David Rush

31 October 2022

General Manager

Policy Development

Policy and Advice Division

Australian Prudential Regulation Authority

Email: Insurance.Policy@apra.gov.au

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

While I am broadly supportive of the proposed changes to the Life and General Insurance Capital (LAGIC) framework to integrate AASB 17, I am concerned about the last-minute changes that have been made to the general capital adequacy requirements (paragraph 12 of GPS 112 and paragraph 15 of LPS 112) – that capital base must at all times exceed capital requirements.

I acknowledge that the circumstances that these changes will address will only arise in a very few insurers, and that most others will be unaffected. Consequently, implementation for the many should not be delayed. Still, the changes proposed are very fundamental and I believe there should be ways for the few affected to be appropriately supervised without proper processes being subverted in this way. Because most insurers will be unaffected by the changes, they will give limited thought to what in my view are changes that are excessive, complicated and confusing.

I understand that APRA's supervision needs to consider the accounting position of insurers as well as their prudential strength. In the past, this has been largely unnecessary because accounting liabilities were based on prudential liabilities, and accounting equity and prudential capital were aligned. However, this is no longer the case as the two potentially diverge with the implementation of AASB 17. It is therefore appropriate that APRA's supervision considers the level of accounting equity as well as the capital base.

## Confusion

In the proposed changes, “net assets” have been used as the measure of accounting equity. However, in LPS 112, net assets less regulatory adjustments has been used to date as a proxy for the measurement of prudential capital in a fund where CET1 and AT1 can’t be readily identified. The proposed changes therefore create confusion as to whether the capital adequacy requirements (in paragraph 53) are in respect of accounting equity or prudential capital.

Furthermore, the new (accounting) requirements appear contradictory.

- In paragraph 15(d) the requirement in respect of the company is that 120% of net assets exceeds [only] **60%**of the PCA; and
- In paragraph 53(c) the requirement in respect of the fund is that 120% of net assets exceeds **80%** of the PCA.

Also, the requirement in paragraph 53(d) is that

> 120% of net assets + T2 capital exceeds the PCR.

Yet, the requirement in paragraph 53(b), combined with the definition in paragraph 51 is that

> 100% of net assets – regulatory adjustments + T2 capital exceeds the PCR.

Therefore, if the requirement in paragraph 53(b) is met, the additional requirement in paragraph 53(d) seems to be simply ensuring that the regulatory adjustments are of comparable size relative to net assets. It is therefore unclear what this additional requirement is assessing.

## Quality

It is noted that the requirements in relation to the quality of capital appear to have been replicated in the proposed additions. While it is appropriate to assess the quality of prudential capital, it is unclear why the quality of accounting equity needs to be assessed as well.

## Consistency

Finally, it is noted that for general insurers the prudential capital (represented by CET1, AT1, etc.) is independent of the accounting equity (represented by net assets). This is because of the adjustment to CET1 for general insurers in GPS 112 paragraph 31(f) for any difference between accounting liabilities and prudential liabilities (as per GPS 340). Thus, the new requirements in paragraph 12 of GPS 112 are clearly assessing accounting equity.

However, there is no such adjustment for life insurers in LPS 112 paragraph 33. The equivalent adjustment is made in paragraph 25 of Appendix B of LPS 112. While the effect is the same, the presentation in the standards for each industry is different. Furthermore, it means that references to “net assets” in the requirements of paragraph 53 of LPS 112 are not clear (as noted above) - on their own they are assessing accounting equity, but in conjunction with regulatory adjustments any

changes in accounting liabilities cancel out and they are assessing prudential strength.

(This is ignoring the impact on net assets of changes in accounting assets, and whether changes in prudential liabilities should be consistent with changes in capital requirements to ensure that LAGIC framework remains appropriately calibrated.)

### Recommended Solution

In conclusion, it is noted above that only a few insurers will be affected by this change. Yet, it is appropriate for APRA to assess accounting equity. The recommended solution is therefore to consider the accounting position elsewhere, leaving GPS 112 and LPS 112 to solely consider the prudential strength of insurers. For example, a paragraph might be included in GPS110 (paragraphs 8-16) and LPS 110 (paragraphs 10-18) requiring insurers to include the adequacy of their accounting equity in their ICAAP. In this way, specific limits on accounting equity can be appropriately monitored by APRA without the need to set “one-size-fits-all” limitations on accounting equity. Specific limits need only be set for prudential capital, as currently.

In the meantime, any specific limitations on accounting equity can be properly assessed and exposed in accordance with proper due process for such a fundamental change.

*******************************************

Should you wish to discuss this submission further please do not hesitate to contact me via the contact details above.

Yours sincerely,

David Rush