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15 December 2017

Submission on RBNZ Consultation Paper dated October 2017: "Audit requirements for insurer data returns"

The New Zealand Society of Actuaries ("NZSA" or the "Society") welcomes the opportunity to comment on the above Consultation Paper.

The NZSA is the professional body for actuaries practising in New Zealand. Our purpose includes establishing, promoting and maintaining high standards of competence and conduct within the actuarial profession and providing a source of reference on actuarial matter for government and various official and interested bodies.

The form of this submission is to make some specific comment on the matters we wish to highlight in the body of this letter and to attach our responses to the questions you have raised as an Appendix to this submission (including repeating points from the main section where relevant).

Our responses in this submission has been informed by a survey of our members, including 19 respondees who hold Appointed Actuary roles, drawn from both insurers and consulting firms.

Background

Content of insurer returns

Insurer returns can be considered as including the following three classes of components:

- Information that is usually calculated by actuaries (for the financial statements):
 - policy liabilities and their break-down, tax components
 - claim provisions and risk margins
 - the movement in the above items, and the reconciliation of the movement from the previous returns.



- Accounting information, including:
 - trial balance information which is already available from the Company's accounting database, separately for each product class;
 - trial balance information which requires further apportionment between types of insurance (Life, Non-life and Health) as well as by product class, since the expense category is required to be split under the current RBNZ template;
 - trial balance information which is not class-specific, and does not require further apportionment (e.g. investment income)
- Statistics and administrative information, including:
 - in-force at start and end of period (Life, Non-life, and Health),
 - statistical movements (Life and Health only, not required for Non-life).

The current role of Actuaries in relation to Insurer and Solvency Returns

Some NZSA members are extensively involved in the preparation of insurer data returns and solvency returns. The work is carried both by Appointed Actuaries, and by other actuaries or actuarial analysts, some of whom are employed by the insurer, some of whom are employed in consultancy firms.

A significant amount of the work on these returns by Appointed Actuaries is not directly related to the work that they have done in their statutory capacity, but is more associated with their role in each particular company. For example, the Appointed Actuary will have reviewed the company's solvency calculations in their statutory capacity, but may also complete the statistics sections of the data returns because of the particular preferences of the insurer, or particular circumstances that mean the Appointed Actuary may be in the best position to produce the statistical data.

On the other hand, some insurers currently prepare their insurer returns with no input whatsoever from an actuary.

Comments on concerns raised by the RBNZ on Data Submissions

In late 2015 and during 2016, the RBNZ commissioned an actuary, on contract, to review the detail of a significant number of insurer returns, and a number of these insurers received quite long and detailed lists of queries regarding their returns. We understand that the RBNZ purposely raised some items which were below the RBNZ's stated materiality for the returns.

We raise this in our submission for three reasons:

- Some lists of queries returned to insurers were long, which may have created an impression that issues relating to the insurer returns are significant, when a consideration of the materiality of the items relative to the intended use of any data may not support this impression.



- The Reserve Bank has already completed an extensive review process and notified insurers of issues with their data collation. It is not clear that significant additional areas of improvement would be identified by introducing an audit requirement for submitters at this point.
- As the RBNZ has not provided any public commentary as to the nature of the data limitations (with feedback being provided only to individual insurers) it is difficult to understand whether issues are truly unique to each insurer, so an audit may be of benefit, or whether the issues are more systemic and therefore other approaches may be more effective.

Comments on specific aspects of the consultation

A. The cost of and responsibility for monitoring compliance

The proposals within the consultation document will transfer a significant proportion of the cost of monitoring compliance with the regulatory regime from the regulator to the industry.

While the introduction of an audit may reduce the work for the regulator in checking and rejecting returns, it cannot eliminate it altogether. In particular, the levels of materiality accepted by the auditor may or may not agree to those of the RBNZ.

We note that, as proposed, the audit requirement is a blunt tool and would impose costs on even those insurers who are already submitting compliant returns. Many of our members support imposing a requirement for an audit only on those insurers who are found to be submitting non-compliant returns (eg as a licensing requirement).

B. Analysis of costs and benefits to policyholders

The NZSA asserts that the introduction of an audit requirement for the Insurer Return would impose significant cost on policyholders. We are concerned that this cost is being partially justified by the perceived value of the data published by the RBNZ. There is already extensive information regarding the industry including:

- statistical information from the Insurance Council, the Financial Services Council, and the Health Funds Association of New Zealand
- underwriting/claims performance information from the above industry bodies
- financial performance and solvency information from published accounts, available via the Companies Office.

Anything published by the RBNZ may supplement, but is unlikely to replace these sources of data. The primary users of statistics derived from the Insurer Returns are therefore likely to be the regulator, international monitoring organisations and occasional non-industry commentators.



The NZSA recommends that the RBNZ considers the costs to policyholders relative to the benefits to policyholders of this proposal. The proposed new audit requirement, as it stands, will impose significant cost for what might be marginal gains, which may be able to be achieved far more cost effectively through other means. In particular, we note the proposals to (1) amend and improve the supporting documentation including guidelines and definitions and (2) to introduce a degree of self-checking into the data return spreadsheet.

C. Increased compliance costs

Indications from our members suggest costs in the range of \$5,000 to \$45,000 to complete an audit of the Insurer Return.

The likely cost of an audit will vary widely depending on factors such as:

- the assurance professional's interpretation of the requirements on the Insurer Return
- the level of assurance required
- the level of materiality that is expected to be applied
- the degree to which the business management reporting aligns with the requirements of the return
- the degree to which the requirements of the return align with the financial statements
- the quality of systems and processes at the insurer
- the degree to which core systems need to be modified to provide the data for the compilation of the Insurer Return.

A consistent item of feedback from our members is that having the insurer returns audited or reviewed by an audit firm is likely to be a costly exercise.

Section 4 of the Insurance (Prudential Supervision) Act 2010 outlines the Principles to be taken into account under the Act; item (h) notes the need to avoid unnecessary compliance costs.

D. Nature of problems with Insurer Returns and how to address them

Feedback from across the NZSA membership on the data quality issues raised by the Reserve Bank identified a number of common causes:

- lack of clarity within the Guidelines issued by the RBNZ
- differences in interpretation resulting from the lack of this lack of clarity
- company management reporting differing from what is envisaged by the Insurer Return template, resulting in estimation of some items
- core data systems not being calibrated in a way that facilitates data in the format specified by the RBNZ, resulting in estimation of some items.



These issues are compounded where a single company writes products that need to be allocated across types of insurance (Life, Non-Life and Health) as well as different product lines.

As mentioned above in B, the NZSA believes that further guidance from the RBNZ, including fuller definitions and discussion of items that are being commonly misinterpreted, would be beneficial in addressing the first two items above, before imposing a requirement for an audit.

The need to allocate items across types of business and product lines can make the analysis required for the Insurer Returns extremely complex, particularly where there are multiple systems and product variants spanning decades.

There has been and continues to be a significant volume of systems work related to regulatory change, including Fire Service, EQC levy and changes to financial accounting standards. In particular, the incoming accounting standard for insurance companies is suggesting significant changes to the presentation of financial information going forward, and is likely to require significant systems changes.

We wonder if it would be appropriate to allow some leniency (perhaps on a materiality basis) to those with historical systems limitations (preventing completely accurate completion of the returns) until the requirements of IFRS17 are clearer, particularly if there is any chance that the RBNZ may alter the requirements of the Insurer Return when IFRS17 comes into force.

E. Proposal for increased audit requirements for the Insurer Solvency Return

The Insurer Solvency Return is currently subject to a minimum of a limited assurance audit with a carve out for the catastrophe charge and the solvency projection. In addition the Solvency Standard, including the catastrophe charge and the solvency projection, are subject to Board attestations.

Insurers have their own risk management programmes to ensure that any information requiring Board attestation is true and correct. The existing audit requirements already test the controls and processes used for the preparation of the Solvency Return.

Generally, our members are generally satisfied that the current minimum level of assurance is appropriate and does not need to be increased.

F. Obtaining assurance on the Catastrophe Risk Capital Charge

The catastrophe risk charge for general insurers required by the Non-Life Solvency Standard is subjective in that the range of methodologies and models used to accomplish the requirements of the standard are not prescribed. In addition, the Standard requires evaluation of risks with a very low frequency (1:1000 year return period) where there is a high level of uncertainty inherent in the result. 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 statistical distribution.



This has resulted in a wide range of methods and models being utilised across the industry, with significant reliance placed on the professional judgement of the actuary, and often incorporating the results of proprietary risk models. An independent consideration of the catastrophe risk charge by a third party could well suggest a very different result, each based on a reasonable set of assumptions.

For this reason, we believe a greater degree of assurance can only be obtained on the Catastrophe Risk Capital Charge if there is more consistency in approach. Publication by RBNZ of fuller definitions and guidance in this area would facilitate this. Failing this, the calculation of a catastrophe risk exposure separate from the current Capital Charge, using a simple non-probabilistic approach, would provide a greater degree of comparability across insurers and might better allow the RBNZ to identify companies whose approach is out of step with the rest of the industry.

Conclusion

Overall, our members have concerns regarding the current proposal to increase the audit/review requirements of the respective insurer data returns. Our members believe that constructive engagement with insurers, focusing on material areas for improvement, and focusing on those insurers with material errors in their returns, is the appropriate way forward. Failing this, our members believe a more targeted audit requirement, applied to persistent offenders, would create a better result than a blanket requirement.

We would be happy to discuss our submission with you or provide more detail on any aspect of it.

Yours sincerely
for **New Zealand Society of Actuaries (Inc)**



Andrea Gluyas
President



Insurer Return

1. Do you support the idea of introducing an Insurer Return audit/review requirement?

The Society believes there is further work to be undertaken first to address current issues more effectively than the imposition of the additional compliance cost and effort of an audit regime.

Feedback from across the NZSA membership suggests the data quality issues raised by the Reserve Bank result from a number of common causes:

- lack of clarity within the Guidelines issued by the RBNZ
- differences in interpretation resulting from of this lack of clarity
- company management reporting differing from what is envisaged by the Insurer Return template resulting in estimation of some items
- core data systems not being calibrated in a way that facilitates data in the format specified by the RBNZ resulting in estimation of some items

These issues are compounded where a single company writes products that need to be allocated across types of insurance (Life, Non-Life and Health) as well as different product lines.

The NZSA believes that further guidance from the RBNZ including fuller definitions and discussion of items that are being commonly misinterpreted would be more beneficial in addressing the first two items above, with significantly lower cost, than will be achieved by implementing an audit of all Insurer Returns.

If an audit requirement were to be introduced, the majority view of our members was that it should be applied to offenders, rather than all insurers.

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?

The NZSA asserts that the introduction of an audit requirement for the Insurer Return would impose significant cost on the industry, which would impact policyholders.

Indications from our members suggest costs in the range of \$5,000 to \$45,000 to complete an audit of the Insurer Return.

The likely cost of an audit will vary widely depending on factors such as:

- the assurance professional's interpretation of the requirements on the Insurer Return
- the level of assurance required



- the level of materiality that is expected to be applied
- the degree to which the business management reporting aligns with the requirements of the return
- the degree to which the requirements of the return align with the financial statements
- the quality of systems and processes at the insurer
- the degree to which core systems need to be modified to provide the data for the compilation of the Insurer Return.

A consistent item of feedback from our members is that having the insurer returns audited or reviewed by an audit firm in any capacity whatsoever, is likely to be a costly exercise, but one of only limited benefits to policyholders.

Section 4 of the Insurance (Prudential Supervision) Act 2010 outlines the Principles to be taken into account under the Act; item (h) notes the need to avoid unnecessary compliance costs.

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.

Given the extensive review already undertaken by the RBNZ, it is unlikely that the introduction of an audit, at any level, will identify further deficiencies in the processes and systems contributing to the insurer returns that have not already been identified.

The main benefit of an audit, in the view of the majority of members, is that returns are more likely to be correct. However, a quarter of our survey respondents do not think there would be any benefit arising from an audit requirement of any kind.

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

The Society has no comment on this question.

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 Society has no comment on this question.



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 Society has no comment on this question

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

The majority view of our members is that only those insurers who do not satisfactorily complete their Insurer Return should be subject to an audit requirement. This acts as both a carrot and a stick in incentivising accurate completion, whilst keeping the overall cost of compliance down, relative to a blanket 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?

If an audit requirement were to be implemented, members believe an annual requirement would be appropriate. This applies to both reasonable and limited assurance reviews.

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

The Society has no comment on this question.

Insurer Solvency Return

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

A majority of members believe there has been an improvement in the quality and/or the knowledge and understanding through the audit process, though this varies by individual experience.



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?

The Society has no comment on this question

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 Non-Life Solvency Standard is subjective in that the range of methodologies and models used to accomplish the requirements of the standard are not prescribed. In addition the Standard requires evaluation of risks with a very low frequency (1:1000 year return period) where there is a high level of uncertainty inherent in the result. 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.

This has resulted in a wide range of methods and models being utilised across the industry with significant reliance placed on the professional judgement of the actuary. An independent consideration of the catastrophe risk charge by a third party could well suggest a very different result, with each being based on a reasonable set of assumptions.

For this reason, a greater degree of assurance can only be ascertained on the Catastrophe Risk Capital Charge if there is more consistency in approach. Publication by RBNZ of fuller definitions and guidance in this area would be helpful. Failing this the calculation of a catastrophe risk exposure separate from the current Capital Charge, using a simple non-probabilistic approach, would provide a greater degree of comparability across insurers and might better allow the RBNZ to identify companies whose approach is out of step with the rest of 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?

The Society has no comment on this question

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

Yes – these are contained in full in the accompanying letter.