



7 May 2019

General Manager, Policy Development
Policy and Advice Division
Australian Prudential Regulation Authority

By email only: [REDACTED]

RE: OFFSHORE REINSURERS AND THE REVIEW OF PRUDENTIAL STANDARD LPS 117 CAPITAL ADEQUACY: ASSET CONCENTRATION RISK CHARGE

Dear General Manager,

Further to your letter dated 4 March 2019, please find below OnePath Life's input on APRA's review of *Prudential Standard LPS 117 Capital Adequacy: Asset Concentration Risk Charge* (LPS 117).

By way of background, OnePath Life Limited (**OPL**) does not currently use offshore reinsurers to support its group business. It has recently (May 2018) entered into an offshore reinsurance arrangement with Zurich Insurance Company (based in Switzerland) covering the majority of its in-force retail and direct lump sum business. This was undertaken as part of the planned sale of OPL to Zurich.

Question 1: *APRA's position on offshore reinsurers is outlined in this letter. Are the concerns identified realistic and relevant?*

OPL recognises and agrees with APRA's concerns identified in the letter.

In particular, OPL believes it is difficult for an offshore reinsurer to have a good understanding of the Australian market without operating within it. Examples where detailed understanding is required include:

- Delay in reporting Group TPD claims (and its current lengthening); and
- Likely impacts on existing cross-subsidies that Protecting Your Super legislation will change.
- The Australian Disability income business, which is very different to many Disability income markets globally.

Overall, OPL believes that features of the Australian market are most easily understood by reinsurers who participate in the Australian market regularly.

Question 2: *In the context of the options discussed in this paper, what issues should APRA consider to ensure it strikes an appropriate balance between the objectives of financial safety and efficiency, competition, contestability and competitive neutrality, whilst promoting financial stability?*

OPL believes that APRA may want to also consider the following:

- Capacity of the local reinsurance market:
 - Is there sufficient active local reinsurers to support all of the existing direct writers in the Group market (especially on the very large schemes);

- Approximately, five years ago a number of reinsurers temporarily withdrew from offering new business terms – which forced direct writers to either increase the proportion of risk held or seek reinsurance support offshore;
- Diversification benefits the use of offshore reinsurers can bring if there was a localised systemic issue affecting domestic reinsurers; and
- Pricing from offshore reinsurers that is not based on long-term participation in, and an incomplete understanding of, the Australian market may generate unhealthy competition with artificially low reinsurance quotes enabling unsustainable pricing at a scheme level.

Question 3: *This letter outlines a number of options APRA is currently considering as part of the review of LPS 117, including but not limited to, those relating to asset concentration limits and risk mitigants. APRA requests feedback on the appropriateness, feasibility and effectiveness of these options.*

OPL has considered the options that APRA has outlined and has the following comments:

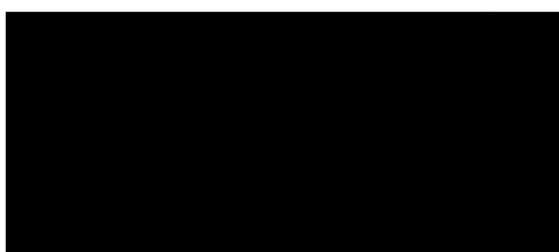
- **3.1 Exposure to offshore reinsurers:**
 - It is appropriate for the exposure to offshore reinsurers to be measured in aggregate;
 - The proposed limits do not feel unreasonable although OPL recognises that for some companies this could be a substantial change from current practice; and
 - Given current exposures APRA may want to consider transitional arrangements as immediate implementation may not be feasible.
- **3.2 Related party exposures:**
 - It is appropriate to have a higher limit for related party reinsurance as this enables a Group to better manage its overall exposure; and
 - Some of the potential risks of a 'less knowledgeable' participant are reduced by that participant being a related party.
- **3.3 Measurement of limits:**
 - OPL agrees with APRA that an assessment of limits based on the VAF fails to take into account other business written within the statutory funds that may not be available as support in stressed circumstances; and
 - APRA may want to consider transitional arrangements for existing exposures to allow for an orderly transition to a new basis.
- **4 Risk Mitigants:**
 - It is appropriate that risk mitigants are properly defined so that there is clarity between APRA and the industry as to what is acceptable and permissible;
 - Similarly, it is also appropriate, dependent on the mitigant, that a limit is placed on the use of a particular mitigants;
 - Where the mitigant involves a legal structure, then it is appropriate that legal advice is obtained. OPL does not believe that this needs to be independent as long as there is appropriate in-house expertise; and
 - OPL would suggest that any further governance and oversight of mitigants should be included within existing requirements such as the review of the ICAAP framework.

Question 4: *APRA is considering responding to increasing use of offshore reinsurers by changing LPS 117. Are there other policy responses which APRA should consider?*

OPL believes that APRA could consider the following, besides looking to increase capital requirements in response to the increased risk resulting from the use of offshore reinsurers:

- Require more oversight of the pricing basis and overseas reinsurer termination terms for scheme quotations that are based on the use of offshore reinsurance; and
- Introducing a limit at the scheme level (for large schemes) so that the use of offshore reinsurers does not unduly impact market competition.

Should you wish to discuss the details above, please do not hesitate to contact me by phone on [REDACTED]



Managing Director Insurance