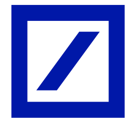
Deutsche Bank



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By Email: InsuranceCapital@apra.gov.au

Dear Mr Littrell,

Submission for discussion of the Draft Information Paper: Asset Risk Charge

We write in reference to the *'Draft Information Paper: Asset Risk Charge'* section in APRA's recent publication '*Consultation on draft prudential practice guides'*. In conversations with Deutsche Bank's clients we have repeatedly encountered uncertainty around the treatment of standard derivative instruments. As the new LAGIC framework focuses on the management of asset and liability mismatches instruments such as forwards/futures, swaps and options will play a vital role in handling asset liability mismatches.

In the following we have compiled a set of recurring discussion topics around the treatment of derivatives for which we are seeking clarification.

Default stress

In regards to the formulation *"APRA expects an insurer to assess its potential post-stress default risk exposures to reinsurers and other counterparties in its ICAAP."* Is this assessment for informational purposes only or will the post-stress default risk exposure be factored in to the default risk charge? As the latter would make the default risk charge a function of the up or down stress scenario rather than a constant. Does there exist any guidance as to which combination of scenarios is to be used for the aggregation of market risk and default risk?

Default stress & Collateralisation

Paragraph 72 (Paragraph 64) in LPS (GPS) 114 reads: *"For other assets, the default factor must be applied to the amount of loss that would be incurred if the counterparty defaulted and no recovery was made."*

We ask APRA to clarify this statement by calculating the applicable default stress for a single A counterparty for the following examples:

1) How is the above statement interpreted for a derivative with a zero present value (PV), if the derivative is not collateralised?

2) How is the above statement interpreted for a derivative with a PV of A$10mn to the insurance company, if the derivative is not collateralised?

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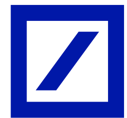

Options

In conversations with our clients we have noticed uncertainty about the impact of equity / currency options on the equity / currency risk charge. Two conceivable methods we have heard are:

1) Calculating and netting the delta exposure of the option and the underlying position
2) Capping the capital charge at the strike level. For example a put option struck at 85% of spot would cap the maximum loss at 15% and therefore the capital charge at 15%.
3) Capping the capital charge at the strike level and applying the default risk charge on the difference between the original equity stress and the strike level. For example, for A$100mn equity position at a time of a 38% equity stress a put option with a single A counterparty struck at 85% of spot, would result in a risk charge of A$15mn in the equity module and 4% * (A$38mn-A$15mn) = 4% * A$23mn = A$0.92mn in the default module.

If you like to discuss the above topics or have further questions, please contact

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Yours sincerelv

Deutsche Bank Insurance Team