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21 September 2016

Mr Pat Brennan
General Manager
Policy Development
Australian Prudential Regulation Authority
GPO Box 9836
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Dear Mr Brennan

Submission on Discussion Paper: The role of the Appointed Actuary and actuarial advice within insurers

KPMG Actuarial provides actuarial consulting services and advice to clients in the life, general and health insurance industries. Employing more than 40 qualified actuaries, KPMG Actuarial partners and directors currently hold three Appointed Actuary roles in life insurance and three in general insurance; we have experience in developing insurance regulation frameworks, financial reporting, risk management and acting as Appointed Actuaries (and equivalent positions) in Australia and other jurisdictions.

Please find below KPMG Actuarial's submission on the Discussion Paper on the role of the Appointed Actuary and actuarial advice within insurers, released for comment in June 2016.

Overall, KPMG Actuarial strongly supports APRA's intent to clarify the strategic importance of the Appointed Actuary role and allow the insurer to tailor the role to the requirement of the insurer via the actuarial advice framework, while ensuring sound prudential outcomes. We recognise that a great deal of consideration has gone into the discussion paper which has taken into account the feedback from industry and professional bodies, such as the Actuaries Institute.

We further support the aim to align requirements, where appropriate, between life and general insurance to simplify regulatory requirements. However, we note that there are also distinct differences in the way the general and life insurance industries utilise the Appointed Actuary, in which case these differences should also be accommodated.

We note that the Discussion Paper is silent on whether the Appointed Actuary should be employed by an insurer or an external provider. We believe that it is important the prudential standards ensure it is clear that the role can be filled either internally or externally as is currently the case.

We set out our detailed comments on specific issues raised in the Discussion Paper below.

1. Purpose statement for the Appointed Actuary (DP 2.1.1)

We support the introduction of a purpose statement for the Appointed Actuary role, as we agree that the current tasks based approach can contribute to the role being seen as a compliance, rather than strategic, role. The purpose statement provides the Appointed

Actuary with an opportunity to play a key role in the decision making processes that affect an insurer's financial condition.

While we support the intent of the purpose statement, there are some wording changes we would suggest APRA consider in the final wording of the purpose statement.

Firstly, we believe that the Appointed Actuary advises the company, that is senior management as well as the board; currently the wording in the discussion draft only refers to the board.

Secondly, we suggest that the terms "treatment of policyholders" be removed from the second paragraph. As it stands, it could be misconstrued as either:

- Implying that the Appointed Actuary's responsibilities extend to many (unrelated) operational and distribution issues over which the Appointed Actuary has no jurisdiction, or
- Implying the prevention of excessive cross subsidisation between groups of policyholders or protecting consumers against product with excessively low loss ratios.

If APRA has specific intentions in respect of protecting the interests of general insurance or non-participating life insurance policyholders, then we recommend that these intentions be clearly stated, so that the Appointed Actuary can respond appropriately and such that the responsibility, and associated mandate to review and comment, is clear.

In respect of the reference to "adequate consideration to the protection of policyholder interests", the role of the Appointed Actuary is quite different in life insurance compared to general insurance, for instance in respect of pricing, and it would be helpful that the final wording acknowledges this difference.

We note that there is no equivalent in the legislation for the health insurance industry.

2. Actuarial advice framework (DP 2.2.1)

As the Appointed Actuary role will no longer be defined by a series of 'tasks', we agree that it is important for each licenced entity to establish a clear actuarial advice framework that identifies the areas where actuarial advice would be required, as well as a materiality and delegations framework specific to the individual insurer.

For life insurance, an actuarial advice framework is the mechanism whereby the insurer explicitly considers issues such as external peer review, the role of other senior actuaries in the company, such as the pricing actuary vs the Appointed Actuary, and the delegations framework.

For general insurers, where the Appointed Actuary is effectively the valuation actuary, but is not currently required under APRA regulation to advise the insurer on capital management or pricing, we believe it is highly desirable that the prudential standards require the insurer to notify their Appointed Actuary of the following material notifiable circumstances before they are approved, or as soon as is practicable after becoming aware of the notifiable circumstance:

- Management's intention to make material changes to the reinsurance program;

- Management's development of or material revisions to the capital management strategy, including ICAAP; and
- Development of, or material revisions to, the risk management framework.

Currently the Appointed Actuary in general insurance may not be aware of such changes until he or she is in the process of preparing the Financial Condition Report.

This is similar to the 'notifiable circumstances' requirement for private health insurance and the above notifiable circumstances are currently contained within the minima applying for Appointed Actuaries advising life insurers. In our view, these elements are equally helpful to general insurers and possibly life insurers which are branches of large multinational corporations.

3. Level of strategic influence

While the discussion paper clearly sets out APRA's overall objective for the Appointed Actuary to play a more strategic role within insurers, it is less clear how APRA is planning to support this shift in practice. We suggest that APRA consider how it may influence this shift, for instance:

- Via discussion with the board about the steps they have taken to be comfortable that the Appointed Actuary has the seniority and access necessary to be a strategic advisor to the company;
- By requiring that the Appointed Actuary is invited to participate in the leadership team and board agenda items that relate to financial and strategic discussions; and
- By requiring a minimum level of attendance of the Appointed Actuary at board and risk committee meetings. For an insurer which is a branch (Category C Insurer), the Appointed Actuary may be expected to be invited and to attend at least one of the management meetings each year with the Senior Officer Outside Australia and the Corporate Agent. This would give the Appointed Actuary further opportunity to play a more strategic role, and also allow him/ her to keep abreast of material developments in the insurer.

Clearly, a direct reporting line to the CEO would also be an indication of influence and access, however we acknowledge that different insurers have different organisational structures, and that in a general insurance context, this may not be suitable.

Without a clear articulation in the standards of what is required we expect that practice may vary substantially from one licensed entity to another and APRA's objectives may not be met.

4. Branches

For many branches and subsidiary insurers of overseas entities, the Appointed Actuary role is often outsourced. The introduction of the purpose statement and actuarial advice framework could result in a significant change to the way these insurers are required to engage with the Appointed Actuary. For these insurers, many strategic decisions tend to be made at the group, or regional, level.

For a general insurance company, which is a branch of a multinational, the engagement of the Appointed Actuary is often focussed on writing the annual Insurance Liability Valuation Report (ILVR) and Financial Condition Report, rather than being actively involved as a 'strategic advisor' during the year. A consequence of the proposed changes is that the new Appointed Actuary role requirements may increase the level of involvement and costs associated with running the local entity.

While there may be some benefits in requiring this additional actuarial involvement in branches and smaller companies, we recommend that APRA considers the proposals specifically from the perspective of branches and what they see as minimum requirements for such entities. Particular considerations may include:

- Where reinsurance is determined at a global level and the local operations are a small part of the group, how actively involved does APRA believe the local Appointed Actuary should be in those strategic deliberations at a group level?
- If the parent has a strategy of maximising the fungibility of capital by maintaining capital in the parent entity and injecting capital as required into local entities, to what extent should the local Appointed Actuary's remit be extended to advise the Group regarding its capital strategy and the ramifications for the Australian branch?
- If other key strategic functions are performed at a group level – such as key pricing changes, new product design, key changes in policy conditions, system implementations, etc. – does APRA anticipate that the Appointed Actuary of the Australian branch should be actively involved in these deliberations?

5. Provision of the ILVR to the Board

We support APRA's proposal that the Board should receive the ILVR executive summary, but recommend that this be done for both Level 1 and Level 2 entities. The results of the ILVR are one of the key determinants of the insurer's reported profit and balance sheet, and consequential actions are often decided following the receipt of this information.

As the board only receives the executive summary of the ILVR, it would be good practice for the executive summary to contain a minimum level of detail. However, we believe this is a matter of professional judgement, and should be dealt with in the professional standard rather than the prudential standards.

6. Prudential Standards

6.1. Increasing consistency between GPS 320 and LPS 320

We support a better alignment between GPS 320 and LPS 320, noting it is important to consider the different nature of general insurance and life insurance, and also the expected responsibilities of the Appointed Actuary from each insurer. Examples of differences are:

- The Appointed Actuary's current responsibility to policyholders are different in general insurance and life insurance;
- The methodology to value general insurance liabilities (at both central estimate and at 75% Probability of Sufficiency) can vary significantly in practice, and therefore it is important that this is documented appropriately for the board's consideration; and

- Some of the minimum areas requiring actuarial advice are not common across general and life insurance e.g. at present the life insurance Appointed Actuary needs to sign off on pricing.

We further note it would be preferable if the requirements around the actuarial advice framework and the minimum areas requiring actuarial advice are specified to avoid any ambiguity and misinterpretation. Failure to do this could result in an unintended scenario where insurers only engage the Appointed Actuary to provide actuarial advice on areas that are explicitly required by the standard as an opportunity to reduce costs.

6.2. Create a new Prudential Standard GPS 340

We support APRA's proposal to create a new prudential standard GPS 340 Valuation of Insurance Liabilities to capture all the liability valuation requirements for general insurers. Given the technical nature of the requirements of GPS 340, it is important to keep this standard prescriptive with minimal ambiguity.

If you would like to discuss any matter raised in this letter, please let me know.

Yours sincerely



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KPMG Actuarial Pty Ltd*