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Dear Mr Grummitt

SUPERVISION OF CONGLOMERATE GROUPS

The Insurance Council of Australia¹ (Insurance Council) welcomes the opportunity to comment on the APRA's Response to Submissions on Supervision of Conglomerate Groups (the Response Paper). We appreciate the additional time given to finalise this submission.

After going through the Response Paper and associated draft prudential standards, the Insurance Council would like to flag the following issues:

The scope of what may be taken to be a Level 3 group is very broad and not clearly defined:

- If APRA proposes to retain the right to include or exclude specific institutions that make up a consolidated Group, the Insurance Council urges APRA to publish guidance on how they will make this determination and what factors will be used to inform this decision.
- The current definition of Level 3 group could also be read as applying to overseas based groups because they have a Level 1 subsidiary in Australia.
- It is illogical and impractical that a small regulated entity may be made the head of a Level 3 group with responsibilities over much larger non-APRA regulated entities.
- It would be more effective to define the composition of a Level 3 group with reference to the level of risk presented.
- If APRA visits an overseas non-APRA regulated entity as part of its supervision of a group, APRA should be accompanied by a representative of the appropriate regulator in order to fully appreciate the environment in which the entity is operating.

1) 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 2012 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross written premium of \$37.9 billion per annum and has total assets of \$115.7 billion. The industry employs approx 60,000 people and on average pays out about \$116 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).

The industry cannot comment meaningfully on risk exposure aggregation without considering draft prudential standard on capital adequacy. The Insurance Council requests that any comments made on this matter be taken as preliminary pending the industry having the opportunity to consider the details of APRA's proposed approach on capital adequacy.

The Insurance Council and its members are concerned about giving APRA greater powers without adequate safeguards to ensure they are used solely to achieve prudential objectives. Presumably, in a free market economy such as Australia's, good governance would require there be such a connection to justify APRA's intrusion into the everyday management of an organisation.

As argued in previous Insurance Council submissions (most recently on Strengthening APRA's Crisis Management Powers), APRA should be mindful of the impact of additional regulation on the international competitiveness of Australian insurers and not put Australia "ahead of the pack" on regulatory matters. There is the danger that if domestic requirements are implemented prematurely, regulated entities will need to rework compliance systems to meet subsequent international regulatory initiatives.

It is essential that implementation times are aligned with developments occurring internationally. In particular, the recent Basel Committee on Banking Supervision (BCBS) final paper on risk data aggregation reporting which articulates similar requirements to 3PS 221 (Aggregate Risk Exposures) proposes implementation by 2016 for Globally Systemically Important Financial Institutions (G-SIFIs).

There is the possibility of serious unintended and unwarranted consequences for non-Australian or non APRA regulated entities which are part of an insurance group. In terms of competition in the Australian market, APRA's Level 3 framework could place non-APRA regulated businesses viewed as part of a conglomerate group at a competitive disadvantage compared to equivalent businesses held outside a conglomerate group that will continue to be subject only to the existing non-APRA requirements.

APRA's Level 3 framework should have regard to comparable requirements in other jurisdictions. APRA already has in place MOUs with a number of overseas regulators which provides a mechanism to access relevant information. In addition, IAIS principles on supervisory colleges also exist. To the extent they are equivalent, compliance with the foreign requirement should be recognised as satisfying APRA's Standards. This should be clarified in the prudential standards. Attention should also be given to how differences between APRA and local jurisdiction requirements are resolved and how more extensive APRA requirements would be communicated to foreign regulators.

We understand that APRA is willing to consider applications for transitional relief on a case by case basis. However, given the substantial changes to systems and processes required for some members to become compliant with APRA's requirements for Level 3 groups and the numerous other changes taking place in the regulatory regime (for example implementation of the LAGIC outcomes), the Insurance Council submits that the proposed implementation date of 1 January 2014 should be reconsidered.

Moreover, consultation on the prudential practice guides and reporting standards will occur over the 'course of 2013' and the industry is unlikely to see all the complete package of requirements finalised until the second half of 2013. This provides members with less than six months to develop and implement compliance frameworks and monitoring processes to meet the obligations. Given the short timeframe, insurers may be required to implement an interim manual solution.

As noted above, APRA's current proposed timing of 1 January 2014 does not align to the BCBS proposal for a blanket transition period until 2016 for banks identified as being a G-SIFI. The Insurance Council advocates an equivalent transition period to 2016 for the Level 3 group requirements.

Specific comments on the draft prudential standards are detailed in the Attachment. The Insurance Council and its members would welcome the opportunity to meet APRA officials to discuss the matters raised in this submission.

If you require further information in relation to this submission, please contact Mr John Anning, Insurance Council's General Manager Policy – Regulation Directorate by email: janning@insurancecouncil.com.au or tel: 029253 5121.

Yours sincerely



Robert Whelan
Executive Director & CEO

**SUPERVISION OF CONGLOMERATE GROUPS: INSURANCE COUNCIL COMMENTS
ON DRAFT PRUDENTIAL STANDARDS**

3PS 001 Definitions

Para 5: This states that:

“Level 2 means supervision applied by APRA to an ADI Level 2 group or a GI Level 2 group.”

The Insurance Council suggests that this be changed to:

“Level 2 means supervision applied by APRA to an ADI Level 2 group or a General Insurance Level 2 group.”

APRA-regulated institution: As recognised in the Treasury Consultation Paper on Strengthening APRA’s Crisis Management Powers and supported in the Insurance Council submission of 31 January 2013, the Insurance Act 1973 definition of subsidiary needs to be brought into line with the Corporations Act 2001 definition for ‘subsidiary’ and so become consistent with the Banking Act 1959 and the Life Insurance Act 1995. Consequently, until this occurs, the definition of “APRA-regulated institution” in the proposed 3PS 001 should be changed to reflect the updated versions of GPS 001, ADS 001 and LPS 001.

Aggregated Risk Exposures 3PS 221

Responsibilities of a Board of a Level 3 Head

Para 11(c): It is not clear what a Board is required to do in order to engage in “active oversight” of the approach to the identification, measurement, management and monitoring of aggregate risk exposures and compliance with the aggregate risk exposures policy.

The aggregate risk exposures policy

Para 12(c): It is not clear how the policy would “consider the impact of material changes in macroeconomic conditions, including foreign exchange rates, interest rates and inflation”. Rather, it seems to be something that the regulated entity should do.

Para 13: The proposed matters that the aggregate risk exposures policy should take into account are very detailed and would require considerable work without any strong practical justification. Satisfying the level of detail required would effectively also place the requirements on Level 2 entities.

Para 14: Given the number of factors to be looked at, stress testing and scenario analysis will be a significant burden. A materiality filter should be applied.

As the aggregate risk exposures are at the Level 3 group level, it is unclear whether risk factors relevant to one sector, for example credit risk for banking, will also need to be applied to the general insurance parts of the group. It would make more sense for the Level 3 group to total all sectoral risk exposures calculated according the prudential requirements for that sector.

Intra Group Transactions and Exposures (ITE) 3PS 222 Responsibilities of the Board of a Level 3 Head

Para 11: This appears to effectively require **all** institutions in the Group (regulated and unregulated) to have limits in place with regards to all other entities (regulated and unregulated) within the Group. This is unnecessary and should only apply to entities that are material.

Para 11(a): There are currently no quantitative limits which apply to ITEs for general insurers at Levels 1 and 2. Is APRA intending to apply them to Level 1 and 2 general insurers as well as banks?

Para 11(b): This provision touches on matters dealt with in resolution plans. The Insurance Council is interested to know whether APRA is intending to require general insurers to develop these.

Para 13 (a): This requires exposure limits be put in place for the Level 3 Group for a very wide range of exposures. This negates the ability of the Level 3 Head to determine what their material aggregate risk exposures are (in consultation with APRA). A conglomerate's Risk Appetite Statement and supporting RASs will already detail the Group's risk appetite and the exposures the Group takes.

For market risk exposures, the standard effectively requires new limits for exposures to paragraph 13 (a) (vii) various asset classes such as equities, property holdings and other investments and (viii) market risks such as interest rate, foreign exchange and commodities. Groups will already have a framework of exposure limits in place that adequately govern material market risks across the Group including its insurance and funds management businesses.

Para 13(f): The Insurance Council would appreciate clarification of the meaning of "transparency" in this context. Is APRA looking for more detail on third party dealings or more evidence of the decision-making process such as defined processes and Committee minutes?

Para 14: Similar to the concern expressed regarding para 14 in 3PS221, the Insurance Council questions the need for such extensive stress testing. It does not seem necessary to repeat stress testing at Level 3 that has been satisfactorily performed at Level 1 and Level 2.

Para 16(a): Will it be necessary for there to be written service agreements between Level 1 and Level 3 entities?

Para 16(b): All operations present some level of risk. The wording of this provision should be tightened to give a better indication of when safety and soundness has been undermined".

Audit and Related 3PS 310

Conglomerates will have a large number of non-APRA regulated entities. If all non-regulated entities are within scope then this will pose significant costs and process difficulties.

Outsourcing CPS 231

Interpretation

Para 15: The outsourcing by the international business of a group to a service provider outside its local jurisdiction appears to fall within the definition of para 14. The international business of a group had not been previously required to comply with APRA's 'offshoring' outsourcing requirements and the Insurance Council submits that this position should be reinstated in the absence of any good policy reason to the contrary.

APRA access to service providers

Para 35: There may be significant practical difficulties in ensuring that an outsourcing agreement for an international business provides APRA access to documentation and information related to that agreement. The Insurance Council therefore recommends that the requirement in relation to international businesses within a Level 3 group should be on a best endeavours basis.

Business Continuity CPS 232

Business Continuity Management

Para 21: As explained in the covering letter, the Insurance Council is concerned that the standard is intended to apply to non regulated entities within the Level 3 group. Without prudential justification, this would be an unwarranted intrusion to the management of a non regulated business.

Governance CPS 510

Requirements of a Head of a Group

Para 14: This reads as:

"The Head of a group must develop and maintain governance arrangements for the group."

It is felt that the current wording of this obligation would impose an unsustainable burden on the individual holding the head of group position, especially in a large group.

The Insurance Council recommends that the wording of CPS 510 paragraph 14 be changed to:

"14. The Head of a group must ensure that appropriate governance arrangements are developed and maintained for the members of the group covered by this Prudential Standard."

Para 15: This introduces the following new requirement:

"15. Where a member of a group that is not an APRA-regulated institution engages in business activities that may have a material financial or operational impact on the group, the Head of a group must ensure that such business activities are undertaken in a way that complies with relevant requirements of this Prudential Standard."

In the Draft Prudential Standards most, but not all, existing instances of 'regulated institution' have modified to 'APRA-regulated institutions'. So it would appear that the new paragraph 15 requirement would apply to any requirements that do not include the words "APRA-regulated institution".

However, there is ambiguity as:

- CPS 510 paragraph 13 says this Prudential Standard only applies to APRA-regulated institutions;
- The CPS 510 paragraphs between 16 and 45 are all part of section that has the heading “**A. Governance arrangements – locally incorporated APRA-regulated institutions**”. However, some of the paragraphs / requirements in this section include the words ‘APRA-regulated institution’ whilst other paragraphs / requirements in this section do not include these words.

The Insurance Council has serious concerns if the omission of the words “APRA-regulated institution” between paragraphs 16 and 45 is deliberate and the intention is that such unqualified paragraphs are subject to the new paragraph 15:

- a) The first sentence in paragraph 28 – i.e. “28. The Board must have a majority of independent directors at all times.” which is not qualified to only apply to an “APRA-regulated institution”, even though the remainder of this paragraph is applicable only to “a locally incorporate APRA-regulated institution”.
- b) Paragraph 30 –i.e. “30. A majority of directors present and eligible to vote at all Board meetings must be non-executive directors” which again is not qualified to only apply to an “APRA-regulated institution”.

These requirements should not be applied to the members of the Level 3 group that would be covered by the new paragraph 15, because:

- These subsidiaries are already subject to the oversight of the boards of the APRA-regulated entities and/or the main NOHC board and as such there seems to be no value in creating further ongoing cost and administrative burdens in managing these entities, and
- Some of affected subsidiaries operate in overseas jurisdictions where these requirements clash with the local requirements, leading to an uneven playing field.

In order to remove this ambiguity, the Insurance Council recommends that all the CPS 510 paragraphs between 16 and 45 be updated to include the words ‘APRA-regulated institution’ and paragraph 15 should explicitly identify the paragraphs to which it applies to.

Remuneration Policy

Para 53: This introduces the following changed requirement (change shown in blue):

*“53. For the purposes of this Prudential Standard, remuneration arrangements include measures of performance, the mix of forms of remuneration (such as fixed and variable components, and cash and equity-related benefits) and the timing of eligibility to receive payments. All forms of remuneration are captured by this Prudential Standard, **regardless of where, or from whom, the remuneration is sourced.**”*

The Insurance Council is strongly opposed to the additional clause that has been added to this paragraph as it would have significant impacts. It also appears to add no benefits as the consideration of conflicts of interest is already covered in CPS 520 for people considered for Responsible Person Roles.

Furthermore:

- The remuneration paragraph in CPS 510 explicitly state that persons covered by these paragraphs can include both employees and non-employees of the APRA-regulated institution. So, “...*regardless of where, or from whom, the remuneration is sourced*” covers every type of remuneration from both inside and outside the Group, including such things as director fees, consultancy remuneration, income from investments (interest, dividends, capital gains, rental from properties, etc). Requesting such details raises issues of privacy and ‘commercial in confidence information’ – even more so for non-employees.
- Apart from paragraph 53, the term “remuneration arrangements” is only used in two other paragraphs (51 and 55), although it could be assumed to be intended in paragraph 68 (b) and (c). However, none of these requirements extend beyond remuneration provided by the APRA-regulated institution or group.

The Insurance Council therefore recommends that the last sentence in CPS 510 be replaced with: “*All forms of remuneration provided by the APRA-regulated institution or group are captured by this Prudential Standard.*”

Determinations made under previous prudential standards

Para 103: This includes:

“(e) Prudential Standard CPS 231 Governance made on 30 November 2012.”

This needs to be corrected as CPS 231 is for Outsourcing not Governance

Fit and Proper CPS 520

As noted in the covering letter, there are often similar requirements to those in this standard which are imposed by host regulators on international businesses within a Level 3 group. To avoid unnecessary duplication, allowance should be made if an international business is subject to obligations substantially the same as the Australian requirements. We would ask that APRA allow mutual recognition of offshore regulatory regimes that seek to supervise the same risks. This may be an area where APRA could engage with other regulators to ensure international harmonisation, for example through developing Memorandums of Understanding with those offshore regulators.

Cover Page: This has the statement that:

“Persons who are responsible for the management and oversight of an APRA-regulated institution, and persons employed by a member of the group whose activities may materially affect the business or financial standing of the group, need to have appropriate skills, experience and knowledge....”

As stated in paragraph 22:

“22. A person need not be an employee of an APRA-regulated institution to be a responsible person if they are within the definitions in paragraph 21 and Attachments A to F inclusive. In some circumstances a consultant, contractor or employee of another entity may be a responsible person.”

The Insurance Council therefore recommends that the cover page be changed to:

"Persons who are responsible for the management and oversight of an APRA-regulated institution, and persons whose activities may materially affect the business or financial standing of the group, need to have appropriate skills, experience and knowledge...."

Responsible persons

Para 21; This has been extended to include:

"(g) for the purposes of a group, a person whose activities may materially affect, either directly or indirectly, the whole, or a substantial part, of the business or financial status of the group."

The Insurance Council suggests that for consistency paragraph 21 (g) should be removed and this point added to Attachments A to F. In addition, "business or financial" should be changed to "financial or operational".

Informing APRA

Para 58: This has been updated to include a new point (a):

"58. An APRA-regulated institution must notify APRA of the following information for each responsible person:

(a) the title of the responsible person position; "

The Insurance Council would appreciate clarification whether this new point is intended to capture the responsible person's position title (e.g. General Manager Finance), or, the title of the responsible person role (e.g. Director, CEO, Senior Manager, etc)? If the latter, then it needs to be acknowledged that some persons can hold multiple responsible person role (e.g. Director, CEO, Senior Manager) within a single APRA-regulated institution and across multiple APRA-regulated institutions.

Issues across a number of draft prudential standards

Extent of obligations

Within CPS 510, CPS 520, CPS 231 and CPS 232 paragraph 4 describes the obligation on the Head of a Group and applies that *"....throughout the group"*.

However:

- The wording in CPS 520 is different to that in the other Prudential Standards.
- Every instance of paragraph 4 uses a footnote to provide clarification.
- Within CPS 510 the intent of paragraph 4 introduces ambiguity because of paragraph 15 of CPS 510, which limits the implication for non APRA-regulated entities in the group. As required by CPS 510 paragraph 15, the Head of the group must ensure compliance with relevant requirements of this Prudential Standard for members of a group that are not APRA-regulated institutions and which engage in business activities that may have a material financial or operational impact on the group.
- Within CPS 232 the intent of paragraph 4 introduces ambiguity because of paragraph 15 of CPS 232, which limits the implication for non APRA-regulated entities in the group. As required by CPS 232 paragraph 15, the Head of the group must ensure compliance with relevant requirements of this Prudential Standard for members of a

group that are not APRA-regulated institutions and which engage in business operations critical to the group.

- Within CPS 231 the intent of paragraph 4 introduces ambiguity because of paragraph 20 of CPS 231 which limits the implication for non APRA-regulated entities in the group. As per CPS 231 paragraph 20, the Head of the group must ensure compliance with relevant requirements of this Prudential Standard for members of a group that are not APRA-regulated institutions that outsource business activities that are material to the group

The Insurance Council suggests that the wording of paragraph 4 in CPS 520, CPS 231 and CPS 232 be deleted and replaced with the contents of the existing footnote to that paragraph, obviating the need for the footnote.

Furthermore, the wording of CPS 232 should be amended to that shown below (i.e. the wording from CPS 510) and the wording shown below inserted into CPS 520 and CPS 231:

“Where a member of a group that is not an APRA-regulated institution [engages in/ outsources] business activities that may have a material financial or operational impact on the group, the Head of a group must ensure that such business activities are undertaken in a way that complies with relevant requirements of this Prudential Standard.”

Where only a limited set of requirements apply to the ‘material’ non APRA-regulated entities in the group, the phrase “*relevant requirements*” should be replaced with “*paragraphs n, n1, and n2*” – with the appropriate paragraph numbers inserted.

All requirements then assigned to the Head of a group should then be updated to explicitly apply to “*the members of the group covered by this Prudential Standard*” rather than wording that could be interpreted as applying to the whole group.

Policy Requirements

The requirements in relation to having a policy, its approval and use are covered in:

- CPS 510 in paragraphs 51, 52 & 62
- CPS 520 in paragraphs 16, 19 & 20
- CPS 231 in paragraphs 5, 19 & 24
- CPS 232 in paragraphs 6, 14 & 24.

Whilst the three paragraphs in CPS 231 and CPS 232 use largely consistent wording, this varies from the various wordings used in CPS 510 and CPS 520. CPS 510 paragraph 62, CPS 520 paragraph 19, CPS 231 paragraph 52 and CPS 232 paragraph 6 all use similar wording that is structured along the following lines:

*“Nothing in this Prudential Standard prevents an APRA-regulated institution from adopting and applying a group policy used by a **related body corporate**⁵, provided that the policy has been approved by the **Board** of the regulated institution and meets the requirements of this Prudential Standard.”*

These paragraphs require each APRA-regulated institution that adopts a group policy to approval that policy. This introduces some ambiguity with CPS 510 paragraph 43 (see

below) which only requires each APRA-regulated institution that is part of a Group to approve the use of group policies in order to utilise these.

*“43. Where a locally incorporated APRA-regulated institution is part of a Level 2 group, Level 3 group or any other **corporate group**, and the regulated institution utilises group policies or functions, the Board of the regulated institution must approve the use of group policies and functions and must ensure that these policies and functions give appropriate regard to the regulated institution’s business and its specific requirements.”*

Consequently, the Insurance Council recommends that CPS 510, CPS 520, CPS 231 and CPS 232 (and others as they are reviewed) be amended so that the three paragraphs related to the existence, approval and use of a required policy be consecutive in each Prudential Standard. We suggest that the following standard wording approach be adopted in these (and others as they are reviewed):

“50. An APRA-regulated institution must establish and maintain a documented ‘[insert name] Policy’. The [insert name] Policy must outline the [insert details], of the APRA-regulated institution or group.

51. The [insert name] Policy must be approved by either:

- a) the Board of the Head of a group or the Board of the APRA-regulated institution; or*
- b) the senior officer outside Australia or the Compliance Committee in the case of a foreign ADI, Category C insurer or an EFLIC.*

52. Nothing in this Prudential Standard prevents an APRA-regulated institution from adopting and applying a group [insert name] Policy that is also used by a related body corporate provided that the policy has been approved in accordance with paragraph 51 and meets the requirements of this Prudential Standard and paragraph 43 in Prudential Standard CPS 510.”

Consistency of the term “APRA-regulated institution”

Throughout the draft prudential standards most instances of the term ‘institution’ or ‘regulated institution’ have been changed to ‘APRA-regulated institution’. However not all instances have been changed. The Insurance Council recommends that all of the draft Prudential Standards be updated to ensure that all applicable instances of ‘institution’ or ‘regulated institution’ be consistently changed to ‘APRA-regulated institution’.

“Authority” section of the draft Prudential Standards

Paragraph 1 of CPS 510, CPS 520, CPS 231 and CPS 232 reads:

“1. This Prudential Standard is made under:

*(a) section 11AF of the Banking Act 1959 (Banking Act) in relation to **authorised deposit-taking institutions (ADIs) and non-operating holding companies** authorised under the Banking Act (authorised banking NOHCs);*

*(b) section 32 of the Insurance Act 1973 (Insurance Act) in relation to **general insurers and non-operating holding companies** authorised under the Insurance Act (authorised insurance NOHCs) and **parent entities of Level 2 insurance groups**; and*

*(c) section 230A of the Life Insurance Act 1995 (Life Insurance Act) in relation to **life companies, including friendly societies, and non-operating holding companies** registered under the Life Insurance Act (registered life NOHCs).”*

The general insurance reference in paragraph 1(b) includes the words “and parent entities of Level 2 insurance groups”, but this is not used in the parts relating to ADIs and life companies. We cannot see a justification for this inconsistency

Definitions within the draft Prudential Standards

Within CPS 510, CPS 520, CPS 231 and CPS 232:

- Paragraph 2 provides a definition of “APRA-regulated institutions”;
- A footnote is used to define “Head of Group”; and
- Paragraphs are included to define “Level 2 Group”, “Level 3 Group”, “Level 2 Head” and “Level 3 Head”.

Also:

- CPS 510 paragraph 57 includes the words ‘related body corporate’ (in bold) and then provides a definition in a footnote. Paragraph 6 says terms defined in 3PS 001, APS 001, GPS 001 or LPS 001 appear in bold the first time they are used in this Prudential Standard. Accordingly, there should definitions included as footnotes for terms in bold and
- Within CPS 510 a footnote is used to define “subsidiary”.

For the sake of consistency and ease of reference, the Insurance Council recommends that all definitions embedded within the draft prudential standards be removed and be covered in 3PS 001 &/or APS 001&/or GPS 001 &/or LPS 001.