



15 December 2017

TO: ALL LIFE INSURERS

REVIEW OF PRUDENTIAL STANDARD LPS 117 CAPITAL ADEQUACY: ASSET CONCENTRATION RISK CHARGE

The Australian Prudential Regulation Authority (APRA) has received a number of representations regarding the increasing use by APRA-registered life insurers of reinsurance arrangements entered into with offshore life reinsurers which are not registered under the *Life Insurance Act 1995* (non-registered reinsurers).

These representations have focused on two main issues. Firstly, that non-registered reinsurers are not subject to the same regulatory requirements as APRA-registered life insurers. Secondly, that there may be potential for systemic risks being introduced to the Australian life insurance market through increased involvement of non-registered reinsurers.

In some cases, APRA has exercised its discretion to adjust the requirements of *Prudential Standard LPS 117 Capital Adequacy: Asset Concentration Risk Charge* (LPS 117), to allow collateral trust arrangements to be used to mitigate exposures to non-registered reinsurers for the purposes of calculating the Asset Concentration Risk Charge (ACRC). These adjustments have been made where APRA was satisfied that the specific collateral trust arrangements provided an effective risk mitigant for ACRC purposes. The exercise of this discretion has facilitated some involvement by non-registered reinsurers in the Australian market.

Following consideration of the issues raised and in light of the potential risks that may arise from further involvement of non-registered reinsurers in the Australian market, APRA has decided to undertake a review of LPS 117, to ensure it remains fit for purpose and in line with the objectives in the APRA mandate.¹ APRA intends to commence this review in the second half of 2018.

The review will focus on the elements of LPS 117 dealing with asset concentration risk arising from reinsurance arrangements. It may also be necessary to review related aspects of *Prudential Standard LPS 114 Capital Adequacy: Asset Risk Charge* (LPS 114).

Until the outcomes of the review of LPS 117 are clearly known, APRA is not inclined to grant any further 'discretionary' approvals to allow entities to mitigate exposures to non-registered reinsurers for the purpose of calculating the ACRC. As part of the review, APRA will assess the future use of collateral trust arrangements, including whether they should be permitted for the purposes of LPS 117.

To inform the review of LPS 117, APRA intends to gather further information on existing collateral and offsetting arrangements being relied on by life insurers for the purposes of calculating the ACRC. APRA will release an information request in early 2018 regarding all

¹ Refer to section 8 of the *Australian Prudential Regulation Authority Act 1998*.

arrangements which are being relied on to provide capital relief under paragraphs 25 to 28 of LPS 117.

If you have any questions, please contact your APRA supervision team.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Geoff Summerhayes', written over a light blue horizontal line.

Geoff Summerhayes
Member
Australian Prudential Regulation Authority