Insurance Council of Australia

3 June 2022

Ms Renée Roberts
Executive Director Policy and Advice Division
Australian Prudential Regulation Authority
Level 12, 1 Martin Place
SYDNEY NSW 2000

By email: Renee.roberts@apra.gov.au
CC: DataConsultations@apra.gov.au

Dear Ms Roberts,

Round three – Response Paper and Draft Standards - Integrating AASB 17 into the capital and reporting framework for insurers and updates to the LAGIC framework

The Insurance Council of Australia **(Insurance Council**)[1] is writing to you as an escalation point in relation to one specific issue connected to APRA's proposed suite of reporting changes. These reporting changes are mostly, but not entirely, related to the commencement of AASB17 on 1 January 2023. As we understand the origin of the proposed 0/2-month rule to replace the 2/6-month rule for reinsurance contracts, it was introduced as part of the LAGIC "tidy up" and not AASB17. There appears to be no necessity to progress this proposal in conjunction with AASB17.

The Insurance Council has been pleased to contribute to the first two rounds of this consultation process which included our submissions of 31 March 2021 and 31 March 2022, relevant extracts from which are reproduced in Appendices 1 and 2.

Our membership remains deeply concerned and strongly opposed to APRA's mooted proposals in relation to 2/6-month rule for reinsurance contracts. Those concerns are founded on APRA's proposed changes being contrary to commercial practice, impractical and likely to create unnecessary costs to be borne by consumers who are already experiencing the consequences of a hardening market.

Explanation of the two/six-month rule

There are established practices within the international reinsurance market that should be recognised by APRA when considering rule changes that constrain the extent to which APRA can act unilaterally with respect to the operation of this market.

[1]The Insurance Council is the representative body of the general insurance industry in Australia and represents approximately 95% of private sector general insurers. As a foundational component of the Australian economy the general insurance industry employs approximately 60,000 people, generates gross written premium of $59.2 billion per annum and on average pays out $148.7 million in claims each working day ($38.8 billion per year).

A high-level overview of the process and challenges are included below:

- Reinsurance brokers prepare standard and desired slip wording early in negotiations for the upcoming treaty renewal that are the insurers offer to the reinsurance market based on a 100% assumed support on that basis.
- Insurers, together with their brokers, aim for best practice in negotiating the best possible terms in all areas by inception.
- Due to developments in market conditions, reinsurers no longer accept terms on a pure subscription basis, (that is the initial offer to the market would not find 100% support from reinsurers). Therefore, to meet and declare the contract certainty requirements under GPS230, separate contracts are required for each reinsurer per treaty. (For one insurer, this involves close to five hundred separate contracts that need to be fully documented on a slip wording basis within two months of the finalisation of treaty negotiations.)

Further, it should be noted that many negotiations are not finalised until the point of inception. This situation is not expected to improve in the light of current hardening reinsurance market.

The current two-month rule (after inception) allows sufficient time to ensure that all documentation is verified according to legal intent, checked, corrected if necessary and countersigned by all parties. Any change to these requirements would result in significant regulatory burden which could expose all parties to error if forced to meet unrealistic timeframes.

Explanation of the harm caused by APRA's proposed changes

The proposed rule would be impractical to implement, particularly in the hardening international reinsurance market. It would place insurers at a negotiating disadvantage with the prospect of gaps in coverage and increased cost, both of which would be passed to customers. It would also increase the risk of error and oversights in the negotiation process that could affect business risk.

- Reinsurers have different views on terms and subjectivities which form part of the agreements reached. These are verified with the original business and legal to confirm mutual understanding. The time and resources required to complete this process within shorter timeframes than is currently prescribed would be costly, and extremely challenging that would require crucial parts of the reinsurance framework, through reinsurer negotiation on key terms, being completed in parallel.
- Reinsurers who offer collateralised solutions require a separate Trust Deed which adds to the contract negotiation and documentation complexity. Any continued hardening in the reinsurance market conditions would be likely to drive increased exposure to these markets.
- Counterparty downgrades result in immediate replacement of any counterparty that fails to meet the Risk Appetite Statement (RAS) and Reinsurance Management Strategy (ReMS) requirements. Downgrades can intervene in the normal process and cause delay.
- Reinsurer negotiating leverage would be increased by the introduction of a harder deadline that would provide reinsurers with an additional negotiation advantage, allowing them to hold out for harder terms which would potentially have a negative flow-on effect to policyholders in terms of cost and/or coverage.

Further, APRA needs to be mindful of the hardening reinsurance market conditions, cost increases and pressures on insurers, which have been driven by recent catastrophe events.

We would welcome the opportunity to discuss our concerns with you.

If you have any questions or would like to discuss further, please contact Aparna Reddy, General Manager, Policy – Regulatory Affairs, on telephone: 0427 902 960 or email: areddy@insurancecouncil.com.au.

Yours sincerely

Aparna Reddy

General Manager Policy Regulation Affairs

Appendix 1

Extract of relevant commentary in ICA submission of 31 March 2022

From cover letter

"the Industry does not support the proposed changes relating to procedural requirements for reinsurance contracts. These will drive unnecessary regulatory cost into the provision of insurance to consumers for little to no benefit: see Appendix 3, item 11;"

Appendix 3, item 11

Procedural requirements for reinsurance contracts

> *"APRA is proposing to adjust the revisions to reinsurance management requirements to an 'inception date and two-month rule', rather than requiring contracts to be fully finalised by inception. This proposal would require the terms and coverage of reinsurance contracts to be finalised by inception, but provide an additional two month period for wordings to be finalised, stamped and signed. APRA views this proposal as a transitionary measure and will consider making further revisions to require reinsurance contracts to be fully placed, executed and finalised by the inception date of the contract."*

APRA's further developed proposal does not enjoy the Industry's support.

The proposed requirement to have all contracts fully executed by inception, imposes unnecessary administrative burden on the industry, and may have a detrimental effect on the rates paid by insurers for their reinsurance programmes. These increased, regulator created costs, will ultimately be borne by consumers.

It is common practice with reinsurance programs of Australian insurers for the formal binding of reinsurers to take place, in certain circumstances, immediately prior to inception.

In practical terms, the requirement to have fully executed contracts at inception may not be viable in all cases, particularly when dealing with international reinsurers, and may have adverse effects. Whilst all bound, lines are confirmed in writing at or before the time of inception, there is still the potential for some intricacies around bespoke terms, clauses and variations and further negotiations around parts of the contracts which do not materially affect the cover provided.

Requiring reinsurers to provide their terms early enough to ensure a fully signed contract wording prior to inception is likely to disadvantage insurers in their negotiations which in turn may lead to significantly higher reinsurance costs than may be available under the current regulation. This will also mean that the achievement of contract certainty will be highly reliant on the efficiency of reinsurers' administrative abilities and therefore may be to some extent out of insurers' control.

Of particular significance in the current environment, it would be helpful to understand how the purchase of back up reinsurance covers would operate under the future state proposal, if contract certainty is required "by inception".

In particular, the industry does not support APRA's proposal to require general insurers failing to meet the inception date rule to provide detail on the actions taken to ensure the appropriate documentation is in place in their reinsurance declaration (even where the two-month rule is met). This adds additional

administrative burden for no added value, given contract certainty would already be achieved by the time the declaration is issued.

The industry also seeks further detail from APRA with respect to the Reinsurance Arrangements Statement and CEO signed Reinsurance Declaration requirements which are linked to contract certainty. Does APRA also require these to be completed at inception?”

Appendix 2

Extract of relevant commentary in ICA submission of 31 March 2021

> *"APRA Proposal 30: Procedural requirements for contracts: APRA is proposing to remove this requirement to recognise the improvement, and instead require all formal procedures to be in place by inception date of the reinsurance contract. APRA expects that industry will continue to maintain good practice and the formal procedures which are currently in place, despite this change.*

There is no member consensus as to whether this proposal is a positive suggestion or not. This is perhaps because there is presently a lack of clarity as to what the proposal is intended to achieve. The majority of members are concerned that the change will impose a significant burden and all agree that this is an important issue.

The range of feedback from members included:

- We did not envisage an issue with ensuring that the reinsurers have signed the contract by inception date as this is our current practice.
- We currently adhere to the "two and six" month rule. If the formalisation requires all placements signed and contracts checked this would present a significant challenge and place an impossible burden on organisations seeking to get this done by 1 July.
- It is not clear what APRA is seeking to replace the existing benchmarks with. What are the 'formal procedures' envisaged? At the moment APRA seems to be proposing to replace something that is clear with something that isn't?
- More detail is needed to understand what APRA is proposing needs to be done for all formal procedures to be in place by inception date. The Reinsurance Arrangement Statement (RAS) and Reinsurance Declaration are not too cumbersome to produce and have set parameters. However, procedural documents are broader and are not defined as well. They also likely contain the vast majority of information the already contained in the RAS.
- Having fully signed and stamped reinsurance treaty contracts in place by inception date will be onerous and another significant step up from current state. With reinsurer negotiations becoming tougher in a hardened RI market our members are better served with negotiating the best program placement possible, rather than diverting resources to an accelerated documentation deadline. While 6 months is now too long a time frame 0 months (at inception) would be too short (particularly if the renewal date occurs during a CAT event e.g.: 1st January.
- Whilst we understand what APRA is aiming to achieve with this proposal, it would put a significant impost on the industry particularly given that contracts are often being renewed up to the date of renewal particularly if influenced by current market conditions (e.g. a large catastrophic event). A two-month rule for all procedural documentation might be a more viable option."