16 April 2015

To: All general insurers and other interested parties

CONSULTATION ON EXTERNAL PEER REVIEW REQUIREMENTS FOR GENERAL INSURERS

Purpose

This letter outlines APRA’s proposal to amend the requirements in Prudential Standard GPS 320 Actuarial and Related Matters (GPS 320) that relate to the external peer review (peer review) of the Appointed Actuary’s Insurance Liability Valuation Report (ILVR). APRA welcomes feedback from general insurers and other interested parties on the proposals discussed in this letter.

Background

In February 2015, APRA provided an update on its project to identify potential regulatory cost savings across all industries. The update mentioned that APRA would be progressing work on the proposal outlined in this letter. This proposal addresses one opportunity for cost savings to be made without compromising the soundness of the prudential framework.

Current peer review requirements

APRA places responsibility on the Appointed Actuary of a general insurer to provide impartial advice to the board and senior management on their operations, financial condition and insurance liabilities. Advice on the insurance liabilities is provided by the Appointed Actuary to the board of a general insurer in the ILVR, which assists the board and senior management in carrying out their responsibilities. GPS 320 outlines the requirements relating to matters that are to be addressed by the Appointed Actuary in the ILVR.

In 2006, recognising the responsibility placed on the Appointed Actuary and the significance of insurance liabilities on a general insurer's balance sheet, APRA introduced formal requirements for the ILVR to be peer reviewed by an independent Reviewing Actuary. The Reviewing Actuary provides their findings in a report (review report) addressed to the general insurer or the general insurer’s Appointed Auditor.

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APRA observations

At the time the peer review requirement was implemented, APRA considered that it would assist in maintaining and improving the quality and consistency of the reports produced and work undertaken by Appointed Actuaries.

APRA recognises that there is prudential value in the peer review process. It provides the general insurer with an independent review of the Appointed Actuary’s insurance liability valuation. Having a second opinion can add weight to the Appointed Actuary’s findings. The review report can also be a useful document for the board and senior management, in understanding the drivers underlying the liability valuation.

APRA has observed that the quality of analysis provided in the ILVR has improved. Since the introduction of the peer review requirement, APRA has noted very few issues of material significance identified by Reviewing Actuaries. APRA has also observed that recommendations made by Reviewing Actuaries predominately relate to issues that would not have a significant impact on the insurance liability estimation. Such recommendations have included that the Appointed Actuary could consider the use of alternative assumptions or methodologies at the next valuation, for consistency with industry practice. APRA understands, though, that the Reviewing Actuary’s findings may be mentioned in the ILVR prior to its finalisation, and as a result these findings may not be incorporated into the review report. Informal discussion with a number of Appointed and Reviewing Actuaries supports this analysis.

Interaction with other review mechanisms

The significance of the insurance liabilities to the financial statements of a general insurer necessitates the Appointed Auditor devoting substantial attention to the liability valuation in their assurance engagement. Observations suggest that the peer review process has supported and helped to improve the Appointed Auditor’s work in this area.

APRA acknowledges that the Appointed Auditor’s work will not necessarily be as detailed as that undertaken by a Reviewing Actuary. However, currently the ILVR is typically reviewed by a number of actuaries, including colleagues of the Appointed Actuary, and actuaries engaged by the Appointed Auditor, in addition to the Reviewing Actuary. APRA considers that internal and external audits and reviews, and APRA’s supervisory process can provide a sufficiently robust and independent review of the insurance liability valuation.

Peer review costs

The peer review process can be a significant cost imposition for general insurers, which varies depending on the size, mix and complexity of the general insurer’s business.

APRA has estimated that the annual regulatory cost savings for the general insurance industry, through the removal of the peer review requirements, would be in the range of $3.5-$6.1 million, taking into account industry estimates and APRA’s own analysis.
Implementation approach

APRA has formed the view that the compliance costs of requiring an annual peer review for all general insurers outweigh the benefits. APRA considers that amendments can be made to GPS 320 that will achieve the objective of reducing compliance costs without compromising the soundness of the prudential framework.

APRA proposes to amend GPS 320 to remove the annual peer review requirements that are currently specified in paragraphs 70 to 78. In their place, APRA proposes to introduce a paragraph that allows it to request a peer review be undertaken in circumstances where APRA considers that this would be appropriate. APRA proposes that the review report would be required to address the matters listed in GPS 320, as well as ‘any other matters that are specified in writing by APRA’, to allow for flexible application of the requirement. APRA welcomes feedback on the proposed changes in the draft version of GPS 320 released with this letter.

Should the proposal outlined in this letter be implemented, APRA will strongly encourage each board, before discontinuing the peer review, to carefully consider its value to the board in the context of the company’s particular circumstances and the board’s risk appetite.

APRA will continue to monitor findings in the ILVR and industry developments through regular supervisory activities and industry liaison. APRA will also monitor the effectiveness of the proposed amendments to GPS 320 over time, which may include a periodic request for a sample of general insurers to obtain a review report.

Next steps

APRA invites general insurers and other interested parties to submit feedback on the proposal presented in this letter and the accompanying changes to GPS 320 by Thursday, 16 July 2015. A draft of the amended GPS 320 can be found on the APRA website:


APRA is particularly interested in relevant information regarding the benefits of the current requirement (both to general insurers and in terms of prudential outcomes), the potential cost savings available and the appropriate balance to be struck between the two. Given that the board is a primary beneficiary of the peer review, APRA strongly encourages the general insurer to consult with their board before responding to this consultation. In particular, APRA is interested in the views of the board regarding the benefits of the peer review.

APRA requests that general insurers provide an estimate of the annual compliance cost savings realisable under the proposed changes. This information can be provided to APRA in the template provided on APRA’s website. This template is consistent with the

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Australian Government’s online regulatory burden measure and is designed to assist respondents to provide the necessary compliance cost information to APRA.

APRA intends that amendments made to peer review requirements in GPS 320 would be finalised by the final quarter of 2015. The first period that the amendments apply would be for general insurers with financial year end of 31 December 2015.

Written submissions should be sent to insurance.policy@apra.gov.au by 16 July 2015 and addressed to:

Mr Pat Brennan
General Manager, Policy Development
Policy, Statistics and International
Australian Prudential Regulation Authority

Yours sincerely

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**Important disclosure notice - publication of submissions**

All information in submissions will be made available to the public on the APRA website unless a respondent expressly requests that all or part of the submission is to remain in confidence. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain in confidence should provide this information marked as confidential in a separate attachment.

Submissions may be the subject of a request for access made under the *Freedom of Information Act 1982* (FOIA). APRA will determine such requests, if any, in accordance with the provisions of the FOIA. Information in the submission about any APRA-regulated entity that is not in the public domain and that is identified as confidential will be protected by section 56 of the *Australian Prudential Regulation Authority Act 1998* and will therefore be exempt from production under the FOIA.