



Background



LCP has advised clients in Australia for decades

Including Appointed Actuary roles

Actuarial specialist but also advises range of clients on all aspects of governance and risk management



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Agenda

Setting the scene

- Some history
- The regulatory environment in Australia
- The Financial Condition Report
- The opinion on the risk management framework

What does this mean for actuaries?

- And what can we learn?

The regulatory environment in Australia

... and the history that led them to it

- HIH Insurance
 - Founded in 1968
 - Expanded significantly up to 2000
 - Group of several insurance companies
 - Australia's second largest insurer with assets of A\$7.8bn
 - Wrote insurance in Australia, USA and UK
 - Compulsory and non-compulsory insurance
- HIH went into liquidation in 2001
 - Liquidators estimated deficiency as at 15 March 2001 was between A\$3.6bn and A\$5.3bn



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The regulatory environment in Australia

... and the history that led them to it

- Report by John Dingell in 1990 suggested that insurance companies fail due to:
 - ✓ rapid expansion
 - ✓ unsupervised delegation of authority
 - ✓ extensive/complex reinsurance arrangements
 - ✓ under pricing
 - ✓ reserve problems
 - ✓ false report
 - ✓ reckless management
 - ? incompetence
 - ✓ fraud
 - ? greed
 - ? self-dealing

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The regulatory environment in Australia

... and the history that led them to it

- HIH Royal Commission set up to perform public enquiry
- 7 senior management were sent to prison, 2 received suspended sentences and 1 got 500 hours community service
- Actuary banned by APRA in 2004 from holding any appointment as an actuary
- Institute of Actuaries Australia also suspended him for 12 months



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The regulatory environment in Australia

... and the history that led them to it

- Australian government bailout of United Medical Protection in 2002
 - UMP covered 60% of Doctors in Australia
 - Doctors threatened to down tools when UMP solvency was in question
 - Bailout effectively guaranteed unfunded IBNR
- Insurance industry still feeling effects of the late 1990s soft market and 9/11
- HIH Royal Commission report published in 2003 with recommendations



Stricter regulatory
environment



Reliance on...
Power for...



Actuaries!

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The regulatory environment in Australia

... and the history that led them to it

- Australian Prudential Regulation Authority (APRA) inception in 1998
- Regulation by reference to Insurance Act 1973
- Regulatory reforms approved by the government in November 2000 and took effect from 1st July 2002
- Intended to improve public confidence in industry via:
 - The shift to upgraded, risk-based capital adequacy requirements;
 - The checks and balances created by stronger governance standards; and
 - The universal 'health check' on all companies under the re-authorisation process.
- *(in addition, LAGIC capital regime came into effect from 1 January 2013)*

The regulatory environment in Australia

What does the stricter regulation involve?

Amongst other things, every insurer has to have:

- Insurance Liability Valuation Report (ILVR) each year by the "Appointed Actuary"
 - Hold liabilities at the greater of 75th percentile and central estimate + $\frac{1}{2}\sigma$
- External Peer Review on their ILVR each year
 - Rotated every five years
- Financial Condition Report (FCR) each year by the Appointed Actuary

... and requirements are much more onerous than we are used to in the UK



The Financial Condition Report

What does it consider?

“To provide an impartial assessment of the overall financial condition of the insurer”

Required to consider:

- business overview
- summary of the key reserving results and adequacy of past estimates
- pricing process and adequacy of premiums
- recent experience and profitability
- asset and liability management, including the investment strategy
- current and future capital adequacy and management and the Internal Capital Adequacy Assessment Process (*similar to the ORSA*)
- the adequacy of calculation of each element of the insurers capital requirement
- the suitability and adequacy of the reinsurance arrangements
- the suitability and adequacy of the risk management framework (RMF)

Source: APRA Prudential Standard GPS 320

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The Risk Management Framework

What is it?

*“‘risk management framework’ includes systems (including the structures, processes, policies and roles supporting them) for **identifying, assessing, mitigating** and **monitoring** the risks that may affect a regulated institution’s ability to meet its obligations to policyholders”*

Source: APRA Prudential Standard GPS 220

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The opinion on the RMF

Institute of Actuaries Australia’s Risk Management Practice Committee produced an Information Note on Actuarial Advice regarding Risk Management of a General Insurer

The note highlights the importance of Enterprise Risk Management:

“Enterprise Risk Management is the process by which organisations in all industries assess, control, exploit, finance, and monitor risks from all sources for the purpose of increasing the organisation’s short and long term value to its stakeholders.”

Link: http://www.actuaries.asn.au/library/Standards/RiskManagement/2012/RMPC_IN_ActuarialAdviceRiskManagementNov12.pdf

The opinion on the RMF

The note also encourages the Appointed Actuary to consider:

- 1. Risk appetite and related concepts
- 2. Risk management processes
- 3. Culture and capability
- 4. Risk management issues and exposures
- 5. Communication and managing conflicts of interest

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Actuaries
Institute

RISK MANAGEMENT PRACTICE COMMITTEE
Information Note: Actuarial Advice regarding Risk Management of
a General Insurer (SFS 220) or General Insurer (SFS 220)
November 2012

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Link: http://www.actuaries.asn.au/library/Standards/RiskManagement/2012/RMPC_IN_ActuarialAdviceRiskManagementNov12.pdf

1. Risk appetite and related concepts

Opinion on the risk management framework

- Risk appetite and risk appetite statement
- Integration of capital models and business' risk appetite and risk limits
- Alignment of and links between the following:
 - Risk appetite
 - Risk assessment
 - Risk monitoring
 - Capital management processes
 - Business plan and strategic objectives



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2. Risk management processes

Opinion on the risk management framework

- Findings of internal reviews
- Company's Risk Management Strategy and Policy
- Processes, procedures, documentation and systems supporting operation of RMF
- Processes used to inform Board / senior management of
 - Risk management issues
 - Policies and practices
- Ongoing reporting and monitoring requirements



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3. Culture and capability

Opinion on the risk management framework

- Risk management culture and level of staff engagement
- Management of conflicts of interest
- Responsibilities and structure of RMF
- Capabilities within functional units and within specialist RMF



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4. Risk management issues and exposures

Opinion on the risk management framework

- Previous risk management issues addressed in a timely manner
- Key risk management issues arising over year and quality of response(s)
- Internal and external views on the RMF
- Risks to which the company is exposed or contributes
- Fundamental complexity
- Horizon-scanning
- Response to identification and potential impact of “extreme” events
- Compliance with Prudential Standards



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5. Communication and Conflicts of Interest

Opinion on the risk management framework

- Opinion will be based on actuary's judgement
- Be clear on how that judgement arises and can be supported
- Communicate proactively, especially if RMF is materially inadequate or unsuitable
- Recognise and manage potential conflicts of interest that may arise



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What does this mean for Actuaries?

Australia vs UK

The requirements are both **onerous** and **intimate**

... like asking an outsider to opine on whether my baby is ugly

- Would actuaries be seen as the go-to experts in the UK?
- Issues include:
 - More responsibility (liability?)
 - Wider knowledge base
 - Additional skills
 - Different style of communication
 - Complications for both internal and consulting actuaries



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And what can we learn?

Parallels with Solvency II

- Solvency II is all about building effective risk management frameworks!
- Opportunity vs simple compliance
- Australia ahead of the curve? Already embedded processes/guidance could help us
- Solvency II reporting: Solvency and Financial Capital Report
 - Business & performance
 - System of governance
 - Risk profile
 - Valuation for solvency purposes
 - Capital management
- Additional reporting requirements from the PRA?



Source: EIOPA Final Report on Public Consultations No. 11/009 and 11/011 On the Proposal for the Reporting and Disclosure Requirements

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Discussion/questions?



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Scope

- This generic presentation should not be relied upon for detailed advice or taken as an authoritative statement of the law.
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