



Insurance Council
of Australia

5 July 2022

Mr Gideon Holland
General Manager, Policy
Policy and Advice
Australian Prudential Regulation Authority

By email: PolicyDevelopment@apra.gov.au

Dear Mr Holland

Strengthening Crisis Preparedness (CPS 190)

The Insurance Council of Australia (**ICA**)¹ welcomes the opportunity to provide feedback to APRA on their consultation regarding the proposed draft Prudential Standard (CPS 190 Financial Contingency Planning) and acknowledges the additional time granted by APRA to make this submission.

We acknowledge and broadly support APRA's intention to ensure the Australian financial system is adequately prepared for financial stress. We also note that other associations including the Australian Banking Association (ABA) and the Actuaries Institute have provided submissions on a number of issues, which we do not propose to cover again in this submission. Our submission focuses on some key proposals in the draft standard that could result in unintended consequences for the insurance industry. We would also like to raise some concerns that are specific to non-SFI insurers.

Below are key feedback points:

- Some requirements in the draft CPS 190 overlap with the existing requirements that provide for financial contingency planning by APRA regulated entities and could result in inefficiencies and unintended consequences. We therefore ask that APRA update GPS 110 to clearly articulate the role of ICAAP, Recovery Planning and Resolution planning to facilitate clearer segregation of these three phases of capital management.
- Also, in doing so, consider integrating as much as possible of the CPS190 requirements with the existing ICAAP process in relation to trigger frameworks, stress testing and monitoring to minimise duplication, inconsistency and additional costs to APRA regulated entities.
- Stress testing and scenario testing are valuable tools in business as usual and contingency planning for capital management, as well as the operational management of strategies. We are concerned by the number of requirements for stress testing across different APRA standards.
 - CPS 190 asks insurers to include at least two scenarios (systemic and idiosyncratic) severe enough to threaten the entity's viability and test its recovery options.

¹The Insurance Council is the representative body of the general insurance industry in Australia and represents approximately 89% 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).

- At the same time, insurers are asked to develop claim risk scenarios as part of CPG 229 Climate change financial risks (released in 2021)². Certain climate scenarios (e.g. no transition to low-carbon economy) are long-term slow emerging changes over decades that do not involve traditional recovery options. Other scenarios need to be developed over successive stress tests given the complex nature of climate risk and APRA's acknowledgement it needs to evolve over time.
 - We propose that the scenario analysis requirements in the draft CPS 190 are completed as part of the existing ICAAP stress and scenario process over a multi-year cycle which will enable better integration with APRA's other stress testing initiatives. This will allow management and Board more time to focus on the results and implications of each stress test over a broader risk continuum.
- Exit options and associated pre-positioning steps to support exit options in CPS190 are most akin to resolution planning and as such should be combined into resolution planning standard (CPS 900).
 - Recovery options and exit options lie on different points of the supervisory crisis continuum. Orderly exit (currently in CPS 190) and disorderly exit (CPS 900) options (whether it be transfer of business or wind-down of business) share similar considerations in relation to feasibility or pre-positioning measures (changes to shared services, legal structure, etc).
 - In order to reduce overlap, improve consistency and minimise additional compliance cost, it is more pragmatic to have all exit options and considerations self-contained in CPS 900.
- We ask that APRA clarify its expectations on 'reasonable' preparatory steps to support contingency planning in advance of recovery actions including legal, financial, structural, etc).
 - Certain structures (such as maintaining common reinsurance contracts or IT systems across an insurance Group) are setup to enable the efficient running of the business on a 'going concern' basis.
 - By dissolving certain structures to improve the resolvability of exit options (eg. separate reinsurance or IT systems to simplify selling a segment) it is likely to damage the underlying profitability levels and subsequent trade-through ability and resilience of an APRA regulated entity.

We are concerned that the draft Prudential Standard will impose significant regulatory burden on insurers and in particular, non-SFI insurers as they may not have participated in APRA's pilot exercise on recovery planning. We note that the regulatory burden to non-SFI insurers is likely to be significant and therefore should be assessed by APRA through a regulation impact statement.³

Comments relevant to non-SFIs only

The draft Prudential Standard does not provide for recognition of financial contingency plans developed by the parent entity within a global insurance group under the supervision of an overseas prudential authority. In instances where an APRA regulated entity is a category B insurer the financial contingency plan for the parent of the group may in part or whole meet the intent of the draft Prudential Standard. Even if this is not the case, coordination of plans may avoid unintended consequences such as inconsistent planning that could lead to ring-fencing of capital that could be detrimental to the overall group in pre-crisis and crisis situations. Accordingly, the draft Prudential Standard should contain provisions that enable reliance on financial contingency

² CPG 229 states that it provides guidance on compliance with Prudential Standards CPS 220 Risk Management (CPS 220), SPS 220 Risk Management (SPS 220), CPS 510 Governance (CPS 510), SPS 510 Governance (SPS 510)

³ Regulation impact statements are required for all regulatory proposals and the only exception is where a proposal will have an insignificant impact (on business or the community). (Australian Government Guide to Regulatory Impact Analysis, 2020, page 15.)

plans developed within a global group and for APRA to coordinate with the overseas authority overseeing the parent or group.

A lower level of planning required for non-SFIs is an appropriate application of the proportionality principle as outlined in the Discussion Paper. To ensure there is no unintended spill-over of requirements, the draft Prudential Standard could make clear that small insurers would not be required to comply with the requirements for SFIs by virtue of membership of a group containing an SFI.

The ICA is concerned that the proposal appears to create a new penalty for non-SFI insurers where APRA is not satisfied with their financial contingency plan:

40. APRA may adjust prudential requirements for capital and liquidity where it assesses there to be material weaknesses in the contingency plan.

It is not clear on what basis APRA would adjust prudential requirements. It is also not clear how APRA would determine the extent of additional risk presented by the insurer and the quantum of additional capital and liquidity requirement and how it would relate to existing requirements. In face of the lack of guidance, the quantum could be significant and affect the competitiveness of a non-SFI insurer. It may also be out of step with and potentially duplicate existing penalties and remedies that are already available to APRA for a breach of a Prudential Standard. Any change to capital and liquidity requirements should be decided under existing standards and processes and not through a parallel process as is suggested by section 40. Section 40 should be removed from the draft Prudential Standard.

We trust that our initial observations are of assistance. If you have any questions or comments in relation to our submission please contact Aparna Reddy, General Manager, Policy – Regulatory Affairs, on telephone: + 61 427 902 960 or email: areddy@insurancecouncil.com.au.

Yours sincerely



Andrew Hall
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