Ernst & Young
2 Takutai Square
Britomart
Auckland 1010 New Zealand
PO Box 2146 Auckland 1140

Tel: +64 9 377 4790
Fax: +64 9 309 8137
ey.com/nz

Adrian Allott
Senior Adviser
Prudential Supervision Department
Reserve Bank of New Zealand
PO Box 2498
Wellington 6140

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Dear Adrian

Consultation Paper: Audit Requirements for insurer data returns

Thank you for the opportunity to participate in the consultation process in respect to audit requirements for insurer data returns ("Insurer return").

1. Background

In October 2017, the Reserve Bank of New Zealand ("RBNZ" or "the Bank") issued the above consultation paper with the aim of canvasing the views of the insurance industry, audit profession and the general public with respect to the possibility of introducing an audit requirement for the financial year end Insurer Return. The Bank is also seeking feedback about the possibility of strengthening the existing requirement relating to the Insurer Solvency Return.

As outlined in the consultation paper, the Bank are proposing the following:

1.1 Insurer Return

- A reasonable assurance engagement (as described in ISAE 3000 s12) with respect to the year-end Insurer Return, presenting an opinion "that the data as reported is consistent with audited financial statements and prepared in accordance with the definitions and guidance documents provided by the RBNZ."
- The audit requirement is to apply to large and medium size insurers only.
- The audit is required each financial year for large insurers and every third financial year for medium size insurers.
- The audit requirement will be in place until rescinded by the RBNZ.

1.2 Insurer Solvency Return

- A reasonable assurance engagement (as described in ISAE 3000 s12) to audit the year-end Insurer Solvency Return for all insurers subject to RBNZ solvency standards. Carve outs would remain for solvency projections and the catastrophe charge.

The proposals in 1.1 and 1.2 will result in a significant change to the current state.

It is not possible from the information provided in the consultation document to fully understand the rationale and cost / benefit analysis supporting the need for the change. Given the anticipated additional cost to insurers of a move to reasonable assurance for both the Insurer Return (from no assurance currently) and Insurer Solvency Return, our view is that further articulation of the rationale of the proposed change to assurance requirements would be helpful to insurers and audit firms.

Insurers we work with acknowledge receiving constructive feedback from the Bank on the initial Insurer Returns submitted. Most insurers viewed this as an inevitable part of the process of introducing such returns whereby insurers worked through how certain Reserve Bank requirements should be interpreted through receiving constructive feedback. Anecdotally the level of feedback provided to Insurers by the Bank has reduced and become less significant in nature over the last few years. More specific discussion of the significant recent issues the RBNZ has experienced with the Insurer Returns would be useful to industry participants in allowing the issues the consultation document is seeking to address to be better understood. In addition, if the challenges the RBNZ observe with the Insurer Return relate primarily to application of consistent definitions and data quality, then these may be better addressed via increased guidance issued by the RBNZ.

This letter summarises our perspective on the impacts to auditors of the proposals, along with certain background information that we consider relevant.

We have not directly answered the questions outlined in the consultation document, as the majority of the questions are targeted to the insurers and as a participant in the audit market, there is a self-interest perception risk in answering the questions. Rather we have made a series of overall comments under specific headings as outlined below. We hope our responses are helpful.

2. Assurance levels provided by the Auditor

International Standards on Auditing (New Zealand) ("ISANZ") provide for a range of different levels and types of assurance engagements that can be performed by auditors over historical financial information and other matters. It is therefore necessary for the auditing profession and RBNZ to agree on the subject matter over which the auditor is to report and the level of assurance and type of reporting required by the RBNZ.

ISANZ provide for two levels of reporting by auditors as follows:

- ► **Audit** – reasonable assurance providing a positive assurance opinion
- ► **Review** – limited assurance providing a negative assurance opinion

In addition audit firms can perform Agreed upon procedures engagement, where no assurance is provided, rather a statement of factual findings is the output of the engagement.

The type of information over which the auditor is required to report may determine the level of assurance that the auditor is able to provide, the work required to be performed by the auditor and ultimately the cost to the insurer. The information types included in the insurer data and solvency returns have been assessed below, together with the implications for auditor reporting.

Where there is currently an annual assurance requirement, as is the case with the solvency return, insurer practice is varied as to level (i.e. audit or review) and frequency of assurance. In our view there is a strong case for ensuring consistent practice across the insurance sector in this regard. Further, we do not necessarily see the case for limiting the frequency and requirement of assurance for medium and small insurers, given, we understand, insurers of all sizes have historically faced challenges in producing the required information for the Bank.

3. Content of returns and subject matter of auditor reporting

The contents of the solvency returns comprise three types of information as follows:

Type of information to be included in the insurer data and solvency return	Auditor reporting implications
► Information extracted from or based on audited financial statements.	Conducive to reasonable or limited assurance reporting.
► Information drawn from the same data used to prepare the audited financial statements.	Conducive to reasonable or limited assurance reporting once additional audit or review work is performed.
► Prospective information[1] and other information not included in audited financial statements.	Not conducive to reasonable assurance reporting. Limited assurance or agreed upon procedure reporting could be provided under certain circumstances.

[1] Not considered further as proposal is to maintain the carve out of prospective information

In respect to the above table, we discuss further the following considerations:

- Other information
- Insurer data and solvency return components that are not addressed in the financial statement audit
- Materiality thresholds for financial statement audits compared to insurer data and solvency return assurance

3.1 Other information

Both returns currently comprise a number of excel based worksheets containing information (both quantitative and qualitative) which are linked through to calculations, detailed workings and comment boxes. As a result the subject matter for the auditor to report on is extensive, and potentially more granular than what is included in the information covered by the financial statement audit. Further we anticipate challenges specifically around qualitative information which could differ by entity and not necessarily be comparable.

3.2 Return components not addressed by the financial statement audit

Certain return calculation components can be agreed or reconciled to audited financial statements. Other components are not separately identifiable in the financial statements or not included in the financial statements and will require the auditor to perform additional procedures.

We have the following observations on the detailed data required to be included in the Insurer Returns:

- A large part of the return is P&L and balance sheet data disaggregated across insurance classes. The insurance classes used by the Reserve Bank are closer to benefit types rather than product types which is often what life insurers use when analysing performance or managing operational elements of the business so the information that goes to the RBNZ isn't typically used for other purposes within the business. This means that the cost of preparing the data relates solely to regulatory compliance and there are limited other benefits the business gets from preparing this data.
- While some data such as premium revenue can be clearly attributed to specific insurance classes, this is not necessarily the case for other financial statement line items including expenses and reinsurance. These items need to be allocated to insurance classes based on

drivers which could include the number of policies written, aggregate sum insured or premium revenue. While the Reserve Bank provides guidance and definitions for what should be included in each particular line item of the return, less guidance is provided on how to apportion aggregate amounts across classes of insurance and there is varying practice amongst insurers. If large parts of the data at an aggregated level can be agreed to the entity's financial statements and associated work papers, the additional audit work for these returns will primarily relate to how information has been disaggregated. However, if there is less guidance for how data should be disaggregated and insurers do this differently, the lack of consistency would reduce the value of assurance provided. We are also aware of instances where the allocation is made more complex by entities having both insurance and non-insurance operations, meaning that before such entities get to the point of allocating amounts to insurance classes amounts need to be allocated between the insurance and non-insurance businesses.

- ► The returns for life insurers appear to require more actuarial input than the general insurer returns. The cost of providing assurance over the life insurance returns in particular would need to factor in an increased level of actuarial support, with an associated cost impact to the insurer.

We observe that the proposed opinion wording for the insurer return being *"that the data as reported is consistent with audited financial statements and prepared in accordance with the definitions and guidance documents provided by the RBNZ"* could be mutually exclusive, as the definitions and guidance provided by the RBNZ, could differ from the basis of the financial statement presentation.

3.3 Materiality thresholds

Materiality levels for the audit of the financial statements and the reasonable assurance (as proposed) for the insurer data and solvency returns will need to be aligned.

The RBNZ includes guidance on materiality for the Insurer Returns in the definitions booklet which states materiality should be considered with respect to each insurance class rather than solely at an aggregate level. While we appreciate the guidance is aimed at preparers, it would be advisable that the RBNZ as the key user of the assurance report, be specific as to whether it is appropriate for the auditor to apply financial statement materiality to the insurer return. Our reading of the consultation document is that materiality would have to be established on an insurance class basis and if this is lower than financial statement materiality, this will require additional assurance work and associated cost to the insurer.

In particular, for very large insurers where the $5m cap on materiality suggested in the Reserve Bank's definitions publications is applied, or materiality is calculated for a class of insurance that is very small compared to the insurer's overall business, the low materially levels may result in (potentially significant) additional cost which potentially won't be justified through the associated benefit.

3.4 Other considerations

- ► **Model assurance** - The RBNZ provides the models for the insurers to populate for the insurer data and solvency returns. Our discussions with insurers indicate there is an appetite for models that have additional inbuilt consistency and sense checks to assist insurers with completing the returns. The current excel models provided to insurers are simplistic in nature but to the extent these models are further developed over time and become more complex auditors may need to consider the level of reliance they can place on the models and whether a specific emphasis of matter is required in their assurance report.

- **Reporting timeline** – The consultation document proposes a 4 month window to provide the audited insurance data and solvency returns. This has the potential to increase the pressure on some insurer finance teams.
- **Fees for proposed assurance services** – We have intentionally not commented on the expected fee levels for the proposed assurance services. This is primarily because we expect fees to vary between insurers and generic groupings based on insurer size or using a life / general split would not be helpful in providing indicative fee guidance because there other factors that we would expect to have a significant bearing on fees. Two key drivers of fees for the Insurer Return would be how closely the insurance classes used in the return align to data already used in the business and the nature of the methodology used to allocate values across the insurance classes.

4. Concluding comments

We hope the information contained in this letter is useful.

If you require clarification of any matters contained in this letter, please contact the undersigned.

Yours sincerely

BR Penrose

BR Penrose
Partner