



RESPONSE TO SUBMISSIONS

Review of the role of the Appointed Actuary and
actuarial advice within insurers

September 2017

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Executive summary

In June 2016, the Australian Prudential Regulation Authority (APRA) proposed to make a range of changes to the current framework for the Appointed Actuary role to improve the functioning of the role within insurers.

APRA observed that, as the responsibilities of the Appointed Actuary had expanded over time, the role had become more compliance-focused. This had impeded the ability of the Appointed Actuary of some insurers to provide strategic advice to the board and senior management. Within life companies, APRA observed increased turnover of Appointed Actuaries and was alerted to difficulties in recruiting for Appointed Actuary roles. APRA also noted comments received from industry and from actuaries themselves about how the role of Appointed Actuary had evolved since it had first been introduced.

In response to these concerns, APRA made a number of proposals to increase flexibility, streamline requirements, and clarify the seniority of the Appointed Actuary role within insurers.

While the general and life insurance industries were the primary focus of the proposals, submissions were also invited from private health insurers. Submissions were broadly supportive of the proposals, while questions were raised about the extent to which the reforms would, on balance, reduce the total compliance obligations associated with the actuarial function.

This paper sets out APRA's response to submissions, including changes to the proposals which have been made in response to those submissions. It also seeks feedback on proposals to apply these principles to the role of the Appointed Actuary in the private health insurance industry.

In light of the 2016 consultation process, APRA considers that a single cross-industry prudential standard and prudential practice guide on actuarial and related matters allows for consistent wording of common concepts across the insurance sector while continuing to accommodate industry-specific differences.

APRA seeks feedback on this consultation package, which contains the following draft prudential standards and practice guide:

- *Prudential Standard CPS 320 Actuarial and Related Matters* (CPS 320)
- *Prudential Practice Guide CPG 320 Actuarial and Related Matters* (CPG 320)
- *Prudential Standard GPS 340 Valuation of Policy Liabilities* (GPS 340).

Glossary

AVR	The proposed Actuarial Valuation Report under CPS 320
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CRO	Chief Risk Officer
CPG 320	The proposed new <i>Prudential Practice Guide CPG 320 Actuarial and Related Matters</i>
CPS 320	The proposed new <i>Prudential Standard CPS 320 Actuarial and Related Matters</i>
FCR	Financial Condition Report required under GPS 320, LPS 320, HPS 320 or CPS 320.
GPS 320	The current general insurance <i>Prudential Standard GPS 320 Actuarial and Related Matters</i>
GPS 340	The proposed new <i>Prudential Standard GPS 340 Valuation of Policy Liabilities</i>
HPS 320	The current private health insurance <i>Prudential Standard HPS 320 Actuarial and Related Matters</i>
ICAAP	A general insurer or life company's Internal Capital Adequacy Assessment Process, required under <i>Prudential Standard GPS 110 Capital Adequacy</i> or <i>Prudential Standard LPS 110 Capital Adequacy</i>
ILVR	The Insurance Liability Valuation Report of a general insurer, required under GPS 320
Insurance Act	<i>Insurance Act 1973</i>
Life Insurance Act	<i>Life Insurance Act 1995</i>
LPS 320	The current life insurance <i>Prudential Standard LPS 320 Actuarial and Related Matters</i>
PHIPS Act	<i>Private Health Insurance (Prudential Supervision) Act 2015</i>

Chapter 1 Introduction

In June 2016, APRA released a discussion paper, *'The role of the Appointed Actuary and actuarial advice within insurers'*, which outlined proposed changes aimed at improving the functioning of the Appointed Actuary role and ensuring that it remains fit-for-purpose. Key proposals were to:

- introduce a purpose statement for Appointed Actuaries¹;
- implement a clear actuarial advice framework;
- improve the management of potential conflicts of interest;
- improve reporting requirements; and
- harmonise prudential standards across industries.

APRA received 26 submissions from a range of stakeholders including industry associations, APRA-regulated institutions and other stakeholders. Five submissions were provided in confidence.

Submissions were broadly supportive of the proposals, while making specific comments on a wide range of issues and providing feedback on each of the aspects outlined in the paper.²

This Response to Submissions paper sets out the proposals, submissions received on those proposals and APRA's response to those proposals. The draft CPS 320, CPG 320 and GPS 340 incorporate many aspects of the existing prudential standards together with the June 2016 proposals.

In assessing changes to the role of the Appointed Actuary and actuarial advice within insurers, APRA sought to balance the objectives of financial safety, efficiency, competition, contestability and competitive neutrality, while promoting financial stability.

The objective of the changes is to enhance the financial safety of individual entities by allowing the Appointed Actuary to focus less on compliance issues and more on matters of strategic significance, while retaining key elements of the role.

In some areas, initial investment in changing processes and frameworks will be necessary to achieve these improvements. APRA considers that this trade-off will have overall positive impacts.

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.

¹ The purpose statement is reflected in paragraphs 2 and 3 of the 'Objectives and key requirements of this Prudential Standard' box on page 1 of draft *Prudential Standard CPS 320 Actuarial and Related Matters*.

² APRA Discussion Paper *The role of the Appointed Actuary and actuarial advice within insurers* (June 2016) at <http://www.apra.gov.au/CrossIndustry/Pages/Review-of-the-Appointed-Actuary-June-2016.aspx>

PRIMARY OBJECTIVES	
<p>Financial safety</p> <p>↑</p>	<p>Financial system stability</p> <p>↔</p>
<p>Marginally enhanced. Insurer soundness is expected to be enhanced through higher quality advice from Appointed Actuaries and more focus on the material risks to financial soundness.</p>	<p>Unchanged. No identified risks to the stability of the financial system.</p>
OTHER CONSIDERATIONS	
<p>Efficiency</p> <p>↑</p>	<p>Enhanced. Proposed flexibility permitted to insurers to adopt Actuarial Advice Frameworks that suit their particular business and restrict Appointed Actuary activities to material matters should enhance efficiency.</p>
<p>Competition</p> <p>↔</p>	<p>Unchanged. No changes to the prudential framework that would have a material impact on competition.</p>
<p>Contestability</p> <p>↑</p>	<p>Marginally enhanced. The proposed refinements in reporting should reduce compliance burden across industry and are expected to help ensure that the standards applying to Appointed Actuaries do not act as an undue constraint to potential new entrants.</p>
<p>Competitive Neutrality</p> <p>↑</p>	<p>Marginally enhanced. Proposed changes should marginally improve aspects of prudential requirements that have a disproportionate impact on smaller entities.</p>

Chapter 2 Specific proposals

2.1 Purpose statement for the Appointed Actuary role

The Discussion Paper set out APRA's proposal to introduce a clear purpose statement for the Appointed Actuary role. The draft purpose statement described the overarching principles that guide APRA's expectation of the role, function and attributes of the Appointed Actuary. In addition, the proposed principles and attributes were intended to further clarify how the role is positioned with respect to other roles, such as the Chief Risk Officer (CRO).

2.1.1 Comments received

Submissions expressed broad support for the purpose statement. Some submissions suggested refinements or requested greater clarity around how APRA would expect the purpose statement to be implemented in practice. A number of submissions requested that APRA amend the draft purpose statement to recognise that the Appointed Actuary is not only to be a strategic advisor to the board, but also to senior management.

In relation to the positioning of the Appointed Actuary, two issues emerged in submissions that are relevant not only to the purpose statement but to the broader suite of proposals. One of them is whether the Appointed Actuary is expected to be employed as a direct report of the Chief Executive Officer (CEO). The other is whether the proposals place any limitations on the appointment of an external Appointed Actuary.

There were a range of views on how the Appointed Actuary role should be positioned, including:

- as a direct report of the CEO, to ensure that the Appointed Actuary has the necessary authority and support for his or her views to be considered seriously by the board, and to make the position more attractive.
- as either the most senior actuarial role in an organisation (as opposed to the Chief Actuary) or potentially one of a small number of similarly senior actuarial roles. It was submitted that this would help to change the current practice, where a Chief Actuary tends to take more of a strategic role within an insurer and the Appointed Actuary remains focused on compliance.
- in a similar way as an insurers' risk function, requiring the insurer to have an actuarial function with the Appointed Actuary as its head.

The issue of whether the purpose statement allows for insurers to engage external Appointed Actuaries was also raised in submissions. Some felt that the purpose statement should explicitly recognise that the Appointed Actuary can be an external appointment.

Another issue raised in submissions related to the references to 'policyholder interests' and the 'treatment of policyholders' in the purpose statement. Concern was expressed that the word 'treatment' may be interpreted to mean that Appointed Actuaries are required to give consideration to operational issues outside of their area of expertise. Other submissions suggested the purpose statement should acknowledge the different considerations

Appointed Actuaries would give to policyholder interests in general insurance and life insurance.

2.1.2 APRA response

APRA agrees it is appropriate to explicitly recognise the role the Appointed Actuary plays in advising senior management and has amended the purpose statement to acknowledge this. An explicit reference to providing advice to senior management will help to ensure the Appointed Actuary's involvement in the strategic decision making process at the senior management level, rather than only advising the board after decisions have been made.

The use of the term 'seniority' in the purpose statement caused some uncertainty among stakeholders regarding the position of the Appointed Actuary within an insurer. APRA's intention was to ensure that the Appointed Actuary is in a position to have his or her views heard and seriously considered. Positioning the Appointed Actuary as a direct report of the CEO is one way to achieve that aim, but it is not the only way. On that basis, APRA does not intend to mandate that the Appointed Actuary must report to the CEO. Regardless of the positioning of the Appointed Actuary in the organisational structure, APRA expects the structure will support the ability of the Appointed Actuary to provide advice on important financial and strategic issues in a timely manner.

APRA remains of the view that the decision as to whether the Appointed Actuary should be internal or external is appropriately a decision to be made by the insurer, taking into account its size, structure and needs. APRA has included an explicit statement in CPG 320 to make it clear that the Appointed Actuary can be external.

APRA has also considered the references to policyholders in the purpose statement and maintains that there is an important role for the Appointed Actuary to ensure that the insurer gives adequate consideration to the protection of policyholder interests. To avoid ambiguity, APRA has amended the purpose statement in the draft prudential standards to replace 'its treatment of policyholders' with 'policyholder interests'.

Although there are different considerations regarding policyholder interests for general insurers and life companies, these differences are detailed in the prudential standards and are well understood within each industry. APRA considers that it is not necessary to use the purpose statement as a tool to elaborate on them.

2.2 Actuarial advice framework

APRA proposed requiring insurers to establish a framework for the provision of actuarial advice within the company. The proposal was for the Appointed Actuary to 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.

As part of this framework, APRA proposed requiring the Appointed Actuary to comment in the Financial Condition Report (FCR) on the materiality policy, how the organisation has used other actuaries and whether the delegations framework has worked effectively over the year.

2.2.1 Comments received

Submissions generally supported the rationale for an actuarial advice framework and commented that it had the potential to reduce the compliance burden placed on the Appointed Actuary. Some submissions requested further clarification on how the framework would work in practice, and how different aspects of the framework might best be implemented.

There were conflicting views in submissions on the question of whether APRA should provide further clarification as to how materiality will be defined, or whether it should be left to the judgement of the Appointed Actuary. Some submissions commented that care should be taken that the materiality policy requirements are not operationally burdensome.

Other submissions suggested that the 'notifiable circumstances' component of *Prudential Standard HPS 320 Actuarial and Related Matters* (HPS 320) offers an effective example of an actuarial advice framework. Under the 'notifiable circumstances' regime, a private health insurer is required to notify the Appointed Actuary of certain matters being considered by the insurer. The Appointed Actuary then has the discretion to decide whether advice is required. Examples of notifiable circumstances in the private health insurance sector include proposing changes to benefits, significant revision of the strategic or business plans of the insurer, or significant changes to the investment policies of the insurer.

Several submissions represented the 'notifiable circumstances' regime as a well-functioning framework for the provision of actuarial advice which provides opportunities for dialogue with the management and the board, even where no formal advice is provided.

Regarding temporary Appointed Actuary appointments, submissions sought clarification of the proposed process, including specifying who should be responsible for signing the letter advising APRA, whether electronic submission is acceptable, and notice periods. One submission proposed permitting delegation to multiple appropriate individuals.

2.2.2 APRA response

APRA considers that a clear actuarial advice framework can help reduce the non-material compliance activity currently undertaken as part of the Appointed Actuary's responsibilities. APRA expects this to increase the opportunity for the Appointed Actuary to provide strategic advice to the insurer and fulfil the role set out in the purpose statement. In the interests of creating the flexibility to allow the Appointed Actuary the time to focus on strategic issues, APRA has considered what tasks require actuarial advice and what tasks specifically need to be undertaken by the Appointed Actuary.

The draft prudential standard specifies the minimum areas where it is proposed that actuarial advice would be required. Not all the minimum tasks outlined will need to be performed by the Appointed Actuary. The responsibility for tasks is able to be determined by the insurer through its actuarial advice framework. CPG 320 provides further guidance on APRA's expectations of actuarial advice frameworks.

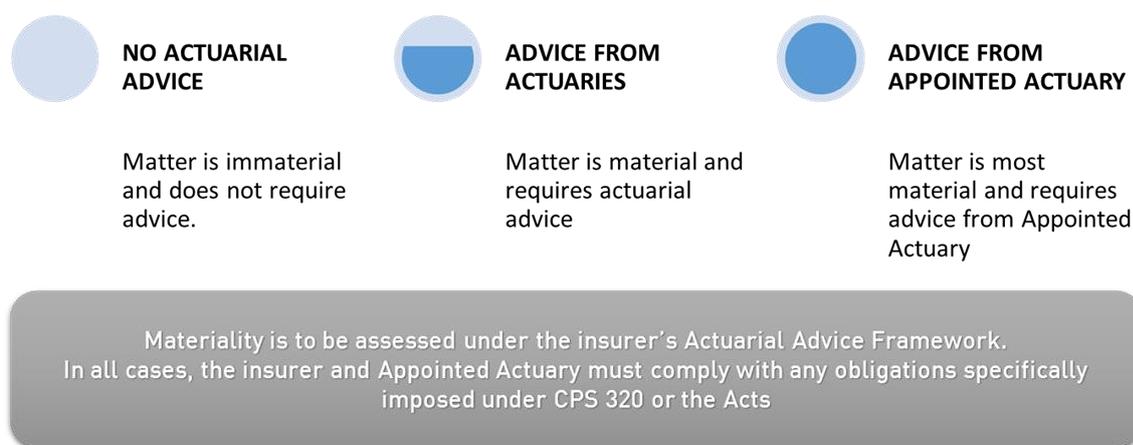
APRA does not propose that the actuarial advice framework be approved by APRA or solely owned by the Appointed Actuary. It is a matter for the insurer to determine with oversight from the board. However, APRA may review and discuss the framework with insurers as part

of regular supervisory activities. The framework must, however, be approved by the board following advice from the Appointed Actuary, to ensure that the board has oversight and comfort with how actuarial advice will be structured within the insurer.

Draft CPG 320 includes, consistent with the current GPS 320, a high level definition of materiality. APRA considers that it is not appropriate to define materiality solely through quantitative monetary limits or financial definitions. Qualitative factors should be used to complement quantitative metrics.

Figure 1 illustrates APRA’s expectations of how the actuarial advice framework would operate.

Figure 1: Operation of an Actuarial Advice Framework



Having considered submissions that it may be unduly burdensome to require that the Appointed Actuary provide a formal assessment of whether an item is immaterial, APRA has refined its proposal. The draft CPS 320 requires the Appointed Actuary to only comment on the materiality policy in exceptional circumstances, such as where the Appointed Actuary considers that it is not functioning effectively.

Regarding the ‘notifiable circumstances’ regime, APRA acknowledges the positive views that various stakeholders have taken of that regime in the context of private health insurance. A ‘notifiable circumstances’ type framework is one potential implementation of the actuarial advice framework. Given that the needs and structures of insurers will differ, APRA does not propose to mandate the use of a notifiable circumstances framework for life and general insurers, but does not preclude it if an insurer chooses to adopt a ‘notifiable circumstances’ type framework. The draft CPG 320 notes that the ‘notifiable circumstances’ framework could be used to meet the requirements of the prudential standard.

In response to submissions, APRA has also provided guidance in draft CPG 320 with respect to temporary Appointed Actuaries.

2.3 Management of conflicts of interest or duty

The Discussion Paper noted the potential for conflicts of interest or duty to arise in the Appointed Actuary role. In particular, APRA noted that the Appointed Actuary role can span

multiple 'lines of defence' within an organisation, and that this was appropriate and beneficial. However, it drives a clear need to ensure that resulting conflicts are identified and appropriately managed.

To that end, APRA proposed that an insurer's approach to managing potential conflicts would be documented as part of its framework for the provision of actuarial advice.

In addition to the above general principle, the Discussion Paper discussed two specific examples of the Appointed Actuary holding other roles:

- the Appointed Actuary should not be permitted to be the CRO, as combining the role of the Appointed Actuary, CRO, Chief Executive Officer or a director of the insurer gives rise to unmanageable conflicts; and
- the Appointed Actuary could serve as the Chief Financial Officer (CFO), but appropriate care must be taken to ensure that any conflicts are identified and appropriately managed.

2.3.1 Comments received

There was clear recognition in submissions that conflicts can arise and that these conflicts must be managed by both insurers and actuaries. However, there were differing views on how manageable certain conflicts were, especially with regards to dual hatting of the CRO and Appointed Actuary roles. There were also differing views on whether APRA should take a rules-based or a principles-based approach to conflict management, and queries as to the circumstances that would warrant a special purpose review into the management of conflict.

Submissions contained mixed views on whether the CRO and Appointed Actuary roles could be performed by the same person. Some submissions supported the prohibition and others argued that the conflict can be managed. Some argued that the prohibition makes it inevitable that the Appointed Actuary will be less senior in the organisation and that lifting the prohibition would make the Appointed Actuary role more attractive, and encourage the development of a range of skills including risk, technical, leadership and strategy.

Submissions outlined ways that the risks of CRO and Appointed Actuary roles being performed by the same person could be mitigated where the Appointed Actuary role is largely second-line, or the insurer is smaller or less complex. Submissions also suggested that the risks could be mitigated by removing the requirement for the Appointed Actuary to review the effectiveness of the insurer's risk management framework.

2.3.2 APRA response

APRA's intention is to impose a principles-based obligation on insurers to manage conflicts of interest or duty. CPG 320 contains principles-based guidance to assist insurers and actuaries to manage such conflicts.

Under draft CPS 320, APRA has broad powers to request that an insurer undertake an actuarial review. In relation to conflicts of interest or duty, APRA expects that it would exercise this power infrequently, and only after discussion with the insurer.

APRA has considered the suggestion to remove the requirement for the Appointed Actuary to review the effectiveness of the insurer's risk management framework, but does not consider

this to be appropriate. As the financial condition of an insurer depends on the effectiveness of its risk management framework, APRA considers that in most cases the Appointed Actuary and CRO roles should not be shared.

APRA notes the view that it may be appropriate for smaller organisations to have a shared CRO and Appointed Actuary where there is an ability for the Appointed Actuary to implement and maintain controls. APRA's existing approach is to assess applications for sharing the CRO role and other roles in limited circumstances, particularly where an insurer is smaller and less complex. This requires careful management of risks, and would only be approved in cases where it is demonstrated that having separate Appointed Actuary and CRO would not be practicable for that institution.

2.4 Actuarial reports

APRA outlined proposals in the Discussion Paper that aimed to streamline the work of the Appointed Actuary in relation to reporting and, where appropriate, harmonised requirements between life and general insurers.

APRA proposed to provide the Appointed Actuary with greater discretion to focus the FCR on risks and issues material to the insurer's financial condition. Under the proposal, the prudential standard would set out the minimum areas that the Appointed Actuary must consider. It would allow the Appointed Actuary to exercise discretion as to whether or not to comment on those minimum areas in the FCR, depending on the Appointed Actuary's view of the matter's relevance and materiality to the financial condition of the insurer. APRA would expect a comment on each of these matters, which may simply be a comment that the matter has been considered and is not relevant or material.

In order to allow boards greater flexibility to control the information flow they consider necessary to perform their role, APRA proposed to remove the current requirement that the board receive and consider the Insurance Liabilities Valuation Report (ILVR) of a general insurer. For Level 2 insurance groups (which are not required to produce an FCR), APRA proposed the inclusion of an executive summary in the ILVR. This was intended to facilitate board review without mandating that the entire ILVR be considered by the board.

APRA also proposed a number of measures to improve alignment between the life and general insurance industries:

- to introduce a requirement for life companies to produce a technically focused ILVR to document the key aspects of the valuation process, given the demonstrated value and usefulness of doing so in the general insurance context;
- to introduce a power for APRA to request a peer review of a specified actuarial report on prudential grounds; and
- that the FCR and ILVR be submitted within three months of the end of the financial year.

Finally, APRA proposed a two-limbed approach to actuarial involvement in the review of the risk management framework and the Internal Capital Adequacy Assessment Process (ICAAP). The first limb involves prospective advice under the actuarial advice framework when the risk management framework and ICAAP are developed or materially changed, and

the second limb involves discussion of the risk management framework and ICAAP in the FCR at a reduced level of detail compared to the current requirements.

2.4.1 Comments received

Submissions supported APRA's proposal to allow the Appointed Actuary to have greater discretion over the contents of the FCR. A number of respondents expressed concern with APRA's proposal to require the Appointed Actuary to comment in the FCR on how the organisation has used other actuaries and whether the delegations framework and materiality policy has worked effectively over the year. The following concerns were also raised about the proposals for the FCR to contain comments on the operation of the actuarial advice framework:

- the work required to establish the framework and the comment on its effectiveness undermines the benefits of the changes;
- including an assessment of framework effectiveness reduces the usefulness of the FCR as a strategic document and could be done outside the FCR;
- if the Appointed Actuary has concerns about the effectiveness of the framework, they should rectify them, not report on them; and
- the requirement to comment on the effectiveness of the materiality policy risks being interpreted as requiring the Appointed Actuary to consider all matters that had been classified as immaterial during the year.

In relation to APRA's proposal to replace the four month report due date with a three month due date, responses were mixed. It was submitted that in some cases it may lead to a trade-off between early submission and engagement with the board and that the shorter timeframe is likely to compromise the quality of the reports. Other submissions commented that a four month deadline better allows for consideration of the FCR as distinct and separate from the other year-end reports, such as the annual accounts and the ILVR. It was suggested that an alternative to requiring the FCR within the three month due date was to allow APRA access to any necessary information as part of supervisory activities.

There were a range of views on APRA's proposal to reduce the Appointed Actuary's review of the ICAAP and the risk management framework and instead require high level observations on capital management and risk management. Some were supportive of APRA's approach, however it was also submitted that APRA should go further and remove even these high level observations in the FCR on the basis that requiring the Appointed Actuary to formally comment could lead to a compliance sign off rather than an active participation in the process. Several submissions noted that the reduction in effort to produce the FCR under this proposal would be counterbalanced by the need for actuarial involvement in providing prospective advice on the risk management framework and ICAAP, potentially at multiple points through the year. Submissions queried whether this would reduce overall burden to a material extent. A number of submissions commented that there should be greater flexibility and simpler processes applied for smaller insurers.

In relation to ILVRs, submissions supported APRA's proposed approach of leaving the receipt of the ILVR to the board's discretion and received no objections to this proposal. There was also support from submissions on the introduction of the ILVR for the life industry, on the basis that it formalised existing documentation. It was, however, submitted that the

requirement for a life insurance ILVR will increase the compliance burden, limit the capacity for strategic advice and possibly lead to duplication of information currently contained in the FCR. Two submissions requested that the intent of the ILVR requirement for life companies be better explained by APRA. As part of this assessment, the value the board would obtain from the ILVR should also be explained.

2.4.2 APRA response

APRA acknowledges the mixed views on the three month FCR submission date for general insurers. Although the amount of time available to discuss the FCR may be reduced when it must be considered in the same meeting as the annual financial statements and supporting material, APRA also sees benefits from the board considering all these reports at the same time so that there is a holistic view of financial condition and valuations for the insurer.

The three month due date also has other benefits, including allowing more timely input into decision making, and potentially improving prudential outcomes by providing APRA with access to the FCR sooner. APRA already has access to information as part of supervisory activities, but this does not provide APRA with the comprehensive views of the Appointed Actuary on the financial condition of the insurer. For these reasons, APRA intends to maintain the three month due date. This is reflected in the draft CPS 320.

APRA has considered the concerns that the proposed two-limbed approach to considering the risk management framework and ICAAP will not materially reduce burden. APRA's view is that the proposed requirement to provide prospective advice, subject to the materiality policy, will better enable advice to be integrated into decision-making by insurers, and will allow the Appointed Actuary greater opportunity to provide ongoing strategic input. In many cases, this is a formalisation of existing processes whereby the Appointed Actuary is involved in the development of the risk management framework and ICAAP.

CPG 320 outlines guidance on where it may be appropriate not to obtain prospective advice on the risk management framework or ICAAP, including where the benefits from obtaining advice are limited in the circumstances and the proposed change is not detrimental to policyholders. APRA anticipates that this would be more likely to be appropriate for smaller and less complex insurers and would be documented in the actuarial advice framework.

There will continue to be some reporting burden, subject to the materiality policy, associated with including high level observations on capital management and risk management in the FCR, although this will be at a reduced level compared to currently. Were APRA to remove this requirement, the FCR would not provide a comprehensive overview of the financial condition of an insurer.

APRA considered the concerns expressed about the proposal for the Appointed Actuary to comment in the FCR on the actuarial advice framework and related matters. Consideration has been given to how to minimise unnecessary reporting burden while maintaining mechanisms to ensure that the frameworks operate effectively. APRA is now proposing to only require comment where the Appointed Actuary has concerns regarding the operation and effectiveness of the actuarial advice framework, whether the materiality policy has worked effectively or how the insurer has used other actuaries.

In relation to technically focused actuarial reports, APRA's view is that these reports provide significant value as they promote transparency in the actuarial process and provide a record of the justifications underlying key decisions made. APRA has removed some of the prescriptive requirements that currently apply to ILVRs for general insurance in recognition of the fact that these processes are now well established within insurers and the actuarial profession.

For life companies, the technically focused report will cover the liability valuation as discussed in the Discussion Paper, but APRA proposes that it would also cover the Appointed Actuary's calculation of the capital base and prescribed capital amount, as the prudential benefits of formalising the documentation of these calculations are equally strong. In recognition of the fact that, for life companies, the report covers more than only the liability valuation, the report has been renamed from the ILVR to the Actuarial Valuation Report (AVR).

APRA intends to retain the proposal to leave the receipt of the AVR to the board's discretion and this flexibility is included in the draft CPS 320. APRA is conscious of the need to limit any unnecessary reporting requirements and does not expect the ILVR to duplicate material from the FCR. APRA has taken this into account in the draft CPS 320 and draft CPG 320.

2.5 Actuarial reviews

The Discussion Paper proposed to provide that APRA may request that an insurer arrange a review of a specified actuarial report by a specified actuary. Currently, APRA has the power to request a peer review of the ILVR of a general insurer. The proposal in the Discussion Paper sought to replace this specific power with a general provision to request a review of an actuarial report by a specified actuary.

2.5.1 Comments received

APRA received submissions seeking clarification of the circumstances under which APRA would require an insurer to arrange a review of an actuarial report.

2.5.2 APRA response

APRA's proposed approach would apply to general insurers, life companies and private health insurers. Where APRA has concerns relating to the actuarial advice framework, the quality of actuarial advice or the management of conflicts, a review may be required. APRA expects to use this power infrequently and only after discussion with the insurer, but considers it to be an important prudential control. When making a decision regarding whether or not to require a review, APRA would take into account any quality assurance processes that have already been undertaken, such as other peer reviews or as part of external audit.

2.6 Further life insurance-specific issues

As part of the review APRA also proposed a number of specific changes to life insurance requirements. In particular, APRA sought to remove requirements that no longer aligned with the intended role and purpose of the Appointed Actuary.

2.6.1 Comments received

In addition to the requirements proposed by APRA for removal, two respondents suggested that the requirement in *Prudential Standard LPS 230 Reinsurance* (LPS 230) 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. One submission suggested that doing so would be unlikely to have a negative impact on prudential outcomes. Instead, the respondent suggested that comment on the appropriateness of reinsurance arrangements in aggregate should be required as part of the FCR from the perspective of its impact on the current or prospective financial condition of the insurer.

Another respondent expressed support for the proposed removal of requirements, but requested that APRA provide further clarity as to expectations of life companies to have the correct policies, systems and processes to ensure continued compliance once the obligations have been removed.

There was general support in submissions for the requirements APRA proposed to retain, namely the areas which require specific advice from the Appointed Actuary:

- under sections 62 and 63 of the *Life Insurance Act 1995* (Life Act) in relation to the distribution of retained profits or shareholder capital of a statutory fund;
- in *Prudential Standard LPS 600 Statutory Funds* and the Life Act in relation to the restructure of life insurance business; and
- on apportioning income and outgoings under section 80 of the Life Act.

2.6.2 APRA response

APRA has considered the suggestion to review LPS 230 to ensure that the requirements of the Appointed Actuary are aligned to the proposed purpose statement for the role. APRA intends to review LPS 230 ahead of the standard sunset in early 2018. As part of this revision, APRA is proposing to remove the requirement for the Appointed Actuary to provide an opinion on the administration of reinsurance arrangements as part of the reinsurance report. APRA considers that comment by the Appointed Actuary on the suitability and adequacy of the reinsurance strategy is appropriate, and that this assessment should be included in making any assessments of the financial condition of the insurer in the FCR.

APRA intends to retain the areas which require specific advice from the Appointed Actuary outlined in the Discussion Paper, such as apportioning income and outgoings under section 80 of the Life Act, given the general support in submissions.

2.7 Further alignment between GPS 320 and LPS 320

In the Discussion Paper, APRA acknowledged the differences that have evolved over time in the language and content of GPS 320 and LPS 320.

To ensure equivalent levels of expectation between the industries, APRA proposed to:

- align the language and structure of the standards;
- amend GPS 320 to make it less prescriptive; and
- create a new GPS 340 on liability valuation for general insurers.

2.7.1 Comments received

There was general support among submissions for making GPS 320 less prescriptive and for creating the new GPS 340 to better align general insurers with requirements in the life insurance industry. However, submissions argued that there needs to remain an appropriate level of detail to avoid compromising clarity and creating regulatory uncertainty.

2.7.2 APRA response

APRA recognises the need for a balanced approach when streamlining existing prudential standards and believes that the revised standards and accompanying prudential practice guide provide sufficient clarity to ensure that the industries understand their obligations. APRA does not view these changes as compromising prudential outcomes.

At the time the Discussion Paper was released APRA consulted on aligning the language and structure of the standards across industries. In the process of reviewing GPS 320 and LPS 320, APRA also undertook an extensive review of HPS 320.

Having regard to the similarity of intent that underpins the three prudential standards (GPS 320, LPS 320 and HPS 320), APRA now considers that there is value in consolidating all three standards in one single standard. In preparing the draft standards released with this response paper, APRA's view is that the best way to achieve this objective is through a single, cross-industry standard and prudential practice guide.

The draft standard addresses common concepts across industries in a consistent way, while still recognising industry-specific differences where required. It harmonises the prudential expectations across the insurance sector.

Chapter 3 Private health insurers

The Discussion Paper released in June 2016 was largely focused on changes to the prudential framework applying in the general insurance and life insurance industries. In that paper, APRA noted that a number of the proposals might also be relevant in the private health insurance industry. APRA noted its intention to consult with private health insurers in due course on whether the principles underpinning the review could also be relevant to the private health insurance industry.

This chapter outlines how APRA proposes to apply each of the May 2016 proposals to the private health insurance sector, taking into account preliminary feedback from submissions received to date. These proposals have been incorporated into the draft CPS 320.

APRA invites comment on the proposed changes to the role of the Appointed Actuary and actuarial advice within private health insurers.

3.1 Purpose statement for the Appointment Actuary

The Appointed Actuary of a private health insurer, whether they be internal or external, is subject to statutory functions and duties³ and Actuaries Institute *Professional Standard 600 Financial Condition Reports for Private Health Insurers* (Actuarial Professional Standard 600). The introduction of a purpose statement in the draft cross-industry prudential standard would emphasise the strategic nature of the Appointed Actuary role and clarify how the role is positioned with respect to other roles in insurers.

Purpose statement for the Appointment Actuary

APRA welcomes feedback on the proposed purpose statement contained in paragraphs 2 and 3 of the 'Objectives and key requirements of this Prudential Standard' box on page 1 of the draft CPS 320 for the Appointed Actuary of a private health insurer.

3.2 Actuarial advice framework

A board-approved actuarial advice framework should allow insurers and Appointed Actuaries greater flexibility and reduce the compliance burden on the Appointed Actuary. Board approval promotes better engagement and transparency as to the level and types of changes to business activity that are deemed material for actuarial advice purposes.

APRA notes the initial feedback from some stakeholders that an actuarial advice framework need not be introduced for private health insurers as the notifiable circumstances framework already acts as a well-accepted actuarial advice framework. Under the notifiable circumstances framework, the insurer is required to notify the Appointed Actuary of certain matters being considered by the insurer, and the Appointed Actuary has the discretion as to

³ Part 5, Division 2 of the *Private Health Insurance (Prudential Supervision) Act 2015*

whether advice is required. A private health insurer may also request advice from the Appointed Actuary on a notifiable circumstance. APRA understands the value stakeholders see in the notifiable circumstances framework and does not propose to remove the ability to use that framework. However, APRA is seeking stakeholder views on whether, as proposed for general insurers and life companies, the actuarial advice framework should be permitted to allow for a range of different formats, including notifiable circumstances. APRA is interested to understand whether the flexibility to determine a less prescriptive, more principles-based framework might better meet the needs of different private health insurers, depending on their size and structure. The Appointed Actuary would play a key role in developing the actuarial advice framework and advising on any subsequent changes.

This broad level, principles-based actuarial advice framework would address the following criteria:

- identification of the areas where actuarial advice is required;
- a materiality policy;
- identification of what advice must only be provided by the Appointed Actuary and what may be provided by other actuaries; and
- the private health insurer's approach to managing potential conflicts of interests in the Appointed Actuary role.

As part of the actuarial advice framework, APRA is proposing that insurers document a materiality policy to be approved by the board. In particular, the policy would identify when advice must be provided to the board and when it would be presented only to senior management. Other than obligations imposed specifically on the Appointed Actuary, only material matters would require actuarial advice.

In the private health insurance sector this should not represent a significant change as HPS 320 already allows the Appointed Actuary to make materiality judgements.⁴

Actual advice framework

APRA welcomes feedback from private health insurers on:

- the proposed actuarial advice framework; and
- the proposed approach to addressing materiality.

3.3 Managing conflicts of interest or duty

Conflicts can arise between the role of the Appointed Actuary and other roles undertaken by that individual. Conflicts can also arise where the Appointed Actuary undertakes both first line-of-defence (provision of advice) and second line (review and challenge). As proposed for general insurers and life companies, APRA intends to largely leave the management of conflicts related to the Appointed Actuary role to individual private health insurers and their Appointed Actuaries to address.

⁴ For example, Appointed Actuaries are required to make judgements with respect to materiality under Actuarial Professional Standard 600.

To assist insurers in understanding APRA's expectations, guidance has been included in draft CPG 320. APRA proposes the guidance will be applicable to private health insurers as well as general insurers and life companies.

APRA's view is that the conflicts that are likely to emerge if the roles of the Appointed Actuary and the CRO are combined are unmanageable.

Under the extension of *Prudential Standard CPS 220 Risk Management*, private health insurers will be required to appoint a CRO unless an alternative arrangement has been approved by APRA.

Similar to the treatment of general insurers and life companies, APRA does not intend to prohibit the Appointed Actuary also holding a CFO role in the private health insurer. However, APRA has firm expectations that any conflicts that may arise will require careful consideration and management by the insurer.

Managing conflicts of interest

APRA welcomes feedback from private health insurers on the approach to managing conflicts of interest outlined in draft CPG 320.

3.4 Actuarial reports

3.4.1 Financial Condition Report

The FCR is a key document, relied upon by the board and by APRA for a comprehensive, impartial view of the condition of the insurer. The review of requirements in general insurers and life companies was designed to give the Appointed Actuary greater discretion to focus on the risks and issues that are material to the financial condition of the insurer.

In line with other sectors, APRA sets out in draft CPS 320 the minimum areas that the Appointed Actuary must consider in preparing the FCR. It gives the Appointed Actuary the discretion to decide which matters to comment on in the FCR, depending on an assessment of the matter's relevance and materiality to the financial condition of the insurer. APRA does not expect that this would be a significant change for private health insurers, as private health insurance Appointed Actuaries already make these materiality judgements.

As proposed for general insurers and life companies, APRA is proposing to require reporting on the operation and effectiveness of the actuarial advice framework on an exceptions basis where the Appointed Actuary wishes to draw particular matters to the board's attention.

3.4.2 Actuarial Valuation Report

As noted above, APRA proposes to introduce a requirement for life companies and general insurers to produce a technically focused report of certain actuarial matters, referred to as an Actuarial Valuation Report (AVR).

APRA considered whether to extend this requirement to private health insurers. Due to the nature of private health insurance liabilities, APRA does not propose to require an AVR from private health insurers.

HPS 320 already makes provision for the Appointed Actuary to value or review the valuation of the insurance liabilities, and any deficiencies in the process can be identified over a period of two to three months. APRA expects that Appointed Actuaries document the methodology and assumptions underpinning the valuation in a transparent manner⁵. Similarly, APRA expects that the methodology and assumptions underpinning the determination of the stress test amount under *Prudential Standard HPS 110 Capital Adequacy* will be appropriately documented and available to APRA on request.

3.5 Review of actuarial advice and reports

Across general insurers, life companies and private health insurers, there may be instances where APRA has concerns about a specific actuarial report. APRA has included a provision in draft CPS 320 to allow APRA to request a peer review by a specified actuary in circumstances where APRA considers this appropriate. This provision would be similar to the existing power in relation to the ILVR for general insurers. This power is expected to be used infrequently and only after consultation with the insurer. It would support APRA's ability to supervise the actuarial advice framework requirements and conflict management requirements, amongst other matters.

Review of actuarial advice and reports

APRA welcomes feedback from private health insurers on:

- the proposed FCR requirements outlined in the draft CPS 320; and
- the proposed power for APRA to request a peer review.

3.6 Alignment between GPS 320, LPS 320 and HPS 320

The wording and the structure of the current HPS 320 evolved under the former private health insurance regulator. This has resulted in different language and content from the other insurance industries. Whilst harmonising the language and structure of the private health insurance prudential standards with the other APRA-regulated industries is not APRA's main goal, there is concern that the differing language and structures could make it unclear as to whether there is an equivalent level of expectation of Appointed Actuaries in different sectors.

As noted above, APRA's view is that the best way to achieve the objective of clear and consistent requirements is through a single, cross-industry standard and prudential guidance. The standard would address common concepts across industries in a consistent way, while still recognising industry-specific differences where required. APRA seeks

⁵ Actuarial Professional Standard 600

feedback on the proposed approach of having a single, cross-industry prudential standard and prudential practice guide on actuarial matters.

This is expected help to clarify the consistent expectations for the roles and responsibilities of the Appointed Actuary across insurers, while recognising industry-specific differences.

**Alignment between
GPS 320, LPS 320
and HPS 320**

APRA welcomes feedback on the proposed wording and structure of draft CPS 320, including whether the expectations of private health insurers and their Appointed Actuaries are clearly articulated.

Chapter 4 Consultation and next steps

APRA invites written submissions from all interested parties on its proposals in relation to the Appointed Actuary and the role of actuarial advice within insurers. Written submissions should be sent to insurance.policy@apra.gov.au by 15 December 2017 and be addressed to:

Senior Manager, Insurance Policy
Policy and Advice Division
Australian Prudential Regulation Authority

4.1 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.

4.2 Consultation issues

Submissions are welcome on all aspects of the proposals. APRA anticipates that submissions from life companies and general insurers will be primarily focused on the draft CPS 320, CPG 320 and GPS 340, in particular how the principles APRA consulted on in the Discussion Paper have been incorporated in those documents.

For private health insurers, this Response Paper is the first formal consultation on APRA's proposed approach. In addition to general comments on APRA's proposals, specific areas where feedback on the proposed direction would be of assistance to APRA in finalising its proposals are outlined below.

Table 1: Consultation issues for private health insurers

Purpose statement for the Appointment Actuary	APRA welcomes feedback on the proposed purpose statement contained in paragraphs 2 and 3 of the 'Objectives and key requirements of this Prudential Standard' box on page 1 of the draft CPS 320 for the Appointed Actuary of a private health insurer.
Actual advice framework	APRA welcomes feedback from private health insurers on: <ul style="list-style-type: none">• the proposed actuarial advice framework; and• the proposed approach to addressing materiality.
Managing conflicts of interest	APRA welcomes feedback from private health insurers on the approach to managing conflicts of interest outlined in draft CPG 320.
Review of actuarial advice and reports	APRA welcomes feedback from private health insurers on: <ul style="list-style-type: none">• the proposed FCR requirements outlined in the draft CPS 320; and• the proposed power for APRA to request a peer review.
Alignment between GPS 320, LPS 320 and HPS 320	APRA welcomes feedback on the proposed wording and structure of draft CPS 320, including whether the expectations of private health insurers and their Appointed Actuaries are clearly articulated.

Next steps

Submissions are due on 15 December 2017.

Once submissions on the draft prudential standards and practice guide have been considered, APRA intends to release the final prudential standards and prudential practice guide in early 2018. APRA proposes to set the implementation date at least six months after the release of the final prudential standards and prudential practice guide.

Transition period	APRA seeks feedback on the appropriate transition period, noting that some insurers may wish to move to take advantage of the changed requirements more quickly, while others may require further transition time.
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APRA will consider applications for transitional arrangements on a case-by-case basis once the revised requirements have been finalised.

Depending on the feedback received from this consultation, in particular from private health insurers, further consultation may be undertaken.

As noted in APRA's August 2016 letter to private health insurers on the prudential policy outlook, APRA intends to consult private health insurers regarding fit and proper requirements, which is expected to include fit and proper requirements for Appointed Actuaries.⁶ That consultation will have interdependencies with the proposals in the Response Paper, as CPS 320 includes references to *Prudential Standard CPS 520 Fit and Proper*. Prior to finalising these two consultations, APRA will ensure that the provisions relating to appointment and fitness and propriety of Appointed Actuaries are appropriately addressed under the prudential framework.

In due course, APRA will also consult on the consequential changes needed to other prudential standards to reflect the changed requirements proposed in this paper.

⁶ <http://apra.gov.au/PHI/consultations/Pages/prudential-policy-outlook.aspx>



 **APRA**