19 August 2016

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

Email: insurance.policy@apra.gov.au

Dear Mr Brennan

THE ROLE OF THE APPOINTED ACTUARY AND ACTUARIAL ADVICE WITHIN INSURERS

We refer to the Discussion Paper released on 21 June 2016 entitled "The role of the Appointed Actuary and actuarial advice within insurers" (**Discussion Paper**).

The Financial Services Council (**FSC**) has over 115 members representing Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, licensed trustee companies and public trustees. The industry is responsible for investing more than $2.6 trillion on behalf of 11.5 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the third largest pool of managed funds in the world.

The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

The FSC is supportive of the Australian Prudential Regulation Authority's (**APRA**) objective to improve the functioning of the Appointed Actuary role and ensure that it remains fit-for-purpose. The role of the Appointed Actuary is valued by life insurers at a strategic level, so any measures to streamline Appointed Actuaries compliance requirements would be welcomed.

The FSC would welcome the opportunity to discuss its submission. Should you have any questions about this submission please contact Jesse Krncevic at jkrncevic@fsc.org.au or on 0431 536 068.

Yours sincerely

ANDREW BRAGG
DIRECTOR OF POLICY & GLOBAL MARKETS

1. General comments

The Appointed Actuary of a life insurance company must perform for the company the functions of an actuary set out in the prudential standards and in reporting standards made by APRA under the *Financial sector (Collection of Data) Act 2001.*

The FSC believes that the Appointed Actuary's responsibilities have increased in recent years, contributing to the diminished attractiveness and stature of the role.

The FSC suggests that there are opportunities for companies to reposition the Appointed Actuary roles closer to executives responsible for decision-making in the organisation, to allow the Appointed Actuary to be more effective in the role but that this would be aided streamlining compliance obligations required of the Appointed Actuary.

The responsibilities of the Appointed Actuary are far broader than in most other jurisdictions and the local general insurance industry, in particular in relation to product and reinsurance advice.

The FSC believes that the frequency and volume of advice that the Appointed Actuary is responsible for should be more targeted, and that measures should be implemented to give Appointed Actuaries more flexibility to delegate authority.

2. Response to APRA Discussion paper

Section 2.1.1 – Purpose statement for the Appointed Actuary

The FSC is very supportive of the introduction of a purpose statement for Appointed Actuaries. The purpose statement is useful to capture succinctly why the role of an Appointed Actuary is important and what it does.

The first paragraph of the purpose statement says that it is "…to ensure that the board has unfettered access to expert and impartial actuarial advice and review…". The FSC believes that it is not just the Board who need this unfettered access – but also the executive level.

There is also some inconsistency in wording between the purpose statement and the first paragraph of 2.1.1 which refers to 'senior management' and the second paragraph of the purpose statement that refers to the 'executive level'. The term 'senior management' could be interpreted as a group of leaders that sit under the executive level.

There needs to be more clarity given as to what is meant by "the necessary authority, seniority and adequate support" of an Appointed Actuary in the second paragraph. If the intent is for the Appointed Actuary to make a "significant contribution to the debate of strategic issues at the executive level" then this requires the Appointed Actuary to operate and be part of that executive level. Strategic issues are discussed continuously, and for the Appointed Actuary to participate in this debate it is difficult to do without regular interaction at the executive level.

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The revised purpose statement may also change what boards currently receive from their Appointed Actuary.

Recommendation 1

The FSC suggests that the first paragraph of the purpose statement is amended to "The purpose of the Appointed Actuary role is to ensure that the board and executive level have unfettered access to expert and impartial actuarial advice and review...".

The FSC suggests that APRA considers whether it is possible for an Appointed Actuary to 'make a significant contribution to the debate of strategic issues at the executive level' if they are not regularly part of the executive level and to clarify what is meant by the terms "necessary authority, seniority…".

The FSC would suggest that APRA consistently uses the term 'executive level' rather than 'senior management' to avoid any doubt as to what level APRA expect the Appointed Actuary to operate.

Section 2.2.1 – The actuarial advice framework

The FSC is supportive of the development of an actuarial advice framework. We believe that the proposal of the development of an actuarial advice framework, in conjunction with an overarching materiality policy and the ability to delegate parts of the role (from an advice perspective) is a step in the right direction to alleviate some of the individual pressures resulting from the frequency and volume of compliance.

The ability of the role of the Appointed Actuary to be seen as a natural strategic adviser to executive level management of insurers is a significant key to attracting and retaining talent to the role, in addition to entrenching the role in day to day business.

However, it is not clear that the overarching proposal outlined in the guidance note contains sufficient change to make a significant difference to the capacity constraints and compliance nature placed on the role. We would be pleased to work with APRA to develop the key elements of this framework in more detail, including assessing any additional opportunities to reduce the compliance and "one-stop" nature of the Appointed Actuary role.

The FSC also supports the requirement for the framework to be approved by the board and comments to the Financial Condition Report (FCR) as to how the framework has been utilised through the year, as this demonstrates appropriate credibility and visibility to the framework.

Section 2.2.1.1 specifies certain areas that would require actuarial advice as part of any advice framework implemented by insurers, subject to materiality limits outlined in the materiality policy (see 2.2.1.2 below).

In general, the FSC supports these key areas being specifically called out as requiring actuarial advice. We would be pleased to work with APRA in working through these specific requirements and ensure that the implementation of such frameworks does not lead to unintended consequences or areas of uncertainty. For example, is the intention that bonus recommendations

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to the board remain with the Appointed Actuary or does this sit in the advice delegation framework.

The FSC believes that key to the success of any actuarial advice framework is the establishment of clear accountabilities and responsibilities, and a clear materiality policy. Both of these need to ensure that any ambiguity is minimised to deliver the intended benefits to the role from the proposal without unduly increasing the risk to the insurer.

Recommendation 2

The FSC recommends further consultation with APRA in relation to the consistent and unambiguous development of this framework (and associated guidance notes), in addition to the identification of additional opportunities to deliver the stated benefits to the Appointed Actuary role.

Section 2.2.1.2 – Materiality policy

The FSC supports the documentation of a materiality policy as part of the development of an insurer's actuarial advice framework.

However, we believe that further guidance is needed in relation to the development of the policy through both Prudential Standard LPS320 (Actuarial and Related Matters and Actuaries Institute) and PS 200 (Actuarial Advice to a Life Insurance Company or Friendly Society). In particular, to the extent that a materiality policy is implemented based purely on monetary limits, there is a residual risk that:

- Items which require advice may not be covered as they may not explicitly lend themselves to a natural monetary quantification (for example, changes to underwriting policy, policy wording etc)
- Any ambiguity that remains with regard to changes and downstream monetary impacts, may lead to items that may, in fact, require appointed actuary challenge not being challenged.

Recommendation 3

The FSC recommends that further guidance is provided through LPS 320 and PS 200 with regard to the development of an appropriate and industry consistent approach to materiality policy development.

Section 2.2.1.3 – Temporary delegations

The FSC supports the proposal to introduce a temporary delegations model in the event the Appointed Actuary is unavailable for various reasons.

The proposal currently outlined is based on the premise that the delegation is to a single nominated individual, identified under the model and deemed appropriate as per Prudential Standard CPS 520 (Fit and Proper, the Appointed Actuary and the Board).

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The FSC would like to explore the need for this to be a single individual with consideration to the following:

- Depending on the insurer, there may be valid reasons why there may not be an appropriate single individual to whom all of the functions of the Appointed Actuary could be suitably delegated. For example, a relatively small actuarial function may find it difficult to find someone appropriate internally.
- The various components of the Appointed Actuary responsibilities may be better served by delegating to senior subject matter experts in the relative areas of responsibility – i.e. the sum of the parts may be greater.

An insurer could always source the temporary delegation using external resourcing, but this outsourcing model loses the connection and closeness to the insurer and removes the benefit of the temporary delegation model in developing the next generation of Appointed Actuaries from within the insurers.

We view the ability to delegate parts of the appointed actuary role to multiple appropriate individuals internally as being important in the development of future Appointed Actuaries from insurers' employees, and useful for the Appointed Actuary in communicating to the Board plans regarding succession.

Recommendation 4

The FSC recommends consideration of a temporary delegations model which permits the separation of duties for separate delegation to the most appropriate nominated and approved individuals. We recommend that the model aligns more closely to the proposed delegations framework in relation to the provision of actuarial advice.

Section 2.3 – The management of conflicts of interest

The FSC would encourage APRA to support the life insurance industry's view that any conflicts of interest between Appointed Actuaries in their statutory roles, and their other roles within an organisation and other appointments are identified from the outset, and, if possible, avoided, rather than being required to be managed.

In that context, we are encouraged to note APRA's proposals on the involvement of the Appointed Actuary in the ICAAP and the Risk Management Framework, which assist in managing conflicts in those areas.

In the FSC's view, the role of Appointed Actuary has few conflicts with other statutory roles (please see further comments below on the dual-hatting issue). For example, in our view, there is no conflict between the role of providing advice on pricing and reserving.

Areas where conflicts should be considered include:

- Responsibility for sales performance (where the Appointed Actuary provides advice on pricing and/or products).

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- Responsibility for product development (where the Appointed Actuary may be providing the advice to the person with responsibility for product development).
- KPIs which involve being rewarded for profit targets (where the Appointed Actuary is recommending a particular level of reserves).

The FSC would welcome clarification from APRA on these areas.

Section 2.3.1 – Conflicts management with respect to the Appointed Actuary

The FSC appreciates that APRA may request a special purpose review of an insurer's management of conflicts. Special purpose reviews have been conducted at APRA's request in a variety of circumstances in the past. In this particular case, we would appreciate clarification of the type of situations in which such reviews may be requested. In the FSC's view, such reviews would only be expected to be required in exceptional circumstances.

Recommendation 5

The FSC would like APRA to confirm that independent reviews into the management of conflicts will only occur in exceptional circumstances.

Section 2.3.2— Dual-hatting

The FSC is supportive of APRA's proposal regarding the dual-hatting of the Appointed Actuary and Chief Financial Officer roles.

Furthermore, the FSC recommends APRA to consider allowing the Appointed Actuary and Chief Risk Officer roles to be dual-hatted subject to careful management, measures and process to ensure objectivity and conflicts are effectively managed. These measures could include, obtaining from time to time, an independent external opinion on the effectiveness of the risk management framework to address the specific concern over a potential direct conflict raised by APRA in the fourth paragraph of 2.3.2. We believe that the removal in this proposal of the requirement for the Appointed Actuary to opine on the appropriateness and effectiveness of the insurer's risk management framework removes one of the main conflicts facing a dual-hatted Chief Risk Officer and Appointed Actuary.

By allowing dual-hatting, in the appropriate circumstances, this could help drive the role in support of other objectives noted by APRA including ensuring an improved strategic advice focus, and reducing the compliance focus.

Recommendation 6

The FSC is supportive of dual-hatting of the Appointed Actuary and Chief Financial Officer roles.
The FSC recommends APRA to consider allowing the Appointed Actuary and Chief Risk Officer roles to be dual-hatted.

Section 2.4.1 – The Financial Condition Report

The FSC endorses APRA's statement in the opening paragraph of 2.4.1 that "the FCR is a key document relied on by the board and by APRA for a comprehensive, impartial view of the financial condition of the insurer." The FSC would also suggest that this statement is augmented to include "senior management/executive level" alongside the board and APRA.

The FSC supports the proposal 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 in the FCR.

The FSC supports the model in relation to prospective advice on the Risk Management framework and Internal Capital Adequacy Process (ICAAP) when developed initially and when material changes are made. The FSC also supports the proposal to reduce the Appointed Actuary's review of the Risk Management Framework and ICAAP in the FCR and replace it with high-level observations in relation to risk and capital management in the FCR.

Although the FSC supports the proposed Actuarial Advice framework and the need to review its operation and effectiveness, it is concerned that this will add to the compliance aspects of the FCR and, therefore, detract from its value as a strategic document.

The FSC notes that in respect of the changes in the above two paragraphs, further guidance may be required in order to assess 'materiality' and define 'high level observations' and would expect that Actuaries' professional guidance would be updated to provide an appropriate framework to assess materiality which can be used consistently to support brief statements in the FCR as to whether matters are not material, and to appropriately define 'high-level observations'.

To ensure Professional Standards remain appropriately up-to-date, the FSC suggests that APRA consider whether it should require an annual or bi-annual review of the Actuaries Institute Professional Standards.

Recommendation 7

- ***(a)*** The FSC suggests that the opening paragraph of 2.4.1 is expanded to include "executive level/senior management" alongside the board and APRA.
- ***(b)*** The FSC suggests that any required annual review of the operation and effectiveness of the Actuarial Advice framework is kept outside the Financial Condition Report in order to not detract from the strategic nature of the document.
- ***(c)*** FSC suggest that APRA consider whether it should require an annual or bi-annual review of the Actuaries Institute Professional Standards.

Section 2.4.2 – The Insurance Liability Valuation Report (ILVR)

APRA requires in Prudential Standard LPS 320 section 21 that the calculation of policy liabilities are to be made in accordance with the methodology which has been the subject of advice provided by the Appointed Actuary. This methodology must be documented with a copy provided to APRA on request.

Prudential Standard LPS 320 section 22 also requires the Appointed Actuary to document in the FCR details of the calculation processes and the assumptions used in determining the policy liabilities.

It is unclear if there are deliberately different meaning ascribed to the words methodology, calculation processes and assumptions in applying the above standard.

Currently, it is common practice for many life companies to include the methodology and assumptions used to value the policy liabilities as an appendix to the FCR with the main outcomes discussed in the FCR body. Given APRA receives the FCR in entirety, the assumptions and methods are already disclosed. However, it is currently left for the Appointed Actuary to determine an appropriate level of disclosure of the valuation methodology and assumptions.

Section 2.4.2.2— ILVRs for life companies

The APRA proposal to require the Insurance Liability Valuation Report (ILVR) from life companies with Appointed Actuary sign-off and submission to APRA within three months of the financial year-end formalises the documentation many may be routinely producing.

By mandating the ILVR, we anticipate the following impacts to the role of the Appointed Actuary:

(i) A minimum standard of detail will be introduced with respect to details required in the process, data and assumptions used in the life company valuation

(ii) the requirement to disclose additional information that is currently contained in the FCR will involve additional actuarial resources in the life company to produce

(iii) For APRA's benefit there would be greater consistency in disclosure between life companies on valuation methodology and assumptions

(iv) Making the ILVR a standalone report to APRA is likely to attract more, not less scrutiny by the boards of life insurance companies, regardless of APRA's intent not to mandate that boards receive the ILVR in full.

(v) Condensing the FCR by moving the technical discussion of data, process, methods and assumptions to the ILVR should facilitate better-targeted communications to the board of life companies on key outcomes.

APRA's intent in the proposal for life companies to produce a technically-focused ILVR is unclear. APRA appears to be motivated by:

(i) Increasing transparency in the valuation process

(ii) Increasing formal controls around the valuation process

(iii) Letting the board of life companies decide the information flow it requires to perform its role.

If APRA considers the current disclosures with respect to valuation methodology and assumptions in the FCR to be inadequate, APRA already has the power to request further detail to its satisfaction from individual offices without unnecessarily burdening all life companies to produce ILVRs.

Similarly, if the valuation process controls are inadequate, behaviours can be easily addressed on an individual company basis, although the current requirements for the

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appointed actuary to provide advice on policy liability valuation methodology should mitigate such instances.

The FSC would welcome further clarification from APRA on its intent.

Recommendation 8

The FSC would like further clarification of APRA's intent on requiring life companies to produce an ILVR that is not adequately addressed by documentation required on calculation processes and assumptions already contained in the FCR.

The FSC would welcome clarification from APRA on the value that a board would gain from the ILVR.

Section 2.4.2.3 -- Peer review of the actuarial reports

The FSC is supportive of APRA introducing a general provision to request a peer review of a specified actuarial report by an independent actuary, however we would like APRA to clarify how this is different from current practices in place.

Recommendation 9

The FSC would encourage APRA to provide clarification on the envisaged general provision to request a peer review of a specified actuarial report by an independent actuary.

Section 2.5.1 — Reducing certain life insurance appointed actuary obligations

The FSC supports APRA's removal of the requirement for Appointed Actuaries to assess compliance with:

- the capital adequacy standards under subparagraph 12(d) of Prudential Standard LPS 320;
- directions or conditions of registration applicable to the life company under the Life Insurance Act 1995 (Cth) under subparagraph 12 (d) of Prudential Standard LPS 320;
- surrender values and paid-up values as relevant to Prudential Standard LPS 360 (Termination Values, Minimum Surrender and Paid-up values)

However, it is unclear that the proposed change that is being suggested in respect of Prudential Standard LPS 370 will actually change anything. Under Prudential Standard LPS 320 currently, the Appointed Actuary must assess the cost of any investment performance guarantees and whether the life company has complied with Prudential Standard LPS370 (that for investment-linked funds the cost of those guarantees is less than 5% assets of the statutory fund). The test is implying that this will change to only requiring the Appointed Actuary to include comment in the FCR where there are material guarantees.

The Appointed Actuary will still need to calculate the costs and on the assumption that materiality is taken at 5% then this is effectively not a change.

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The FSC notes that the actuarial requirements of Prudential Standards LPS 230 have not been mentioned.

Recommendation 10

The FSC supports the intent of section 2.5.1, however, we suggest that APRA provide clarity around what is expected from life companies in regards to having the right policies, systems and process in place to ensure compliance with the obligations that have been removed.

The FSC asks for the requirements with respect to Prudential Standard LPS 370 to be clarified.

The FSC requests that the requirements for Actuarial Advice contained within Prudential Standard LPS 230 are also considered in this section.

Section 2.5.2.1 – Distribution of retained profits or shareholder capital of a statutory fund

The FSC is supportive of the proposal to retain the requirement to obtain Appointed Actuary advice in relation to the release of capital, as per sections 62 and 63 of the Life Insurance Act 1995 (Cth). The FSC agrees with APRA's assertion that the provision of such advice is an important element of the framework for the protection of policyholder interests.

Recommendation 11

The FSC is supportive of the requirement in the Life Insurance Act 1995 (Cth) that requires the Appointed Actuary to provide advice on the likely consequences of the distribution of statutory fund retained profits prior to such distributions being able to be made.

Section 2.5.2.2 – Restructure of life insurance business

The FSC is supportive of the proposal to retain the requirement to obtain Appointed Actuary advice in relation to the restructure, establishment, transfer or amalgamation of a life insurance business, as per sections 191 and 192 of the Life Insurance Act 1995 (Cth), Prudential Standards LPS 600 (Statutory Funds) and LPS 700 (Friendly Society Benefits Funds). Similarly to the previous section, the FSC agrees with APRA's assertion that provision of such advice is an important element of the framework for the protection of policyholder interests.

Recommendation 12

The FSC continues to be supportive of the Life Insurance Act and the relevant APRA Prudential Standards that require the Appointed Actuary to provide advice in relation to the restructure, establishment, transfer or amalgamation of a life insurance business.

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Section 2.6.1 – Create new Prudential Standard GPS 340 Valuation of Insurance Liabilities

The FSC supports APRA's proposals to create a new Prudential Standard GPS 340 (Valuation of Insurance Liabilities) and to amend Prudential Standard GPS 320 (Actuarial and Related Matters) to make it less prescriptive.

As noted by APRA, Prudential Standard LPS 320 (Actuarial and Related Matters) for life insurers is less detailed than Prudential Standard GPS 320. Prudential Standard LPS 320 covers only general requirements of the Appointed Actuary, whereas Prudential Standard GPS 320 includes Appointed Actuary requirements as well as technical aspects of how to conduct an insurance liability valuation (particularly in attachment A). For life insurance, the technical aspects of liability valuations are covered in Prudential Standard LPS 340 (Valuation of Policy Liabilities).

It is, therefore, reasonable to align the approach for general insurance with that used for life insurance by covering only general Appointed Actuary requirements in Prudential Standard GPS 320 and introducing a new standard for the technical liability valuation aspects.

Recommendation 13

The FSC supports APRA's proposals to create a new Prudential Standard GPS 340 Valuation of Insurance Liabilities and to amend Prudential Standard GPS 320 to make it less prescriptive. The FSC also supports APRA's suggestion to harmonise Prudential Standards GPS 320 and LPS 320.

3. Conclusion

Thank you for the opportunity to provide a submission in relation to the role of the Appointed Actuary and actuarial advice within insurers. If you have any questions in relation to material outlined in this letter, please do not hesitate to contact us.

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