



31 March 2022

General Manager,
Policy Development,
Policy and Advice Division,
Australia Prudential Regulation Authority
1 Martin Place (Level 12)
Sydney
NSW
2000

By email: insurance.policy@apra.gov.au

Dear General Manager, Policy Development and Policy and Advice Division at APRA,

Re: Response paper - Integrating AASB 17 into the capital and reporting frameworks for insurers and updates to the LAGIC framework.

We are writing on behalf of Insurance Australia Group Limited (IAG) to provide comments on the paper, issued to the industry by APRA on 13 December 2021 ('response paper'), regarding its proposals for the integration of AASB 17 into the capital and reporting frameworks for insurers, along with other updates to the LAGIC framework.

IAG as a member of the Insurance Council of Australia (ICA), has also contributed to the discussions supporting the comment letter that will be submitted by the ICA on behalf of its members. The points raised in this letter provide due prominence to those areas of greatest significance to IAG.

We appreciate the efforts made to date by APRA in providing a detailed response to the industry's concerns, which were raised via response letters submitted in March 2021 and we welcome this opportunity to provide further feedback on the proposals as set out in your response paper. We also continue to appreciate APRA's proactive engagement with the industry throughout the process via various forums.

Moving forward, we would encourage APRA to consider undertaking a post-implementation review subsequent to the integration of AASB 17 into the capital and reporting framework and to seek industry feedback at that future date. This would help facilitate the assessment of any further refinements and the remediation of any unintended consequences not identified at this stage.

In general terms, we agree with APRA's overarching approach of not making fundamental changes to the current capital (LAGIC) framework and aligning, where possible, the reporting requirements under the relevant framework with the accounting standards. This approach provides for more clarity and consistency across the industry and for stakeholders more broadly. As we have previously highlighted, the implementation of AASB 17, in itself, does not change the fundamental economics of our business and, consequently, should not materially impact the level of regulatory capital required to be held.

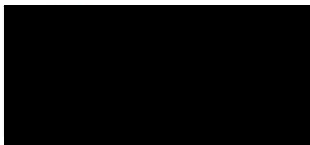
In relation to the question whether the proposed approach will create a material incremental reporting burden. We do not believe the incremental burden relative to the existing framework will be material for IAG. There are, however, a number of areas that we believe require further consideration by APRA. These are primarily in relation to those areas that may place undue burden on the industry or could give rise to unintended consequences. These include:

- the date at which procedural documentation is required to be in place in respect of reinsurance contracts. This proposal could drive both the incurrence of incremental regulatory costs and result in more volatile reinsurance pricing outcomes, which could be detrimental for both insurers and customers; and
- capital relief for the proportionate protection whole of account quota share reinsurance arrangements provide with regards to exposure to operational risks. Not permitting an appropriate relief against the operational risk charges potentially leads to a double-counting at an industry level, which is an undesirable outcome for the industry as a whole and for individual insurers and reinsurers; and
- certain proposed amendments to GPS 112 *Capital Adequacy: Measurement of Capital*.

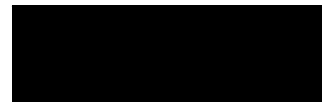
In addition to the points noted above, we have attached appendices to this letter which include our detailed response to each of the areas that APRA responded to in its paper to the industry.

If you wish to discuss further any of the contents of this letter, please contact us.

Yours faithfully,



Peter Grant
Chief Financial Officer, Australia



Brett Ward
Chief Actuary

Appendix 1: Response to APRA's 'Proposed changes to the capital framework'

	APRA's proposal	APRA Letter Page Ref	IAG's Response
1	2.2.1 Regulatory Adjustments	19	<p>Overall, we agree with the proposal to continue to determine the capital base using GPS 340 liabilities via an appropriate adjustment, resulting in capital neutrality. The mechanism proposed by APRA provides a relatively straightforward approach to determine the adjustment, being the difference between the GPS 340 liabilities and the aggregate of AASB 17 insurance and reinsurance liabilities, including the effect of accrual items.</p> <p>IAG acknowledges that AASB 17 has an enhanced focus on measurement approaches that may result in a different timing of profit/(loss) recognition and, consequently, may have potentially less utility in a solvency assessment context. On this basis, it provides further support for retaining the existing infrastructure that produces the GPS 340 liabilities.</p>
2	2.2.2 Four quarters dividend test	20	<p>For IAG, AASB 9 <i>Financial Instruments</i> became effective for periods beginning on 1 July 2018. Under this Standard, IAG adopted the option to value all of its investment portfolio, and other financial assets, at fair value through profit or loss. IAG does not anticipate this accounting policy choice to change on adoption of AASB 17 and expects to continue to present all finance income/expense in the profit or loss. On this basis, IAG does not consider that this proposal will have any material impact and are supportive of the proposal as an appropriate mechanism.</p>
3	2.3.1 Expense basis	21	<p>IAG is supportive of the changes made to this part of the proposal by APRA. The definitions provided by APRA for both claims handling and policy administration expenses are aligned with our expectation.</p>
4	2.3.2 Risk margin requirements	22	<p>IAG acknowledges APRA's desire to maintain risk margins on a probability of sufficiency basis at 75% to which capital figures are applied. As the probability of sufficiency needs to be reported under AASB 17, then this same infrastructure, with some adjustment, can also produce the required risk margins. On balance, this approach should not present a significant burden to IAG. Accordingly, IAG is generally supportive of APRA's decision not to propose changing the underlying methodology for the calculation of the risk margin for solvency purposes.</p>
5	2.3.3 Discount rate	22	<p>Whilst IAG still holds the view that alignment should be achieved between AASB 17 and the Prudential Standards on this point, on materiality grounds, IAG generally has no concerns with respect to this proposal.</p>
6	2.3.4 Capital risk charges and other requirements	23	<p>IAG is supportive of the proposal by APRA in order to maintain capital neutrality, with the clarification being provided in respect of the tax treatment associated with the regulatory capital adjustments.</p>

	APRA's proposal	APRA Letter Page Ref	IAG's Response
7	Groups of insurance contracts acquired	26	IAG has no particular concerns with this proposal.
8	Projection period	27	IAG is generally supportive of APRA retaining the existing approach to projecting GPS 340 liabilities, particularly in the context of our existing systems and processes.
9	Reinsurance default risk	27	IAG has no particular concerns with this proposal.
10	Unclosed business	27	IAG has no particular concerns with this proposal.

Appendix 2: Response to APRA's 'Proposed changes to the reporting framework'

	APRA's proposal	APRA Letter Page Ref	IAG's Response
1	3.1 Introduction	29	<p>IAG notes APRA's proposal that "from 1 July 2023, for all insurers, reporting in APRA's revised quarterly reporting forms will be on a discrete reporting period basis and not on a cumulative year to date basis".</p> <p>IAG seeks clarification on the purpose of changing reporting in APRA's revised quarterly reporting forms for all general insurers from a cumulative year to date basis to a discrete reporting basis, given that insurers analyse results on a year-to-date basis. IAG's current interpretation is that insurers will still be able to report their results on a year-to-date basis, but this proposal is simply requiring a movement to be calculated between certain items contained within the quarterly forms.</p> <p>In due course, IAG would like to discuss with APRA the intent behind this proposal to confirm there is an alignment of expectations.</p>
2	3.3.1 New product groups	31	IAG is generally supportive of APRA's proposed definitions for the new product groups, being D&O and Cyber insurance.
3	3.3.2 Product group allocation principles	32	IAG is supportive of the amendments proposed by APRA, in particular the removal of reference to "profitability" as an allocation driver.
4	3.3.3 Approach to liability data collection	33	IAG has no particular concerns with this proposal.
5	3.3.4 Reporting direction for supplementary data collection	34	IAG has no particular concerns with this proposal.
6	3.3.5 Audit requirements	35	IAG is generally supportive of the proposal to broadly follow the existing approach to the audit and assurance requirements that underpin the submission of data returns to APRA.

Appendix 3: Response to APRA's 'Proposed LAGIC updates'

	APRA's proposal	APRA Letter Page Ref	IAG's Response
1	4.1.1 Real interest rate stress test	41	In principle, IAG supports APRA's direction of ensuring that the capital framework remains appropriate in a low or negative interest rate environment. IAG believes the proposed approach maintains an appropriate level of consistency with the current LAGIC stress tests.
2	4.1.2 Expected inflation stress test	42	In principle, IAG supports APRA's direction of ensuring that the capital framework remains appropriate in a low or negative interest rate environment.
3	4.1.3 Removing the floor of zero for nominal interest rates	42	IAG has no particular concerns with this proposal.
4	4.2 All insurance industries – Dollar value exposure limits	43	IAG has no particular concerns with this proposal.
5	4.3 All insurance industries – Maintaining alignment in APRA's approach to the measurement of capital instruments for ADIs and insurers	44	There are two key points contained within the draft marked-up version of GPS 112 for which IAG is seeking clarification from APRA: <ul style="list-style-type: none"> • clarification of the intent behind the proposed inclusion of paragraphs 33 and 34, which reference 'fee income'. There is neither an explanation provided in APRA's response paper, nor a definition included in the draft Prudential Standards; and • IAG notes that APRA is proposing to amend Attachment D paragraph 24 to include the wording "is deemed to" instead of "may". IAG would like to discuss in due course APRA's intention for this change and their expectations with regards to fulfilling this requirement.
6	4.4 General insurers and life companies – Removal of Internal Capital Models	45	IAG has no particular concerns with this proposal.
7	4.5 General insurers – Default stress	45	IAG is supportive of the amendments proposed by APRA, with the appropriate capital relief being provided for whole of account quota share reinsurance contracts.
8	4.6 All industries – Fair value requirement for the measurement of assets	46	IAG is supportive of the amendments proposed by APRA.

	APRA's proposal	APRA Letter Page Ref	IAG's Response
9	4.8.1 General insurers and life companies – Operational risk charge for whole of account quota share arrangements	48	<p>IAG encourages APRA to reconsider this proposal. This is in order to address the double counting of operational risk charges across the industry by providing the relief for insurers who enter into whole of account quota share arrangements and to work with industry to design an appropriate mechanism in order to moderate and share the overall industry operational risk charge.</p> <p>The operational risk charge is calculated by applying a risk charge to an exposure base that acts as a proxy for exposure to operational risks. Under long-term quota share reinsurance arrangements, both the insurer and the reinsurer are required to hold an operational risk charge for the full amount of premium ceded at the respective rates. In the case of long-term quota share arrangements where the reinsurer 'follows the fortunes' of the insurer, many of the operational risks inherent in the business, and covered by the risk charge, are passed proportionally to the reinsurer. In IAG's view, this means that there is a double count at the industry level.</p>
10	4.8.2 General insurers – Duration of policies in the calculation of the Insurance Risk Charge	48	IAG is broadly supportive of the amendments proposed by APRA.
11	4.8.3 General insurers – Procedural requirements for contracts	49	<p>IAG has concerns with regard to APRA's proposed requirement to have all reinsurance contracts fully executed at their inception, as this would place a significant incremental burden on the industry. Whilst the industry strives to have fully signed contract wording before inception, and this would be the case in most instances, requiring reinsurers to provide their terms (and for insurers to accept and bind those terms) early enough to ensure this is achieved under all circumstances has the potential to limit access to reinsurance capacity and impose additional costs on insurers (and customers).</p> <p>It is common practice with reinsurance programs of Australian insurers for the provision of terms and formal binding of reinsurers to take place, in certain circumstances, immediately prior to inception. This is particularly the case for covers exposed to a frequency of natural perils where reinsurers may require an understanding of the loss position of the expiring contract before providing terms. A requirement to have fully executed contracts at inception will not be viable in all cases, particularly when considering the logistics of dealing with international reinsurers. Whilst all bound lines are confirmed in writing at or before the time of inception, there is still the potential for some intricacies and further negotiations around parts of the contracts which do not materially affect the cover provided.</p> <p>A more practical target requirement for consideration may be that the current proposed two-month rule is reduced in time to one month, which would require all contracts to be fully executed within one month of their</p>

