hannover re®

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Via email: insurance.policy@apra.gov.au

Re: Feedback on APRA Discussion Paper - Integrating AASB 17 into the capital and reporting frameworks for insurers and updates to the LAGIC framework

Hannover Life Re of Australasia ("HLRA", "Company", "We") appreciate the opportunity to provide feedback on APRA's Discussion Paper on Integrating AASB 17 into the capital and reporting frameworks for insurers and updates to the LAGIC framework review.

Please refer to HLRA's feedback below to the questions raised in the Discussion Paper for APRA's consideration.

Proposed changes to capital framework

1. **(GI, LI and Friendly societies) Would maintaining the existing regulatory capital and measurement substantially increase regulatory burden?**

   HLRA support APRA's proposal to maintain the existing regulatory capital and measurement. We envisage this will not substantially increase our regulatory reporting efforts.

Questions 2 relate to general insurers and therefore is not applicable to HLRA.

3. **(LI) Will there be challenges calculating RFEFCF by projecting cash flows and not using account balance for all investment account business?**

   HLRA do not have investment account business and therefore we prefer to not provide feedback to this question.

4. **(GI and LI) How would the new four quarters dividend test affect your entity?**

   HLRA support the proposed new four quarters dividend test for the purposes of LPS 110 paragraph 50(c). OCI is a component of balance sheet equity for capital determination when considering dividend payment. Therefore, in our view, the four quarters dividend test should be based on after-tax earnings inclusive of OCI.

Proposed changes to reporting framework

5. **(All insurers) What types of challenges would the new product groups bring to your entity, including any transitional challenges?**

   For HLRA products where more than one benefit type is offered in the same insurance contract, the new APRA product groups for death, Total and Permanent Disability (TPD), trauma and Disability Income Insurance (DII) do not align with the Groups of Insurance Contracts (GICs) that HLRA has established for our Group IFRS 17 as well as AASB 17 statutory reporting. Therefore, we will need to determine methodologies and set up processes to produce reported results at the higher granularity required by the new APRA product groups.

   The requirement to report under the new product groups would present significant transitional challenges and lead to additional efforts in our regulatory reporting processes. These challenges

stem from the need to allocate and account for Contractual Services Margins (CSMs) by the APRA product groups to ensure they show the relative profitability of each product group and the sum of the allocated results matches the overall GIC results.

HLRA would prefer that APRA do not introduce the proposed new product groups. There are alternative data collection that APRA can consider to show the relative profitability of the APRA product groups (which are discussed under question 12 below). If APRA, however, proceeds with this requirement then HLRA support the use of the allocation principles (with the suggested changes discussed under question 7 below) to allocate GIC results for the reporting of the new product groups. The allocation approach is considered to be less burdensome than requiring GICs to be established for each APRA product group.

Questions 6 relate to general insurers and therefore is not applicable to HLRA.

7. **(All insurers) Are the allocation principles outlined in this Discussion Paper adequate for reporting of APRA product group data? Are there any ways to make the allocation principles more effective?**

HLRA consider the allocation principles, together with suggested modifications below, are adequate for reporting by the APRA product groups.

Principle 1: Allocation of AASB 17 income statement items should be performed in a way that reflects the underlying profitability of each APRA product group

Principle 5: Allocation of CSM – The approach applied should result in reported CSM (or loss component where relevant) and insurance service result amounts that reflect the expected relative profitability of each APRA product group – i.e. no offsetting of profit and losses

HLRA suggest the grouping of principles 1 and 5 as these appear to achieve essentially the same aim. Overall, we consider that these principles may be difficult to follow in practice unless there are modifications to the wording. HLRA suggest the following revised combined principle:

"The allocation approach applied to determine the reported balance sheet and income statement (including CSM and/or Loss Component) should reflect the expected relative profitability of each APRA product group and the contribution of the APRA product group to the results for the GIC in which the product group belongs."

Principle 2: A systematic and rational approach should be applied;

HLRA supports this principle. This is consistent with the requirement under the AASB 17 standard.

Principle 3: The approach applied should be consistent over time;

HLRA supports this principle. This allows flexibility for different approaches that can be adopted over time provided that the approaches are consistent.

Principle 4: The aggregate of the allocated numbers across APRA product groups should be consistent with AASB 17 numbers reported on a statutory basis;

HLRA supports this principle. We note that there may be unallocated differences at a granular level but on a comparable grouping level, the APRA results should be consistent with the AASB 17 results on a statutory basis.

Principle 6: A single allocation approach need not necessarily be applied. Insurers could apply different allocation approaches across AASB 17 items.

HLRA supports this principle. We would add that any allocation approach adopted should not be an unreasonable regulatory burden to insurers.

8. (LI) Would the proposal underlying separate valuation of insurance and reinsurance assets and liabilities in accordance with the Life Act reporting structure cause issues despite the proposed reporting exemption for Non-participating risk business? Are there any other specific issues in relation to the proposal?

HLRA note that the GICs under the AASB 17 standard do not necessarily align with the Life Act reporting structure. Whilst we support the separate valuation of insurance and reinsurance assets and liabilities by statutory fund, Australian vs Overseas business, and participating vs non-participating business, we view that any requirement to separate valuation by classes of business i.e. ordinary vs superannuation may contravene AASB 17 requirements (as noted by APRA in the Discussion Paper). The latter, if imposed, would also result in dual reporting and increased regulatory burden for insurers preparing reports for APRA. Hence, HLRA support the proposed reporting exemption for non-participating risk business i.e. insurers may choose to determine insurance and reinsurance assets and liabilities at a combined level across ordinary and superannuation classes.

9. (LI) How should APRA define reporting components for Participating business given AASB 17 and the Life Act reporting structure?

HLRA do not have participating business and therefore we prefer to not provide feedback to this question.

Questions 10 and 11 relate to friendly societies and therefore are not applicable to HLRA.

12. (GI and LI) Would the liability data collection approach outlined in the QIS workbook cause significant issues? How can APRA improve its collection of the liability data items to better understand profitability profiles by APRA product groups?

HLRA has not been selected to participate in the targeted QIS and therefore do not have a practical understanding of whether the liability data collection approach outlined in the QIS workbook may cause significant issues. We are however progressing well with our Group IFRS 17 implementation and plan to conduct a "dry run" of AASB 17 statutory reporting as part of participating in APRA's full QIS (expected in the second half of 2021). We will share our thoughts and insights with APRA in due course.

In terms of how APRA can better understand the profitability profiles by the new APRA product groups, HLRA has the following suggestions:

- Under the AASB 17 standard, "measurement" is performed at Group of Insurance Contracts (GIC) which represents how insurers "manage together" the products or businesses that have "similar risks". By applying the allocation principles, the GIC results that are allocated to the new APRA product groups should provide an indication of the relative profitability and contribution of each product group to the overall profitability of each GIC.

- In addition to the reported financials by the new APRA product groups, APRA could also consider collecting the following data or information to supplement their analysis of APRA product group profitability:

    - Best Estimate Liability (BEL) at inception for new business each year at the new APRA product group level. This provides an early indication of the profitability of the new business cohort for each product group.

    - Actual-to-expected ratios for premiums and claims. This provides information of how emerging experience compares with expected experience and hence the sustainability of the assumptions underpinning the profitability profiles.

- Loss ratios at the product group level. This provides information of how claims experience as a percentage of premiums are changing and hence how the profitability profile maybe changing over time.

13. (All insurers) Are there any supplementary data collections that insurers deems unnecessary in the AASB 17 environment?

Supplementary data currently collected in the form of Income Statement and Summary of Revenue and Expenses such as those required under the LRF 300s forms may become redundant in the AASB 17 environment.

LAGIC updates

14. (All insurers) Are there any other potential impacts of low or negative interest rates, not already mentioned in this Discussion Paper, on the current capital framework?

Under low or negative interest rates environment, the Risk Free Best Estimate Liability (RFBEL) for certain businesses may become positive and larger than current termination value. This has implications for Adjusted Policy Liability, particularly businesses with a long duration cash flow profile.

15. (All insurers) Will the expected inflation stress to 50 basis points when nominal risk-free interest rates are negative cause any unintended consequences?

HLRA do not envisage any unintended consequences with this proposal. However, unintended consequences may arise that are currently unknown.

16. (All insurers) Will removing the floor on nominal risk-free rates of zero that applies to the downward inflation stress cause any unintended consequences?

Depending on how much nominal risk-free rates fall below zero, APRA may need to consider introducing a negative nominal risk-free rate floor. Otherwise, HLRA do not envisage any unintended consequences with this proposal. However, unintended consequences may arise that are currently unknown.

17. (All insurers) Will the clarification on the usage of the inflation stress cause any unintended consequences?

HLRA do not envisage any unintended consequences with this proposal. However, unintended consequences may arise that are currently unknown.

18. (GI and LI) What should the new dollar value limit be? Will indexing future-proof the value?

HLRA suggest that the new dollar value limit be determined as the existing dollar value limit in LPS 117, indexed by the annual inflation rates from 2013 to 2020. The dollar value limit should be reviewed regularly (perhaps triennially) and indexed by the annual inflation rates since the last review.

19. (GI and LI) Will the alignment in APS 111 for insurers and ADIs bring any significant burden to the insurance industry?

HLRA appreciate APRA's intention to adopt the APS 111 proposals into the LAGIC framework to increase transparency and ensure consistent treatment of capital instruments across insurers and ADIs. We do not envisage that this alignment will bring significant burden to the insurance industry.

20. (GI) What are industry views on the proposal to cease allowing the use of ICMs in the calculation of regulatory capital?

As this question relates to general insurers, HLRA assumes that APRA has the intention to continue allowing the option for life insurers to adopt Internal Capital Models (ICMs), subject to APRA's approval, for the calculation of regulatory capital. HLRA support the continuation of the option for insurers to use ICMs for regulatory capital as this provides insurance organisations the flexibility to adopt a global insurance capital standard for the calculation of regulatory capital.

Questions 21 and 22 relate to general insurers and therefore are not applicable to HLRA.

23. (LI) How can APRA best future-proof the requirement of illiquidity premium if written into the prudential standard?

HLRA agree with APRA's view that allowing an illiquidity premium for certain liabilities where cash flows are sufficiently certain in timing and quantum remains appropriate for prudential purposes. Due to changing market conditions, to future-proof the requirement of illiquidity premium, we suggest that the formulation and parameters used to determine the illiquidity premium is subject to regular review, perhaps triennially to ensure the ongoing relevance of the illiquidity premium requirement.

24. (All insurers) APRA is seeking improvement suggestions on the current double counting risk charge under quota share reinsurance arrangements.

HLRA agree that, for long-term quota share arrangement, requiring both the insurer and reinsurer to hold an Operational Risk Charge (ORC) for the full amount of the premium ceded is an undesirable outcome for insurers, reinsurers and policyholders. HLRA is unaware of any heightened level of operational risk associated with long-term quota share arrangements that would warrant both the insurer and reinsurer to hold an ORC on the ceded premium.

25. (All insurers) APRA is seeking improvement suggestions on solving the mismatch between IRC and the duration of quota share reinsurance policies.

This is not a relevant issue for HLRA and therefore we prefer to not provide feedback on this matter.

26. (All insurers) Would a requirement of inception date of having all procedural documentation of reinsurance arrangements formalised be a significate burden on the industry?

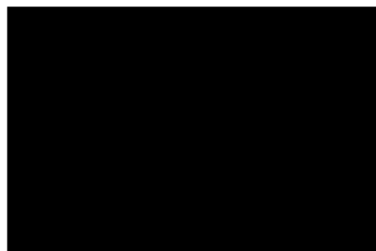
HLRA recommend that APRA maintain the current requirement that fully signed and stamped reinsurance contracts are in placed within six months of inception. Reinsurance negotiations are complex undertakings and there are practical challenges for both the insurer and reinsurer to agree commercial terms as well as ensuring the reinsurance contracts reflect all the legal, operational and pricing details on a timely manner by the inception date. Requiring formal procedures to be in place by the inception date of the reinsurance contract therefore can be a significant burden for both the insurer and reinsurer.

27. (All insurers) Are there any additional LAGIC updates, not already mentioned, that would be beneficial to APRA and the industry?

As interest rates fall, insurers will increasingly look to invest in lower credit-rated bonds to generate higher yields on their investment portfolio. Any capital relief for lower credit quality assets, without compromising capital coverage for the additional credit risk exposure, will be beneficial to the industry.

If you have any comments or questions in relation to our submission, please do not hesitate to contact us.

Yours faithfully,



Chief & Appointed Actuary

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