



30 March 2023

## **TO: ALL GENERAL INSURERS, LIFE INSURERS AND PRIVATE HEALTH INSURERS**

### **AASB 17: ACCOUNTING EQUITY AND THE CAPITAL BASE**

On 27 September 2022, APRA finalised changes to the capital and reporting frameworks for insurance in response to the introduction of the Australian Accounting Standards Board's new standard, AASB 17 *Insurance Contracts* (AASB 17).

As part of this release, APRA commenced a targeted consultation on additional requirements to ensure regulatory capital levels are sufficient to protect the prudential soundness of insurers and encourage appropriate accounting decisions. This followed observations from the 2020 and 2021 quantitative impact studies where APRA identified circumstances where an insurer's accounting equity (or net assets) under AASB 17 was significantly lower than the capital base.

#### **Finalising the standards**

Eight submissions were received in response to the consultation, which closed on 31 October 2022. Five were opposed and three were supportive. Key issues raised in those submissions opposed to the changes were:

- preference for adopting a less prescriptive approach where APRA incorporates the requirements as part of its supervisory approach rather than in the prudential standards;
- concerns with APRA seeking to influence accounting decisions;
- limitations of the Quantitative Impact Assessment (QIS) data provided to APRA; and
- lack of clarity around the specific situation the additional requirements are seeking to address.

Following consideration of the feedback, APRA's view is that the additional requirements remain necessary to ensure that regulatory capital levels are sufficient to protect prudential soundness, taking into account consideration of the impact of accounting decisions, and ensure a consistent approach is achieved within the regulatory framework.

The current consultation has confirmed that the policy setting is appropriate for the vast majority of entities. This position has been supported by the QIS and detailed discussions with insurers. APRA has outlined in previous consultations situations where accounting equity under AASB17 can be significantly lower than the capital base and the risks associated with that.

APRA has finalised the amendments without further revision and has incorporated them into *Prudential Standard GPS 110 Capital Adequacy*, *Prudential Standard GPS 112 Capital Adequacy: Measurement of Capital*, *Prudential Standard LPS 112 Capital Adequacy: Measurement of Capital* and *Prudential Standard HPS 112 Capital Adequacy: Measurement of Capital* as proposed.

APRA will consider applications for transitional relief from insurers on a case-by-case basis. APRA will also continue to monitor implementation of the revised requirements to ensure they remain fit for purpose and do not impose undue regulatory burden.

### Other minor amendments

APRA also received feedback on other aspects of the final package that has resulted in the following additional amendments. The details of these amendments can be found in Attachment A. The revised GPS 230 and LPS 117 will take effect on 1 July 2023.

<p><i>Prudential Standard GPS 230 Reinsurance Management</i></p>	<p>Submissions highlighted the operational difficulty of satisfying the ‘inception date rule’ (paragraph 41). APRA understands that these requirements introduced additional complexity for some insurers, as market practice no longer aligns with the specific documentation options detailed in the standard.</p> <p>APRA has simplified the requirement by removing detail of the documentation options from the standard. This is intended to ease operational complexity for insurers, without compromising the original policy intent of achieving contract certainty prior to inception.</p>
<p><i>Prudential Standard LPS 117 Capital Adequacy: Asset Concentration Risk Charge</i></p>	<p>Submissions requested further clarification on two aspects of LPS 117. Amendments have been made to the standard to ensure that it operates as originally intended.</p>

Yours sincerely,

Helen Rowell  
Deputy Chair

## Attachment A – Detail of amendments

### PRUDENTIAL STANDARD GPS 230 REINSURANCE MANAGEMENT

Paragraph	Amendment made
40	<p>Where an insurer complies with the ‘two month rule’ in accordance with paragraph 42, the reinsurance declaration must confirm that there are:</p> <ul style="list-style-type: none"> <li>(a) no outstanding clauses, terms and conditions or other provisions yet to be agreed (that is, that no alterations or amendments to the contract are outstanding).; <del>and</del></li> <li>(b) <del>no differences in content or intention between the full treaty contract wording and the placing slip.</del></li> </ul> <p><del>Where such differences exist, these must be detailed in the reinsurance declaration. The insurer must set out the corrective action(s) being undertaken to seek to eliminate these differences.</del></p>
41	<p><i>The ‘inception date rule’</i></p> <p>The ‘inception date rule’ is that by the inception date(s) of <u>a reinsurance arrangement the regulated institution has written evidence each participating reinsurer is bound by the terms and coverage of the arrangement.</u> <del>the regulated institution’s reinsurance arrangements:</del></p> <ul style="list-style-type: none"> <li>(a) <del>the regulated institution has a placing slip(s) pertaining to these reinsurance arrangements, which:</del> <ul style="list-style-type: none"> <li>(i) <del>has been signed and stamped by all participating reinsurers; and</del></li> <li>(ii) <del>contains slip wordings or full treaty wordings agreed to by the regulated institution, with no outstanding terms and coverage to be agreed<sup>5</sup>; or</del></li> </ul> </li> <li>(b) <del>the regulated institution has a placing slip(s) pertaining to the reinsurance arrangements, which has been signed and stamped by all participating reinsurers, with no outstanding terms and coverage to be agreed<sup>6</sup>; or</del></li> <li>(c) <del>the regulated institution does not have a placing slip(s), but the regulated institution has a cover note(s) issued by the participating reinsurer(s) (in the case of direct placements with reinsurers) and/or from its appointed reinsurance broker (in the case of intermediated reinsurance placements). The regulated institution also must have systems to verify that the content of the cover note(s) is the same as the placing slip(s) agreed between the regulated institution and the reinsurer(s).<sup>7</sup></del></li> </ul> <p>Footnotes</p> <p><del><sup>10</sup> For this purpose, ‘slip wording’ means standard contractual wording that has been agreed upon in advance by the contracting parties and is used as the sole contractual document between the contracting parties. A slip wording may be issued by a reinsurance broker, or by a reinsurer(s).</del></p> <p><del><sup>11</sup> For this purpose, ‘placing slip’ means a summary of the reinsurance contract terms and conditions used either by an insurer for directly placed reinsurance or by a reinsurance broker, for intermediated placements, when offering a risk or risks to a reinsurer in advance of the preparation of the full reinsurance contract documentation.</del></p> <p><del><sup>12</sup> For this purpose, a ‘cover note’ means written confirmation issued by the reinsurer(s) or the appointed reinsurance broker to the regulated institution detailing</del></p>

	<del>the contract terms and conditions and details of the percentage of risk placed with each reinsurer.</del>
42	<p><i>The 'two month rule'</i></p> <p>The 'two month rule' is that within two months after the inception date(s) of the regulated institution's reinsurance arrangements:</p> <p><del>(a) — the regulated institution complies with paragraph 41(a); or</del>  <b>(b)</b> the regulated institution has in its possession full treaty contracts <b>wordings</b> (including any appending contracts <b>wordings</b> and/or schedules) that have been signed and stamped by all contracting parties, namely the regulated institution and all participating reinsurers.<sup>13</sup></p> <p>Footnote</p> <p><sup>13</sup> For this purpose, full treaty contract <b>wording</b> (including any appending contract <b>wordings</b> and/or schedules) is defined as a legally binding document on all parties that provides a complete, accurate and definitive record of all the terms and conditions and other provisions of the contract of reinsurance between the contracting parties.</p>
Att. A Paragraph 4	<p>At a minimum, the submission for approval must include:</p> <p><b>(a)</b> a draft contract <b>wording</b> or other draft proposed agreement and collateral or 'side' agreements, and any other documentation or information relevant to the transaction (including a written description of any verbal understandings and/or undertakings that are material to the operation of the arrangement); and</p>

**PRUDENTIAL STANDARD LPS 117 CAPITAL ADEQUACY: ASSET CONCENTRATION RISK CHARGE**

Paragraph	Amendment made
16	<p><i>Determining VAF for asset concentration limits that apply to non-reinsurance assets</i></p> <p>For the purpose of determining the asset concentration limits for non-reinsurance assets, VAF is determined as:</p> <p><b>(a)</b> the sum of the:</p> <ul style="list-style-type: none"> <li><b>(i)</b> total assets of the fund reported in the life company's statutory accounts;</li> <li><b>(ii)</b> value of adjusted reinsurance assets of the fund; and</li> <li><b>(iii)</b> value of insurance policy receivables of the fund; less</li> </ul> <p><b>(b)</b> the value of insurance and reinsurance contract assets of the fund reported in the life company's statutory accounts.</p> <p>The value of adjusted reinsurance assets must be determined by calculating the adjusted policy liabilities gross of reinsurance, and deducting the corresponding net of reinsurance values. Where a life company has entered into deferred premiums, deposit backs or funds withheld arrangements, the value of adjusted reinsurance assets must be <del>net of reduced by</del> the value of assets held in the statutory fund under these arrangements <u>(regardless of whether they meet the requirements for netting under paragraph 28)</u>.</p>

20	<p><i>Determining VAF for asset concentration limits that apply to reinsurance assets</i></p> <p>For the purpose of determining the asset concentration limits for reinsurance assets, VAF is determined as in paragraph 16 but with the following modifications:</p> <p>(a) the stressed value of reinsurance assets <del>(less any reinsurance liabilities that have been netted according to paragraph 28)</del> is added to VAF <u>in place of the value of adjusted reinsurance assets of the fund</u>; and</p> <p>(b) VAF excludes assets allocated to support:</p> <p style="padding-left: 40px;">(i) participating <b>traditional business</b> and participating <b>unbundled investment business</b> (gross policy liabilities, policy owners' retained profits, and shareholders' retained profits);</p> <p style="padding-left: 40px;">(ii) <b>non-participating benefits</b> with entitlement to <b>discretionary additions</b> (gross policy liabilities only).</p> <p>The stressed value of reinsurance assets <u>must be determined in accordance with paragraph 17. For the purposes of paragraph 20(a), where a life company has entered into deferred premiums, deposit backs or funds withheld arrangements, the stressed value of reinsurance assets must be reduced by the value of assets held in the statutory fund under these arrangements (regardless of whether they meet the requirements for netting under paragraph 28).</u></p> <p><u>Exposures</u></p>
44	<p>Note: this paragraph will be corrected to read '...after apply<u>ing</u> netting...'</p>