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Dear Ms Richards

### **Submission on Prudential Standard LPS 230 Reinsurance**

This letter sets out the Actuaries Institute's submission in response to APRA's draft Prudential Standard LPS 230 Reinsurance released for feedback in November 2017.

The Institute supports the principles-based approach and also the alignment to the approach taken in the general insurance industry. We also support the removal of the current requirement for the Appointed Actuary to express an opinion on reinsurance arrangements in the reinsurance report and its replacement by the proposed assessment of the insurer's reinsurance strategy in the draft CPS 320.

#### **Potential for Expanded Scope**

We do note that the principles approach is likely to increase the level of uncertainty for the industry in determining the type of contract requiring submission to APRA for approval. Given the increased requirements within applications, including the need for certification by the appointed auditor, this would represent an additional burden and reduction in the efficiency of the reinsurance market. It would assist the industry if APRA is able to clarify the type of contracts that would and would not require approval either within the Standard or through updated guidance. As an example, the standard identifies high levels of acquisition cost funding as likely to be a Limited Risk Transfer Arrangement requiring APRA approval. Guidance could describe features that clearly do not require approval as well as features that are very likely to be classified as financing.

#### **Timing Guidance**

Given the potential for increased approval requirements and the increased information required as part of the approval process, it would help the industry to have guidance from APRA as to timings for approval consideration. In particular, reinsurance arrangements are often the result of a tender process with subsequent negotiation and refinements to contracts. An extended approval process would add further delays to the timely implementation of reinsurance arrangements.

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## Reinsurance Report

The footnote to section 6 notes that the reinsurance report may be provided as part of the Financial Condition Report. Given the overall direction of the changes being made to the Appointed Actuary role, the absence of any opinion required in the reinsurance report and the creation of the new Actuarial Valuation Report, it may be more appropriate to include the detailed reinsurance report as a separate report to APRA or together with the Actuarial Valuation Report, not the FCR. These options could also be mentioned in the footnote.

## Acquisition Costs

Attachment B paragraph 3 proposes that “arrangements where the reinsurer funds a share of the insurer’s acquisition costs that exceeds the share of the insurer’s gross claims ceded to the reinsurer” are likely to be Limited Risk Transfer Arrangements. It would be helpful to clarify that acquisition costs include the total of commission and non-commission expenses as well as marginal and non-marginal expenses related to the establishment of a new policy. This could be achieved by relabelling this as acquisition expenses with reference to the term defined in LPS 001 Definitions. This would also ensure that the definition is not impacted by changes in accounting definitions of deferrable acquisition expenses.

Over the next few years the commission related acquisition costs may reduce on policies as the ASIC’s commission and clawback requirements are implemented. It would be helpful to clarify if these changes will trigger reviews of reinsurance arrangements under Attachment B section 2 in the absence of any other modifications.

## Material Changes

In order to not create barriers to change, it is suggested that APRA clarifies that material changes to existing contracts referred to in section 16 do not include changes that would increase the level of risk transfer or be neutral on the level of transferred risk (e.g. operational changes). A similar consideration could apply to changes to reinsurance agreements classified as a “Limited Risk Transfer” under the new Standard. This clarification could be included in the Standard or in accompanying guidance.

## Use of the term “Limited Risk Transfer”

The Standard, in particular section 11, uses the term “Limited Risk Transfer” to refer to arrangements that can be assessed as having significant risk transfer over the life of the contract – effectively these contracts do not have a *limited* risk transfer. It would be helpful, for clarity, to use a different term to refer to reinsurance contracts that require written approval from APRA prior to the determination of whether they do actually have limited risk transfer.

For example, a simple quota share reinsurance contract in respect of an in-force individual portfolio could have initial reinsurance commission of 120% of the unamortised acquisition expense balance after allowing for the reinsurer’s share of the gross claims. Effectively there has been a transfer of the quota share of risk plus an additional component that increases the amount of lapse risk transferred to the reinsurer. Such an arrangement does not have limited risk transfer, but the Standard would apply this label.



Please do not hesitate to contact Elayne Grace, Acting Chief Executive Officer to discuss any aspect of this paper (phone 02 9239 6100 or email [elayne.grace@actuaries.asn.au](mailto:elayne.grace@actuaries.asn.au)).

Yours sincerely

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