27 July 2012

Mr Neil Grummitt
General Manager, Policy Development
Australian Prudential Regulation Authority
GPO Box 9836
SYDNEY NSW 2001

Dear Neil

Submission on APRA's LAGIC Proposals – May 2012 Response Paper

This submission sets out Finity's comments on the latest version of proposed changes to capital standards, as set out in APRA's "Response to Submissions – Review of Capital Standards for General Insurers and Life Insurers" dated 31 May 2012.

We have previously prepared submissions to APRA on this topic, our most recent being contained in our letter "Submission of APRA's LAGIC Proposals" dated 1 March 2012 ('our previous submission'). We thank APRA for the opportunity to make a further submission on this important topic.

Implementation Questions

We understand that the revised capital framework will be effective from 1 January 2013, with the first reporting under the revised framework commencing from the first quarter in 2013 (i.e. the quarter ending 31 March 2013). Could you please confirm whether this includes all insurers or only those with balance dates on 31 March 2013? That is, for a 30 June balancing company, for example, will they have to prepare their 31 March 2013 quarterly returns on the new basis or the old basis?

Also, in relation to the ICAAP report, we understand that the timing has been de-coupled from the year-end balance date, which is a welcome change. However, could you please clarify what this means for the timing of the first ICAAP report? Does APRA require that the first ICAAP report be prepared any time within the first year of the new capital framework applying i.e. before end of 2013, which would mean APRA would receive it by 31 March 2013 at the latest?

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Change in timing of ILVRs and FCRs

In our previous submission, we included some quite detailed discussion on our reasons against APRA's proposal to bring forward the timing of the ILVR and FCR reports to be due within three months of insurers' balance dates. We are disappointed that APRA have continued to adopt the three month timeframe in the latest package. We continue to be of the view that –

- it will be difficult to complete both the ILVR and FCR to the current level of quality within three months
- shortening the timeframe will detract significantly from the quality of the discussion between the AA and management and the Board of insurers on the FCR, thereby reducing the value of this report to both insurers and APRA. This is at odds with APRA's assertion in the Response Paper that the 'three-month deadline will increase their usefulness because they will be considered closer to year-end'. We disagree with this assertion
- the reporting requirements of General Insurer AAs are not equivalent to those of Life Insurer AAs, hence APRA's 'harmonisation' rationale for the change is flawed. General Insurer AAs are required to prepare two reports (ILVR and FCR) compared to the one report prepared by Life Insurer AAs (FCR), and the general insurance FCR is more wide-reaching that the life insurance FCR.

ICRC

We find the new wording of paragraphs 18(a), 21 and 23 of GPS116 in relation to the calculation of the NP VR to be very confusing (and similarly for the corresponding paragraphs that relate to the H3 and H4 calculations). We would have liked to provide APRA with some alternative wording that we would find more helpful, but we found that the words of the standard (and the Response Paper) were so confusing that we are unsure of APRA's intention. We are unsure whether the intention is to try to draw the distinction between –

1. a single-site, single peril approach versus a multi-event, multi-site (whole-of-portfolio) approach

OR

2. gross losses at the 0.5% probability of occurrence less RI recoveries, versus directly calculating the net losses at the 0.5% probability of occurrence, with both calculations performed using a whole-of-portfolio approach.

Further clarity around what is expected here is necessary.

We also request that APRA provide further clarity around the elements to include in the calculation of the PL Offset. In undertaking work for our clients, a few questions have cropped up as to what exactly to include. Specifically, we would like some clarity on whether the PL Offset should include –

- The future cost of reinsurance (FCoR) – we think that this *should not* be included in the PL Offset?
- Claims handling expenses (CHE) - we think that this *should* be included in the PL Offset?

GPS320

There is a new paragraph 14 in Attachment A of GPS320 that says the AA must 'explain … their assessment of the gross uncertainty in the estimate of insurance liabilities. The explanation may include commentary on the gross uncertainty at the 75% probability of sufficiency level, or other analysis such as measures of skewness or potential gross-loss scenarios.'

This description implies that a significant amount of work would need to be undertaken in quantifying the level of uncertainty in the gross insurance liabilities, whereas we expected to see wording that allowed a more qualitative discussion of the uncertainty. We would prefer to see more flexibility in the wording of this paragraph such that formal quantification of the uncertainty in the gross liabilities is not required.

[As an aside, a more correct description in paragraph 14 would be "assessment of the ~~gross~~ uncertainty in the gross estimate of insurance liabilities"]

We have two other minor comments in respect of GPS320 –

- in paragraph 31(b), the Actuary is required to comment in the ILVR on the methods and approach taken to calculate the NP HR PL offset, the OA VR premiums liability offset and the LMI premiums liabilities offset. We feel that this commentary more naturally belongs in the FCR rather than the ILVR.

  Similarly, paragraphs 17 and 19(b) of Attachment C discuss how the Actuary must include comments on the ICRC in the Group ILVR – again, with think this would fit more naturally within the FCR.
- in Attachment B on Matters to be included in an FCR, we feel that the second half of point (h) is very specific and not in keeping with the rest of the standard and could be dropped i.e. it should read –

  "(h) an assessment of the adequacy of the calculation of the insurer's ICRC"

Disclosure Requirements

Paragraph 40 of GPS110 sets out the items that an insurer needs to disclose annually, including item (i) that says the 'components of (the insurer's) prescribed capital amount'.

Set out below is an example of what we think this disclosure would look like. Can you please confirm whether this is what APRA expects?

Table 1 – Example Disclosure Requirements

Item	Value
Common Equity Tier 1 Capital (CET1)	10,000,000
Regulatory adjustments to CET1	(50,000)
	9,950,000
Additional Tier 1 Capital	1,000,000
Regulatory adjustments to Additional Tier 1	0
	1,000,000
Tier 2 Capital	200,000
Regulatory adjustments to Tier 2	(50,000)
	150,000
Total Capital Base	11,100,000
Asset Risk Charge	2,000,000
Asset Concentration Risk Charge	400,000
Insurance Risk Charge	3,000,000
Insurance Concentration Risk Charge	700,000
Operational Risk Charge	600,000
Aggregation Benefit	(1,000,000)
Prescribed Capital Amount	5,700,000
Transition Amount	200,000
Total Prescribed Capital Amount	5,900,000
Capital Adequacy Multiple	188%

We would be pleased to answer any questions you have on this submission; I can be contacted on [redacted]. We would also be happy to meet informally with APRA staff to discuss our comments.

Yours sincerely

K. Cutter

Karen Cutter