INSURANCE COUNCIL OF AUSTRALIA

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Dear Mr Grummit

LAGIC: SUBMISSION ON APRA'S RESPONSE PAPER DECEMBER 2011

The Insurance Council of Australia[1] (Insurance Council) appreciates the meetings and discussions that APRA has had with the Insurance Council and its members throughout the lengthy LAGIC consultation process. Most recently, we are grateful for the meeting on 16 February 2012 which went through issues that members had identified with APRA's Response to Submissions Paper of December 2011 (the Response Paper).

You would be aware from previous Insurance Council submissions on LAGIC that members have raised a number of concerns for consideration by APRA. However, as reflected in the discussion on 16 February, there are no general issues with the LAGIC methodology that members wish to pursue further as an industry.

We are aware that several members have taken up with APRA questions specific to their own operations about application of aspects of the LAGIC proposals. Again, the Insurance Council acknowledges APRA's willingness to consult and develop mutually satisfactory outcomes to regulatory matters.

I would take the opportunity to flag that there may be issues which the industry will want to revisit in the future after experience of working with the new regime. Operational Risk for example is one area that APRA acknowledged in the Response Paper could be further refined in light of developments in the modelling and measurement of this risk.

The Insurance Council welcomes APRA's positive reaction to the suggestion of a joint industry/APRA workshop on draft GPS 116. We are currently working with APRA to identify a suitable date. We believe that this co-operative approach should facilitate the introduction of the Insurance Concentration Risk Charge (ICRC).

The Insurance Council of Australia is the representative body of the general insurance industry in Australia. Our members represent more than 90 percent of total premium income written by private sector general insurers. Insurance Council members, both insurers and reinsurers, are a significant part of the financial services system. September 2011 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross written premium of $35.1 billion per annum and has total assets of $113.9 billion. The industry employs approx 60,000 people and on average pays out about $104 million in claims each working day.

Insurance Council members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, and directors and officers insurance).

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You may be aware that the Insurance Council made a submission to APRA on 3 August 2011 with suggestions for the determination of the ICRC for Lenders' Mortgage Insurers (LMIs) with the aim of simplifying and giving greater certainty to the calculation. A particular issue was the deduction for premium liabilities. APRA decided not to take up the suggestions made but the Insurance Council considers that there is a need to clarify how the deduction is to be calculated in order to minimise the inconsistencies across LMIs. The Insurance Council would appreciate the opportunity of a separate meeting for its LMI members to discuss with you and your colleagues the LMI aspects of the ICRC.

Further to discussion at the 16 February meeting, we would like to formally propose that the timing of the annual provision of an insurer's Internal Capital Adequacy Assessment Process (ICAAP) should be flexible in order for it to fit in with preparation of the insurer's business plan, and the timing of the FCR and ILVR would remain as it is at 4 months from the end of the insurer's financial year.

In the context of the discussion on the ICAAP requirements, we valued APRA's clarifications on specific points raised by members. Particularly welcome was APRA's offer include in the next Response Paper that it was willing to work with industry on implementation of the LAGIC changes and would be flexible in its compliance expectations in the "settling-in" period. This is especially significant given that in practice, insurers will need to have their ICAAPs approved by their Boards and in place well before the final of APRA's Prudential Practice Guidance will be released.

The proposed Common Equity Tier One (CET1) capital ratio is a significant concern to a subset of the Insurance Council members. It represents a considerable departure from current practice, decreases the flexibility of capital management options whilst not appearing to materially increase policyholder protection. In order to preserve a level playing field for all insurers, the Insurance Council supports APRA's ongoing dialogue with affected companies to find a mutually acceptable outcome on this issue. As APRA recognised at the 16 February meeting, general insurers are not banks; they face different risks and manage them differently. It is crucial for example that APRA take account of the fact that while banks may raise capital with a 5 year maturity, general insurers operate on a 20 to 30 year timeframe.

In addition, you will recall the discussion at the meeting on the adverse market implications of requiring insurers to hold a set percentage of their Prudential Capital Requirement (PCR) as CET1 capital. This would enable analysts to calculate an insurer's PCR, a figure that is not publicly known. Consequently, the Insurance Council would propose that any reference to the level of CET1 to be held should be a percentage of the Prescribed Capital Amount, rather than the PCR which is not disclosed.

The Insurance Council would like to emphasise the importance of realistic transition provisions in relation to the ICRC horizontal requirement and composition of capital. We welcome APRA's willingness to discuss these issues both at an industry and individual insurer level. We are currently consulting members on proposals that could be put to APRA.

If you require further information in relation to this submission, please contact Mr John Anning, Insurance Council's General Manager Policy – Regulation Directorate at [redacted].

Yours sincerely

Robert Whelan
Executive Director & CEO