Prudential Standard LPS 230

Reinsurance Management

Objectives and key requirements of this Prudential Standard

This Prudential Standard is designed to ensure that reinsurance arrangements of life companies are subject to minimum standards of independent oversight by APRA. To that end, it addresses the regular reporting of reinsurance arrangements to APRA, and APRA's oversight of Referable Reinsurance Arrangements.

The key requirements of this Prudential Standard include:

- a life company must report on prescribed matters in relation to its reinsurance arrangements annually;
- a life company must not enter into a Referable Reinsurance Arrangement unless prior written approval has been granted by APRA; and
- a life company must comply with any condition imposed by APRA in respect of an approved reinsurance or financing arrangement.

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Authority

1. This Prudential Standard is made under subsection 230A(1) of the *Life Insurance Act 1995* (the Act).

Application

2. This Prudential Standard applies to all life companies, including friendly societies, registered under the Act.

3. This Prudential Standard commences on 1 January 2027 (the commencement date).

Interpretation

4. Terms that are defined in *CPS 001 Defined terms* appear in bold the first time they are used in this Prudential Standard.

5. Where this Prudential Standard provides for APRA to exercise a power or discretion, this power or discretion is to be exercised in writing.

Reinsurance reporting

6. A life company must give APRA a reinsurance report relating to the financial year of the company within 3 months after the end of each financial year.[1]

7. The reinsurance report must set out the particulars of each reinsurance contract or group of reinsurance contracts in force between the company and a **reinsurer** during the financial year. The particulars are outlined under Attachment A.

Referable Reinsurance Arrangements

8. A life company may only enter into:

   (a) a proposed 'Referable Reinsurance Arrangement';[2] or

   (b) a proposed modification to an existing arrangement that would, if undertaken, result in the existence of a Referable Reinsurance Arrangement

   with the prior written approval of APRA.

9. A life company may apply to APRA for approval under paragraph 8.[3] Any application by a life company seeking APRA's approval must be submitted prior to entering into the arrangement or modification and address the matters detailed in Attachment B.

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1 This report may be provided as part of another report required to be submitted to APRA (including the Financial Condition Report) or separately.

2 Referable Reinsurance Arrangement is defined in Attachment B.

3 For the avoidance of doubt, the requirement to apply for approval is on the cedant life company under the proposed arrangement, not the reinsurer.

10. Where APRA approves a Referable Reinsurance Arrangement it may do so as either a reinsurance arrangement or a financing arrangement. This approval may be subject to conditions that require the life company to modify the proposed arrangement. These conditions may involve the life company being required to modify the proposed arrangement in a manner which will result in two arrangements, one to be approved as a reinsurance arrangement and the other as a financing arrangement.

11. APRA will generally consider a Referable Reinsurance Arrangement to be a reinsurance arrangement where the purpose and effect of the arrangement is to genuinely transfer significant insurance risk from the life company to the reinsurer.

12. A Referable Reinsurance Arrangement (or part thereof) that is approved by APRA as a reinsurance arrangement must be treated accordingly by the life company for prudential purposes.[4]

13. A Referable Reinsurance Arrangement (or part thereof) that is approved by APRA as a financing arrangement must be accounted for by the life company so that:

    (a) the arrangement has a legitimate purpose and effect; and

    (b) the arrangement is not likely to misrepresent, or is not designed to disguise a material risk to, the life company's current or continuing profitability, financial position, solvency or capital adequacy.

14. Where APRA approves a Referable Reinsurance Arrangement (or part thereof) as a financing arrangement, the life company must not account for the arrangement as a reinsured policy liability for the purposes of determining its **capital base** or **prescribed capital amount** under the **capital adequacy standards** or treat the arrangement as reinsurance for any other purpose.

Adjustments and exclusions

15. APRA may adjust or exclude a specific requirement in this Prudential Standard in relation to a life company.

Determinations made under previous prudential standards

16. An exercise of APRA's discretion (such as an approval, waiver or direction under a previous version of this Prudential Standard continues to have effect as though exercised pursuant to a corresponding power (if any) exercisable by APRA under this Prudential Standard.

[4] Refer to the **capital standards** and reporting standards made under the *Financial Sector (Collection of Data) Act 2001*.

Attachment A - particulars of reinsurance arrangements to be set out in reinsurance report

1. The particulars are:

   (a) the name of the reinsurer and, if it was not a life company registered under the Act, the following details about it:

      (i) its Australian Company Number or Australian Registered Body Number (if any);

      (ii) if it was a foreign entity, its place of business and any number under which it was registered in its place of business;

      (iii) the address of its registered office or, if it had no registered office, the address of its principal place of business;

      (iv) any business name it used in Australia; and

      (v) the name of any life company registered under the Act to which it was related (within the meaning of section 16 of the Act);

   (b) the type of reinsurance provided for by the reinsurance contract or group of reinsurance contracts (for example, treaty reinsurance or facultative reinsurance);

   (c) the main features of the reinsurance contract or group of reinsurance contracts;

   (d) the classes of life insurance business that were reinsured;

   (e) the categories of life insurance business within each of those classes that were reinsured;

   (f) the kinds of policies written by the company within those categories that were reinsured;

   (g) the extent of the reinsurance cover provided (including the company's retention parameters);

   (h) in the case of a reinsurance contract that does not solely provide facultative reinsurance - how any commission payable by the reinsurer was determined (including selection discount terms);

   (i) in the case of a reinsurance contract that does not solely provide facultative reinsurance - the date on which the contract was entered into;

   (j) in the case of a reinsurance contract that was still in force at the end of the financial year - the circumstances in which the contract may be terminated;

(k) in the case of a reinsurance contract that was not in force at the end of the financial year - the date on which the contract ceased to be in force; and

(l) whether the contract contains terms that would require the life company to seek APRA's prior approval under this Prudential Standard and a statement regarding whether such approval has been applied for and granted.

Attachment B - Referable Reinsurance Arrangements

Definition of Referable Reinsurance Arrangements

1. Referable Reinsurance Arrangements typically:

   (a) do not involve significant transfer of insurance risk; and/or

   (b) involve significant financing elements.

   An arrangement may involve one contract, or a combination of two or more individual contracts and/or side letters or other forms of agreement.

2. An arrangement may be a Referable Reinsurance Arrangement even if there is significant risk transfer on commencement, if there are features of the arrangement that act to limit the extent of risk transfer at certain points over the life of the contract, or on the happening of certain contingencies. Arrangements with significant risk transfer that also include significant financing elements are also likely to be Referable Reinsurance Arrangements, including arrangements where the reinsurer funds a share of the insurer's **acquisition expenses** that exceeds the share of the insurer's gross claims ceded to the reinsurer.

3. Referable Reinsurance Arrangements are often characterised by requirements placed on the life company to limit loss experienced by the reinsurer over a certain period of time. This may include arrangements designed to allow the reinsurer to achieve a specified level of return or benefit from the contract regardless of actual experience. This may be relevant where there are contingent events that could lead to the early termination of the reinsurance arrangement, particularly if there is provision for the subsequent recapture of the business transferred. The matters listed in paragraph 7 of this Attachment provide further guidance on factors that could indicate the existence of a Referable Reinsurance Arrangement.

4. While the main purpose of such arrangements is usually financing, Referable Reinsurance Arrangements can be used to affect the presentation of financial results. This can lead to a misrepresentation of the true financial position of the life company that may ultimately pose risks to policy owners.

Applications for approval of Referable Reinsurance Arrangements

5. At a minimum, the application for approval must include:

   (a) a draft contract wording or other draft proposed agreement and collateral or 'side' agreements, and any other documentation or information relevant to the transaction (including a written description of any verbal understandings and/or undertakings that are material to the operation of the arrangement);[6]

[6] Where 5(a) is not available, the life company must submit to APRA a comprehensive description of the proposed arrangement including details of any risk transfer and financing elements.

(b) details of the proposed accounting treatment and the effect of the proposed arrangement on the statement of financial position[7], capital base and prescribed capital amount of the life company over the full period of the arrangement;

(c) an explanation of how the proposed arrangement meets the criteria in paragraph 7 of this Attachment and complies with the Act (for example sections 32 and 48 of the Act); and

(d) a copy of any actuarial advice on the proposed arrangement.

6. When seeking approval, the life company must demonstrate to APRA that it has formal written policies and procedures addressing the purpose, nature and use of the proposed Referable Reinsurance Arrangement. Specifically, the life company must, at a minimum, demonstrate that:

(a) the purpose and effect of the Referable Reinsurance Arrangement is fully understood;

(b) the associated risks have been identified and addressed;

(c) appropriate internal approvals have been identified and implemented;

(d) the **Appointed Actuary** has provided advice on the Referable Reinsurance Arrangement; and

(e) all documentation has been scrutinised by suitably qualified and experienced persons.

7. APRA will only approve a Referable Reinsurance Arrangement where it is satisfied that the following criteria are met:

(a) the arrangement has a legitimate purpose and effect;

(b) the arrangement is not likely to misrepresent, or is not designed to disguise a material risk to, the life company's current or continuing profitability, financial position, solvency or capital adequacy;

(c) the financial costs and benefits of the arrangement, and the nature and potential quantum of any potential risks to policy owners, are reflected in the application for approval and the proposed accounting and disclosure arrangements;

(d) there will be no inappropriate adverse effect on the life company's balance sheet and capital position in any one period or over the entire term of the arrangement, or in the event that any contingency provided for in the arrangement occurs;

[7] Prepared with regard to reporting standards made under the *Financial Sector (Collection of Data) Act 2001.*

(e) the life company has reviewed the effect of the arrangement within the context of its overall risk management and control systems and its Internal Capital Adequacy Assessment Process; and

(f) the arrangement will not overall adversely affect the interests of policy owners.

8. For applications which are approved, APRA will consider the nature and purpose of the arrangement and deem the arrangement (or parts thereof where APRA requires the arrangement to be restructured as a condition of approval) to be either reinsurance or financing (as appropriate) for the purposes of:

(a) the calculation of the life company's prescribed capital amount; and

(b) reporting under reporting standards made under the *Financial Sector (Collection of Data) Act 2001*.