14 December 2017

Senior Manager, Insurance Policy
Policy and Advice Division
Australian Prudential Regulation Authority
insurance.policy@apra.gov.au

Submission on APRA's Proposals on the Role of the Appointed Actuary and Actuarial Advice

Finity Consulting appreciates the opportunity to provide our comments on APRA's recent response paper and the associated draft standards and guidance. Our comments, which reflect the broad views of Finity actuaries as a group, are set out in this letter.

The context of our feedback is that we work mostly within the general insurance and private health insurance sectors, and have external Appointed Actuary (AA) roles in those areas. Our comments therefore relate to the implications of APRA's proposals for actuaries working in those industries. We understand that the proposals largely respond to issues for actuaries within the life insurance sector – and we cannot comment specifically on the expected impact of the proposals for life insurance.

This letter follows our earlier feedback relating to APRA's June 2016 discussion paper on the AA role, which was set out in our letter dated 21 September 2016.

General Comments

We remain generally supportive of the proposals, and assess that they will mean little change to the way actuaries operate in general insurance and health insurance.

Internal vs External AA

We appreciate that APRA has clarified (in CPG 320) that both internal and external AA appointments are considered appropriate.

Dual Hatting

We support APRA's proposals around the AA role, potential dual hatting with other roles, and management of conflicts of interest or duty. We agree that dual hatting of the AA and CRO roles would be appropriate only for the smallest and least complex insurers.

Group AAs

Our interpretation of APRA's material is that there is no change in the particular requirements of a group AA.

Sydney
Tel +61 2 8252 3300
Level 7, 68 Harrington Street
The Rocks, NSW 2000

Melbourne
Tel +61 3 8080 0900
Level 3, 30 Collins Street
Melbourne, VIC 3000

Auckland
Tel +64 9 306 7700
Level 5, 79 Queen Street
Auckland 1010

Finity Consulting Pty Limited ABN 89 111 470 270 finity.com.au / finityconsulting.co.nz

Purpose Statement for AAs

We continue to support APRA's proposal to introduce the purpose statement. In our view the revised purpose statement (in CPS 320) positions the AA role in a clear and appropriate way.

Provision of Actuarial Advice

Actuarial Advice Framework

As noted in our feedback last year, we believe the introduction of an actuarial advice framework (AAF) will be a positive step, encouraging insurers to obtain timely actuarial input in relevant areas. A well-drafted framework will provide clarity for both insurer and Appointed Actuary about where actuarial input will be sought. We support the proposal that the board consider the AA's view of the framework before approving it.

We imagine that smaller companies and branches will require only a simple framework, which may consist of a single overarching statement.

Materiality Policy

We agree with APRA's view (CPG 320) that materiality will need to be assessed with reference to both quantitative and qualitative considerations.

In our view, developing a complete 'definition' of materiality will not be possible for an insurer, and inevitably there will be need to be room for judgement to be applied. In particular, defining two 'levels' of materiality – distinguishing between matters that need to go to the board, and those for senior management only – will be challenging. We envisage that the materiality policy may simply give guidance on the sorts of factors that need to be considered to assess materiality, and to assess the degree of materiality.

ICAAP and RMF

We agree that it is appropriate for the AA to provide advice about the RMF and ICAAP (or Capital Management Plan) prospectively rather than 'after the fact'.

We observe, though, that the wording relating to this in CPS 320 (paragraph 23(f)), and also in CPG 320 (paragraph 33), appears unclear (our bold below):

*"The actuarial advice framework is required to also set out the **insurer's approach to seeking actuarial advice on reviews of** the [RMF, ICAAP and CMP]."*

This wording could be interpreted as seeking advice from the AA on whether to undertake, or how to undertake, reviews of the RMF etc. Our suggestion would be to reword as:

*"The actuarial advice framework is required to also set out the **insurer's approach to seeking actuarial advice as part of reviews of** the [RMF, ICAAP and CMP]."*

Retention of Working Papers

Paragraph 21 of CPS 320 requires that actuarial working papers and documentation relating to prudential requirements be retained for seven years.

We would appreciate further clarification relating to this requirement – what is APRA's intent here, and what specifically needs to be retained? For example, would this include all analysis and models? (We note that this is Finity's practice.) Would the same requirements apply to both internal and external AAs?

It would generally be our view that an insurer should determine its own document retention policy.

Actuarial Valuation

Our interpretation is that APRA does not propose changes to the nature or conduct of an actuarial valuation.

We are supportive of APRA's proposals for change relating to the Actuarial Valuation Report (AVR):

- We assess that the proposed new reporting requirements are slightly less prescriptive, and in our view this is an improvement
- We believe it is appropriate that boards do not receive the full AVR, as we do not see them deriving a great deal of benefit from the more technical aspects of the report. We do, however, believe it is appropriate for an executive summary to be provided to boards, given the materiality of the insurance liabilities to the balance sheet.

Paragraph 33 of the draft CPS 320 has the AA providing the AVR directly to APRA. From our perspective as external AAs to a range of insurers, we observe that we would always allow the insurer to provide the AVR to APRA – in consideration that the direct relationship is between the insurer and APRA. We suggest that having **the insurer** provide the report to APRA would be more appropriate, at least for external AAs.

Financial Condition Report

FCR Content

We are generally supportive of the proposed changes in focus for the FCR. We make the following comments on some of the specific changes:

- The one area where we feel the change in focus may detract from the AA's value-add is in the review of the insurer's **reinsurance**, where the requirement could be seen as a 'downgrade', from:
    - "Assess suitability and adequacy of reinsurance **arrangements**" (including documentation, coverage of PML; GPS 320, Attachment B, (i))

  to

  - "Assess suitability and adequacy of reinsurance **strategy**" (paragraph 25(d) of CPS 320)
  - In our view the AA can add (unique) value by reviewing the detail of reinsurance arrangements
- We support the inclusion of any concerns the AA has about the operation of the AAF (paragraph 25(l) of CPS 320)
- The requirement of the AA in relation to the RMF and capital management is to include "general observations" (CPS 320 paragraphs 25(g) and 25(h) respectively). This phrase is rather broad and non-specific; we suggest "high level commentary" may be a better way of expressing what is expected.
- We believe that, in relation to the RMF, the AA's perspective (considering the **financial condition**) is unique, so we see value in the AA reviewing the RMF. We note that this is covered by APRA's expectation that the AA will contribute **prospectively** as part of any review of the RMF.

We assume that under CPS 320 insurers would retain the flexibility to incorporate the annual ICAAP Report into the FCR.

Notwithstanding the changes proposed, we expect that in practice our FCRs will not change materially in their coverage or depth of analysis.

Due Date of FCR

We continue to be of the view that, in the general insurance context, a four-month deadline for the FCR has substantial benefits for both the quality of the report and its consideration by the insurer:

- It allows more time for the preparation of the report – providing the AA more opportunity (after year-end) for thoughtful analysis and reflection
- It provides boards with a better opportunity to consider the FCR and its implications separately from other year-end reporting (accounts and valuation report).

Final year-end figures need to be included in the FCR, and these are adopted as the starting position for business/capital projections, which are often the AA's responsibility and are also incorporated into the FCR. These steps take time – which this restricts the available time for the AA to prepare meaningful, insightful commentary.

We also note that provision of the FCR within three months may mean preparation of the report in much less time than this. Typically:

- The board meeting is held a week or more before the end of the three month period after balance date (sometimes as early as three weeks prior)
- Board papers are required at least a week in advance of the meeting
- Senior management are provided with a draft FCR to review in advance of the draft for the board

- Senior management are often still materially focussed on year-end reporting in the six to eight week period immediately after the balance date.

This can mean that the AA has at most two months after balance date to complete the valuation (and AVR) as well as the FCR.

While we believe that three months gives sufficient time for preparation of an FCR in health insurance, we note that the liability valuations are typically less time consuming than for general insurance.

We also refer APRA to our previous correspondence on this issue, which is attached to this letter.

Provision of FCR

We observe that the proposed CPS 320 does not explicitly indicate that the FCR goes to the insurer's board; it is only implied by paragraph 29(a) of CPS 320. In our view there would be value in making this more explicit – for example, by stipulating that the FCR be addressed to the board.

We also note that (as for the AVR) CPS 320 has the AA providing the FCR directly to APRA, in paragraph 29(b). Once again we suggest that it would be more appropriate for the insurer to provide this to APRA.

Comments – Health Insurance

We welcome the inclusion of health insurance in the proposed framework.

Based on our work as AAs in health insurance, our feedback is:

- We are generally supportive of the proposals, and do not see them having a material impact on the work of actuaries in health insurance
- It is appropriate that the level of documentation for the liability valuation is agreed between the insurer and the AA, rather than being specified in regulations
- We imagine that a health insurer's AAF would generally incorporate the elements that are currently included in the Notifiable Circumstances regime.

Other Areas

In relation to parts of APRA's proposal not mentioned in this letter, we are comfortable with APRA's proposals – once again noting that we are largely unfamiliar with the detail of the life insurance context.

Lastly, we have attached a brief list of (minor) editorial corrections and suggestions.

Yours sincerely

Gae Robinson

Attachments

Attachment A: Editorial Corrections/Suggestions

CPS 320

- Paragraph 7(e) – refers to senior officer outside **of** Australia. The "of" is spurious.
- Paragraph 25(b)(i) – needs a space after "paragraph 30"
- Paragraph 30(a) – suggest "estimate" the value of liabilities, rather than "calculate"
- Paragraph 31(d) – should be "effect", rather than "affect"

CPG 320

- Paragraph 5 – should be "insurer's" rather than "insurers' ".

1 April 2014

Kate Bible
Senior Manager, Policy Development
Australian Prudential Regulation Authority
400 George Street
SYDNEY NSW 2000

Dear Kate

Timing of GI Actuarial Reports

This letter sets out Finity's observations and issues relating to the announced changes in APRA's reporting deadlines for general insurance, which mean that ILVRs and FCRs will need to be provided to APRA within three months of balance date rather than four months (beginning with June 2014 year-ends).

We are providing our input in advance of the meeting between AAs and APRA this Wednesday, 2 April (and the equivalent Finity-specific session Monday 7 April), in the hope that this can be part of a general discussion at these meetings. We intend to make a formal request to APRA that it reconsider the changes in timing.

Finity's views are based on our extensive experience of many year-ends, relating to the AA roles we have held over the last few years (between 25 and 30 roles at any one time). We have experienced the year-end process many times over, for many companies and in many different circumstances.

We have considered questions of timing and quality from the perspective of insurance companies, not solely from the AA's view.

Our Suggestion – Four Months for FCRs

In our view the move to a three-month deadline for both ILVR and FCR will be difficult and will have negative impacts on:

- The quality of the documents produced by AAs
- The ability of Boards and management to give the reports meaningful time and consideration.

Our suggestion is that the ILVR move to three months, along with the APRA returns, but that **a four month deadline apply for FCRs.**

The rest of this letter sets out the considerations that lead us to make this suggestion.

Tue 1 April 2014 12:17 PM

Finity Consulting Pty Limited
ABN: 89 111 470 270

www.finity.com.au
www.finityconsulting.co.nz

Sydney
Level 7, 155 George Street
The Rocks NSW 2000
Ph: + 61 2 8252 3300
Fax: + 61 2 8252 3399

Melbourne
Level 3, 30 Collins Street
Melbourne VIC 3000
Ph: + 61 3 8080 0900
Fax: + 61 3 8080 0999

Auckland
Level 27, 188 Quay Street
Auckland 1010
Ph: + 64 9 363 2894
Fax: + 64 9 363 2895

Purpose of FCRs

The main purpose of the FCR is to **advise an insurer and its Board** about the financial condition of the insurer – both current and prospective. The FCR considers a wide range of factors which influence the financial condition, and represents commentary and interpretation rather than facts and numbers. Preparing the report requires reflection by the AA. In our view it is important that, in order to derive maximum value from the advice, the reports are prepared 'after all the numbers' are completed (and after the ILVR) so that:

- The AA has sufficient time to deliberate and to form his or her assessment
- Boards and management have 'time and space' in which to consider the report and any recommendations.

The year-end for general insurers now involves three, and often four, important documents in addition to the financial statements – ILVR, EPR review, FCR and (usually) ICAAP Report. We believe that a three-month timeframe which included the FCR would be crowded and rushed, and would not give Boards and management the opportunity to consider all four documents, especially the FCR, with clear minds and with sufficient perspective.

At the extreme – depending on Board meeting dates – a Board could be asked to consider all four documents (along with year-end accounts) in one meeting. In our experience this would not do the documents justice. For some of our clients, the Board considers the FCR twice – once in an initial meeting (about an hour of engaged discussion), and then returning to it at a subsequent meeting after any issues have been discussed or investigated.

In our view, in order for the FCR to be 'fit for purpose' the FCR timetable needs to have sufficient time for:

- Collation of factual and numerical information
- Crucially, collection of other information, including opinions and views from a range of people
- Preparation of draft FCR
- Management to review for errors, omissions and misunderstandings
- Draft report to Board and full discussion of the issues
- Management to respond to the Board on reactions to, and plans arising from, the FCR
- Review and finalisation by the AA
- Acceptance by the Board and submission to APRA.

We see the provision of FCRs to APRA as an important, but secondary, part of the process. If the main aim of the FCR is to assist in maintaining a stable, well capitalised GI industry, we wonder how moving to a three month deadline for FCRs will contribute to achieving this objective.

Timing Difficulties

The normal year-end sequence of the actuarial work, where one piece of work logically follows another, is shown below. The typical time taken to complete each step is also shown; it is easy to

see how, when these are added up (and required to fit into a Board/committee schedule), it can be challenging to complete the full process within four months, let alone three.

Table 1 – Stages in Year-End AA Work

Order	Stage	Typical time taken
1	Valuation data provided	2 days – 3 weeks
2	AA completes valuation - Sometimes having done significant work before balance date	1 – 3 weeks
3	AA produces ILVR	1 – 4 weeks
4	Insurer completes annual APRA returns - Incorporating valuation results	2 – 3 weeks
5	Reviewing Actuary reviews valuation and produces EPR report	2 – 3 weeks (can be concurrent with APRA returns)
6	AA may assist with ICAAP Report (esp. scenario and stress testing)[1]	1+ weeks (concurrent with FCR)
7	AA produces FCR	3 – 4 weeks

We also note that this actuarial work is happening at the same time as the year-end audit.

Generally speaking, each step relies on the steps that go before[2] – and there is limited opportunity to complete the work in a different order. In the table below we make some comments on the stages and their timing.

[1] Smaller companies and branches are less likely to have DFA models or other models to assist with capital modelling – and incorporating the ICAAP scenario and stress testing, done by the AA, into the year-end, will be the most efficient use of AA's time and input.

[2] For June 2014, we understand that FCRs are due within three months and APRA returns in four months – this seems problematic.

Table 2 – Timing Challenges

Issue	Observations
Timing of valuation data	Completing the valuation promptly depends on receiving complete and 'correct' valuation data soon after balance date. - Often, year-end data cannot be supplied until 1-3 weeks after balance date. - There are often issues with data which mean the AA receives two or more versions. Getting complete and correct data can take up to a month. - Unclosed premium balances (which feed into the premium liability) are sometimes not known for up to month after balance date.
Work may need to be done more than once	For a range of reasons, any step of the year-end process may need to be done more than once, and this means additional time which could easily put significant pressure on a three-month deadline. Examples: - As noted above, valuation data may be provided more than once - Typically, an insurer will have feedback on the valuation, and the AA will need to respond, sometimes with changes to be made. The feedback may not be provided until the (draft) ILVR has been provided - Post-balance date events may delay the valuation results (unusual, but has happened in recent years with January floods) - APRA returns may need reworking (see point below) - Insurer will have feedback on FCR (potentially both management and Board), AA responds.
FCR relies on information from annual APRA returns	The APRA returns have become more and more complex, and at Finity we are finding that: - We are generally waiting longer to receive the completed returns - We are increasingly finding errors in the returns, which means that they have to go back to the insurer for further work. This can happen a number of times.

We note that having sufficient time and space for all stages is particularly important in more 'high risk' situations – such as a company which has trouble producing reliable data, or a company which is finding itself in some sort of difficulty.

Small Insurers and Branches

We have some clients who routinely complete their year-end reporting within three months. These tend to be medium to large companies who are Australian-based, have internal AA teams (or at least actuarial staff). Some are listed companies who are forced to be on very tight reporting deadlines.

In our experience, though, it is much harder for smaller insurers and branches to turn around year-end work quickly, for several reasons:

- Smaller insurers are less likely to have valuations performed during the year (e.g. quarterly reviews), and therefore when the AA reviews the experience and considers the valuation basis they have had no earlier 'heads up' on the experience (and therefore possible responses) during the year.
- Smaller insurers have limited resources, and at year-end staff members are required to wear multiple hats – accounting, APRA information, ICAAP work – as well as interact with and provide data to the AA
- For branches, obtaining valuation data for the Australian branch, and getting feedback on valuation results, 'competes' with the same processes happening at home office, and the branch often needs to wait. This is particularly the case if the insurer does its reserving at whole-company level and the branch valuation results are not taken up into the company's accounts.
- It is harder for smaller companies to 'get the attention' of auditors and actuaries (this was a direct comment from a small branch) – audit firms in particular appear to prioritise larger clients, and the time at which they start (and complete) work for smaller clients is less predictable.

Our Experience of Working to Three Month Deadline

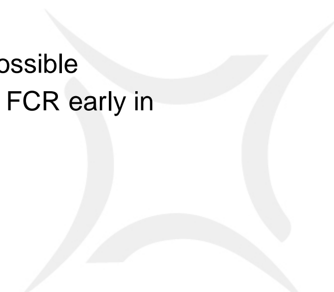
In anticipation of the change to three-month reporting, we have aimed to complete our work within three months this year on a 'trial basis' for a group of four clients.

First, we observe that working on a tighter timetable naturally tended to put pressure on the quality of the work we produced, as well as on the depth of discussion we were able to have with the client. For instance, we did not have as much time to discuss our FCR findings with management before presenting them to the Board; we consider this 'pre-consultation' to be a very important part of our provision of valuable advice.

In terms of process, bringing the work forward proved to be difficult for a range of reasons (different for each company), which are generally covered by our discussion above, but include:

- Valuation data provided late and/or incomplete (or incorrect)
- Competing with other demands made of Finance staff during year-end
- Company reworking APRA returns after our input – particularly with the new more complex Asset Risk Charges and related calculations. In one case we did not see full APRA returns until 31 March, in another we received the final (Version 5) on 24 March
- For branches, waiting for feedback from 'home office' on valuation and FCR – with rework needed once we received input e.g. notice of additional claim notifications which should be included in valuation, late changes to reinsurance programme
- Waiting for the ICAAP Report to be prepared by the company
- EPR and audit time delays.

In a couple of cases, we aimed to complete as much of the FCR before year-end as possible (sections that do not depend on year-end figures). We did complete about 40% of the FCR early in



one case, but found the process somewhat inefficient – inevitably we did have to come back and rework some sections (e.g. late changes to reinsurance arrangements), and the review process was complicated by having to ask the client to re-review some parts. This meant additional work for us (and additional fees for our client) as well as for the company.

General Insurance vs Life Insurance

It is often argued that "life insurance AAs produce their FCRs within three months, so why can't GI AAs?"

There are a number of fundamental differences between the life insurance and GI circumstances which in our view make a faster turnaround possible for Life AAs (although still challenging). The differences are set out in the table below – noting that this is our understanding as GI actuaries with (mostly) limited life insurance experience.

Table 3 – Life vs GI

Area	Life	GI
Nature of markets	Most insurers are large and have significant resources. Many life companies are listed and this drives timing.	Many companies are small and outsource AA work and other functions. Few listed companies.
Valuation	Some liabilities are investment-linked and therefore straightforward (and 'instant') to value. Valuation basis has long term focus and responses to experience are made over long term. Basis is often set before year-end because experience has been monitored during year.	No simple valuations – and each class of business is unique. Experience more volatile and responses need to be formed every year. Basis sometimes set before year-end but latest experience always needs to be reviewed.
Reports prepared by AA	Only one significant report – the FCR – which incorporates valuation and reporting on financial condition.	Two major reports – ILVR and FCR.
EPR	No EPR requirement.	EPR adds another step, and additional time requirement, to year-end process.

We emphasise that we understand that it is typical for Life AAs to be working very long hours during the three-month reporting period. In addition, we note that we have heard in recent times from Life AAs that they are finding the three-month deadline difficult to meet, especially with ICAAP Reports being added to year-ends.

Finally, while we understand and appreciate that from APRA's perspective consistency between the timelines for different industries is generally helpful, we do not believe that it is ideal to value consistency 'for its own sake', over providing valuable input to Boards and management, particularly when there are real differences between industries (which we believe is the case here).

We believe that the year-end timing is an important determinant of the quality of GI AAs' work, and (more importantly) the value in improving prudential management of insurers when needed. Otherwise we would not be proposing a change to APRA's plans.

We have no objection to this letter being provided to the other AAs for the meeting on 2 April, and look forward to discussing our views with you and others.

Yours sincerely

Andrew Cohen
Senior Actuary

cc. Ian Laughlin