

Mr Pat Brennan
General Manager
Policy Development
Australian Prudential Regulation Authority
GPO Box 9836
SYDNEY NSW 2001
AUSTRALIA

21 September 2016

The role of the Appointed Actuary and actuarial advice within insurers

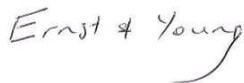
Dear Mr Brennan

This letter represents EY's written submission on each of the proposals in APRA's Discussion Paper "The role of the Appointed Actuary and actuarial advice within insurers", released in June 2016 (the Discussion Paper).

EY is a global leader in assurance, tax, transaction and advisory services. Our Asia-Pacific Financial Services Office has over 4,300 professionals focussed on the insurance, superannuation, banking, wealth and asset management sectors. We perform external audit roles for several major life insurers and have one of the largest actuarial consulting practices in Australia. We work closely with all the major Australian life, general and health insurers and EY partners and staff currently hold a number of Appointed Actuary (AA) roles. Through these roles we interact with actuaries, executives and Board members and we understand the issues and challenges relating to the AA role. We are aware of, and understand, the range of views held by insurance company executives and Board members through our regular interactions with corporate clients.

EY is supportive of APRA's stated objective of improving the functioning of the AA role and ensuring that it remains fit-for-purpose. Our submission provides a number of areas for further consideration by APRA and we welcome the opportunity to discuss this submission. If you have any questions on our submission, please don't hesitate to contact Andrew Mead on (02) 9276 9074 or Brendan Counsell on (02) 9276 9040.

Yours sincerely



Ernst & Young

Background and summary of EY recommendations

EY's Actuarial Services practice provides consulting services, including Appointed Actuary services, to a wide range of life, general and health insurers in Australia. Through these roles we interact with actuaries, executives and Board members and we understand the issues and challenges relating to the AA role. We are aware of, and understand, the range of views held by insurance company executives and Board members through our regular interactions with corporate clients.

The comments we make in this submission reflect our experience and interactions with insurers and our views of how the functioning of the AA role could be further improved. We are supportive of APRA's stated objective of improving the functioning of the AA role and ensuring that it remains fit-for-purpose. However, we believe that a number of further changes could be made to the proposal which would improve the positioning of the AA role as a strategic adviser to senior management and the Board.

In summary, we encourage APRA to consider the following changes to the proposal which we believe would lead to better outcomes in positioning the AA as a senior role within insurers and reducing the compliance burden:

1. The purpose statement could be improved by amending it to make clear that the AA is a strategic adviser to *the Board and executive management* rather than only the Board.
2. We believe that dual-hatting of the CRO and AA should be permissible so long as potential conflicts between first-line and second-line tasks are carefully managed. We support APRA's proposal for insurers to formally document their approach to the management of conflicts and this would provide a good framework for the management of conflicts in instances where the CRO and AA roles are held by the same individual.
3. We support APRA's proposal to provide more discretion to the AA regarding the content of the FCR. However we do not believe that the AA should be required to comment in the FCR on the operation and effectiveness of the actuarial advice framework as this does not appear to be in accordance with the stated aim of reducing the AA's compliance burden.

The following sections discuss in more detail the points noted above and responses to other aspects of the Discussion Paper.

Our comments on the Discussion Paper

General comments

We agree that the AA has played, and should continue to play, an important role within insurers. However it is evident that the role has become more compliance focussed and that the seniority (and hence the attractiveness) of the AA role has diminished in many insurers (and particularly in a number of life insurers) in recent years.

We believe that APRA's proposals take steps to improve the current framework and will provide insurers with more flexibility in tailoring the AA role to the individual circumstances of the organisation. We are pleased with APRA's proposals to reduce certain aspects of regulatory compliance on the AA, particularly in the areas of reinsurance administration and materiality, which we believe will assist in the repositioning of the AA as a strategic adviser to executive management and the Board.

However, we believe that a number of further changes could be made to the proposal which would improve the positioning of the AA role as a strategic adviser to senior management and the Board. These are summarised as follows and discussed further in the following sections.

Purpose statement

EY supports APRA's proposal to introduce a purpose statement for the AA role which clearly sets out APRA's expectation that the AA is to be a strategic adviser to the Board. In our view, the AA role needs to be held by an experienced, senior actuary, and to make the position attractive, the AA role needs to be more senior in the organisational structure. In circumstances where the AA does not directly report to the CEO, or hold another senior role reporting to the CEO, it may be difficult for the AA to fulfil the expectation that the AA has *"the necessary authority, seniority, and adequate support to ensure their views are considered seriously by the Board and they are able to make a significant contribution to the debate of strategic issues at the executive level"*.

We therefore propose that the purpose statement be amended to make clear that the AA is a strategic adviser to *the Board and executive management* rather than only the Board. We believe that explicit reference to executive management in the purpose statement will go some way to ensuring that the AA is involved in the executive decision making process rather than only as an adviser to the Board after executive business decisions have been made. It will also be important for individual insurers to have appropriate support structures in place to ensure that the AA's views are considered as part of the executive decision making process and to ensure that the AA has access to sufficient resources to support their role.

Actuarial advice framework

EY supports APRA's proposal to introduce an actuarial advice framework including the explicit materiality and temporary delegations policies as part of this framework. However, we do not believe that the AA should be required to comment on the operation and effectiveness of the actuarial advice framework in the annual FCR. Further comments on this are set out in the "Actuarial Reports" section below.

We would like to note that the 'Notifiable Circumstances' component of the Private Health Insurance (PHI) regulatory standards (as defined in APRA HPS 320) represents an effective example of an actuarial advice framework in practice. Key features of the PHI actuarial advice framework include:

- ▶ Prescribing a list of situations or events that is sufficiently flexible to capture a variety of insurer activities that require the AA to be notified.
- ▶ Sufficiently providing the AA with the responsibility for determining materiality and whether advice is required, and in either case providing opportunities for dialogue between the AA and management and the Board. This has the additional benefit of satisfying one of APRA's proposals to "Provide greater discretion to the Appointed Actuary to focus on the risks and issues that are material to the financial condition of the insurer".

Conflicts of interest and 'dual-hatting'

EY agrees that the management of potential conflicts of interest is an important issue for insurers and we support APRA's proposal for insurers to document their approach to managing conflicts as part of the framework for the provision of actuarial advice. We don't believe further guidance is necessary.

However we believe that the current regulation preventing dual-hatting of the CRO and AA should be reconsidered. The price paid for preventing dual-hatting of the CRO and AA roles, when combined with

the mandatory requirement that the CRO report to the CEO, is that it remains inevitable that the AA role will be, in many instances, a less senior role in the organisation. In circumstances where the CRO is part of the executive team but the AA is not, it is difficult to envisage how APRA's proposed purpose statement could be fulfilled.

Therefore we believe that dual-hatting of the CRO and AA should be permissible as long as potential conflicts between first-line and second-line tasks are carefully managed (for example by the delineation of duties to other individuals on tasks where the AA could be perceived as performing both a first-line and a second-line role).

In particular, we note that:

- ▶ Where the CRO is an actuary, it is not uncommon for the AA to report to the CRO. In these instances it is clear that the AA is not the most senior actuarial role.

Allowing the 'dual-hats' of CRO and AA (not just by exemption) would encourage companies to determine their best structure, considering their company size and the experience and skill-sets of personnel available to fill these roles. Additionally, such a change in regulation should result in AAs having a position in more executive teams, given that the regulation requires CROs to report to the CEO. This should also improve the attractiveness of the AA role as a career aspiration, as it can combine skill-sets (risk, technical actuarial, along with leadership, communication and strategy).

- ▶ Similarly, in smaller companies there can be justification for a single person to have other 'dual-hats' along with the AA role (e.g. CFO).

To allow companies to determine the structure which best suits their individual circumstances and to potentially attract and retain more experienced individuals to AA roles, we recommend that APRA regulation be updated to allow the CRO and AA roles to be performed by the same person (and not just on an exemption basis).

We agree with APRA's proposal to allow the AA to perform other executive roles such as CFO in certain circumstances, subject to appropriate conflicts management and that the individual has appropriate qualifications, experience and capacity to perform each role. We believe this will enable the AA to have a more senior role in the organisation.

Actuarial reports

EY agrees with APRA's view that the FCR is a key document relied upon by the Board and by APRA for a comprehensive, objective view of the financial condition of an insurer. In our experience, both Boards and executive management view the annual FCR as a key document which comprehensively sets out the key risks and issues which may materially affect the financial condition of the insurer.

We therefore support APRA's proposal to provide more discretion to the AA regarding the content of the FCR. In particular, we support the proposal to reduce the AA's review of the RMF and ICAAP with advice to be provided on the same basis as other advice under the actuarial advice framework.

However we do not believe that the AA should be required to comment in the FCR on the operation and effectiveness of the actuarial advice framework. This does not appear to be in accordance with the stated aim of reducing the AA's compliance burden. We believe that the AA should decide on the contents of an FCR. If the AA is concerned that the actuarial advice framework is ineffective then

these concerns should be raised with the executive management and / or the Board in a timely fashion along with any recommended actions to address the concerns raised.

Insurance Liability Valuation Reports (ILVRs)

EY supports the introduction of annual ILVRs for life insurers as well as the proposal to remove the requirement mandating that the Board receive the ILVR. We believe that ILVRs represent good practice and we observe that most life insurers already produce some form of annual valuation report which sets out the key methodologies and assumptions adopted and data reconciliations performed as part of the valuation. As such, we agree with APRA's expectation that this will be a formalisation of existing documentation for life insurers.

Further life insurance specific issues

EY supports APRA's proposals to remove the requirement that the AA assess compliance with the standards relating to capital adequacy, directions or conditions of registration of the life company, surrender values and paid up values and investment performance guarantees.

We further recommend that the requirement for the AA to provide an annual opinion on adequacy and effectiveness of reinsurance administration under Prudential Standard LPS 230 also be removed. We believe that, consistent with APRA's other proposals noted above, this requirement also does not align with the intended role and purpose of the AA.

EY supports the retaining of certain other requirements as set out in APRA's proposal, namely the provision of advice for distributions from statutory funds, restructure of life business and apportionment of income and outgoings.

Disclaimer

This communication provides general information which is current at the time of production. The information contained in this communication does not constitute advice and should not be relied on as such. Professional advice should be sought prior to any action being taken in reliance on any of the information. Ernst & Young disclaims all responsibility and liability (including, without limitation, for any direct or indirect or consequential costs, loss or damage or loss of profits) arising from anything done or omitted to be done by any party in reliance, whether wholly or partially, on any of the information. Any party that relies on the information does so at its own risk.

© 2016 Ernst & Young, Australia.
All Rights Reserved.

APAC no. AUNZ00002770