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To Whom It May Concern

Aon welcomes the opportunity to provide comments on APRA's consultation on integrating AASB 17 into the capital and reporting frameworks for insurers and updates to the LAGIC framework.

Aon agrees to the main body of our submission being made public. Aon notes the attachment relate to a separate matter outside of APRA's specific consultation questions and therefore the attachment should remain in confidence.

As a leading reinsurance broker, Aon is in a unique position to provide APRA with comments related to reinsurance arrangements. Whilst we are not an APRA-authorized insurer or reinsurer, we are a key stakeholder in the industry and see a large majority of transactions and documentation relating to reinsurance placement. The views presented here are based on both our experience in placing reinsurance arrangements for APRA-authorized insurers and insights gleaned from our global operations in the (re)insurance industry. We would welcome the opportunity to meet with APRA to discuss the points raised in this submission in relation to reinsurance documentation and second balance date collateralisation.

#### Section 4.6 GI – Default stress

Aon agrees that double counting of capital requirements is not a preferred outcome of the framework and notes that APRA appears to have proposed to adjust the capital for both insurers and reinsurers.

Regarding the reinsurer capital charge: We are of the view that APRA has misunderstood the information provided to reinsurers when a quota share (whether whole account or otherwise) is in place. Typically, information relating to the quota share transaction is provided from an insurer to the reinsurer (often via a reinsurance broker) on a quarterly basis. Each quarter, premiums for the quarter as well as adjustments for prior quarters (such as cancellations, rectification of what was unclosed business etc) are provided. The information provided does not include detailed customer level information, so the reinsurer would not be able to identify unpaid premium or unclosed business (prior to it becoming unpaid premium and then paid premium) as part of its share of the underlying premium, and there would therefore need to be assumptions and approximations made to determine an adjustment to capital charge for reinsurers.

Regarding the insurer capital charge: Aon suggests that, if this proposal goes ahead, APRA apply the amended methodology to all business subject to a quota share arrangement. It is not clear to Aon as to why quota shares for a portion of an insurer's total portfolio (eg motor, property, casualty) would not have the same issue with double counting. We would note that, given the insurer can identify the business that is unpaid and/or unclosed, they would be able to determine if it is subject to a quota share and adjust accordingly.



## Section 4.9 Reinsurance

### *Operational Risk (4.9.1)*

Aon notes that the operational risk charge uses gross written premium and net technical provisions to determine the proxy for exposure to operational risk. As APRA noted in the development of this charge ten years ago, there are shortcomings to using these measures. For example, an insurer increasing premiums charged to the same customers year on year (to ensure products remain profitable) increases the operational risk charge, without any necessary change to the risk profile of the insurer. Another example is an insurer entering a loss development cover that reduces net technical provisions and does not necessarily decrease operational risk. Entering into a reinsurance contract with a reinsurer, or indeed a panel or reinsurers, may in fact increase operational risk exposures and so it does not appear to be appropriate to automatically reduce the operational risk charge simply because a quota share exists.

It is also not clear why entering into a 'long term quota share arrangement' or 'whole of account quota share arrangement' (both of these terms are used) are any different to other reinsurance arrangements when determining the operational risk charge. If APRA was to make a change to the operational risk charge, Aon would encourage APRA to consider all types of reinsurance and what the operational risk charge "reduction" would be. We are of the view that it certainly would not be the full extent of the three percent currently held on that portion of gross premium.

If APRA proceeds with this proposal (and limiting to types of reinsurance), clarification should be made on the definition of contracts that do qualify for this treatment, including whether they need to be with an APRA-authorized insurer, given the modification is in relation to double count of risk charge.

### *Duration of Policies (4.9.2)*

Aon welcomes the review by APRA of the treatment of multi-year reinsurance transactions in its capital framework. Aon agrees that the capital impost may deter insurers from placing multi-year reinsurance in Australia given the local reinsurer is required to hold capital for the duration of the contract, which may be materially more than the insurer (and reinsurers globally). Aon notes that whole account quota share arrangements, as well as quota shares that cover some (but not all) of an insurer's portfolio, can run for terms other than those specified by APRA. Aon encourages APRA to ensure the treatment is applied uniformly to both non-whole account, as well as arrangements that are less than five years. If APRA is going ahead as per the original proposal, clarification should be made on the definition of multi-year and "whole account".

In terms of the adjustment, Aon suggests that APRA consider a methodology whereby (for the purposes of the insurance risk charge) the premiums liability and net written premium of the reinsurer are reduced to take into account the premium that would be received from the cedant (insurer) in the same period as the liability. Whilst not removing the impost altogether, it may provide a suitable middle ground that is relatively easy to implement.

### *Procedural requirements for contracts (4.9.3)*

Aon agrees with APRA that great improvement has been made in the insurance / reinsurance industry since the introduction of the two and six month rules. However, Aon is strongly opposed to the removal of these requirements and replacing them with inception date requirements.

There appears to be a potential misunderstanding by APRA of commercial practices: in particular the difference between what occurs prior to inception and what occurs in the months following the inception date. It is worth noting that every reinsurance transaction that Aon completes on behalf of APRA-authorized insurers is placed on the basis of "contract at inception" rather than the old practice of a Placing Slip followed by a Contract Wording at a point after inception. "Contract at inception" entails an insurer agreeing with us their required contract wording and reinsurers will agree key details, including premium, share of placement, limits,



deductibles etc and appropriately execute a reinsurer signing page attaching to the proposed contract. However, there may be outstanding terms or conditions (eg sanctions clauses, privacy etc) that are being individually negotiated and updated after inception, and these need to be formally completed prior to the full treaty wording being executed by all parties (being reinsurers and the insurer). Note that this process needs to be completed for each reinsurer on each reinsurance contract, which can add to a large total for some insurers. After all terms and conditions are agreed, the appropriate person within the insurer signs all contracts. Requiring all of these contracts to be fully executed prior to inception is effectively bringing forward negotiations that occur on the key components of the transaction so that full wordings can then be agreed with individual reinsurers prior to the start of the treaty year. This is not an ideal negotiation position for insurers and may result in adverse outcomes for insurers and ultimately policyholders.

Whilst it is likely that the industry comfortably meets the current two and six month rules, that is not to suggest that there is significant flex in the process to bring that process forward to having all contracts fully finalised and executed at inception. Aon would welcome an opportunity to meet with APRA and take your team through the procedures in terms of placement, inception and documentation after inception.

In addition, Aon would like to raise an issue that we discussed with the Insurance Risk team in 2020 regarding electronic signing of reinsurance documentation. Attached to this response is feedback from Aon and the APRA response at the time on this matter. We would request that APRA consider amending GPS 230 to encompass electronic signing.

#### Question 27 – Additional updates

Aon would like to raise consideration of revisions to APRA's requirements for second balance date collateralisation requirements. Aon would welcome the opportunity to meet with APRA to discuss these further.

The first matter is to consider a change to the prudential policy to (a) make it later than the second balance date and/or (b) have a threshold to remove small matters that have a disproportionate cost and administration burden. Aon makes this proposal because we find that we are having to implement collateralisation arrangements on either reinsurance contracts covering property portfolios where an event has occurred close to the first balance date and all matters have not been quite finalised 12 months later (ie when second balance date occurs); or for small claims that are not material in nature to the insurer or reinsurer but require collateralisation because of the contract wording. We believe these amendments would still ensure APRA's prudential intent is implemented but remove the burden of implementing small amounts and/or short term collateralisation, which cost insurers and ultimately policyholders money.

The second matter is that APRA consider allowing for electronic signatures and approvals for implementation of the arrangements. Similar to the points raised in relation to electronic signatures for reinsurance arrangements, we are of the view that the market will continue to evolve and use of electronic signatures and approvals will further increase. It would be beneficial to all parties that use of electronic means be explicitly stated as acceptable.


Thank you for the opportunity to comment on APRA's proposals. We look forward to discussing these matters further with you.

Kind regards

*[signed]*

  
President APAC, CEO Australia & NZ  
Reinsurance Solutions, Aon

*[signed]*

  
Head of Broking  
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