

IAIS Consultation

Print view of your comments on "Draft Application Paper on Supervision of Control Functions" -
Date: 25.03.2021, Time: 21:39

Organisation	International Actuarial Association
Jurisdiction	International
Role	Other (not IAIS Member)
Email	amali.seneviratne@actuaries.org
Phone	+1-613-219-0394
Treat my comments as confidential	No

Question	
	Q1 General comment on the draft Application Paper
Answer	<p>The IAA believes this AP provides useful insights for supervisors as they assess the work of insurer control functions (e.g., risk management, compliance, actuarial, internal audit) etc.. The AP usefully addresses many of the practical supervisory issues that span the control functions. The IAA understands why the internal audit control function was singled out for emphasis in the AP however, the other control functions received little specific reference. For example, the actuarial function is mentioned briefly 8 times in the paper but 3 of those are simply within a list of the other control functions. The IAA believes that supervisors with little or no actuarial expertise are in need of practical guidance on how to assess the effectiveness of this control function. In our comments to this AP the IAA suggests some specific practices that may be useful. Additional IAA publicly available resources include an IAA Risk Book chapter on the « Actuarial Function ».</p> <p>In general, the IAA notes that it supports a principle-based approach leaving it up to the insurer to set up a risk management system that is appropriate and adequate to accomplish the tasks assigned to the control functions. The IAA observes that some of the guidance in this application paper could be misinterpreted to impose stronger constraints. For example, the IAA believes that the organizational structure of the control functions and the positioning of the Key Persons in Control Functions should generally be at the discretion of the insurer.</p>
	Q2 General comments on Section 1: Introduction
Answer	<p>The IAA notes that the word 'effective' features prominently in ICP 8 (i.e., 'The supervisor requires an insurer to have, as part of its overall corporate governance framework, effective systems of risk management and internal controls, including effective functions for risk management, compliance, actuarial matters and internal audit.' – emphasis added). The IAA suggests that the AP could usefully include a section of practical techniques supervisors can use in making this assessment. It is also important that the supervisor takes the work already performed by the insurer on this aspect into consideration, so as to prevent unnecessary double-checking. It is also the task of the insurer itself and more specifically the control functions themselves to evaluate their effectiveness. The paragraphs 36 and 58 contain some high-level questions and indicators for this exercise. The IAA notes that much of the language in this AP makes reference to insurers. In our comments the IAA has assumed that the AP equally (or appropriately) applies to reinsurers as well. Perhaps this point could be made clear in the introduction to the AP.</p>
	Q3 Comment on paragraph 1
Answer	

	Q4 Comment on paragraph 2
Answer	<input type="text"/>
	Q5 Comment on paragraph 3
Answer	<input type="text"/>
	Q6 Comment on paragraph 4
Answer	<input type="text"/>
	Q7 Comment on paragraph 5
Answer	<input type="text"/>
	Q8 Comment on paragraph 6
Answer	<input type="text"/>
	Q9 Comment on paragraph 7
Answer	The IAA notes that while assessing the effectiveness of control functions is mentioned several times in the AP as an important supervisory objective, it appears not to be identified as a key topic in the list provided in this paragraph. The IAA believes there is considerable valuable guidance that can be provided to supervisors to assist them in assessing the effectiveness of the actuarial function. Recently the IAA in conjunction with the IAIS and A2ii conducted a webinar for supervisors on « Using Actuarial Reports – Getting the Added Value ».
	Q10 General comments on Section 2: Role of control functions
Answer	<input type="text"/>
	Q11 Comment on paragraph 8
Answer	<input type="text"/>
	Q12 Comment on paragraph 9
Answer	<input type="text"/>
	Q13 Comment on paragraph 10
Answer	The IAA believes that effective communication and cooperation between the first and second lines of defence is important to the proper functioning of the control functions. For example, the actuarial function should ensure that pricing and valuation of liabilities work have equal access to relevant experience data and make consistent use of that data in making business decisions.
	Q14 Comment on paragraph 11
Answer	<input type="text"/>
	Q15 Comment on paragraph 12
Answer	<input type="text"/>
	Q16 Comment on paragraph 13

Answer

The IAA believes that the reference made in this paragraph to the actuarial function may cause confusion regarding the issues raised. The IAA recommends the IAA Risk Book Chapter on the « Actuarial Function » as it provides relevant and useful guidance for supervisors. In discussing the actuarial function, paragraph 13 comments that actuarial function responsibilities may straddle the first and second lines of defence and further suggests that pricing lies within the first line and valuation of liabilities lies in the second.

The IAA suggests this characterization is incorrect. The IAA would be pleased to assist the IAIS in improving the wording of this paragraph. A more accurate series of statements may include the following: - Actuaries are involved in many aspects of work within an insurer (e.g. pricing, underwriting, marketing, investment, claims, valuation of liabilities, risk and capital management etc.) - Actuaries may be involved in each of the lines of defence within an insurer. - The actuarial control function as defined by the IAIS refers to work in the second line of defence. - Actuarial work related to pricing, valuation may be frequently carried out within the operational business units (first line of defence) of the insurer but should be subject to overall control by the actuarial control function (second line of defence). - In their review of the actuarial control function, supervisors seek the person(s) responsible for the second line of defence task of controlling actuarial work/processes (e.g., pricing, valuation of liabilities etc.) - The person(s) responsible for the actuarial control function should not have significant operational duties (first line of defence) which will conflict with their second line of defence role.

Q17 Comment on paragraph 14

Answer

This paragraph accurately indicates that smaller insurers tend to outsource one or more control functions (e.g., actuarial function). However, the closing sentence indicates this may create supervisory challenges. The IAA suggests this presents a one-sided view of the business decision to outsource and the sentence should be amended. A decision to outsource (e.g., actuarial function) results from a balancing of the advantages and disadvantages of doing (not doing) so. For example, outsourcing provides access to specialized expertise for certain required tasks on a contract basis that the insurer might not be able to secure or afford from a full time employee. A possible related disadvantage is that a contractor may not have sufficient proximity to or knowledge of the insurer's circumstances. As a result, communications between the insurer (or supervisor) and the contractor may be less effective. The IAA has provided further comment on this issue of outsourcing under the relevant section later in this response.

Q18 Comment on paragraph 15

Answer

Q19 Comment on paragraph 16

Answer

Q20 Comment on paragraph 17

Answer

Q21 Comment on paragraph 18

Answer

The IAA suggests that in the first line of this paragraph that the words « effective internal controls system » be replaced with the words used in ICP 8 (i.e., effective systems of risk management and internal controls). The IAA also suggests that the wording of this paragraph can lead the reader to the conclusion that assessing the effectiveness of a control function lies principally in observing two fundamental qualities – independence and stature. While the IAA agrees these are important, supervisors should also seek to validate their assessment in other ways (e.g. communications/decisions between operational areas and the control function, review of key work, role of control function during key risk discussions, engagement in insurer risk management and governance, supervisory comparison of peer control functions at other insurers etc.).

Q22 Comment on paragraph 19

Answer	<input type="text"/>
	Q23 General comments on Section 3: Independence of control functions
Answer	<input type="text"/>
	Q24 Comment on paragraph 20
Answer	<input type="text"/>
	Q25 Comment on paragraph 21
Answer	<input type="text"/>
	Q26 Comment on paragraph 22
Answer	<p>The IAA notes that independence may be achieved by outsourcing a control function but this independence can be compromised if the outsourcer is too dependent on retaining the firm as a client such that it is wary of being too critical or unsupportive of management. The outsourcing of a control function such as the actuarial function can be chosen to secure cost effective access to technical skills and expertise that may not exist or be affordable to an insurer. In this situation it is also important that the outsourced function be able to demonstrate its knowledge and control of relevant actuarial processes within the insurer. The IAA suggests that the third bullet may need to be expanded to clarify some of the types of performance related remuneration. For example, does it include stock ownership?</p>
	Q27 Comment on paragraph 23
Answer	<input type="text"/>
	Q28 Comment on paragraph 24
Answer	<input type="text"/>
	Q29 Comment on paragraph 25
Answer	In the second bullet, delete the 's' at the end of 'Controls'.
	Q30 Comment on paragraph 26
Answer	<input type="text"/>
	Q31 Comment on paragraph 27
Answer	<p>It is stated in this paragraph that the responsibilities of the risk management function and the actuarial function could conflict as regards quantitative risk measurement. The paragraph paints this situation as a concern for supervisors. The IAA believes this is an incorrect view of the vast majority of cases in which CRO's and actuarial functions (i.e., second line of defence) interact constructively to share their perspectives on the risks of the insurer.</p>
	Q32 Comment on paragraph 28
Answer	<input type="text"/>
	Q33 Comment on paragraph 29
Answer	<input type="text"/>

	Q34 Comment on paragraph 30
Answer	<input type="text"/>
	Q35 Comment on paragraph 31
Answer	<input type="text"/>
	Q36 Comment on paragraph 32
Answer	<input type="text"/>
	Q37 Comment on paragraph 33
Answer	<input type="text"/>
	Q38 Comment on paragraph 34
Answer	<input type="text"/>
	Q39 General comments on Section 4: Stature of control functions
Answer	<input type="text"/>
	Q40 Comment on paragraph 35
Answer	The IAA agrees with the importance of stature for a control function, that the person(s) involved have the necessary skills, experience and respect for their role. The IAA notes that, on occasion, titling of positions can confuse supervisors (or other outside stakeholders) as to the person(s) who truly are responsible for a control function (e.g. in some jurisdictions the head of the actuarial function need not be formally designated by the Board to the supervisor). An additional challenge is that titling is not consistent across companies.
	Q41 Comment on paragraph 36
Answer	The bullets in this paragraph are most useful for supervisors and can help them assess the effectiveness of the control function. For example, in assessing the effectiveness of the actuarial function a practical supervisory technique can be (as suggested in the last 2 bullets) to discuss with the actuarial function their concerns, findings and recommendations and how they were handled/resolved within the insurer. The responses will help to reveal the effectiveness of the control function.
	Q42 Comment on paragraph 37
Answer	<input type="text"/>
	Q43 Comment on paragraph 38
Answer	<input type="text"/>
	Q44 Comment on paragraph 39
Answer	<input type="text"/>
	Q45 Comment on paragraph 40

Answer The IAA suggests that the key point to be made is that supervisors assess whether an appropriate balance is in place between the various control functions (level 2) and the operational (level 1) activities of the insurer. Having either one of them dominate the other may ultimately be harmful to protecting policyholders.

Q46 Comment on paragraph 41

Answer The IAA supports the IAIS view that assessing the effectiveness of a control function is not straightforward. In reviewing the different approaches used by supervisors, the IAA suggests that some (e.g. periodic on-site reviews) are likely to provide much more pertinent information about control function effectiveness than others (e.g. desk reviews of filed documents). It is true the latter can be helpful but without follow-up, they may not provide sufficient evidence by themselves of control function effectiveness. The IAA suggests this be pointed out in the AP.

Q47 Comment on paragraph 42

Answer The IAA is supportive of the bullet points made in this paragraph but suggests there is need for an additional bullet identifying how control issues, key risks etc., were handled; evidence of governance and risk management discussions; and evidence of linkages with both senior management and operational units.

Q48 Comment on paragraph 43

Answer This paragraph indicates it can be difficult for supervisors without their own actuarial expertise to assess the skills and experience of an insurer's actuarial function. The IAA understands that having access to such expertise would be beneficial to supervisors. However, the IAA notes that actuaries commonly have a duty to report on their work and 'any communication should be appropriate to the particular circumstances and take the skills, understanding, levels of relevant technical expertise, and needs of the intended user into consideration to allow the intended user to understand the implications of the actuary's communication' (ISAP 1). Supervisors can gain an understanding of the skills and experience of the actuarial function in a variety of ways including, - Disclosure by the actuary(ies) involved of their professional qualifications, work experience, - References from current and past employers/clients - Examples of current reports, findings, recommendations etc. - Comparison of high-level work product against peers in the industry. - Feedback from Board members on their ability to understand the communications from the actuary

Q49 Comment on paragraph 44

Answer It can also be difficult for small teams to have skills and experience in all aspects of actuarial work that may be needed, and this is where having the facility and budget to get additional support from external consultants can be beneficial, notwithstanding the outsourcing governance challenges which are covered elsewhere in the paper.

Q50 Comment on paragraph 45

Answer

Q51 Comment on paragraph 46

Answer

Q52 Comment on paragraph 47

Answer

Q53 Comment on paragraph 48

Answer	<input type="text"/>
	Q54 Comment on paragraph 49
Answer	<input type="text"/>
	Q55 Comment on paragraph 50
Answer	<input type="text"/>
	Q56 Comment on paragraph 51
Answer	<input type="text"/>
	Q57 Comment on paragraph 52
Answer	<input type="text"/>
	Q58 Comment on paragraph 53
Answer	<input type="text"/>
	Q59 Comment on paragraph 54
Answer	<input type="text"/>
	Q60 General comments on Section 5: Internal audit function
Answer	The IAA recognizes the very important work of the internal audit function and the valuable guidance provided in section 5 but wonders why there is no specific guidance provided for the other control functions. The IAA suggests that the AP provide sufficient practical examples for each of the control functions, not just the actuarial function or internal audit.
	Q61 Comment on paragraph 55
Answer	<input type="text"/>
	Q62 Comment on paragraph 56
Answer	The IAA suggests that this paragraph (or a neighbouring one) mention the need for internal audit to have access to an appropriate diversity of expertise (e.g. actuarial, accounting etc.) to properly review the insurer's internal controls. While it is unlikely that an internal audit function could employ sufficient staff to directly address this diversity, some internal audit functions effectively make use of individuals with the relevant skill set who are seconded on a project basis from other areas of the insurer.
	Q63 Comment on paragraph 57
Answer	<input type="text"/>
	Q64 Comment on paragraph 58
Answer	The IAA suggests that another possible bullet relates to whether internal audit reviews demonstrate a lack of technical skills to properly assess the controls (see IAA suggestion for paragraph 56). The list here and the list in paragraph 36 could be more aligned as they appear to serve the same purpose.
	Q65 Comment on paragraph 59

Answer	
	Q66 Comment on paragraph 60
Answer	
	Q67 Comment on paragraph 61
Answer	
	Q68 Comment on paragraph 62
Answer	
	Q69 Comment on paragraph 63
Answer	
	Q70 Comment on paragraph 64
Answer	
	Q71 Comment on paragraph 65
Answer	
	Q72 Comment on paragraph 66
Answer	The IAA notes that the second sentence appears circular and should be dropped or re-worded.
	Q73 Comment on paragraph 67
Answer	
	Q74 General comments on Section 6: Combination of control functions
Answer	
	Q75 Comment on paragraph 68
Answer	The IAA notes that this paragraph appears to set the norm that key persons in control functions do so without overlap with other control functions. While this may be desirable and practical for large insurers, it is not always practical for many insurers. In addition, some insurers, even large ones have found useful synergies between some of their control functions (e.g., risk management and actuarial function). Of course, the larger and more complex the insurer, the larger and more complex the work for each control function and the value of separating the control functions.
	Q76 Comment on paragraph 69
Answer	
	Q77 Comment on paragraph 70

Answer	This paragraph indicates it is important for there to be separation of control functions from senior management. This reference (i.e., from ICP 8.3.10) appears to ban Chief Risk Officers from heading the risk management control function as well as serving on the senior management team. The same could be said for an insurer's chief/appointed actuary if they were also head of the actuarial function. The IAA suggests that this forced separation of duties may not be wise for insurers. The IAA notes that subsequent paragraphs 78 and 79 appear to support the IAA view of the need for flexibility in this regard,
	Q78 Comment on paragraph 71
Answer	
	Q79 Comment on paragraph 72
Answer	
	Q80 Comment on paragraph 73
Answer	The IAA notes that this paragraph allows for the head of the control function (e.g., actuarial function) of an insurer within an insurance group to also serve as head of the control function for the group. The IAA believes this may be a viable and pragmatic choice for the head of the insurance group as its actuarial function duties may not be full time and could indeed be filled by the head of the actuarial function of the largest insurance entity in the group (for example). Of course, the named head of the actuarial function would need to adhere carefully to conflict of interest guidelines.
	Q81 Comment on paragraph 74
Answer	
	Q82 Comment on paragraph 75
Answer	The IAA understands the organizational challenges expressed in this paragraph (and others). Where full segregation of duties between key staff is not possible due to the small size of insurer, it may be helpful and practical if such staff are subject to a matrix of responsibilities and reporting relationships. For example, if the head of the actuarial function reported to a member of the senior management team (e.g., CRO or CFO) for most purposes yet also had a dotted line ability to report to the Board, this would help to ensure that the actuarial function was free to report on relevant matters without undue pressure from senior management.
	Q83 Comment on paragraph 76
Answer	
	Q84 Comment on paragraph 77
Answer	
	Q85 Comment on paragraph 78
Answer	The distinction between this paragraph and the former section is not clear. What is the difference between "responsible for carrying out operational tasks or operational functions" and a "Senior Management function"?
	Q86 Comment on paragraph 79
Answer	

Q87 General comments on Section 7: Outsourcing of control functions

Answer

Q88 Comment on paragraph 80

Answer

The IAA suggests that 'are' in the first sentence be replaced with 'may include some combination of'.

Q89 Comment on paragraph 81

Answer

Q90 Comment on paragraph 82

Answer

The bullets in this paragraph should highlight the continuing ultimate insurer responsibility for any outsourced control function work.

Q91 Comment on paragraph 83

Answer

The IAA notes that, while there may be benefits of outsourcing (as mentioned in paragraph 80) in respect of access to skills, expertise and resources, these benefits may only be delivered if there is an adequate budget for those services. The IAA notes that the last bullet in this paragraph may have general applicability across control functions if the bullet ends after the word 'circumstances'.

Q92 Comment on paragraph 84

Answer

The IAA notes that it is important that the outsourcing agreement gives unfettered access to internal audit to the relevant activities of the outsourcer.

Q93 General comments on Section 8: Group-wide control functions

Answer

Q94 Comment on paragraph 85

Answer

Q95 Comment on paragraph 86

Answer

The IAA suggests the need for a bullet referring to the challenges of the group-wide control function (e.g., actuarial function). One of the issues faced by the actuarial function of the group is maintaining group-wide actuarial practices and standards while respecting the corporate culture (i.e., centralized, decentralized etc.) within the group.

Q96 Comment on paragraph 87

Answer

Q97 Comment on paragraph 88

Answer

Q98 Comment on paragraph 89

Answer

Q99 Comment on paragraph 90

Answer

Q100 Comment on paragraph 91

Answer

Q101 Comment on paragraph 92

Answer

Q102 Comment on paragraph 93

Answer