

Biennial Convention 2009

Go for Gold

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Institute of Actuaries of Australia



GFC: APRA ACTIVITIES

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Introduction

- Given GFC, what has APRA been doing?
- In each regulated industry
- Across all industries
- Role of professionals, actuaries in particular
- Our well-deserved reputation requires constant maintenance



Areas of Focus - ADI

- Liquidity
- Credit quality
- Capital
- Risk Management



ADI - Liquidity

- Assessed ADI funding plans, including more rigorous stress-testing
- Special team to monitor ADI liquidity
- Existing prudential standards to cover a broader range of scenarios



ADI - Liquidity

- Earlier concerns have eased following government guarantee eg., domestic access to wholesale funds
- The vulnerabilities of models that rely on a significant offshore funding
- Liquidity triggers for APRA scrutiny increased



ADI - Credit Quality - SME

- Exposures reliant on debt / other deteriorating industry segment may lead to bankruptcy
- A range of indicators, including 'watch lists' of larger institutions
- Need to apply risk grading, valuation & provisioning against problem loans

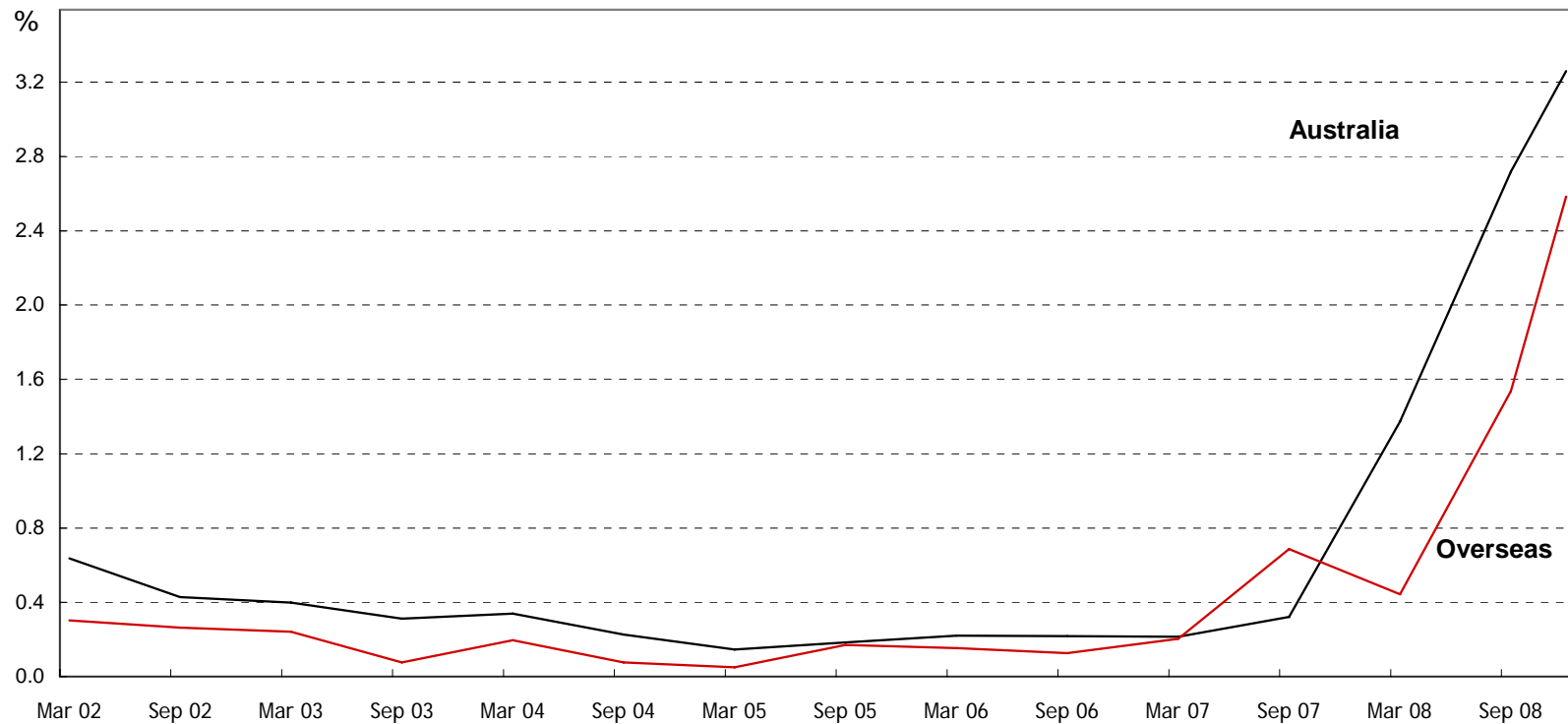


ADI - Credit Quality – Commercial Property

- Strong growth in commercial property lending in recent years
- LVRs are rising due to:
 1. Past equity redraws
 2. Most loans are 'interest only'
 3. Property values are dropping
- Large increase in impaired commercial property - past 12 to 18 months



Banks' Impaired Commercial Property Assets



Notes:

Some entities were not required to submit data for December 2008.



ADI - Credit Quality – Commercial Property (cont.)

- ‘Stress tests’ on commercial property portfolios
- Commercial property exposures dominate ‘watch lists’ in size and number of exposures



ADI – Capital

- The capital positions of ADIs remain sound, but no complacency
- Access to additional capital has been strained
- Slower profit growth this year, likely to continue



ADI – Capital (cont.)

Year ended 31 December	Major Banks		Other Australian Banks	
	2008	2007	2008	2007
RoA(%)	0.8	1.0	0.7	1.2
RoE(%)	14.6	18.8	8.8	16.1
Cost/Income (%)	34.1	50.2	80.2	77.0
Non-interest/Total Income (%)	16.2	44.4	75.3	80.9
Net Interest Margin (%)	2.2	2.2	2.0	2.0



ADI – Capital (cont.)

- APRA is testing the robustness of Capital Management Plans
- risk appetite, loan quality, systems to identify and manage problem loans, provision for potential losses
- Dividend policies



Areas of Focus - General Insurance

- Solvency
- Downward trend in underwriting profits
- Reinsurance



General Insurance - Solvency

- In October 2008, survey to assess solvency
- The industry well capitalised
- Importance of 'stress tests' and robust contingency plans
- Stress testing appears to be mostly confined to the larger insurers



General Insurance – Underwriting Profit

- Tied to domestic developments - adverse natural events and strong market competition
- Concerns that underwriting profits will continue to reduce due to:
 1. Downward trends in pricing
 2. Continuation of current wet weather trends that may lead to higher claims
 3. Drop in premiums as less people take out insurance (increasing proportion of uninsured home/contents)



General Insurance – Underwriting Profit

- How widely spread across insurers?
- Concentration exposures
- Focus on underwriting and pricing disciplines



General Insurance – Group Supervision

- Think AIG...
- Cover all risks that may directly or indirectly impact on insurer
- Consolidated supervision of insurance groups from end-March



Areas of Focus - Life Insurance

- Capital adequacy



Life Insurance - Capital

- In early 2008, sensitivity of capital to adverse equity markets / interest rates
- As markets deteriorated, an internal team to monitor capital and coordinate supervisory responses
- In December 2008, a Stress Test Survey on all life insurers



Life Insurance – Capital (cont.)

- Broadly, life insurance industry remains well capitalised despite volatile markets
- APRA will continue to monitor capital and work with institutions on case by case basis depending on risk
- High risk insurers providing weekly reporting



Areas of Focus - Superannuation

- Liquidity
- Valuation of unlisted assets
- Solvency risk for defined benefit funds



Superannuation - Liquidity

- In May 2008, Liquidity questionnaire sent to all trustees
- Understanding of member demographics
- Rigorous scenario analysis under a range of extreme but plausible scenarios
- Responsible and proportionate responses seen



Superannuation – Liquidity (cont.)

- Robustness of contingency plans
- Member investment choice: consequences
- Strategic Asset Allocation review
- Pension payments
- Case by case relief, but trustee assessment ongoing



Superannuation – Valuation of Unlisted Assets

- Risk of inequities between incoming / outgoing members
- Valuation risks expected to be addressed in Risk Management Framework, including clearly documented policies and procedures
- Additional guidance



Superannuation – Valuation of Unlisted Assets (cont.)

- Costs – benefits of more frequent valuations
- Reasonableness of assumptions in valuation methodologies
- Trustees should define significant events that would trigger a revaluation
- Trustees to ensure that indices used in ‘soft’ unit pricing appropriate



Solvency Risk for Defined Benefit Funds

- Solvency of DB funds tested
- Survey all DB or hybrid funds re funding position
- Ensure robust rectification plans to restore solvency within acceptable time
- Liaise with actuary, trustee & employer
- Unprecedented times: can all survive?