



28 March 2014

Mr Neil Grummitt,
General Manager, Policy Development
Policy, Research and Statistics
Australian Prudential Regulation Authority
400 George Street
Sydney NSW 2000

Email: riskmanagement@apra.gov.au

Dear Mr Grummitt

**Submission on Draft Prudential Practice Guide CPG 220 Risk Management
Harmonising cross-industry risk management requirements**

The Actuaries Institute is the sole professional body for actuaries in Australia. It represents the interests of over 4,100 members, including more than 2,200 actuaries. Our members have had significant involvement in the development of insurance regulation, financial reporting, risk management and related practices in Australia and Asia.

The attached brief note sets out the Actuaries Institute's submission in response to APRA's discussion paper on the draft Prudential Practice Guide CPG 220 Risk Management released for consultation in January 2014.

Please do not hesitate to contact David Bell, Chief Executive Officer of the Actuaries Institute (phone _____ or email _____) to discuss any aspect of this paper.

Yours sincerely

A handwritten signature in black ink, appearing to read "D. Smith".

Daniel Smith
President

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1 Summary

In January 2014, the Australian Prudential Regulation Authority (APRA) released the finalised Prudential Standard CPS 220 Risk Management as part of its ongoing programme of enhancements to risk management requirements in Australia. At this time, APRA also released a draft Prudential Practice Guide CPG 220 Risk Management for consultation.

CPG 220 provides guidance on the application of CPS 220, and more generally, guidance on APRA's views as to what constitutes sound risk management practice for authorised deposit-taking institutions, general insurers, life insurers, single industry groups (level 2 groups) and conglomerate groups (level 3 groups), referred to hereafter as 'institutions'. The CPG is not intended to address all prudential requirements in respect of risk management for these institutions.

The Actuaries Institute supports the release of additional guidance to assist institutions in their compliance with CPS 220. More generally, the Actuaries Institute is also supportive of APRA providing greater insight into its views on the nature of sound risk management practice.

There are however some aspects of CPG 220 that the Actuaries Institute believes are unrealistic with regard to the responsibilities of Directors and overly prescriptive in terms of operational decisions which should be the responsibility of each institution. The issues identified are outlined below.

2 Obligations of the Board of directors

Whilst noting and agreeing that an institution's Board of directors ('Board') is ultimately responsible for the risk management framework of the institution, the Actuaries Institute believes that there are issues with the proposed CPG 220 regarding the specificity of knowledge required.

Knowledge of operational structure

Paragraph 27 states an expectation that the Board knows and understands the institution's operational structure and associated risks.

This is a rather broad requirement and subject to various interpretations regarding its intention. It would be more appropriate and consistent with the Board's governance oversight role for this requirement to be for the Board to understand the risks associated with the operational structure, as opposed to necessarily understanding the operational structure itself.

Understanding of risk model limitations and assumptions

Paragraph 43 conveys an expectation that the Board understands "the limitations and assumptions relating to any models used to measure components of risk that could materially affect its decision-making".

Again, consistent with the Board's oversight role this should be clarified to relate to the implications of any limitations or assumptions relating to models rather than to understand the technical aspects of every model's limitations and assumptions.

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Experience and capability of staff members in the risk management function

Appendix A, paragraph 5(a) notes that under the three lines-of-defence model, the Board is expected to ensure that staff members in the risk management function are appropriate with respect to their levels of experience and technical knowledge. It is unlikely to be feasible for the Board to develop such a level of understanding of the capability of all staff members involved in risk management.

3 APRA notification requirements

The types of changes that APRA expects would be subject to the notification requirements of CPS 220 are flagged in paragraph 87.

The Actuaries Institute suggests that the wording of the paragraph be clarified to ensure that only events with a material impact on the business are subject to notification requirements. As currently worded, it is possible to interpret CPS 220 as suggesting that, for example, any change in organisational structure is automatically deemed material. This could be achieved by altering the sentence “APRA expects that this would include, but not be limited to, the following material changes:” to “APRA expects that this would include, but not be limited to, events such as the following, where the changes involved are material:”.

4 Risk management framework implementation and ongoing maintenance responsibility

Appendix A sets out the workings of the three lines-of-defence risk governance model as defined in paragraph 4 of the main text to be a model that facilitates effective risk governance for risk management. Among the flagged responsibilities of the first line-of-defence is the effective implementation and ongoing maintenance of the risk management framework.

Specifying the responsibilities of each of the three lines-of-defence model in definitive terms appears overly prescriptive, and permitting a suitable level of flexibility in the duties of the various lines-of-defence would not be detrimental to the suitability, adequacy, and effectiveness of the risk management framework. In particular, the implementation and maintenance of the risk management framework could be seen as validly falling within the scope of the first line-of-defence, the second line-of-defence, or both lines.

Inclusion of additional text at the commencement of Appendix A would help to communicate this flexibility for risk management governance. A suggestion is “Some flexibility in the responsibilities quoted below of the various lines of defence is possible, though the purposes of each of the three lines-of-defence will typically be as set out at the end of this Appendix.”

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