



21 September 2016

Mr Pat Brennan
General Manager
Policy Development
Australian Prudential Regulation Authority
GPO Box 9836
Sydney NSW 2001

Email: insurance.policy@apra.gov.au

Dear Mr Brennan

Submission on Discussion Paper: The role of the Appointed Actuary and actuarial advice within insurers

The Actuaries Institute is the sole professional body for actuaries in Australia. It represents the interests of over 4,600 members, including more than 2,900 actuaries. Our members have had significant involvement in the development of insurance regulation, financial reporting, risk management and related practices in Australia and Asia.

The attached brief note sets out the Actuaries Institute's submission in response to APRA's discussion paper on the role of the Appointed Actuary and actuarial advice within insurers released for consultation in June 2016.

Please do not hesitate to contact David Bell, Chief Executive Officer of the Actuaries Institute (phone 02 9239 6106 or email david.bell@actuaries.asn.au) to discuss any aspect of this paper.

Yours sincerely

A handwritten signature in black ink, appearing to read "L Smartt".

Lindsay Smartt
President



1 Introduction

In June 2016, the Australian Prudential Regulation Authority (APRA) released a discussion paper on the role of the Appointed Actuary and actuarial advice within insurers, to explore the potential to significantly improve the functioning of the Appointed Actuary role and ensure that it remains fit-for-purpose. The release of this paper followed earlier rounds of feedback provided to APRA from actuaries and other insurance industry stakeholders.

The review has been prompted by a perception that, over time, the responsibilities of the Appointed Actuary in life insurance companies have become increasingly compliance focused, which has limited the ability of the Appointed Actuary to provide advice to the board and senior management on strategic issues that pertain to the financial condition of the company. This may have contributed to increased turnover of Appointed Actuaries within life insurers and difficulties in recruiting into Appointed Actuary roles in recent years.

The objective of the review is to improve the functioning of the Appointed Actuary role across both life insurance and general insurance, improving prudential outcomes while also enhancing efficiency. The Actuaries Institute supports the need for a review.

The discussion paper proposes a number of changes to the role of Appointed Actuary, with the intent of achieving increased flexibility, streamlined requirements and greater clarity over the role that the Appointed Actuary plays within an insurer, while also achieving greater alignment between life insurance and general insurance where this makes sense. In forming this submission, the Actuaries Institute has also had regard to the potential for the new framework to ultimately be extended to cover the Appointed Actuary role in health insurance.

The Actuaries Institute strongly supports the intent of the changes that APRA is proposing, and considers that the changes proposed generally represent improvements over the current state. We appreciate that APRA's proposals reflect to a large degree the recommendations made by the Institute's Life Appointed Actuary Task Force, and acknowledge that in some areas they have gone further than the feedback recommended.

Nevertheless, the Actuaries Institute believes that further changes could be made beyond those proposed in the discussion paper that would lead to improved outcomes. Changes in a number of specific areas have been suggested in this letter.

The Actuaries Institute also acknowledges that to achieve the desired outcomes, changes will be required from actuaries. The Actuaries Institute itself will play a key role via the professional standards and guidance it issues. Work has commenced to review all relevant documents, with updates expected to follow release of final prudential standards.

2 Summary of recommendations

The Actuaries Institute strongly supports the intent and basic wording of the purpose statement for Appointed Actuaries. While the discussion paper sets out a number of worthwhile improvements to the role and function of the Appointed Actuary, in our view, they may prove insufficient of themselves to change practice in a way that would achieve APRA's desired outcomes.



Our key recommendations as to the changes necessary to achieve the desired outcomes comprise:

- some subtle but important modifications to the purpose statement (see Section 3);
- clarifying the obligation of each insurer to ensure that the Appointed Actuary has sufficient authority, seniority and support to make a significant contribution to the debate of relevant strategic issues at the executive level (see Section 4); and
- for life insurers consider expressing the Appointed Actuary as head of the actuarial function (see Section 5).

Responses to the specific questions posed in the discussion paper together with a few other comments are provided in Section 6.

3 Purpose statement for the Appointed Actuary

The Actuaries Institute agrees with APRA's view that there is value in maintaining a single individual as "Appointed Actuary" (consistent with current legislation).

The Actuaries Institute supports the development of a strong purpose statement, and supports the overall direction of the proposed statement. The Actuaries Institute does recommend some changes to clarify the purpose, as set out below.

- Who does the Appointed Actuary advise?

The current purpose statement focuses on the role of the Appointed Actuary as an adviser to the Board. This should be broadened to include senior management.

- What are the obligations in regards policyholder interests?

The Actuaries Institute supports a reference to "adequate consideration to the protection of policyholder interests" in the purpose statement. This is consistent with the objectives of both the Life Insurance Act 1995 and the Insurance Act 1973. When extending the Appointed Actuary principles to health, it is noted there is no equivalent objective in the legislation governing private health insurance. Given the differences in the role of the Appointed Actuary in general and life insurance (for example pricing) it may also be worthwhile acknowledging that there are different considerations in regards to policyholder interests in the two industries.

The Institute recommends that the reference to the "treatment of policyholders" be removed from the second paragraph of the purpose statement. Whilst the Institute acknowledges the importance of the Appointed Actuary role in protecting the interests of policyholders, the reference to "treatment" may be interpreted to mean that Appointed Actuaries are required to give consideration to numerous operational issues outside their area of expertise. The Institute submits that the initial reference to policyholder interests is sufficient to acknowledge the purpose of the Appointed Actuary in relation to policyholders.



- Contribution to the debate of strategic issues at the executive level

While the Actuaries Institute supports the deeper involvement of Appointed Actuaries, we believe that from a regulated role perspective this should focus on strategic issues which might impact the financial condition of the insurer.

Finally, the Actuaries Institute appreciates APRA's acknowledgement that the Appointed Actuary role may span the "three lines of defence", and supports there being no attempt to allocate the role to a single line.

4 Authority, seniority and support

The Institute supports the overall direction of the purpose statement of the Appointed Actuary. In line with this overall purpose, it is necessary for companies to consider how they provide the Appointed Actuary with sufficient insight and opportunity to provide input into relevant strategic issues and the activities and decisions that may materially affect the insurer's financial condition. One particular issue to be considered is that the Appointed Actuary should be involved in the development phase of key (relevant) business initiatives, not merely provide an opinion on a fully formed proposal as part of the final approval process, as it will often be too late to modify proposals in response to challenges raised by the Appointed Actuary at that stage.

The company should actively consider whether there are sufficient and effective mechanisms in place to ensure that the Appointed Actuary is made aware of and able to give advice on key financial and strategic issues, particularly where the Appointed Actuary is not a direct report of the CEO nor a member of the Leadership team. We would expect to see this addressed as part of the actuarial advice framework. In its oversight role the Board of Directors is expected to understand the extent of the Appointed Actuary's participation and advice on these issues.

Some organisations have responded to the existing prudential regulations by creating a Chief Actuary role and having the Appointed Actuary report to the Chief Actuary. Under this construct, the Appointed Actuary role is focussed on compliance with prudential standards while the Chief Actuary is able to contribute at a more strategic level. For the Appointed Actuary to make a significant contribution to the debate of strategic issues at an executive level, the Appointed Actuary should be either the most senior actuarial role in an organisation, or potentially one of a small number of similarly senior actuarial roles (depending on how the actuarial function is structured).

We would encourage APRA to reflect in a few years on whether the changes that are ultimately implemented have delivered the desired outcomes, particularly in terms of improving the contribution of the Appointed Actuary to relevant strategic matters.

5 Individual responsibilities

The Actuaries Institute believes that a significant contributing factor to the perceived reduction in stature of the role of the Appointed Actuary in life insurance has been the prudential requirements for the Appointed Actuary as an individual to be responsible for the completion of a series of defined tasks. Addressing this will assist in enabling the Appointed Actuary to fulfil the purpose set out in the discussion paper.



A potential concern for life insurance actuaries with APRA's proposals as set out in the discussion paper is that, depending on how the prudential standards are drafted, there may still be a focus on the role of the Appointed Actuary as an individual undertaking a large series of tasks (albeit tasks that can be delegated). The Actuaries Institute would hope that the mandated responsibilities of the Appointed Actuary could be limited to a very small list of practice-specific key tasks while other tasks could be considered the responsibility of an "actuarial function" that effectively represents the collective of activities that are proposed in the discussion paper to be the responsibility of the Appointed Actuary. The Appointed Actuary would be the head of the actuarial function. This would also have the benefit of creating greater alignment between the regulatory structures applying to the Chief Risk Officer and the Appointed Actuary, and would assist in ensuring that the Appointed Actuary has the appropriate level of seniority within each insurer.

The details of the structure and operation of the actuarial function would be set out as part of the actuarial advice framework and may vary depending on the individual institution's size, business mix and complexity. In particular, it may be possible that components of the actuarial function do not sit in the direct reporting tree of the Appointed Actuary in some organisations.

For clarification, this is not a concern for general insurance actuaries, and the Actuaries Institute would expect that the mandated responsibilities of the general insurance Appointed Actuary would be unchanged from the current situation.

Again we would encourage APRA to reflect in a few years on whether the changes that are ultimately implemented by companies under the actuarial framework have resulted in an appropriately senior Appointed Actuary.

6 Responses to questions posed in the discussion paper

Actuarial advice framework and materiality policy

The proposal to require an actuarial advice framework subject to a materiality policy represents an improvement over the current state, in particular for life insurance. It presents a number of benefits, not least allowing the Appointed Actuary to reduce, to some degree, the non-material compliance activity currently undertaken. Further benefits include the documentation of the actuarial function's operating model, delegations and conflict management approaches, and the explicit acknowledgement of the role of actuaries other than the Appointed Actuary within each insurer.

The Actuaries Institute recommendation for life insurers (section 5) that the prudential standards should focus on the responsibilities of an actuarial function rather than the individual responsibilities of the Appointed Actuary would take this concept further and likely produce better outcomes. If the concept of an actuarial function is adopted, one element of the actuarial advice framework would be to define the structure of the actuarial function).

We believe that there is merit in having insurers develop an actuarial advice framework. The Actuaries Institute:

- agrees with the areas listed in the discussion paper as requiring actuarial advice;
- supports the proposed approach to addressing materiality; and
- supports the proposed approach to temporary delegations.



‘Notifiable Circumstances’ under Actuarial Advice Framework

Currently, a “Notifiable Circumstances” regime operates in private health insurance. The insurer is required to notify the Appointed Actuary of material financial matters being considered by the insurer, however the Appointed Actuary has discretion as to whether or not advice is required. Even in situations where no formal advice is provided, there is valuable dialogue (and perhaps challenge) between the Appointed Actuary and the insurer’s management or Board.

The actuarial purpose statement states that “The actuary plays a key role in, and provides effective challenge to, the activities and decisions that may materially affect the insurer’s financial condition”. APRA also proposes that “only material matters would be required to be the subject of formal actuarial advice”. The notifiable circumstances regime therefore appears to be strongly aligned with APRA’s proposals for life and general insurance.

The general view is that the notifiable circumstances regime works well. Such a concept could be considered as an element of the actuarial advice framework, and the Actuaries Institute would welcome the opportunity to discuss this further with APRA.

The management of conflicts of interest

The Actuaries Institute agrees that conflicts management is an issue that requires thought on the part of insurers, and supports the proposal to leave the management of conflicts related to the Appointed Actuary role to individual insurers to address. No further guidance is necessary.

In regards dual-hatting, we believe that generally it would be inappropriate for one individual to act as both the CRO and the Appointed Actuary, but can envisage structures where the Appointed Actuary role is largely second line, in which case it may be reasonable to allow dual-hatting.

We support the proposal not to prohibit dual hatting between the CFO and Appointed Actuary.

Improving reporting requirements

The Actuaries Institute supports APRA’s proposals in regards reporting requirements, including:

- the separation of the two main reports (FCR and ILVR);
- the ILVR not being required to be submitted to the board;
- the provision of an executive summary of the ILVR of a Level 2 insurance group for board review, rather than the full ILVR;
- the new requirement for a technically-focused ILVR for life insurers (noting most life insurers would already have documentation that would largely satisfy this requirement);
- the ability of APRA to request a peer review of a specified actuarial report on prudential grounds; and
- the timeframes for submission of reports however, we believe in some cases there is a trade-off between early submission and engagement with the board.



The Actuaries Institute supports the distinction that has been proposed between matters that the Appointed Actuary must consider in the preparation of the FCR and those matters that the Appointed Actuary must comment on in the FCR, and welcomes the discretion provided to Appointed Actuaries to decide the matters that warrant detailed discussion.

In regards the content of the FCR, the Actuaries Institute notes that there is limited value in the Appointed Actuary providing formal advice on items that were developed by the Appointed Actuary.

The Institute suggests that, in terms of the risk management framework and ICAAP, the role of the Appointed Actuary should be to consider these in the context of the overall financial condition of the company. They are subject to other required reviews that should be sufficient to provide adequate assurance to the company and to APRA. Accordingly, the Institute recommends that Appointed Actuary advice on the risk management framework and ICAAP should be limited to matters that are assessed by the Appointed Actuary to be material in the context of the financial condition of the company. The Institute supports a move away from detailed commentary being required on the risk management framework and ICAAP. The Institute supports the proposal that the high level observations on the risk management framework should focus on financial risks.

We also note the potential for some of the proposed reporting requirements to eliminate the efficiency gains of other proposals. For example, the requirement to comment on the effectiveness of the materiality policy could be interpreted as requiring the Appointed Actuary to consider all matters that had been classified as immaterial during the year.

Further life insurance-specific issues

The Actuaries Institute supports the proposals to remove the requirements for the Appointed Actuary to assess compliance as set out in the discussion paper.

In addition, the Institute recommends that the requirements set out in LPS230 for the Appointed Actuary to provide an opinion on the administration of and accounting for reinsurance arrangements as part of the reinsurance report should be removed. This would be consistent with the proposed removal of other requirements, and would not have a negative impact on prudential outcomes given the controls that companies have in place to satisfy themselves of these outcomes.

The Actuaries Institute supports the proposals to retain requirements for actuarial advice on:

- the distribution of retained profits or shareholder capital of a statutory fund;
- restructure, establishment, transfer or amalgamation of life insurance business; and
- the proposed basis for apportioning income and outgoings.

In addition, the Institute supports the requirement to comment on the appropriateness of reinsurance arrangements in aggregate from the perspective of its impact on the current or prospective financial condition of the insurer as part of the FCR.

However, the Actuaries Institute recommends that the advice should be provided by the actuarial function, rather than the Appointed Actuary individually. This would allow each company to develop a structure that is appropriate for the size and nature of its business.



Further alignment between GPS 320 and LPS 320

The Actuaries Institute supports the proposals to:

- create a new Prudential Standard GPS 340 Valuation of Insurance Liabilities;
- amend GPS 320 to make it less prescriptive (including the proposal to allow Professional Standards issued by the Actuaries Institute to address some areas of detail); and
- increase consistency in wording and broad structure between GPS 320 and LPS 320.

Other comments

Sign-off: There are references in the discussion paper to items requiring “sign-off” from the Appointed Actuary. We assume that this means that the Appointed Actuary signs-off on the advice provided, rather than necessarily be required to support the matter on which the advice is given. Such items should be clarified.

Independent vs impartial: The executive summary refers to the Appointed Actuary providing “independent advice”, while the purpose statement refers to “impartial advice”. The Actuaries Institute believes that the Appointed Actuary should be impartial but in many cases would not be independent, and so strongly prefers the use of the term “impartial” when referring to actuarial advice.

Requirement to consider the equitable treatment of life insurance policyholders: This requirement should be limited to participating policyholders.

Throughout this submission, we have not explicitly dealt with consideration of whether the Appointed Actuary is an internal member of staff or an external provider. Given the importance of flexibility for companies in resourcing the Appointed Actuary role in the way that best suits their business, we recommend that, in drafting of the prudential standards, it is made clear that the role can be filled either internally or externally, as is currently the case.