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Dear [REDACTED]

Offshore Reinsurers and the Review of Prudential Standard LPS 117 Capital Adequacy: Asset Concentration Risk Charge

We refer to APRA's letter dated 4 March 2019 to all life insurers regarding LPS 117. Please take this letter as General Reinsurance Life Australia Limited's (GRLA's) submission to the consultation. GRLA thanks APRA for extending the time available for a response.

1 Effective Supervision of Life Industry

Participation of offshore reinsurers particularly in the group risk market has to a large extent been promoted by brokers who advanced the idea that there was insufficient reinsurance capacity in Australia for group risks. Whilst local reinsurers did indeed attempt to offer less generous terms, e.g. on rate guarantee periods, that is no longer the case due to competition both from offshore and amongst local reinsurers. The seven APRA-authorized life reinsurers generate significant competition, more so after consolidation in the primary market, and between them offer sufficient local reinsurance capacity.

Local life reinsurers offer more than pure financial capacity. They also provide assistance in co-managing life insurance risks. While additional less expensive capacity may be attractive in the short-term, it could very well turn out to be unsustainable in the long-term and undermine the sustainability of products or product designs. Should potentially unrealistic reinsurance pricing be used to support an insurer's competitive position, there could be a very real risk that loss of less expensive capacity together with less informed underwriting and/or claims decisions lead to unsatisfactory outcomes for the consumer, a topic of consideration by the Hayne Royal Commission.

From another perspective, insurers may look for naïve (i.e. offshore) reinsurance capacity. Offshore reinsurers may not have adequate understanding of changes in the local environment (e.g. Protecting Your Super, Hayne Royal Commission, worsening disability income insurance experience, etc.) and the terms that they offer may not reflect the conditions seen in the current local and regulatory environment. Reinsurance should be a transaction between sophisticated parties, but should local developments not be adequately considered then that poses the risk of reinsurance recovery requests being challenged and local insurers being thus exposed.

Individual disability income insurance, the subject of an APRA thematic review, is a prime example of a product with emerging/evolving experience that is less than satisfactory. In this case, APRA is looking for reinsurers to proactively engage with and to assist their ceding company clients in assumption-setting and other tasks. Local reinsurers are better positioned to satisfy this need and to be an effective influence on the primary market, in contrast to offshore reinsurers.

At the same time, however, the more intensely APRA supervises local reinsurers, the more onerous responsibilities become under the Code to satisfy consumer expectations, etc., the more the level playing field is in danger due to the higher costs of compliance that local reinsurers have to meet. GRLA agrees that APRA's concerns about the increasing use of offshore reinsurers are realistic and relevant particularly as regards the ability to maintain effective oversight and supervision of the industry risk profile; as such, we would welcome and indeed encourage changes that promote the use of reinsurers with a long-term strategy and perspective on the Australian life market. To this end, it would make sense for APRA to ensure that local reinsurers are encouraged and supported by the regulatory capital standards.

2 Options to Limit Exposures

APRA described a number of options aimed at improving financial safety and promoting stability within the Australian life industry. GRLA's comments are as follows:

(i) **Asset concentration limits**

Given that VAF (value of the assets of the statutory fund) is defined only for the purposes of LPS 117, it could be redefined to exclude assets backing participating policies or investment business; for consistency with limits expressed as a percentage of the capital base, it may also be appropriate to exclude collateral assets from the definition of VAF. It is unclear whether APRA may intend to also define limits for specialist reinsurers as a percentage of the capital base – for GRLA such an approach could potentially have a very material impact.

(ii) ***Risk mitigants***

LPS 117 currently does not differentiate between life insurers and specialist reinsurers in the recognition of collateral within the capital standards. In order to support and encourage the operation of local reinsurers within the Australian life industry, any cap on the extent to which asset concentration limits can be reduced should not be applied to specialist reinsurers for collateral provided by approved retrocessionaires.

GPS 117 (and GPS 114) include additional information on requirements in relation to collateral, including the use of collateral trusts – it may be appropriate to align the approach across the two industries.

(iii) ***Other issues including investment risk sharing***

In our letter to APRA dated 2 July 2018 we suggested applying the asset concentration limit to the reinsurance/retrocession assets from the LPS 110 combined stress single scenario (used to calculate the combined stress scenario adjustment) where that exceeds the reinsurance/retrocession assets from the IRC plus ARC net of aggregation benefit – that continues to be our recommendation as it covers asset risk as well as insurance risk and can be applied without an additional stress scenario calculation.

3 Other Policy Responses

As well as the policies described in APRA's letter dated 4 March 2019, other options that APRA may like to consider are:

- Apply limits on the proportion/amount of each large scheme and of the schemes in aggregate that may be placed with offshore reinsurers.
- Require the primary insurer's Chief Risk Officer and Appointed Actuary (through LPS 320) to explicitly challenge decisions to use offshore reinsurance capacity where the primary insurer is not seeking local capacity at all and/or where comparable quotations from local reinsurers are significantly less favourable to the offshore capacity.
- Require local insurers to select a local reinsurer as lead reinsurer, with offshore reinsurers only permitted to take following positions that are direct with the primary insurer. The lead reinsurer must be a meaningful lead in terms of share and/or co-management.
- GPS 114 (Asset Risk Charge) applies higher default factors for non-APRA-authorized reinsurers which are higher still from the second balance date onwards – a similar philosophy could be applied in the life insurance asset risk charge calculations although the latter may be less prevalent except perhaps for disability income insurance (which is a product where APRA would like to strengthen reinsurers' engagement).

We hope that our comments above provide useful input into APRA's considerations around the positioning of offshore reinsurers in the Australian life industry and look forward to upcoming changes to encourage sound practices that will, ultimately, benefit consumers.

