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Written submission with regards to APRA's draft prudential standards

Dear Sir or Madam

Here is Swiss Re's combined feedback & recommendations with regards to APRA's draft prudential standards and recommendations as set out in the response paper. Swiss Re welcomes a discussion with APRA on any of the topics in our response.

Yours sincerely,



Debbie Wilson
Chief Financial Officer

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

A. Request for cost benefit analysis information:

Based on our current assessment additional effort and cost would be required in the following areas:

1. System set-up/functionality:
 - Due to Swiss Re portfolios being different to the proposed APRA product groupings, additional effort would be spent on creating the CSM allocation requirement in our systems to enable us to report on the APRA product group level. (One-off and ongoing effort/cost)
2. Updating the APRA reporting process (IFRS 17 data)
 - A gap analysis will be performed based on the new APRA reporting requirements, determining:
 - Identifying new data sources and mapping these to the new APRA reporting templates (One-off effort/cost)
 - Creating a new business as usual reporting process (One-off effort/cost)
3. Updating the Capital reporting process (Capital data)
 - A gap analysis will be performed based on the new APRA capital requirements, determining:
 - Data sources taking the new system landscapes into consideration and mapping these to the new APRA forms (One-off effort/cost)
 - Creating a new business as usual reporting process and incorporating new LAGIC requirements into the capital model (One-off cost)
 - Maintaining external models as the capital numbers would not be available from our reporting system. Reporting systems are set up based on the IFRS 17 requirements (Ongoing cost)

B. Reporting period 1 Jan 2023 - 30 June 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.

Can APRA clarify that where the Income Statement and Balance Sheet items depend on policy liabilities, whether those items should be reported by deriving them from the policy liabilities using the pre-Jan 2023 standards, or should those items be sourced directly from the existing balance sheet? The most notable example would be tax; should the Income Statement and Balance Sheet reflect the tax arising from the old standards or the new? Other items which may be impacted include funds withheld/ claims paid reinsurance treaty balances.

C. Feedback with regards to draft prudential standard:

1. LPS 001 Definitions

1.1. Defined the term APRA product group for the purposes of LPS 340

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.

Swiss Re will be applying an allocation approach to derive the CSM on the APRA product group level by utilising the coverage unit as a basis for the allocation. Swiss Re would for instance apply a CSM allocation for splitting out step versus level business, Disability income and Total Permanent Disability (TPD) business which is reported in the same Swiss Re IFRS 17 portfolios for statutory and internal reporting.

1.2. Defined the term unpaid premium for the purposes of LPS 114 and LPS 118

***Unpaid premium** means the value of premiums due but not received. Premiums are defined as gross of commissions and before profit share rebates (for example included in group insurance and reinsurance contracts issued). Premiums must also be inclusive of stamp duty, policy fees, loadings and discounts.*

Swiss Re Feedback:

Swiss Re recommends APRA to consider defining unpaid premium net of commission, and various loadings.

- By defining unpaid premium to be gross of commission and before profit share rebates could be more conservative than necessary
- As commission is usually deducted at source, the amount open to default risk is generally premium net of commission
- In other words, if unpaid premium becomes irrecoverable, a reinsurer will not be liable for the commission/profit share component

Can APRA please clarify if this recommended change is driven by the IFRS 17 implementation or a revision of the LAGIC framework.

- APRA should note if the change is a result of introducing AASB17 (and hence no impact on capital levels), this would result in an unintended impact (adverse) on ARC.

2. LPS 112 Capital adequacy measurement of capital

Swiss Re's general feedback with regards to the current draft version of LPS 112 is that there is a lot of repetitive requirements in the criteria for inclusion between CET1, Tier 1 and Tier 2, it may be preferable to consolidate them & refer to it each time rather than duplicating lengthy paragraphs.

2.1 Several amendments made to align with APS 111, see Appendix C of the response paper

Previous exercise of discretion

Par 6 *APRA may adjust or exclude a specific requirement in this Prudential Standard in relation to a life company.*

Par 7 *A life company must contact APRA if it seeks to place reliance, for the purposes of complying with this Prudential Standard, on a previous exemption or other exercise of discretion made by APRA under a previous version of this Prudential Standard.*

Swiss Re Feedback Par 6 & 7:

Can APRA clarify whether Life Companies that had previous LPS 230 exemptions or allowances need to contact APRA to place reliance on these exemptions or allowances. Swiss Re had in the past obtained approval from APRA in relation to internal retrocession arrangements with large upfront commissions, we would therefore appreciate clarification whether we need to contact APRA in relation to these.

Par 19 A life company must ensure that funds raised by a related entity, and invested in the life company, are not upgraded to a higher category of capital when measured in a life company's capital base. Any such component of capital must be reclassified to the appropriate lower category of capital when included in the life company's capital base.

Swiss Re Feedback Par 19:

Swiss Re Life & Health Australia Limited (hereunder SRLHA) related to Swiss Reinsurance Company Ltd (hereunder SRC) via the holdings Swiss Re Reinsurance Holding Company Ltd., Swiss Re Asia Holding Pte. Ltd. and Swiss Re Australia Ltd.

The sources of funds raised by SRC are used to cover all insurance and reinsurance activities across the groups different carriers and cannot be directly segregated to each of its related entities such as SRLHA.

In absence of a directly attributable source of funding from SRC, Swiss Re is not able to determine whether any component of capital must be reclassified.

Any unnecessarily conservative approach to reclassify capital to a lower category from the SRC leverage position may lead to an undesired volatility in the tiering of SRLHA and an increase cost of reinsurance for its clients.

Swiss Re welcomes a discussion with APRA in relation to Par 19.

Par 23 A life company must not include a capital instrument that involves the use of a special purpose vehicle (SPV), or a stapled security structure consisting of the issue of a preference share and a stapled instrument of another form, in its regulatory capital.

Swiss Re feedback Par 23:

Can APRA clarify if the use of all SPVs would be excluded from an entity's regulatory capital, or if the use of Insurance Linked Securities structured into SPVs can be recognized, to the extent that it can be proven to meet the entity capital requirements adequacy in distress.

Par 24 A life company must not include a capital instrument in its capital base if the capital instrument has features that hinder recapitalisation of the life company, or a related entity of the life company. This includes features that require the life company or a related entity of the life company, to compensate investors if a new instrument is issued at a lower price during a specified timeframe.

Swiss Re Feedback Par 24:

In order to best comply with this paragraph, Swiss Re would welcome if APRA could share some examples to understand what APRA is trying to enforce.

Swiss Re has a similar question in relation to par. 19, where APRA interlinks the capitalisation of SRLHA with related entities unregulated by APRA.

***Par 47** In assessing the overall strength of the capital adequacy of a life company APRA will have regard to the level of capital adequacy of individual group members of a group to which the life company belongs, including any limitations in the amount of capital that may be readily extracted from individual group members to provide support, if required, to recapitalise the life company.*

Swiss Re feedback Par 47:

Swiss Re would recommend changing the terms from "**individual group members of a group to which the life company belongs**" to "**related entities**", individual group members being a term not defined otherwise in the standard.

Swiss Re would consent to disclose SRC capital adequacy under the SST framework but would not consent to provide non-public solvency position of entities which do not exercise an influence over SRLHA.

***Par 48** In assessing the overall capital strength of a life company, APRA may request that the parent entity provide APRA with details of relevant intra-group exposures, including capital transactions and intra-group guarantees. The information on intra-group exposures would typically include details of all intra-group exposures provided by the life company to other members of the group. APRA may also request details of material exposures between other members of the group to which it belongs.*

Swiss Re feedback:

Swiss Re would appreciate if APRA can clarify under which circumstances "APRA may request details of material exposures between other members of the group to which it belongs", and how APRA defines "material exposures".

2.2 Clarified the application of fair value measurement for capital base determination

Swiss Re Feedback:

When adopting AASB 9 the majority of Swiss Re's investments will be measured based on fair value through OCI. However, our infrastructure investments and cash & cash equivalents will be measured based on amortised cost. For these investments Swiss Re would be required to maintain two measurement bases.

Swiss Re's recommendation is for APRA to consider aligning the measurement approach to the AASB 9 measurement approach of the relevant legal entity.

2.3 Group of Insurance contracts acquired

*In the **response paper section 2.5** APRA has made a proposal regarding the group of insurance contracts and that the CSM on a group of insurance contracts acquired should be excluded from CET1 capital until earned.*

Swiss Re Feedback:

With regards to the above proposal can APRA provide the following clarifications:

- Reference the relevant standard and paragraph that includes this requirement as we were not able to locate this in the draft standards

- Clarify the definition of 'acquired'
- Clarify if this requirement would be applied retro-or prospectively (Swiss Re would not recommend applying retrospectively)
- Provide clarification on the background and risk driver of the proposed requirement

3. LPS 340 Valuation of policy liabilities

3.1 Classification requirements

***Par 16 Participating contracts** Subject to paragraphs 18 and 19, a life insurer must make a separate valuation of policy liabilities for each statutory fund and must meet the following requirements:*

- (a) for each Australian or Australian/overseas fund, a life insurer must make 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; and*
- (b) for each overseas fund, a life insurer must make 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.*

***Par 19** 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 company may group these classes when valuing the relevant policy liabilities, provided that income tax attributable to shareholder profit on the business is calculated at the same tax rate for both classes.*

Swiss Re feedback:

Please note Swiss Re will be implementing the following simplifications with regards to paragraphs 16-19:

Swiss Re notes that par 19 of LPS 340 is only relevant to **non-participating risk business** which allows a company to group ordinary and superannuation classes within a single statutory fund when valuing the relevant policy liabilities.

Swiss Re has **non-participating non risk business (VPST business)** across both the ordinary and superannuation classes and therefor the allowance to determine the value of the policy liabilities on a combined level per par 19 is not applicable to this business.

The majority of the VPST business sits within the ordinary class and a very small portion (less than AUD500k) in the superannuation class. Swiss Re has made the decision to group these two classes together when determining the policy liabilities on the basis that the portion in the superannuation class is not material. Swiss Re has applied par 112 and 113 of LPS 340 which indicates a company may consider materiality when valuing its policy liabilities.

With respect to **non-participating risk business**, Swiss Re will be applying par 19 and therefore will be valuing the policy liabilities on a combined basis across ordinary and super classes within the same statutory fund.

LPS 340 Materiality

Par 112 A life company may consider materiality when valuing its policy liabilities. Particular values or components are considered material to the overall result of a calculation if misstating or omitting them would produce results likely to be misleading to the users of the information.

Par 113 For a life company which is not a friendly society, policy liabilities and regulatory capital calculation (including determination of BEL) are subject to materiality standards applied at a statutory fund level.

3.2 Valuation of policy liability Part B – Projection period

LPS 340 Par 72 The best estimate liability is determined as the value of the expected future payments and receipts under the policy based on obligations at the reporting date. This best estimate liability is equal to:

(a) the value of expected future benefit payments; plus

(b) the value of expected future expenses; less the value of expected future receipts.

Swiss Re feedback:

Swiss Re recommends that APRA clarifies whether its intention within LPS340 is to retain the existing approach to project liabilities.

Specifically, regarding the Projections for the RFBEL calculation, where we are required to reflect expected renewals and lapses throughout the guaranteed renewability period.

IFRS17's definition for contract boundary utilises "obligation" as period which "entity has a substantive obligation to provide the policyholder with insurance contract services".

Although IFRS17 further elaborates "substantive obligations" (p34, B61-B71), there is opportunity to further remove existing ambiguity within draft LPS340.

4. LPS 600 Statutory funds

Swiss Re Feedback:

APRA has provided very clear guidelines with regards to how the starting amount needs to be determined at adoption date i.e., 1 January 2023.

Swiss Re recommends that APRA clarifies whether there are any transitional requirements for the quarterly reporting as of 1 July 2023 when entities are required to commence reporting based on the updated prudential standards.

APRA only refers to the impacts from adoption of AASB 17 and should consider including AASB 9 adoption impacts as well.

5. LPS 117 Asset Concentration Risk Charge

Swiss Re Feedback:

Under APRA's latest proposal for LPS 117, APRA has adopted the most prudent option for calculating VAF for non-reinsurance assets: remove AASB 17 insurance and reinsurance asset items and add premiums and other receivables.

Under the current standard, the VAF for non-reinsurance assets includes "gross policy liabilities ceded under reinsurance". This concept has since been replaced by AASB 17's reinsurance asset/liabilities. Therefore, to remove this AASB 17 reinsurance asset without any further allowance for reinsurance benefit/asset would significantly reduce the VAF for non-reinsurance assets.

VAF for non-reinsurance assets sets the threshold of counterparty exposures for investment assets and outstanding premiums. To reduce this exposure limit due to AASB 17 (without any further adjustment to % limits) implies that these assets are inherently riskier under the new accounting regime compared to now.

Swiss Re recommends APRA further clarify the reasoning behind this stance, and intent. Otherwise, APRA should consider other alternatives to minimise impact of AASB 17 on ACRC. Examples include: Increasing "% of VAF" under each asset exposure for non-reinsurance items, or to include reinsurance benefit/assets within VAF for non-reinsurance assets calculation. Although various alternatives would affect individual companies differently, they these alternatives still be more acceptable/less prudent than current proposal.

6. LPS 118 Operational Risk Charge

Swiss Re Feedback:

APRA's latest directive is for insurers to manage a different definition of revenue for ORC (Accrued premium) to the new accounting standard (Insurance revenue). Swiss Re agrees 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 ORC.

However, this proposal would result in insurers having to manage two sets of revenue definitions. Swiss Re would like APRA to clarify if there is appetite (and consequently guidelines) for insurers to adopt AASB 17's definition of insurance revenue if there is a preference to do so to streamline reporting process.

For the purpose this QIS, Swiss Re has adopted current definition of earned premium to calculate ORC as further analysis needs to be completed to ensure compliance with the revised standard in 2023.

D. Feedback with regards to GI draft prudential standards

1. GPS 230 – Reinsurance management

Proposed by APRA:

Replace two- and six-month rule with inception and two-month rule.

Swiss Re Feedback:

Swiss Re appreciates APRA listening to the industry feedback and stopping short of requiring all documentation in place by the contract inception date. Swiss Re would

encourage APRA to reconsider its intention to move the requirement further to prescribe reinsurance contract wordings be finalised and executed by the inception of the contract in the medium term. Swiss Re believes that both insurers and reinsurers should have enforceable rights and obligations at the inception of the contract, but due to peak renewal periods should be afforded a period in which to finalise the execution of the contract, the proposed two-month period would seem an appropriate timeframe.

2. GPS 112 & GPS 114 – Fair value measurement

Proposed by APRA:

Fair value adjustment, APRA is proposing an adjustment to capital for the difference between fair value and the reported value of each asset. APRA considered industry feedback allow for assets that are not valued at fair value, but rather under accounting standards an appropriate alternative.

Swiss Re Feedback:

Swiss Re appreciates APRA listening to the industry feedback and seeking to address this concern. Swiss Re has reviewed the proposed changes in paragraphs 27 and 28 of GPS 112 and paragraph 19 of GPS 114 and wonder if these provide the certainty APRA was intending. We would understand if certain assets are valued under an Australian Accounting Standard then that value is taken as the fair value. APRA could consider an amendment to the wording as follows:

Paragraph 28 (GPS 112) and Paragraph 19 (GPS 114)

"Where a regulated institution measures its non-financial assets, short term receivables and intercompany receivables and payables in accordance with the requirements in Australian Accounting Standards this measurement would be deemed a fair value for prudential capital purposes."