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APRA's discussion paper – Capital and reporting framework and updates to the LAGIC framework

Dear Sir or Madam

Here is Swiss Re's combined response to APRA's recommendations and consultation questions as set out in the discussion paper. Swiss Re welcomes a discussion with APRA on any of the topics in our response.

Yours sincerely,

On behalf of Swiss Re Life & Health Australia Limited, Swiss Re Asia Pte. Ltd., Australia Branch and Swiss Re International SE, Australia Branch

1. Request for cost benefit analysis information:

Swiss Re acknowledges APRA's request to provide information on the compliance impact of the proposed changes and other substantive costs associated with the changes. We understand that the specific request is for information on any increase or decrease in the compliance cost Swiss Re will incur as result of APRA's proposals, and should exclude any compliance cost that Swiss Re would incur from the implementation of AASB 17 regardless of the proposals contained in the discussion paper.

Swiss Re is currently not in the position to provide accurate estimations of these costs. However, we can confirm that we are expecting to incur additional set-up (one-off) and ongoing costs to comply with APRA's requirements as set out below:

One-off/set-up costs:

a) Set-up of APRA product grouping requirements *(refer to question 5 for more detail)*
- Software development time & resources
- Available resources to test the set-up of these groupings or allocations

b) Set-up of APRA ordinary vs super allocation requirement for LI *(refer to question 5 for more detail)*
- Software development time & resources
- Available resources to test the set-up of these allocations

c) Set-up of APRA quarterly regulatory forms in our accounting system *(the current APRA forms have been set-up in our accounting system SAP and would need to be replaced, pending APRA's communication of the new forms)*
- Software development time & resources
- Available resources to test the set-up of the regulatory forms

d) Updating of capital models for the new requirements *(refer to question 1 for more information)*
- Resource time and effort to update the capital models with new requirements, as well as associated review/testing

Ongoing costs:

a) Maintenance of capital models *(refer to question 1 for more information)*
- Resource time and effort to maintain and review the capital models

b) Compliance with more granular APRA reporting requirements *(refer to question 12 for more information)*
- Increased resource time & effort required to complete more granular quarterly and annual reporting requirements

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2. Feedback on QIS:

Swiss Re would like to take the opportunity to provide feedback on some of the areas in the QIS, following the completion of the Swiss Re Asia Pte. Ltd., Australia Branch submission.

Balance Sheet
A split between Liability for Remaining Coverage (LRC) and Liability for Incurred Claims (LIC) for the Insurance Contract Liabilities in the balance sheet (in 19.1 and 19.2) seems a duplication of information already provided in the Part A Roll Forward 1 form and unnecessary in the Balance Sheet statement.

Profit and loss & OCI
Previously APRA collected "Non-Reinsurance Recoveries" as a separate line item in the Profit & Loss and Balance Sheet as well as other form disclosures. Since APRA has more closely followed the principles of AASB 17 we would now expect recoveries related to a contract of insurance to fall under Incurred claims and hence Insurance Service Expense (Profit & Loss) and Insurance Contract Assets/Liabilities (Balance Sheet). It would be helpful for the APRA reporting forms guidance to confirm this aspect. We note in the Liabilities form that APRA is maintaining a separation between non-reinsurance recoveries and reinsurance recoveries, but do not feel this needs to be separately identified in either the roll forward, Profit & Loss or Balance Sheet forms.

Roll Forward Forms
As per Profit & Loss and OCI above, it would not be efficient for Insurers to need to submit each year the comparative information that APRA would have previously received.

3. Consultation questions:

Questions:	Responses:
Chapter 2 – Proposed changes to capital framework	
1. **(GI, LI and Friendly societies)** Would maintaining the existing regulatory capital and measurement substantially increase regulatory burden?	• As there is a material amount of changes to our financial reporting and reporting systems due to implementation of IFRS 17 and IFRS 9 we are pleased that the capital calculations will be kept consistent • Its currently not in the development plan for our new reporting system to supply the capital reporting and we would be required to update and maintain our current models to provide the capital reporting requirements. This would

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	require additional time, effort and resource • Hence, once IFRS 17 reporting is further embedded in companies' processes, we welcome APRA to review again the capital reporting framework if there are further areas that can be leveraged against the IFRS 17 framework and seek further alignment
2.**(GI)** Are there any types of expenses that should not be included in the expense basis and its justification?	• Our preference would be that APRA should align the expenses with IFRS17 (paragraph B65 and B66) which has clear requirements for the types of expenses to be included in the cashflow calculations • Currently any capital reporting deviation from the IFRS 17 reporting requirements would need to be maintained in models outside of our reporting systems
3.**(LI)** Will there be challenges calculating RFEFCF by projecting cash flows and not using account balance for all investment accounting business?	• Not applicable to Swiss Re L&H as we currently use projected cash flows for investment accounting business for internal reporting purposes • Not expecting significant challenges

4.**(GI and LI)** How would the new four quarters dividend test affect your entity?	• Swiss Re's preference is to account for fair value movements as well as interest rate fluctuations through OCI
	• We are not expecting an impact from the dividend test proposals, due to:
	  o Our assets and liabilities being closely matched and,
	  o The availability of the Insurance finance expense and fair value movements via our reporting systems on a quarterly basis
	• We want to ask whether APRA has considered GPS 110 for Branches, where in some circumstances paragraph 45 (c) does not apply to Category C insurers. We would assume APRA's intention behind this proposed change is to also apply in the interpretation of paragraph 50 for Category C insurers and trust the draft prudential standards will reflect alignment across the different classes of insurers.

Chapter 3 – Proposed changes to reporting framework	
5.**(All insurers)** What types of challenges would the new product groups bring to your entity, including any transitional challenges?	• Swiss Re's systems would require additional set-up of APRA product groups which would require additional development resource and cost • Swiss Re's IFRS 17 portfolio classifications are set-up for our Statutory reporting as well as internal Group reporting purposes when the Swiss Re Group adopts IFRS 17 in 2024. These portfolio classifications are in line with how we manage our business and it would be our preference if the APRA product groupings could be aligned • Please refer to Q7 on some of our observations on the challenges on applying allocations • As mentioned in point 1, Swiss Re's capital models will be used for capital reporting and require updating with the new APRA product groups. This would also require additional time, effort and resources
6.**(GI)** How should APRA define Cyber and Directors & Officers insurance?	• Swiss Re defines cyber insurance as Liability Insurance and/or business interruption covering a business or a natural person arising from a data or privacy breach • Note that Swiss Re writes minimal direct cyber insurance • Swiss Re defines Directors & Officers insurance as Liability Insurance covering litigation against a natural person arising from their capacity as a director or officer of a company, and/or as cover for the company arising from a breach arising from the trading of its own securities • APRA's proposal for GI to have Directors & Officers (D&O) split out from Professional Indemnity (PI) for reporting purposes would require Underwriters to split out D&O from PI from the outset when each treaty/risk are underwritten and costed so

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	that these product groups can be identified separately in financial reporting systems • This will also require our cedants to report at that level of granularity for all the treaties impacted such as Whole Account Quota Share and Combined casualty/PIDO treaties • Swiss Re product groupings are based on similar risk and all the professional liability lines are hence grouped together, including P&O. For any granular splits we would need to allocate CSM down
7.**(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?	• APRA requires specific IFRS 17 product groups which would require us to show CSM at a lower level of granularity. Performing a CSM allocation that would reflect the potential onerousness of some of these groups is a major operational issue. We came to the conclusion that it would be potentially simpler to do dual reporting. This is far from a satisfactory outcome, when we know the complications and challenges that come with dual reporting. We would encourage APRA to explore other options and leverage on all the information already submitted by the insurance industry. • For most products in an IFRS 17 group, most of the components are calculated at a more granular level such as Future Cashflow and Risk Adjustment. Allocating these to more granular APRA product groups based on APRA's principles is typically operationally feasible • However, for the CSM and loss components which are calculated and rolled forward at an IFRS 17 group level, there are potential challenges for companies to consider if the allocation can be done in an efficient and pragmatic way, without the need for dual reporting • If there is a portfolio that comprises two APRA product groups, and which overall has a CSM, but if calculated separately one product group has a CSM and the

	other product group a loss component, it is more challenging operationally to reflect this in the allocation to split the overall CSM into a separate CSM and loss component. Potentially, dual reporting is required to facilitate the allocation.
	• We are wondering if the following modifications to the principles will still meet APRA's needs:
	    o For Principle 5, to consider removing the following "no offsetting of profit and losses ". We believe the allocation can still reflect expected relative profitability of each APRA product group
	    o For Principle 1 to be modified to "... that reflects the ***relative*** underlying profitability of each APRA product group." This will then be consistent with the terminology of "relative profitability" in Principle 5
	• Also, it is worth highlighting that for a lot of stepped products written by direct life insurers, the profit and loss results will only relate to a one year contract boundary, and not the expected renewals. This might be considered a limitation of the overall IFRS 17 results, and with this potential limitation on how the results will then be used, if a less stringent allocation method overall is acceptable
	• With the challenges and limitations highlighted above, we are wondering if the analysis of monitoring profitability by APRA product groups can also be achieved using alternative information such as
	    o (1) Information from the "Liabilities" for capital reporting tabs. This will then exclude the CSM/Loss component information which companies have challenges allocating and for step business will have a long contract boundary (which might be more reflective of the longer term profitability of the

	business, and not reflected fully in the IFRS 17 results) o (2) Loss ratios analysis
8.**(LI)** Would the proposal underlying separate valuation of insurance and reinsurance assets and liabilities in accordance with the Life Act reporting structure cause issues despite the proposed reporting exemption for Non-participating risk business? Are there any other specific issues in relation to the proposal?	• As this is also a requirement under IFRS 17 we do not foresee any issues in reporting the underlying and reinsurance assets and liabilities separately
9.**(LI)** How should APRA define reporting components for Participating business given AASB 17 and the Life Act reporting structure?	• Swiss Re does not have any comments on this question
10.**(Friendly societies)** Would the proposal underlying separate valuation of insurance and reinsurance assets and liabilities by benefit funds cause issues? Are there any specific issues in relation to the proposal?	• Swiss Re does not have any comments on this question
11.**(Friendly societies)** Are there any reporting components that APRA should clarify for friendly societies given the existence and operation of benefit funds?	• Swiss Re does not have any comments on this question
12.**(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?	• We are of the view that quarterly reporting is too frequent, as any change in profitability profile (or premium rate changes) will take time to flow through as new and renewal business gradually earn through • In addition, to prepare the data collection as proposed would be a material exercise every quarter for the actuarial team • APRA already collects some data only on an annual basis e.g. claims development table, and we would suggest more granular reporting such as the QIS Liability data collection could be performed annually
13.**(All insurers)** Are there any supplementary data collections that insurers	• We recommend that APRA needs to be clear and concise around data collection

deems unnecessary in the AASB 17 environment?	• The current QIS data collection will cause operational burdens. APRA also need to be clear as to why the additional information is required • The QIS template indicates that it requires respondents to collect Prior Year data in the Part A and Part B Roll forward templates. Although shaded areas in blue are not to be completed in the QIS, it appears APRA is thinking of collecting the data items under the revised reporting framework • If this understanding is correct this would serve no purpose to submit this to APRA again since APRA would already have received such information from the prior year. This seems like a duplication of effort for the industry to do so each and every quarter
Chapter 4 – LAGIC updates	
14.**(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?	• Investment strategies would need to be considered • We don't see any issues for fixed rate assets • For floating rate assets/loans with no contractual zero interest rate floor, in practice it would seem unlikely that bond issuers would ever collect cash from investors even if theoretically possible, as the market infrastructure is not laid out for such flows (bondholders are usually too numerous and anonymous to be all tracked down) For floating rate assets or loans where there is only a handful of known investors, it may be technically possible for the issuer to collect • The main question for asset risk charge purposes will be: **How will the market value/fair value for floating rate assets be impacted?** • Can APRA please provide their view on this and if possible, clarify whether insurers can continue to apply the assumption that that there will not be any

	material impact on floating rate assets' fair value since interest rate paid is assumed to move up/down in line with stresses, and therefore we can continue to apply nil RIR and INF risk charges for these type of assets even if the coupons/interest rates go negative? • We also note that additional effort would also be required when considering the application of negative interest rates for different securities (such as those mentioned here for floating rate assets) and the operation thereof. Increased complexity in the computation could potentially lead to increased operational risks
15. **(All insurers)** Will the expected inflation stress to 50 basis points when nominal risk-free interest rates are negative cause any unintended consequences (4.2.2)?	• We are of the view that the proposed changes would not cause any unintended consequences • It's a welcome relief as it reflects the decreased likelihood of an even more negative scenario when the nominal interest rate is already negative or low
16. **(All insurers)** Will removing the floor on nominal risk-free rates of zero that applies to the downward inflation stress cause any unintended consequences (4.2.3)?	• We do not see any issues with the proposed, except that we need to check for any contractual / embedded features in the securities that we currently hold on whether there is a zero interest rate floor and the implications on floaters' fair value
17. **(All insurers)** Will the clarification on the usage of the inflation stress cause any unintended consequences (4.2.2)?	• Although our liabilities are valued using an implicit (and not explicit) inflation assumption, this clarification will not impact us but will instead provide further justification to our current approach. This is because we have <u>not only</u> assumed "that the liability values fall under the upward inflation stress and rise under the downward inflation stress", we have <u>also assumed</u> that the nominal discount rate which is applied to the future insurance liabilities will also increase and decrease to the same extent under the upward and downward inflation stresses respectively. The result of this is that currently we

	already do not have any inflation stress from our insurance liabilities (since change in PV is nil) to offset the corresponding inflation stress which is applied to our non-inflation linked assets, meaning that we've already fully allowed for (or already being fully penalised for) the imbalance between liabilities affected by inflation and non-inflation linked assets. • We welcome this clarification as it would 'level the playing field' in terms of having a consistent application of the APRA LAGIC standards to potentially different approaches/interpretations adopted by different insurers.
18.**(GI and LI)** What should the new dollar value limit be? Will indexing future-proof the value?	• Currently doesn't affect Swiss Re L&H and not a concern for Swiss Re GI
19.**(GI and LI)** Will the alignment in APS 111 for insurers and ADIs bring any significant burden to the insurance industry?	• The alignment of APS111 has no impact to Swiss Re
20.**(GI)** What are industry views on the proposal to cease allowing the use of ICMs in the calculation of regulatory capital?	• The recommendation has no impact on Swiss Re • We are of the view there are very few insurers with approved ICMs so overall impact should be limited
21.**(GI)** Will applying a charge to the net rather than gross of the quota share position realign the risk to the insurer rather than the reinsurer? Are there any other methods that may achieve the same goal?	• For treaties where the non-reinsurance recoveries (NRR) are not separately reported by our cedants (most all the treaties with exception for our large whole account quota shares (WAQS)), APRA's observation is correct that the reinsurer does not report NRR separately and reinsurers simply tend to hold smaller gross outstanding claims (i.e. assumed to already be net of non-reinsurance recoveries) • However, this observation is incorrect for cases where NRRs are separately reported by cedants • There does seem to be a potential of double counting if the insurer is allowing

	for risk charge on the gross of quota share NRR position, and the reinsurer is also allowing for the risk charge on the quota share cession of the same NRR asset • Can APRA clarify how the reinsurer should be reporting the NRR for any materially large WAQS ceded to the reinsurer so any one reinsurer would not be unfairly disadvantaged by having the NRR appropriately accounted for as an asset and being default risk charged (compared to a reinsurer which just reports net of NRR and therefore not being default risk charged since there's no NRR asset held) and to ensure consistency in the accounting and capital treatment of such WAQS • Can APRA also clarify that the application to the charge to the net for insurers are not just applicable for (net of) WAQS reinsurance but also for (net of) single line QS reinsurance arrangements as well? • As for the unpaid premium and unclosed business it makes sense that default risk charge of the ceded portion is excluded by the insurer/cedent if the reinsurer has already (implicitly or explicitly) allowed for any such premiums and is already risk charged accordingly for the ceded portion.
22. **(GI)** Are there situations where general insurers shouldn't use fair value for capital base determination?	• Swiss Re did not have any comments on this question
23. **(LI)** How can APRA best future-proof the requirement of illiquidity premium if written into the prudential standard?	• We are of the view each entity should determine their own liquidity premium methodology • Our current thinking is to apply the same liquidity premium as applied for statutory purposes
24. **(All insurers)** APRA is seeking improvement suggestions on the current double counting risk charge under quota share reinsurance arrangements.	• Operational risk relates to failed systems, processes and people which impacts both the insurer and the reinsurer. Therefore, we are of the view that that an operational risk charge would be appropriate for both the insurer and the reinsurer

	• Our recommendation is that a simplified approach is implemented • We also welcome further debate with APRA on this topic to understand APRA's view
25. **(All insurers)** APRA is seeking improvement suggestions on solving the mismatch between IRC and the duration of quota share reinsurance policies.	• Swiss Re L&H does not have any comments on this question • Swiss Re GI is of the opinion that the reporting for reinsurers should be aligned with the insurer where such cover is offered. The requirement for the reinsurer to hold more capital on risks which are not yet written by the insurer for the duration of the multi-year contract is too onerous • If the insurer and reinsurer could agree on an appropriate writing pattern in order to capture the Bound but not Incepted Business (BBNI) exposures as at the reporting date, there would be better alignment. Otherwise, an allowance for additional exposures for the next 6 or 12 months unless expiration date is less than 6 or 12 months away respectively would be more appropriate and simpler to administer
26. **(All insurers)** Would a requirement of inception date of having all procedural documentation of reinsurance arrangements formalised be a significate burden on the industry?	• We are of the view that the current requirements should remain unchanged as they are working effectively for the industry and APRA has commented that they are seeing benefits of these requirements • Removing these requirements seems like a tightening of requirements that removes the ability of the cedant and reinsurer(s) to work through all of the terms and conditions of a reinsurance agreement without the time pressure usually associated with the pricing and capacity allocation of a reinsurance placement. If APRA is of the view these requirements should be tightened then perhaps a staged approach would be better than moving from 6 months down to inception date for full contract wording

	• Would be useful if APRA could clarify whether the removal of these requirements would also remove the requirement to lodge a Reinsurance Declaration as per the requirement of GPS 230 Reinsurance Management? • Swiss Re L&H has the offer and acceptance process (binding offer and acceptance) in place for all new and renewal of contracts at the date of inception • For Swiss Re GI, Typical Offer and Acceptance is agreed prior to reinsurance contract's inception date via the broker. Our Acceptance is evidenced with % of Written Line and SR Stamp & Signature on broker's full Slip Contract Wording
27. **(All insurers)** Are there any additional LAGIC updates, not already mentioned, that would be beneficial to APRA and the industry?	• No further LAGIC updates to be noted by Swiss Re