Discussion Paper

Refinements to the prudential framework for general insurance groups

16 May 2011

Preamble

APRA is proposing refinements to the prudential and reporting framework for the supervision of general insurance groups. These proposals make minor amendments to the prudential standards and align aspects of the reporting framework with that for individual APRA-authorised general insurers.

Accompanying this discussion paper are draft prudential standards, reporting forms and reporting instructions which contain the detail of the proposed amendments.

APRA is inviting comments on the proposals in this paper. Written submissions should be sent to GILevel2@apra.gov.au by 15 July 2011 and be addressed to:

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Important

Submissions will be treated as public unless clearly marked as confidential and the confidential information contained in the submission is identified.

Submissions may be the subject of a request for access under the *Freedom of Information Act 1982* (FOIA). APRA will determine such requests, if any, in accordance with the provisions of the FOIA.

Information in the submission about the regulated entity which is not in the public domain will be protected by section 56 of the *Australian Prudential Regulation Authority Act 1998* and therefore will ordinarily be exempt from production under the FOIA.

Contents

Glossary

AASB 1023	*Australian Accounting Standard AASB 1023 General Insurance Contracts*, the principal accounting standard for the accounting treatment of general insurance contracts
Group Actuary	Group Actuary as defined in *Prudential Standard GPS 311 Audit and Actuarial Reporting and Valuation: Level 2 Insurance Groups*
APRA-authorised NOHC	A non-operating holding company authorised by APRA in accordance with the *Insurance Act 1973*
Capital base	Capital eligible under *Prudential Standard GPS 111 Capital Adequacy: Level 2 Insurance Groups* for meeting the Minimum Capital Requirement
GRF 120.0_G	*Reporting Form and Instruction Guide for GRF 120.0_G Determination of Capital Base (Level 2 Insurance Group)*
GRF 210.0_G	*Reporting Form and Instruction Guide for GRF 210.0_G Outstanding Claims Liability – Insurance Risk Charge (Level 2 Insurance Group)*
GRF 210.1_G	*Reporting Form and Instruction Guide for GRF 210.1_G Premiums Liabilities – Insurance Risk Charge (Level 2 Insurance Group)*
GRF 300.0_G	*Reporting Form and Instruction Guide for GRF 300.0_G Statement of Financial Position (Level 2 Insurance Group)*
GRF 301.0_G	*Reporting Form and Instruction Guide for GRF 301.0_G Reinsurance Assets and Risk Charge (Level 2 Insurance Group)*
GRF 302.0_G	*Reporting Form and Instruction Guide for GRF 302.0_G Statement of Financial Position by Region (Level 2 Insurance Group)*
GRF 310.0_G	*Reporting Form and Instruction Guide for GRF 310.0_G Income Statement (Level 2 Insurance Group)*
GPS 001	*Prudential Standard GPS 001 Definitions*
GPS 111	*Prudential Standard GPS 111 Capital Adequacy: Level 2 Insurance Groups*
GPS 114	*Prudential Standard GPS 114 Capital Adequacy: Investment Risk Capital Charge*
GPS 221	*Prudential Standard GPS 221 Risk Management: Level 2 Insurance Groups*
GPS 310	*Prudential Standard GPS 310 Audit and Actuarial Reporting and Valuation*
GPS 311	*Prudential Standard GPS 311 Audit and Actuarial Reporting and Valuation: Level 2 Insurance Groups*
Level 1 insurer	A general insurer authorised under the *Insurance Act 1973*
Level 1 prudential framework	APRA's supervisory framework that applies to a Level 1 insurer on a stand-alone basis. It encompasses the *Insurance Act 1973, Insurance Regulations 2002*, prudential standards and reporting standards

Level 2 insurance group or Level 2 group	A consolidated general insurance group headed by either an APRA-authorised Level 1 insurer or an APRA-authorised NOHC and including all general insurance controlled entities (both domestic and international) and any other controlled entities integral to its general insurance business. The Level 2 insurance group includes any entities APRA determines to be within the Level 2 insurance group and does not include entities that are treated as non-consolidated subsidiaries. The definition of a Level 2 insurance group is detailed in GPS 001
Level 2 prudential framework	APRA's supervisory framework that applies to a Level 2 insurance group. It encompasses the *Insurance Act 1973, Insurance Regulations 2002*, prudential standards and reporting standards
MCR	Minimum Capital Requirement as detailed in GPS 111
Reporting framework	The reporting framework encompassing the applicable reporting standards made under the *Financial Sector (Collection of Data) Act 2001*

Executive summary

This discussion paper proposes a number of refinements to the prudential and reporting framework for general insurance groups (Level 2 groups). It also proposes to align aspects of the reporting framework between Level 2 groups and individual APRA-authorised general insurers (Level 1 insurers).

The proposals are divided into two chapters. After the Introduction, Chapter 2 covers the proposed refinements to the Level 2 prudential framework, which address minor issues that have been identified as part of implementation of the Level 2 supervision framework. These proposals make amendments to the Level 2 group prudential standards and consequential changes to the current reporting standards.

Chapter 3 covers the proposed refinements to the Level 2 reporting framework. The proposed refinements aim to align aspects of Level 2 reporting with the reporting framework for Level 1 insurers, for which changes were made in July 2010.[1] Level 2 group reporting on financial position and income broadly aligns with Australian accounting standards and a consistent approach was implemented for Level 1 insurers in 2010. In some aspects, however, there are differences between the Level 1 and Level 2 reporting frameworks and the alignment of these frameworks is proposed. Chapter 3 also proposes clarifications to the reporting forms and instructions to address issues that have been identified since the reporting standards became effective in August 2009.

The proposals in this paper are separate to the proposals relevant to Level 2 groups that were outlined in APRA's March 2011 response to submissions on the review of capital standards for general insurers and life insurers.[2]

Subject to the submissions received on this consultation package, final prudential standards and reporting standards implementing the proposals outlined in this paper are expected to be effective from 1 December 2011. The first half-yearly and annual reporting based on the proposed revised reporting requirements will be for the reporting period ending 31 December 2011.

APRA invites comments on the proposals in this paper. Written submissions should be sent to GILevel2@apra.gov.au by 15 July 2011 and be addressed to:

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1 www.apra.gov.au/Policy/Proposed-changes-to-general-insurance-prudential-reporting-June-2010.cfm.

2 www.apra.gov.au/Policy/Review-of-capital-standards-for-general-insurers-and-life-insurers-May-2010.cfm.

Chapter 1 – Introduction

During 2008 and 2009, APRA finalised its prudential framework for the supervision of general insurance groups domiciled in Australia (Level 2 groups). The framework, comprising three prudential standards and streamlined reporting requirements, was the outcome of more than three rounds of consultation with industry, over a three-year period.

APRA's prudential framework for Level 2 groups is focussed on contagion risk: the risk that adverse developments in activities conducted by other group members could affect the health of the regulated insurer (or insurers) in the group. APRA's approach is to treat the Level 2 group, in principle, as one economic entity and apply prudential requirements to the group similar to those applying to individual APRA-authorised insurers (Level 1 insurers). The Level 2 framework includes requirements in relation to capital, risk management, audit and actuarial reporting and valuation, governance, and fitness and propriety of responsible persons. The objective of the framework is to ensure that Level 2 groups are financially sound and that financial and operational interrelationships within the group do not compromise the financial position of any APRA-authorised members of the group.

The prudential standards came into effect on 31 March 2009. Final reporting standards were released in August 2009. This prudential and reporting framework has been successful in achieving the majority of APRA's aims and objectives. A small number of areas have been identified, however, where the prudential and reporting standards need refinement. APRA is proposing to modify the framework to address these areas.

Chapter 2 – Refinements to the prudential standards for Level 2 groups

This chapter details proposals to refine the prudential standards that apply to Level 2 groups. These proposals make amendments to the Level 2 group prudential standards and consequential changes to the reporting standards. All proposed changes are shown in mark-up in the relevant draft standards, reporting forms and reporting instructions that accompany this paper.

In summary, these proposals affect:

- the definition of a Level 2 group;
- intra-group transactions;
- the Group Actuary;
- actuarial peer review;
- reinsurance arrangements and governing law requirements; and
- share-based employee remuneration schemes.

Definition of a Level 2 group

A Level 2 group is defined in *Prudential Standard GPS 001 Definitions* (GPS 001) as a Level 1 insurer and its controlled entities or an APRA-authorised non-operating holding company (NOHC) and its controlled entities. Once the Level 2 group exists, GPS 001 gives APRA the discretion to require a non-APRA-authorised entity that is not controlled by the NOHC or Level 1 insurer to be notionally consolidated into the Level 2 group.[3] APRA can exercise this power if the entity conducts insurance or insurance-related business and it has a similar ownership to the insurer. This discretion allows APRA to consider an entity part of the Level 2 group when assessing contagion risk and capital requirements.

There is a range of corporate structures that may be used by groups undertaking insurance activities in Australia, not all of which may be adequately captured by the current definition in GPS 001. In particular, the current wording of GPS 001 does not give APRA the discretion to consolidate a non-APRA-authorised entity with a Level 1 insurer where a Level 2 group is not already in existence. As an example, there may be a single APRA-authorised insurer operating in Australia as part of a wider corporate group, where the wider group has other entities undertaking insurance-related business in Australia. It is APRA's view that in certain circumstances it is appropriate to notionally consolidate the insurer with the insurance-related businesses of the corporate group. This allows APRA to adequately assess contagion risk and set appropriate capital requirements.

APRA is therefore proposing to give itself the ability to capture, as a Level 2 group, legal structures where there is a single Level 1 insurer and other insurance-related entities in Australia. This is limited to where the entities have similar ownership and conduct insurance or insurance-related business. This will enable APRA to appropriately assess an insurer and its related parties within the Level 2 supervision framework. The proposed amendment to the definition of a Level 2 group is detailed in paragraph 6 of Draft GPS 001.

Intra-group transactions

The Level 2 prudential framework focuses on contagion risk. This risk can arise for transactions that are entirely within the Level 2 group and may also arise when a Level 2 group is part of a wider corporate group, such as where it has an overseas parent.

3 Paragraph 8 of GPS 001.

APRA currently imposes, via *Prudential Standard GPS 111 Capital Adequacy: Level 2 Insurance Groups* (GPS 111), capital and other requirements with respect to on- and off-balance sheet transactions between a Level 2 group and its wider corporate group (if applicable). Off-balance sheet transactions within a Level 2 group typically eliminate on consolidation, resulting in no capital impost on the Level 2 group. However, such transactions within a Level 2 group can create material contagion risk that may have an adverse impact on the individual APRA-authorised insurers within the Level 2 group. APRA does not currently collect information on these intra-group transactions.

APRA proposes to give itself the ability to request a Level 2 group to report on- and off-balance sheet intra-group transactions. These provisions ensure APRA can adequately assess contagion risk and are detailed in paragraph 50 of Draft GPS 111.

Group Actuary

Prudential Standard GPS 311 Audit and Actuarial Reporting and Valuation (GPS 311) details the audit and actuarial requirements that must be met by Level 2 groups. One of these requirements is the appointment of a Group Actuary who satisfies certain prudential requirements.[4] These requirements seek to ensure the actuary has the appropriate skills, experience and independence to be able to undertake the important role of Group Actuary. The requirements explicitly exclude the Group Actuary from being the Chief Executive or director of an insurer within the Level 2 group. However, GPS 311 is silent as to whether or not the Group Actuary may be the Chief Executive or director of other entities within the group, such as a NOHC, or within the wider corporate group.

It is APRA's view that holding a Chief Executive or director position within the Level 2 or wider corporate group could present a conflict of interest or compromise the Group Actuary's independence. As a result, APRA proposes to amend GPS 311 to restrict the Group Actuary from being the Chief Executive or director of any entity within the Level 2 group or wider corporate group. This is detailed in paragraph 9 of Draft GPS 311.

Actuarial peer review

GPS 311 requires the Group Actuary to provide advice on the Level 2 group's insurance liabilities and prepare an insurance liability valuation report (ILVR).[5] The Group Actuary must also review the determination of the group's Maximum Event Retention and include relevant comments on this review in the ILVR.[6] This actuarial advice is not required to be subject to peer review by another actuary. This is in contrast to the requirements for Level 1 insurers where the ILVR is required to be peer reviewed.

There may be times, however, when the Group Actuary's advice expressed in the ILVR would benefit from peer review by an external actuary. APRA proposes to amend GPS 311 to give APRA the discretion to have the Group Actuary's advice subject to peer review. This is detailed in paragraph 17 of Draft GPS 311.

4 Paragraph 9 of GPS 311.

5 Paragraph 44 of GPS 311.
6 Paragraph 25 of GPS 311.

Reinsurance arrangements and governing law requirements

GPS 111 requires Level 2 groups to deduct reinsurance assets that are due to any Level 1 insurer in the group if the reinsurance assets do not meet certain documentation and governing law requirements in *Prudential Standard GPS 230 Reinsurance Management* (GPS 230).[7] The documentation requirements (but not the governing law requirements[8]) also extend to any reinsurance assets of entities within the Level 2 group carrying on insurance business in a foreign jurisdiction, if the deduction is required in that jurisdiction.

It is APRA's view that, if a foreign entity in the Level 2 group is carrying on insurance business in another jurisdiction that is not meeting equivalent governing law requirements, these reinsurance assets should not be included in the capital base of the group. APRA is therefore proposing to require Level 2 groups to deduct from capital any reinsurance assets that do not meet any relevant governing law requirements in a foreign jurisdiction. This is detailed in paragraph 56 of Draft GPS 111. Consequential amendments to the reporting standards are also detailed in *Draft Reporting Form and Instruction Guide for GRF 120.0_G Determination of Capital Base (Level 2 Insurance Group)* (Draft GRF 120.0_G) and *Draft Reporting Form and Instruction Guide for GRF 301.0_G Reinsurance Assets and Risk Charge (Level 2 Insurance Group)* (Draft GRF 301.0_G).

Share-based employee remuneration schemes

The determination of the capital base of a Level 2 group includes consideration of share-based employee remuneration schemes. Equity settled share-based payments granted as part of remuneration are permitted to be included in reserves if:

- the shares or share options granted relate only to the ordinary shares of the insurer itself; and
- there are no circumstances in which such remuneration can be converted into another form (e.g. cash).

There is an additional criterion when these types of shares are held within a special purpose vehicle (SPV). These shares can only be included in the capital base of the Level 2 group if the holding is matched by an equivalent charge to the profit or loss of the Level 2 group for expensing the issue or funding the acquisition of ordinary shares by the SPV. When determining the capital base, the holdings are included in capital as the SPV is excluded from the consolidated Level 2 group.

New ordinary shares

When a Level 2 group does not issue new ordinary shares as part of a remuneration scheme, there is a potential overstatement of the capital base. This arises because the addition to reserves will not be offset by a future increase in ordinary shares on issue. APRA proposes to amend GPS 111 to ensure that new ordinary shares must be issued under the scheme in order for the reserves to be included in the capital base. This amendment is detailed in paragraph 14 of Draft GPS 111.

7 Paragraphs 30 and 31 of GPS 230.

8 The governing law requirements, for the purposes of this discussion paper, refer to the requirement for contracts entered into by a Level 1 insurer incepting on or after 31 December 2008, to include the governing law of the contract as Australian law and for any disputes that fall to be determined by a court to be heard in an Australian court. Foreign governing law requirements are similar regulatory requirements, but where the governing law and dispute clauses relate to that foreign jurisdiction.

APRA also intends that this treatment will be implemented for Level 1 insurers when it releases draft prudential standards in conjunction with the general and life insurance capital review. Feedback regarding the implementation of this amendment for Level 1 insurers will be sought during future consultation.

Holdings by special purpose vehicles

APRA has identified a provision with respect to the treatment of SPV holdings which requires clarification in the existing paragraph 50 of GPS 111. In relation to the treatment of fair value of the shares, APRA intends to amend the standard so it reads:

> 'As a consequence, **any associated change** in the fair value of the shares held by the SPV must be excluded from both the group's capital and the assets subject to a risk charge'.

This amendment is shown in paragraph 52 of Draft GPS 111.

Basel III capital reforms

In December 2010, the Basel Committee on Banking Supervision (BCBS) published its final package of reforms to strengthen global capital and liquidity requirements for internationally active banks (Basel III).

APRA is currently developing draft prudential standards, prudential practice guides and reporting requirements to give effect to these reforms for authorised deposit-taking institutions (ADIs) in Australia. APRA will begin consultation on the reforms for ADIs in coming months, which will continue into 2012.

It remains APRA's intention to seek broad consistency between the definition and measurement of the capital base for insurers and ADIs. Any proposed revisions to the capital base for insurers as a result of APRA's implementation of Basel III will be the subject of detailed consultation with the insurance industry.

Outsourcing and business continuity management

In December 2010, APRA released a consultation package proposing to harmonise the current industry-specific requirements with respect to outsourcing and business continuity management by issuing single cross-industry prudential standards.[9] Each cross-industry prudential standard will ensure harmonised prudential requirements apply across industries, except where there are specific reasons for maintaining an industry-specific approach. These standards are intended to be finalised in 2011. These consolidated standards will require consequential changes to be made to *Prudential Standard GPS 221 Risk Management: Level 2 Insurance Groups* (GPS 221). These changes, removing the specific outsourcing and business continuity management requirements from GPS 221, will be undertaken as part of APRA's response to submissions on the cross-industry standards proposals.

9 www.apra.gov.au/Policy/Consolidating-prudential-standards.cfm

Chapter 3 – Refinements to the reporting framework for Level 2 groups

This chapter details the proposed refinements to the reporting framework for Level 2 groups and considers the alignment with aspects of the Level 1 reporting framework and a number of other minor amendments to the current reporting framework. All proposed changes are shown in mark-up in the relevant draft prudential standards, reporting forms and reporting instructions that accompany this paper.

Alignment with the Level 1 reporting framework

APRA's proposals in this section aim to align aspects of the reporting framework for Level 2 groups with the current framework for Level 1 insurers.

In July 2010, APRA implemented amendments to the reporting framework for Level 1 insurers.[10] These changes aligned prudential reporting more closely with statutory reporting for general insurers, whilst maintaining the capital framework.

Some of the amendments made in 2010 are already in place for Level 2 groups, including, for example, reporting the income statement and statement of financial position in accordance with *Australian Accounting Standard AASB 1023 General Insurance Contracts* (AASB 1023). There are, however, areas of Level 2 group reporting that are not aligned with the Level 1 framework and the changes outlined in this paper are intended to improve the alignment.

APRA proposes to make the following amendments to the Level 2 group reporting framework, which will require changes to the reporting forms and reporting instructions, and consequential changes to the prudential standards.

Deferred reinsurance expense and expected reinsurance recoveries

The reporting framework for Level 1 insurers requires insurers to recognise deferred reinsurance expense as an asset on the balance sheet. For capital purposes, APRA requires the insurer to include the cost of reinsurance arrangements for the full term of the reinsurance contract and not any shorter period. This treatment applies to ensure that all insurers determine their capital requirements and capital base in a prudent and consistent manner. While this approach is consistent with AASB 1023 requirements, it may differ from the deferred reinsurance expense recognised under the insurer's own application of AASB 1023.

APRA proposes to implement the Level 1 treatment of reinsurance costs for Level 2 groups. Further details on this treatment are outlined below. No amendment to GPS 311 is required, but consequential changes to paragraph 40 of Draft GPS 111 and to a number of the Level 2 reporting standards are required. The reporting standards affected are:

- Draft GRF 120.0_G;
- *Draft Reporting Form and Instruction Guide for GRF 210.1_G Premiums Liabilities – Insurance Risk Charge (Level 2 Insurance Group)* (Draft GRF 210.1_G[11]);
- *Draft Reporting Form and Instruction Guide for GRF 300.0_G Statement of Financial Position (Level 2 Insurance Group)* (Draft GRF 300.0_G);
- Draft GRF 301.0_G; and
- *Draft Reporting Form and Instruction Guide for GRF 302.0_G Statement of Financial Position by Region (Level 2 Insurance Group)* (Draft GRF 302.0_G).

10 For further details on the refinements made at Level 1, refer to www.apra.gov.au/Policy/Proposed-changes-to-general-insurance-prudential-reporting-June-2010.cfm

11 Note that this includes Draft GRF 210.1A_G and Draft GRF 210.1B_G as discussed in the 'Insurance liability forms' sub-section on page 16

For prudential reporting purposes, the cost of current reinsurance arrangements can be split into two separate components under this proposal:

- one component is current period reinsurance that has already been expensed and is attributable to paid claims and outstanding claims provisions;
- the other component is current period reinsurance that covers future risks, for which the reinsurance expense is deferred as a deferred reinsurance expense (DRE) asset. The DRE is further split into:
  - (a) current reinsurance cover and associated DRE attributable to unexpired risk, i.e., business already in force. This reinsurance cover relates to premiums liabilities; and
  - (b) current reinsurance cover and associated DRE attributable to future business that has not yet been written but that is covered by current reinsurance.

APRA proposes a treatment of reinsurance costs that is consistent with the treatment at Level 1.

When calculating premiums liabilities, the Group Actuary is currently required to make an allowance for future reinsurance expenses that are attributable to premiums liabilities that extend beyond the current reinsurance cover. This amount represents the cost of reinsurance in excess of the current business portion of DRE in (a) above, that is not yet purchased but that is assumed to be purchased under similar terms.[12] APRA proposes that this treatment remain in place. Current reinsurance coverage of future business not yet written ((b) above) cannot be used to offset additional reinsurance costs to cover premiums liabilities.

The excess technical provision calculation for the Level 2 group requires the comparison of premiums liabilities in accordance with GPS 311 with those calculated under AASB 1023 as reported to APRA. This results in all DRE being deducted from excess technical provisions. The inclusion of DRE on future business ((b) above) in this calculation reduces the capital base of the group. APRA proposes to allow the Level 2 group to adjust the calculation of the excess technical provisions to ensure that the Level 2 group's capital base is not adversely impacted by the timing of its reinsurance renewals.

APRA proposes that the total DRE be subject to a risk charge in the determination of the Minimum Capital Requirement, in lieu of a risk charge on expected reinsurance and non-reinsurance recoveries on premiums liabilities.

For worked examples and a more detailed explanation of the treatment of the components of the cost of reinsurance arrangements, APRA refers Level 2 groups to Appendix A of APRA's response paper on the changes to the Level 1 prudential framework.[13] APRA plans to release the Appendix as a prudential practice guide later in 2011 to provide guidance to Level 1 insurers and Level 2 groups.

Bound but not incepted business

The Level 1 reporting framework requires insurers to hold capital, via a premiums liabilities risk charge, for net written premium relating to bound policies that incept after period-end and that have a material impact on capital adequacy.[14] This approach was a simplification of reporting requirements and replaced the previous Level 1 treatment of bound but not incepted business.

12 This treatment is applied irrespective of whether the Level 2 group uses paragraphs 40 and 41 of Draft GPS 311 and records accounting entries for premiums liabilities.

13 www.apra.gov.au/Policy/upload/GI_RP_GIPR_052010_ex_r.pdf

14 Materiality is measured in accordance with the Australian accounting and auditing standards.

Under the previous reporting framework, Level 1 insurers were required to adjust the AASB-compliant statement of financial position and income, for any business that has been accepted but not yet incepted. The process of estimating the value of this business was often largely manual, complex and time-consuming. For many insurers, the adjustment did not have a material impact on capital requirements. As a result, APRA amended the treatment for Level 1 insurers to require insurers to hold capital for any material exposure to this type of business, but only in the calculation of capital requirements and not in the income statement or statement of financial position.

APRA proposes to implement this approach for Level 2 groups. This risk charge is outlined in Draft GRF 210.1_G.[15] Consequential changes have been made to paragraph 29 of Draft GPS 111.

Inwards proportional reinsurance business

The Level 1 reporting framework requires insurers to hold capital, via a premiums liabilities risk charge, for inwards reinsurance premium revenue that is not recognised in the income statement and statement of financial position for the full term of the reinsurance contract. This approach was a simplification of reporting requirements.

Under the previous reporting framework, Level 1 insurers were required to adjust the AASB-compliant income statement and statement of financial position for the premium arising over the full term of the inwards reinsurance contract. APRA amended this approach for Level 1 insurers to require them to hold capital for any material exposures to this type of business, but only in the calculation of capital requirements and not in the income statement or statement of financial position.

APRA proposes to implement this approach for Level 2 groups. This risk charge is outlined in Draft GRF 210.1_G.[16] Consequential changes have been made to paragraphs 29 and 56 of Draft GPS 111.

Other alignment

The Level 1 reporting framework also collects a number of data items that APRA proposes to implement for Level 2 groups. These are shown in mark-up in the draft reporting forms and reporting instructions. These proposed changes are:

- reinsurance assets risk charge on Draft GRF 302.0_G be based on balance sheet reinsurance assets;
- explicit asset items for current tax assets and deferred levies and charges in Draft GRF 300.0_G;
- inclusion of commission expense as a separate item on *Draft Reporting Form and Instruction Guide for GRF 310.0_G Income Statement (Level 2 Insurance Group)* (Draft GRF 310.0_G);
- inclusion of net incurred claims that is current period net claims expense, replacing the concept of gross and net prior period releases/ strengthening on Draft GRF 310.0_G; and
- amounts transferred to reserves, now included with amounts transferred from reserves on Draft GRF 310.0_G.

15 Note that this includes Draft GRF 210.1A_G and Draft GRF 210.1B_G as discussed in the 'Insurance liability forms' sub-section on page 16.

16 Note that this includes Draft GRF 210.1A_G and Draft GRF 210.1B_G as discussed in the 'Insurance liability forms' sub-section on page 16.

Other reporting framework refinements

APRA proposes to make the following clarifications to the reporting framework for Level 2 groups.

Insurance liability forms

The forms and instructions for insurance liabilities (GRF 210.0_G[17] and GRF 210.1_G[18]) allow a Level 2 group to report Australian business by region rather than by class of business, if an adjustment to the reporting standard is in place. This different reporting of outstanding claims and premiums liabilities for Australian business is currently undertaken in GRF 210.0_G and GRF 210.1_G respectively. The option to report Australian business in two tables within a form creates ambiguity. To overcome this, APRA proposes to split the outstanding claims liability form into two separate forms (Draft GRF 210.0A_G[19] and Draft GRF 210.0B_G[20]) and to split the premiums liability form into two separate forms (Draft GRF 210.1A_G[21] and Draft GRF 210.1B_G[22]). The Level 2 group will complete only the 'A' or 'B' forms based on whether a reporting adjustment in relation to Australian business is in place.

Investment risk charge on investments in related entities

The statement of financial position requires a Level 2 group to report investments in related entities, including a parent entity, associates and joint ventures. These related-entity investments are subject to a risk charge in accordance with *Prudential Standard GPS 114 Capital Adequacy: Investment Risk Capital Charge* (GPS 114) as read with GPS 111. However, it is not clear on the reporting form where this risk charge is to be included. APRA proposes to amend GRF 300.0_G to provide for the calculation of the risk charge.

Assets with a counterparty grade 1 or 2

The statement of financial position requires a Level 2 group to report a number of assets split by counterparty grade. For assets with a counterparty grade 1 or 2, the risk charge under GPS 114, as read with GPS 111, varies depending on whether the asset matures or is redeemable in less than one year or in one year or more. APRA proposes to add additional line items on GRF 300.0_G to ensure that, for any assets with counterparty grade 1 or 2, the correct risk charge is applied to these assets.

17 *Reporting Form and Instruction Guide for GRF 210.0_G Outstanding Claims Liabilities – Insurance Risk Charge (Level 2 Insurance Group)* (GRF 210.0_G)

18 *Reporting Form and Instruction Guide for GRF 210.1_G Premiums Liabilities – Insurance Risk Charge (Level 2 Insurance Group)* (GRF 210.1_G)

19 *Draft Reporting Form and Instruction Guide for GRF 210.0A_G Outstanding Claims Liability – Insurance Risk Charge – Australia by class of business (Level 2 Insurance Group)* (Draft GRF 210.0A_G)

20 *Draft Reporting Form and Instruction Guide for GRF 210.0B_G Outstanding Claims Liability – Insurance Risk Charge – Australia by region (Level 2 Insurance Group)* (Draft GRF 210.0B_G)

21 *Draft Reporting Form and Instruction Guide for GRF 210.1A_G Premiums Liabilities – Insurance Risk Charge – Australia by class of business (Level 2 Insurance Group)* (Draft GRF 210.1A_G)

22 *Draft Reporting Form and Instruction Guide for GRF 210.1B_G Premiums Liabilities – Insurance Risk Charge – Australia by region (Level 2 Insurance Group)* (Draft GRF 210.1B_G)

Treatment of overdrafts and defined benefit superannuation funds

The statement of financial position requires a Level 2 group to report overdrafts as loans and advances, and recognise deferred tax amounts with respect to defined benefit superannuation funds. It is APRA's understanding that the guidance provided in relation to these items may be inconsistent with Australian accounting standards. APRA proposes to revise the wording in GRF 300.0_G to ensure that these items are aligned with the Australian accounting standards.

Excess technical provisions calculation

The instructions for the calculation of excess technical provisions for outstanding claims refer to the net amount of reinsurance recoverable calculated on GRF 301.0_G instead of GRF 300.0_G. Whilst these amounts are equal, APRA proposes to correct this reference in *Draft Reporting Form and Instruction Guide for GRF 210.0_G Outstanding Claims Liability – Insurance Risk Charge (Level 2 Insurance Group)* (Draft GRF 210.0_G[23]).

Statement of financial position by region

The instructions for the regional statement of financial position (GRF 302.0_G) provide guidance on the regions to be used for Australian and international insurers. However, the instructions do not provide guidance on the region in which non-insurers should be included, such as locally incorporated NOHCs. The instructions for GRF 300.0_G provide extra detail in this respect and APRA proposes to include this additional information in Draft GRF 302.0_G.

Other minor clarifications

APRA proposes to make a number of other minor clarifications to the forms and instructions. These are limited to the wording, numbering and format of the items and tables, and do not have an impact on the figures collected under the reporting standards. All of these changes are shown in mark-up in the draft reporting forms and draft reporting instructions.

23 Note that this includes Draft GRF 210.0A_G and Draft GRF 210.0B_G as discussed in the 'Insurance liability forms' sub-section above

Chapter 4 – Timetable and process

APRA is seeking submissions on the proposals in this discussion paper by 15 July 2011.

Following its review of submissions, APRA expects to release a response paper and final prudential standards and reporting standards in early October 2011.

The prudential standards will be effective for all Level 2 groups from 1 December 2011.

The reporting standards will apply to all Level 2 groups for reporting periods commencing on or after 1 July 2011. This means the first half-yearly reporting on the revised basis will be for the period ending 31 December 2011 and will be due on 31 March 2012.

The first audited annual reporting on the revised basis will be for Level 2 groups with a balance date of 31 December 2011. This will be due on 30 April 2012. For Level 2 groups with a balance date of 30 June, the first audited annual reporting will be for the year ending 30 June 2012 and will be due on 31 October 2012.

Chapter 5 – Request for cost-benefit analysis information

While APRA anticipates that all Level 2 groups will be affected to varying degrees by these proposals, it does not expect that the effects will be significant.

To improve the quality of regulation, the Australian Government requires all proposals to undergo a preliminary assessment to establish whether it is likely that there will be business compliance costs. In order to perform a comprehensive cost-benefit analysis, APRA welcomes information from interested parties. As part of the consultation process, APRA requests respondents to provide an assessment of the impact of the proposed changes and, specifically, the marginal compliance costs general insurers are likely to face. Given that APRA's proposed requirements may impose some compliance costs, respondents may also indicate whether there are any other regulations relating to general insurance prudential reporting that should be improved or removed to reduce compliance costs. In doing so, please explain what they are and why they need to be improved or removed.

Respondents are requested to use the Business Cost Calculator (BCC) to estimate costs to ensure that the data supplied to APRA can be aggregated and used in an industry-wide assessment. APRA would appreciate being provided with the input to the BCC as well as the final result. The BCC can be accessed at www.finance.gov.au/obpr/bcc/index.html

Appendix – Summary of changes to prudential standards, reporting forms and reporting instructions

The proposals in this paper involve amendments to prudential standards as well as reporting forms and reporting instructions. These amendments are summarised in the table below. For full details of the amendments, refer to the mark-up version of the draft prudential standards, reporting forms and reporting instructions that accompany this paper.

	Proposal	Proposed changes to standards
Definition of a Level 2 insurance group	APRA proposes to extend the definition of a Level 2 group to capture legal structures where there is a single Level 1 insurer and any other insurance-related entities in Australia. This is limited to where the entities have the same or similar ownership.	Paragraph 6 of Draft GPS 001
Intra-group transactions	APRA proposes to give itself the ability to request a Level 2 group to report on intra-group transactions.	Paragraph 50 of Draft GPS 111.
Group Actuary	APRA proposes to restrict the Group Actuary from being the Chief Executive or director of any entity within the Level 2 group or wider corporate group.	Paragraph 9 of Draft GPS 311
Actuarial peer review	APRA proposes to give itself the discretion to have the Group Actuary's advice subject to peer review.	Paragraph 17 of Draft GPS 311
Reinsurance arrangements and governing law requirements	APRA proposes to require reinsurance assets which do not meet any relevant foreign governing law requirements to be deducted from capital.	Paragraph 56 of Draft GPS 111
Share-based employee remuneration schemes	APRA proposes to allow Level 2 groups to include equity settled share-based payments in reserves and, therefore, capital base only if the Level 2 group issues new ordinary shares. In addition, APRA intends to clarify the treatment of the change in fair value of the shares held by a SPV for this purpose.	Paragraphs 14 and 52 of Draft GPS 111
Deferred reinsurance expense and expected reinsurance recoveries	APRA proposes to implement the Level 1 treatment of reinsurance costs to Level 2 groups.	Changes to GRF 120.0_G, GRF 210.1_G, GRF 300.0_G, GRF 301.0_G and GRF 302.0_G Consequential changes to paragraph 40 of GPS 111

	Proposal	Proposed changes to standards
Bound but not incepted business	APRA proposes to implement the Level 1 treatment of bound but not incepted business that simplifies reporting whilst maintaining the capital requirements.	Changes to GRF 210.1_G Consequential changes to paragraph 29 of GPS 111
Inwards proportional reinsurance business	APRA proposes to implement the Level 1 treatment of inwards proportional reinsurance business to simplify reporting whilst maintaining the capital requirements.	Changes to GRF 210.1_G Consequential changes to paragraphs 29 and 56 of GPS 111
Other	APRA proposes a number of amendments to the reporting forms and instructions to align with the Level 1 reporting framework or provide clarification to Level 2 groups on current reporting requirements.	Changes to GRF 120.0_G, GRF 210.0_G, GRF 210.1_G, GRF 300.0_G, GRF 301.0_G, GRF 302.0_G and GRF 310.0_G

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