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Mr Pat Brennan
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By email: insurance.policy@apra.gov.au

22 September 2016

Dear Mr Brennan

AFA Submission – Superannuation and Competitiveness Study

The Association of Financial Advisers Limited (**AFA**) has served the financial advice industry for 69 years. Our objective is to achieve *Great Advice for More Australians* and we do this through:

- advocating for appropriate policy settings for financial advice
- enforcing a Code of Ethical Conduct
- investing in consumer-based research
- developing professional development pathways for financial advisers
- connecting key stakeholders within the financial advice community
- educating consumers around the importance of financial advice

The Board of the AFA is elected by the Membership and all Directors are required to be practising financial advisers. This ensures that the policy positions taken by the AFA are framed with practical, workable outcomes in mind, but are also aligned to achieving our vision of having the quality of relationships shared between advisers and their clients understood and valued throughout society. This will play a vital role in helping Australians reach their potential through building, managing and protecting wealth.

Summary of the AFA's position

The AFA welcomes APRA's review of the role of the Appointed Actuary and actuarial advice within insurers. Actuaries play an important role beyond just computing compliance calculations and making forecasts for an insurer's business units. We agree with the Actuaries Institute[1] that an Appointed Actuary's central role and primary objective is to be the keystone in the insurer's financial risk management system. This means that Appointed Actuaries need to have the necessary authority and reporting lines to insurer Boards and senior management to facilitate effective actuarial advice being considered strategic operational and governance decisions.

Recent failures to predict claims trends in the life insurance industry concern the AFA because the outcome has been to substantially raise life insurance premiums (including some increases for level premiums of up to 40% in one year) over short periods of time. This is a clear indication to the AFA and others within the life insurance industry that actuarial advice has either not been followed by several life insurers or has not been performed as effectively as it should have been. This has an effect on the accessibility of life insurance which we expect will further exacerbate the under insurance problem in Australia.

Unexpected, large premium increases also affect the relationship between financial advisers and their policy holder clients. Financial advisers arrange approximately 50 per cent of life insurance policies in Australia. Many consumers can (mistakenly) perceive financial advisers as a representative or agent of the ultimate insurer. This is largely because the financial adviser is the conduit for many Australians to obtain life insurance. When those people have a problem with a product they purchase, it is natural consumer behaviour for them to complain to the person who assisted them to purchase the product. This is especially problematic for the adviser-client relationship when the premiums are increased within the first two years of policy commencement because the adviser and client may not have had a pre-existing relationship.

Something needs to change to mitigate against significant premium increases recently experienced being repeated again in future and the AFA accordingly welcome APRA's proposals.

Actuarial autonomy and tenure certainty to be reflected in the purpose statement for the Appointed Actuary

Insurance is a business that operates in the future more than it does in the present. Although current data is important to insurers, information about the future is more valuable. Professional actuaries have the technical skills to link the organisational governance of an insurer to the operational effectiveness of the business units. They do

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[1] Actuaries Institute - Life Appointed Actuary Task Force, *The Role of the Appointed Actuary in Life Insurance in Australia: Final Report* (20 February 2015)
http://actuaries.asn.au/Library/Miscellaneous/2015/LAATFReportFinal.pdf

this through forecasting and modelling what future requirements and expectations will be to better predict and manage risks.

This is a traditional area for actuaries. But actuarial roles have evolved as insurance itself (especially life insurance) evolves. Classic actuarial roles include designing and pricing contracts, monitoring the funds required to provide the benefits promised, and recommending the bonuses to be added to with-profit policies. These are key areas to ensure sustainability of the business. Actuaries now also provide expert advice on insurer investments and hedging, get involved in the planning and marketing of product lines, and advise on strategic risk measurement. Nowadays, actuaries can be involved in almost any aspect of an insurance company's activity.

The AFA considers that although actuarial advice in these additional areas is important and adds value to insurers and their customers, the role of the appointed actuary must not be diluted or undermined. We agree the Appointed Actuary plays a significant role in providing independent and unbiased advice on issues that are material to the financial condition of an insurer, including by providing effective challenge on decisions.

The AFA considers that the Appointed Actuary role, like independent compliance and auditing roles, is a key impartial role which requires autonomy and protection from threats of tenure. The AFA is not suggesting that life insurers have threatened the tenure of actuaries in the past. We merely seek to ensure that undue influence cannot be exerted upon appointed actuaries in future to provide advice that an insurer's board would find preferential or to provide a less than comprehensive assessment of future outcomes.

The AFA accordingly recommends two amendments (underlined in red below) to APRA's proposed 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 <u>autonomy,</u> authority, seniority, and adequate support to ensure their views are considered seriously by the board<u>, without improper influence from the board (such as a threat to tenure)</u> 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."*

The AFA agrees that the wording in APRA's proposed set of principles and attributes will guide the Appointed Actuary in understanding their role and assist to ensure that actuaries are less burdened by compliance tasks. The wording appears to have a greater instructive effect, however, upon the way in which the management of insurers structure the actuary role to remove systemic impediments – such as the unmanageable conflicts arising from dual-hatting – to receiving the benefit of effective strategic advice from actuaries.

Certainty of tenure and financial independence goes hand-in-glove with impartial advice. The AFA therefore considers actuarial autonomy and freedom from improper influence to be important additions to the prudential standards. Including these amendments will contribute to greater confidence and trust in the life insurance system and mitigate against future significant premium increases being caused by the way the actuarial role is structured within insurers.

Further life insurance-specific issues

The AFA supports practical and effective regulation that is consumer centric. Reducing the requirement for actuarial assessments of an insurer's capital adequacy levels would not appear to be regulation that is in the public's interest. The AFA understands, however, that this proposal and APRA's other proposals to no longer require actuarial compliance assessments of other tasks should not be considered on their own. We appreciate that removing these requirements means lifting some unnecessary burden from actuaries to free them up to provide a greater level and quality of strategic advice to boards and senior management.

We also note that other prudentially regulated businesses do not require capital adequacy to be assessed by actuaries – only insurers do. Assessment of registration requirements can be competently fulfilled by other roles, such as lawyers. Prudentially standardising the assessment of surrender values and paid-up values is becoming less necessary with the modern insurance products that have less investment components. Likewise, we consider that actuarially assessing the Cost of Investment Performance Guarantees is not a core function of an actuary within a life insurer.

The AFA agrees with APRA's view Appointed Actuaries hold the specialist financial skills required to assess the insurer's profit retention, income and outgoing apportionment, business restructuring policies. For insurers, these are different aspects of financial management to assessing capital adequacy. Unlike other prudentially regulated business, insurance is a business that operates in the future more than it does in the present. Retaining the requirement to seek the 'soothsaying of actuaries' in the future-affected areas of profit retention, income and outgoing apportionment and business restructuring are core financial management tasks necessary to protect the future interests of policyholders – such as through future unexpected and significant premium increases.

As the proposals within section 5.2 of APRA's Discussion Paper would not appear to compromise prudential safety, the AFA accordingly supports these life industry-specific issues.

Closing remarks

The insurance system is the primary means by which Australians financially protect their families from the unexpected. The system has developed over time into a complex mechanism that requires insurer staff to implement detailed procedures and processes over the entire life cycle of an insurance policy. Whilst we understand that these processes and procedures have developed through necessity due to an environment that over time has become more complex, we accept that some duplication and increasing compliance focus has crept into the Appointed Actuarial. As a result, insurer boards have lost some benefit from impartial actuarial advice about the financial management and condition of insurers – especially life insurers.

The AFA considers that the Australian public will in time benefit from APRA's proposals because they largely appear to address the concerns of actuaries with how their roles are structured and access to their strategic advice. The measures proposed around requiring insurer boards to develop actuarial frameworks that set minimum advice tasks, specify conflicts management requirements and harmonise actuarial reporting are welcome developments to ensure a more sustainable insurance industry that benefits more Australians and their families. Whilst the proposed life insurance-specific measures appear to reduce unnecessary duplication the reduction is not adverse to the future interests of policy holders.

With the recommended amendment to the role of the appointed actuary in prudential standards, the AFA considers that the measures would represent a practical, consumer-focussed set of reforms that should ultimately contribute to Australian's restoring confidence and trust in life insurers.

If you require clarification of anything in this submission, please contact us on 02 9267 4003.

Yours sincerely,

Brad Fox
Chief Executive Officer
Association of Financial Advisers Ltd