TAL

14 February 2012

Mrs Helen Rowell
General Manager, Policy Development
Australian Prudential Regulation Authority
400 George Street
Sydney NSW 2000

Dear Helen

Re: Review of Draft Prudential Standards for General Insurers and Life Insurers

Thank you for the opportunity to submit comments on the APRA Draft Prudential Standards – December 2011 and the Response to Submissions dated 9 December 2011. This letter contains our submission based on our review of the draft Prudential Standards for Life Insurers.

Although we still have some concerns around the content of the latest APRA response paper and draft standards, we acknowledge the steps APRA has taken to address the industry concerns raised as part of previous submissions.

In particular we welcome the fact that the following items have been maintained in the draft capital standards and would encourage APRA to maintain them in the final standards:

- The larger product groupings at which the comparison of termination value and stressed liabilities is made which is consistent with the actual risk exposure; and

- The view that an insurer that is part of a tax consolidation group may not recognise tax benefits whose value is contingent on payments from other entities within the group.

We reiterate our comments from previous submissions that policyholders should not pay higher premiums to support unnecessarily high capital levels and capital levels should be appropriate to policyholder protection requirements and not exceed what is required. We continue to be concerned that increased capital for reinsurance policies will result in additional costs to policyholders. This effect should be offset by a lowering of the capital requirements for reinsurance assets of insurers given the strengthening of the reinsurers' capital strength.

We have outlined below our other on-going areas for concern (some of which have been included in previous responses) along with recommendations which we believe could improve the capital standards in line with APRA's objectives.

Discount rate and liquidity premium

We reiterate our support for the introduction of a liquidity premium adjustment to the discount rate for disability income claims in course of payment, particularly where benefits are often payable until age 65, as the liability cannot be surrendered for a specific value.

We consider that this can be achieved in a "clear and unambiguous" way as the stated criteria in APRA's response.

Recommendation

We recommend extending the liabilities to which liquidity premium adjustments apply to include disability income claims in course of payment for the reason outlined above and do not believe that this extension would lead to any misinterpretation or ambiguity regarding the standards.

Asset Risk Capital Charge – Reinsurance Default Risk

The proposed draft capital standards require a charge on reinsurance assets starting at 2% of the value of reinsured capital requirements. This is double the amount that was originally proposed in the technical papers associated with QIS1. We consider this amount to be excessively prudent given that most reinsurers used by the Australian life industry are APRA regulated companies and as such will be holding capital under the same standards.

Recommendation

We recommend a better approach would be to charge a default risk charge on APRA regulated entities that reflects APRA's stated loss criteria (i.e. 0.5%).

Aggregation benefit

We understand that APRA intends to conduct a further review of the correlation factors used to determine the aggregation benefit for diversification between asset and insurance risks. We believe that these correlation factors along with the insurance risk diversification factors and the separate asset risk correlation matrix will make it challenging when assisting the Board to understand the underlying drivers of capital.

Recommendation

We recommend that APRA reviews the parts of the proposed guidelines (such as the correlation factors mentioned above) which may be overly complex relative to the benefits gained. One alternative would be to calculate separate asset and insurance risk charges at a lower level with an implicit allowance for diversification (as per the current standards).

Timing of implementation of new standards

We note that APRA will be releasing draft prudential practice guides (PPGs) in September 2012 which will give additional information for the ICAAP and supervisory adjustments and release final reporting standards in October 2012. As an insurer with a March year end for reporting purposes we want to highlight to APRA the risk that this short time frame will bring in successfully implementing all aspects of the new capital standards by 1 January 2013. In particular, any new guidance given on ICAAP in September will emerge late in our planned timeframe of engaging the Board in reviewing and approving our ICAAP.

In order to enable insurers to meet the 2013 timescale, we encourage APRA to continue to provide on-going guidance and feedback on their expectations regarding the ICAAP during 2012.

I would like to thank APRA for the opportunity to make a submission on the response paper and the draft prudential standards and we welcome the collaborative approach that APRA has taken.

We are available to discuss the points discussed in this letter with you in more detail if you wish.

Kind regards

Jim Minto
Managing Director
TAL Limited