

20 December 2012

Australian Prudential Regulation Authority
Via email: InsuranceCapital@apra.gov.au

Dear Sir/Madam,

Submission on Prudential Practice Guides and Information Paper

Thank you for the opportunity to make a submission on the prudential practice guides (PPGs) on ICAAP, supervisory review and ICRC, and also the asset risk information paper. This submission is made on behalf of Finity Consulting.

In general, we find the PPGs and information paper useful documents. However, we do have a number of comments as set out below.

1. In CPG 110 in respect of ICAAP, paragraph 28 lists the range of actions that may be available to a regulated institution to protect its capital position. We think that an important action that has been omitted from this list is for the regulated institution to increase premiums
2. For GPG 116 in respect of the ICRC, we think that the PPG appears to be written from the perspective of being suitable for large insurers, with many more resources available to them (including data, modelling tools, and financial resources), than for small- to medium- sized insurers. Some examples of this are –
 - The discussion of the whole-of-portfolio approach, particularly paragraphs 24 to 27
 - The discussion of catastrophe models in paragraphs 88 to 108.

We feel that in these areas that APRA are perhaps being too prescriptive, rather than allowing a principle's based/best endeavours approach.

3. It would be helpful if GPG 116 clarified whether the future cost of reinsurance should be included in the premiums liability offset or not.

Paragraph 48 of GPG 116 describes the PL offset as “the annualised net central estimate of the net premiums liability plus its risk margin and Insurance Risk Charge arising from accumulations of exposures to catastrophic losses. *It includes all components of the central estimate and risk margin* including, for example, claims handling expenses and non-reinsurance recoveries.” (emphasis added)

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Paragraph 48 of the prudential standard GPS 320 states that, “For the calculation of premiums liabilities, the premiums liabilities must include the purchase cost for reinsurance arrangements where existing reinsurance arrangements are insufficient to fully cover the exposure period for premiums liabilities.”

In practice, where the reporting date corresponds to the catastrophe reinsurance program renewal date, a DRE will have been created and the future cost of reinsurance will be nil. However, if the catastrophe reinsurance program renewal date is different to the reporting date, the premium liabilities will include at least some allowance for the future cost of reinsurance.

Could APRA confirm whether the intention of paragraph 48 of GPG 116 is that future cost of reinsurance should be included in the PL offset where it is part of the net premiums liabilities? We think that it should not be.

4. It would be helpful if GPG 116 clarified which risk margin should apply in the calculation of the PL offset.

Paragraph 52 of GPG 116 says “For the purposes of determining the PL offset for NP HR, the risk margin to be included is the margin determined by the Appointed Actuary as part of the insurance liability valuation.”

Our understanding is that it should be the risk margin for the class as a whole (as opposed to a higher risk margin that may apply to the catastrophe claims component of the premium liability).

5. We have a question on the Asset Risk Charge Information Paper regarding the recognition of tax benefits as discussed on page 11. The second sentence of the second paragraph on page 11 says that the “ATO does not allow current tax assets arising from losses in the value of fixed interest assets to be offset against current tax liabilities arising from capital gains on equity and property assets”. We are not tax experts, but our general understanding of taxation law was that an ordinary income loss would be offset against a capital gain, but a capital loss was not deductible from an ordinary income gain.

We understand that this submission will be made available to the public on the APRA website.

We would be happy to discuss any of these comments with APRA.

Yours sincerely



Karen Cutter
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