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MEMBER

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To: Level 2 insurance groups

Treatment of foreign currency exposures in the Asset Risk Charge

Under the revised general insurance capital framework effective on 1 January 2013, Level 2 insurance groups must calculate a prescribed capital amount. One of the components of the prescribed capital amount is the Asset Risk Charge (*Prudential Standard GPS 114 Capital Adequacy: Asset Risk Charge* (GPS 114)). The Asset Risk Charge is the minimum amount of capital required to be held against asset risks.

The Asset Risk Charge includes a risk charge component for foreign currency exposures, known as the currency stress. This is calculated by assessing the impact on the capital base of the Level 2 insurance group of an appreciation or depreciation of the Australian dollar against all foreign currency exposures. APRA acknowledges that, for Level 2 insurance groups with significant operations in foreign countries, the application of the currency stress to the foreign currency assets needed to support regulatory capital requirements for the foreign currency liabilities may produce an overly conservative outcome.

To allow for this, APRA is prepared to consider an application from a Level 2 insurance group to use an adjustment to the standard method for determining the currency stress. Any adjustment must be robust and fully documented (including detailed supporting calculations) and must demonstrate that the underlying foreign currency risk of the Level 2 insurance group is fully captured. The application must clearly articulate the group's view on the extent to which the method set out in GPS 114 overestimates the capital required for foreign currency risk and the basis on which the proposed alternative method produces a more appropriate outcome.

APRA will review each application and, on a case-by-case basis, may agree to an adjustment to the method for determining the currency stress. Any such adjustment to the requirements in GPS 114 will outline the method to be used by the Level 2 insurance group to calculate the currency risk charge component. The adjustment may be subject to conditions.

If you have any questions on this letter, or wish to submit an application for adjustment, please contact your APRA Responsible Supervisor.

Yours sincerely