

15 December 2017

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Dear Sir

## REVIEW OF THE ROLE OF THE APPOINTED ACTUARY AND ACTUARIAL ADVICE WITHIN INSURERS

### Introduction

Set out below is dbn actuaries Pty Limited (**dbn actuaries**) response to APRA's consultation package on the role of the Appointed Actuary (September 2017). dbn actuaries has four Fellows of the Institute of Actuaries of Australia who act as Appointed Actuary (**AA**) to 25 private health insurers, and our response deals only with the issues applying for private health insurance (**PHI**).

dbn actuaries consents to this submission being available to the public on the APRA website.

### Comments on Draft Standard CPS 320

Our comments on the areas where feedback is requested are set out below.

#### *Purpose statement for the Appointment Actuary*

Our 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 (repeated below) for the Appointed Actuary of a private health insurer is set out overleaf.

**Paragraph 2** states *"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 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."*

**Paragraph 3** states *"The Appointed Actuary must 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. 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 policyholder interests."*

Our feedback is:

- While the sentiment is to be commended, draft CPS 320 provides insurers with the flexibility to use the AA or *another actuary*, which appears to diminish the authority and seniority of the AA role.
- In establishing the actuarial advice framework, in particular with respect to the materiality policy requirement set out in paragraph 23 (a), there is a risk that a board may modify their actuarial advice framework to “opinion shop” or seek low cost/low quality advice.
- While the AA can comment on the framework on implementation (paragraph 22) and annually in the FCR (paragraph 25 (l)), risks by their very nature are uncertain and include events which cannot be foreseen. The materiality decision is ultimately made by the board based on their view of the risks. The prudential and financial position of an entity could deteriorate significantly prior to the FCR being issued with the possibility of limited involvement from the AA prior to the annual review. We prefer the current working of Prudential Standard HPS 320 Actuarial and Related Matters (**HPS 320**) under which the AA assesses whether actuarial advice is required which includes consideration of materiality.
- While Paragraph 3 supports an AA in their interactions with senior management and the Board, it is important that APRA understands that the AA role in PHI is relatively new compared with Life and GI, with a limited number of AAs (currently 10 across all insurers) and this commentary may be interpreted by boards in such a way that it becomes an impediment to the widening and renewing the pool of PHI AAs.

### *Actual advice framework*

Our feedback on the proposed actuarial advice framework and the proposed approach to addressing materiality for the AA of a private health insurer is as follows:

- The ‘notifiable circumstances’ framework has served the PHI industry well, and we believe care should be taken in weakening the approach embedded in that regime. The current provisions of HPS 320 require the materiality of each notifiable circumstance to be assessed by the AA in considering whether actuarial advice on the notifiable circumstance is warranted. However, the proposed draft CPS 320 transfers the assessment of materiality to the insurer, which in our opinion, weakens the existing regime.

For example, consider a scenario where a small private health insurer has variable experience (reflecting its size), but is under pressure to reduce its management expenses, and consequently the board sets a high materiality threshold for requiring actuarial advice. While the AA can comment on the risks of this approach, is the intention that it becomes APRA’s issue to opine as to whether the insurer’s approach is appropriate?

- It is unclear how 23(c) (“specify when advice must specifically be given by the Appointed Actuary rather than another actuary, having regard to the materiality of the matter”) could work in practice. Materiality is difficult to define in PHI. The risks of anti-selection in a market with guaranteed portability may mean what is seemingly an innocuous change is high risk.

- Attachment C 1(j) refers to a “major” revision of an existing product, while all other elements included within HPS 320 have had the qualifiers of “significant” or “major” removed. How the inclusion of “major” sits with the materiality framework needs to be explained.

### *Review of actuarial advice and reports*

Our feedback on the proposed FCR requirements outlined in the draft CPS 320 is as follows:

- While the proposed requirements are similar to the requirements of the Actuaries Institute’s Professional Standard 600: Financial Condition Reports for Private Health Insurers, the following additions should be considered:
  - 25(e) – investment strategy should be expanded to include “current asset mix”;
  - 25(i) – this should be expanded as a projection considers profitability as well as current and future capital adequacy. In addition, specific reference should be made to regulatory capital requirements.
- Elements which are not required for PHI should be marked as such (e.g. reinsurance)

Our feedback on the proposed power for APRA to request a peer review is as follows:

- This is a suitable power for APRA if the circumstances warrants.
- The current wording of paragraph 35 could be interpreted as the insurer only meets the costs of the provider of the additional report. Where the AA is an external party, the AA would also be expected to incur costs from the provision and discussion with the reviewing actuary. According a minor change such as “All costs associated with a review under paragraph 35 are to be borne by the insurer” would add clarity.

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

Our feedback on the proposed wording and structure of draft CPS 320, including whether the expectations of private health insurers and their AAs are clearly articulated is as follows:

- Paragraph 10 implies Prudential Standard CPS 520 Fit and Proper may now apply to AAs in PHI, and insurers may be required to introduce a fit and proper policy. Whilst at least 6 months’ notice is flagged for the implementation of CPS 320, private health insurers will be at a disadvantage to general or life insurers if they have to introduce CPS 520 over the same 6 month period as general and life insurers already comply with this standard for other roles, whereas CPS 520 currently does not apply to private health insurers. A longer implementation period may be helpful for PHI.
- In regard to paragraph 11, the definition of a Level 2 insurance group needs to be expanded to clarify what occurs where a health insurer is owned by a life or general insurer, or a private health insurer owns another private health insurer.
- Paragraph 34(a) should be clarified as to whether this applies only to an FCR and AVR or at other times. HPS 320 specifies that the valuation of insurance liabilities for a health insurer must be calculated or reviewed by the AA only for the year end financial statements and annual APRA return. The final part of paragraph 34 implies this is the case but it should be made clearer.

- HPS 320 requires the AA to assess the reasonableness of the amount of uncertainty allowed for by the insurer in calculating the stress test amount, i.e. HPS 110 requires the stress test to be set by the private health insurer and HPS 320 requires a review by the AA. However, paragraph 34(d) implies the stress test amount is calculated by the AA which is not correct and this should be amended to reflect consistent wording in HPS 320.

### Comments on Draft Standard CPG320

#### *Managing conflicts of interest*

The approach to managing conflicts of interest outlined in draft CPG 320 are suitable for the Appointed Actuary of a private health insurer.

#### Conclusion

Overall dbn actuaries is supportive of the changes and welcomes APRA's commentary that "depending on the feedback received from this consultation, in particular from private health insurers, further consultation may be undertaken".

We would be pleased to discuss any aspect of this submission as you require.

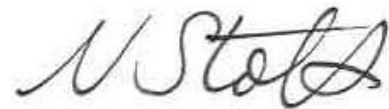
Yours sincerely



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