



**RESERVE  
BANK**

O F N E W Z E A L A N D  
T E P Ū T E A M A T U A

**Consultation Paper:**

**Audit requirements for insurer data returns**

**October 2017**

## **Submission contact details**

**The Reserve Bank invites submissions from insurance industry participants, industry & professional bodies, audit firms, consumer representatives and the general public on this Consultation Paper by 5pm on Friday 16th December 2017. Please note the disclosure on the publication of submissions below.**

The Reserve Bank would appreciate receiving a copy of your submission, in electronic form, to the email address: [adrian.allott@rbnz.govt.nz](mailto:adrian.allott@rbnz.govt.nz).

Text-based pdf and/or Microsoft Word (.doc or .docx) formats are preferred.

Please address hard copy submissions and enquiries to:

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## **Publication of submissions**

All information in submissions will be made public unless you indicate you would like all or part of your submission to remain confidential. Submitters who would like part of their submission to remain confidential should provide both a confidential and public version of their submission. Apart from redactions of the information to be withheld (i.e. blacking out of text) the two versions should be identical.

Submitters who request that all or part of their submission be treated as confidential should provide reasons why this information should be withheld if a request is made for it under the Official Information Act 1982 (OIA). These reasons should refer to section 135 of the Insurance (Prudential) Supervision Act 2010 (as applicable) or other grounds for withholding information under the OIA. If an OIA request for redacted information is made the Reserve Bank is required to make its own assessment of what must be released taking into account the submitter's views.

The Reserve Bank may also publish an anonymised summary of the submissions received in respect of this Issues Paper.

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# Background

## The Purpose of Data Collections

In New Zealand, licensed insurers operate within the framework established by the Insurance (Prudential Supervision) Act 2010 (“IPSA”) and its supporting secondary legislation. The purpose of IPSA is to promote the maintenance of a sound and efficient insurance sector, and to promote public confidence in the insurance sector.

Section 12 of IPSA gives the Reserve Bank of New Zealand (“the RBNZ”) some specific functions in support of these purposes. These are to

- (a) license insurers,
- (b) impose prudential requirements on insurers,
- (c) supervise compliance with those requirements, and
- (d) take action in respect of insurers in distress.

There are a number of ways in which the provision of high quality data by insurers to the RBNZ helps meet the purposes of IPSA and helps the RBNZ to undertake its functions. Firstly, the RBNZ itself gains a better picture of the insurer for use in its supervisory activities. Secondly, publication of data collected by the RBNZ, at aggregate and company level, facilitates analysis by third parties, contributing to market discipline<sup>1</sup>. Finally, the provision of high quality data provides some evidence that the insurer has good information systems, reducing the risk that management and the board are misinformed.

## Data Collection Experience

Collection of data<sup>2</sup> from licensed insurers commenced in 2013 (Insurer Solvency Return) and 2015 (Insurer Return & Quarterly Insurer Survey).

The major method we have used for assessing the quality of returns received has been review of the documents by the RBNZ’s staff. These reviews have involved checks against the definitions document, checks for consistency across time, checks against other information received and general reasonableness.

These reviews have revealed a wide range of issues with the quality of the data in the returns, and these issues are hampering the full and unrestricted use of this data for both supervisory and disclosure purposes. Examples include:

- Mis-classification of items by product group
- Mis-classification of items by revenue or expense line
- Difficulties with presentation of life insurance liabilities and the taxation thereon
- Weaknesses in valuation methods used for general insurance classes
- Mistakes in metadata entry – dates, contact details, control fields etc.
- Generally poor systems for generating statistical information

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<sup>1</sup> Market discipline is one of the three pillars in the RBNZ’s prudential framework, the other two pillars being self-discipline & regulatory discipline.

<sup>2</sup> Insurer Solvency Returns, Insurer Solvency Exempt Returns, Foreign Business Returns, Insurer Returns & Quarterly Insurer Surveys

## **Initiatives to Improve Data Quality**

In response, we are working through a number of initiatives designed to raise the quality of the data and make some of it available for use. These include:

- Publication of fuller definitions and guidance for completing returns,
- A requirement for insurers to validate elements of their returns prior to submission,
- A broadening of sign-off requirements to include management, finance and actuarial functions, and
- Stricter enforcement with respect to insurers that consistently fail to meet standards for quality and timeliness.

Another initiative (and the subject of this document) is to consider requiring a reasonable assurance audit of the year-end Insurer Return and Insurer Solvency Return, as a way of ensuring more quality assurance is provided prior to submission.

There is already a requirement for an audit/review of the year-end Insurer Solvency Return. This requirement carves out solvency projections and catastrophe risk charges, and may take the form of a 'limited assurance' engagement.<sup>3</sup>

### **This Document**

The RBNZ aims to canvas 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 seeks feedback about the possibility of strengthening the existing requirement relating to the Insurer Solvency Return.

The following section sets out the current situation in more detail. The document then looks at the potential impacts of an audit requirement before detailing the Bank's proposal and suggesting alternative options. The final section of the paper sets out specific questions on which we would like to receive submissions.

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<sup>3</sup> "Reasonable" and "limited" assurance engagements are described in Annex A, in accordance with Section 12 of the International Standard on Assurance Engagements (New Zealand) 3000, issued by the External Reporting Board in July 2014 ("ISAE 3000").

## Current Situation

### Required Returns

The following table sets out the returns and other information currently required from licensed insurers on a regular basis. Returns that are the subject of this paper are highlighted.

Return	Scope	Existing Audit Requirement
Financial Statements	All insurers except those with the small insurer exemption.	Under the Financial Markets Conduct Act 2013 (“FMCA”), every licensed insurer is an “FMC reporting entity”. All FMC reporting entities must prepare financial statements within four months of their balance date, and these statements must be subject to audit. (subject to some exemptions under IPISA regulations or from the FMA).
Financial Condition Report	All insurers <sup>4</sup>	None
Insurer Return <sup>5</sup>	All insurers	None
Quarterly Insurer Survey <sup>3</sup>	Large insurers only	None
Insurer Solvency Return	NZ-domiciled insurers & non-exempt branches	The financial-year-end return is audited on a limited assurance basis with a carve-out for the catastrophe charge and solvency projections. There is no audit requirement for half-year returns.
Solvency Exempt Return	Solvency exempt branches of foreign insurers	None
Foreign business Return	NZ-domiciled insurers with significant foreign business	None

While the Quarterly Insurer Survey is not a subject of this paper, readers should note that it covers much of the same material as the Insurer Return, albeit at a higher level of aggregation. We expect there to be a high degree of consistency between the two returns.

<sup>4</sup> Solvency exempt branches of overseas insurers may provide their parent’s FCR provided that it has sufficient coverage of the New Zealand branch.

<sup>5</sup> A modified version of the return is submitted by Lloyds of London.

## Legal Empowerment

The collection of licensed insurer data is empowered by s121 of IPISA. S125 of IPISA gives the RBNZ the additional power to require that information submitted under s121 is audited. In the initial consultation report regarding the establishment of data returns (see Annex B), use of this power was anticipated in the event that the quality of returns is found to be unacceptably low.

## Comparators

Data returns analogous to the Insurer Solvency Return, Insurer Return and Quarterly Insurer Survey are required to be audited on a “reasonable assurance” basis in both Australia and the United Kingdom.

The following table summarises existing audit requirements for NZ Banks, NZ Insurers and NZ Non-Bank Deposit Takers (“NBDTs”).

	<b>Banks</b>	<b>Insurers</b>	<b>NBDTs</b>
<b>Financial Statements</b>	Audit of registered banks is required under FMCA	Audit of licensed insurers is required under FMCA	Audit of credit unions & building societies is required under FMCA
<b>Other data</b>	Year-end financial disclosures are subject a full audit. Half-year financial disclosures are subject to a limited scope review.	The RBNZ can require any data requested to be subject to audit. Solvency returns are currently subject to a minimum of a limited assurance review requirement.	The RBNZ can require any data requested to be subject to audit.
<b>AML / CFT<sup>6</sup></b>	Audit of programme & risk assessment is required under the AML/CFT Act 2009.	Audit of programme & risk assessment is required under the AML/CFT Act 2009.	Audit of programme & risk assessment is required under the AML/CFT Act 2009.

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<sup>6</sup> Anti-money laundering / countering terrorist financing

## Our Proposal

The Reserve Bank’s preferred option is to require a “reasonable assurance” audit of:

- the Insurer Return, on an annual basis for large insurers, and triennially for medium-size insurers;
- the annual Solvency Return for licensed insurers subject to RBNZ solvency standards, whilst retaining the existing carve out of catastrophe risk calculations and future projections.

The following tables set out the preferred option that the RBNZ is proposing to implement with respect to audit of the Insurer Return and the Solvency Return alongside some alternatives the Reserve Bank has considered

### Insurer Return

Aspect	Proposal	Rationale	Possible Alternative
Level of assurance	A ‘reasonable assurance’ engagement <sup>7</sup> 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 <sup>8</sup> 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"> <li>• all insurers without exemption.</li> <li>• Insurers with poor data quality histories only.</li> </ul>

<sup>7</sup> As described in ISAE 3000 s12 (see Annex A)

<sup>8</sup> As described in ISAE 3000 s12 (see Annex A)



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.

### 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. <sup>9</sup> 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. <sup>10</sup> (2) A 'reasonable assurance' audit with some form of 'limited assurance' being provided in respect of the catastrophe risk charge.

<sup>9</sup> 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."

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

## **Possible Impacts of an Audit Requirement**

We have identified the following potential costs and benefits of implementing our proposal. These are not intended to be definitive lists; instead they are provided to prompt further thought.

### **Robust Review**

Introduction of a reasonable assurance audit requirement will provide another perspective on the return, fully engage the responsibility of the auditor and lead to the deployment of additional and more experienced audit professionals.

A limited assurance review, on the other hand, would be less thorough, reducing the potential quality benefit.

### **Follow-up Action**

Reasonable assurance audits are likely to uncover deficiencies in data systems and infrastructure that will need to be addressed by insurers. As remediation plans are executed, the quality of data being submitted to the RBNZ should rise.

### **Other Benefits**

Improved data quality will:

- reduce the need for resubmissions of returns, freeing up RBNZ and insurer staff time,
- hasten the clearance of data for publication & use,
- broaden the range of items that can be published, and
- support higher quality analysis by the RBNZ, insurers and other interested parties.

### **Cost**

Our proposal may impose costs on insurers in two ways:

- The marginal cost of extending the existing audit requirements to encompass the Insurer Return and to provide fuller assurance for the Insurer Solvency Return.
- The (likely more significant) cost of remediating processes and systems found to be producing low quality data.

Costs may be higher in the short-term as quality issues are addressed, however later on they should decline to a lower level.

### **Timeliness**

An audit requirement implies an additional step in the process of completing returns; however the RBNZ already allows insurers to submit Insurer Returns up to four months post balance date.

## **Implementation**

Following consultation, the RBNZ will make decisions on

- whether to impose an audit requirement in respect of the Insurer Return,
- the level of assurance that would be required, together with the scope, frequency and permanence of the requirement, and
- whether to strengthen the existing audit requirement for the Insurer Solvency Return.

Any new or amended audit requirements will be implemented by way of a notice from the RBNZ putting into effect the requirement in accordance with section 215 of IPISA.

## **Next Steps**

The consultation period will close at 5pm on Friday the 16th of December 2017. In the weeks following, all submissions that have received will be analysed and summarised in a report for consideration by management of the RBNZ.

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.

## 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
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?
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.
4. Please discuss the timeframes that you believe would be reasonable for the remediation of systems and processes identified as deficient by audit.
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?
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?
7. What types of insurers do you believe should be in-scope for an Insurer Return audit/review requirement, and why?
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?
9. Have you identified any benefits and costs (other than those listed in the introduction) of introducing an audit requirement for the Insurer Return?

## **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?

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?

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

What approach could work in practice?

## **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?

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

## **Annex A – Excerpt from ISAE 3000 s12**

- a. Reasonable assurance engagement—An assurance engagement in which the assurance practitioner reduces engagement risk to an acceptably low level in the circumstances of the engagement as the basis for the assurance practitioner’s conclusion. The assurance practitioner’s conclusion is expressed in a form that conveys the assurance practitioner’s opinion on the outcome of the measurement or evaluation of the underlying subject matter against criteria.
- b. Limited assurance engagement—An assurance engagement in which the assurance practitioner reduces engagement risk to a level that is acceptable in the circumstances of the engagement but where that risk is greater than for a reasonable assurance engagement as the basis for expressing a conclusion in a form that conveys whether, based on the procedures performed and evidence obtained, a matter(s) has come to the assurance practitioner’s attention to cause the assurance practitioner to believe the subject matter information is materially misstated. The nature, timing and extent of procedures performed in a limited assurance engagement is limited compared with that necessary in a reasonable assurance engagement but is planned to obtain a level of assurance that is, in the assurance practitioner’s professional judgement, meaningful. To be meaningful, the level of assurance obtained by the assurance practitioner is likely to enhance the intended users’ confidence about the subject matter information to a degree that is clearly more than inconsequential.

## **Annex B – Excerpt from Consultation Report dated 7/7/14**

- C1. There is a sign off requirement for the Insurer Returns as a whole by the CEO (or optionally by two directors on behalf of the Board). This is discussed further in Part 1.
- C2. Section 125 of the Act permits the Reserve Bank to require Insurer Returns to be audited or reviewed. At present, there are audit requirements in respect of annual financial statements and annual solvency return.
- C3. It is not proposed to require an audit or independent review of the Insurer Returns (other than the annual solvency return which is included as Part 4 Solvency Summary of the annual Form I01A).
- C4. Insurers are expected to provide high quality information to the best of their abilities, and to notify the Reserve Bank of any problems with providing accurate data (including all material errors identified subsequent to submission of any forms). Where relevant, annual or end of financial year figures should be able to be fully reconciled to audited financial statements and balances used in solvency calculations.
- C5. If the quality of Insurer Returns is found to be unacceptably low, the Reserve Bank may in future amend the requirements to include an audit or other independent review before Forms are submitted. There will be a consultation if this change is proposed in future.