



22 September 2010

To all Locally Incorporated General Insurers and Authorised Non-Operating Holding Companies (NOHCs) under the *Insurance Act 1973*

REFORMS TO GLOBAL MINIMUM CAPITAL STANDARDS FOR BANKS - IMPACT ON GENERAL INSURERS AND NOHCs

As you would be aware from our discussion paper dated May 2010 and other communications, APRA is reviewing its general insurance and life insurance capital frameworks. We are also engaged in an extensive and globally coordinated effort to reform the capital framework for authorised deposit-taking institutions (ADIs). This letter touches upon some cross-industry coordination issues for capital definitions.

Background

Since 2002 APRA has sought to maintain a broadly consistent approach to the definition of capital for general insurers and authorised deposit-taking institutions. This is the case for both Level 1 insurers and Level 2 insurance groups. The definition of eligible capital for general insurers is also being considered as part of the broader review of the general insurance and life insurance capital standards. As part of this review APRA is undertaking extensive consultation with the insurance industry.

On 12 September 2010, the Group of Governors and Heads of Supervision (GHOS), the oversight body of the Basel Committee on Banking Supervision, announced a substantial strengthening of existing capital requirements for banking institutions. The full details of the reforms can be located on the Bank for International Settlements' website www.bis.org.

In brief, the reforms will increase the minimum ordinary equity capital requirement and require institutions to hold an additional capital conservation buffer of ordinary equity to withstand future periods of stress. The total Tier 1 capital requirement will also be raised. The new capital requirements are to be phased in from 1 January 2013. These capital reforms will be presented to the G20 Leaders Summit in Seoul in November. The Basel Committee intends to publish its final package of reforms in December 2010.

As a member of the Basel Committee, APRA has been actively involved in developing these global reforms and it fully supports the package announced by the GHOS. APRA has begun work developing draft prudential standards, prudential practice guides and reporting requirements to give effect to these reforms for banking institutions in Australia. APRA anticipates that it will begin consultation for banking institutions on the reforms in 2011 and continue into 2012. As part of this consultation, APRA will consult on appropriate transitional arrangements for ADIs.

Eligible capital

On 9 April 2010, we wrote to you in relation to the Basel Committee's December 2009 consultative document *Strengthening the resilience of the banking sector* which set out proposals to strengthen global capital requirements for banks. In that letter APRA flagged that capital instruments issued subsequent to 9 April, and that are clearly inconsistent with the proposals contained in the BCBS proposals, would be unlikely to be eligible for transitional arrangements. A number of regulated institutions have sought further clarity on this matter.

APRA can confirm that:

- Tier 1 and Tier 2 capital instruments that are issued by insurers subsequent to the date of the April 2010 letter and contain so-called ‘incentives to redeem’ or other features clearly at odds with the Basel 2009 proposals will not be eligible for whatever transitional arrangements are ultimately determined; but
- capital instruments issued subsequent to the April 2010 letter need not, at this stage, include clauses that give effect to the Basel Committee’s proposals to improve the loss-absorbency of regulatory capital, as described in the Consultative Document of 19 August 2010.

The Basel Committee’s Consultative Document of 19 August 2010 *Proposal to ensure the loss absorbency of regulatory capital at the point of non-viability* forms part of the ongoing regulatory capital review being undertaken by the Basel Committee. It is likely that APRA will continue its policy of equivalent capital definitions between the ADI and insurance sectors, including any further reforms agreed by the Basel Committee as part of this capital review. We will provide additional information on further developments, as that information comes to hand.

Yours sincerely,



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