

24 February 2012

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

Dear Sir

I write in response to APRA's 'Review of capital standards for general insurers and life insurers' issued on 9 December 2011.

RACQ Insurance (RACQI) welcomes the introduction of capital standards that will improve the monitoring of risk sensitivities and is in general agreement with the proposed standards as they are currently drafted.

There are two key points that RACQI would like to further address following the receipt of the Draft Prudential Standards.

### **Internal Capital Adequacy Assessment Process**

We understand from industry discussions that APRA is aware that the Internal Capital Adequacy Assessment Process to be implemented by insurers poses some timing issues to ensure readiness for the 1 January 2013 implementation date. RACQI has in place a comprehensive Capital Management Plan, which incorporates triggers, monitoring practices and is regularly reviewed against business performance and outlook.

The Prudential Practice Guide (PPG) currently scheduled for release in September 2012 will be a key component and reference tool for Management to ensure the process is implemented to APRA's satisfaction. We concur with industry sentiment that an earlier release of the PPG would be desirable.

### **Insurance Concentration Risk Charge**

We are aware that APRA's views on aggregate catastrophe reinsurance have altered over recent years and that during 2011 a directive was issued that such cover could not count towards eligible reinsurance recoveries when calculating the company's Maximum Event Retention.

The draft standard *GPS116 Capital Adequacy: Insurance Concentration Risk Charge* indicates that reinsurance recoveries from aggregate reinsurance cannot be considered in the H3 and H4 Horizontal calculations (paragraphs 24 & 29). Providing agreement of the methodology to determine the credit with APRA potential relief is then provided (as detailed in section 32 *Aggregate Offset*).

The Insurance Concentration Risk Charge (ICRC) under LAGIC will be sensitive to available reinsurance recoveries attaching to aggregate reinsurance.

Capital benefits pertaining to reinsurance is one factor that is considered when placing the company's catastrophe reinsurance program. While it is not the determining factor it does play a central role and uncertainty around its ability to contribute to minimising the capital charge attaching to the ICRC causes concern.

Throughout the LAGIC process APRA has commented that in practice the impact of the revised standards will be less than indicated through the studies conducted, as insurers revise their business and capital management strategies. Placement of aggregate reinsurance is a critical element of an enhanced capital management strategy to lessen the impact of the revised standards, whilst also maintaining and/or improving the financial soundness of regulated insurers. The current lack of clarity with aggregate reinsurance appears in conflict with APRA's view that insurers will adjust their business and capital management strategies to meet the new requirements. Insurers may be reluctant to include aggregate reinsurance within the catastrophe reinsurance programs without certainty of its capital benefit.

RACQ Insurance would like to better understand how the requirement to agree the methodology for determination with APRA will be undertaken in practice. Will APRA be able to provide a prospective approval based on existing treaties and their structure / wording of renewing cover or draft reinsurance treaty slip ahead of placement? Alternatively does APRA intend to issue a PPG that sets out the key elements of an aggregate reinsurance contract that would meet APRA's methodology for allowing the cover to contribute to an Aggregate Offset? This would reduce uncertainty and potential significant shifts in solvency as insurers place their catastrophe reinsurance programs.

We look forward to receiving further updates from APRA in respect of these changes, however should you like to discuss the feedback provided please do not hesitate to contact me on

Yours faithfully



**Michael Lonergan**  
Chief Financial Officer