



31 March 2022

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

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Dear General Manager,

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

The Actuaries Institute ('the Institute') welcomes the opportunity to comment on the Response Paper and the draft Prudential Standards from APRA.

The Institute is supportive of the proposed changes to the Life and General Insurance Capital (LAGIC) framework to integrate AASB 17 with the exception of those impacting Friendly Societies. The draft standards will require some friendly societies to dual report on an APRA AASB 17 basis and on an ASIC AASB 17 basis. The Institute believes this is unjust and constitutes too high a regulatory burden upon friendly societies because many of them are smaller companies, some are still mutuals and most offer products with limited complexity.

We set out our feedback from a general insurance and life insurance perspective below. It does not include our feedback on APRA's planned approach to reviewing the capital framework applicable to private health insurers, including the impacts of AASB 17 Insurance Contracts, which we are commenting upon separately in that APRA consultation process.

The Institute will continue to provide more granular feedback to APRA via the AASB 17 Task Force Working Groups.

Should you wish to discuss this submission further please do not hesitate to contact Chief Executive Officer of the Actuaries Institute.

Yours sincerely,

President



Cross Practice Feedback

Implementation Date

The Actuaries Institute is broadly supportive of a 1 July 2023 implementation date for prudential reporting. However, as acknowledged by APRA, this will result in up to six months of dual reporting for a number of entities. We continue to propose such insurers have the option to align reporting bases earlier if desired to avoid the regulatory burden imposed due to dual reporting.

We welcome the opportunity to discuss how we could support and address what we understand to be APRA's concern that risk-based assessments for such entities cannot be performed until all entities have transitioned. Is it possible, for example, for reporting standards to align to AASB 17 and prudential standards to have a 1 July 2023 implementation date?

As noted earlier, we have also raised a concern with the way starting amounts are defined in LPS 600 for life insurers.

Tax implications on capital

Much uncertainty remains on the treatment of deferred and/or current tax assets arising from the transition to AASB 17. These can have potentially significant capital impacts depending on the treatment for capital purposes, which is potentially contrary to APRA's desire to maintain consistent capital across the industry.

Notwithstanding the impact of tax benefits on capital, we believe that APRA should maintain its principles – i.e. capital resources should be adjusted for any tax benefit that could not be realised in adversity. Nevertheless, we request that APRA engages with the ATO / Treasury on likely transition rules for tax to provide APRA and industry with clarity around any potential capital implications resulting from tax legislation.

General Insurance Feedback

Reinsurance documentation test

Reinsurance is an important element in managing and protecting Australian insurers. We broadly support the changes APRA has made to the initial proposal in allowing coverage to be finalised by inception, and wordings to be finalised, stamped and signed within two months.

However, we believe that care needs to be taken in making this change. Australian insurers are purchasing reinsurance in a global marketplace. Existing practices within the global reinsurance marketplace may hamper Australian APRA-regulated insurers' ability to meet the new requirements. There is also a risk of unintended consequences if some Australian insurers 'rush' the finalisation of their reinsurance program in order to meet shorter timeframes.

APRA has expressed an intention to review the operation of the rule and potentially shorten the deadline for when wordings must be finalised, stamped and signed. We strongly recommend APRA consult the industry again prior to making this change, after observing how practices evolve.



Friendly Society Feedback

APRA's current proposed approach for reporting for friendly societies for policy liabilities (as per the P&L and Balance Sheet) is set out in section 3.4.3 of the 'Response paper'. The Institute addresses each of the three items in turn.

1. Separate valuation of policy liabilities for each approved benefit fund

APRA has proposed that friendly societies make a separate valuation of policy liabilities for each approved benefit fund. As set out in item 1 of page 39:

'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.'

This approach essentially results in dual reporting because friendly societies will need to determine insurance liabilities on an ASIC AASB 17 basis (including all cash flows relevant to the contract regardless of where they arise in the company) and policy liabilities on an APRA AASB 17 basis (including only those cash flows in the Benefit Fund).

Dual reporting is an onerous process as it essentially requires the company on an ongoing basis to maintain two sets of accounts. We consider dual reporting to not be justified and constitutes a too high regulatory burden because many friendly societies are smaller companies, some are still mutuals and most offer products with limited complexity.

APRA commented that it believes that *'friendly societies will continue to perform calculations at a benefit fund level for the determination and distribution of the surplus'*. If this is APRA's driving consideration, the Institute proposes that dual reporting need not be required for:

- (a) any funds where there is no surplus; or
- (b) any funds which are pure investment funds and therefore the Benefit Fund will adopt an approach similar to IFRS 9 for the purpose of distributing surplus.

The Institute welcomes the opportunity to continue to assist APRA (via the AASB 17 Friendly Society Working Group) to identify alternative methods that avoid dual reporting for the remaining funds.

The Institute's preferred approach is an apportionment of the AASB 17 result between the Benefit Fund and Management Fund with fulfilment cash flows arising from each respective fund reported in that fund and the Contractual Service Margin (CSM) apportioned between the funds. The Institute acknowledges that this approach has some complexities when the contracts are onerous.



2. Additional reporting requirements on surplus in an approved benefit fund

The Institute considers that the additional items that APRA is proposing to collect in the draft reporting standard *LRS 114.5 Friendly Society Related Items* appear reasonable and is data that Friendly Societies would already be calculating. We do not expect them to impose an unreasonable regulatory burden.

3. Expanded LRS 200 capital data collection for friendly societies that provide defined benefit risk products

APRA proposes to expand the capital data collection for friendly societies that provide defined benefit risk products (i.e. product group F4) under *Reporting Standard LRS 200.0 Capital Adequacy Supplementary Information* (LRS 200). This additional data collection is being sought to assist APRA in performing comparability analysis of profitability and risk profiles of insurance risk components across different friendly societies. The data is supplementary to that required under AASB 17.

The Institute is unaware of the additional regulatory burden the expanded data collection would place on friendly societies. However, we consider that the regulatory burden might be eased if APRA were to exercise discretion and only apply this reporting requirement for more complex defined benefit risk funds. Typically defined benefit risk products are a small component of a friendly society's overall portfolio, are generally simpler in nature and in many cases are legacy. We also recognise that APRA needs to approve each benefit fund and is thus in a position at the point of approval to make a determination as to whether enhanced LRS 200 reporting would be required for any new funds.

Life Insurance Feedback

LPS 112: Capital Adequacy Measurement of Capital

APRA has proposed the following new draft LPS 112 standard that restricts the ability to upgrade funds to a higher category of capital when measured in a life company's capital base.

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.

While the Institute is broadly supportive of this new standard, we recognise that it may have unintended solvency consequences for some entities if applied retrospectively or prospectively for the renewal of such funds. Therefore, we propose at a minimum that transitional relief be provided to companies that are adversely impacted.



LPS 340: Valuation of Policy Liabilities

The Institute supports the flexibility offered in paragraph 26 of the draft LPS 340 prudential standard, which enables the entity to elect one of two methods to determine the policy liabilities of life insurer participating business and the resulting profit to report to meet the Life Act: (1) the accounting standard led method and (2) the Value of Supporting Asset (VSA) led method.

We suggest the following clarifications to the proposed LPS 340 to improve clarity:

- paragraph 25, change reference from 'relevant accounting standards' to 'accounting standard AASB 17, *Insurance contracts*' for avoidance of doubt;
- paragraphs 49 and 70, change reference from 'related product group' to 'subcategory'; and
- paragraph 71, explicitly state that the Risk Free Best Estimate Liability (RFBEL) is not necessarily equivalent to amounts determined under AASB 17, again for the avoidance of doubt.

LPS 600: Statutory Funds

We suggest changing the reference to 'transition date' in paragraph 31(g) of LPS 600 to avoid confusion with the equivalent term but different meaning under AASB 17. This term means 'the day before the AASB 17 adoption date' in the draft LPS 600 but means 'the beginning of the annual reporting period immediately preceding the date of initial application' under AASB 17.C2(b).

We also note the following with regards to LPS 600.

- The new values (for retained profits, etc) are defined in terms of the values applying under the new APRA standards – but at transition to AASB 17 the new APRA standards may not yet apply for some insurers.
- 'Aggregate shareholder retained profits on AASB 17 adoption' is defined in terms of 'net assets' which is assumed to automatically change with AASB 17, and only be affected by changes in retained profits. It is not certain that this will be the case. (Indeed, 'net assets' under the APRA returns will depend on the liabilities in those returns, which in turn will depend on retained profits - which is circular.) It will be more certain if 'aggregate shareholder retained profits on AASB 17 adoption' is defined in terms of 'aggregate shareholder retained profits at transition', with the change specified.
- LPS 600 defines 'aggregate shareholder retained profits at transition', in paragraph 33, but this definition is not subsequently used, although starting amounts for Australian policy owners' retained profits (APRP) and overseas policy owners' retained profits (OPRP) are defined.