

General Manager
Policy Development
Policy and Advice Division
Australian Prudential Regulation Authority
1 Martin Place (Level 12)
Sydney, NSW 2000

31 March 2022

David Field
Chief Financial Officer

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[Redacted]

Dear Sir or Madam

Integrating AASB 17 into the capital and reporting frameworks and updates to the LAGIC framework

In December 2021, APRA released a response paper on its previous consultation on proposals outlined in the Discussion Paper entitled “Integrating AASB 17 into the capital and reporting frameworks for insurers and updates to the LAGIC framework”. The proposals outlined in the response paper and the changes detailed in the draft prudential and reporting standards released are open for consultation until 31 March 2022. APRA has invited written submissions on their proposals, provided they are submitted by 31 March 2022.

Munich Re is pleased to be able to provide the attached comments in respect of APRA’s proposals and draft prudential standards.

Munich Re conducts insurance business in Australia across both life and general insurance. With this letter we are providing a response in respect of our life insurance operation, Munich Reinsurance Company of Australasia Ltd (MRA). Our comments are set out in Appendix A.

Should APRA require further clarification of comments made, please do not hesitate to contact me.

Yours sincerely,

David Field
Chief Financial Officer
Munich Re Australia

**Munich Holdings of Australasia
Pty Limited**

ABN 80 000 159 651
Level 28
60 Martin Place
Sydney NSW 2000

PO Box H35
Australia Square
Sydney NSW 1215

Tel.: +61 (2) 9272 8000
www.munichre.com

Appendix A

APRA's Response Paper

Sections 3.3 APRA Product Groups and Allocation principles

MRA supports the proposal to remove the reference to the word "profitability" in the APRA allocation principles given AASB 17 would require profitability/ onerousness to be determined at a level different to APRA product groups therefore allocating AASB 17 numbers to more/less granular level would likely give misleading indicator of profitability. For example, in applying APRA's proposed product grouping, Lump Sum Risk business and Disability Income Insurance will be separated into different product groups.

From MRA's perspective, treaties are priced, entered into and administered as a whole and according to the treaty policy terms and conditions. These treaties may include both Lump Sum Risks and Disability Income coverages. AASB 17 accounting will appropriately follow MRA's reinsurance policies (treaties) and report their profitability according to those standards.

MRA notes that APRA has maintained the separation of Lump Sum Risk business into death, TPD and trauma for capital data. MRA observes that within lump sum business, the split between death and rider (including acceleration of benefits) will produce loss ratios that are misleading under some circumstances. For example, claims incurred under rider benefits that are an acceleration of death benefit could significantly outweigh the premium for these rider benefits, leading to a favourable reported profit position for the death benefit but reported losses for the rider benefits.

APRA should note that it may be inappropriate for other government agencies to rely on these allocations.

Section 3.1 Discrete quarter reporting

From 1 July 2023, APRA's revised quarterly reporting forms will be on a discrete reporting period basis and not on a cumulative year to date basis. MRA will complete the quarterly reporting forms on a discrete reporting basis using the results generated on a cumulative basis.

Prudential Standards

LPS 110: Capital Adequacy

With respect to the paragraph 49 (c) and in particular the accompanying footnote, MRA's view remains unchanged from last year and believes that the proposed adjustment is one-sided (i.e. only when the sum of changes in fair value of financial assets through OCI plus the net insurance financial result are negative). To reflect the implied investment profit or loss effects for (re)insurers adopting the FVOCI measurement method, we believe the adjustments should be applied irrespective if the sum is negative or positive.

LPS 112: Capital Adequacy: Measurement of Capital

APRA has proposed a range of additional regulatory adjustments to achieve a neutral impact on the capital base. Under AASB 17, the treatment of funds withheld/deposit back arrangements will change and where appropriate insurers will be required to consider cash flows relating to projected funds withheld/deposit back components in the measurement of (re)insurance contract liabilities/assets.

MRA is currently working through the impact of these changes and would be better placed after completion of the APRA QIS to provide further comments on the impact on accounting equity and capital base, as well as whether further liability adjustment components would be required to achieve a neutral capital base outcome. Should MRA's analysis of these changes indicate that there are unexpected impacts on the capital base, MRA will contact APRA.

LPS 114: Capital Adequacy: Asset Risk Charge

MRA notes that there are additional regulatory adjustments (insurance policy receivables and payables) to LPS 112 which are then required to be stressed under LPS 114. MRA is currently working through the impact of this change and notes that they have the potential to materially impact the prescribed capital amount.

LRS 118: Capital Adequacy: Operational Risk Charge

MRA notes that LRS 118 only includes the underlying components that make up the calculation of the ORC and does not actually include the calculation of the ORC itself, this being only shown in LRS 110. We would recommend, for completeness, including the ORC in LRS 118.

LPS 340: Valuation of Policy Liabilities

MRA notes that under the proposals of this standard, non-participating business policy liabilities will be determined based on AASB 17 whereas the risk-free best estimate liability (RFBEL) under regulatory capital calculation is a separate construct to policy liabilities and needs to be determined based on requirements set out in LPS 340 and LPS 112.

MRA notes that paragraph 25 of LPS 340 states that policy liabilities (in respect of life insurer non-participating business) are to be determined in accordance with the relevant accounting standards. Given that the relevant accounting standards that will apply is AASB 17 which does not actually define the term "policy liabilities" it would seem to be ambiguous as to how APRA intends policy liabilities to be determined.

MRA notes the substantial changes introduced in LPS 340 and for further clarity would suggest requirements for participating, non-participating business and friendly society business be separated out to aid clarity where appropriate, for example the requirements set out in paragraphs 73 and 81.

MRA notes clarification has now been provided in LPS 340 paragraph 81 explaining that when determining the risk-free best estimate liabilities, the discount rate is specified in LPS 112. LPS 112 paragraph 4 states that the discount rate should be set equal to the risk-free discount rate which is defined

in LPS 001 as being based on yields of Commonwealth Government Securities. AASB 17 also defines risk-free discount rates and MRA notes that, many companies are adopting the EIOPA Swap Rates as the risk-free yield curve in calculating the AASB 17 Insurance Contract Liabilities. Using two different sets of discount rates for the AASB 17 liabilities and risk-free best estimate liabilities would seem to contradict APRA's stated principle to achieve alignment with AASB 17 and it is no longer necessary from a policy perspective to define a different risk-free yield basis in either LPS 340 or LPS 112

Paragraph 82 of LPS 340 makes it clear that investment management expenses may be allowed for in the discount rate in determining the best estimate liability and risk-free best estimate liability. Paragraph 86 also explains that the best estimate assumption for investment management expenses must be sufficient to cover the cost of managing an asset profile which would be expected to yield a return equal to the discount rate assumptions. However, MRA notes that LPS 112 itself is silent on the allowance for investment management expenses and would recommend that APRA provide some clarity within LPS 112 itself to avoid the risk of misinterpretation. For example, MRA notes that where the discount rate is set to be risk-free it is likely to be interpreted that there is no adjustment for investment management expenses.