

IAG SUBMISSION

RESERVE BANK OF NEW ZEALAND

AUDIT REQUIREMENTS FOR INSURER DATA RETURNS

December 2017

1. INTRODUCTION

- 1.1 The Reserve Bank of New Zealand (RBNZ) is proposing to require a “reasonable assurance” audit of the year-end Insurer Return (IR) for large insurers and triennially for medium size insurers. Furthermore, it is also proposing for the annual Solvency Return for licenced insurers to be audited on a “reasonable assurance” subject to RBNZ solvency standards.
- 1.2 RBNZ has set out a proposed option along with some possible alternatives to be considered. The scope will be guided by feedback from stakeholders.
- 1.3 This submission is a response by IAG New Zealand Group (IAG) to the RBNZ publication dated October 2017 inviting insurers to provide their feedback to the RBNZ on the proposed Audit Requirements by Friday 16th December 2017.
- 1.4 IAG is New Zealand’s leading general insurer. We insure more than 1.5 million New Zealanders and protect over \$450 billion of commercial and domestic assets across New Zealand.
- 1.5 KPMG are the auditors for IAG.
- 1.6 We would like to thank you for the opportunity to discuss our submission with you.
- 1.7 IAG’s contacts for matters relating to this submission are:

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2. EXECUTIVE SUMMARY

- 2.1 The Reserve Bank is proposing to require a “reasonable assurance” audit of the year-end Insurer Return (IR) for large insurers and triennially for medium size insurers. Furthermore, it is also proposing for the annual Solvency Return for licenced insurers to audited on a “reasonable assurance” subject to RBNZ solvency standards.
- 2.2 RBNZ is to consider requiring a reasonable assurance audit of the year-end Insurer Return (IR) and Insurer Solvency Return (ISR), as a way of ensuring more quality assurance is provided prior to submission.
- 2.3 More so, strength the existing requirement relating to the ISR. The Current requirement for ISR is an audit/review of annual ISR with exemptions to Solvency projections and CAT risk.
- 2.4 The RBNZ seeks to get feedback on 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 (IR).
- 2.5 Furthermore, the RBNZ seeks feedback about the possibility of strengthening the existing requirement relating to the Insurer Solvency Return (ISR).
- 2.6 The RBNZ believes that requiring “reasonable assurance” audit on both the IR and ISR would improve the quality of the returns submitted, albeit, costs incurred by the insurers pertaining to obtaining the audit report from their auditors. Currently, the RBNZ has identified a range of quality issues with the Returns submitted which is difficult to use for both supervisory and disclosure purposes. In addition, in having these new requirements would enable the New Zealand Insurance Industry to be in line with other jurisdictions such as Australia and the United Kingdom.
- 2.7 In terms of IAG’s annual ISR, KPMG performs a “reasonable assurance” engagement with some audit exclusions to the 3 year forecast, the Catastrophe Risk capital charge and the Capital Management section of the ISR.
- 2.8 Following consultation, the RBNZ will make decisions on
 - 2.8.1 whether to impose an audit requirement in respect of the Insurer Return,
 - 2.8.2 the level of assurance that would be required, together with the scope, frequency and permanence of the requirement, and
 - 2.8.3 whether to strengthen the existing audit requirement for the Insurer Solvency Return.
- 2.9 Any decisions taken with respect to audit requirements will be communicated to the industry in an appropriate manner, providing sufficient guidance and allowing sufficient lead time to facilitate successful implementation.
- 2.10 The following tables set out the preferred option being proposed by the RBNZ pertaining to the audit of the IR and ISR. In addition, it has also provided with some alternatives that the Bank has considered.

Insurer Return

Aspect	Proposal	Rationale	Possible Alternative
Level of assurance	A 'reasonable assurance' engagement ⁷ 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."	Other levels of assurance – "limited" and "agreed-upon procedures" will bind the auditor insufficiently, reduce the degree of auditor attention accorded and thereby have a lesser impact on data quality.	A 'limited assurance' engagement ⁸ in which the auditor provides a 'meaningful' and 'not inconsequential' level of assurance having performed a limited review of the data.
Scope of audit	The audit requirement is to apply to large and medium size insurers only.	Standards need to be lifted across the board, as data quality issues are widespread across insurance companies.	Apply the audit requirement to: <ul style="list-style-type: none"> • all insurers without exemption. • Insurers with poor data quality histories only.

Frequency of audit	Each financial year for large insurers. Every third financial year for medium-size insurers (with the first audit at the end of the year following introduction of the requirement.)	The costs of an annual audit of medium-size insurer returns, which account for a relatively small proportion of the industry in financial terms, are not justified by potential improvements in aggregate data.	All in-scope insurers be required to have their Insurer return audited at the end of every financial year.
Permanence of requirement	The audit requirement will be in place until rescinded by the RBNZ.	It will take a number of years until the audit requirement brings its full potential benefits.	Audits are required only until the RBNZ is satisfied that that data quality has improved to a sufficient degree.

⁸
As described in ISAE 3000 s12

Insurer Solvency Return

Aspect	Proposal	Rationale	Possible Variations
Level of assurance	A 'reasonable assurance' engagement to audit the year-end Insurer Solvency Return for all insurers subject to RBNZ Solvency Standards. ⁹ Carve-outs would remain for Solvency projections and the catastrophe charge.	Other levels of assurance – "limited" and "agreed-upon procedures" will bind the auditor insufficiently, reduce the degree of auditor attention accorded and thereby have a lesser impact on data quality.	(1) A 'limited assurance' engagement. ¹⁰ (2) A 'reasonable assurance' audit with some form of 'limited assurance' being provided in respect of the catastrophe risk charge.

⁹ This would require the auditor to present 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."

¹⁰ Here, the auditor would provide a 'meaningful' and 'not inconsequential' level of assurance having performed a limited review of the data.

3. GENERAL COMMENTS

The following comments provide our feedback in regards to the specific questions raised by the RBNZ in relation to the proposed audit requirements.

Insurer Return

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

IAG NZ Response: Yes, on a temporary basis and only for those insurers who frequently have had to resubmit amended Insurer Returns. Ever since IAG has been submitting the Insurer Return, we had only one resubmission. Furthermore, a risk based approach should be taken for those insurers who have been consistently misreporting or providing inaccurate data and should be required to undertake a limited audit of their Insurer Return.

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?

Accurate costs can only be obtained if KPMG (IAG's External Auditors) knows what is the scope of the work that needs to be audited to give the required opinion, the level of assurance and guidance by RBNZ.

- We feel there is a gap in the expectations of what the RBNZ expect the audit profession to review.
- There also seems to be a gap in understanding of the materiality thresholds applied.

Furthermore, RBNZ is to agree the above with the Audit Firms.

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**

We believe that an audit requirement would not be effective in identifying deficiencies in the processes and systems contributing to the IR.

It all depends on what would constitute an audit in the views of both the RBNZ and KPMG. Discussions need to happen between RBNZ and the Audit Firms so that everyone's on the same page in regards to what is a reasonable assurance audit and a limited assurance audit.

We think that the idea for such an audit is not to detect errors but rather give an independent reasonable assurance conclusion as to whether the returns has been prepared in all material aspects in accordance with the Solvency Standards and consistent with the Management Statements and Financial Statements of the organisation.

We therefore strongly believe that the RBNZ should consult and involve the auditing professions to get their views as to whether what or how much audit work should be involved as to give a "reasonable assurance" opinion to RBNZ's satisfaction.

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

We believe this can't be quantified due to the nature and materiality of the deficiencies identified.

We believe that there is no intention to change IAG's legacy systems for merely reporting required statistics data.

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?**

Here again in order to answer the above question, KPMG needs to know to the scope of the work to audit in order to perform a reasonable assurance opinion. RBNZ should consult and involve the auditing professions to get their views on this question.

Furthermore, we would like to let the RBNZ know that we are generally required to report the annual results to the NZ Board within a relatively tight deadline and at the same time getting KPMG's clearance on time. Alternatively, if no Board sign off is required then we could always get the Insurer Return audited after IAG's Annual Audit.

Currently, KPMG also performs a reasonable assurance audit on our Annual Insurer Solvency Return (ISR) and does not perform any audit work on the 3 year forecast, the Catastrophe Risk capital charge and the Capital Management section of the ISR.

Therefore, factoring in the above, and based on KPMG's capacity to evaluate data systems and infrastructure around the annual audit, we definitely believe that time would be a critical factor in trying to squeeze the IR under either of the above audit opinions.

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?

This depends on KPMG's resource and requirements to fulfil the Audit. Furthermore, additional work may be required by IAG to enable this to happen.

RBNZ should also consult and involve the auditing professions to get their views on this question.

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

We believe that it should be either all insurers or none. There should be an "equal playing field" for all and exceptions should not be granted as that in the case of those insurers who are regarded as branches of an overseas insurer.

Alternatively, a risk based approach should be taken for those insurers who have been consistently misreporting or providing inaccurate data and should be required to undertake a limited audit of their Insurer Return.

8. How frequently should an audit/review of the Insurer Return be performed (given that one is required)? Annually or alternatively undertaken on a risk basis as discussed in previous comments.

Does your answer differ by size and/or nature of the insurer, or by level of assurance provided? No, however, the level provided we believe should be limited assurance review.

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

There would be no visible benefits to IAG as the annual audit that is done on our Financial Statements already performing this but would rather involve significant costs relating to the audit/reviews and making changes made to the legacy systems. This cost would be most likely passed onto the policyholders across the industry making insurance less affordable to policy holders.

Insurer Solvency Return

10. Has the existing audit/review of the Insurer Solvency Return been beneficial in improving the quality of the data submitted? No

In what respects? Existing Audit/Review of IAG's ISR was only useful in the early stages as it assisted us to understand the solvency standards guidance around reporting IAG's solvency position. These days it only serves as a purpose of giving the IAG NZ board some level of "comfort" around the ISR before they can sign the directors' attestation as required under the Solvency Standards.

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?

Please refer to our comments on question 2 above.

12. How can a greater degree of assurance be obtained with respect to the Catastrophe Risk Charge? Referring to the different CAT Models used by IAG and other insurers, this is a difficult question to answer.

We think more guidance is needed from RBNZ about the specific models and approach to use in calculating the Catastrophe Risk Charge.

What approach could work in practice? See above comment.

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? Yes, but we need to check this further with KPMG. We believe the difficulties, if any, would stem from the scope of the audit to perform and understanding the gaps in between.

RBNZ should also consult and involve the auditing professions to get their views on this question.

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

Do we really need to have Statistics data from the Insurer Return to be audited, in terms of providing “reasonable assurance” or “limited assurance review? Do we really need to go to this level of assurance?

We believe better reliance can be obtained by a Reconciliation between the Returns and the Financial Statements of the entity. This would offer a linkage to the Financial Statements that is currently not existing and would improve the accuracy of data.

4. CONCLUSION

- 4.1 IAG is committed to working in partnership with the RBNZ to ensure that New Zealanders benefit from the Insurance Industry being as transparent as possible. IAG support improving accuracy of returns.
- 4.2 However, we also believe that insurers, should not be made to have the IR statistical data, going through an audit process.
- 4.3 We also suggest that audit/reviews should be imposed on those insurers who have been consistently misreporting or providing inaccurate data and should be required to undertake a limited audit/reviews of their Insurer Returns until such time the returns accuracy is up RBNZ’s standard.
- 4.4 There would be significant costs and complexity involved with this proposal from the RBNZ, to IAG which would more than likely be passed on to the policyholders.
- 4.5 As an alternative a reconciliation between the IR and the financial statements would offer the increase in accuracy that the RBNZ are seeking for a fraction of the cost.

We are more than happy to discuss our responses in person if need be.