



 APRA

# PRUDENTIAL PRACTICE GUIDE

CPG 320 – Actuarial and Related Matters

September 2017

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## About this guide

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Prudential Practice Guides provide guidance on the Australian Prudential Regulation Authority's (APRA) view of sound practice in particular areas. Prudential Practice Guides frequently discuss legal requirements from legislation, regulations or APRA's prudential standards, but do not themselves create enforceable requirements.

*Prudential Standard CPS 320 Actuarial and Related Matters* (CPS 320) sets out the role of the Appointed Actuary. It also sets out requirements for insurers to appoint an Appointed Actuary in accordance with relevant legislation and to establish a framework for the provision of actuarial advice.

This prudential practice guide was developed to support insurers and actuaries in fulfilling their responsibilities to comply with the requirements contained in CPS 320.

Not all practices outlined in this guide will be relevant for every insurer, and some aspects may vary depending upon the size, business mix and complexity of the insurer's business operations.

## Introduction

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1. The information in this guide supports compliance with CPS 320. It relates to general insurers, life companies and private health insurers, collectively referred to in this guide as insurers.

## The Appointed Actuary and other actuaries subject to prudential requirements

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2. An Appointed Actuary is an actuary appointed under section 39 of the *Insurance Act 1973* (Insurance Act), section 93 of the *Life Insurance Act 1995* (Life Insurance Act), or subsection 106 of the *Private Health Insurance (Prudential Supervision) Act 2015* (PHI(PS) Act) (together, the Acts). In the case of a Level 2 insurance group, CPS 320 requires the appointment of a Group Actuary. In CPS 320, the Group Actuary is included in the term Appointed Actuary.
3. The purpose of the Appointed Actuary role is to ensure that the board and senior management have unfettered access to expert and impartial actuarial advice and review. The Appointed Actuary role is intended to assist with the sound and prudent management of an insurer and ensure that the insurer gives appropriate consideration to the protection of policyholder interests.
4. APRA expects the Appointed Actuary to have the necessary authority, seniority and support to contribute to the debate of strategic issues at a senior management level and provide advice that is considered seriously by the board.
5. The Appointed Actuary plays a key role in the protection of policyholder interests and APRA expects that the Appointed Actuary will be able to challenge the board and senior management regarding the activities and decisions that may materially affect the insurers' financial condition where necessary.
6. The Appointed Actuary is a statutory role with multiple functions within an insurer. The prudential requirements, as defined in CPS 320, impose obligations on the Appointed Actuary and on insurers with respect to actuarial matters.
7. To comply with prudential requirements, insurers are required under CPS 320 to establish an actuarial advice framework that must include certain prescribed matters. The actuarial advice framework must specify when actuarial advice must be given by the Appointed Actuary and when it can be given by another actuary.
8. The prudential requirements impose specific obligations directly on the Appointed Actuary as part of the statutory framework for the role. In those cases, the responsibility for complying with those obligations continues to rest personally with the Appointed Actuary and APRA expects the actuarial advice framework will reflect this accordingly. Otherwise, CPS 320 provides flexibility for insurers to determine their framework for receiving actuarial advice.

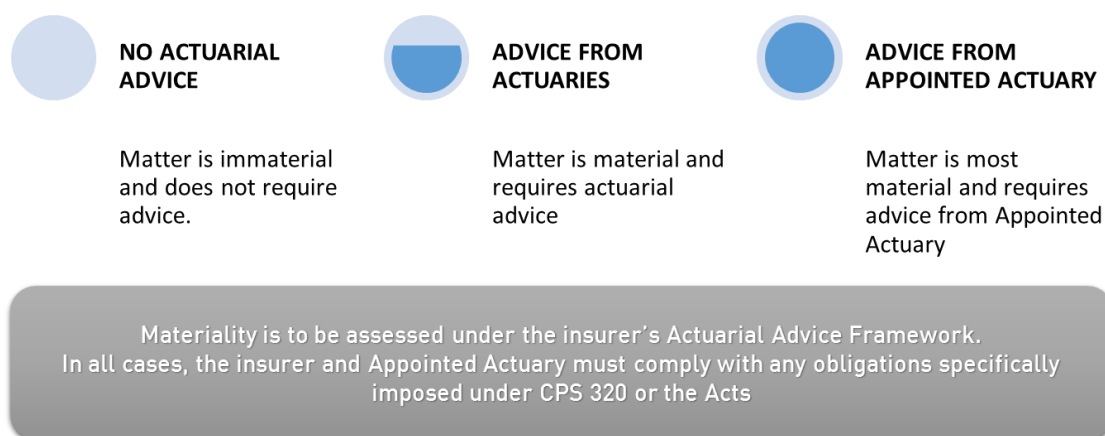
9. APRA expects the Appointed Actuary to provide the board with expert and impartial actuarial advice and review. Accordingly, insurers are required to ensure that the Appointed Actuary, whether internal or external, satisfies the eligibility criteria in *Prudential Standard CPS 520 Fit and Proper* (CPS 520), as applicable, and meets the insurer's own fit and proper policy.
10. The eligibility and suitability requirements for the Appointed Actuary under CPS 520 are complemented by professional standards and practice guidelines maintained and enforced by the Institute of Actuaries of Australia (Actuaries Institute). The Actuaries Institute sets minimum standards of professionalism across all insurance practice areas, and enforces Codes of Conduct and Continuing Professional Development requirements across its membership.
11. Where other actuaries perform functions under the prudential requirements, CPS 320 requires that they be assessed as fit and proper under CPS 520 (as applicable) and are either a Fellow or Accredited Member of the Actuaries Institute. CPS 520 sets additional criteria for fitness and propriety that apply to Appointed Actuaries. CPS 320 does not require that actuaries other than the Appointed Actuary meet those additional criteria.

## Actuarial advice framework

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12. CPS 320 requires an insurer to document a framework for the provision of actuarial advice in relation to the entity (actuarial advice framework). APRA expects that the insurer would review the framework regularly, to ensure that it remains fit for purpose and is operating effectively.
13. APRA expects the actuarial advice framework to set out when actuarial advice is needed, and the circumstances in which that advice will be given by the Appointed Actuary or can be provided by other actuaries. It is required to include a materiality policy which can be used to identify when advice will be provided to the board and when it will be provided to senior management. It is required to set out how the insurer will manage conflicts of interest or duty in the Appointed Actuary role and in the operation of the actuarial advice framework. The actuarial advice framework of an insurer would ordinarily align to its risk management framework. An illustration of how APRA expects the actuarial advice framework to operate is contained in Figure 1.
14. The Appointed Actuary is expected to play an active role in the development of the framework and in any future amendments to it. CPS 320 requires approval of the framework by the board, having taken into account advice from the Appointed Actuary.
15. A well designed actuarial advice framework allows for flexibility to make use of actuaries other than the Appointed Actuary, as illustrated in Figure 1. It is expected to thereby increase the capacity for the Appointed Actuary to contribute at a strategic level.

Figure 1: Operation of actuarial advice framework



16. APRA expects differences between actuarial advice frameworks across the insurance industry. 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 rely on support from an individual actuary. Some insurers choose to employ the Appointed Actuary internally; others choose to engage an external party. A diversity of practice is appropriate but it is critically important in all cases that the actuarial functions are adequately resourced with actuaries that possess the appropriate level of skill and experience, consistent with the size, business mix and complexity of the insurer.
17. CPS 320 specifies a number of prescribed matters that must, at a minimum, be included in the advice framework of any insurer. It also lists a number of additional areas that are specific to general insurers, life companies and private health insurers. Not all the prescribed tasks will need to be performed by the Appointed Actuary. Some may be performed by the other actuaries and in certain cases the matter may be immaterial and actuarial advice may not be required.<sup>1</sup> This decision can be made based on the insurer's own materiality policy, subject to the minimum requirements of CPS 320. APRA expects that the actuarial advice framework will provide that advice on the most material decisions continues to be the domain of the Appointed Actuary.
18. These provisions balance flexibility with minimum standards. For example, they allow a private health insurer the flexibility to decide whether to use a 'notifiable circumstances' approach as the basis of its actuarial advice framework.
19. APRA expects the actuarial advice framework to be a living document. Best practice is for an insurer to regularly reflect on the operation of the framework, take account of any comments on the framework made by the Appointed Actuary and make appropriate adjustments.

<sup>1</sup> Obligations that are specifically imposed on the Appointed Actuary under the prudential requirements are required to be met by the Appointed Actuary regardless of materiality.

20. APRA expects insurers to position the Appointed Actuary role according to its size, structure and needs. It is a matter for the insurer whether an Appointed Actuary is internal or external, and to whom the Appointed Actuary reports. APRA expects that the Appointed Actuary will have sufficient seniority to be able to provide timely advice on important financial and strategic issues. An insurer may include its own statement on the role, position and responsibilities of the Appointed Actuary as part of its actuarial advice framework. Such a statement may help establish clear boundaries between the role of the Appointed Actuary and its positioning with respect to other roles in the organisation, for example, the Chief Risk Officer (CRO).

## Materiality policy

21. As part of its actuarial advice framework, an insurer is required to document a materiality policy. Information is likely to be material if it would cause the results or opinions expressed by an actuary to be misleading, if that information were to be misstated or omitted. It is not appropriate to assess materiality solely through quantitative monetary limits or financial definitions. Qualitative factors are necessary to complement quantitative metrics.
22. APRA expects that the materiality policy would specify how to determine the matters that are material to the financial condition of the insurer or the interests of policyholders and therefore require formal actuarial advice. The policy is required to identify when the advice will be provided to the board and when advice would be provided to senior management only. Clearly, more material matters are more likely to be appropriate to be considered by the board.
23. Once the materiality policy is established as part of the actuarial advice framework, materiality thresholds would not ordinarily need to be continually assessed by the board but would be subject to periodic review.

## Temporary Appointed Actuaries

24. APRA is aware of instances in which the Appointed Actuary of an insurer is temporarily absent, and this has caused logistical challenges for insurers. In some cases the absence is planned, such as annual leave, and in other cases the actuary may have been temporarily incapacitated. To alleviate these challenges, while respecting the requirements in the Acts that a single specified individual occupies the statutory Appointed Actuary role, a framework for temporary appointments of Appointed Actuaries can be created and documented as part of the actuarial advice framework.
25. An insurer may nominate an individual or individuals under this framework who can temporarily replace the Appointed Actuary if necessary. Only one individual may be the Appointed Actuary at any particular point in time. Any individual occupying the Appointed Actuary role is required to be appropriately qualified and satisfy the fit and proper requirements under CPS 520. An insurer may find it useful to complete a fit and proper assessment of the nominated individual(s) ahead of time, so that they can be expeditiously appointed to the Appointed Actuary role if necessary.



26. It is good 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 where this is possible in the circumstances.
27. In the event that the current Appointed Actuary will be absent and the insurer wishes to temporarily appoint a replacement, the insurer can notify APRA in writing to the effect 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 in writing to APRA, ahead of the change, can suffice for both changes of Appointed Actuary.

## Managing conflicts of interest or duty

28. The actuarial advice framework is required to document processes for identifying and managing potential conflicts of interest or duty that may arise from the Appointed Actuary's role or in the operation of the actuarial advice framework. As part of this requirement, the insurer would ordinarily have regard to whether any of the duties of the person appointed to the Appointed Actuary role compromise the person's ability to meet the purpose of the role set out in CPS 320. Similarly, APRA expects that the insurer would have regard to whether potential conflicts of interest or duty can arise in relation to the role of other actuaries in the actuarial advice framework.
29. APRA considers that the Appointed Actuary performs a role that spans multiple lines of defence in the three line-of-defence approach to risk governance. The role has aspects that form part of the first line of defence and part of the second line of defence. For smaller insurers, the Appointed Actuary may also be involved in the third line of defence by providing a regular comprehensive review of the risk compliance framework. Further information on the three lines of defence is available in *Prudential Practice Guide CPG 220 Risk Management*. While APRA does not consider it necessary to confine Appointed Actuaries to a single line of defence, and indeed recognises the important role that the Appointed Actuary can fulfil across multiple lines, it also recognises that conflicts of interest and duty can arise as a result. It is necessary for both insurers and actuaries to appropriately manage these potential conflicts.
30. There are various ways in which insurers and actuaries can manage conflicts. For example, insurers may seek an independent review of an actuary's advice. Such an approach may assist in a scenario where the Appointed Actuary is required to provide review and challenge to decisions that were based on the Appointed Actuary's own advice. The review could be undertaken by a different actuary within or external to the insurer. An insurer may also structure its actuarial advice framework so that first and second line-of-defence roles are separated. For example, some insurers choose to structurally separate pricing roles from reserving roles.
31. The Appointed Actuary is expressly excluded from holding the CRO position under *Prudential Standard CPS 220 Risk Management* (CPS 220), although APRA may consider, on a case-by-case basis and for a specific institution, an application for an alternative arrangement. Such applications would most appropriately be made by

smaller and less complex insurers and are expected to be unusual. A key part of the Appointed Actuary's role is to assess the financial condition of an insurer. The financial condition of an insurer depends, among other matters, on the effectiveness of the risk management framework developed by the CRO. The Appointed Actuary needs to be able to consider that framework objectively as part of assessing the financial condition of the insurer. Appropriate management of this potential conflict would need to be addressed in any application.

32. Roles other than the CRO may be combined with the Appointed Actuary role, subject to appropriate arrangements being put in place to identify and manage any resulting conflicts of interest. For example, combining the Appointed Actuary role and the Chief Financial Officer role is not prohibited, but the potential conflicts would warrant careful management.

## Advice on the risk management framework, and Internal Capital Adequacy Assessment Process, or Capital Management Plan

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33. The actuarial advice framework is required to also set out the insurer's approach to seeking actuarial advice on reviews of the risk management framework, Internal Capital Adequacy Assessment Process (ICAAP) of a general or life insurer and Capital Management Plan (CMP) of a private health insurer.
34. It would be prudent practice for an actuary to provide this advice prospectively, whenever material changes are being made or a significant review is being undertaken.
35. Where an insurer assesses that, due to a particular circumstance, there are limited benefits from obtaining such prospective actuarial advice, the insurer may choose not to obtain such advice. APRA anticipates that this may be more likely in the case of smaller and less complex insurers and where the proposed change to the risk management framework, ICAAP or CMP is not detrimental to policyholders. APRA expects that the insurer's approach would be documented in the actuarial advice framework.

## Financial Condition Report

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36. The Financial Condition Report (FCR) is a key document relied on by the board and APRA for a comprehensive evaluation of the financial condition of an insurer. It provides an annual opportunity for the Appointed Actuary to provide impartial and expert advice to the board and senior management. It is a tool for the Appointed Actuary to effectively communicate with the board. As such, the FCR is expected to communicate the financial condition of an insurer at a level appropriate for consideration by the board. CPS 320 lists the minimum areas that must be

considered by the Appointed Actuary in assessing the financial condition of the insurer. If, having considered each of the areas listed in CPS 320, the Appointed Actuary forms the view that an area is not material or relevant to the financial condition of the insurer, CPS 320 requires the Appointed Actuary to state the basis on which he or she has formed that opinion.<sup>2</sup>

37. An FCR is required to include a summary of the valuation process and outcomes and, in addition for a life company, the process and outcomes underpinning the Appointed Actuary's advice regarding the capital base and prescribed capital amount, aligned to the Actuarial Valuation Report (AVR). This summary is intended to assist the board in understanding the matters covered in the AVR, but without requiring the same level of technical detail. It could comprise an executive summary to the AVR.

## Actuarial Valuation Report

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38. CPS 320 requires general insurers and life companies to prepare an AVR on an annual basis.<sup>3</sup> The AVR is a technically-focused document. It is required to be prepared in accordance with CPS 320 and applicable prudential standards, for example *GPS 340 Valuation of Policy Liabilities* for general insurance and *LPS 340 Valuation of Policy Liabilities* for life insurance.<sup>4</sup>
39. The AVR is a valuable report which functions to document the data, methodology, assumptions, outcomes and reconciliations performed as part of the valuation process and, for life insurers the determination of the capital base and prescribed capital amount. The AVR is expected to form a key part of the valuation control process. It would ordinarily provide a record of the justifications underlying key decisions made in the process in sufficient detail to enable an informed audience (such as a reviewing actuary) to assess whether the documented process, data, assumptions and outcomes are reasonable.
40. There is no requirement for the AVR to be provided to the board of an insurer in full, although the board may request the AVR. In cases where a group FCR is not prepared, it is likely to be appropriate for a summary of the key results from the AVR to be provided to the board to assist the board in fulfilling its role.<sup>5</sup> The Appointed Actuary may choose to document the AVR with a self-contained executive summary that can be readily separated from the full AVR and provided to the board. APRA requires the Appointed Actuary to sign-off and submit a copy of the AVR to APRA.

<sup>2</sup> The Appointed Actuary is also expected to meet applicable professional standards in the preparation of the FCR.

<sup>3</sup> PHIs are not required to prepare an AVR.

<sup>4</sup> The Appointed Actuary is also expected to meet any applicable professional standards in the preparation of the AVR.

<sup>5</sup> A Group Actuary of a Level 2 insurance group is not required to produce a group FCR, although the Appointed Actuary may choose to do so in certain circumstances under CPS 320.

## Actuarial reviews and meetings

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41. APRA may request an actuarial review under CPS 320 and request that a report documenting the results of that review be submitted. APRA will specify whether the review is to be undertaken by the insurer's Appointed Actuary or another actuary depending on the circumstances. For example, APRA may request a review if it has concerns about the actuarial advice framework, the quality of actuarial advice or the manner in which an insurer is managing conflicts of interest or duty in relation to actuarial advice.
42. APRA expects to use this power infrequently and, typically, after discussion with the insurer. When determining whether to request an actuarial review, APRA typically takes into account any internal or external quality assurance processes that have already been undertaken. For example, APRA would take into account whether an actuarial report prepared by an external Appointed Actuary has already been subject to peer review as part of the external Appointed Actuary's standard quality assurance process.
43. Typically, APRA would expect to see the following matters addressed in the report, but may specify other matters depending on the circumstances:
  - a) a description of the scope of the review, including details of the investigations and any reports being reviewed and the processes followed in the review;
  - b) an assessment of the appropriateness in the actuarial report of the data, information and reports to which the actuary had access;
  - c) if the review is of an advice or report, an assessment of the reasonableness of the advice or report being reviewed.
44. APRA's liaison with the Appointed Actuary will normally involve APRA, the insurer and the insurer's Appointed Actuary. However, APRA and an insurer's Appointed Actuary may meet whenever either party considers it necessary.



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