RESPONSE PAPER

Integrating AASB 17 into the capital and reporting frameworks for insurers and updates to the LAGIC framework

December 2021

Contents

Executive summary

AASB 17 Insurance Contracts (AASB 17) is a new accounting standard issued in 2017 by the Australian Accounting Standards Board (AASB), which establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts. AASB 17 incorporates the International Financial Reporting Standard 17 (IFRS 17) and has a commencement date of 1 January 2023, with early adoption permitted.

APRA's capital and reporting frameworks are based on the existing accounting standards. The introduction of AASB 17 will both modify a number of accounting concepts which underpin APRA's prudential framework and introduce some new concepts. Due to the new accounting standard, not making adjustments to APRA's capital and reporting frameworks could result in unintended changes to reported capital levels across the insurance industries. It would also significantly increase regulatory burden due to the need for insurers to maintain dual valuation, actuarial, accounting and reporting systems to meet the different requirements of the accounting standard and APRA's prudential framework.

Since 2017, APRA has communicated its intended approach to the integration of AASB 17, and in particular APRA's intention to align capital treatment with accounting standards unless departure is justified on prudential grounds. APRA also conducted two information requests in 2017 and 2019 to understand the impacts AASB 17 would have on industry from both an operational and capital perspective. In November 2020, APRA released the discussion paper *Integrating AASB 17 into the capital and reporting frameworks for insurers and updates to the LAGIC framework* (discussion paper) and a target quantitative impact study (QIS). The discussion paper proposed substantial updates to APRA's capital and reporting frameworks so that they would remain compatible, where possible, with the new accounting standard, reduce the likelihood of unintended changes to an insurer's capital base or reported capital, and avoid the significant ongoing regulatory burden on industry that would result from misalignment between APRA's framework and the accounting standard. Following consideration of feedback provided on the discussion paper, APRA is now releasing draft standards and QIS workbooks to inform the development of the final prudential and reporting standards that will be released in Q3 2022.

APRA's approach to integrating AASB 17 into APRA's capital and reporting frameworks is based on the following principles:

- Maintain the resilience of the capital and reporting frameworks
- Not seek to generally increase or reduce capital levels
- Minimise the regulatory impact for industries
- Align to AASB 17 where appropriate

Feedback and APRA response

APRA invited submissions from stakeholders on the proposals and conducted a targeted QIS to assess the impact AASB 17 would have on insurers' financial statements and capital position, understand accounting choices that insurers are likely to make, obtain a better understanding of the expected level of regulatory burden across the insurance industries, and inform APRA's policy development more broadly.

Submissions were broadly supportive of APRA's direction in aligning the prudential framework with AASB 17 where possible. Key areas of stakeholder feedback included:

- the proposal for the expansion of the expense basis for general insurers – where submissions generally opposed the proposal as it would likely require general insurers to hold materially more capital;
- the introduction of new reporting product groups for life insurers – where submissions noted that AASB 17 portfolios and groups will be established at a higher level than the granular APRA product group level, resulting in the data reported not necessarily providing useful insights to APRA;
- the removal of the two and six month rule for reinsurance contracts – where submissions commented that it would place heightened operational burden on insurers; and
- the proposed removal of the internal capital models (ICMs) for insurers – where some submissions commented on the value that ICMs offer as a more risk-sensitive capital management tool, while others were generally agnostic to the proposal due to the limited direct impact.

APRA has considered the feedback received in the submissions in the development of the proposals contained in this response paper, which aims to strike an appropriate balance between prudential benefit and regulatory burden. Key changes have been made, particularly on the more material issues where industry had strong views. Further details are included in the relevant chapters of this response paper.

APRA's objective, throughout this consultation, has been to minimise undue burden on industry, and seek capital neutrality where possible and appropriate. The majority of revisions proposed do not fundamentally change the operation of the prudential framework, nor do they aim to generally increase or reduce capital levels.

Key capital proposals due to the introduction of AASB 17

As outlined in the discussion paper, APRA proposed to retain the majority of the existing requirements for the regulatory capital calculation for general insurers and life companies. The majority of the capital proposals outlined in this response paper relate to clarifications of the regulatory capital calculation given the introduction of AASB 17. Each of the key proposals outlined in the discussion paper are set out in the table below, along with an indication of whether APRA's initial positions have been further developed, changed or maintained following consideration of stakeholder feedback. More detail is provided in chapter 2. Where a proposal has been 'further developed', APRA's overall position and intent remains unchanged, however detail has either been modified or added in response to industry feedback.

Issue	APRA position
Regulatory adjustments (all insurance industries)	**Further developed.** Maintain the current framework for the calculation of the capital base as the net assets of the insurer less all regulatory adjustments (positive and negative). Additional regulatory adjustments have been proposed to maintain capital neutrality.
Expense basis (general insurers)	**Changed.** Maintain the existing methodology for the calculation of expenses. APRA has provided definitions and clarifications for claims handling expenses and policy administration expenses to promote further consistency in approaches used by insurers.
Capital risk charges and other requirements (general insurers)	**Further developed.** Consequential amendments to the measurement of capital – Clarification on the regulatory adjustments to CET1 capital for deferred tax Clarify that when making the regulatory adjustment to CET1 capital for deferred tax, deferred tax assets (DTAs) and deferred tax liabilities (DTLs) must include any tax effects (i.e. tax asset or tax liability) that would result from the insurance liability adjustment as well as the additional accounts receivable and accounts payable adjustments.
Capital terms and definitions (life companies)	**Changed.** Instead of introducing new terms and definitions leveraging AASB 17 terms and definitions to define regulatory capital requirements, retain the existing terms and definitions including Risk Free Best Estimate Liability (RFBEL). This reflects APRA's direction that the overall capital framework and requirements are retained.
Investment account business (life companies)	**Changed.** While APRA considers projecting cash flows to be best practice, in recognition of the burden this may have, APRA's revised position is that life companies can continue to use approximate methods and reference account balances to calculate RFBEL for investment account business if the life company views that it would not produce a materially different result to the result derived using a projection model.

Issue	APRA position
Capital risk charges and other requirements (life companies)	**Further developed.** Consequential amendments to asset concentration risk charge *Value of assets of the statutory fund or general fund (VAF) for non-reinsurance assets*: Remove AASB 17 insurance and reinsurance asset items for the calculation of VAF for non-reinsurance assets. Non-reinsurance asset exposures would be measured against the total value of non-reinsurance assets in the fund (i.e. exclude insurance and reinsurance assets). Premiums and other accounts receivables are also added to the VAF. *VAF for reinsurance assets:* Replace AASB 17 insurance and reinsurance assets disclosed in the statutory accounts with the stressed reinsurance assets when determining VAF for reinsurance assets (i.e. retains the existing approach). Premiums and other accounts receivables are also added to the VAF. Consequential amendments to the operational risk charge Instead of adopting the AASB 17 definition of insurance revenue for premium income, reference "accrued / earned premium" for the calculation of the Operational Risk Charge.

Key reporting proposals due to the introduction of AASB 17

The discussion paper outlined proposals that, generally, would enable insurers to use AASB 17 accounting policies to report financial statement information, including insurance assets and liabilities, to APRA. The life insurance reporting proposals included some exceptions to full AASB 17 alignment, to cater for requirements of the *Life Insurance Act 1995* (Life Act). Each of the key reporting proposals outlined in the discussion paper are set out in the tables below, along with an indication of whether APRA's initial positions have been further developed, changed or maintained following consideration of stakeholder feedback. More detail is provided in chapter 3.

Issue	APRA position
New product groups (all insurance industries)	**Further developed.** For general insurers, introduce new product groups for Directors and Officers (D&O) insurance and cyber insurance. For life insurers' capital basis data, introduce new product groups for death, Total and Permanent Disability (TPD) and trauma with separate product groups for stepped and non-stepped (i.e. other) business. For AASB 17 data, death, TPD and trauma would be combined and reported as lump sum risk but separated by stepped and non-stepped (other) business.

Issue	APRA position
Allocation principles for reporting to APRA (all insurance industries)	Further developed. Introduce allocation principles so that insurers can systematically allocate AASB 17 accounting financials to APRA product groups to ensure reliable product group financial data are presented for analysis. The allocation principles have been revised and simplified to reduce regulatory burden on APRA reporting.
Supplementary data collection (all insurance industries)	Further developed. Collect enhanced data for the purpose of capital assessment and product profitability monitoring. • For general insurers, the granularity of some supplementary data items has been simplified. APRA is also considering collecting data suitable for performance monitoring purposes such as Loss Ratios and Combined Operating Ratios used by general insurers. • For life companies, the proposed additional and more granular supplementary data collection items primarily relates to enhancing the visibility for participating benefits and friendly societies.
Reporting approach for life insurers	Further developed. The details of APRA's proposal for reporting of accounting financials to APRA have been slightly modified to better reflect the reporting structure outlined in the Life Act. It is proposed that: • for each statutory fund of a life insurer, a separate valuation of policy liabilities will be made; • for each Australian or Australian/overseas statutory fund of a life insurer, a separate valuation of policy liabilities for each class of life insurance business to which the fund relates, each category of business within such a class and each subcategory of business within such a category will be made; and • for each overseas statutory fund of a life insurer, a separate valuation of policy liabilities for each class of life insurance business to which the fund relates and each category of business within such a class will be made. Where a life insurer writes non-participating risk business in both the ordinary and superannuation classes of life insurance business within a single statutory fund, the life insurer may combine these classes when valuing the relevant policy liabilities, provided that income tax on shareholder profit is calculated at the same tax rate for both classes.

Issue	APRA position
Reporting for participating benefits	**Further developed.** Two methods are available to life insurers. Accounting standard led method: The Life Act operating profit allocated to shareholders would be the same as the shareholder profit reported under AASB 17. Value of supporting asset (VSA) led method: Maintain existing valuation practices, noting that the Life Act reporting may potentially be inconsistent with reporting under AASB 17 and reconciliation adjustments may be necessary for comparisons.
Reporting for friendly societies	**Further developed.** Benefit fund identification: • Friendly societies to identify the types of benefit fund to help APRA in assessing the risk profiles of benefit funds. Reporting direction for benefit and management funds • Friendly societies must make a separate valuation of policy liabilities for each approved benefit fund. • Adjustments to reconcile policy liabilities reported to ASIC under the relevant accounting standards with the sum of policy liabilities across benefit funds must be reported in the management fund. • APRA to collect additional data items that form the basis of the determination and distribution of the surplus in an approved benefit fund. • APRA to expand the capital data collection for friendly societies that provide defined benefit risk products.
Reporting for private health insurers	**Maintained.** Definition of health related (insurance) business and health related (non-insurance) business • Clarify the definition of health related (insurance) business and health related (non-insurance) business to improve the completeness of reporting of financials to APRA.

Key LAGIC updates

The LAGIC framework has not been substantively reviewed since it was introduced in January 2013. APRA is of the view that the LAGIC framework continues to achieve its objectives, as it has improved risk sensitivity and alignment in the capital standards for life and general insurers. However, APRA has taken this opportunity to propose updates to address issues that have been identified since the implementation of the framework, to ensure it remains fit for purpose. The LAGIC proposals outlined in the discussion paper are set out in the table below, along with an indication of whether APRA's initial positions have been further developed, changed or maintained following consideration of stakeholder feedback. More detail is provided in chapter 4.

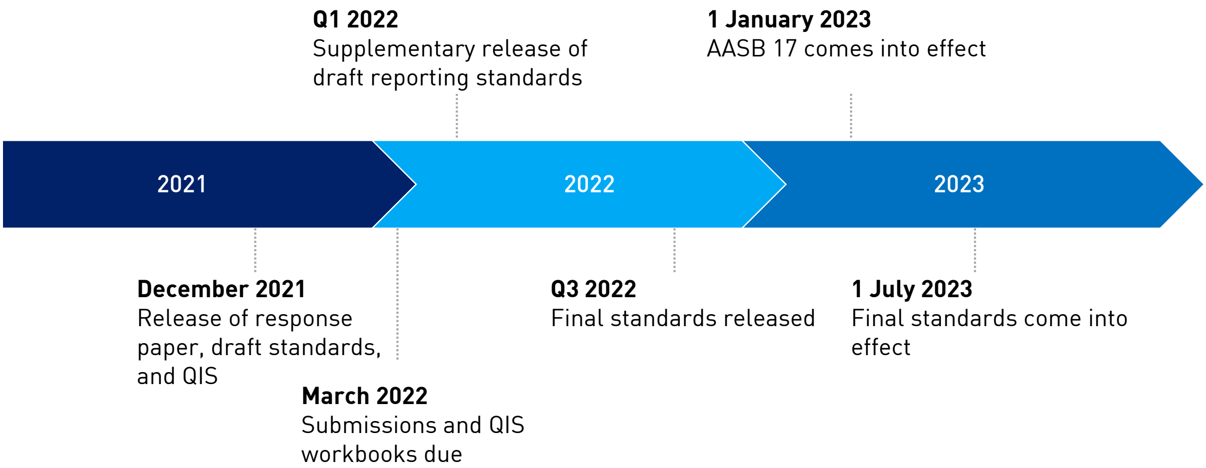
Issue	APRA position
Real interest rate stress test (all insurance industries)	**Maintained** Alter the calculation of the stress adjustment required for the real interest rate stress by applying a three per cent floor to the nominal risk-free rate before multiplying by the prescribed factors.
Expected inflation stress test (all insurance industries)	**Maintained** Alter the calculation of the stress by reducing the downward expected inflation stress to 50 basis points when nominal risk-free rates are negative. When nominal risk-free rates are between zero and one per cent, the downward expected inflation stress would be determined as the sum of 50 basis points and half of the nominal risk-free rate.
Removing the floor of zero for nominal interest rates (all industries)	**Maintained** Remove the floor on nominal risk-free rates of zero that applied to the downward inflation stress and real interest rate stress to allow the calculation to produce appropriate results in a negative interest rate environment
Dollar value exposure limits (all insurance industries)	**Further developed** Adjust dollar value exposure limits based on the existing dollar value limit indexed by historic inflation. An indexation mechanism will not be introduced at this stage.
Maintaining alignment in APRA's approach to the measurement of capital instruments (all insurance industries)	**Further developed** Adopt previous revisions to APS 111 that improve the simplicity and transparency of capital instruments, as well as those which clarify expectations and existing requirements. APRA's current proposal includes further detail on which revisions are proposed to be adopted within insurance standards. This includes incorporating previous rounds of APS 111 revisions, introduced prior to the most recent consultation. Allowances for mutual equity interests have also been introduced.
Removal of Internal Capital Models (general insurers and life companies)	**Maintained** No longer allow ICMs to determine regulatory capital requirements.
Default stress (general insurers)	**Maintained** Apply a charge for default stress to the net rather than gross quota share position for unpaid premium and unclosed business, for business ceded under a whole of account quota share arrangement.

Issue	APRA position
Fair value requirement for the measurement of assets (all insurance industries)	**Further developed** APRA's current proposal includes further detail on certain asset classes which may be measured using accounting values, instead of fair value. APRA is proposing to require all assets to be measured at fair value for capital base determination, other than non-financial assets, short-term receivables and intercompany receivables and payables which may be measured in accordance with the requirements in the AASB financial reporting standards.
Specification of illiquidity premium (life companies)	**Further developed** APRA's current proposal includes further detail on a proposed alternate methodology, available to insurers for the determination of illiquidity premium. APRA is proposing to allow a best estimate assumption of the spread to be published by the RBA in 'Statistical Table F3 – Aggregate Measures of Australian Corporate Bond Spread and Yields' (Table F3) if obtaining the spread from Table F3 is impractical. This estimate must not be deliberately overstated or understated.
Operational risk charge for whole of account quota share arrangements (general insurers and life companies)	**Changed** Maintain the existing methodology for the calculation of the operational risk charge for whole of account quota share arrangements.
Duration of policies in the calculation of the Insurance Risk Charge (general insurers)	**Further developed** APRA's current proposal includes further detail on an alternate method available for calculating the capital charge for a multi-year quota share reinsurance arrangement with a remaining term of up to 5 years. The proposed method requires a reinsurer to calculate material net written premium using the full premium revenue, subject to the material net written premium not exceeding the amount expected to be written in 18 months.
Procedural requirements for reinsurance contracts (general insurers)	**Further developed** Require the terms and coverage of reinsurance contracts to be finalised by inception, and provide an additional two month period for wordings to be finalised, stamped and signed.

Next steps

APRA welcomes feedback on the draft standards which accompany this response paper. APRA is also asking all insurers to complete the QIS workbooks to evaluate the impact the revised proposals are expected to have on capital levels, as well as to understand the level of preparedness across the insurance industries. Submissions containing feedback on the draft standards and the completed QIS are due by 31 March 2022. A supplementary release of draft reporting standards is expected to occur in Q1 2022. Following consideration of feedback received, APRA expects to release final standards in Q3 2022.

APRA proposes that all insurers, regardless of their financial year end, commence reporting to APRA (for quarterly, interim and annual reports) and determining regulatory capital requirements on an AASB 17 basis from 1 July 2023. APRA is also reviewing the prudential framework for private health insurers. APRA intends to integrate AASB 17 into the private health insurance capital framework where possible and appropriate. Further details can be found in APRA's December 2021 response paper *A proposed new capital framework for private health insurance.*



Glossary

AASB	Australian Accounting Standards Board
AASB 1023	AASB 1023 General Insurance Contracts
AASB 1038	AASB 1038 Life Insurance Contracts
AASB 17	AASB 17 Insurance Contracts
AASB 9	AASB 9 Financial Instruments
ADI	Authorised Deposit-taking Institution
APRA	Australian Prudential Regulation Authority
ARC	Asset Risk Charge
ASIC	Australian Securities and Investments Commission
CET1	Common Equity Tier 1
CSM	Contractual Service Margin
D&O	Directors and Officers
D2A	Direct to APRA prudential reporting system
DAC	Deferred Acquisition Costs
DII	Disability Income Insurance
DTA	Deferred tax asset
DTL	Deferred tax liability
Friendly society	A friendly society as defined in the *Life Insurance Act 1995*
General Insurer	A general insurer authorised under the *Insurance Act 1973*
GICs	Groups of Insurance Contracts
IASB	International Accounting Standards Board
ICM	Internal Capital Model(s)
IFRS	International Financial Reporting Standards
IFRS 17	IFRS 17 Insurance Contracts
IRC	Insurance Risk Charge
LAGIC	Life and General Insurance Capital Standards

Life company	A life company registered under the *Life Insurance Act 1995* (includes friendly societies)
Life insurer	A life insurer registered under the *Life Insurance Act 1995* (excludes friendly societies)
LIC	Liability for Incurred Claims
Life Act	*Life Insurance Act 1995*
OCI	Other Comprehensive Income
OCL	Outstanding Claims Liability
ORC	Operational Risk Charge
PCA	Prescribed Capital Amount
Q1	January, February and March
Q2	April, May and June
Q3	July, August and September
Q4	October, November and December
QIS	Quantitative Impact Study
RFBEL	Risk Free Best Estimate Liability
TPD	Total and Permanent Disability
VAF	Value of assets of the statutory fund or general fund
VSA	Value of supporting asset

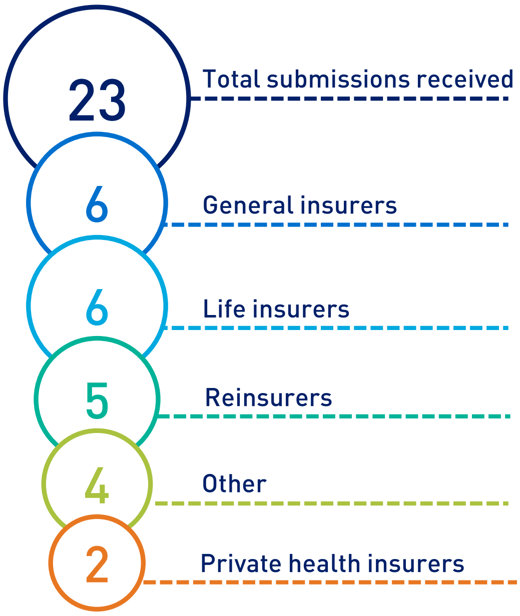
Chapter 1 - Introduction

1.1 Background

AASB 17 will replace three existing accounting standards currently being used by insurers - AASB 4 Insurance Contracts (AASB 4), AASB 1023 General Insurance Contracts (AASB 1023), and AASB 1038 Life Insurance Contracts (AASB 1038). These accounting standards govern the performance and liability valuation reporting of insurance contracts. APRA's capital and reporting frameworks have close linkages with the existing accounting standards that determine the accounting treatment of insurance liabilities. As a result, substantial updates are required to APRA's capital and reporting frameworks to ensure compatibility with the new accounting standard.

In November 2020, APRA released the discussion paper *Integrating AASB 17 into the capital and reporting frameworks for insurers and updates to the LAGIC framework*. For capital, the discussion paper proposed keeping APRA's capital framework largely unchanged with the introduction of AASB 17. For reporting, the discussion paper proposed aligning with AASB 17, allowing insurers to use the AASB 17 accounting policies and principles to report financial performance and insurance asset and liability items to APRA. To address concerns that existing APRA reporting does not provide detailed insights on certain product groups, APRA proposed to add new product groups and collect enhanced liability data. For LAGIC updates, while not seeking to generally increase or reduce capital levels, the paper made some proposals to improve clarity, and to ensure the framework remained appropriate in the current environment.

1.2 Consultation process



Since 2017, APRA has communicated its intended approach to the integration of AASB 17, in particular APRA's intention to align capital treatment with accounting standards unless departure is justified on prudential grounds. APRA also conducted two information requests in 2017 and 2019 to understand the impacts AASB 17 would have on industry from both an operational and capital perspective.

This informed APRA's development of policy and reporting proposals, which were outlined in its discussion paper. The consultation was open for four months, with interested stakeholders invited to make submissions.

23 written submissions were made to the discussion paper, from insurers across all three insurance industries as well as from industry bodies and brokers. APRA has also been engaging with a wide range of external industry stakeholders including the AASB 17 Transition Resource Group, the Accounting and Actuaries Liaison Committee, and working closely with the Actuaries Institute AASB 17 Taskforce.

1.3 Interactions with the review of the Private Health Insurance capital framework

APRA is currently in the third and final stage of its review of the prudential framework for private health insurers. APRA's primary goal in undertaking the review has been to ensure that the capital standards for private health insurers provide for an appropriate level of financial resilience, and that the level of capital required is aligned with the risks in the insurer's operations, so that policyholders are adequately protected.

As the LAGIC framework has been the starting point for this review, the Australian accounting standards will be the base for the capital framework. As such, the revised capital framework for private health insurers will be designed from an AASB 17 base, as well as incorporating the applicable LAGIC updates as outlined in this paper.

The details of the integration of AASB 17 and the LAGIC updates for private health insurers can be found in APRA's December 2021 response paper *Private Health Insurance Capital Standards Review.*

1.4 Interactions with the revisions to Prudential Standard LPS 117 Capital Adequacy: Asset Concentration Risk Charge

APRA is currently reviewing the requirements under *Prudential Standard LPS 117 Capital Adequacy: Asset Concentration Risk Charge* (LPS 117), to strengthen the standard in response to prudential concerns from the increased use of offshore reinsurers. Given that the LPS 117 review is progressing separately, APRA has not included a draft version of LPS 117 as part of this consultation.

APRA expects to release a draft LPS 117 in Q1 2022, which will reflect both the AASB 17 driven proposals (refer to section 2.4.2) as well as the final proposals determined under the review of LPS 117.

1.5 Commencement and transition

Commencement

APRA proposes that all insurers, regardless of their financial year end, will commence reporting to APRA (for quarterly, interim and annual reports) and determining regulatory capital requirements on an AASB 17 basis from 1 July 2023.[1] Although AASB 17 has a commencement date of 1 January 2023, insurers will be required to determine regulatory capital and submit regulatory reports under the existing prudential and reporting standards until the new prudential and reporting standards come into effect from 1 July 2023. This is to ensure APRA's continued visibility of the reported capital strength, risks and operations throughout transition. Insurers are expected to indicate to APRA as early as possible if they will adopt AASB 17 prior to 1 January 2023.

Some stakeholders raised concerns with APRA's proposal to have a single implementation date as this will result in up to six months of dual reporting for a number of entities. The single implementation date is important to ensure like-for-like comparisons of reporting data and will provide APRA with robust and consistent data to inform prudential supervision. APRA is seeking to ensure this burden is minimised by selecting a 1 July implementation date given 30 June financial year end dates are more common across the insurance industries. APRA has signalled to industry its intent to adhere to this commencement date since September 2019.

Transition

APRA recognises that there could be capital implications as a consequence of some of the proposals and is considering appropriate transitional arrangements for insurers.

Before granting transitional relief, APRA may seek additional information from insurers to understand the capital and accounting impacts arising and hence the circumstances (if any) in which adjusting or excluding specific requirements, or granting transition relief from obligations, may be appropriate.

APRA will also use insights from the QIS (see Chapter 6) to further inform the need for transition arrangements and/or any additional adjustments or refinements to the prudential framework that might be needed to ensure the desired prudential outcomes are met.

APRA will provide further clarity on transitional arrangements as part of the release of the final standards.

---

[1] Further information on reporting period basis is included in Chapter 3.

Chapter 2 - Proposed changes to the capital framework

2.1 Introduction

APRA's LAGIC framework is based on the existing accounting standards that determine accounting of insurance liabilities. In the discussion paper, APRA proposed updates and clarifications to APRA's capital framework with the intent of maintaining the objectives and outcomes of the LAGIC framework and mitigating the risk of substantially changing industry capital levels. In this context, the existing capital measurement model would be retained, which would depart from AASB 17 measurement models.

Feedback received in submissions were mostly supportive of APRA's overall approach to regulatory capital. Reflecting industry feedback, APRA does not intend to make significant changes to the proposed approach other than targeted updates and clarifications.

This chapter sets out the details of the individual capital proposals, the feedback received from submissions, and APRA's response. A summary of the key drafting changes made to the general insurance and life insurance prudential standards can be found in Appendix A.

2.2 All insurance industries

2.2.1 Regulatory Adjustments

APRA's proposal in the discussion paper was for insurers to maintain the current framework for the calculation of the capital base as the net assets of the insurer less all regulatory adjustments (positive and negative). In order to maintain capital neutrality, APRA proposed a range of additional regulatory adjustments.

Comments received

Feedback received on this proposal were mostly supportive of APRA's approach, however some suggested that more adjustments may be required to achieve a neutral impact on the capital base. These included reinsurance and non-reinsurance recoveries, commissions payable, indirect taxes payable and receivable, and other accounts receivable and payable items.

APRA's response

APRA's position has been to minimise impacts on industry, seeking capital neutrality where possible and appropriate. By working with the industry, a range of additional adjustments were identified and categorised. Broadly, these related to the effects of accruals (i.e. accounts receivable and payable related items) which will be within the insurance and reinsurance contract liabilities and assets under AASB 17 but are currently recognised as separate assets and liabilities on the balance sheet under the existing accounting standards. These additional regulatory adjustments have been incorporated into the drafts of *Prudential*

Standard GPS 112 Capital Adequacy: Measurement of Capital (GPS 112) and *Prudential Standard LPS 112 Capital Adequacy: Measurement of Capital* (LPS 112).

Additionally, some respondents suggested the associated tax effects on the adjustments also need to be reflected in the capital base calculation to achieve capital neutrality. APRA proposes that the tax effect be calculated by considering both the insurance liability adjustment and the additional adjustments. See draft prudential standards GPS 112 and LPS 112 for the proposed changes.

To ensure that insurers continue to apply asset risk stresses to these accounts receivable and payable related items (which will not be recognised separately on the AASB 17 balance sheet), APRA proposes clarifications to drafts of *Prudential Standard GPS 114 Capital Adequacy: Asset Risk Charge* (GPS 114) and *Prudential Standard LPS 114 Capital Adequacy: Asset Risk Charge* (LPS 114).

APRA will continue to work with industry to ensure that the material regulatory adjustments and associated tax effects are appropriately captured.

2.2.2 Four quarters dividend test

APRA's proposal in the discussion paper was to modify its approach to the four quarters dividend test outlined in *Prudential Standard GPS 110 Capital Adequacy* (GPS 110) and *Prudential Standard LPS 110 Capital Adequacy* (LPS 110). APRA's proposed modification responds to the impact of options that will be available to insurers on implementation of AASB 9 and AASB 17.

Under these new accounting standards, insurers will have the option to (a) process changes in fair value of financial assets through Other Comprehensive Income (OCI), or (b) classify these financial assets at amortised cost and depart from fair value altogether. These new options are now available because the concept of 'assets backing insurance liabilities' no longer exists. The options may result in insurers paying dividends based on reported profits, which now exclude unrealised losses that are recognised outside their profit numbers.

APRA's proposed adjustment looks to ensure that this optionality does not result in a less sound prudential outcome compared to the framework in place prior to AASB 17 implementation.

Comments received

The feedback received in submissions was generally supportive of the direction. Some submissions suggested that an adjustment also be applied when the balance is positive. That is, when these changes processed through OCI reflect unrealised gains. There was also a submission that suggested the test be based on after tax earnings inclusive of OCI.

APRA's response

APRA's view is that the proposed adjustment remains appropriate, and therefore its position is unchanged from the discussion paper.

APRA considers the proposals on applying an adjustment when the balance is positive may have unintended consequences with respect to an insurer's capital management that would lead to a less prudent outcome than under the current framework.

Adjusting the test to be based on after tax earnings inclusive of OCI would be a departure from the existing capital requirement. This is because a wide range of items are or may be classified as OCI, including foreign currency translation differences, property revaluation movements, and defined benefit superannuation plan surpluses (and deficits). These items are currently not included as part of after-tax earnings when applying the four quarters dividends test.

2.3 General insurers[2]

2.3.1 Expense basis

APRA's proposal in the discussion paper was for general insurers to include all expenses (other than one-off expenses) when valuing liabilities under *Prudential Standard GPS 340 Insurance Liability Valuation* (GPS 340), rather than just claims handling expenses and policy administration expenses. This aimed to improve alignment both within the general insurance industry and when compared to the life insurance capital framework.

Comments received

Feedback received in submissions generally opposed the proposal as it would likely require general insurers to hold materially more capital (in effect being perceived as an additional risk charge above current LAGIC requirements), and likely reduce general insurers' capital base. It would also require general insurers to maintain dual valuation and reporting bases. Feedback and discussion with industry also highlighted a number of differing interpretations and approaches to the current expense requirements. There were also alternative approaches, such as the application of factors and loading amounts, put forward in submissions to ensure the expense basis was appropriate.

APRA's response

After considering feedback from submissions, APRA's revised position is to promote better consistency in approach across the industry through providing clarifications to the existing definitions, rather than mandate the inclusion of all expenses. This in turn should ensure that an appropriate level of capital is held.

In particular, APRA has provided definitions and clarifications for claims handling expenses and policy administration expenses. APRA's proposed definitions are as follows.

> ***Claims handling expenses*** *are the costs that an insurer expects to incur in the management and settling of claims, which includes an appropriate allocation of business overheads such as claims department and corporate office overheads. For the outstanding claims liability, this includes the cost of future claims management, claims administration expenses for all incurred claims and the establishment expenses of unreported claims. For premiums liabilities, this includes claims management and claims administration expenses for claims establishment and run off.*

[2] APRA is not proposing to make any changes in regard to the existing requirements including reporting requirements for Lloyd's. The reporting to APRA should continue to be done on the existing basis.

Policy administration expenses are costs that an insurer expects to incur in administering policies, which includes an appropriate allocation of business overheads such as corporate office overheads. This includes, but is not limited to, policy management and administration expenses to allow for the cost of managing unexpired policies for which the insurer is on risk.

2.3.2 Risk margin requirements

APRA's proposal in the discussion paper was for general insurers to continue to apply the existing GPS 340 risk margin requirements. APRA outlined a number of clarifications to the risk margin requirement given that AASB 17 will introduce a number of principles on the risk adjustment, which in APRA's view, are different to the existing principles of the risk margin.

Comments received

Feedback received in submissions on this proposal were generally supportive of no change to the risk margin requirements. Some suggested that APRA consider providing factors that should be applied to the net central estimate as a means of reducing some of the need to maintain dual risk margin and risk adjustment models.

APRA's response

APRA's position is unchanged from the discussion paper. APRA holds the view that the risk adjustment required for AASB 17 and the APRA risk margin are two different concepts. Furthermore, APRA's view is that prescribing factors to be applied to the net central estimate would reduce the effectiveness of the risk margin (reflecting the inherent level of uncertainty within the insurance liabilities). APRA does not propose changing the underlying methodology for the calculation of the risk margin.

2.3.3 Discount rate

APRA's proposal in the discussion paper was to retain the existing requirement on discount rates for the regulatory capital calculation. That is, to apply the existing GPS 340 definition of risk-free discount rate for discounting cash flows of the GPS 340 liabilities.

Comments received

One submission suggested that APRA reconsider its position of not allowing for an illiquidity premium when discounting the GPS 340 liabilities. The submission argued that the impact of allowing for an illiquidity premium would be immaterial while reducing operational effort and complexity, the use of an illiquidity premium does not violate the risk-free principle, and that it was an opportunity to adopt a consistent approach across insurance industries.

APRA's response

APRA's position is unchanged from the discussion paper. APRA's view is that the requirement on discount rates and the illiquidity premium remain appropriate as it minimises subjectivity and achieves a more prudentially sound outcome for the insurer. APRA considers that both the fundamental structure and overall calibration of the LAGIC framework are appropriate.

2.3.4 Capital risk charges and other requirements

APRA's proposal in the discussion paper was to maintain the overall approach and requirements of capital risk charges (subject to the LAGIC updates outlined in the discussion paper).

Comments received

APRA did not receive submissions on this proposal.

Subsequent amendments

Further to the proposal in the discussion paper, APRA has subsequently identified a targeted number of areas within the capital requirements (covering the capital risk charges) where updates are required due to linkages with the accounting framework.

<u>GPS 112 – Clarification on the regulatory adjustments to CET1 capital for deferred tax</u>

For general insurers, APRA proposes to clarify that, when making the regulatory adjustment to CET1 capital for deferred tax, DTAs and DTLs any tax effects (i.e. tax asset or tax liability) that would result from the insurance liability adjustment as well as the additional accounts receivable and accounts payable adjustments must be included (refer to section 2.2.1).

When calculating CET1 capital, DTAs and DTLs can arise due to the differences between the GPS 340 liability and the corresponding carrying amount of the accounting liability. For example, if the GPS 340 liability is greater than the corresponding AASB 17 liability, there would be a tax asset (i.e. DTA would be generated), which must be added to the DTA balance from the balance sheet (DTA is grossed-up). The DTA balance is further increased by the tax asset arising from the additional payable adjustments (refer to section 2.2.1). On the other hand, the DTL balance is increased by the tax liability arising from the additional receivable adjustments. The amount to be deducted from CET1 capital is the net DTA balance, which is calculated by deducting the grossed-up DTL from the grossed-up DTA. This calculated deduction could be greater than the net DTA amount calculated from the balance sheet DTA and DTL. This effectively ensures that the tax asset arising from the insurance liability adjustment as well as the additional payable adjustments is recognised to the extent that there is a net DTL balance available.[3] For APRA reporting under *GRS 112 Determination of Capital Base* (GRS 112), general insurers should assume the full tax effect for net surplus / (deficit) relating to insurance liabilities and for regulatory adjustments to CET1 capital for receivables and payables, but increase the deduction amount reported under excess DTAs over DTLs.

This clarification is necessary because APRA views that currently, there is lack of clarity on how the tax effect should be recognised and it could become more common for the GPS 340 liability to exceed the corresponding accounting liability under AASB 17.

See draft prudential standard GPS 112 for the proposed changes.

---

[3] On the other hand, if AASB 17 liability is greater than the corresponding GPS 340 liability, insurers can reduce the tax liability to the extent that there is a DTA balance available (after allowing for the tax effects of the additional regulatory adjustments).

2.4 Life insurers and friendly societies

2.4.1 Capital terms and definitions

APRA's proposal in the discussion paper was to require life companies to apply the General Measurement Model of AASB 17 reflecting expected renewals and lapses throughout the guaranteed renewability period, with prescribed parameters. This would have resulted in an outcome of effectively maintaining the current RFBEL requirements for the capital calculation but the capital terms would be updated to reflect AASB 17 terms.

Comments received

Feedback from industry supported the proposal of effectively retaining the existing RFBEL requirements. Industry preferred maintaining existing terms to the alternative of updating definitions to reflect AASB 17 terms

APRA's response

In line with the feedback provided in submissions, APRA recognises the potential for added complexity from leveraging the AASB 17 definitions. APRA will retain the existing capital terms and definitions. This will also emphasise that the liability valuation for regulatory capital calculation is a separate construct to AASB 17 liabilities, and that the capital calculation methodology remains unchanged. APRA has proposed updates to *Prudential Standard LPS 340 Valuation of Policy Liabilities* (LPS 340) to add clarity that RFBEL is a separate construct to policy liabilities, and that RFBEL should be calculated using the existing valuation approach and LPS 112 rather than using the AASB 17 valuation approach. In general, policy liabilities would be determined in accordance with the relevant accounting standards other than separate determination of policy liabilities by the Life Act reporting structure and participating business, where some life insurers may elect to use the existing valuation approach outlined in LPS 340. Further details on the proposed reporting approach for life companies is outlined in Chapter 3.

2.4.2 Capital risk charges and other requirements

APRA's proposal in the discussion paper was to maintain the overall approach and requirements of capital risk charges (subject to the LAGIC updates outlined in the discussion paper).

Comments received

APRA did not receive submissions on this proposal.

Subsequent amendments

Further to the proposal in the discussion paper, APRA has subsequently identified a targeted number of areas within the capital risk charge requirements where updates are required due to linkages with the accounting framework. These areas are as follows.

<u>LPS 117 Capital Adequacy: Asset Concentration Risk Charge (LPS 117)</u>

When determining VAF for non-reinsurance assets, life companies currently reference the total assets of the fund as per the life company's statutory accounts. APRA views that as a result of AASB 17, the total assets of the fund could change significantly due to the new accounting measurement models and the fact that life companies would be disclosing insurance and reinsurance assets as separate asset items on the balance sheet.

APRA has considered a number of options but views that the most prudent option is to remove AASB 17 insurance and reinsurance asset items and add premiums and other receivables for the calculation of VAF for non-reinsurance assets. These receivable items are the same items that would be recognised as the additional regulatory adjustments for the capital base calculation but gross of any tax effects.[4] Non-reinsurance asset exposures would be measured against the total value of non-reinsurance assets in the fund. This option would remove the impact of AASB 17 on VAF.

When determining VAF for reinsurance assets, life companies currently replace 'gross policy liabilities ceded under reinsurance' disclosed in the statutory accounts with stressed reinsurance assets calculated in accordance with *LPS 115 Capital Adequacy: Insurance Risk Charge* (LPS 115). Reflecting this, APRA proposes that life companies replace AASB 17 insurance and reinsurance assets disclosed in the statutory accounts with the stressed reinsurance assets when determining VAF for reinsurance assets. Life companies would also add premiums and other accounts receivables to the VAF.

APRA views that for reinsurance assets, this proposal would achieve capital neutrality given that APRA is not proposing to change the RFBEL and LPS 115 requirements. APRA also views that this approach will not impact the proposals being considered under the concurrent review of LPS 117.[5]

Given that the LPS 117 review is progressing separately to the APRA AASB 17 consultation, APRA has not included a draft version of LPS 117 reflecting the VAF adjustment proposal outlined above. Instead, APRA has provided an early indication of the proposed changes driven by AASB 17 and seeks feedback on whether the proposal would be workable for life companies in the context of the proposals being considered under the LPS 117 review. APRA expects to release a draft LPS 117 in Q1 2022 and the draft will reflect the VAF adjustment proposals as well as the final proposals determined under the review of LPS 117.

For the 2021 QIS, APRA proposes that life companies determine VAFs for non-reinsurance and reinsurance assets by applying the VAF proposal outlined above. This will assist APRA in understanding whether the proposal would have any impact on VAFs. However, life companies do not need to calculate Asset Concentration Risk Charge for the QIS and other *LRS 117 Asset Concentration Risk Charge* (LRS 117) data items have been scoped out from the QIS.

LPS 118 Capital Adequacy: Operational Risk Charge (LPS 118)

Life companies currently reference the definition of life insurance direct premiums under the existing accounting standard when determining premium income for the calculation of Operational Risk Charge. AASB 17 will replace direct premiums with insurance revenue. APRA views that they are two different constructs. If APRA adopts AASB 17 insurance

[4] Refer to section 2.2.1.

[5] More information about the concurrent review of LPS 117 is available on APRA's website.

revenue for the calculation of Operational Risk Charge, this could lead to systematic changes to the capital requirement for the industry.

In the context of the above, APRA proposes to reference "accrued / earned premium" for the calculation of the Operational Risk Charge, and has proposed a definition of this term in LPS 118. APRA views that this proposal would not result in significant changes to the capital requirement because the definition is not materially different to how life companies currently determine premium income for the calculation of the Operational Risk Charge.

2.4.3 Investment account business

APRA's proposal in the discussion paper was for life companies to calculate liabilities for the regulatory capital calculation by projecting cash flows and not use account balances for all investment account business.

Comments received

Feedback received in submissions on this proposal was mixed. While some life insurers already use a projection approach, a key concern was the additional regulatory burden for those that use account balances on grounds of materiality or because they measure investment account business under AASB 9. It was suggested that, in these cases, the cost of the development of a projection model to meet regulatory reporting requirements outweighed the benefits.

APRA's response

While APRA considers projecting cash flows to be best practice, in recognition of the burden this may have for some insurers, APRA's revised position is that life companies can continue to use approximate methods and reference account balances to calculate RFBEL for investment account business if the life company views that it would not produce a materially different result to the result derived using a projection model. There are no proposed changes to the prudential standards because this position retains the existing approach (under the approximate method provision).

2.5 Other proposals and clarifications

The following issues were either supported by industry or APRA did not receive submissions on the proposal. APRA is therefore not proposing any changes to the proposal set out in the discussion paper.

All insurance industries
Groups of insurance contracts acquired APRA's proposal in the discussion paper was that the CSM of a group of insurance contracts acquired (including contracts acquired by way of a business combination) be excluded from CET1 capital until it is earned. In contrast, losses on onerous contracts acquired were to be recognised on day one for capital purposes (a deduction to CET1 capital). Insurers would then determine liabilities using the APRA bases and apply the liability regulatory adjustments. No change was proposed to the current prudential treatment of goodwill and negative goodwill and the approach to insurance contracts in run-off.

General insurance
Projection period APRA's proposal in the discussion paper was to retain the existing approach to projecting GPS 340 liabilities. For clarity: • For outstanding claims, APRA proposed that general insurers project cash flows reflecting the ultimate payments of the outstanding claims. • For premiums liabilities, APRA proposed that general insurers project cash flows to the expected expiry of the benefit. APRA proposed that general insurers apply the existing GPS 340 requirements to align gross and reinsurance cash flows.
Reinsurance default risk AASB 17 liabilities include allowance for expected reinsurance default risk. APRA's proposal in the discussion paper was for general insurers to retain the existing GPS 340 requirements around expected reinsurance default risk. That is, for general insurers to not include an allowance for expected reinsurance default risk and to continue applying an asset risk charge (ARC) on the expected reinsurance recovery components within the GPS 340 liabilities. This proposal avoids double counting of reinsurance default risk.
Unclosed business APRA's proposal in the discussion paper was that general insurers continue to include unclosed business for the GPS 340 liabilities calculation.

Life insurance
Termination value requirements APRA's proposal in the discussion paper was to retain the existing requirement on termination values but proposed definitional updates to the termination value requirements reflecting how AASB 17 would classify insurance and investment contracts.
Projection period APRA's proposal in the discussion paper was to retain the existing approach to projecting liabilities. <u>Other considerations</u> APRA does not propose to change the existing RFBEL requirements. Projections for the RFBEL calculation must reflect expected renewals and lapses throughout the guaranteed renewability period.
Risk margin requirements APRA's proposal in the discussion paper was to not introduce a risk margin requirement for life companies and to continue to enforce the termination value requirements. <u>Other considerations</u> APRA does not propose to change the existing RFBEL requirements.
Risk adjustment and contractual services margin APRA's proposal in the discussion paper was for life companies not to require calculation of risk adjustment and CSM for regulatory capital. <u>Other considerations</u> APRA does not propose to change the existing RFBEL requirements.

Life insurance

Discount rate

APRA's proposal in the discussion paper was to retain the existing requirement on discount rates for the regulatory capital calculation.

Other considerations

There are no proposed changes to the prudential standards for RFBEL discount rate requirements other than a minor change to enable more timely determination of the illiquidity premium.

APRA has outlined its view on the illiquidity requirements in section 4.7 of the response paper.

Expense basis

APRA's proposal in the discussion paper was to continue to include all expenses other than one-off expenses for the derivation of liabilities for the regulatory capital calculation.

Other considerations

APRA does not propose to change the existing RFBEL requirements.

Reinsurance default risk

APRA's proposal in the discussion paper was to not include allowance for expected reinsurance default risk for the derivation of liabilities for the regulatory capital calculation. Life companies would apply an ARC on expected reinsurance recovery components within the adjusted policy liabilities.

Other considerations

APRA does not propose to change the existing RFBEL requirements. RFBEL should not include allowance for expected reinsurance default risk.

Classification of claims in course of payment (CICP) reserves

APRA's proposal in the discussion paper was to continue determining CICP as past premium liabilities.

Other considerations

APRA does not propose to change the existing RFBEL requirements. CICP must be treated as past premium liabilities for the calculation of RFBEL.

Stressed liabilities

APRA's proposal in the discussion paper was to retain the existing requirement for stressed liabilities.

Other considerations

APRA does not propose to change the existing RFBEL and stressed RFBEL requirements.

For reporting, APRA has proposed that life companies separately report the components of stressed RFBEL by both gross and net of reinsurance.

Investment linked business

APRA's proposal in the discussion paper was, consistent with the existing approach, for life companies to continue to reference the fair value of units to calculate the liabilities for the regulatory capital calculation for investment linked business.

Chapter 3 - Proposed changes to the reporting framework

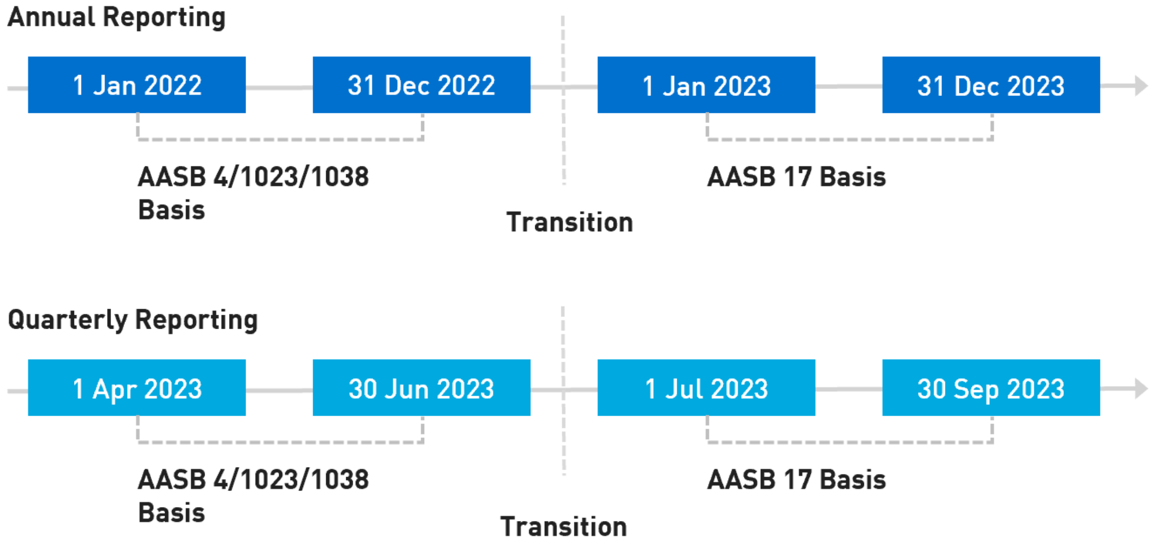
3.1 Introduction

The introduction of AASB 17 will change the basis for reporting to APRA on insurers' financial performance and the valuation of insurance contract assets and liabilities. In the discussion paper, APRA proposed aligning its reporting framework with AASB 17 to minimise the need for insurers to maintain two separate accounting reporting systems. Generally, financial statement information, including insurance assets and liabilities, submitted to APRA will be based upon the AASB 17 accounting policies of the insurer. However, for life insurance, there are a number of areas where APRA proposed prescribing reporting requirements that may deviate from AASB 17 given the requirements of the Life Act. APRA also proposed to enhance the granularity of its reporting groups to provide improved and more detailed insights on product groups. Further details on the proposed new product groups are listed below.

APRA's new data collection solution, APRA Connect, was introduced in September 2021. The revised reporting standards have been designed on the APRA Connect platform, providing greater flexibility for collecting and submitting data, and will ensure both industry and APRA are well placed to continue to meet evolving regulatory needs.

From 1 July 2023, for all insurers, reporting in APRA's revised quarterly reporting forms will be on a discrete reporting period basis and not on a cumulative year to date basis. For clarity, figures reported in the 30 September 2023 quarterly returns will reflect the period from 1 July 2023 to 30 September 2023 on an AASB 17 basis and the figures reported in the 31 December 2023 quarterly returns will reflect the period from 1 October 2023 to 31 December 2023 on an AASB 17 basis.

For all insurers, the first annual return for periods ending after 1 July 2023 will be on an AASB 17 basis for the full reporting year. For example, figures reported in an annual return for the reporting period 1 January 2023 to 31 December 2023 should be on an AASB 17 basis for an insurer with a 31 December balance date.



This chapter sets out the details of the reporting proposals, the feedback received from submissions, and APRA's response. A summary of the changes to reporting standards released in the full QIS for general insurance and life insurance is provided in Appendix B.

3.2 APRA Connect

APRA has introduced a new data collection solution, APRA Connect, to progressively replace Direct to APRA (D2A) and facilitate entities meeting other reporting obligations. APRA Connect will enable APRA to improve the way data is collected into the future, strengthening our data-enabled decision-making and enabling enhanced data submission capabilities. In the discussion paper it was proposed that from 1 July 2023, APRA's revised data collection, incorporating changes due to AASB 17 and LAGIC updates, will be collected through APRA Connect.

Given the level of modifications to the reporting framework associated with the integration of AASB 17 and LAGIC updates, APRA has sought to adopt a targeted approach to the changes in the data items collected from insurers. While limiting the scope of the change, APRA has also taken the opportunity to redesign a number of the collections to simplify reporting, reduce duplication of data submitted, and facilitate future extensions of the data collected.

The redesign has been influenced by the APRA data strategy, which looks to reduce duplication of collections, simplify reporting requirements and increase the usefulness of the data to both APRA and other agencies.

The QIS, which is structured to be compatible with the APRA Connect data collection approach, has been designed to give the industry an early view of how the collections will operate under the revised reporting standards. APRA welcomes feedback from industry on these proposals, and encourages industry to take the opportunity to access the APRA Connect test environment to become familiar with the data preparation and submission process and functionality.

APRA's update of insurance reporting standards not affected by AASB 17 and LAGIC updates will occur at a future date.

3.3 All insurance industries

3.3.1 New product groups

APRA's proposal in the discussion paper was to introduce additional product groups across the insurance industries, for the purposes of reporting to APRA. These additions were proposed to address the need for improved insights (relative to the existing data collection), and thereby enable enhanced monitoring of sustainability and performance for more granular product classes. The proposed product groups are outlined below.

General Insurance
Directors and officers insurance
Cyber insurance
Life Insurance
Individual death – stepped premium
Individual TPD – stepped premium
Individual trauma – stepped premium
Individual DII – stepped premium
Individual death – other
Individual TPD – other
Individual trauma – other
Individual DII – other
Group death
Group TPD
Group trauma

Comments received

Feedback received from the general insurance industry was mostly supportive of APRA's intention of having D&O Insurance and Cyber Insurance as separate product groups. However, some submissions suggested that reporting be done on a best endeavours basis, in the first instance, as there would likely be data quality issues at commencement. It was also suggested that there may be inconsistencies in the data, due to the way that insurers determine their allocations of policies to the product classes.

Feedback from the life insurance industry was that AASB 17 portfolios and groups will be established at a higher level than the granular APRA product group level, due to AASB 17 applying at the contract level. As each life insurer is likely to apply different approaches to allocation under different AASB 17 measurement bases, it would mean that the AASB 17 death, TPD and trauma data reported would not necessarily provide meaningful insights to APRA.

APRA's response

For general insurers, APRA's position is the same as in the discussion paper. APRA's proposed definitions are as follows:

> *D&O covers directors and officers of a company, and the company itself, for liability in the event of a legal action brought for alleged wrongful acts in their capacity as directors and officers. Cover for legal expense is generally included in this type of policy.*
>
> *Cyber insurance provides first party and third party coverage in respect to the insured's exposures relating to indemnified cyber events.*

To address feedback from life insurers, APRA's revised proposal is that APRA will collect AASB 17 data at a combined level for death, TPD and trauma lump sum risk business, but collect lump sum risk data separately for stepped and non-stepped (other) policies. For the capital data (i.e. RFBEL data and loss ratio data), APRA will collect the data separately for death, TPD and trauma benefits for stepped and non-stepped (other) policies.

APRA's view is that the revised proposal will promote consistency within the industry, reduce the burden compared to the initial proposal of collecting AASB 17 data for the granular product groups, while still providing APRA with greater visibility over the performance of these separate products.

3.3.2 Product groups allocation principles

APRA's proposal in the discussion paper was to introduce a number of principles for insurers to follow when allocating AASB 17 financials to APRA product groups. This followed feedback from industry that the groups of insurance contracts that insurers would determine under AASB 17 would not necessarily mirror the APRA product groups.

Comments received

Submissions to this proposal from insurers were generally supportive of APRA's intention of using a principles-based approach for allocating AASB 17 financials to APRA product groups but raised issues and sought additional clarifications given the reference to the word "profitability" within the principles. This is because AASB 17 could require insurers to determine profitability and onerousness of a group at a higher level than APRA product groups. Therefore, allocating AASB 17 numbers to a more granular level reflecting the true view of profitability would be a challenging exercise and would require substantial work.

APRA's response

To address feedback from insurers, APRA has revised the allocation principles by removing the reference to the word "profitability" and introducing allocation drivers to reduce the burden of allocating AASB 17 financials to APRA product groups. The revised allocation principles are as follows.

- Principle 1: To the extent that AASB 17 balance sheet and income statement items can be readily allocated to APRA product groups, they must be so allocated. Otherwise, the items (including CSM and / or loss component) are to be allocated using allocation approaches. The allocation approaches are to reflect allocation drivers determined based on accounting and / or actuarial judgments.

For example, an insurer may decide to determine annual premium income and / or expected claims to be the allocation drivers to allocate AASB 17 items using proportions and / or ratios.

- Principle 2: A systematic and rational approach should be applied.
- Principle 3: The approach should be consistent over time. However, an insurer may change the approach if it views that the approach is no longer appropriate based on accounting and / or actuarial judgements.
- Principle 4: The aggregate of the allocated numbers across APRA product groups should be consistent with AASB 17 numbers reported on a statutory basis.
- Principle 5: A single allocation approach need not necessarily be applied.

Allocation approaches and allocation drivers should be clearly documented. This would support clarity and consistent application of the approaches and drivers for APRA product group reporting over time.

3.3.3 Approach to liability data collection

APRA's proposal in the discussion paper was to collect additional data on regulatory liabilities to better understand profitability and risk profiles of insurers and insurance risk components. This was because AASB 17 would allow insurers to determine different accounting positions on key AASB 17 valuation constructs, which would result in challenges and complexities when comparing financials across insurers. Furthermore, the comparability of pre-2023 to post-2023 accounting financials would be lost.

Comments received

Feedback received in submissions from GIs were mostly not supportive, stating that the additional data collection would be burdensome. Submissions asked that APRA provide clarity on how the additional data collection would improve understanding of profitability trends. Some suggestions to reduce the level of burden were for the collection frequency to be reduced from quarterly to annually.

Feedback received in submissions from life insurers were mostly supportive, although the appropriateness of the quarterly frequency was raised.

APRA's response

For general insurers, APRA has incorporated the liability data collection into the existing reporting collections suite and removed elements that industry considered burdensome. The changes include:

- Removal of the “LYLY” (last year last year), “LYTY” (last year this year), “TYTY” (this year this year) valuation bases[6] by APRA class of business.

- Removal of “Insurance Acquisition Cash Flow” balance sheet memo items by APRA class of business.

- Incorporating additional information on Claims Handling Expenses, Policy Administration, Commissions and Reinsurance Exchange commissions into *Reporting Standard GRS 115.0 Outstanding Claims Liabilities – Insurance Risk Charge* and *Reporting Standard GRS 115.1 Premiums Liabilities –Insurance Risk Charge.*

- Incorporation of the additional regulatory adjustments into *Reporting Standard 112.0 Determination of Capital Base.*

For life insurers, APRA has reflected the proposed liability data collection in *Reporting Standard LRS 200.0 Capital Adequacy Supplementary Information* (LRS 200). The proposed LRS 200 includes additional granular data items and reflects a number of the reporting principles in the existing *Reporting Standard LRS 400.0 Statement of Policy Liabilities* (LRS 400) and *Reporting Standard LRS 430.0 Sources of Profit* (LRS 430). For the quarterly LRS 200 collection, APRA proposes a simplified reporting approach.

APRA’s proposed reporting approach with supporting reasons for individual reporting standards are outlined in Appendix B of the response paper.

3.3.4 Reporting direction for supplementary data collection

APRA proposed in the discussion paper to continue the collection of information that is important for APRA’s capital assessment, such as:

- All insurers: Breakdown of investment assets and data underlying regulatory adjustments and the capital risk charges.

- General insurers and Private Health insurers: Premiums receivable and unearned premium reserve.

- General insurers: Deferred reinsurance expense, amounts due on reinsurance contracts, non-reinsurance recoveries, gross written premium and transaction-based taxes and levies and claims development data.

- Life insurers: Life Act participating liability components such as policy owners’ retained profits and shareholders’ retained profits.

Comments received

Feedback received in submissions from GIs were largely not supportive, stating that the additional data collection would be burdensome and that APRA should provide clarity on how the additional data collection would be used in its capital assessment. Feedback received in submissions from life insurers noted that many of the existing forms based on the existing

[6] See the APRA 2020 QIS for further details.

life insurance accounting standard would become redundant because these forms would need to be replaced by new forms under AASB 17.

APRA's response

For general insurers, APRA has considered the feedback received and reduced the granularity of some items collected and removed other items no longer relevant to reduce burden on industry. In particular:

- Product Group level information is no longer required for premiums receivable and amounts due on reinsurance contracts. These items will be collected at an entity level in the context of the additional regulatory adjustments.
- Unearned premium reserve and deferred reinsurance expenses, while collected for the full QIS, will not be required after the full QIS.

Items relating to non-reinsurance recoveries, gross written premium and transaction-based taxes and levies and claims development data will continue to be collected via the existing collections.

Prior to finalising draft reporting standards, APRA may refine its approach to collecting data relating to performance metrics. In particular, APRA is still considering collecting data suitable for performance monitoring purposes such as Loss Ratios and Combined Operating Ratios used by general insurers.

For life companies, APRA's proposed supplementary data collection mainly relates to the following areas:

- Participating benefits: APRA proposes two new reporting categories – participating benefits and non-participating benefits for the collection of asset, liability and performance data items at an APRA product group level. This will support APRA in obtaining enhanced visibility over participating benefits.

  APRA also proposes to collect additional data on Life Act liability components, policy owners' and shareholders' retained profits, as well as the AASB 17 liability components for participating benefits.

- Friendly societies: APRA proposes to collect additional data that forms the basis of the determination and distribution of the surplus in an approved benefit fund as well as expanding the capital data collection only for friendly societies that provide defined benefit risk products (i.e. product group F4).

Additional details on APRA's proposed reporting approaches for participating benefits and friendly societies are outlined in section 3.4 and Appendix B.

3.3.5 Audit requirements

APRA's intention is to broadly follow the existing approach to the audit and assurance requirements for data returns to APRA (see draft *Prudential Standard LPS 310 Audit and Related Matters* (LPS 310) and the relevant draft general insurance reporting standards).

For data and controls relating to LRS 200, APRA proposes to increase the required level of assurance from none to limited assurance. This reflects the challenges in analysing AASB 17 data across life companies and to the resulting increased reliance on the regulatory liability data for analysis and regulatory decisions. In this context, this proposal would support APRA in receiving higher quality data on the regulatory liabilities. This proposal is reflected in the draft LPS 310.

APRA welcomes feedback from industry on the appropriateness of the requirements.

3.4 Life insurers and friendly societies

3.4.1 Reporting approach for life insurers

APRA's proposal in the discussion paper for the reporting of accounting financials to APRA was that life insurers determine the valuation of insurance and reinsurance liabilities and assets separately for:

1. each statutory fund;
2. each of the ordinary and superannuation classes within a statutory fund;
3. each of the Australian participating, overseas participating and non-participating categories within a class; and
4. each of the subcategories within a category, where the subcategory is defined in the Life Act.

APRA proposed that for non-participating risk business within a statutory fund, life insurers may choose to determine insurance and reinsurance assets and liabilities at a combined level across ordinary and superannuation classes within the statutory fund and apply the allocation principles outlined above to allocate the results for APRA reporting of ordinary and superannuation classes.[7]

Comments received

The majority of submissions were supportive of the direction, with some noting the particular need for the exemption to allow the determination to occur at a combined level across ordinary and superannuation classes within the statutory fund for non-participating risk business.

APRA's response

The details of APRA's proposal have been slightly modified to better reflect the reporting structure outlined in the Life Act. The proposal would ensure that APRA continues to obtain appropriate standalone views by statutory and general funds and by the Life Act reporting components. APRA may not receive appropriate standalone reporting if, for example, a life insurer determines insurance and reinsurance assets and liabilities at a combined level across statutory funds and applies apportionments to the assets and liabilities. Insurance

[7] APRA proposed to adopt the LPS 001 definition of risk business.

and reinsurance assets and liabilities must be determined separately for each statutory fund by firstly allocating the underlying expected cashflows to the statutory funds.

APRA's position on the exemption proposal for non-participating risk business within a statutory fund is unchanged except to remove any unforeseen consequences from a tax perspective. The exemption would be applicable provided that income tax attributable to shareholder profit on the business is calculated at the same tax rate for both classes.

APRA notes that for non-participating life insurer business, other than the proposal outlined here, life insurers would generally determine insurance and reinsurance liabilities and assets for APRA reporting in accordance with AASB 17.

The draft prudential standard LPS 340 reflects APRA's policy liability reporting proposals for life insurers.

3.4.2 Reporting for life insurer participating business

In relation to reporting for life insurer participating business, APRA proposed to align its standard for valuing policy liabilities with AASB 17. In most situations, it is expected that this should result in shareholder profit being the same for Life Act reporting and for general purpose financial statements. The policy owner profit would be generated pro-rata from the shareholder profit based on the profit share proportion. APRA's proposal was that total benefit payments to policy owners would be unaffected by the adoption of AASB 17.

Comments received

Some submissions agreed with APRA's proposal for life insurers to perform appropriate splits of AASB 17 liabilities to derive all information required under the Life Act (AASB 17 driven approach).

Some submissions proposed that the Life Act reporting components would continue to be derived using the existing valuation practice (as is reasonably possible). Life insurers would then perform additional calculations to derive all information required under AASB 17.

APRA's response

APRA proposes to allow life insurers to choose one of the following methods:

<u>Accounting standard led method</u>

The Life Act operating profit allocated to shareholders would be the same as the shareholder profit reported under AASB 17. The Life Act operating profit allocated to policy owners would reflect the allocation percentages applied according to the Life Act. The Life Act policy liability would be the balance of the AASB 17 liability after deducting Policy Owners' Retained Profits.

<u>VSA led method</u>

Life Act reporting will potentially be inconsistent with AASB 17 and reconciliation adjustments would be necessary in order to compare the two. On the other hand, existing valuation practice may be a more useful tool for managing distributions to policy owners than

AASB 17 and it minimises the potential for changes to policy benefits as a result of the introduction of AASB 17.

The draft prudential standard LPS 340 reflects APRA's policy liability reporting proposals for life insurers.

For the 2021 QIS, APRA proposes that life insurers outline in detail in their QIS response letters how they have approached the valuation of policy liabilities and profit determination of participating business for both Life Act and AASB 17 reporting. The QIS will inform APRA as it refines the LPS 340 policy liability requirements for participating business.

3.4.3 Reporting for friendly societies

Benefit fund identification

APRA's proposal in the discussion paper was to require friendly societies to identify the types of benefit fund. Specifically:

- identify whether a benefit fund is a defined contribution fund or a defined benefit fund; and
- for defined benefit funds, identify whether all surplus belongs to the management fund, must be used for benefit enhancements or may either be transferred to the management fund or used to improve member benefits.

Reporting direction for benefit and management funds

APRA proposed that friendly societies determine their insurance and reinsurance assets and liabilities separately for each benefit fund for reporting of accounting financials to APRA. Friendly societies would not be able to determine insurance liabilities at a combined level across benefit funds and the management fund for reporting of accounting financials to APRA.

Comments received

Benefit fund identification

APRA did not receive submissions on this proposal.

Reporting direction for benefit and management funds

APRA received a submission opposing the proposal to separate determination of insurance and reinsurance assets and liabilities by benefit funds. This submission noted that the proposal would result in regulatory burden and dual reporting of accounting numbers as many friendly societies would have products that span benefit funds and the management fund and these products would be consolidated for AASB 17 reporting.

APRA's response

Benefit fund identification

Given there were no submissions on this proposal, APRA's position is the same as in the discussion paper.

Reporting direction for benefit and management funds

APRA recognises that friendly societies will make a number of accounting decisions, in conjunction with their auditors, which could significantly impact determination of policy liabilities across the benefit funds. In this context, APRA would like to emphasise the importance of continuing to obtain standalone views of the benefit funds of the friendly societies for the purposes of administering the Life Act. These calculations must make explicit allowance of fees payable to the management fund under the benefit fund rules.

APRA has worked with stakeholders to develop the following proposals reflecting APRA's view above, while recognising industry's submission about implications for potential regulatory burden from an APRA reporting perspective. The proposals also reflect the fact that friendly societies will continue to perform calculations at a benefit fund level for determination and distribution of the surplus.

1. Friendly societies must make a separate valuation of policy liabilities for each approved benefit fund. However, APRA understands that this approach could result in deviations from the policy liabilities reported to ASIC under the relevant accounting standards. As such, friendly societies are to report adjustments to reconcile policy liabilities reported to ASIC with the sum of policy liabilities across the benefit funds (determined for APRA reporting) in the management fund.

2. The introduction of the new accounting standard may result in a departure from the basis used by friendly societies in the determination and distribution of the surplus in an approved benefit fund and the accounting basis. As a result, APRA intends to collect additional data items that form the basis of the determination and distribution of the surplus in an approved benefit fund. This information should be readily available. The data items are reflected in the draft reporting standard *LRS 114.5 Friendly Society Related Items* (LRS 114.5).

   APRA notes that the Board of Directors and the Appointed Actuary of a friendly society need to ensure that policyholder expectations are met in relation to determination and distribution of surplus regardless of the accounting standard change.

3. APRA proposes to expand the capital data collection for friendly societies that provide defined benefit risk products (i.e. product group F4). This reflects the fact that accounting profit and loss will be influenced by differences in business models and accounting policy decisions, so the expanded capital data items will assist APRA in performing comparability analysis of profitability and risk profiles of insurance risk components across different friendly societies. The expanded capital data items are reflected in the draft reporting standard LRS 200. APRA proposes that friendly societies submit LRS 200 as part of the annual submission only (i.e. no quarterly submission of LRS 200 would be required).

APRA welcomes feedback from friendly societies on the proposals outlined above. In particular, APRA welcomes feedback on whether there are any additional items other than the ones outlined in LRS 114.5 which would support APRA in assessing the surplus distribution basis of friendly societies.

3.5 Private health insurers

3.5.1 Definition of health related (insurance) business and health related (non-insurance) business

APRA's proposal in the discussion paper was that, from 1 July 2023, the definition of health related (insurance) business would include overseas visitors cover and overseas student health cover. Health related (non-insurance) business covers all other businesses within the meaning of *health-related business* as defined by 131-15 of the *Private Health Insurance Act 2007*.[8]

Comments received

APRA did not receive submissions opposing this proposal.

APRA's response

APRA is proposing to maintain the position outlined in the discussion paper.

[8] Health related (non-insurance) businesses are classified as retail businesses, and therefore do not fall under the remit of AASB 17.

Chapter 4 - Proposed LAGIC updates

The LAGIC framework has not been substantively reviewed since it was introduced in January 2013. While the framework continues to achieve its objectives and remains fit for purpose, APRA is taking the opportunity to propose updates to address issues that have been identified since its implementation. The majority of proposals outlined in this paper do not seek to implement any structural change in policy or alter the fundamental operation of LAGIC, but rather seek to clarify or ensure the effectiveness of existing requirements in the framework.

4.1 All insurance industries - APRA's prudential requirements in a low or negative interest rate environment

The discussion paper outlined the interactions between low and negative nominal interest rates and the ARC prescribed in GPS 114 and LPS 114. The ARC calculations do not produce robust outcomes in the current low interest rate environment, and will not be appropriate if interest rates in Australia are negative. APRA sought feedback on proposed changes to GPS 114 and LPS 114 to address this.

4.1.1 Real interest rate stress test

When nominal risk-free rates are negative, the intended direction of the real interest rate stress applied under GPS 114 and LPS 114 is reversed and a shock is produced in the wrong direction. Where nominal risk-free rates are close to zero, the shock applied will be minimal and not operate as a realistic stressor as the standard intends.

APRA proposes to alter the calculation of the stress adjustment required for the real interest rate stress by applying a three per cent floor to the nominal risk-free rate before multiplying by the prescribed factors.

Comments received

While general insurers were mostly supportive and did not observe unintended consequences, some respondents commented that applying a minimum interest rate shock would increase the ARC capital charge and might have a bearing on investment strategy in relation to exposure to interest rate risk.

For life companies this is a significant issue – long dated liability cashflows are common and low and negative interest rates have a significant impact on the value of liabilities.

APRA's response

APRA considered the feedback received and the alternative proposals provided within submissions. While recognising this proposal may impact an insurer's ARC and therefore their investment strategy, APRA has concluded that introducing a three per cent floor to the nominal risk-free rate before multiplying by the prescribed factors remains the most effective proposal to ensure the standard operates as intended in a low or negative interest rate environment. As such, APRA's position remains the same as in the discussion paper.

See draft prudential standard LPS 114 and GPS 114 for proposed changes.

4.1.2 Expected inflation stress test

APRA proposed amendments to the expected inflation stress within GPS 114 and LPS 114 to ensure it remains fit for purpose in a low and negative interest rate environment.

Amendments were also proposed to ensure insurers appropriately allow for expected inflation risk and hold appropriate capital against this risk. Specifically, APRA proposed to clarify that:

- stress adjustments for expected inflation rates be added to any explicit expected inflation rates used in the valuation of assets or liabilities; and
- the inflation stress should also be applied to liabilities valued using an implicit inflation assumption.

Comments received

While submissions were generally supportive of APRA's proposal to amend the expected inflation stress, some submissions noted that this proposal will complicate the process of determining stress values and may be more difficult to operationalise. Additional justification and clarification of the proposal was also requested by respondents.

Submissions did not express concerns with APRA's additional clarification proposals.

APRA's response

APRA's position is the same as in the discussion paper. These amendments are necessary to ensure the risk charge operates appropriately in a low or negative interest rate environment. Without these amendments, an insurer's ARC may not appropriately reflect the risks present.

APRA has been mindful of the potential for this proposal to complicate the ARC calculation while drafting the amendments. It is APRA's view that these changes will not be difficult to implement. APRA requests specific feedback from insurers regarding difficulties faced when operationalising these proposals.

See draft prudential standards LPS 114 and GPS 114 for proposed changes.

4.1.3 Removing the floor of zero for nominal interest rates

APRA proposed to remove the floor on nominal risk-free rates of zero that applied to the downward inflation stress. Removing the floor will allow the calculation to produce appropriate results in a negative interest rate environment.

Comments received

Respondents did not identify unintended consequences associated with this proposal. Some submissions noted that there may be implications depending on how much nominal risk-free rates fall below zero and suggested considering a negative nominal risk-free rate floor.

APRA's response

APRA's position remains the same as in the discussion paper. APRA's view is that a negative risk-free rate floor is not necessary as it is unlikely nominal risk-free rates would fall to a point where a floor is required to ensure the effectiveness of this revision. See draft prudential standards LPS 114 and GPS 114 for proposed changes.

4.2 All insurance industries – Dollar value exposure limits

Given that dollar value limits within the life and general insurance capital standards have remained unchanged for some time, APRA communicated its intention to review such limits, considering inflation, to determine if the limits remain fit for purpose. APRA also signalled it was contemplating methods to future proof the dollar values within the standards.

Comments received

Submissions generally supported APRA's intention to update the dollar value exposure limits across life and general insurance standards and did not identify any unintended consequences. Further details were sought on APRA's methodology for calculating the revised limits.

APRA's response

APRA will proceed with its proposal to revise the dollar value exposure limits within LAGIC. It is proposed that the adjusted dollar value exposure limits are determined as the existing dollar value limit indexed by inflation, rounded to the nearest $100,000

APRA considered an indexation mechanism so that these limits would in the future respond to inflation. Due to complexity, this will not be introduced at this stage. At this point in time, the added drafting complexities associated with future proofing the values outweigh the benefits of including them.

APRA will consider an indexation mechanism in the future when all dollar values in the framework are reviewed, not only dollar value exposure limits.

See draft prudential standards LPS 114, GPS 114, GPS 117 for proposed changes. Proposed changes to LPS 117 will be consulted on separately.

4.3 All insurance industries – Maintaining alignment in APRA's approach to the measurement of capital instruments for ADIs and insurers

Where appropriate, the methodology for measuring regulatory capital is aligned for ADIs, general insurers and life companies. APRA has recently finalised changes to APS 111 which details the criteria for measuring the regulatory capital for an ADI.[9] To ensure there continues to be alignment, APRA proposed to adopt for LAGIC the changes to APS 111 that improve the simplicity and transparency of capital instruments, as well as those which clarify expectations and existing requirements.

Comments received

While submissions were generally supportive of APRA's proposal, some submissions suggested that these changes be the subject of a separate consultation.

Respondents also sought clarification on whether the changes have retrospective impacts for existing capital instruments.

APRA's response

While a separate consultation on these changes was considered, APRA's view is that it is most efficient to consult on these consequential amendments through this process. This consultation process will allow for all insurers to provide feedback on any of the changes proposed for LPS 112 and GPS 112.

APRA notes that APS 111 has undergone several revisions since LAGIC was introduced which are not currently built into the equivalent insurance standards. A number of revisions made in the most recent consultation on APS 111 build upon previous iterations of changes. On this basis, APRA is proposing to incorporate several additional minor changes to ensure the ongoing alignment of the relevant insurance standards.

APRA does not anticipate the proposed changes will impact the eligibility of capital instruments, as they relate to clarifying and simplifying aspects of the prudential standards. Most of APRA's proposed changes are intended to assist regulated institutions in their interpretation of the prudential standards, or incorporate aspects of existing FAQs which currently exist on GPS 112 and LPS 112.[10] However, entities with concerns relating to the eligibility of capital instruments, should raise specific transition issues with APRA.

A summary of the proposed changes to GPS 112 and LPS 112 is outlined in Appendix C.

---

[9] Revisions to Prudential Standard APS 111 Capital Adequacy: Measurement of Capital | APRA.

[10] Measurement of capital - frequently asked questions | APRA

4.4 General insurers and life companies – Removal of Internal Capital Models

APRA proposed the removal of *Prudential Standard GPS 113 Capital Adequacy: Internal Model-based Method* (GPS 113) in the discussion paper. This change would mean all general insurers would be required to adopt APRA's standard method for calculating regulatory capital.

Comments received

Feedback received in response to this proposal was mixed, with most submissions' agnostic to the proposal due to the limited direct impact. Opposing submissions commented on the value that ICMs offer as a more risk-sensitive capital management tool, and that APRA's proposal may send the wrong message to industry and lead to decreased investment in capital modelling. Supporting submissions commented on the benefits of having a consistent approach to the determination of regulatory capital.

APRA's response

Following consideration of feedback received, APRA is proposing to retain the proposal to remove GPS 113 and require general insurers to adopt APRA's standard method for calculating regulatory capital. APRA recognises and agrees with industry observations on the value that modelling offers to drive decision making and as a risk-sensitive capital management tool. However, APRA has observed that this is more often driven by economic capital models, rather than the use of ICMs across the industry. APRA strongly encourages insurers to continue to develop and use economic capital models to drive robust risk and capital management decisions. APRA is looking at ways to promote information sharing and dialogue between insurers and APRA on the variety of uses to which models can be applied.

Given the limited take-up in the use of ICMs across the general insurance industry and the fact that many general insurers already use economic capital models, APRA does not believe this proposal will compromise prudential outcomes. APRA's view is that this proposal will promote the development of economic capital models to suit the risk profile of each insurer and foster appropriate internal risk and capital management decisions, while promoting consistency and comparability for regulatory capital purposes.

If GPS 113 is removed, APRA also intends to remove the mirroring provision for life companies in paragraph 43 of LPS 110. This is being proposed for consistency. No life companies currently have approval to use internal capital models for regulatory capital purposes in Australia.

4.5 General insurers – Default stress

APRA proposed amendments to GPS 114 to reduce double counting of risk in respect of business ceded under a whole of account quota share arrangement. Under the current standard there may be an element of double counting in relation to unpaid premiums and unclosed business as reinsurers generally also record this business as unpaid premium, thereby attracting a capital charge. To address this, APRA proposed that general insurers would apply a charge to the net rather than the gross of the quota share position in relation to unpaid premium and unclosed business.

Comments received

Submissions generally supported the principles underlying this proposal and agree with APRA's observations in relation to double counting of unpaid premiums and unclosed business. However, a number of submissions noted that further information is needed to determine how unpaid premiums and unclosed business is quantified and how this information is reported between an insurer and reinsurer. One submission suggested APRA should apply the same methodology to all quota share arrangements, not just whole of account quota share.

APRA's response

Following consideration of feedback received, APRA is proposing to maintain the proposal to permit general insurers to apply a charge for default stress to the net rather than gross quota share position for unpaid premium and unclosed business, for business ceded under a whole of account quota share arrangement. While APRA recognises some general insurers may not have access to appropriate data to determine a net of quota share position, APRA believes it is appropriate for this option to be available for general insurers who are able to determine the net of quota share position, and views this is a better reflection of the transfer of risk.

APRA is proposing to limit the application of this adjustment to whole of account quota share reinsurance arrangements, due to the usual materiality of such arrangements and the ease of calculating capital outcomes when applied to a whole portfolio.

4.6 All industries – Fair value requirement for the measurement of assets

APRA proposed clarifications to reflect the expectation that general insurers measure all assets at fair value for the capital base. While GPS 114 requires that the fair value of assets is used to calculate the asset risk charge, GPS 112 does not explicitly require the fair value of assets be used. APRA proposed to amend GPS 112 to explicitly require general insurers to adjust the difference between fair value and the reported value of each asset when determining the capital base.

Comments received

Submissions generally supported the principle of requiring fair values to be used for capital base determination. However, a number of submissions commented that there are certain assets that may not be measured at fair value on an insurer's balance sheet and therefore should not be required to be measured at fair value for the capital base determination. These assets include non-financial assets, short-term receivables and intercompany receivables and payables. Submissions commented that the requirement to maintain two bases of measurement would result in additional complexity and may present unnecessary cost on insurers for no material benefit.

It was suggested that APRA permit these assets be measured using the requirements in the accounting standards as an approximation of fair value for capital base determination. Submissions noted that this is the approach currently used to comply with the existing prudential requirement in GPS 114.

APRA's response

Following consideration of feedback received, APRA is proposing to revise its position to allow non-financial assets, short-term receivables and intercompany receivables and payables to be measured in accordance with the requirements in the Australian Accounting Standards (AASBs). APRA understands that these assets are not measured at fair value under the relevant AASB standards, however the methodology currently used to value these assets results in a reasonable outcome. APRA is proposing to maintain the requirement to measure all other assets using fair value for capital base determination.

Given the feedback received, APRA is also proposing to adjust the existing requirement in GPS 114 to reflect industry practice. APRA is proposing to make amendments to LPS 112 and LPS 114 to align fair value requirements across both industries. These revisions seek to clarify APRA's existing expectations.

See draft prudential standards GPS 112, GPS 114, LPS 112 and LPS 114 for proposed changes.

4.7 Life companies – Specifications of illiquidity premium

APRA stated its intention to update the formula for illiquidity premium specified in LPS 112. The illiquidity premium is included in the discount rate used in certain circumstances for valuing the adjusted policy liabilities, which determine the capital base.

The proposed revision will incorporate the alternative methodology, which utilises 'Statistical Table F3 – Aggregate Measures of Australian Corporate Bond Spread and Yields' (Table F3). This method was communicated to industry via a letter in 2014 after the RBA ceased to publish the information required for the formula included in LPS 112. APRA also communicated in the November 2020 paper that it was considering alternative calculation methods to address issues arising from the change in publication timing of RBA data required for the illiquidity premium calculation.

Comments received

Suggestions were received on how to address the changes in publication timing of RBA data. Suggestions included permitting entities to determine their own illiquidity premium methodology, APRA publishing illiquidity premium on a periodic basis and specific methodology suggestions.

APRA's response

Following consideration of feedback, it is proposed that if obtaining the spread from Table F3 is impractical, a best estimate assumption of the spread to be published in Table F3 may be used. This estimate must not be deliberately overstated or understated.

Changes are also proposed to incorporate the current methodology for calculating illiquidity premium into the prudential standard. This methodology is consistent with that communicated to industry via a letter in 2014.

See draft prudential standard LPS 112 for the proposed changes.

4.8 Reinsurance

The discussion paper suggested a number of enhancements to ensure that the LAGIC framework remains fit for purpose given the change in the reinsurance landscape.

4.8.1 General insurers and life companies – Operational risk charge for whole of account quota share arrangements

APRA communicated its intention to consider whether the operational risk charge (ORC) is appropriate where an insurer enters into a long-term quota share arrangement. This matter is being considered because when an insurer enters into a long-term quota share arrangement, both the insurer and reinsurer would be required to hold an ORC for the full amount of premium ceded, and this could be perceived as double counting.

Comments received

APRA received diverse feedback on this proposal. Views were mixed on whether the current methodology caused double counting of risks when a long-term quota share arrangement is entered into. Supporting submissions commented that there is no heightened operational risk associated with long-term quota share arrangements that would warrant both an insurer and reinsurer to hold an ORC on ceded premiums. One supporting submission viewed that long-term quota share arrangements do add to operational risk, but does not double it and therefore was in favour of an adjustment.

Opposing submissions highlighted the complexities of developing a suitable adjustment for all long-term quota share arrangements, observing that the impact of double counting would vary depending on the underlying nature of the original business. These submissions encouraged APRA to consider whether the proposal would introduce unintended complexity and inconsistency.

APRA's response

Given feedback received, APRA has chosen not to proceed with this proposal. The current methodology for calculating the ORC will be retained.

APRA agrees with feedback highlighting that the level of operational risk borne by insurers and reinsurers varies depending on the nature of each arrangement and underlying business. On this basis, the complexity of introducing a change is expected to outweigh the benefits.

4.8.2 General insurers – Duration of policies in the calculation of the Insurance Risk Charge

APRA proposed an adjustment to the method for calculating the IRC component of the PCA to more appropriately deal with multi-year proportional reinsurance contracts. This reflects APRA's observation that existing requirements necessitating that reinsurers hold capital based on their inwards reinsurance exposure for the full duration of a multi-year contract is not reflective of the risk of the transaction.

Comments received

Submissions generally supported APRA's proposal, noting that the amount of capital an insurer holds at inception should be aligned with the overall risk of the transaction. A small number of submissions viewed that the current treatment is appropriate, and any adjustment would introduce additional complexity. It was suggested that APRA may consider allowing exemptions on a case by case basis. One submission encouraged APRA to ensure treatment is applied uniformly to both non-whole of account, as well as arrangements that are less than five years.

APRA's response

APRA maintains that the current method for calculating the IRC results in excessive capital being held for multi-year quota share arrangements. The IRC is designed to set capital for reinsurance contracts on a basis that reflects the risk of the transaction.

APRA notes that the relevant requirements in *Prudential Standard GPS 115 Capital Adequacy: Insurance Risk Charge* (GPS 115) envisaged a contract with multiple termination dates, rather than a multi-year reinsurance contract without any cancellation clauses before the first termination date. The current requirement results in a reinsurer holding capital at a 99.5% probability of sufficiency each year for the duration of the contract. Given outcomes in each year of the contract are unlikely to be perfectly correlated with outcomes in all other years, this current level of capital is unlikely to be appropriate.

On this basis, APRA is proposing an adjustment to paragraphs 17 and 18 of GPS 115 to introduce an alternate method to calculating the capital charge for material net written premium for multi-year quota share reinsurance arrangements of up to 5 years' remaining term. APRA is proposing to require a reinsurer to calculate material net written premium using the full premium revenue, subject to the material net written premium not exceeding the amount written in 18 months. APRA views that this better reflects the nature of risk in multi-year quota share reinsurance arrangements, and recognises that the outcomes of each year are unlikely to be fully dependent on one another.

See draft prudential standard GPS 115 for the proposed changes.

4.8.3 General insurers – Procedural requirements for contracts

Given significant improvements in the formalisation of reinsurance arrangements, APRA outlined its proposal to remove the 'two and six month' rule as it viewed it to be no longer necessary. It was proposed that the 'two and six month' rule be replaced with a requirement for all formal procedures to be in place by inception date of the reinsurance contract.

Comments received

Submissions generally opposed this proposal, commenting it would place heightened operational burden on general insurers as negotiation on certain terms of reinsurance contracts are often ongoing beyond the inception date. Submissions also commented that placing a hard deadline on the finalisation of reinsurance contracts would provide reinsurers with greater bargaining power, and result in a hardening of reinsurance contracts.

APRA's response

Having considered stakeholder feedback, APRA is proposing to adjust the revisions to reinsurance management requirements to an 'inception date and two month rule', rather than requiring contracts to be fully finalised by inception. This proposal would require the terms and coverage of reinsurance contracts to be finalised by inception, and provide an additional two month period for wordings to be finalised, stamped and signed.

Due to the timing of quarterly reporting, under the revised proposal an insurer may still receive capital credit for reinsurance arrangements where the inception date rule is not met. In these circumstances, capital credit can be taken for reinsurance arrangements as long as both the inception date rule and two month rule are met at the time of reporting. APRA intends to require general insurers failing to meet the inception date rule to provide detail on the actions taken to ensure the appropriate documentation is in place in their reinsurance declaration, even where the two month rule is met.

APRA notes that the two and six month rules were initially introduced to formalise reinsurance contract procedures and promote contract certainty. The intention was for this requirement to tighten as industry practice improved over time. APRA maintains that there is significant prudential and legal risk if the detailed terms of a reinsurance contract are not agreed in the event of a loss, and this may lead to a reinsurer denying a claim that an insurer believes is covered. APRA believes that neither party's interests are served if contract negotiations after a loss potentially influence the quantum of any reinsurance recovery. APRA views that the 'inception date and two month rule' strikes an appropriate balance between meeting the prudential objective the proposal is seeking to address, while managing the risk of heightened operational burden on industry.

APRA views this proposal as a transitionary measure. In the medium term, APRA will consider making further revisions to require reinsurance contracts to be fully finalised by the inception date. APRA strongly encourages general insurers to begin putting processes in place as soon as possible to ensure that reinsurance contracts are fully placed, executed and finalised by the inception date of the contract.

4.9 Other amendments

APRA shared its intention to make additional minor drafting changes to the capital standards to enhance clarity. These minor drafting changes are contained within the draft prudential standards and do not alter the policy intent of the prudential standards.

Industry feedback was requested on minor wording change suggestions needed to provide further clarity in the standards. Respondents provided some suggested enhancements to LAGIC. Most were material in nature, not minor wording changes. Given the materiality of the suggestions, APRA has chosen to collate these proposals for consideration at a later date.

Chapter 5 - Insights from the Quantitative Impact Study and Implementation Survey

5.1 Introduction

To assess the impact of APRA's proposals in the discussion paper, APRA concurrently conducted a targeted quantitative impact study (QIS) with select insurers across the industry. APRA's intention was to:

- assess the impact of AASB 17 on insurers' financial statements and capital position;
- understand insurers' AASB 17 accounting policies and choices;
- get a better understanding of the level of regulatory burden for insurers; and
- obtain feedback that could inform future policy development and preparation for the full QIS in 2021.

The QIS was supplemented by a second implementation survey, released in May 2021 for all insurance entities, to assess the maturity of insurers' preparedness to implement AASB 17 as well as the regulatory capital impacts of APRA's proposed LAGIC updates (excluding PHIs). These were both undertaken on a best endeavours basis. A summary of the key insights is included in this chapter.

5.2 Key findings from the Quantitative Impact Study

Accounting equity and the capital base

APRA has identified instances in the QIS, for some insurance industries, where accounting equity is lower than the capital base. This potentially introduces a scenario where the insurer could become insolvent for accounting purposes before breaching APRA's capital requirements. APRA will review the results of the 2021 QIS and consider what policy changes, if any, are needed.

Life insurers

Life insurers were most impacted in the targeted QIS. It was observed that:

- There was some volatility in the results of life insurers. This volatility is mainly driven by accounting policy choices and reinsurance arrangements.
- Capital levels are expected to remain broadly unchanged. However, it has been observed that AASB 17 insurance liabilities are higher relative to adjusted policy liabilities in some instances.

General insurers

General insurers were moderately impacted in the targeted QIS. It was observed that:

- The accounting metrics on an AASB 17 basis compared to existing (D2A) metrics at an entity level were broadly comparable.
- Mismatches with reinsurance arrangements and treatment of items (e.g. commissions) under AASB 17 resulted in some differences in key ratios (e.g. combined and cession ratios) that get amplified at a product group level.
- Capital levels are expected to remain broadly unchanged.

Private health insurers

Private health insurers were least impacted in the targeted QIS. It was observed that:

- The accounting metrics on an AASB 17 basis compared to existing (D2A) metrics at an entity level were broadly comparable.
- Capital levels and profits are expected to remain broadly unchanged under AASB 17.

5.3 Findings from the implementation survey

The implementation survey had a strong participation from insurers. In line with the findings from the QIS, the key observations from the survey were:

Preparedness

Insurers are at different stages in terms of their preparedness to adopt AASB 17.

Systems, processes, and business lines

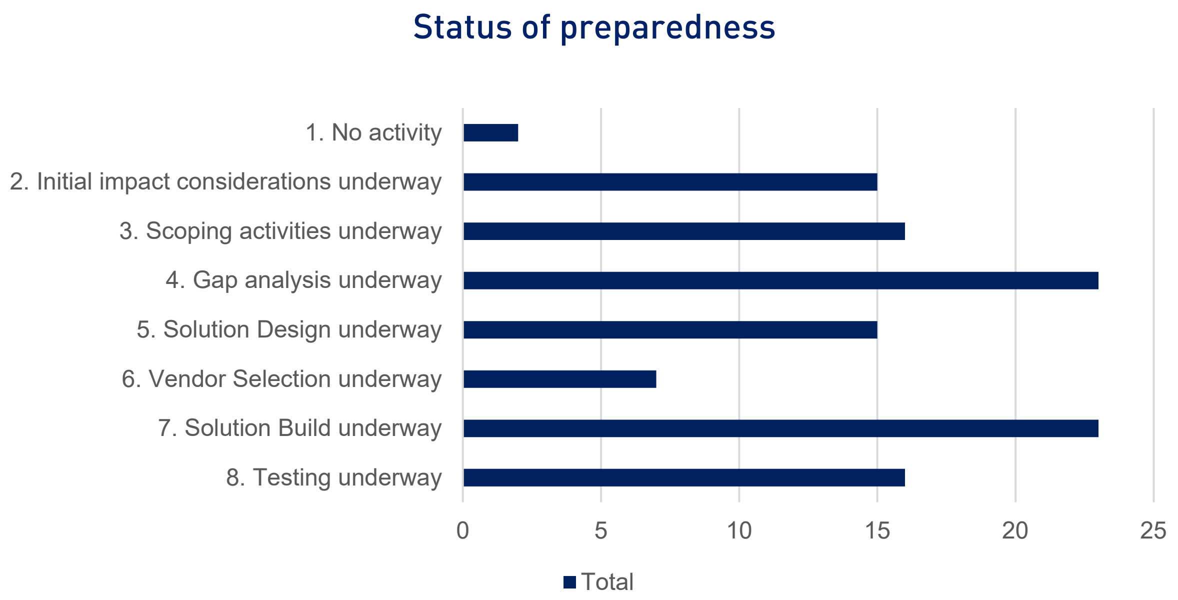
Will be impacted. This varies across general insurers and life insurers.

Capital and earnings

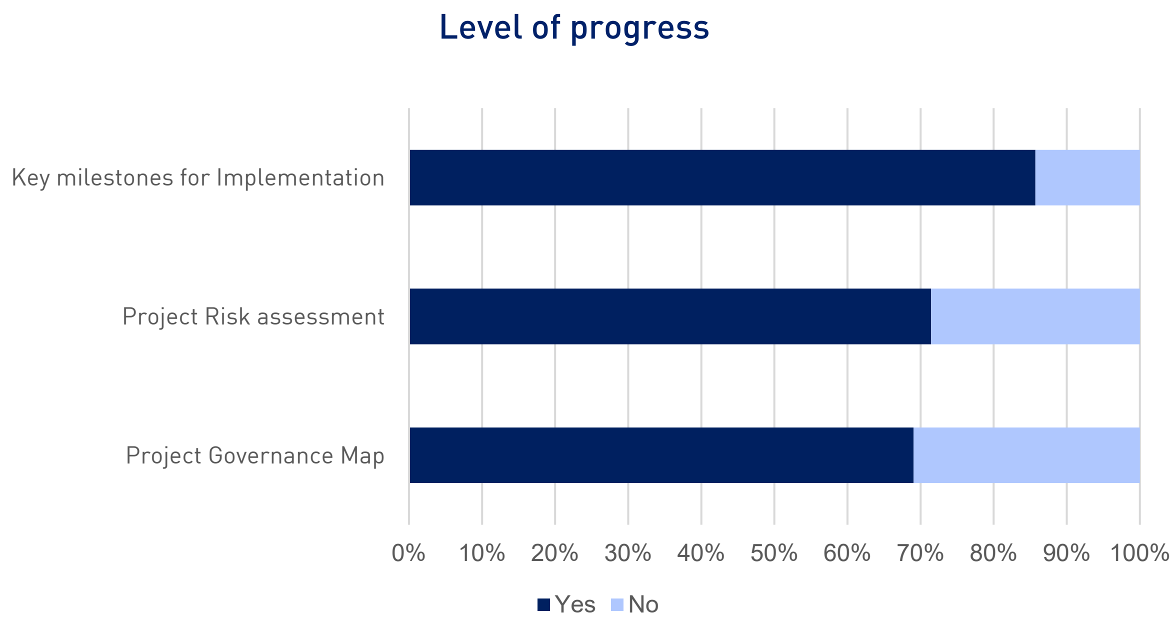
Will be impacted. Life insurers are likely to be more impacted than general insurers.

Engagement

Boards and management are engaging with AASB 17.

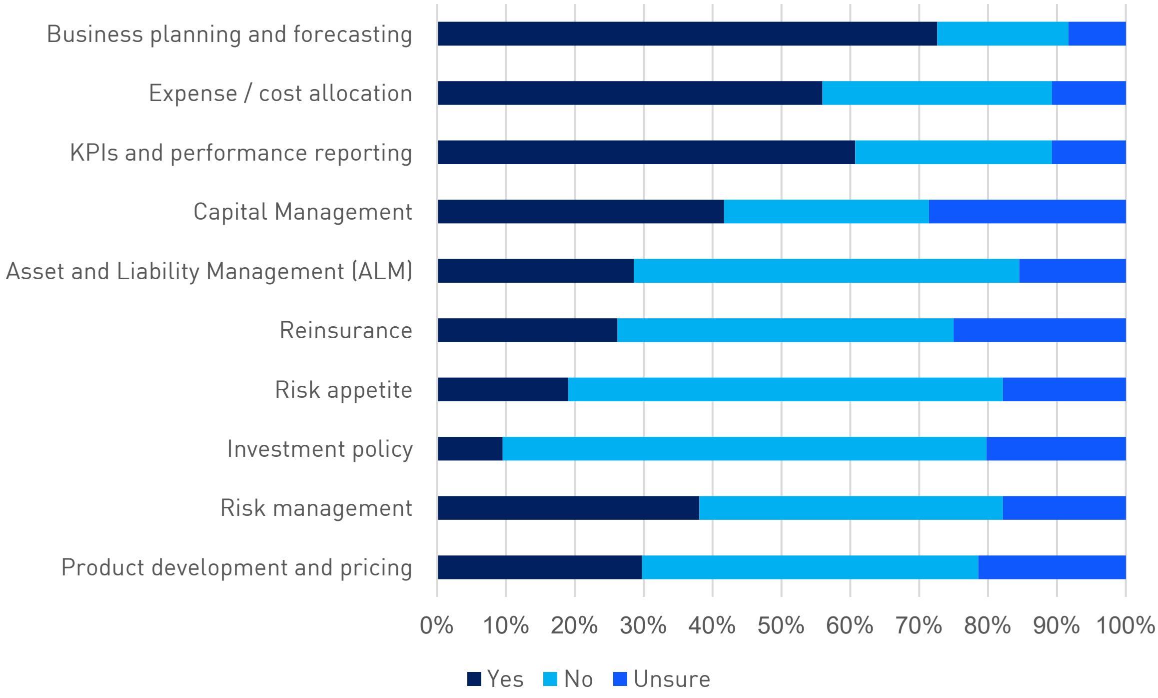


There are differences in terms of the level of progress made by insurers. Insurers have identified the key milestones for implementation. However, there is more to do in terms of project governance, and project risk assessment.



The implementation of AASB 17 leads to an increase in operational risk for insurers. Several business processes are likely to be impacted including: business planning and forecasting, expenses and cost allocation, KPIs and performance reporting, and capital and risk management. In order to facilitate the implementation of AASB 17, insurers are likely to adapt existing systems, purchase new systems, or build new systems in-house.

Impact on processes



Given the differing stages and levels of impact on the industry, APRA plans to continue to engage with insurers on their operational readiness to adopt AASB 17.

Chapter 6 - Next steps and consultation

6.1 Timetable

Submissions on the proposals in this consultation package should be provided by 31 March 2022.

To minimise the level of burden on the industry, the draft reporting standards being consulted on have been limited to those requiring amendments due to the integration of AASB 17 and LAGIC updates that form the basis of the QIS. APRA expects to release the remaining draft reporting standards impacted by AASB 17 and LAGIC updates in Q1 2022.

Following consideration of feedback received, APRA expects to begin the release of final standards in Q3 of 2022. The effective date of the revised standards will be 1 July 2023.

6.2 Request for submissions and cost-benefit analysis

APRA invites written submissions on the proposals set out in this paper and the draft standards.

Written submissions on the **prudential standards** should be sent to insurance.policy@apra.gov.au by 31 March 2022 and addressed to:

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

Written submissions on the **reporting standards** should be sent to dataconsultations@apra.gov.au by 31 March 2022 and addressed to:

General Manager
Data Analytics and Insights
Cross-Industry Insights and Data Division
Australian Prudential Regulation Authority

APRA requests that all interested stakeholders use this consultation opportunity to provide information on the compliance impact of the proposed changes and any other substantive costs associated with the changes. Compliance costs are defined as direct costs to businesses of performing activities associated with complying with government regulation. Specifically, information is sought on any increases or decreases to the compliance costs incurred by businesses as a result of APRA's proposal. Please exclude any compliance costs that businesses would have incurred from the implementation of AASB 17 regardless of the proposals contained in this response paper. The compliance costs should also be measured relative to APRA making no change to the capital and reporting frameworks (i.e. continued misalignment between APRA's frameworks and the accounting standard).

Consistent with the Government's approach, APRA will use the methodology behind the Regulatory Burden Measurement Tool to assess compliance costs. This tool is designed to capture the relevant costs in a structured way, including a separate assessment of upfront costs and ongoing costs. It is available at: https://rbm.obpr.gov.au/.

Respondents are requested to use this methodology to estimate costs to ensure that the data supplied to APRA can be aggregated and used in an industry-wide assessment. When submitting their cost assessment to APRA, respondents are asked to include any assumptions made and, where relevant, any limitations inherent in their assessment. Feedback should address the additional costs incurred as a result of complying with APRA's requirements, not activities that entities would undertake regardless of regulatory requirements in their ordinary course of business.

6.3 Important disclosure requirements – publication of submissions

All information in submissions will be made available to the public on the APRA website unless a respondent expressly requests that all or part of the submission is to remain in confidence. Requests for submissions to remain in confidence are to be clearly marked on the first page of the submission.

Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain in confidence should provide this information marked as confidential in a separate attachment.

Submissions may be the subject of a request for access made under the *Freedom of Information Act 1982* (FOIA). APRA will determine such requests, if any, in accordance with the provisions of the FOIA. Information in the submission about any APRA-regulated entity that is not in the public domain and that is identified as confidential will be protected by section 56 of the *Australian Prudential Regulation Authority Act 1998* and will therefore be exempt from production under the FOIA.

6.4 Quantitative Impact Study (QIS)

To evaluate APRA's revised proposals, all general insurers[11], life insurers and friendly societies, and private health insurers have been invited to complete the QIS issued alongside the draft standards. As AASB 17 is a major change for the industry, APRA has observed that participation in the 2020 targeted QIS and previous implementation surveys was a valuable exercise for entities to identify the additional work required to fully implement AASB 17. APRA strongly encourages all insurers including friendly societies to participate in the QIS, as it will assist in ensuring that sound prudential outcomes are being achieved and to minimise any unintended consequences and additional burden on industry.

Insurers are to complete the QIS based on the updated capital (including LAGIC update proposals) and reporting proposals outlined in the response paper, which are also reflected

[11] Level 2 insurance groups have not been asked to complete to this QIS.

in the draft prudential and reporting standards. APRA's preference is that insurers use the 2021 full financial year end for completing the QIS. For insurers with a 31 December balance date, the 2020 full financial year end may be used.

Draft reporting standards on QIS data definitions, the associated workbooks, and supplementary instructions are available on the APRA website. Completed QIS workbooks should be provided to APRA by 31 March 2022. APRA will provide details on the method of submission early in the new year.

Appendix A – Prudential standards being updated

This appendix summarises the key changes to the prudential standards. The purpose is to help industry identify and understand the intent of the changes proposed. Paragraph or section references have been included where the changes may not be obvious.

General insurance

Prudential standard	Key APRA proposals
GPS 001	• Added definition for "Acquisition expenses" used in GPS 340, to replace "Deferred acquisition costs" which is no longer a concept under AASB 17. • Added definition for "Claims handling expenses" used in GPS 340, to clarify existing APRA requirements in light of different requirements from AASB 17. • Removed definition of "Deferred reinsurance expense (DRE)" which is no longer a concept under AASB 17. • Removed definition for "Internal Model based Method" as APRA is proposing to no longer allow the use of internal capital models to determine regulatory capital. • Added definition for "Policy administration expenses" used in GPS 340, to clarify existing APRA requirements in light of different requirements from AASB 17. • "Expected reinsurance recoveries" to be used in place of DRE in "Reinsurance assets" definition. • Added and updated definition for "Unclosed business" definition as referenced across multiple standards. • Added definition for "Directors and Officers" class of business as noted in Discussion Paper. • Added definition for "Cyber" class of business based on ICA work.
GPS 110	• Clarified the four quarters dividend test. • Clarified the frequency that an ICAAP report must be provided to APRA. • Removed references to the 'Internal Model based Method'. • Clarified that the profits test is intended to apply consistently across Category C insurers and other insurers.
GPS 112	• Added definitions of additional regulatory adjustments ('accounts receivables' and 'accounts payables') to the interpretation section. • Revised terminology to reflect revised terminology relating to AASB 17 insurance liabilities in footnote for technical provisions (paragraph 30 (3)). • Added CET1 regulatory adjustments relating to 'accounts receivables' and 'accounts payables' to neutralise impact of AASB 17 on capital base (Attachment B, paragraph 7). • Added clarification to deferred tax asset and deferred tax liabilities CET1 regulatory adjustment to allow for tax effects that would result from the

Prudential standard	Key APRA proposals
	technical provision adjustment as well as the additional accounts receivable and accounts payable adjustments. Intent was to prevent insurers from over-recognising tax benefit if they do not have the equivalent DTA/DTL balance. (Attachment B, paragraph 10). • Several amendments made to align with APS 111, see Appendix C. • Clarified the application of fair value measurement for capital base determination.
GPS 113	• Removed standard, as APRA is proposing to no longer allow the use of internal capital models to determine regulatory capital.
GPS 114	• Added clarification that additional regulatory adjustments relating to 'accounts receivable' and 'accounts payable' be included in asset risk charge, gross of tax effects via footnote (paragraph 15 (1)). • Added clarification that reinsurance assets and non-reinsurance assets per GPS 340 are to be stressed to ensure APRA's capital framework is unchanged (via footnote (paragraph 19 (2)). • Moved and updated "unclosed business" description to GPS 001 as it is referenced by multiple standards. • Clarified the application of fair value for capital base determination. • Introduced a three per cent floor to the real interest rate stress to ensure the standard produces appropriate results in a low or negative interest rate environment. • Adjusted the parameters of the expected inflation stress test to ensure all insurers appropriately allow for expected inflation risk, even in a low or negative interest rate environment. • Clarified that the inflation stress test applies for both explicit and implicit inflation assumptions. • Updated the dollar value exposure limit to reflect inflation since LAGIC was introduced. • Introduced an additional paragraph to allow insurers to apply the default stress to the net of a quota share position in relation to unpaid premium, unclosed business and non-reinsurance recoveries to better reflect the transfer of risk. • Clarified APRA's requirements relating to surety bonds to better reflect APRA's intended treatment of different types of off-balance sheet exposures.
GPS 115	• Added Directors and Officers and Cyber to Tables 1 and 2 of Attachment A • Introduced an alternate method to calculate the capital charge for material net written premium for multi-year quota share reinsurance arrangements of up to 5 years' remaining term (paragraph18).
GPS 116	• Amended references to the 'two and six month rules' to the 'inception date and two month rules', to reflect the proposed changes to reinsurance contract documentation requirements. • Minor clarification made to ensure consistent wording across the H3 and H4 loss where consistent interpretation is intended, now consistently referring to 'probability of occurrence' across both tests.

Prudential standard	Key APRA proposals
GPS 117	• Updated the dollar value exposure limits to reflect inflation since LAGIC was introduced.
GPS 118	• Clarified definition for "written premium revenue" as previous definition relates to old accounting standard AASB 1023. • Specified the "NL" term relates to that determined in accordance with GPS 340. • Removed reference to old accounting standard AASB 1023.
GPS 230	• Amended references to the 'two and six month rules' to the 'inception date and two month rules', to reflect the proposed changes to reinsurance contract documentation requirements.
GPS 340	• Clarified definition for "claims handling expenses" and "policy administration expenses" via use of definition in GPS 001 (paragraphs 9 and 10). • Added clarification for OSCL that projection period is to be prospective to clarify that our capital framework does not change with AASB 17 (paragraph 9). • Added clarification for premiums liabilities to include "unclosed business" to clarify that our capital framework does not change with AASB 17 (paragraph 10). • Added clarification that default risk should not be included in reinsurance recoverables and expected reinsurance recoveries to ensure no mix up with AASB 17 concepts (paragraph 11). • Replaced "deferred acquisition cost" with "acquisition expenses" definition as DAC no longer exists under AASB 17 (paragraph 12). • Clarified premiums liabilities and material net written premium requirements (paragraph 13, footnote (1)) as a result of changes made to GPS 115 . • Removed reference to profit due to profit being different under AASB 17 (paragraph 26). • Added paragraph to clarify existing requirements to not allow diversification benefits for risk margins outside of level 1 (and level 2) entities (groups) (paragraph 29). • Replaced "reinsurance assets" with "reinsurance recoverables and expected reinsurance recoveries" to avoid confusion with AASB 17 "reinsurance assets" concept (various paragraphs). • Distinguished risk of non-receipt of reinsurance recoveries from default risk (paragraph 11) through addition of term "material" (paragraph 37). • Removed "deferred reinsurance expense" references as it is no longer a concept under AASB 17 (various paragraphs). • Revised paragraph to address gap where reinsurance is in place but cost not yet expensed (paragraph 41). • Removed "reporting current period claims expense" section as AASB 17 defines the basis for claims expenses, so no longer relevant for GPS 340. • Attachment A - Level 2 insurance groups ○ Removed references to old accounting (AASB 1023) terminology and replaced with more suitable AASB 17 terminology.

Prudential standard	Key APRA proposals
	◦ Restructured "international business" section to combine requirements for Outstanding Claims Liabilities and Premiums Liabilities. ◦ Updated requirements to ensure accounting entries are appropriate and exceed the requirements of GPS 340 if used. • Removed references to Liability Adequacy Test (AASB 1023) while still requiring existing 75% probability of sufficiency treatment for premiums liabilities.

Life insurance

Prudential standard	Key APRA proposals
LPS 001	• Defined the term APRA product group for the purposes of LPS 340. • Defined the term unpaid premium for the purposes of LPS 114 and LPS 118. • Deleted the terms which will no longer be relevant to LPS340. • Modified a number of the existing definitions to reflect the draft LPS 340.
LPS 110	• Clarified the four quarters dividend test. • Corrected a minor drafting issue in Attachment A. • Clarified the frequency that an ICAAP report must be provided to APRA. • Removed references to the 'Internal Model based Method'.
LPS 112	• Several amendments made to align with APS 111, see Appendix C. • Added definitions of additional regulatory adjustments ('insurance policy receivables' and 'insurance policy payables') to the interpretation section given the revised liability adjustment proposal. • Clarified that the regulatory adjustments for deferred tax must reflect the tax effects that would result from the liability adjustment which includes the additional regulatory adjustments (i.e. insurance policy receivables and payables). • Modified the liability regulatory adjustment to reflect AASB 17 insurance liability related items and to add insurance policy receivables and payables to neutralise the impact of AASB 17 on the capital base. • Clarified the application of fair value measurement for capital base determination. • Amended the specifications of the illiquidity premium.
LPS 114	• Added definitions of additional regulatory adjustments ('insurance policy receivables' and 'insurance policy payables') to the interpretation section. • Clarified that insurance policy receivables and payables must be reflected in the asset risk charge calculation, gross of tax effects. • Introduced a three per cent floor to the real interest rate stress to ensure the standard produces appropriate results in a low or negative interest rate environment.

Prudential standard	Key APRA proposals
	• Adjusted the parameters of the expected inflation stress test to ensure all insurers appropriately allow for expected inflation risk, even in a low or negative interest rate environment. • Clarified that the inflation stress test applies for both explicit and implicit inflation assumptions. • Updated the dollar value exposure limit to reflect inflation since LAGIC was introduced. • Clarified the application of fair value for capital base determination.
LPS 118	• Replaced "premium income" with "accrued premium" to neutralise the impact of AASB 17. • Added definition of accrued premium to promote consistency and clarity for the calculation of the ORC.
LPS 310	• Updated Attachment A to reflect the revised reporting standards. • Changed the level of assurance requirement of LRS 200 from none to limited assurance.
LPS 340	• Listed and clarified Life Act terms for the purposes of LPS 340. • Introduced a revised method to classify policies by life insurer participating, life insurer non-participating and friendly society business as opposed to classifying policies by life insurance contracts and life investment contracts. This approach makes it more aligned with the Life Act classification and makes it cleaner to outline LPS 340 reporting requirements for participating business. • Clarified that for the regulatory capital calculation, insurers continue to use the existing method of calculating best estimate liabilities for all types of business. • Clarified the requirement that policy liabilities must be determined separately in accordance with the Life Act reporting structure. The exception is non-par risk business within a statutory fund across ordinary and superannuation classes (subject to the tax rates on profits being the same). • Removed the majority of the unbundling requirements for the valuation of policy liabilities given that AASB 17 will determine the unbundling requirements. • Modified Part B such that the valuation of policy liabilities for life insurer non-participating business and friendly society business are determined by the relevant accounting standards (subject to meeting other policy liability valuation requirements) and not just life investment contracts. • Removed the paragraphs in Part B which outline the policy liability valuation methodology for life investment contracts because the requirements will be outlined in the relevant accounting standards. • Introduced two methods of valuing policy liabilities for life insurer participating business in Part B, the accounting standard led method and VSA led method. A life insurer can choose between the two methods. • Introduced the requirements underlying the accounting standard led method where a life insurer derives Life Act retained profit and policy liability amounts from the AASB 17 carrying amount. • Part C covers the VSA led method for valuing policy liabilities for participating business. Part C retains the existing valuation method outlined in Part C and Part D of the existing LPS 340 but has been simplified to remove the

Prudential standard	Key APRA proposals
	paragraphs relating to life insurer non-participating business and friendly society business, and paragraphs that are duplicative / unnecessary. • Part D covers the valuation method for best estimate liabilities. The best estimate liability requirements are relevant for the VSA led method for life insurer participating business and regulatory capital calculation for all business. • Outlined the circumstances where Part E applies. • Replaced references to related product groups by APRA product groups and / or Life Act reporting components given that related product group is an existing accounting concept. • Clarified that the expense requirements for friendly societies apply to regulatory capital calculation. • Clarified that life insurers must determine materiality at a SF level for both policy liability valuation and regulatory capital calculation. • Clarified that friendly societies must determine materiality at a BF level for both policy liability valuation, regulatory capital calculation and surplus distribution / allocation. • Outlined that life companies can use approximate methods for valuing BEL.
LPS 600	• Introduced requirements about determination of starting amounts for the purposes of the Life Act given the new accounting standard. These new requirements specify how AASB 17 liability restatements impact the various Life Act retained profit balances.

Appendix B - Reporting standards being updated

This appendix summarises the key changes to reporting standards released in the QIS for General Insurance and Life Insurance. Remaining standards (such as those for level 2 groups in general insurance and more detailed data collections) will be consulted on at a later stage. GRS 001 and LRS 001 are also not included due the inclusion of content which is being consulted on at a later stage.

General insurance

Reporting standard	Key APRA proposals
GRS 110	• PCA and capital base and metrics not collected because they can be calculated using other data items or are collected in other standards. • Adjusted net assets inside Australia collection moved into GRS 112. • Some key intermediate calculations from Operational Risk Charge and Asset Risk Charge to be collected.
GRS 111 (new)	• New reporting standard to capture adjustments and exclusions to the prudential standard requirements as approved by APRA. These relate to the PCA and risk charges.
GRS 112	• Additional regulatory adjustments relating to accounts receivables and accounts payables to be captured. • Inclusion of adjusted net assets inside Australia collection (previously included in GRS 110). Additional regulatory adjustments incorporated.
GRS 114.0	• Additional regulatory adjustments to be stressed. • Minor changes to wording for reinsurance assets subject to default stress. • Specifying GPS 340 OCL and GPS 340 PL to be stressed.
GRS 115.0	• Inclusion of Claims Handling Expenses. • Specifying Reinsurance and Non-Reinsurance recoveries to be central estimates. • Calculated fields not collected. • Inclusion of Discount on net OCL (moved from GRF 440). • Cyber and Directors & Officers class of business added.
GRS 115.1	• Removal of AASB 1023 Premiums Liabilities items. • Inclusion of: Claims handling expenses, Policy admin expenses, Commissions, Reinsurance commissions and Expected future reinsurance costs for premiums liabilities not covered by current and future arrangements. • Specifying Reinsurance and Non-Reinsurance recoveries to be central estimates. • Cyber and Directors & Officers class of business added.
GRS 117	• No material changes.

Reporting standard	Key APRA proposals
GRS 118	• No material changes.
GRS 300.0	• Introduction of a new balance sheet reflecting AASB 17 items and aligning to the statutory balance sheet structure.
GRS 310.0	• Introduction of a new income statement reflecting AASB 17 items and aligning to the statutory income statement structure.
GRS 311 (new)	• Introduction of a new income statement by class of business reflecting AASB 17 items and aligning to the statutory income statement structure.
GRS 320 (new)	• Introduction of a new liability roll forward to collect information relating to reconciliations of insurance contract liabilities required by AASB 17 Insurance Contracts (AASB 17).
GRS 600 (new)	• New reporting standard to capture supplementary capital data on premiums, claims and expenses. Collected by class of business and at a related party exposure level. • Broadly intended to be used to calculate Loss Ratio and Combined Operating Ratio metrics on a basis similar to that of the existing D2A forms GRF 310.1, GRF 310.2 and GRF 310.3. • "Accrued premium" to replace "Earned premium".
GRS 400	• AASB 17 Balance Sheet and Income Statement items to be collected at a high level.
GRS 410	• Specifying GPS 340 Outstanding Claims Liabilities to be collected. • Discrete annual year periods to be collected. • Cyber and Directors & Officers class of business added.
GRS 420	• Combined with GRS 430. • Collecting AASB 17 Insurance Revenue and Insurance Service Expenses. • Cyber and Directors & Officers class of business added.
GRS 430	• Combined with GRS 420
GRS 440	• " Accrued premium" to replace "earned premium". • Specifying GPS 340 items to be collected • Cyber and Directors & Officers class of business added.

Life insurance

Reporting standard	Key APRA proposals
LRS 110	• Collect capital risk charge data items at a life company level but remove collection of elimination data items under other capital related reporting standards.

Reporting standard	Key APRA proposals
LRS 111 (new)	• New reporting standard to capture adjustments and exclusions to the prudential standard requirements as approved by APRA. These relate to the PCA and risk charges.
LRS 112	• Collect data on the additional regulatory adjustments because they would be significant items that form part of the liability adjustment.
LRS 114.0	• Collect additional asset and liability items including the additional regulatory adjustments to obtain better visibility over the impact of asset risk stresses on assets and liabilities. • Introduce additional items and clarify definitions relating to items related to the adjusted policy liabilities. This is to better understand the impact of asset risk stresses on the capital base and address reporting issues that were raised in the past. • Collect the impact of interest and inflation stresses on AASB 17 insurance and reinsurance liabilities and assets (and investment liabilities). These would provide useful information to APRA about financial profiles of these liabilities and assets compared to the adjusted policy liabilities.
LRS 114.5 (new)	• New reporting standard being proposed and this needs to be completed by friendly societies only. • This reporting standard relates to additional data items that form the basis of the determination and distribution of the surplus in an approved benefit fund.
LRS 115	• Remove the reporting exemption, which applies when the insurance risk charge is zero. APRA views that this proposal would have minimal impact on insurers. • Collect adjusted policy liabilities and stressed policy liabilities both gross and net of reinsurance. This reflects the proposal of collecting additional data on the regulatory liabilities.
LRS 117	• APRA will consult on the draft LRS 117 and the draft LPS 117 early next year given that revisions to LPS 117 are under separate policy consultation and LRS 117 will be impacted by LPS 117 proposals. • For the QIS, insurers need to calculate VAF using the proposals outlined in the response paper (the VAF items have been included in LRS 200 for the QIS only). Other LRS 117 data items and the calculation of ACRC have been scoped out from the QIS.
LRS 118	• A number of the aggregate data items will be collected under LRS 110 as opposed to LRS 118.
LRS 200	• Propose to expand LRS 200 to reflect the proposal of collecting additional data on the regulatory liabilities that determine the capital base. • For the annual submission, propose to collect detailed data on RFBEL, termination value and loss ratios. Key features of the annual submission are as follows. i) Collect RFBEL component data for non-participating benefits without entitlement to discretionary additions, non-participating benefits with entitlement to discretionary addition, participating benefits and friendly society benefits.

Reporting standard	Key APRA proposals
	ii) Collect RFBEL component data by new business and in-force business. iii) Collect RFBEL component data by gross and net of reinsurance. iv) Collect loss ratio data by gross and net of reinsurance and also by actual vs expected. • For quarterly submission, propose to collect a reduced data set. For example, insurers would not be required to submit RFBEL components for non-participating benefits with entitlement to discretionary addition and participating benefits. Insurers would also not be required to provide new business vs inforce data and actual vs expected data. • Propose friendly societies to submit annual information for LRS 200 but only for F4 – Defined Benefit Risk. Friendly societies would not be required to submit quarterly information for LRS 200.
LRS 300	• Introduce a new balance sheet reflecting AASB 17 items and aligning to the statutory balance sheet structure.
LRS 310	• Introduce a new income statement reflecting AASB 17 items and aligning to the statutory income statement structure.
LRS 311 (new)	• Introduce a new product group income statement reflecting AASB 17 items and aligning to the statutory income statement structure. • Insurers only need to complete the product group income statement at a higher product group level (i.e., at lump sum which includes death, TPD and trauma benefits).
LRS 320 (new)	• Introduce a new liability roll forward to collect information relating to reconciliations of insurance contract liabilities required by AASB 17 Insurance Contracts (AASB 17).
LRS 330	• Remove LRS 330 given proposed LRS 311.
LRS 340.2	• This is an updated version of the existing entity LRS 340. • Propose to collect shareholder retained profit and share capital data at a life company level, and introduce additional data on share capital movements which would help APRA in gaining better insights about share capital injections and reductions. • Propose to significantly expand the statutory fund version of the existing LRS 340 to collect data items underlying AASB 17 liabilities, policy liabilities, and retained profits for participating business. APRA proposes to create a new reporting standard (LRS 340.1) and the draft LRS 340.1 will be released for consultation next year.
LRS 400	• A number of simplifications being proposed given the expanded data collection proposed under LRS 200. i) Insurers do not need to complete LRS 400 data under different valuation bases ii) Insurers only need to complete the data at a higher product group level (i.e., at lump sum which includes death, TPD and trauma benefits).

Reporting standard	Key APRA proposals
	iii) Insurers would not need to provide detailed components of AASB 17 liabilities other than the risk adjustment component of the liability for incurred claims (LIC). • Collect liability for remaining coverage and LIC separately by insurance and reinsurance contracts and by different measurement models. APRA views that these data items would provide important insights on AASB 17 liabilities including liability movements.
LRS 420	• Propose simplifications for LRS 420. Asset data will only be collected for the APRA product groups that have a significant investment component.
LRS 430	• Remove LRS 430 given the expanded data collection proposed under LRS 200. The proposed LRS 200 includes data items on loss ratios and actual vs expected components.

Appendix C – Proposed revisions to GPS 112 and LPS 112

This Appendix summarises the key proposed changes to GPS 112 and LPS 112, to align with revisions made to APS 111 over time. This list is not exhaustive. Further information is available in Section 4.3 of this paper.

Item	Proposal
Simplicity and transparency of capital instruments	As a general principle, APRA considers that the features and structure of capital instruments should be transparent and capable of being readily understood by investors. These provisions currently apply to the use of special purpose vehicles (SPVs). APRA is proposing to remove the relevant Attachment on the use of SPVs (see below). However, APRA considers it appropriate that these provisions should apply to all issues of capital instruments more broadly.
Non-viability triggers	APRA is proposing to clarify the circumstances in which non-viability triggers apply for insurers that are members of groups.
Use of SPVs and stapled security structures	APRA is proposing to remove the relevant Attachments in existing GPS 112 and LPS 112 on the use of SPVs. This seeks to simplify GPS 112 and LPS 112 and ensure that capital instruments are transparent and capable of being readily understood.
Capital arbitrage	APRA is proposing to explicitly clarify that transactions that have the aim of offsetting capital deductions should not be recognised for capital adequacy purposes. Over time, APRA has received requests to review or approve transactions (e.g. credit derivatives, guarantees), that seek to alter the form or substance of items subject to deduction. In APRA's view these transactions can have the effect of overestimating eligible capital, without commensurately reducing the risk in the financial system.
Cross default clauses	APRA is proposing amendments to the existing cross default provisions in GPS 112 and LPS 112. These revisions seek to formalise APRA's current approach to assessing the eligibility of capital instruments, which reflects the importance of capital being freely available to support an insurer's financial position. This could be undermined if an adverse event relating to one capital instrument could trigger a default on other instruments. APRA is further proposing that, in applying these revisions, debt instruments and capital instruments which were issued or drawn prior to the revised draft Prudential Standard being published will be excluded, reflecting the impracticality of having those instruments amended. Any new issue or drawing from this date would need to meet these requirements.
CET1 capital issuance	APRA is proposing new eligibility requirements for CET1 instruments to clarify that CET1 capital is not permitted to have any features that could undermine its role as the highest quality loss absorbing capital. This includes:

Item	Proposal
	- issuers must not assume, or create market expectations, that supervisory approval will be forthcoming for the issuer to redeem, call or purchase an instrument; - the instrument has no features which hinder recapitalisation of the issuer or any members of the group, or related party, to which the issuer belongs; - the instrument must not contain any terms, covenants or restrictions that could inhibit the insurer's ability to be managed in a sound and prudent manner or restrict APRA's ability in its role as a prudential regulator to resolve any of the problems encountered by the insurer.
Fee income	APRA is proposing a revision to GPS 112 and LPS 112 that would affect the calculation of current year and retained earnings such that fee income could be included, subject to certain criteria.
Intra-group capital transactions	To improve transparency, APRA is proposing to include in GPS 112 and LPS 112 more detail on the matters APRA will consider in assessing the impact of intra-group transactions on the strength of insurer's capital adequacy
Disclosure and marketing of capital instruments	APRA is proposing to apply disclosure requirements in GPS 112 and LPS 112 that are common across instruments, but tailored to each form of capital instrument as appropriate. APRA is also proposing to apply a consistent reference to marketing across all forms of capital instruments, including ordinary shares.
Gains and losses arising from changes in own creditworthiness	APRA is proposing that all unrealised gains and losses arising from changes in the value of liabilities and any associated embedded derivatives be eliminated from Common Equity Tier 1 Capital, where the change is related to the insurer's own creditworthiness.
Paid-up	APRA is proposing to clarify that paid up means the capital/payment has been received with finality by the issuer, is reliably valued, fully under the issuer's control and does not directly or indirectly expose the issuer to the credit risk of an investor.
Ordinary shares	APRA is proposing to clarify that in order to be classified as paid-up ordinary shares in CET1 Capital, an instrument must be the only class of ordinary share, except for the distinction between voting and non-voting ordinary shares. Non-voting ordinary shares must be identical to voting ordinary shares of the issuer in all respects except the absence of voting rights.
Allowance of Mutual Equity Interests	Introduce provisions to allow mutually owned life and general insurers to issue Mutual Equity Interests (MEI). It is proposed that the proportion of MEIs is limited to 25 per cent of an insurer's CET1 capital, with any MEIs in excess of this limit eligible for inclusion in Tier 1 capital and the capital base.

APRA