15 December 2017

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

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

Dear Adrian,

Re: MAS submission on audit requirements for insurer data returns

Thank you for the opportunity to submit on the proposal for enhanced audit requirements for insurer data returns. We outline our high-level views below and have appended answers to your specific questions. If you have any questions please contact Nick Mereu at nick.mereu@mas.co.nz or by phoning (04) 496 9236.

General observations

We would like to note:

1. We need to drill further into the nature of the problem RBNZ describes in the consultation paper as we have worked hard to ensure we provide quality returns. Our interactions with RBNZ involve RBNZ asking clarifying questions on the return, or noting there are differences between the return and our financial statements. We note those differences are always well within the defined materiality thresholds. We understand our responses to RBNZ have been prompt and conclusively and satisfactorily addressed RBNZ's concerns – if not, we are concerned we have not had any other bilateral feedback on point.

2. The supervisory regime is relatively new, and so any "ongoing" questions about data quality asked of us are novel issues raised after each round of reporting to RBNZ. RBNZ's experience may be inherent to the process of bedding in a new regulatory regime and ensuring insurers and RBNZ on the same page about what is expected. In this context, we would hope RBNZ works more closely with insurers to ensure RBNZ is communicating its expectations effectively and that insurers are meeting those expectations.

3. We oppose an annual Insurer Return audit as a solution to the problems RBNZ has identified. We support a risk-based approach instead. In particular,
    a. First, the existing initiatives to improve data quality bulleted on page two of your consultation paper are appropriate, effective, and should be continued. We say RBNZ should implement, monitor and evaluate whether these initiatives have been successful before considering more heavy-handed and costly measures like audit requirements.
    b. Second, if RBNZ proceeds with enhanced audit requirements, the audit should only be for consistently poor-performing insurers, where the insurer has been notified of RBNZ's concerns and given reasonable opportunity to address those continued and repeating concerns.
    c. Third, aside of focussing on poor-performing insurers, we say a market share materiality threshold should be applied before RBNZ requires audit of the Insurer Return for any

particular insurer. If the returns are used for aggregation and eventual publication for analysis by third parties, we note MAS' return would be virtually irrelevant in the context of a market snapshot and our current market share. MAS would be an extremely low risk of impacting industry aggregate statistics in this way. We say this means an audit requirement would be disproportionate the RBNZ's ends in this respect.

4. Adopting a risk-based approach is critical given the costs to insurers' business of imposing additional audit requirements. After consulting external auditors there is substantial uncertainty around additional costs depending on RBNZ's requirements but we can expect our external additional costs to be between $10,000 and $30,000, and in addition higher internal resource costs. If the audit was conducted at a "reasonable assurance" standard rather than a "limited assurance" standard, the cost would be at the higher end of that range. We note these audit costs disproportionately impact insurers with less market share. Each insurer's audit costs would be relatively comparable across the insurance industry, but in terms of the impact of compliance costs on an insurer's business, the compliance cost would be far higher as a percentage revenue for a small insurer than a larger insurer.

5. If we have correctly characterised the problem in points 1 and 2 above, we suggest including a reconciliation to the financial statements during the process of submitting/reviewing insurer data returns as an alternative to the RBNZ proposal for an audit.

Yours sincerely,

Nick Mereu
General Counsel

Appendix: answers to the Questions for Consultation

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**

No, not as characterised in the consultation paper and subject to our comments above.

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?**

Between $10,000 and $30,000, depending on whether the was conducted at a “reasonable assurance” standard or a “limited assurance” standard, with a “reasonable assurance” audit at the higher end of that range, and a “limited assurance” audit at the lower end.

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 the effectiveness of initiatives currently being pursued should be monitored and evaluated before an audit requirement is considered, as those initiatives may be effective without having to pursue costlier solutions like an audit.

We anticipate that an audit would be conducted at a materiality level much higher than the appears to be the case for feedback received by MAS from RBNZ on the returns.

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

This depends on the scope of the changes required and the availability of resource to implement that change. There has been, and continues to be, significant systems change to comply with various legislative and regulatory changes. A carefully staged implementation is required to manage the operational risks associated with these changes. We note there are also business as usual initiatives that compete for time and resources with these government and regulator imposed changes.

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?

This would depend on the audit resources available and the scope of the audit. This question is best directed to audit firms.

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?

As per our comments at paragraphs 3-5 in our covering letter above – only repeat poor performers who have had the chance to resolve particular issues directly with the RBNZ, and who have failed to remedy those particular issues, and only insurers whose Insurer Return data is material to an aggregated industry data picture on a market share basis.

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?

As above.

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

No, but we disagree that extending existing audit requirements would be a “marginal” cost. The indicative cost of auditing the Insurer Return relayed to us by external auditors is material, especially for smaller insurers. In addition, we would incur addition internal time and costs.

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?

No. We have not received any material feedback from auditors during their audit of the Insurer Solvency Return.

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?

As above.

12. How can a greater degree of assurance be obtained with respect to the Catastrophe Risk Charge? What approach could work in practice?

The audit itself doesn't necessarily provide more assurance, given that auditors are not specialists at risk modelling. This is even difficult for the Approved Actuary. What would improve assurance is greater guidance from RBNZ about specific models and the approach to calculating the Catastrophe Risk Charge.

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?

This is a question for the assurance professionals.

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

No.