

Rob Paton Consulting Actuaries Pty Limited
ABN: 28 149 496 828

2 Berrillee Lane
Turramurra NSW 2074

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rjp1310@optusnet.com.au
Tel: 0411 039 146

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

Dear Mr Brennan,

This letter responds to APRA's Discussion Paper dated June 2016 on the role of the Appointed Actuary, under the following three headings:-

- Statutory Purpose of the Appointed Actuary role (Appendix 1);
- Statutory Framework for the Appointed Actuary role (Appendix 2); and
- Statutory Tasks for the Appointed Actuary to an insurer (Appendix 3).

APRA has confirmed that, while its current concerns and focus have arisen from Life Insurance, APRA's proposals as to structure will relate to General Insurance, to Life Insurance, and (probably) to Private health Insurance. Care is therefore required that structural issues related to Item 1 (Statutory Purpose) and Item 2 (Statutory Framework) above are industry agnostic. Differences between individual industries can be covered under Item 3 (Statutory Tasks). Appendices 1 & 2 address this structural issue, and support a single Statutory Purpose and single Statutory Framework applying across all three insurance industries.

This submission assumes that matters relevant to the Appointed Actuary role that are not covered in APRA's Discussion Paper (eg limited statutory indemnities for the Appointed Actuary in prescribed circumstances), will not be changed as APRA develops specific proposals.

A summary of my experience as an Appointed Actuary to private health insurers is at Appendix 4. Thank you for the opportunity to make this submission, which APRA is able to publish on its website if APRA wishes to do so.

Yours sincerely,

Robert Paton
Director

Appendix 1 : Statutory Purpose of the Appointed Actuary role

APRA's proposal to introduce a written Statutory Purpose for the Appointed Actuary role is welcome, because a purpose statement will define both what the role is intended to do, and what the role is NOT intended to do (from a statutory perspective). Boards govern, Managers manage, and Non-Management Employees operate insurers, all these roles being separate to the statutory, advisory role of Appointed Actuary to the insurer. The proposed statutory purpose statement below (which is similar to the wording on page 10 of the Discussion Paper) captures this structure:-

“The purpose of the Appointed Actuary role is to provide:-

- *expert and impartial actuarial advice for consideration by the Board of the insurer regarding the financial condition of the insurer, and*
- *expert and impartial advice covering those tasks set out by APRA for the Appointed Actuary to perform for consideration by the Board and Management of the insurer.”*

A comparison of the text above with the text in the Discussion Paper identifies the following issues:-

1. APRA proposes functions for the Appointed Actuary to “review”, to “challenge” and to “debate”. It is argued that these functions are not necessary statutorily, and imply a role that is necessarily confrontational in nature, beyond the provision of advice for consideration by those who either Govern, Manage or Operate the insurer. Furthermore, it is not appropriate to include in a purpose statement for a role the way in which that role is to be performed.
2. APRA proposes that the Appointed Actuary's duties will necessarily include “adequate consideration to the protection of policyholder interests” and the insurer's “treatment of its policyholders”. While these duties might be relevant in the context of “with-profits” policies issued by mutual life insurers in past times, inclusion of these duties is a substantial extension of the role of the Appointed Actuary in other types of insurers, and therefore needs careful consideration (see further below).

To ensure appropriate focus, regulation of Australia's financial system is separated as between the role of prudential supervision and regulation of financial institutions, and the role of protection of individual customers of financial institutions, between APRA and ASIC respectively. APRA's purpose is “*to ensure that, under all reasonable circumstances, financial promises made by institutions to customers are met within a stable, efficient and competitive financial system*” (APRA's letter to all private health insurers dated 4 August 2016). ASIC has the role of protection of consumers.

Furthermore, extension of the role of Appointed Actuary to consideration of policyholder protection and treatment to wider than the limited contexts currently covered in Life Insurance would impose significant additional areas of responsibility for the Appointed Actuary, which appears to be beyond the scope of the Discussion Paper. If Appointed Actuaries are to have specific policyholder protection roles in life

insurance (eg policyholder reasonable expectations in the context of with-profits Life Insurance), it is suggested that these roles are included as Statutory Tasks for each particular industry, along with details as to the specific circumstances of the responsibility.

To ensure that APRA has a sole focus, APRA (appropriately) does not have responsibilities to policyholders as individual consumers, and nor should Appointed Actuaries fulfilling an APRA mandated role.

Appendix 2 : Statutory Framework for the Appointed Actuary role

Section 2.2.1 of the Discussion Paper states that “APRA proposes allowing insurers to establish a framework for the provision of actuarial advice within the company”. Section 2.2.1.2 states that the framework “could document a materiality policy” which would “confirm the matters that the board considers material to the financial condition of the insurer or the interests of policyholders, and therefore requiring advice”. APRA confirms that “there will be some upfront work to establish the framework”. The proposal sets up a framework for conflict between the Board and its Appointed Actuary over what may be “material”. The problems (both for APRA and for the Appointed Actuary) associated with the framework proposed in the Discussion Paper requires consideration as to whether a better alternative is available. A significant problem with the current Appointed Actuary regimes for General Insurance and Life Insurance is that the Appointed Actuary’s advice often is delivered to the Board and Management via the financial condition report, and therefore **retrospectively**.

The Discussion Paper extends the process of ensuring that the Appointed Actuary’s advice is obtained by the Board **prospectively** (ie before the matter covered by the advice is implemented by the insurer) by including capital and risk related advice as being subject to prospective advice. This proposed structure both avoids conflict and provides an increased level of protection for the insurer, and therefore is welcome.

The question arises as to whether the problems associated with both the receipt of retrospective advice and the establishing a framework for the provision of advice by the Appointed Actuary can be addressed. **The Private Health Insurance industry already operates under an Appointed Actuary statutory framework for the provision of prospective actuarial advice.**

APRA’s HPS 320 sets out in Sections 8, 9, & 22 to 27 a framework for the provision of advice by the Appointed Actuary in specified circumstances. We understand that substantially all Appointed Actuaries and insurer Boards agree that this “notifiable circumstances” framework has operated successfully since 2007 in private health insurance (which APRA is able to confirm). Because the actuarial framework is established under legislation, private health insurer Boards do not need to consider this issue, no conflict can arise as to materiality, and advice is not required on non-material matters. If the Appointed Actuary considers that a matter is material and therefore requires actuarial advice to be provided to the Board, and the Board refuses to commission that advice, the Appointed Actuary is required to notify APRA, who can then consider the matter and determine the appropriate course of action.

Similar “notifiable event” provisions have operated successfully since the early 1990s under the actuarial advice framework for defined benefit superannuation plans under SIS Regulation 9.10 covering Funding and Solvency Certificates.

One additional matter that APRA may wish to consider under the actuarial advice framework is the mandating of a maximum term for which an Appointed Actuary is permitted to perform the role of Appointed Actuary to a specific insurer. APRA’s experience with roles similar to the Appointed Actuary may be relevant in this regard.

Appendix 3 : Statutory Tasks for the Appointed Actuary to an insurer

APRA proposes that the Appointed Actuary's advice relating to the important areas of capital and risk is required prospectively when either policies are made or changed by the insurer, rather than in the annual financial condition report, where the advice both increases the length of the report and is somewhat retrospective. This change is welcome, for the reasons set out earlier.

APRA's HPS 320 (section 10) includes capital and risk related circumstances as requiring prospective actuarial advice, along with several other circumstances, the most important of which are premium rate changes, product benefit changes, strategic plans, and investment policies. While the Appointed Actuary is not required to provide actuarial advice on each such circumstance, the Appointed Actuary is able to assess the materiality of each proposed change, and indicate that advice is either required or not required.

Flexibility between the circumstances of different insurers is addressed under HPS 320 by permitting each Appointed Actuary to specify additional Notifiable Circumstances based on the circumstances of an individual insurer.

The Discussion Paper's proposed approach of specifying different statutory tasks for different industries is therefore both welcome, and consistent with the existing structure of HPS 320. Further flexibility to allow for the circumstances of each individual insurer could be introduced by adopting the approach already set out in HPS 320 of permitting each Appointed Actuary to specify particular circumstances for that insurer. APRA could require each Appointed Actuary to advise APRA as to any additional circumstances which are either specified or deleted from time to time.

Appendix 4 : Experience as an Appointed Actuary

The author provided actuarial advice to Private Health Insurers prior to the introduction of a statutory Appointed Actuary role, and performed the Appointed Actuary role for Private Health Insurers effective from the introduction of that role and up to 2013.

The author continues to provide actuarial support services to an Appointed Actuary currently.

The author therefore is familiar with the Notifiable Circumstances regime under the PHI legislation, and was familiar with the defined benefit superannuation “notifiable event” regime from its introduction in the early 1990s.

The author worked for a number of years in an international firm of actuaries which provided actuarial advice to Life Insurers, and therefore is aware generally of the role of the Appointed Actuary to a life insurer (while not having performed that role).