*

Capital Adequacy Liability Risks

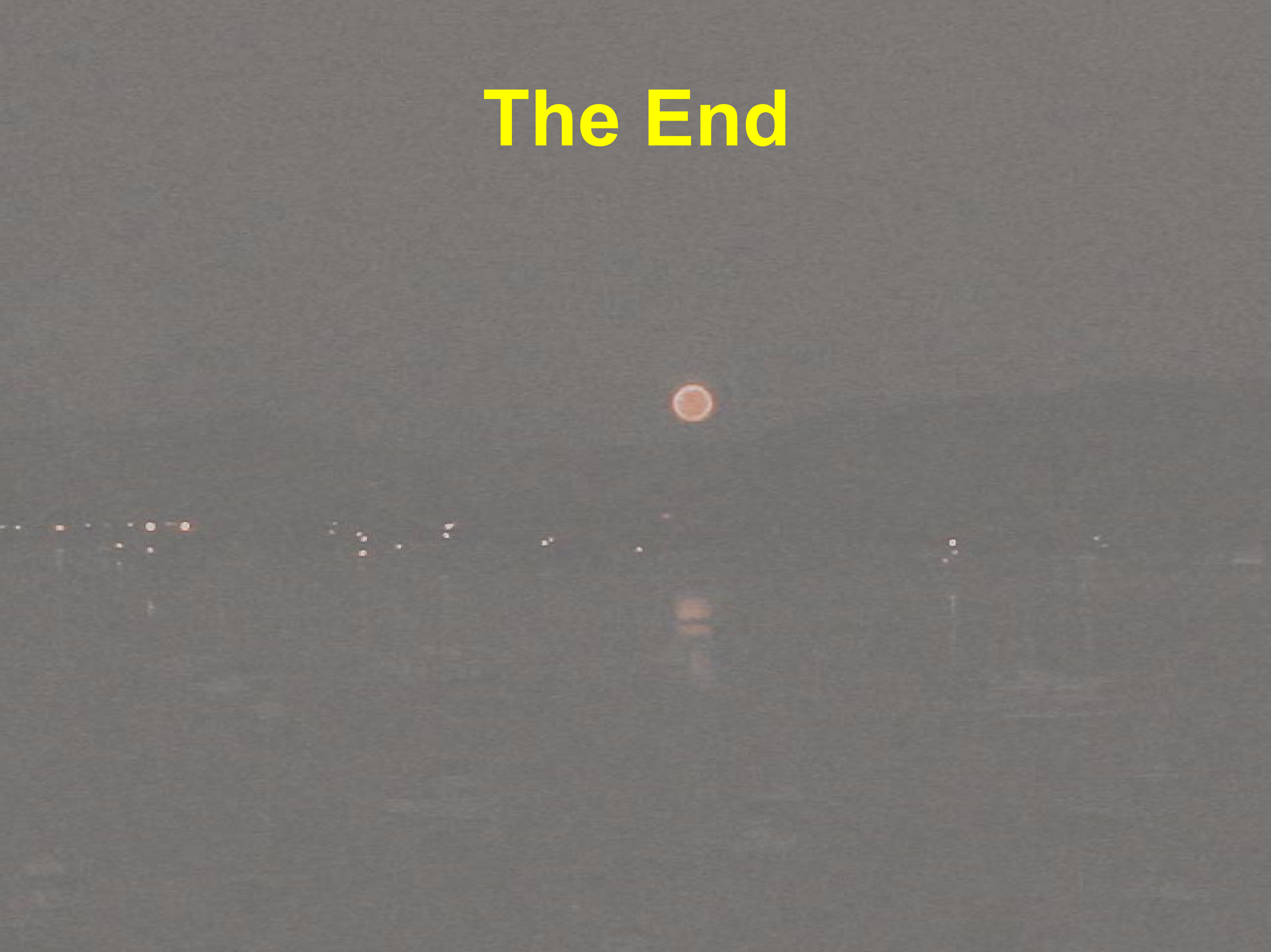
- **Risk margin has 3 components**
  - Base margin is 12.5%
  - Size Margin from 0% to 7.5%
  - Claims/stability margin 0% to 5%

Specific Capital Adequacy Reserves

- **Liabilities**
  - (risk margin)% of best estimates
- **Assets**
  - Inadmissible assets (excludes conduct of business assets)
  - Resilience reserves (2.5% change in yields)
- **Operational**
  - (risk margin)% of one years projected outgo less operational profit.
  - Specific business funding reserve for known extraordinary costs and reserve requirements

Actuarial Involvement

- Actuaries not specifically required to provide solvency and capital adequacy calculations for reporting.
- Biggest insurers use their in house actuary (if they have one). Smallest insurers use consultants.
- Government requires actuaries to certify reasonableness of assumptions for pricing.
- Appointed Actuary concept on current agenda of PHIAC (regulator).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