



Discussion Paper

The role of the Appointed Actuary and actuarial advice within insurers

June 2016

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Executive summary

The Appointed Actuary plays an important role within insurers by providing independent advice to boards and senior management on the key financial risks facing an insurer.

Appointed Actuaries have been in place within the life insurance and general insurance sectors for some time. However, as the responsibilities of the Appointed Actuary have expanded, feedback from actuaries and APRA's own observations suggest the role has become increasingly compliance focused. In particular, stakeholders have told APRA that this has limited the ability of the Appointed Actuary to provide strategic advice to the board and senior management. This issue has been particularly acute in the life insurance sector.

APRA has observed the increased turnover of Appointed Actuaries within life insurers and difficulties in recruiting into Appointed Actuary roles in recent years and is concerned that these trends are driven by the demanding nature and compliance focus of the role.

APRA's objective in issuing this Discussion Paper is to explore the potential to significantly improve the functioning of the Appointed Actuary role and ensure that it remains fit-for-purpose. These proposals have been informed by thoughtful preliminary feedback from actuaries and the insurance sector more broadly.

Although the impetus for reform has come from issues in the life insurance sector, APRA views this as an opportunity to also apply the same lessons in the general insurance industry.

Key elements of the proposals include increased flexibility, streamlined requirements and greater clarity over the role that Appointed Actuary plays within an insurer. A summary of the proposals is listed in Table 1 below.

The role of the Appointed Actuary is influenced by a range of factors beyond the prudential

framework set by APRA. These include the decisions of insurers regarding how they place the role in their organisational structure and the professional standards set by the Actuaries Institute. In conducting its review, APRA has carefully considered how we can improve prudential outcomes while also enhancing efficiency. APRA looks forward to continuing to work with industry and the actuarial profession to discuss ways that they can also contribute to the success of the Appointed Actuary role, within their spheres of influence.

Given the significant contribution that an effective Appointed Actuary can make to an insurer and to prudential safety more broadly, there are strongly aligned interests between APRA, insurers and the actuarial profession in implementing change.

The proposals in this paper require changed behaviour from insurers, actuaries and APRA if the full benefits are to be realised. Through combined effort to effectively implement the proposed changes, APRA expects that the insurance industry will be in a stronger position in the future.

APRA invites comments on the proposals in this paper. Written submissions on this paper should be forwarded by 21 September 2016, preferably by email, to insurance.policy@apra.gov.au.

Submissions can be addressed to:

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The proposals in this paper are not addressed to private health insurers, although in due course, many of the principles may also be relevant in that context. Given this, APRA welcomes submissions on the matters in this paper from private health insurers.

TABLE 1: Summary of Appointed Actuary review proposals

Proposal	Description
Introducing a purpose statement for Appointed Actuaries	<ul style="list-style-type: none"> The purpose statement sets out the principles and attributes to guide the Appointed Actuary role (see section 2.1.1).
Implement a clear actuarial advice framework (see section 2.2.1)	<ul style="list-style-type: none"> Specify a number of areas which must be the subject of actuarial advice under GPS 320 and LPS 320 (see section 2.2.1.1). Require a materiality policy identifying when advice must be provided to the board and to management (see section 2.2.1.2).
Improving the management of potential conflicts of interest	<ul style="list-style-type: none"> Clarify for insurers the need to manage potential sources of conflicts for the Appointed Actuary role (see section 2.3.1). Retain restrictions on dual-hatting to address inherent conflicts of interest (see section 2.3.2).
Improving reporting requirements	<ul style="list-style-type: none"> Provide greater discretion to the Appointed Actuary to focus on the risks and issues that are material to the financial condition of the insurer (see section 2.4.1). Reduce the annual FCR requirement in relation to FCR and ICAAP and only require Appointed Actuary advice when the risk management framework and ICAAP is first developed, and when amendments are made to enable the advice to be integrated into the insurer’s decision making. (see section 2.4.1). Remove the requirement that the board receive the ILVR (see section 2.4.2). Require Level 2 insurers to include an executive summary in their ILVR for board review instead of requiring the full ILVR to be provided to the board (see section 2.4.2.1). Require life insurers to produce a technically focused ILVR and introducing a power for APRA to request a peer review of a specified actuarial report (see section 2.4.2.3). Confirm that the submission date for both the FCR and ILVR will be within three months of financial year-end for both general and life insurers (see section 2.4.2.4). Remove or reduce regulatory requirements specified in section 12 of LPS 320 and only require Appointed Actuaries to include comments on any material guarantees in investment-linked funds in the FCR (see section 2.5.1).
Simplifying prudential standards	<ul style="list-style-type: none"> Amend GPS 320 to make it less prescriptive and create a separate GPS 340 <i>Valuation of Insurance Liabilities</i> prudential standard. The Standard will capture all the liability valuation requirements that are the responsibility of the insurer, keeping the liability requirements that are the responsibility of the Appointed Actuary in GPS 320 (see section 2.6.1). Increase consistency in wording and broad structure across insurer prudential standards (see section 2.6.2).

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 which is not in the public domain and which is identified as confidential will be protected by section 56 of the *Australian Prudential Regulation Authority Act 1998* and therefore will ordinarily be exempt from production under the FOIA.

Chapter 1 – Background

The Appointed Actuary is a statutory role required under section 39 of the *Insurance Act 1973* (Insurance Act) and section 93 of the *Life Insurance Act 1995* (Life Act). In addition, the roles and responsibilities of the Appointed Actuary are set out in *Prudential Standard GPS 320 Actuarial and Related Matters* (GPS 320) for general insurers and *Prudential Standard LPS 320 Actuarial and Related Matters* (LPS 320) for life companies.

Appointed Actuaries are also subject to professional standards and practice guidelines maintained and enforced by the Actuaries Institute. The Actuaries Institute standards reference APRA regulatory requirements, set minimum standards of professionalism across all insurance practice areas and enforce Codes of Conduct and Continuing Professional Development across its membership¹.

APRA is reviewing the requirements applying to actuarial advice and the Appointed Actuary for both general insurers and life insurers (collectively ‘insurers’).

The review is being undertaken for a number of reasons:

- the responsibilities of the Appointed Actuary have, over time, expanded to include a significant number of tasks;
- APRA is concerned about increasing turnover in the Appointed Actuary role and decreasing seniority of the role within life insurers;
- APRA has received industry feedback indicating that the effectiveness of the life insurance role is being compromised

by its demanding nature, heavy compliance focus and constraints on the ability to delegate tasks;

- APRA has received feedback that the heavy compliance requirements on the Appointed Actuary limit the ability for the role to provide strategic input and advice;
- for general insurers, APRA has received significant feedback on difficulties in meeting the changed due date in GPS 320 for the Financial Condition Report (FCR) to be submitted, from three months to four months; and
- APRA, informed by stakeholder feedback, has identified opportunities to streamline and simplify the requirements, without compromising prudential outcomes.

This review implements APRA’s 2014 commitment to general insurers to holistically review the Appointed Actuary role in response to feedback in relation to the FCR². It is also consistent with APRA’s statements in the February 2015 *Update on Regulatory Cost Savings* that a holistic review of the role of the Appointed Actuary would be undertaken³.

The current review

The key objective of the review is to: streamline and sharpen the role of the Appointed Actuary and ensure the role has the capacity to provide independent and unbiased advice and challenge in an efficient and effective manner. This should allow the Appointed Actuary greater capacity to play a strategic role within insurers.

1 Actuaries Institute, Professional Standards and Guidance, <http://actuaries.asn.au/professional-development-regulation/professional-standards-and-guidance>

2 APRA (29 May 2014) *Letter to Appointed Actuaries and Chief Executive Officers of general insurers regarding the due date of the Financial Condition Report (FCR)*

<http://www.apra.gov.au/GI/PrudentialFramework/Pages/Letter-to-general-insurers-FCR-due-date-May-2014.aspx>

3 APRA (February 2015, p 9) *Update on regulatory cost savings*, <http://www.apra.gov.au/CrossIndustry/Documents/Update-on-regulatory-cost-savings-February-2015.pdf>

APRA is seeking to streamline and clarify the role without compromising the soundness of the prudential framework.

Approach to the review

In developing the proposals set out in this paper, APRA considered all prudential requirements for actuarial advice and Appointed Actuaries under APRA's prudential standards and the Insurance Act and Life Act (together referred to as the 'Industry Acts'). APRA also had regard to the professional standards and guidance issued by the Actuaries Institute.

The proposals in this paper have been informed by feedback received from actuaries, industry bodies and other interested parties.

APRA is undertaking its review in two stages:

- this discussion paper proposes a number of changes to the prudential framework at an in-principle level;
- subject to the outcomes of consultation on this discussion paper, APRA will release for consultation draft prudential standards and, potentially, associated guidance incorporating the changes proposed in this paper.

APRA anticipates that this two-stage approach will enhance the consultation process by resolving key questions of principle first, prior to designing the detailed requirements.

Private health insurers

Similarly to general insurers and life insurers, private health insurers are required under the *Private Health Insurance (Prudential Supervision) Act 2015* to have an Appointed Actuary. Further detail on the role of the Appointed Actuary is set out in *Prudential Standard HPS 320 Actuarial and Related Matters*.

Some of the proposals discussed in this paper are also likely to be relevant to private health insurers and APRA will consider applying them to private health insurers in due course. APRA will shortly write to all private health insurers setting out its intentions in relation to the future of the prudential framework for private health insurers. As part of that work plan, APRA will consult the sector on how the principles set out in this paper should apply to that industry.

APRA welcomes any feedback from the private health insurance industry on the proposals in this paper and the extent to which they are relevant to the private health insurance industry. Submissions on those matters will inform APRA's consideration of the future of the prudential framework in relation to private health insurance actuarial advice.

Chapter 2 – Specific proposals

APRA has identified a set of proposals to streamline and sharpen the role of the Appointed Actuary. The proposals re-examine, from first principles, the role of actuarial advice for an insurer and the role of the Appointed Actuary in the overall framework for that actuarial advice.

In developing these proposals, APRA has considered best practice in the life insurance and general insurance frameworks and seeks to align requirements between the insurance industries where it would improve regulatory outcomes.

It is evident from feedback received that the Appointed Actuary role is well-respected within the industry and plays an important role within insurers. APRA's set of proposals aim to clarify the strategic importance of the role of the Appointed Actuary and enhance flexibility to tailor the role to the individual circumstances of an insurer, without compromising sound prudential outcomes.

The proposals in this paper require changed behaviour from insurers, actuaries and APRA if the full benefits are to be realised. Through combined effort to effectively implement the proposed changes, APRA expects that the insurance industry will be in a stronger position in the future.

2.1 Principles and attributes guiding the Appointed Actuary role

The Appointed Actuary plays a significant role in providing independent and unbiased advice on issues that are material to the financial condition of the company, including by providing effective challenge on decisions. The Appointed Actuary plays a key role in the protection of policyholder interests.

Given the complex and often long-term nature of risks involved in the business conducted by insurers, there needs to be a senior individual with the necessary expertise and experience to provide impartial advice to the board and contribute expert insight at a senior-management level within the company.

Depending on the size and complexity of each insurer, APRA observes a wide range of practice in the structure and operation of the actuarial team. A larger, more sophisticated insurer will typically have a team or teams of actuaries working across multiple functions of the insurer. In contrast, smaller, less complex insurers may have a single person fulfilling the actuarial function. Therefore a diversity of practice is appropriate. What is critically important is that the actuarial functions of each insurer are adequately resourced.

Even where actuarial advice is prepared by a number of areas or teams, APRA considers it important that one individual fulfil the functions of the Appointed Actuary within an insurer to provide high quality actuarial advice to the board.

Given the above matters, the Appointed Actuary is a statutory appointed role and APRA continues to be of the view that this is appropriate.

2.1.1 Purpose statement for the Appointed Actuary

At present, the regulatory role of the Appointed Actuary is defined by the series of tasks set out in the Industry Acts, GPS 320 and LPS 320 and other relevant Acts and prudential standards. Feedback indicates that the current task-based approach contributes to a view that the Appointed Actuary role is overly compliance focused, especially for life insurers. There is a view that this has left the Appointed Actuary with limited capacity to provide strategic advice to the board and senior management.

Given the above, APRA is considering amending the prudential standards to clarify the Appointed Actuary's role by introducing a clear purpose statement for the role.

APRA is proposing to introduce a set of overarching principles and attributes emphasising its expectation that the Appointed Actuary is to be a strategic advisor to the board. In addition, the proposed principles and attributes will further clarify how the role is positioned with respect to other roles, such as the Chief Risk Officer (CRO).

APRA proposes to include the following set of principles and attributes to guide the Appointed Actuary role:

“The purpose of the Appointed Actuary role is to ensure that the board has unfettered access to expert and impartial actuarial advice and review, to assist with the sound and prudent management of an insurer and that the insurer gives adequate consideration to the protection of policyholder interests.

The Appointed Actuary must have the necessary authority, seniority and adequate support to ensure their views are considered seriously by the board and they are able to make a significant contribution to the debate of strategic issues at the executive level. The Appointed Actuary plays a key role in, and provides effective challenge to, the activities and decisions that may materially affect the insurer’s financial condition as well as its treatment of policyholders.”

APRA welcomes feedback on the proposed purpose statement for the Appointed Actuary.

2.2 The provision of actuarial advice

Currently, the Appointed Actuary is responsible for a wide range of tasks under the life and general insurance prudential standards and prescribed under the Industry Acts. Stakeholder feedback suggests that the increasing number of specific tasks required of the Appointed Actuary has led to the role of the Appointed Actuary being more focused on compliance.

There is a concern that Appointed Actuaries are unable to formally delegate responsibilities to reduce the compliance workload or meet short-term absences. APRA has made some attempts to address these concerns⁴. However, industry has found these difficult to apply in practice and the concerns remain.

It is also unclear in some cases whether the Appointed Actuary can delegate aspects of its role

⁴ For example, removing the requirement for life Appointed Actuaries to provide product advice for proposed modifications that are not material - see LPS 320 paragraph 24(b);

to other actuaries. Stakeholder feedback notes that an inability to delegate or take into account materiality reduces flexibility and increases compliance workload. These demands can restrict the Appointed Actuary’s time spent advising on strategic matters and have the potential to hinder the effective provision of high-quality and timely actuarial advice to the insurer.

APRA’s review substantiated the stakeholder feedback in many cases. The current Appointed Actuary requirements often do not take appropriate account of materiality. Additionally, the Appointed Actuary does not currently have the flexibility in all cases to delegate tasks.

In some cases, this is due in part to the statutory nature of the Appointed Actuary role. The Industry Acts mandate specific requirements in relation to the appointment of the Appointed Actuary, and prescribe specific tasks that must be carried out by the role. APRA continues to view these as appropriate. Nevertheless, APRA considers that certain requirements of the Appointed Actuary in the prudential standards would benefit by being reshaped, to better reflect the intended role of the Appointed Actuary as set out earlier in section 2.1.

2.2.1 The actuarial advice framework

APRA proposes allowing insurers to establish a framework for the provision of actuarial advice within the company. The Appointed Actuary would play an active role in the development of the framework and in any future amendments to it. The framework would require approval by the board, having taken into account advice from the Appointed Actuary.

The actuarial advice framework would include:

- identification of areas where actuarial advice would be required within the company;
- a policy identifying the materiality of an item requiring actuarial advice based on

permitting ‘umbrella product advice’ covering a number of similar policies - see LPS 320 paragraph 25; and proposing a process for temporary appointment of an Appointed Actuary.

its importance to the financial condition of the insurer or the interests of policyholders. Only material matters would be required to be the subject of formal actuarial advice;

- a delegations framework identifying appropriately qualified occupants in designated positions that may provide specific types of actuarial advice. The framework would also identify what advice must only be provided by the Appointed Actuary. APRA expects that particularly material items would require the sign-off of the Appointed Actuary;
- clearly identified limits for when advice must be given by the Appointed Actuary, to ensure that the Appointed Actuary continues to give advice on the most material matters;
- where necessary, a temporary delegation model for periods when the Appointed Actuary is absent⁵; and
- the insurer's approach to managing potential conflicts in the Appointed Actuary role (discussed under section 2.3).

Although there will be some upfront work to establish the framework, APRA considers that implementing a clear actuarial advice framework will help reduce the non-material compliance activity currently undertaken as part of the Appointed Actuary's responsibilities. This will increase the opportunity for the Appointed Actuary to provide more strategic advice to the insurer and fulfil the intended role proposed under section 2.1.

As part of this framework, the Appointed Actuary would also be expected to comment in the FCR on how the organisation has used other actuaries and whether the delegations framework has worked effectively over the year.

APRA welcomes feedback in relation to the proposed actuarial advice framework (further

detail on some specific aspects of the framework is set out in the next sections).

2.2.1.1 Areas requiring actuarial advice

APRA proposes that the areas requiring actuarial advice as part of the advice framework would be considered by each insurer. However, in APRA's view it is necessary to specify a number of areas that must be included at a minimum to ensure prudential safety. APRA therefore proposes to specify a number of areas which must be the subject of actuarial advice where material. These will vary somewhat by industry.

For general insurers, actuarial advice would at a minimum be required in relation to:

- the adequacy of the calculation of the insurance concentration risk charge;
- the central estimate of insurance liabilities and the value of liabilities that provides a 75 per cent probability of sufficiency;
- the portion of the net premiums liability provision which relates to catastrophic losses (PL offset) in the insurance concentration risk charge;
- planned capital reductions in the case of run-off insurers; and
- any other matter required under the prudential standards and the Insurance Act.

For life companies, it is proposed that subject to materiality considerations, actuarial advice be obtained in respect of the following areas:

- the methodology for determining the capital base, prescribed capital amount and policy liabilities;
- in respect of participating business and business with discretionary participation features, changes to the investment strategy, including asset-liability management;

⁵ See section 2.2.1.3 of this discussion paper for further details.

- pricing for new products and changes in products;
- changes to the reinsurance strategy, new reinsurance arrangements or changes to existing reinsurance contracts; and
- any other matter required under the prudential standards and Life Act.

See section 2.4.1 for discussion of the Appointed Actuary's assessment of the risk management framework and Internal Capital Adequacy Assessment Process (ICAAP) in the FCR.

See also section 2.5.1 for proposals to remove certain specific requirements for actuarial advice currently applying to life insurers.

APRA welcomes feedback on the proposed minimum areas requiring actuarial advice under GPS 320 and LPS 320.

2.2.1.2 Materiality policy

As part of its actuarial advice framework, an insurer could document a materiality policy, to be approved by the board, outlining the areas for actuarial advice.

This would confirm the matters that the board considers material to the financial condition of the insurer or the interests of policyholders, and therefore requiring advice.

In addition, the policy would identify when advice must be provided to the board and when advice would be provided to management only. Once the materiality policy is established as part of the actuarial advice framework, materiality would not need to be continually assessed by the board. The policy would only need to be reviewed periodically

Under the actuarial advice framework, only material matters would require the provision of actuarial advice. APRA proposes to include a statement of this general principle in GPS 320 and LPS 320.

The Appointed Actuary would be expected to comment in the FCR on whether the materiality policy has worked effectively over the year and recommend any necessary changes.

APRA welcomes feedback on:

- the proposed approach to addressing materiality; and
- the proposed approach to delegation.

2.2.1.3 Temporary delegations

A temporary delegations model can be adopted in the event that the Appointed Actuary is unavailable due to, for example, sickness or leave. This temporary delegations model provides a practical approach to addressing temporary absence of the Appointed Actuary.

In the event of the Appointed Actuary's absence, it is necessary to adhere to the temporary delegations model to avoid breaching the Industry Acts. It is also important to adhere to a temporary delegations model so that at all times there is a single person who must perform the specified duties imposed under the Acts and who can access the immunities conferred under the Acts.

Under the model, a nominated individual should be identified who could temporarily replace the Appointed Actuary when required. The nominated individual must be appropriately qualified and satisfy fit and proper requirements under *Prudential Standard CPS 520 Fit and Proper*. More than one individual may be nominated, however only one could be appointed at any particular time. The nominated individual may be either internal or external to the insurer.

It would be best practice for the board to receive advice from the existing Appointed Actuary before approving, or revoking the approval of, a nominated individual as temporary Appointed Actuary.

In the event that the current Appointed Actuary will be absent, the insurer must notify APRA in writing that:

Person A is to cease functioning as the insurer's Appointed Actuary from X date to Y date and in that period, Person B is to hold the office of the Appointed Actuary.

A single notification by letter to APRA, ahead of the change, can suffice for both changes of Appointed Actuary.

Where appropriate, an Appointed Actuary may comment in the FCR on the reasonableness of any advice given by another actuary acting in its role in the event of a temporary absence.

APRA expects that the proposed materiality and actuarial advice framework changes would make temporary delegations less of an issue over time.

APRA welcomes feedback on this approach to temporary delegations, noting the legislative arrangements discussed above.

2.3 The management of conflicts of interest

APRA considered the Appointed Actuary's role within the three lines of defence model⁶. The Appointed Actuary's responsibilities include both first line of defence advice as well as second line of defence review and challenge. There is no clear consensus from stakeholder feedback as to which line of defence the Appointed Actuary role should be assigned.

Given the statutory responsibilities imposed upon them, the Appointed Actuary serves important functions across the first and second lines of defence. It would be undesirable from a prudential perspective to remove the Appointed Actuary from any of these functions. Accordingly, APRA does not intend to prescribe that the role must fit into a particular line of defence. Given that Appointed Actuary responsibilities may cross between all three lines, insurers and actuaries must appropriately manage the potential conflicts of interest.

Conflicts arise, for example, where an individual reviews their own work undertaken in a first line

capacity as part of a second line review and challenge role.

2.3.1 Conflicts management with respect to the Appointed Actuary

APRA considers that there are a number of possible ways an insurer could manage potential conflicts for an Appointed Actuary. Insurers could adopt a framework that provides for independent review of Appointed Actuary advice in certain circumstances.

Given this, APRA is considering introducing specific conflict-management requirements. Insurers would need to manage the potential sources of conflict an Appointed Actuary may encounter in carrying out his or her responsibilities. As part of this requirement, the insurer would have regard to whether any of the duties of the person acting as Appointed Actuary compromise that person's ability to meet the proposed purpose of the role as set out in section 2.1.

An insurer's approach to managing potential conflicts would be expected to be documented as part of its framework for the provision of actuarial advice (proposed under section 2.3).

Where APRA has particular concerns in relation to an insurer's management of conflicts, APRA may request a special purpose review be undertaken on an independent basis.

APRA welcomes feedback on:

- **its proposal to clarify that insurers be expected to manage potential sources of conflicts for the Appointed Actuary role; and**
- **whether additional guidance on managing conflicts of interest would be of assistance and, if so, on what aspects.**

⁶ For more detail on the three lines of defence model, see *Prudential Practice Guide CPG 220 Risk Management* <http://www.apra.gov.au/CrossIndustry/Documents/Prudential-Practice-Guide-CPG-220-Risk-Management-January-2015.pdf>

2.3.2 Dual-hatting

In light of its proposals on management of conflicts of interest, APRA has reviewed the restriction on Appointed Actuary's holding certain dual roles (referred to as dual hatting). At present, the Appointed Actuary is expressly excluded from being the CRO under *Prudential Standard CPS 220 Risk Management (CPS 220)*. Industry feedback has expressed varied views in relation to this prohibition. Some argue the prohibition should remain given the value for insurers to retain a stand-alone Appointed Actuary role. A contrary view is that removal of the express prohibition would allow companies to determine the structure which best suits their individual circumstances.

By enabling dual hatting of the Appointed Actuary and CRO roles, some stakeholders suggest that the stature of the Appointed Actuary role could be enhanced. In their view, a CRO role can sit across multiple entities within a broader division whereas an Appointed Actuary's influence is limited to insurance. As a result, stakeholders suggest that the introduction of the CRO is inadvertently reducing the stature/seniority of the Appointed Actuary.

However, APRA remains concerned that any dual hatting between the roles of the Appointed Actuary, CRO, Chief Executive Officer and a director of the insurer would give rise to unmanageable conflicts.

A key part of the Appointed Actuary's role is to assess the financial condition of the company. Among other matters, the financial condition of the company depends on the effectiveness of its risk management framework developed by the CRO. A direct conflict would arise as part of the risk-management framework assessment if the Appointed Actuary is also the CRO. In this case, the Appointed Actuary would no longer be able to provide an important impartial check as part of assessing the financial condition of the company.

Given this, APRA considers that the current approach set out under CPS 220 remains appropriate. APRA may consider whether alternative arrangements may be appropriate for specific institutions, to allow for various forms of dual hatting. Alternative arrangements may be

agreed in circumstances where, for example, an institution is smaller and less complex.

APRA also considered dual-hatting arrangements between the role of the Appointed Actuary and the Chief Financial Officer (CFO). Given the respective responsibilities of the Appointed Actuary and CFO, APRA considers that dual hatting between the Appointed Actuary and CFO roles could potentially give rise to conflicts of interest. Any dual hatting between these roles would require careful consideration and management by the institution. APRA would expect that appropriate care be taken to ensure the objectivity of the Appointed Actuary role is maintained and that any conflicts are identified and appropriately managed. This is particularly important for a life insurer that has participating business. However, APRA has not reached the conclusion that these conflicts are inherently unmanageable and therefore does not propose to prohibit dual hatting between the CFO and Appointed Actuary.

2.4 Actuarial reports

APRA reviewed the actuarial reports required to be prepared by the Appointed Actuary. APRA proposes a number of changes intended to streamline the work of the Appointed Actuary and, where appropriate, harmonise requirements between life and general insurers.

2.4.1 The Financial Condition Report (FCR)

The FCR is a key document relied on by the board and by APRA for a comprehensive, impartial view of the financial condition of an insurer.

APRA reviewed its expectations in relation to FCR content across the life and general insurance prudential standards. In doing this, APRA considered industry feedback noting the need for targeted advice from the Appointed Actuary. Industry feedback suggested that prescriptive FCR content requirements may obscure the delivery of key messages in the report. APRA also considered how FCR content may overlap with other reports, including the ICAAP.

As a result, APRA considers that greater discretion should be given to the Appointed Actuary to focus on the risks and issues that are material to the insurer's financial condition.

APRA proposes that GPS 320 and LPS 320 set out minimum areas that the Appointed Actuary:

- must consider; but
- may decide to comment on in the FCR, depending on the Appointed Actuary's view of the matter's relevance and materiality to the financial condition of the insurer.

If the Appointed Actuary assesses a matter to be relevant and material to the financial condition of the insurer, the Appointed Actuary would comment on that matter in the FCR.

If, having considered a specific matter prescribed under GPS 320 or LPS 320, the Appointed Actuary concludes that that matter is not sufficiently relevant and/or material, the Appointed Actuary would be required to state briefly in the FCR why that matter is not material or relevant.

APRA proposes that, at a minimum, the Appointed Actuary would be required to consider the following areas:

- an assessment of the actual experience and performance of the institution compared to the expected experience and performance of the institution;
- consideration of the value of the liabilities including an assessment of the adequacy of the past reserves adopted by the insurer, a forward-looking assessment of the adequacy of reserves adopted by the insurer, and any material issues driving uncertainty in valuation results;
- an assessment of the appropriateness of the insurer's pricing practices including the adequacy of premiums;
- an assessment of the company's current and future capital adequacy and high-level observations of material matters arising in the ICAAP.

For life companies, this includes advice on the calculation of the capital base and prescribed capital amount.

For general insurers, this includes an assessment of the adequacy of the calculation of the insurance concentration risk charge;

- the suitability and adequacy of the insurer's reinsurance arrangements;
- the appropriateness of the investment strategy having regard to the nature of the liabilities;
- high-level observations on the overall risk-management framework, with a focus on financial risks such as insurance risk and how these risks are managed by the insurer (refer to further discussion below in this section);
- high-level observations on the insurer's approach to capital management (refer to further discussion below in this section);
- high-level observations on the operation and effectiveness of the actuarial advice framework (proposed under section 2.2);
- for life companies, the equitable treatment of life insurance policyholders; and
- any other matters considered relevant and material to the insurer's current and future financial condition.

The Appointed Actuary would also continue to be required to comply with the Actuaries Institute's professional standards on the provision of advice and FCR (PS 200 Actuarial Advice to a Life Insurance Company or Friendly Society and PS 305 Financial Condition Reports and Review of Run-off Plans for General Insurers).

This proposal includes a number of specific changes to current arrangements. For life companies, the Appointed Actuary's advice on insurance policy liabilities is currently addressed in the FCR. For general insurers, this advice is currently provided in the Insurance Liability Valuation Report (ILVR). APRA considers it appropriate to harmonise this practice for life and

general insurers, by requiring that a summary of the Appointed Actuary's advice on the valuation of insurance policy liabilities be included in the FCR for both industries.

Under GPS 320 and LPS 320, the Appointed Actuary is currently required to assess the suitability and adequacy of the risk management framework and ICAAP in the FCR. Industry feedback suggested that the FCR review of the risk management framework and ICAAP was burdensome for the Appointed Actuary, and overlapped with existing review requirements. Under the prudential standards, an insurer is required to arrange for an independent review of its ICAAP as well as a comprehensive review of the risk management framework at least every three years⁷.

APRA is mindful of removing duplication between processes, which can increase the efficiency of the framework. APRA notes, however, that the involvement of the Appointed Actuary in the ongoing development of the risk management framework and ICAAP could significantly improve the quality of those processes.

Given this, APRA proposes a two-limbed approach to actuarial involvement in the risk-management framework and ICAAP.

The first limb is prospective advice when the risk-management framework and ICAAP is first developed and when any future amendments are made. Providing advice prospectively will enable advice to be integrated into the insurer's decision-making and potentially reduce the level of review needed as part of the FCR and ICAAP on an annual basis.

Therefore, for both life and general insurers APRA proposes that, at a minimum, actuarial advice would be obtained to assess:

- the risk management framework prior to its approval initially, and when material changes are made; and

- the ICAAP prior to its approval initially, and when material changes are made.

This advice would be provided on the same basis as other actuarial advice under the actuarial advice framework. Importantly, this would mean that materiality would be taken into account, and the insurer could determine whether the Appointed Actuary or some other actuary would provide the advice.

For institutions that are smaller and less complex, alternative arrangements may be appropriate where the benefits of obtaining a prospective assessment of the risk management framework and ICAAP may be outweighed by the costs of obtaining the actuarial advice. The insurer's assessment of the costs and benefits would be documented in the actuarial advice framework, and will be assessed by APRA.

The second limb of the approach is that in light of the matters discussed above, APRA considers it appropriate to reduce the Appointed Actuary's review of the risk management framework and ICAAP in the FCR.

APRA proposes that the current requirements be replaced with an expectation that the Appointed Actuary provide high level observations in relation to capital management and risk management in the FCR. The FCR is intended to provide a comprehensive overview of the financial condition of an insurer. In APRA's view, a comprehensive view is not possible without making comments about capital management and risk management, as these are fundamental aspects of the financial management of an insurer.

APRA welcomes feedback on:

- **the proposal to provide greater discretion to the Appointed Actuary to focus on the risks and issues that are material to the financial condition of the insurer;**
- **the costs and benefits of seeking actuarial advice to assess the risk**

⁷ Under *Prudential Standard GPS 110 Capital Adequacy* and *Prudential Standard LPS 110 Capital Adequacy*.

- management framework and ICAAP on a prospective basis; and
- whether it is appropriate to provide alternative arrangements for smaller, less complex institutions.

A number of further life insurance-specific changes are discussed in section 2.5.

2.4.2 The Insurance Liability Valuation Report (ILVR)

For general insurers, an Appointed Actuary is required to prepare an ILVR on an annual basis. APRA considers the ILVR to be a valuable report that promotes transparency in the valuation process and provides a useful record of the justifications underlying key decisions made in the process.

The ILVR performs two key functions:

- as a technically-focused document, intended to document the data, methodology, assumptions, outcomes and reconciliations performed as part of the valuation process. The ILVR should form a key part of the valuation control process and needs to provide sufficient detail to enable another actuary (or APRA) to assess whether the documented process, data and assumptions used in the valuation and its conclusions are reasonable; and
- as a document to communicate key aspects of the valuation process and its outcomes to the board. Under the current GPS 320, the ILVR must be provided to the board in time for it to consider the results as part of preparing the insurer's annual accounts.

On review, APRA considers that the complexity and detail of the ILVR's content may not be appropriate for board review in every instance. A well-functioning board will determine what level of documentation it requires to fulfil its functions. In some cases, the board may find it useful to request the ILVR in full. In other cases, the board may consider that it is able to be sufficiently

informed without requiring the level of detail contained in the ILVR. It is appropriate that the board have the flexibility to control the information flow it considers it needs to perform its role.

Accordingly, APRA does not consider it necessary to mandate that the board receive and consider the ILVR. APRA proposes to remove the current requirement that the board receive the ILVR. APRA will continue to require the Appointed Actuary to sign-off the ILVR and submit a copy of the ILVR to APRA. The FCR would capture a summary of the valuation process and outcomes, aligned to the ILVR, at a level appropriate for consideration by the board.

APRA welcomes feedback on the proposal to remove the requirement mandating that the board receive the ILVR.

2.4.2.1 Level 2 insurance groups

For Level 2 insurance groups, there is no requirement to produce an FCR. To ensure the content remains appropriate for the board's review, APRA recommends a Level 2 insurance group ILVR include an executive summary in addition to a detailed report. This summary can be reviewed by the board in a non-technical document or presentation without the need for the full ILVR to be provided to the board. APRA expects that an executive summary would already be common practice.

APRA welcomes feedback on the proposal to require Level 2 insurance group to include an executive summary in their ILVR for board review, rather than requiring the full ILVR to be provided to the board

2.4.2.2 ILVRs for life companies

For life companies, there is currently no requirement to complete an ILVR. Nevertheless, APRA observes that it is common practice for life insurance actuaries to document the valuation process undertaken. This documentation often uses a structure that is broadly similar to those required by general insurers. Life insurance actuaries currently provide advice on policy liabilities in the FCR and it is common practice for

the summary of valuation outcomes to be supported by an appendix containing the methodology and assumptions used.

As discussed above, APRA sees considerable prudential value in a report documenting the key aspects of the valuation process. APRA has found this very useful in the general insurance context, and also finds the documentation prepared by life insurers of benefit in assessing their valuations. APRA therefore proposes to introduce a requirement for life insurers to produce a technically-focused ILVR. For most well-functioning life insurers, APRA anticipates that this will largely result in a formalisation of documentation that is already produced, rather than a completely new process.

APRA welcomes feedback regarding:

- the proposal for life insurers to produce a technically-focused ILVR; and
- the costs and benefits of introducing a requirement for life insurance actuaries to produce a technically-focused ILVR.

2.4.2.3 Peer review of the actuarial reports

APRA proposes to include a general provision to allow APRA to request a peer review of a specified actuarial report by an independent actuary, in circumstances where APRA considers this appropriate. This provision would be similar to the power currently in place in relation to the ILVR for general insurers and would improve APRA's capacity to review where appropriate. Such a power would support APRA's ability to supervise the proposed actuarial advice framework requirements and the conflicts management requirements. APRA anticipates that the power would be used infrequently.

APRA welcomes feedback regarding the proposal to introduce a power for APRA to request a peer review of a specified actuarial report on prudential grounds, similar to the current power in relation to the ILVR under GPS 320.

2.4.2.4 Due dates of actuarial reports

APRA has reviewed the timeframes for submission of the FCR and ILVR for both general insurers and life insurers. In summary, APRA continues to believe that it is appropriate that these reports be prepared within three months of financial year-end. In determining the appropriate due date for actuarial reports, APRA has weighed the benefits gained by having the FCR and ILVR prepared in a timely manner, together with the costs of preparing the reports.

APRA notes previous feedback from general insurers regarding the feasibility of a three month submission date. In particular, APRA carefully considered feedback that the shorter timeframe had the potential to compromise the quality and the board's consideration of the report. The following factors influence APRA's decision to propose three months for the due date of actuarial reports rather than four:

- Preparing the reports within three months rather than four allows for more timely input into decision making and facilitates timely access to information for prudential purposes by APRA.
- APRA considers that the extensive transition period allowed will enable insurer's to adapt their processes so that the reports can be prepared within three months, and that these changes would be in train.
- APRA notes that the removal of mandatory annual external peer review requirements for general insurers would be expected to streamline the process of preparing the report.
- The proposal to remove the requirement that the board receive the ILVR (see section 2.4.2) is also expected to streamline the process of considering the report.
- APRA notes that life insurers have successfully completed the FCR within three months for an extended period.

For life insurers, consistent with the FCR due date and the timing of the ILVR for general insurers, APRA considers it appropriate that the proposed ILVR for life companies be prepared within three months of financial year-end. APRA notes that it is common practice for life insurance actuaries to document the liability valuation process undertaken as part of preparing the FCR.

APRA welcomes feedback on the proposal to require that the FCR and ILVR be submitted within three months of financial year end.

2.5 Further life insurance-specific issues

APRA proposes a number of further specific changes to life insurance requirements.

2.5.1 Reducing certain life insurance appointed actuary obligations

APRA considers that a number of life insurance requirements no longer align with the intended role and purpose of the Appointed Actuary (as set out in section 2.1).

APRA therefore proposes to remove requirements that the Appointed Actuary assess the insurer's compliance with:

- the capital adequacy standards under subparagraph 12(d) of LPS 320;
- directions or conditions of registration applicable to the life company under the Life Act under subparagraph 12(d) of LPS 320; and
- surrender values and paid-up values as relevant to *Prudential Standard LPS 360 Termination Values, Minimum Surrender Values and Paid-up Values* (LPS 360) under subparagraph 12(c) of LPS 320.

In addition, APRA proposes to remove the requirement for the Appointed Actuary to assess compliance with *Prudential Standard LPS 370 Cost of Investment Performance Guarantees* (LPS 370). Currently, under subparagraph 12(c) of LPS 320 the Appointed Actuary is required to assess the cost of any investment performance guarantees within the meaning of LPS 370 and whether the life company has complied with LPS 370 in respect of each

relevant statutory fund during the financial year concerned. Instead, APRA will only require Appointed Actuaries to include comments in the FCR on any material guarantees in investment-linked funds.

APRA would continue to expect life companies to have in place the policies, systems and processes to ensure compliance with these obligations. Under CPS 220, the board must make a risk management declaration, including a statement that the life company has in place systems for ensuring compliance with all prudential requirements. Supporting that, under *Prudential Standard LPS 310 Audit and Related Matters*, an auditor of a life company must prepare a report that provides limited assurance that the life company has systems, procedures and internal controls that are designed to ensure that the life company has complied with all applicable prudential requirements.

APRA welcomes feedback on the proposal to remove requirements that the Appointed Actuary assess compliance with:

- the capital adequacy standards under subparagraph 12(d) of LPS 320;
- directions or conditions of registration applicable to the life company under the Life Act under subparagraph 12(d) of LPS 320;
- surrender values and paid-up values as relevant to LPS 360 under subparagraph 12(b) of LPS 320; and
- LPS 370 under subparagraph 12(c) of LPS 320.

2.5.2 Retained certain other life insurance appointed actuary requirements

Provision of advice relating to a number of areas in life insurance that require specialised financial expertise have been assigned as the responsibility of the Appointed Actuary. Many of these areas are specified in the Life Act, and some can be found in LPS 320 and *Prudential Standard LPS 700 Friendly Society Benefit Funds* (LPS 700) for friendly societies.

APRA proposes to retain a number of these requirements of the life Appointed Actuary. In APRA's view the Appointed Actuary's unique skills are necessary to fulfil the requirements and to protect the interests of policyholders.

2.5.2.1 Distribution of retained profits or shareholder capital of a statutory fund

Under sections 62 and 63 of the Life Act, distributions of statutory fund retained profits (policyholder or shareholder) or shareholder capital may only be made after directors receive the Appointed Actuary's written advice on the likely consequences of the proposed distribution. APRA considers that the requirement to obtain Appointed Actuary advice should be retained as it remains an important prudential measure for the protection of policyholders to ensure that the capital of the fund is not released without appropriate advice. The need for advice is particularly strong where a statutory fund has participating business.

2.5.2.2 Restructure of life insurance business

Actuarial advice must be sought during a restructure, establishment, transfer or amalgamation of life insurance business. Provisions in *Prudential Standard LPS 600 Statutory Funds* and the Life Act specify circumstances where actuarial advice must be sought during an application for the establishment or restructure of a statutory fund. Sections 191 and 192 of the Life Act specify circumstances where actuarial advice may be sought during an application for the transfer or amalgamation of life insurance business. For friendly societies, LPS 700 specifies circumstances where actuarial advice must be sought in relation to the restructure of approved benefit funds.

APRA considers that the Appointed Actuary's advice and input is essential during this process. In addition, the Appointed Actuary plays a critical role in protecting the interests of policyholders during these processes. APRA proposes no changes to these requirements at this time.

2.5.2.3 Apportioning income and outgoings

Under section 80 of the Life Act, the Appointed Actuary is required to provide advice on the proposed basis for apportioning income and outgoings, which impact participating policyholder outcomes, liability and capital calculations. APRA proposes no change to this requirement, as Appointed Actuary input and advice is valuable during this process.

2.6 Further alignment between GPS 320 and LPS 320

APRA's review has identified that the scope and wording of GPS 320 and LPS 320 has evolved separately over time. This has resulted in different language and content between the two standards. However, the regulatory intent of both standards remains largely equivalent.

As a result, APRA is concerned that the differing language and structure could make it unclear as to whether there is an equivalent level of expectation for general insurance Appointed Actuaries and life insurance Appointed Actuaries.

To address this issue and to ensure greater alignment to improve regulatory outcomes, APRA proposes to align the following areas:

2.6.1 Create new Prudential Standard GPS 340 Valuation of Insurance Liabilities

To ensure that requirements of Appointed Actuaries are aimed at a high level, APRA proposes to amend GPS 320 to make it less prescriptive. At present, GPS 320 includes both the Appointed Actuary requirements and the technical requirements for the insurance liability valuation. In comparison, LPS 320 is less detailed and there is a separate liability valuation prudential standard for life insurers (*Prudential Standard LPS 340 Valuation of Policy Liabilities* (LPS 340)).

APRA is proposing to create a new *Prudential Standard GPS 340 Valuation of Insurance Liabilities*. Consistent with LPS 340, the standard would capture all the liability valuation

requirements that are the responsibility of the insurer.

As part of this process, APRA also intends to remove and/or refine a significant number of paragraphs currently included in Attachment A - Insurance Liability Valuation of GPS 320. This is due to an almost identical overlap with the wording in the Actuaries Institute's *Professional Standard 300 Valuations of General Insurance Claims*.

APRA welcomes feedback on the proposal to:

- **create a new *Prudential Standard GPS 340 Valuation of Insurance Liabilities*; and**
- **amend GPS 320 to make it less prescriptive.**

2.6.2 Wording alignment

APRA proposes to harmonise the wording and broad structure used in GPS 320 and LPS 320. This will clarify the equivalent regulatory intent for the roles and responsibilities of an Appointed Actuary across insurers.

APRA welcomes feedback on the proposal to increase consistency in wording and broad structure between GPS 320 and LPS 320.

Chapter 3 – Cost-benefit analysis information

To improve the quality of regulation, the Australian Government requires all proposals to undergo a preliminary assessment to establish whether it is likely that there will be business compliance costs. Through that process, APRA assessed that, on balance, compliance costs would not be expected to materially increase as a result of the proposals in this paper when considered as a holistic package. Notwithstanding this, if a respondent considers that compliance costs will increase as a result of the proposals in this paper, APRA requests that they provide an assessment of the impact on compliance costs. Compliance costs are defined as direct costs to businesses of performing activities associated with complying with Government regulation.

Consistent with the Government's requirement, APRA will use the methodology behind the Regulatory Burden Measurement Framework to assess any increase in compliance costs identified by respondents. This framework is designed to capture the relevant costs in a structured way, including a separate assessment of upfront cost and ongoing costs. Further information is available at: <http://www.dpmc.gov.au/office-best-practice-regulation/publication/regulatory-burden-measurement-framework-guidance-note>

Respondents are requested to use this methodology to estimate any increase in compliance costs to ensure that the data supplied to APRA can be aggregated and used in an industry-wide assessment. When submitting their cost assessment to APRA, respondents are asked to include any assumptions made and, where relevant, any limitations inherent in their assessment. Feedback should address any additional costs incurred as a result of complying with APRA's requirements or expectations, not activities that institutions would undertake regardless of regulatory requirements in their ordinary course of business.



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