6 May 2022

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

Dear Sir/Madam

Submission to APRA regarding LPS 117 Capital Adequacy: Asset Concentration Risk Charge

This submission is a response from the Actuaries Institute ('the Institute') to the following documents released by APRA on 8 March 2022:

> Response paper - Revisions to Prudential Standard LPS 117 Capital Adequacy Asset Concentration Risk Charge ('Response Paper'); and
>
> Draft Prudential Standard LPS 117 Capital Adequacy Asset Concentration Risk Charge - clean - 8 March 2022 ('Draft LPS 117').

This response was coordinated by a working group ('the group') re-convened by the Institute to consider APRA's Response Paper and the Draft LPS 117.

The group was originally convened in 2019 to consider a response on behalf of the Institute to APRA's letter of 4 March 2019 ('Offshore reinsurers and the review of Prudential Standard LPS 117 Capital Adequacy: Asset Concentration Risk Charge').

The group was again convened in 2021 to consider a response on behalf of the Institute to the documents released by APRA on 8 April 2021: 'Response paper - Revisions to Prudential Standard LPS 117 Capital Adequacy Asset Concentration Risk Charge' and 'Draft Prudential Standard LPS 117 Capital Adequacy Asset Concentration Risk Charge'.

The group has not revisited issues raised in previous Institute submissions.

The Institute notes APRA's comment in the Response Paper that while the offshore reinsurer revisions to LPS 117 are now finalised, feedback is being sought on minor draft updates to LPS 117 to reflect broader reforms to the insurance capital standards from the integration of AASB 17 Insurance Contracts (AASB 17) and LAGIC updates.

The Institute notes that comprehensive feedback relating to AASB 17 and LAGIC updates to LPS 117 and consequential amendments to LPS 114 and LRS 117 has been provided separately by the Institute's AASB 17 Task Force Working Groups in our submission of 31 March 2022.

This submission relates specifically to the consequential amendment to the Draft LPS 117 and the determination of the value of assets of the statutory fund or general fund (VAF) for asset concentration limits that apply to non-reinsurance assets (paragraph 16).

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The Institute notes that APRA has previously stated that it is satisfied with capital levels across the industry. This change, however, has the potential to materially increase capital requirements for companies with a significant reinsurance asset.

Paragraph 16 states:

For the purpose of determining the asset concentration limits for non-reinsurance assets, VAF is determined as the sum of the total assets of the fund as per the life company's statutory accounts and insurance policy receivables less the value of any reinsurance contract assets and insurance contract assets reported in the statutory accounts.

This has changed from the previous Draft LPS 117 released on 8 April 2021:

For the purpose of determining the asset concentration limits for non-reinsurance assets, VAF is determined as the total assets of the fund as per the life company's statutory accounts less the value of any reinsurance liabilities reported in the statutory accounts that have been netted against reinsurance assets according to paragraph 28 and 29.

This also represents a departure from the existing LPS 117 (paragraph 14):

For the purpose of determining the asset concentration limits for non-reinsurance assets, VAF is the total assets of the fund as per the life company's statutory accounts.

The Institute understands this change was made due to concerns around the accounting treatment of reinsurance assets under AASB 17 inflating the VAF and/or contributing to the volatility of the VAF (as alluded to in Section 3.1 of the Response Paper).

However, the Institute considers that this may have a material impact on the calculation of Asset Concentration Risk Charge (ACRC) exposures for life insurers and reinsurers, depending on the level of reinsurance assets comprising the VAF, in turn resulting in breaches of the limits set out in Attachment A where these limits were not previously breached.

A simple numerical example is set out in Appendix A.

Whilst illustrating a simple point, the example may not capture the potential complexity of there being a combination of positive value and negative value reinsurance (e.g. arising from the payment of a large initial ceding reinsurance commission) and the respective treatment of the positive and negative value reinsurance under AASB 17.

The Institute requests APRA consider if these were intended outcomes of this revision to the calculation of the VAF, and to consider an alternative method of addressing concerns relating to the potential inflation or volatility of the VAF resulting from the accounting treatment of reinsurance assets under AASB 17.

For example, if the concern with inflation of the VAF relates to specific types of reinsurance asset (e.g. deposit-back arrangements) then the calculation of the VAF may exclude those specified assets, rather than all reinsurance assets.

Alternatively, the AASB 17 total assets could be reduced by the amount of reinsurance contract liabilities when determining VAF dollar limits for non-reinsurance assets.

If the concern is with the volatility of the VAF, then an averaging approach could be considered.

The Institute would welcome working with APRA to address any potential concerns and develop a solution which addresses concerns with VAF dollar limits for non-reinsurance assets.

The Institute would be pleased to discuss this submission with APRA. If you would like to do so, please contact Chief Executive Officer of the Actuaries Institute,

Yours sincerely

President

Appendix A – Numerical Example

In the following example, gross policy liability is 200 with 50% proportional reinsurance. The ACRC limit for bank deposits is used, however this consideration would apply to any non-reinsurance asset limits specified in Attachment A of LPS 117.

<u>Assets</u>

Cash	100
Reinsurance asset	100

<u>Liabilities</u>

Insurance liabilities	200

VAF (current LPS 117) = 200; limit for bank deposits = 100

VAF (proposed LPS 117) = 100; limit for bank deposits = 50

Where LPS 117 limit for Bank deposits = 50% of VAF