

For the attention of:
General Manager, Policy
Policy Development
Australian Prudential Regulatory Authority

By email: PolicyDevelopment@apra.gov.au

Gallagher Re, Australia and New
Zealand
Level 36, 60 Margaret Street
Sydney, 2000,
NSW
Australia

14th February 2025

Dear Sir/Madam,

Consultation on targeted adjustments to general insurance reinsurance settings

Gallagher Re welcomes the opportunity to provide feedback on APRA's proposed adjustments to the GI reinsurance framework.

As a reinsurance broker, our role is to support clients in transferring risk to local and international markets, via a broad range of reinsurance vehicles, as efficiently and effectively as possible. In Australia, the dominant vehicle to achieve this has been traditional treaty reinsurance with little take-up of alternative reinsurance solutions such as catastrophe bonds. Targeted adjustments to the reinsurance capital settings that make it easier for insurers to access alternative reinsurance capacity are therefore welcomed.

Whilst more detail is required on how the targeted proposals would be implemented, our observations below address the likely impact they would have in making reinsurance capacity more accessible and our comments are subject to the disclaimer set out at the end of this letter. We trust that feedback on other aspects e.g. their impact on financial resilience, will be covered by other industry stakeholders.

All Perils Requirement

The current standard defines the Natural Perils Vertical Requirement (NP VR) as the greater of the Natural Perils Probable Maximum Loss (NP PML) less reinsurance recoveries; and the 'net whole-of-portfolio loss' where the NP PML is defined as the 1 in 200-year *whole-of-portfolio* single event loss. The targeted adjustment proposed is to allow insurers to determine the NP PML as the largest 1-in-200-year single-peril loss, rather than whole-of-portfolio; and buy all-perils reinsurance to that level.

We would expect the impact of this proposal to vary considerably depending on the insurer's portfolio composition as the peak exposure may be driven, to varying degrees, by more than one peril. We do note however, that this influence has lessened with the commencement of the Cyclone Reinsurance Pool.

Allowing insurers to determine the limit of catastrophe programmes by reference to a single peril, provides an insurer with greater flexibility in managing its catastrophe risk appetite, although the impact of this proposal may be limited if the requirement to purchase to the 'net whole-of-portfolio loss' remains.

However, requiring insurers to purchase all-perils reinsurance even in cases where exposure is dominated by one peril, does little to encourage traditional reinsurance capacity that may have appetite for the peak peril in question, but little appetite for other perils exposure. Similarly, alternative reinsurance solutions e.g. parametric solutions, often cover single perils and hence this would do little to encourage access to

this type of capacity. Removing this requirement would provide insurers with greater flexibility in how they design their reinsurance programmes as well as encouraging greater access to reinsurance.

We also note that the impact of single-peril or all-perils coverage in influencing reinsurance pricing for the upper layers of catastrophe programmes is limited as minimum rate-on-line considerations dominate.

Reinstatement Requirement.

The current standard requires an insurer to have a contractually agreed reinstatement of its catastrophe reinsurance arrangements that reduces its natural perils vertical requirement. The proposal is to reduce the return period up to which a contractually agreed reinstatement is required, from 1 in 200-years, to something less e.g. 1 in 100-years, effectively recognising that the likelihood of having two, 1 in 200-year losses in a 12-month period, is very low.

We support this proposal. The current requirement results in reinstatement cover that would only be exhausted at a return period well in-excess-of 1 in 200-years. In addition, this requirement is a significant obstacle in attracting alternative reinsurance capital, which is often deployed in the form of single-shot capacity i.e. without the ability to reinstate. The proposed adjustment would therefore help improve access to alternative reinsurance capacity without materially impacting financial resilience, noting insurers' Boards may choose a higher level of reinstatement cover than the APRA prescribed minimum amount.

The proposal may also help attract additional traditional capacity with some positive influence on pricing although this is unlikely to be material as minimum rate-on-line considerations dominate for the upper layers of catastrophe programmes.

The choice of return period would ideally be low enough to make a material difference without unduly impacting financial resilience.

Reinstatement Premium Requirement.

The current standard requires insurers to include the cost of reinstating reinsurance cover (in the case where reinsurance includes a paid reinstatement) in determining the Natural Perils Vertical Requirement (NP VR). The proposed targeted adjustment is to remove the requirement to include the reinstatement cost in determining the NPVR thereby reducing the NP VR in the case where reinsurance includes paid reinstatements.

Whilst this proposal is unlikely to materially improve access to alternative risk transfer solutions as these are primarily deployed on a 'single-shot' basis, it is likely to improve access to traditional reinsurance capacity with some markets unable to provide cover on a prepaid basis. This proposal could therefore provide insurers with more flexibility and choice when evaluating the cost of reinsurance cover on a paid or prepaid basis.

A further observation is that the scope of this adjustment appears to be restricted to the NP VR and not the Natural Perils Horizontal Requirement (NP HR), noting that the impact of such a change would be limited given the ICRC is the greater of the NP VR and the NP HR.

Other Requirements and Technical Issues.

The various proposals appear sensible and, whilst small in isolation, collectively should help streamline existing approval processes and reduce the volume of referrals to APRA providing that they can be implemented easily and consistently by insurers.

One reinsurance capital setting not addressed in APRA's consultation is the requirement for additional capital to be held in relation to reinsurance assets due from non-APRA authorised reinsurers, if not backed by collateral. The requirement to post collateral in Australia is a significant obstacle for reinsurers who are often considering opportunities with similar risk-return profiles across many jurisdictions. The consequences for insurers placing cover with non-APRA authorised reinsurers who do not post collateral, are often considered disproportionate to the counterparty risk presented. We suggest further consideration could be given to refining the current approach to improve access to non-APRA authorised reinsurance capacity.

We'd also welcome clear guidance on the treatment of parametric reinsurance covers within the reinsurance capital settings, in particular, the evaluation of basis risk. This would provide clarity to insurers and their advisers on this increasingly relevant risk-transfer tool and enable clients to more easily access other forms of risk transfer.

Yours faithfully,



CEO Gallagher Re, Australia and New Zealand

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Signed on behalf of Gallagher Re

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