

Capital Adequacy

Total Industry

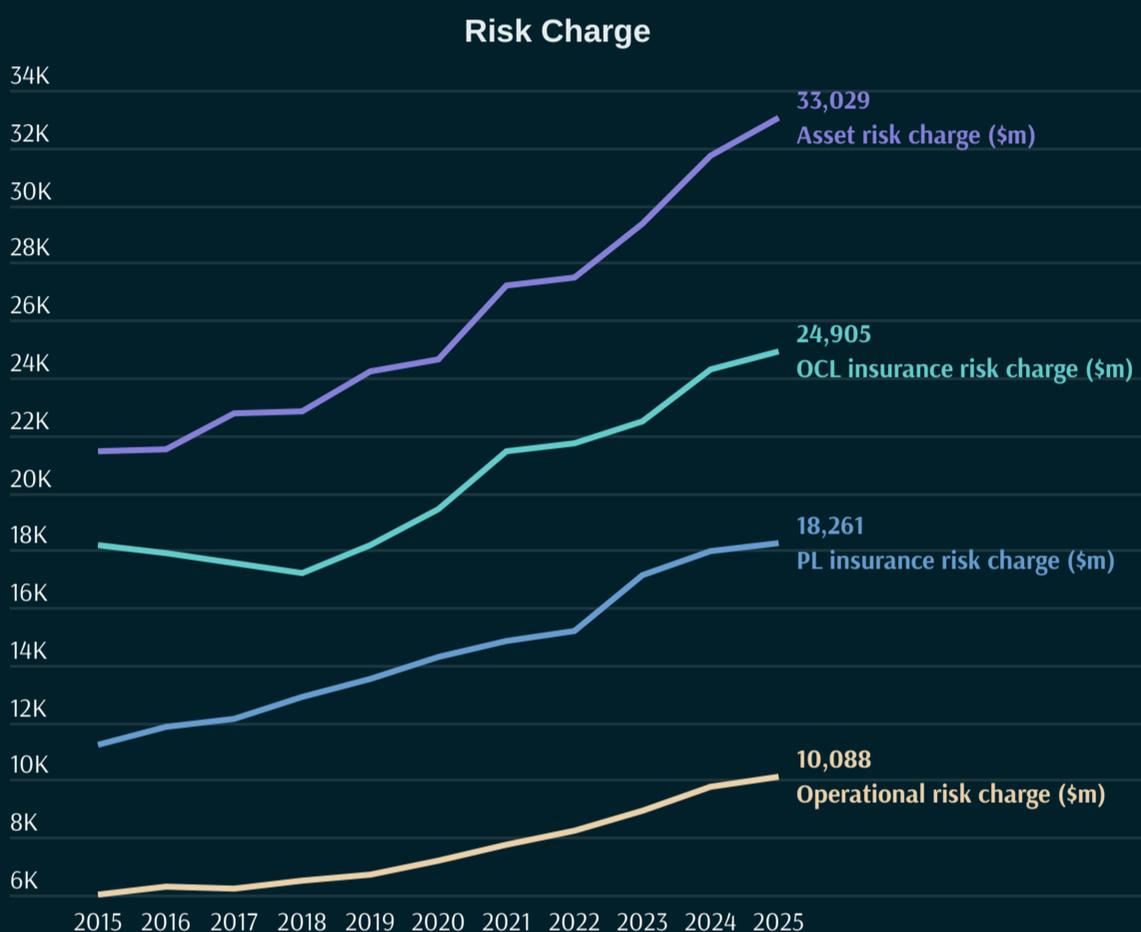
What is Capital Adequacy?

Capital adequacy in insurance refers to an insurer's ability to maintain sufficient capital to absorb losses and meet policyholder obligations under a range of adverse scenarios. It is a key measure of financial strength and is closely regulated to ensure stability within the industry. In Australia, capital adequacy is assessed under the APRA-prescribed framework, which includes a series of risk charges, such as:

1. insurance risk
2. asset risk
3. operational risk

Each risk charge is designed to quantify the potential for financial loss in each area. These charges are aggregated, with diversification benefits applied, to determine the **Prescribed Capital Amount (PCA)**, which insurers must hold at a minimum to remain solvent and protect policyholders.

Definition's applicable to each section below



Evolving Risk Landscape: Rising Insurance Capital Charges Reflect a Decade of Growth and Complexity

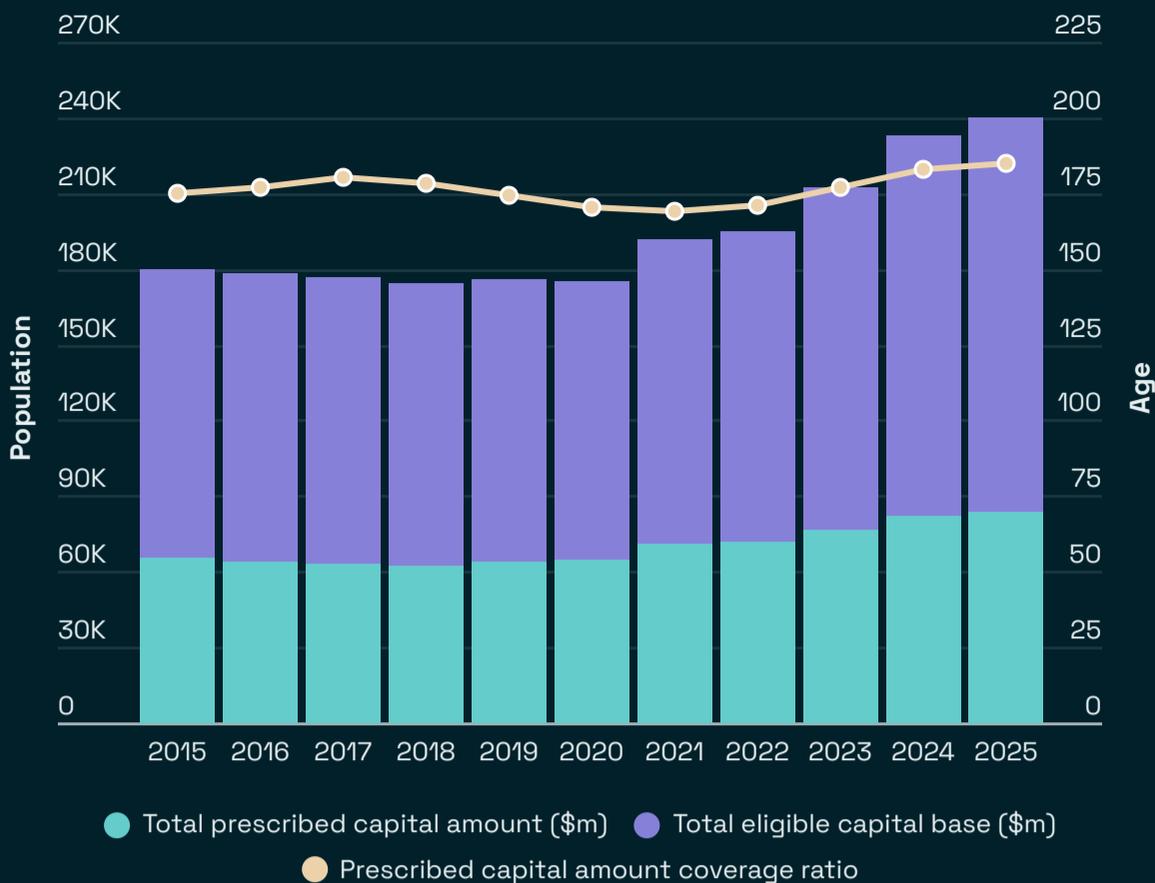
Over the past decade, insurers' capital requirements have been significantly shaped by the steady growth of the OCL and PL insurance risk charges, the asset risk charge, and the operational risk charge. The OCL insurance risk charge increased from **\$18.1 billion in 2015** to over **\$24.5 billion by 2025**, a rise of about **35%**. This sustained growth reflects higher volumes of claims, claims cost inflation, and more complex settlement patterns, particularly as extreme weather events have become more frequent. Similarly, the **PL insurance risk charge** climbed even faster, growing by roughly **60%** over the same period. This trend suggests that insurers are carrying larger portfolios of in-force business, likely driven by expanding demand and rising sums insured.

The **asset risk charge** also rose consistently, from approximately **\$21.4 billion in 2015** to more than **\$33 billion in 2025**. This reflects insurers' increasingly sizeable investment portfolios, as well as the impact of market volatility and potentially higher allocations to growth or credit-sensitive assets to maintain returns in a low interest rate environment.

Finally, the **operational risk charge** grew steadily, increasing from **\$6.0 billion in 2015** to nearly **\$10 billion in 2025**. This indicates that operational exposures, including technology risks, cyber threats, and complex supply chains, are becoming more material components of insurers' overall risk profile.

Together, the rising contributions of these four charges underscore the growing complexity of the insurance landscape and the need for stronger capital buffers to protect policyholders and maintain confidence in the sector's resilience.

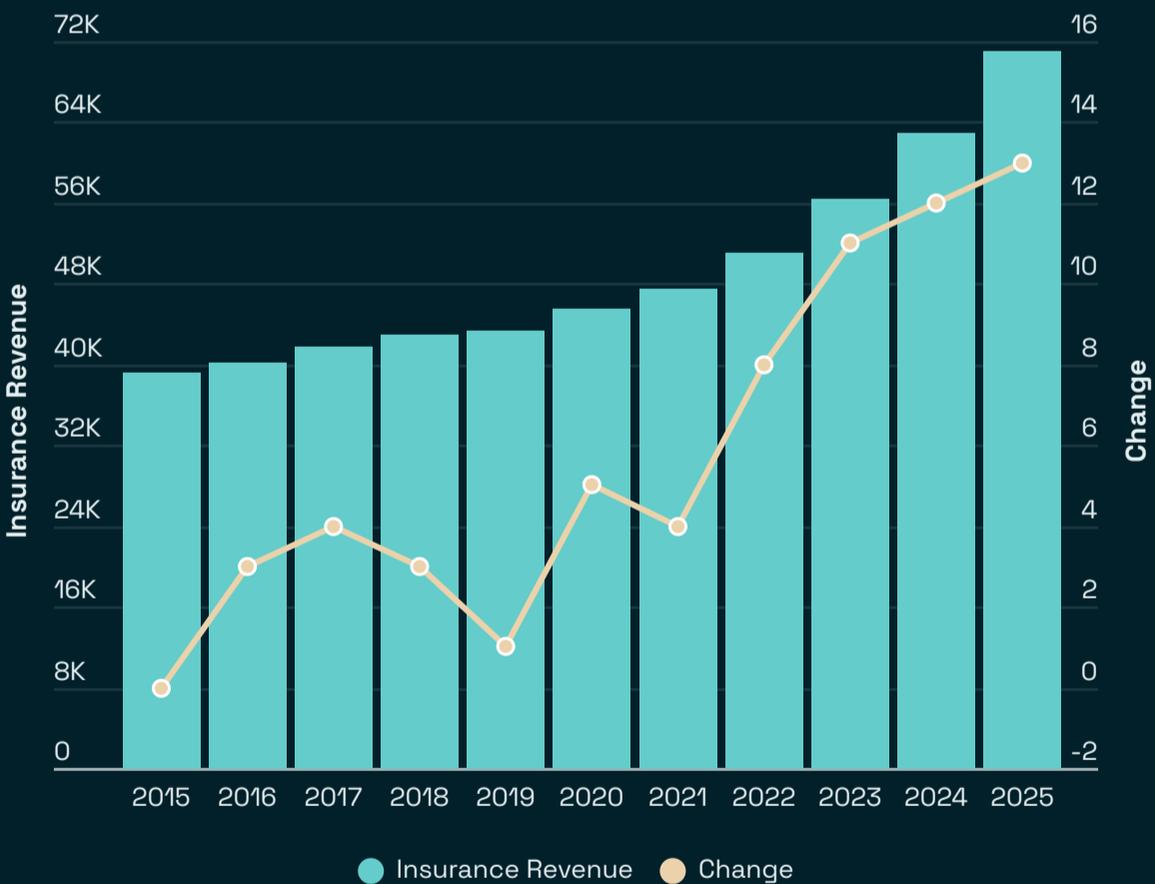
Total Prescribed Capital Base vs Eligible Capital Base



Insurers Strengthen Capital Resilience: A Decade of Growth Beyond Regulatory Requirements

Over the past decade, insurers have steadily strengthened their capital positions relative to risk, as reflected in the growth of both the **total prescribed capital amount** and the **total eligible capital base**. While the prescribed capital amount increased from approximately **\$65 billion in 2015** to over **\$84 billion by 2025**, a rise of about 29% driven by expanding liabilities, higher asset exposures, and operational complexities, the total eligible capital base grew even faster, rising by nearly **36%** over the same period. Notably, the coverage ratio, which measures how much capital insurers hold relative to the regulatory minimum, improved from **175% in 2015 to a robust 185% in 2025**. This trend demonstrates that insurers have not only kept pace with growing risk charges but have proactively built additional capital buffers, enhancing their resilience to economic shocks and large-scale claims events. The marked increase in surplus capital from 2022 onward likely reflects strong profitability, prudent retention of earnings, and a deliberate focus on maintaining high solvency margins amid rising climate and market uncertainties.

Total Industry GWP Growth



Insurance Industry Growth Drives Rising Risk Charges and Capital Requirements

The insurance industry's growth, as measured by Insurance Revenue, is closely correlated with the increase in risk charges. As the industry expands, insurers face escalating liabilities, greater asset exposures, and more complex operational challenges. This growth necessitates higher capital reserves to cover potential claim payments, premium liabilities, asset risks, and operational risks, leading to a proportional rise in risk charges. Consequently, the need for robust capital buffers becomes increasingly critical to maintain stability, protect policyholders, and ensure resilience against economic shocks and large-scale claims events.

Defintions:

Definition's for: Risk Charge

OCL Insurance Risk Charge (Outstanding Claims Liability)

This is the capital insurers must hold to cover the risk that actual payments for claims that have already occurred (but are not yet fully settled) will be higher than expected. It accounts for uncertainties in the valuation of outstanding claims liabilities, including large or complex claims that can develop over time.

PL Insurance Risk Charge (Premium Liability Insurance Risk Charge)

This is the capital required to protect against the risk that future claims arising from policies that are already written but not yet earned will exceed the premiums and reserves set aside. In other words, it covers the possibility that future claims costs are underestimated or that adverse events will occur during the unexpired portion of current insurance contracts.

Asset Risk Charge

This charge represents the capital insurers need to hold to cover the risk of losses arising from their investment portfolios. It includes exposure to fluctuations in the value of shares, bonds, property, and other assets, as well as credit risk from counterparties.

Operational Risk Charge

This is the capital set aside to protect against the risk of losses resulting from failures in processes, systems, people, or external events. It includes a wide range of operational exposures such as fraud, cyber-attacks, processing errors, legal risks, and business disruptions.

Definition's for: Total Prescribed Capital Base vs Eligible Capital Base

Total Prescribed Capital Amount:

This is the minimum amount of capital that an insurance company is required by APRA to hold to cover its risks.

Total Eligible Capital Base:

This represents the total amount of capital that an institution actually holds and that APRA deems acceptable for meeting the prescribed capital requirements. It includes common equity, retained earnings, certain reserves, and other forms of capital that qualify under APRA's rules.

Prescribed Capital Amount Coverage Ratio:

This is the ratio of the Total Eligible Capital Base to the Total Prescribed Capital Amount, usually expressed as a percentage. It shows how well an institution's capital exceeds the regulatory minimum. For example, a coverage ratio of 175% means the institution holds 75% more capital than the minimum required by APRA.