QBE Insurance Group Limited 28 008 485 014
Level 5, 2 Park Street, Sydney NSW 2000 Australia
GPO Box 82, Sydney NSW 2001 Australia

www.qbe.com

30 March 2021

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

By email: Insurance.Policy@apra.gov.au

Dear Sir or Madam,

APRA 'Discussion Paper': Integrating AASB 17 into the capital and reporting frameworks for insurers and updates to the LAGIC framework

QBE Insurance Group Limited (QBE) is pleased to have the opportunity to comment on the proposals in the Discussion Paper.

Broadly, QBE concurs with the overall framework set out in the Discussion Paper and agrees with APRA's stated intentions, which are to align APRA's capital and reporting frameworks to minimise the regulatory burden on the industry when AASB 17 *Insurance Contracts* is adopted.

In particular, QBE supports the aim of preventing "permanent departures between the accounting standard and APRA's prudential framework, resulting in insurers needing to maintain dual valuation, actuarial, accounting and reporting systems".

QBE's comments on the Discussion Paper are made with a view to helping APRA ensure that the overall recalibration of the LAGIC framework remains appropriate, and to support APRA's goal of "not seeking to generally increase or reduce capital levels".

QBE agrees that APRA should continue to obtain useful information for regulatory reporting and capital purposes, whilst ensuring that APRA minimises the regulatory reporting burden on the industry.

In this letter, QBE will highlight our areas of material concern. The Appendix to this letter sets out QBE's detailed response to the consultation questions in respect of general insurers.

Commencement dates of proposed APRA regulation changes

QBE requests that APRA permit a 1 January 2023 start date for the revised APRA regulation for insurers, consistent with the Discussion Paper theme of ensuring the regulatory reporting burden is minimised. If a 1 July 2023 commencement is mandated, QBE will need to perform dual reporting for Q1 and Q2 2023 as we will be reporting under AASB 17 for financial reporting from 1 January 2023.

In broad terms, QBE observes that APRA is proposing to neutralise the impact of AASB 17 on the LAGIC framework. Accordingly, it should not significantly affect APRA's comparative analysis if insurers with calendar year reporting dates apply APRA's new requirements in Q1 and Q2 2023.

QBE recommends that APRA also reconsider whether all of the proposed non-AASB 17 specific changes to LAGIC should be introduced at the same time as those necessary to align with AASB 17. Given the significant effort across the industry on AASB 17 implementation, QBE understands why APRA might view this as an opportune time to make all of these changes. However, we ask APRA to consider the extent to which this expands the scope of insurers' AASB 17 implementation projects. QBE encourages APRA to assess the cost-benefit and timing of each change on a case-by-case basis.

Assumption in respect of regulatory adjustments to the capital base

Given APRA is "not seeking to generally increase or reduce capital levels," QBE's interpretation of APRA's proposals is that the impact of the regulatory adjustments will ensure "capital neutrality" relative

to existing levels of capital, i.e. regulatory adjustments proposed by APRA will mitigate the impact, on the capital base, of any changes imposed by AASB 17.

Supplementary data collections (consultation questions: Q12 & Q13)

QBE observes that APRA is broadly concerned with how AASB 17 may impact the comparability of pre-2023 versus post-2023 financial statements. APRA is also concerned with how AASB 17 profit or loss comparability across the industry may be impacted by differences in insurers' business models and accounting policy decisions.

QBE is concerned with the overall approach that APRA is proposing to address these issues. The effect appears to be one of "catch-all" dual reporting which requires insurers to continue to report AASB 1023 accounting balances for an indefinite period. Dual reporting will be a significant regulatory reporting burden for the general insurance industry, which QBE opposes. QBE asks APRA to consult the industry on other ways to address any perceived lack of continuity between pre-2023 and post-2023 information.

QBE accepts that APRA may require some limited and targeted supplementary reporting for a short transition period. Our view is that APRA should not continue to collect data based on AASB 1023 requirements beyond the transition period, when such information is unlikely to be relevant and will not necessarily be readily available from AASB 17 information systems.

Whilst alternative measurement bases and accounting policy choices are available under AASB 17, they are designed to achieve materially the same outcomes, particularly with general insurers likely to apply the premium allocation approach for most, if not all, of their insurance business. QBE considers it would be highly unlikely that, due to AASB 17, "general insurers' profit or loss patterns would be substantially different depending on the accounting positions adopted."

APRA also highlights a concern that the risk adjustment required for AASB 17 and APRA's definition of risk margin are two different concepts. QBE's view is that the risk margin and risk adjustment, whilst technically defined differently in the respective standards, are both intended to address the compensation that the entity requires, within the entity's chosen risk appetite, for the uncertainty inherent within the insurance liabilities.

Furthermore, QBE observes that APRA is proposing to collect more granular information across certain areas, where AASB 17 is not the reason for change. For example, APRA is proposing to collect more granular data on regulatory capital insurance liabilities.

QBE asks APRA to consult with the industry on the cost-benefit of all supplementary data collections, particularly those not currently being collected by APRA or not required under AASB 17, and to consider whether non-AASB 17 imposed changes should be prioritised at this stage. Such a consultation process would be consistent with meeting the Discussion Paper theme of ensuring the regulatory reporting burden is minimised.

Expenses to be included in the insurance liabilities (consultation question: Q2)

APRA's proposal for general insurers to include all expenses, other than one-off expenses, in the insurance liabilities materially deviates from general insurance accounting principles, and materially deviates from the current practice for measuring insurance liabilities for capital purposes. It is inconsistent with APRA's goal of "not seeking to generally increase or reduce capital levels".

Within the current GPS 340 insurance liability valuation:

a) Expenses are only included where they relate to existing, unexpired policies, for which the entity is on risk. In other words, insurance liabilities do not include expenses related to insurance policies that have not yet been written or which are not yet contractually bound.

b) Only costs that relate directly to fulfilling insurance liabilities are included. These costs are in respect of claims handling and policy administration & maintenance expenses.

QBE views this as the appropriate approach for determining insurance liabilities for regulatory capital purposes, as these are the costs necessary to run-off in-force polices, protecting existing policyholders.

APRA's current proposal is likely to materially increase capital levels, which goes against APRA's stated intentions. QBE asks APRA to further consult with the general insurance industry before imposing any such change.

Removal of internal capital models (consultation question: Q20)

Although not a direct impact to QBE for its regulatory capital reporting, QBE notes APRA's proposal to remove the option for the use of internal models when determining aspects of regulatory capital.

Whilst QBE understands that APRA may wish to ensure consistency in the measurement of regulatory capital, with every insurer adopting the standard LAGIC model, it is QBE's view that implementing, and using, an internal economic capital model, irrespective of whether used for regulatory capital purposes, does improve risk and capital management. In certain instances, internal economic capital models better reflect the nature and extent of risks in the insurer's particular business structure and business mix, compared to different regulatory capital frameworks.

QBE is concerned with APRA's assertion that internal models "often do not materially improve prudential outcomes." APRA's comments, if taken literally, may lead to undesirable outcomes, where insurers invest less resources in risk and economic capital management.

QBE is encouraged, however, by APRA's acknowledgement that "economic capital models, more generally, are a useful risk management tool and could play a role in the dialogue between general insurers and APRA." APRA should ensure that this broader messaging is not lost.

APRA also notes that "since LAGIC was introduced, there has been limited interest and take-up by general insurers". However, APRA should note that insurer interest may be somewhat driven by the lengthy process, and associated high costs, involved in obtaining regulatory approval for internal economic capital models from APRA.

Before progressing this proposal, APRA should consult the local Australian and International general insurance community further. It is important to ensure that Australia does not take a step backwards, relative to the International community, by unintentionally discouraging the use of internal economic capital models.

QBE is seeking to increasingly leverage our economic capital model to make financial, risk and business decisions, and to aid discussions with APRA in relation to our business risk profile and economic capital management. In QBE's view, leverage of an effective internal economic capital model is good financial and underwriting risk management.

Procedural documentation of reinsurance arrangements (consultation question: Q26)

QBE understands that APRA has an important role in setting procedural expectations on the documentation of reinsurance arrangements. However, depending on APRA's intent, QBE is concerned that the proposed changes pose a potentially significant regulatory burden on the industry.

QBE is especially concerned at the proposal, and resulting practical implications, to "require all formal procedures to be in place by the inception date of the reinsurance contract." Given the routine complexities involved in reinsurance negotiations, placements, and administration, it would be a huge task for the industry to have all formal procedures in place prior to inception.

QBE considers this to be a material change from current accepted, and practical, market practice, and would ask APRA to reconsider the cost-benefit of changing GPS 230, which reasonably requires appropriate placing slips or cover notes to be in place within two months of inception, and fully signed and stamped reinsurance treaty contract wordings to be in place within six months of inception.

APRA should also be particularly mindful of the differing reinsurance needs of insurers. For example, QBE has a global business, which complicates the documentation of reinsurance arrangements relative to insurers operating in a single market, or small number of local markets. QBE's view is that the current arrangements under GPS 230 are appropriate to the size and complexity of the QBE Group, and for the local insurance industry.

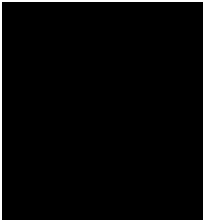
APRA notes that "an insurer unable to meet this rule will be required to notify APRA upon becoming aware of their inability to meet the requirement, and outline the reasons and actions being taken to remedy this". QBE notes that this could mean an increase in administrative requirements without the corresponding material benefit.

Before making any changes, QBE asks APRA to clearly articulate its administrative expectations, and appropriately consider whether they are reasonable and practical. QBE's view is that that there should be no fundamental change to the procedural documentation requirements for reinsurance arrangements without a clear proposal being made by APRA and proper consideration of the costs and benefits of such a proposal.

The remainder of our responses to the consultation questions is set out in the Appendix to this letter.

QBE is happy to discuss and further clarify the points raised in this letter. Please contact the QBE Group Regulatory team, at [redacted], for coordination of further input.

Yours sincerely



Group Chief Financial Officer

Appendix

Responses to consultation questions and related matters raised in:

APRA Discussion Paper *Integrating AASB 17 into the capital and reporting frameworks for insurers and updates to the LAGIC framework*

The responses below relate only to matters affecting general insurers.

Chapter 2: Proposed changes to capital framework

Q2: (GI) Are there any types of expenses that should not be included in the expense basis and its justification?

2.1 APRA's proposal for general insurers to include all expenses, other than one-off expenses, in the insurance liabilities materially deviates from general insurance accounting principles, and materially deviates from the current practice for measuring insurance liabilities for capital purposes. It is inconsistent with APRA's goal of "not seeking to generally increase or reduce capital levels".

2.2 Within the current GPS 340 insurance liability valuation:

a) Expenses are only included where they relate to existing, unexpired policies, for which the entity is on risk. In other words, insurance liabilities do not include expenses related to insurance policies that have not yet been written or which are not yet contractually bound.

b) Only costs that relate directly to fulfilling insurance liabilities are included. These costs are in respect of claims handling and policy administration & maintenance expenses.

2.3 QBE views this as the appropriate approach for determining insurance liabilities for regulatory capital purposes, as these are the costs necessary to run-off in-force polices, protecting existing policyholders.

2.4 APRA's current proposal is likely to materially increase capital levels, which goes against APRA's stated intentions. QBE asks APRA to further consult with the general insurance industry before imposing any such change.

Q4: (GI and LI) How would the new four quarters dividend test affect your entity?

4.1 APRA notes on page 25 of the Discussion Paper: "IFRS 9 Financial Instruments (IFRS 9) introduces a new measurement model for financial assets along with an impairment model for debt securities measured at Fair Value through Other Comprehensive Income (FVOCI). Therefore, there could be a greater use of the Other Comprehensive Income (OCI) option for accounting purposes under both AASB 9 and AASB 17."

4.2 QBE understands that APRA wishes to ensure the four quarters dividend test is not distorted by an insurer's decision to adopt the OCI option. APRA proposes to modify its approach to the four quarters dividend test outlined in Prudential Standard GPS 110 Capital Adequacy [paragraph 45(c)] to neutralise the impact of the OCI option on after tax earnings. QBE supports the overall intent of APRA's proposal.

4.3 QBE also notes that currently OCI amounts are not collected in the Reporting Form GRF310.0. APRA should clarify whether it intends to amend its collection of data forms to capture the impacts of measuring financial assets at fair value through OCI.

Chapter 3: Proposed changes to reporting framework

Q5: (All insurers) What types of challenges would the new product groups bring to your entity, including any transitional challenges?

5.1 Notwithstanding our earlier comments in relation to the timing of the proposed implementation of these non-AASB 17 related changes, QBE is not, in principle, opposed to identifying 'cyber' and 'directors and officers' insurance as separate APRA product groups.

5.2 Directors and officers coverage is typically written as a standalone policy, or is already separately considered by the business if part of a package policy, and so it should be feasible to isolate as an APRA product group.

5.3 A key challenge will be cyber coverage that is a part of contracts that provide coverage for a wider range of risks (typically, a part of commercial casualty policies). This will result in the need for allocation to APRA product groups, and there are likely to be inconsistencies in the ways in which different insurers determine their allocations. Depending on the manner in which cyber insurance is defined (see Q6 below), this issue may be exacerbated for "silent cyber" coverage, where policies have not been specifically designed to cater for cyber risks.

5.4 QBE considers that, as general insurers underwrite more specifically for cyber risks and become more experienced at identifying cyber components, they will become more adept at those allocations over time and that industry practice will develop. Accordingly, if these new product groups are introduced, QBE asks APRA to be tolerant of a level of allocation inconsistency, at least in the short term, with a view to the level of consistency in reporting improving over time, particularly if "silent cyber" is intended to be captured.

Q6: (GI) How should APRA define Cyber and Directors & Officers insurance?

6.1 QBE regards the proposed definitions of 'cyber' and 'directors and officers' insurance as reasonable and workable. QBE supports definitions that do not attempt to address each and every possible event or coverage. However, QBE considers that it should be clarified whether APRA intends capturing only cyber risks that have been specifically addressed as a feature of an insurance contract, or whether APRA also wishes to capture 'silent' cyber coverage.

6.2 QBE supports the cyber definition relating to both first-party and third-party coverage, including costs associated with network security breaches, data and systems recovery, and legal expenses.

Q7: (All insurers) Are the allocation principles outlined in this Discussion Paper adequate for reporting of APRA product group data? Are there any ways to make the allocation principles more effective?

7.1 AASB 17's definitions of portfolios and groups will be different compared with APRA's product groups, and therefore financial information prepared on an AASB 17 basis will need to be allocated to APRA product groups. Section 3.3 of the APRA Discussion Paper outlines six principles for insurers to follow when allocating AASB 17 financial information (for example the onerous loss component) to APRA product groups.

7.2 QBE supports a principles-based approach (rather than a prescriptive approach), which will allow the process to be systematic and operationally efficient for insurers, whilst leaving room for informed judgement.

7.3 QBE notes that Principle 4 states: "The aggregate of the allocated numbers across APRA product groups should be consistent with AASB 17 numbers reported on a statutory basis". For avoidance of doubt, QBE understands this to mean that the aggregate total onerous loss component for the reporting entity, determined under AASB 17, would be <u>equivalent</u> to the aggregate total onerous loss component to be allocated across APRA product groups.

7.4 QBE notes that Principle 3 says: “The approach applied should be consistent over time”. Whilst QBE agrees that, ideally, the approach would be consistent over time, where the facts and circumstances change, the industry should be afforded the ability to make appropriate changes to the allocation approach.

Q12: (GI and LI) Would the liability data collection approach outlined in the QIS workbook cause significant issues? How can APRA improve its collection of the liability data items to better understand profitability profiles by APRA product groups?

12.1 QBE is concerned about the supplementary data collections and additional granularity requested.

12.2 Given the significant effort across the industry on AASB 17 implementation, QBE understands why APRA might view this as an opportune time to seek more granular information from insurers. However, we ask that APRA consider how far this expands the scope of AASB 17 implementation projects, and the subsequent regulatory reporting burden, once in place.

12.3 Accordingly, any supplementary information that APRA seeks that is not currently being collected, or not required for AASB 17, is likely to impose significant costs on insurers.

12.4 APRA should justify the request for supplementary information on incremental cost-benefit grounds. APRA has, for example, articulated why it wants to collect additional granularity to address ‘cyber’ and ‘directors and officers’ insurance as separate APRA product groups but has not explained the need to collect more granular information across other areas – other than expressing broad concerns of comparability of pre-2023 versus post-2023 accounting financial information.

12.5 Whilst alternative measurement bases and accounting policy choices are available under AASB 17, they are all designed to achieve materially the same outcomes, particularly with general insurers likely to apply the premium allocation approach for most, if not all, of their insurance business. QBE considers it would be highly unlikely that, because of AASB 17, “general insurers’ profit and loss patterns could be substantially different depending on the accounting positions adopted.”

12.6 APRA also highlights a concern that the risk adjustment required for AASB 17 and APRA’s definition of risk margin are two different concepts. QBE’s view is that the risk margin and risk adjustment, whilst technically defined differently in the respective standards, are both intended to address the compensation that the entity requires, within the entity’s chosen risk appetite, for the uncertainty inherent within the insurance liabilities.

12.7 QBE asks APRA to consult with the industry on other ways of addressing this perceived lack of continuity, other than APRA requiring “catch all” dual reporting. This is particularly the case given the Discussion Paper theme of ensuring the regulatory burden is minimised. Please also refer to our response to Q13 below.

12.8 QBE accepts that APRA might require some carefully limited and targeted supplementary reporting for a short transitional period. However, beyond that transition period, APRA should not continue to collect data based on applying the AASB 1023 requirement, when such information is not required under AASB 17.

Q13: (All insurers) Are there any supplementary data collections that insurers deem unnecessary in the AASB 17 environment?

13.1 QBE observes that APRA is proposing to collect more granular data on the regulatory capital insurance liabilities. This is an example of a proposed change in reporting that is not imposed by AASB 17’s requirements. QBE asks that APRA consult with the industry on the cost-benefit of all supplementary data collections, and to consider whether non-IFRS 17 imposed changes should be prioritised at this stage.

13.2 It will be a regulatory burden to prepare information currently required in an AASB 1023 context in the post-2023 AASB 17 environment, given that AASB 1023 financial information will not be routinely produced. APRA has not made a supportable case for requiring this information to justify the “catch all” dual reporting cost burden on insurers.

13.3 This issue is exacerbated for insurance contracts accounted for under the AASB 17 general measurement model, where it is also unclear how balances such as unearned premium and premium receivables would be determined. That is, APRA should confirm whether it will require the AASB 1023 unearned premium or the theoretical unearned premium “implied” by the AASB 17 general measurement model.

13.4 QBE will be managing its premium receivables for cash flow and other purposes. However, this is likely to be on an aggregate basis or by debtor, rather than by product group. Accordingly, determining premium receivable information by product group would be a costly additional burden on QBE.

13.5 In order to justify requiring general insurers to supply data based on applying the AASB 1023 requirements on an ongoing basis, when such information is not required under AASB 17, APRA should identify the substantive benefits that would outweigh the potentially considerable cost burden for the industry.

Chapter 4: LAGIC updates

Q14: (All insurers) Are there any other potential impacts of low or negative interest rates, not already mentioned in this Discussion Paper, on the current capital framework?

14.1 QBE supports APRA’s approach for addressing the case of low and negative interest rates, particularly in the case of the real interest rate and inflation stresses, where there are unintended consequences under the existing framework when interest rates are negative. QBE has not identified any other potential impacts of low or negative interest rates.

14.2 QBE notes that, for the real interest rates stress test, APRA proposes to alter the calculation of the stress adjustment requirement by applying a three per cent floor to the nominal risk-free rate before multiplying by the prescribed factors. APRA has chosen a three percent floor such that the practical effect of applying the floor will be to impose a minimum upward stress of 75 basis points, and a minimum downward stress of 60 basis points.

14.3 Whilst introducing a floor is not an unreasonable approach to solving this issue, QBE would like to understand APRA’s reasons for choosing a three per cent floor. For example, a two per cent floor would practically result in a minimum upward stress of 50 basis points, and a minimum downward stress of 40 basis points.

14.4 QBE has determined the choice of floor to be a small impact to its regulatory capital. Nonetheless, APRA should consider the impact of the choice of floor on regulatory capital outcomes across the general industry as a whole i.e. APRA should consider whether a lesser floor would achieve a similar goal of addressing the unintended consequences in a negative interest rate environment, particularly in view of APRA’s stated intention of being satisfied with the overall level of industry regulatory capital.

Q15: (All insurers) Will the expected inflation stress to 50 basis points when nominal risk-free interest rates are negative cause any unintended consequences?

15.1 QBE supports APRA’s proposal to provide some relief from the requirement to assume a flat 100 basis point decrease in expected inflation rates when nominal interest rates are below one percent. Specifically, QBE supports the use of a 50-basis points inflation stress factor when rates are negative, and to adopt a straight-line sliding scale up to 100 basis points when rates are between zero and one per cent.

15.2 QBE does not anticipate unintended consequences to industry regulatory capital as a result of this change.

Q16: (All insurers) Will removing the floor on nominal risk-free rates of zero that applies to the downward inflation stress cause any unintended consequences?

16.1 QBE supports APRA's proposal for dealing with a negative interest rate environment, by removing the floor on nominal risk-free rates of zero that applies to the downward inflation stress. This has no unintended consequences on QBE's capital position.

16.2 Per Q15 above, QBE supports the use of a 50-basis points inflation stress factor when nominal risk-free rates are negative.

Q17: (All insurers) Will the clarification on the usage of the inflation stress cause any unintended consequences?

17.1 QBE supports APRA's proposal which, for the avoidance of doubt, intends to clarify APRA's intent for all insurers to appropriately allow for expected inflation risk and hold appropriate capital against this risk.

17.2 APRA is concerned that there is ambiguity under the existing LAGIC framework. Insurers could interpret that stress adjustments for expected inflation rates should be added only to any explicit expected inflation rates used in the valuation of assets or liabilities. APRA is aware that, particularly for general insurers, not all methods used to value insurance liabilities adopt explicit inflation rates. APRA's proposal is to clarify that the inflation stress also applies to liabilities valued using an implicit inflation assumption.

17.3 QBE's view is that APRA's proposal is appropriate and should have no unintended consequences.

Q18: (GI and LI) What should the new dollar value limit be? Will indexing future-proof the value?

18.1 Given its size, QBE is not generally affected by dollar value limits. QBE regards the current 'percentage of capital base' asset exposure limits in Prudential Standard GPS 117 to be reasonable. For the avoidance of doubt, QBE notes that it will be important that APRA retains the 'percentage of capital base' approach.

18.2 In principle, QBE is supportive of indexing the dollar value of asset exposure limits across the prudential standards to future-proof against inflation. Nonetheless, APRA should consult the industry on the specifics before introducing any change.

18.3 QBE notes that "APRA is proposing to factor in the inflation that has occurred since the values were introduced" given the "values have remained unchanged for some time." It is not entirely clear how far this goes back, and how large the change could be. APRA should consider the implications of this potential step-change on exposure limits and subsequently on industry capital.

Q19: (GI and LI) Will the alignment in APS 111 for insurers and ADIs bring any significant burden to the insurance industry?

19.1 QBE appreciates APRA's motivations for wanting to apply a consistent approach to debt held in special purpose vehicles (SPVs) to banks and insurers.

19.2 In the proposed revisions to Prudential Standard APS 111 *Capital Adequacy: Measurement of Capital*, our understanding is that debt instruments and capital instruments issued or drawn prior to the revised draft Prudential Standard being published were to be excluded from the revisions.

19.3 QBE assumes that the alignment with APS 111 will be prospective and not have any retrospective impact on insurers. However, it would be helpful if APRA could clarify that this is the case.

Q20: (GI) What are industry views on the proposal to cease allowing the use of ICMs in the calculation of regulatory capital?

20.1 Although not a direct impact to QBE for its regulatory capital reporting, QBE notes APRA's proposal to remove the option for the use of internal models when determining aspects of regulatory capital.

20.2 Whilst QBE understands that APRA may wish to ensure consistency in the measurement of regulatory capital, with every insurer adopting the standard LAGIC model, it is QBE's view that implementing, and using, an internal economic capital model, irrespective of whether used for regulatory capital purposes, does improve risk and capital management. In certain instances, internal economic capital models better reflect the nature and extent of risks in the insurer's particular business structure and business mix, compared to different regulatory capital frameworks.

20.3 QBE is concerned with APRA's assertion that internal models "often do not materially improve prudential outcomes." APRA's comments, if taken literally, may lead to undesirable outcomes, where insurers invest less resources in risk and economic capital management.

20.4 QBE is encouraged, however, by APRA's acknowledgement that "economic capital models, more generally, are a useful risk management tool and could play a role in the dialogue between general insurers and APRA." APRA should ensure that this broader messaging is not lost.

20.5 APRA also notes that "since LAGIC was introduced, there has been limited interest and take-up by general insurers". However, APRA should note that insurer interest may be somewhat driven by the lengthy process, and associated high costs, involved in obtaining regulatory approval for internal economic capital models from APRA.

20.6 Before progressing this proposal, APRA should consult the local Australian and International general insurance community further. It is important to ensure that Australia does not take a step backwards, relative to the International community, by unintentionally discouraging the use of internal economic capital models.

20.7 QBE is seeking to increasingly leverage our economic capital model to make financial, risk and business decisions, and to aid discussions with APRA in relation to our business risk profile and economic capital management. In QBE's view, leverage of an effective internal economic capital model is good financial and underwriting risk management.

Q21: (GI) Will applying a default stress charge to the net rather than gross of quota share position realign the risk to the insurer rather than the reinsurer? Are there any other methods that may achieve the same goal?

21.1 QBE agrees that there is currently duplication of the level of regulatory capital across the industry. Under GPS 114, general insurers are charged a default stress in relation to gross (of reinsurance) unpaid premium and unclosed business. Under whole of account quota share arrangements, reinsurers generally also record this business as unpaid premium and therefore also attract a capital charge. The component of premium that has been subject to a default charge is therefore greater than 100%, in aggregate, across the industry.

21.2 An important consideration for APRA will be the fundamental risk of default and how this is apportioned between the insurer and reinsurer. Specifically, the insurer is still subject to risk of default on premiums due from policyholders, whereas the reinsurer is subject to the risk of default of unpaid premiums due from insurers.

21.3 Nevertheless, it is not entirely clear whether APRA's proposal to apply a charge to the net rather than gross of the quota share position is in respect of all whole of account quota shares or only those with APRA authorised insurers.

21.4 APRA notes: "APRA also views that this may unfavourably influence the level of capital held in Australia, where the whole of account quota share arrangement is placed with a non-APRA authorised reinsurer.' If QBE is correct in inferring that this proposed change will only impact whole of account quota shares with APRA authorised reinsurers, then given the narrow range of APRA authorised reinsurers, this change would have limited impact to certain insurers, including QBE.

21.5 QBE encourages APRA to address concerns of potential double counting across arrangements with APRA-authorised and non-authorised reinsurers, either by introducing identical charges, or by lowering the default charges on arrangements with non-authorised reinsurers to compensate.

21.6 QBE also notes that it is not entirely clear why the APRA Discussion Paper emphasises only 'whole of account' quota share reinsurance, and the APRA definition of 'whole of account' is also not clear.

21.7 APRA should consider whether its proposal, or any other proposals, for apportionment of the default risk between the insurer and reinsurer introduces unintended complexity and inconsistency. QBE recommends that APRA carries out a cost-benefit assessment and consults with the industry further before introducing any changes to address potential double counting.

21.8 See Q24 also, which discusses a related issue in relation to the Operational Risk Charge.

Q22: (GI) Are there situations where general insurers shouldn't use fair value for capital base determination?

22.1 QBE considers that, in principle, fair values or proxies for fair value should be used for capital base determination.

22.2 QBE notes that joint ventures and associates are conventionally measured using equity accounting, and trade receivables are measured at amortised cost. QBE views these as appropriate methods in valuing these types of assets.

Q24: (All insurers) APRA is seeking improvement suggestions on the current double counting of the operational risk charge under whole of account quota share reinsurance arrangements.

24.1 Given that the exposure base underlying the Operational Risk Charge (ORC) involves the maximum of ***gross*** written premium and ***net*** technical provisions (that is, a gross ***and*** net element), QBE agrees that, under whole of account quota share arrangements, in aggregate, there is potentially a degree of double counting across insurers and reinsurers.

24.2 The operational risk charge is related to failed processes, systems and people, and ideally, there would be a more appropriate apportionment of the risk charge between the insurer and reinsurer, up to an aggregate maximum of 100%, which is dependent on the operational component of the whole of account quota share arrangement borne by the insurer versus the reinsurer.

24.3 This will vary depending on the nature of the whole of account quota share arrangement:

a) In some cases, a greater portion of the underlying operational risk will lie with the insurer (rather than the reinsurer). For example, through the insurer writing and administrating the underlying policies

b) In other cases, a greater portion, if not all, of the operational risk, could lie with the reinsurer. For example, where the claims are in run-off, and the reinsurer has taken responsibility for the claims handling during the remaining claims settlement period

24.4 APRA should consider whether any proposals for apportionment between the insurer and reinsurer introduce unintended complexity and inconsistency. QBE recommends that APRA carries out a cost-benefit assessment and consults with the industry further before introducing any changes to address potential double counting.

Q25: (All insurers) APRA is seeking improvement suggestions on solving the mismatch between IRC and the duration of quota share reinsurance policies.

25.1 APRA notes on page 43 of the Discussion Paper: "Whole of account quota share reinsurance arrangements involve multi-year contracts running for five to six years with no cancelation clauses in place before the fourth year. If a whole of account quota share arrangement is multi-year, GPS 115 requires a participating reinsurer to hold capital based on their inwards reinsurance premium anticipated for the full five years."

25.2 QBE agrees that the current requirements are an impost, which may result in the transaction being undesirable for reinsurers, and there is a danger that the existing requirements build a bias into APRA authorised reinsurers' decision making by steering them away from multi-year contracts, which might (in some cases) be the best commercial, and financial risk management, option.

25.3 QBE notes that a possible alternative to the current framework is to provide relief to reinsurers by requiring capital on a year-by-year basis. A further consideration here could be the extent to which the cedant has not yet written the direct policies that the reinsurer is expecting to cover.

Q26: (All insurers) Would a requirement of inception date of having all procedural documentation of reinsurance arrangements formalised be a significate burden on the industry?

26.1 QBE understands that APRA has an important role in setting procedural expectations on the documentation of reinsurance arrangements. However, depending on APRA's intent, QBE is concerned that the proposed changes pose a potentially significant regulatory burden on the industry.

26.2 QBE is especially concerned at the proposal, and resulting practical implications, to "require all formal procedures to be in place by the inception date of the reinsurance contract." Given the routine complexities involved in reinsurance negotiations, placements, and administration, it would be a huge task for the industry to have all formal procedures in place prior to inception.

26.3 QBE considers this to be a material change from current accepted, and practical, market practice, and would ask APRA to reconsider the cost-benefit of changing GPS 230, which reasonably requires appropriate placing slips or cover notes to be in place within two months of inception, and fully signed and stamped reinsurance treaty contract wordings to be in place within six months of inception.

26.4 APRA should also be particularly mindful of the differing reinsurance needs of insurers. For example, QBE has a global business, which complicates the documentation of reinsurance arrangements relative to insurers operating in a single market, or small number of local markets. QBE's view is that the current arrangements under GPS 230 are appropriate to the size and complexity of the QBE Group, and for the local insurance industry.

26.5 APRA notes that "an insurer unable to meet this rule will be required to notify APRA upon becoming aware of their inability to meet the requirement, and outline the reasons and actions being taken to remedy this". QBE notes that this could mean an increase in administrative requirements without the corresponding material benefit.

26.6 Before making any changes, QBE asks APRA to clearly articulate its administrative expectations, and appropriately consider whether they are reasonable and practical. QBE's view is that that there should be no fundamental change to the procedural documentation requirements for

reinsurance arrangements without a clear proposal being made by APRA and proper consideration of the costs and benefits of such a proposal.

Q27: (All insurers) Are there any additional LAGIC updates, not already mentioned, that would be beneficial to APRA and the industry?

Asset Risk charges

27.1 QBE proposes that APRA should revisit the use of dividend yield for determining an equity risk charge and the rental/earning yield for the property risk charge. Market volatility, such as that experienced at the beginning of the COVID-19 pandemic, drove some yields to very low levels, which resulted in unreasonable equity and property risk charges, and hence unintended capital outcomes.

27.2 To address this volatility, QBE suggests that APRA consider using fixed percentage risk charge factors, similar to those proposed in the Insurance Capital Standard (ICS) of the International Association of Insurance Supervisors.

~ END ~