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[APRA regulation]

Keeping you informed. MAY 2012

ICAAP – “Do it now” says APRA

APRA's 30 April 'LAGIC Update' letter to general insurer CEOs fleshes out APRA's expectations relating to ICAAP. The ICAAP needs to be completed and documented before 1 January 2013. Insurers should have their ICAAP process well planned and underway by now.

Key ICAAP messages

If you've been following Finity's updates on LAGIC and ICAAP, there's not a lot of new material in APRA's 30 April letter – but there are important messages and clarification:

- >> Don't wait for any further detail from APRA on ICAAP (the last piece of guidance will be a PPG in September)
- >> APRA provides a set of questions for Boards and senior management to consider when developing their ICAAP – a good starting point for a workshop agenda
- >> ICAAPs and their documentation are expected to undergo refinement over the first 1-2 years
- >> The 2013 ICAAP needs to address how the Horizontal Requirement of the ICRC will be met even though it takes effect only from 1 January 2014
- >> Attachment B to the letter sets out the ICAAP wording which will be in the final capital standards released later this month
- >> One new requirement: the ICAAP needs to include “policies to address the capital impact of material risks not covered by explicit capital requirements.”

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ICAAP for Branches

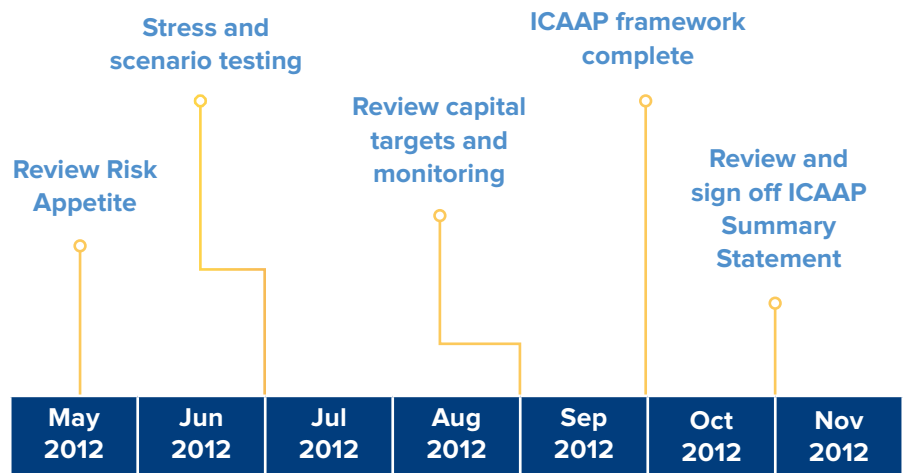
There is a single set of ICAAP requirements for everyone – with nothing different for branches.

The ICAAP practicalities will be a little different for branches.

Finity is preparing material specifically for branches which will be available by the end of May.

ICAAP timetable

It is important that Boards have a timetable for ICAAP development – remembering that the framework needs to be up and running by 1 January 2013, and there will be a limited number of Board meetings in the remainder of the year. The timeline below indicates the type of progress you will need to be making.



ICAAP documents

>> **ICAAP Summary Statement** – APRA’s letter clarifies what they are expecting in this report, with no real surprises. This document needs to be approved by an insurer’s Board before 1 January 2013, as it can be requested by APRA any time after that.

>> **Annual ICAAP Report:**

- > Timing of this report has been ‘decoupled’ from the balance date – a very positive change in our view. The report will need to be prepared annually and provided to APRA within three months of preparation.
 - Some companies see the preparation of the ICAAP report as sitting naturally alongside their annual business planning process.
- > **Report requirements have been expanded.**
 - New requirement for a “breakdown of capital usage over the planning horizon” – by (material) business activity, group members, geographic spread of exposure and risk types.
 - This seems to be suggesting explicit allocation of capital, and we imagine that this requirement means APRA is looking for evidence that insurers have considered capital allocation. Depending on how this requirement is interpreted, it could be complex and potentially onerous, or it could just be a question of communication.

Other LAGIC news in the letter

- >> **Target capital levels under ICAAP** – APRA is expecting a robust process, and the letter specifies what needs to be considered. There are also guidelines for stress testing and scenario analysis (with more to come in September’s PPG).
- >> **Transition arrangements** – insurers seeking transition arrangements for either capital requirement or capital base should discuss it with their APRA supervisor now.

Key LAGIC dates – a reminder

May 2012	Final prudential standards GPS 110, 001, 114-118 Draft GPS 112 – composition of capital base (previously expected Mar 2012)
September 2012	Draft PPGs on ICAAP, ICRC, asset risk charge, supervisory adjustments
End 2012	Insurer ICAAP complete and Summary Statement approved
1 January 2013	New framework takes effect
1 January 2014	Horizontal requirement of ICRC implemented

The Place of DFA

APRA’s ICAAP material refers to “stress testing and scenario analysis” and does not specifically mention DFA modelling.

It is clear that an existing DFA model will be a helpful input for ICAAP development, but its use will be as a supplement to stress testing and scenario analysis, not as a substitute.

The introduction of ICAAP will have prompted some insurers to start developing a DFA model. We note that a ‘partial’ DFA model – where only some key elements of the insurer’s financials are modelled stochastically – can be a practical and economic alternative to a full-blown DFA model.

Supervisory Adjustment

The ‘supervisory adjustment’ has been a source of anxiety for many insurers. APRA’s comments in the letter should be of some comfort. APRA says that there should be fewer insurers in future with a supervisory adjustment than there are now. The reason is that with the prescribed method (the capital formulas) becoming more risk-sensitive, a wider range of insurer circumstances should be dealt adequately by the prescribed method.

The logic of this makes sense. A suggested approach for insurers would be:

- >> If you have a non-standard capital requirement now, ask APRA right away whether they expect it will be removed and what they will need to do this
- >> If you don’t but are concerned about it, talk with your supervisor and ask them if APRA is considering one for you.

It is worth establishing expectations now and then actively managing those expectations over the next six months.

Hybrid Capital

APRA has deferred release of the draft GPS 112 Measurement of Capital Base from March to May. It is not clear what the controversial issues are, but they probably relate to the use of ‘hybrid capital’ and the revised common equity limits. If this is so, then only the listed major insurers and some life insurance companies are likely to be impacted.

Finity brings small to medium insurers together to discuss topical issues in its regular FIAAS and CFO forums - for in-house Appointed Actuaries and CFOs respectively.

If you'd like to hear more about these please call Steve Curley on +61 2 8252 3326

Finity & APRA Regulation

Finity is a firm of experienced consultants and actuaries specialising in general insurance. We are Appointed Actuaries to 30 APRA-licensed insurers. We strive to keep our clients and contacts up to date with developments in the regulatory environment.

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Want to know if your Risk Appetite Statement will pass muster under ICAAP?

Please call Brett Riley on 61 2 8252 3382

This article is based on Finity's current understanding of APRA's proposals. It does not constitute either actuarial or investment advice. While Finity has taken reasonable care in compiling the information presented, Finity does not warrant that the information is correct. We refer the reader to the response paper on APRA's website (www.apra.gov.au) for further detail.

Further clarification can be sought from our consultants.

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