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

Emailed to: adrian.allott@rbnz.govt.nz

Dear Adrian,

FMG feedback on Audit of Insurer Return and Insurer Solvency Return

FMG welcomes the opportunity to provide feedback on RNBZ proposal to change the audit requirements for the annual Insurer Return and the Solvency Return.

FMG is not in favour of requiring all large and medium insurers to have the annual Insurer Return audited. As an organisation we have worked to ensure the returns we provide to the Reserve Bank are of a high standard. We have incorporated changes requested by the RBNZ for future returns, despite these being significantly below the materiality threshold indicated by the Guidance Note issued by the RBNZ. We are of the opinion that to impose an audit requirement now would be counter to guiding principle 4(h) stated in the Insurance (Prudential Supervision) Act 2010 of avoiding unnecessary compliance costs.

1. Do you support the idea of introducing an Insurer Return audit/review requirement?
    a. No
    b. Yes, on a temporary basis until data quality improves
    c. Yes, on a permanent basis

a. No

FMG does not support the idea of introducing an audit/review requirement for the Insurer Return for all insurers.

We would prefer to see audit requirements implemented on an exceptions basis, where continued poor quality has been identified, rather than have a blanket audit requirement that will add complexity and expense to the return process.

Our observation would be that issues with the data returns have arisen from a number of causes:

- Lack of clarity within the Guidelines issued by the RBNZ
- Differences in interpretation resulting from the lack of clarity
- Company management and reporting differing from what is envisaged by the Insurer Return template
- Core data systems not being calibrated in a way that facilitates data in the format specified by the RBNZ

With an initial round of feedback having been provided to individual insurers the majority of these issues have presumably been identified and conducting an audit now may have limited additional value.

The data issues have taken a long time to resolve, in part, because of the time elapsed before insurers received any feedback from the RBNZ. Some feedback to the industry of common issues or omission, rather than feedback being given only to individual insurers, would allow insurers to be proactive with regards to changes to the submissions rather than awaiting individual feedback from the regulator.

Our observation would be that any lack of consistency in the returns may stem from insufficient clarity within the Guidance Note for the Insurer Returns issued by the Reserve Bank. Given the diversity of the participants in the insurance industry this is always going to be a challenge as the different business frameworks do not fit neatly into a single template. Introducing another layer of review will not in itself address these teething issues, and may well add to them.

We would further note that many of the changes requested by the Reserve Bank fell well below the threshold of materiality stipulated in the Guidelines and no third party review could be expected to enforce a standard that has not been fully articulated.

Some elements of the return vary significantly from business practise making the allocation, particularly across business lines subjective. It is hard to believe that auditing subjective allocations adds value to any part of the data collection process.

2. What would your organisation expect the audit fee to be for
    a. a reasonable assurance audit of the Insurer Return?
    b. a limited assurance review of the Insurer Return?

Our auditors have advised that there is likely to be a wide range of fees for the audit of an Insurer Return, the cost being related to:

- Requirements on the Insurer Return
- The degree to which the business management reporting aligns with the requirement of the return
- The degree to which core systems need to be modified to provide the data for the compilation of the Insurer Return.

It is likely that increasing the resource within the RBNZ in order to provide timely and effective feedback to insurers would be the most cost effective way of improving data quality.

3. How effective do you believe an audit requirement would be in identifying deficiencies in the processes and systems contributing to the Insurer Return? Please answer separately in respect of
    a. a reasonable assurance audit, and
    b. a limited assurance review.

As discussed in section 1 we believe that introducing an audit is unlikely to be successful in identifying deficiencies in the process and systems contributing to the Insurer Return that have not already been identified by the business or Reserve Bank. We hold this belief because:

- deficiencies in the returns arise primarily from a difference in interpretation of the Guidance,
- most insurers have received initial feedback from the RBNZ, so significant errors and omissions have already been identified

4. Please discuss the timeframes that you believe would be reasonable for the remediation of systems and processes identified as deficient by audit.

The timeframe required to remediate systems is dependent on the scope of the changes required and the availability of resource to implement that change. It is worth noting that there has been, and continues to be, significant systems changes in order to comply with changes to various legislative and accounting changes. A carefully staged implementation is required to manage the operational risks associated with these changes, let alone the business initiatives that are on-going at the same time.

With the upcoming changes to the Insurance Accounting standards it is unclear whether there will be further changes to the RBNZ data requirements. This makes insurers reluctant to undertake expensive and time consuming systems changes until some assurances on the longevity of the data requirements can be obtained.

5. To what extent do you believe the time to complete the Insurer Return will be impacted if it is subject to
    a. a reasonable assurance audit?
    b. a limited assurance review?

The timeline to file a return would be extended by 1-2 weeks of additional elapsed time required to allow for an audit/review and response to questions arising.

6. How much lead time would you require, from notification of the requirement to implementation, should the RBNZ decide to impose an Insurer Return audit/review requirement?

The implementation process would require the assurance professionals to familiarise themselves with the requirements of the Insurer Return and design suitable testing frameworks. They are therefore better placed to advise on the lead time they would require.

7. What types of insurers do you believe should be in-scope for an Insurer Return audit/review requirement, and why?

Insurers who have a track record of poor quality data and no identified program or timeframe to improve this should be audited on an exceptions basis.

This will ensure there is not undue burden placed on insurers who are already complying, or working toward complying, with the reporting requirements.

The RBNZ has repeated stated that Insurers who have their returns reviewed by senior finance and actuarial staff have significantly higher levels of compliance. It would therefore seem reasonable that these organisations should be exempt from an audit requirement.

8. How frequently should an audit/review of the Insurer Return be performed (given that one is required)?

   Does your answer differ by size and/or nature of the insurer, or by level of assurance provided?

One off audits of insurers, regardless of size, who have a track record of poor quality data and no identified program or timeframe to improve this should be audited on an exceptions basis.

9. Have you identified any benefits and costs (other than those listed in the introduction) of introducing an audit requirement for the Insurer Return?

With the upcoming changes to the Insurance Accounting standards it is unclear whether there will be further changes to the RBNZ data requirements. This makes insurers reluctant to undertake expensive and time consuming systems changes until some assurances on the longevity of the data requirements can be obtained.

Insurer Solvency Return

10. Has the existing audit/review of the Insurer Solvency Return been beneficial in improving the quality of the data submitted?

    In what respects?

Limited review has resulted in minimal feedback, largely with regards the strength of supporting documentation.

It is unclear from the consultation document that the RBNZ has identified specific deficiencies with the limited assurance framework currently applying to the Insurer Solvency Standard. It would appear that this change is being suggested in the interests of consistency with the proposal with the Insurer Returns, in which case it is increased cost for no regulatory improvement.

11. What would your organisation expect the audit fee to be for
    a. a reasonable assurance audit of the Solvency Return?
    b. a limited assurance review of the Solvency Return?

Provided the scope of the limited assurance review remains unchanged we do not forsee any increase in the cost. The additional cost associated with a reasonable assurance review would depend on the scope of work and the timeframe in which it was required.

It is likely that increasing the resource within the RBNZ in order to provide timely and effective feedback to insurers would be the most cost effective way of improving data quality.

12. How can a greater degree of assurance be obtained with respect to the Catastrophe Risk Charge?

    What approach could work in practice?

The catastrophe risk charge for general insurers required by the NZ Solvency Standard is subjective in that the range of methodologies and models used to accomplish the requirements of the standard are not prescriptive. In addition the NZ Standard requires evaluation of risks of an extreme (1:1000 year return period) where there is a high level of uncertainty inherent in the resultant; a 75% POS could be an order of magnitude higher than a central estimate. A very small change in the data, assumption or methodology can have large impacts on the results when working at the extreme tail of a distribution.

Significant reliance is placed on the professional judgement of the actuary and this has resulted in a wide range of methods and models being utilised across the industry. An independent consideration of the catastrophe risk charge by a third party could well suggest a very different result, with neither result having more or less merit than the other.

Without some guidance of what constitutes a best practise approach there is no way to avoid this diversity in results.

A prescriptive approach (be it a very simple rule of thumb or a specified catastrophe model with prescribed parameters) would at least allow the RBNZ to compare the relative exposure of the insurers to catastrophe risk across the industry.

General

13. Do you foresee any difficulties in contracting assurance professionals to perform a reasonable assurance audit of returns to the RBNZ, e.g. with respect to their capacity to evaluate data systems and infrastructure?

They will be able to provide this service, but at what cost and within what timeframe is not possible to determine without knowing the scope of the engagement being sought.

14. Do you have any other comments you would like to make?

We note the reference in the Background section of the consultation paper to the publication of data “at aggregate and company level to facilitate analysis by third parties, contributing to market discipline”. Given that the data collected by the RBNZ replicates each company’s financial statements but is presented in a format prescribed by the regulators it is possible that individual company data may be misleading, particularly if taken out of context without the benefit of the full disclosures included in the notes to the financial accounts

We note that in parallel with this consultation the RBNZ is seeking feedback from insurers on the impact of extending the sign-off responsibilities for the Insurer Data Returns to the Appointed Actuary and other senior finance roles. The RBNZ has repeated stated that the quality of the returns have been higher for insurers who involved these individuals in the preparation or review of the returns. Introducing both higher levels of internal review as well as an external review will compound the costs incurred by the industry and would be counter to guiding principle 4(h) stated in the Insurance (Prudential Supervision) Act 2010 of avoiding unnecessary compliance costs. As the RBNZs primary concern is to improve the accuracy of the returns overall a more flexible model that allows insurers to choose between higher internal review or an external audit of annual returns may achieve this while accommodating the range of business models represented across the insurance industry.