

Draft Public Disclosure Standard for Insurers

Initial thoughts on its value, costs and opportunities

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The Prudential Authority (PA) published in July the draft Prudential Standard on public disclosures for insurers (PDI) and related guidance notice (GN) for public comment.

This briefing note provides a brief background to the PDI and our initial thoughts on the latest draft.

Introduction

In order to make informed decisions relating to an insurer, stakeholders need relevant and reliable information.

The draft PDI objectives are “to set out the information that insurers are required to disclose to the public in order to promote market discipline and an understanding of the risks to which insurers are exposed to, as well as the manner in which those risks are managed.”

Public stakeholders include those buying insurance products (policyholders), advising on insurance products (brokers or financial advisors) and those involved in investing or lending to insurers (i.e., investors, lenders, analysts and credit rating agencies). Insurers also benefit from insights into their competitors.

Increased access to information facilitates more efficient markets, increases competition and can align and even raise the industry standards of financial reporting, governance, risk and capital management. However, providing too much information can be costly for insurers, and may even make it harder for stakeholders to distil the information they need. Furthermore, these additional costs can hurt small insurers more, increase barriers to entry for new entrants and therefore could dampen competition and transformation in the insurance market.

Careful consideration is therefore needed of what information is required for each stakeholder, the format, reliability, ease of access and effort to produce.

Background

INSURANCE ACT (2017) REQUIREMENTS

Section 45 of the Insurance Act (2017) requires insurers (and controlling companies) to annually publicly disclose the required quantitative and qualitative information in the form and manner prescribed by the PA. The detailed requirement is to be set out in the PDI prudential standard.

PREVIOUS PUBLIC REGULATORY REPORTING

Before 1 July 2018 when the previous regulatory regime was still in effect, insurers submitted an annual quantitative return and qualitative return to the regulator (the PA’s predecessor, the Financial Service Board or FSB). These returns contained public and non-public statements. On request, the FSB would release the public information. This previous public information included less than is proposed in the current draft PDI.

NO INTERIM PUBLIC REGULATORY REPORTING

Once the new Solvency Assessment and Management (SAM) regime of the Insurance Act (2017) went live in 2018, the previous source of public information through the FSB returns fell away. With the PDI still in development, the PA did not prescribe any interim public reporting requirement.

Some of the information required by the draft PDI and/or previous regulatory returns may be contained in insurer’s annual financial statements (AFS) and other investor reporting, but this is also limited to insurers who publicly publish their reports. The inclusion of the Statutory Actuary’s report in the AFS is also no longer a requirement due to change in the Companies Act.

Finalising the PDI is therefore long overdue to address the lack of public information and improve on what was previously available.

PREVIOUS DRAFT PDI

The first draft of the PDI was released for public comment in 2017. There have been no developments until now—likely due to other regulatory priorities. The latest draft PDI appears to be an overhaul of this earlier draft.

Overview of the draft PDI

OVERVIEW OF REQUIREMENTS

Below is a high-level summary of the key items in the draft PDI.

Audit and review requirements

- Audit required of disclosed information in accordance with the Prudential Standards ARI—audit requirements for insurers.
- Independent review also required.
- Minimum two senior executive officers at board level to attest in writing that the disclosures have been prepared in accordance with board-approved internal controls and that an independent review has been conducted.

Timing, format and exceptions

- Publish on publicly available website within four months of financial year-end.
- No prescribed format except where applicable quantitative information should be in the same format as the annual QRT and all other information should meet certain prescribed principles.
- Insurers can request approval for non-disclosure of information deemed proprietary or confidential.

Specific information required

- Company profile
- Corporate governance framework
- Technical provisions
- Insurance risk exposures
- Financial instruments and other investments
- Investment risk exposure
- Asset and liability management
- Liquidity risk
- Capital adequacy
- Financial performance
- Operational risk

LEVERAGING INTERNATIONAL PRACTICE

The draft PDI is based on the Insurance Core Principle (ICP) 20 on public disclosures of the International Association of Insurance Supervisors (IAIS).¹ The ICPs were established in 2011 with various subsequent amendments including the 2019 revision of ICP 20.² The ICPs are structured as principle statements (essential elements), standards (fundamental high-level requirement) and guidance (not a requirement, but recommendation or suggestions). The ICPs strive to set out a high supervisory standard level.

The PA appears to have made most of the ICP 20's guidance into a requirement in the draft PDI.

Disclosure of information about an insurer's operational risk management has been included in the draft PDI. This is not included under ICP 20.

The ICP 20 and draft PDI are more extensive than the European Union's Solvency II public disclosure requirements, including the latest proposed amendments under the 2020 review.³

By using the ICP 20 as a basis, the PA appears to want South African insurers to align to some of the highest international standards.

Initial thoughts

The PDI will provide much needed useful information to the public.

The following section covers our initial thoughts on areas of likely challenge, possible pushback from the industry as well as areas that may require further consideration. This includes our observations of Solvency II and IAIS developments on public disclosures.

CONSIDERATION OF SOLVENCY II DEVELOPMENTS

Solvency II public disclosure requirement takes the form of a Solvency and Financial Condition Report (SFCR). European insurers have been publishing their SFCRs since 2016 when Solvency II went live.

While the Solvency II public disclosure requirements are different from the draft PDI, it is still useful to consider the feedback on the SFCRs including the detailed Solvency II 2020 review (as discussed earlier).

We consider some of the key feedback points in the remaining sections where relevant.

BALANCING DIFFERENT STAKEHOLDER NEEDS

The draft PDI requires: *"information must be appropriately detailed in order to provide policyholders and market participants with a view of the business activities, risks, performance and financial soundness position, risk exposures and risk management as well as the governance framework of the insurer."*

Careful consideration needs to be given as to how to ensure the reporting is useful to the two distinct audiences, i.e., policyholders who are typically not technical and market participants (e.g., analysts, investors, competitors and credit rating agencies) who are more technically sophisticated.

This was one of the main areas of concern identified in the Solvency II 2020 review. The 2020 review proposal is to split the report into two distinct sections—the first being a shorter section directed at the policyholder and the second section containing more detailed information for the technical audience.

AUDIT AND REVIEW REQUIREMENTS NOT CLEAR

Some level of audit or review will improve the reliability of published information.

The draft PDI states: *"the information required to be disclosed to the public and as prescribed in this Standard, must be audited and reported on by the auditor of the insurer. The audit of information prescribed in this Standard, shall be in accordance with Prudential Standard ARI - Audit requirements for Insurers and ARG – Audit requirements for Groups."*

¹ IAIS ICPs and ComFrame adopted in November 2019

² Public consultation comments on draft revised ICP 20

³ EIOPA Consultation Paper on proposals for Solvency II 2020 review: Package on Supervisory Reporting and Public Disclosure – Solvency and Financial Condition Report

The draft PDI also requires an independent review of the information disclosed. No detail of the review requirements is provided.

“At least two senior executive officers at a board level” need to also attest that the disclosures have been prepared *“in accordance with board-approved internal controls and that an independent review has been conducted.”*

There are no audit requirements currently for Solvency II, although some member states have introduced their own. These range from the balance sheet solvency capital requirement (SCR), minimum capital requirement (MCR) and Eligible Own Funds (EOF) to only the balance sheet. The latter is the audit requirement proposal under the Solvency II 2020 review. There are also no independent review requirements in Solvency II.

ICP 20 does not include any audit or review requirements or suggestions, except for the availability of audited financial statements.

The following are our views on areas needing further clarity or consideration:

- It is not clear if the audit scope is only limited to the quantitative elements and if this is further limited to that listed in the current (draft) ARI.
- Detail on the requirements of the independent review is needed. Presumably the review would rely on items covered in the audit scope.
- The PA may want to consider only requiring an independent review of the information. The independent reviewers can tie back relevant numbers to the audited AFS and QRT. There is also no detail on who can perform the review, e.g., can this be internal audit or must this be an external party.
- An insurer’s board may not necessarily have at least two executive directors as this is not a requirement elsewhere.

FURTHER CONSIDERATIONS ON AVAILABILITY AND FORMAT

The draft PDI requires the publicly disclosed information to be available *“through a website that is publicly accessible.”*

The draft PDI does not specify the format of the information, but requires the following:

- The information must be appropriately detailed.
- The information disclosed must be timely, comprehensive, meaningful, reliable, comparable to other insurers in the same market and consistent over time.
- Where quantitative information is also included in the annual Quantitative Reporting Template (QRT), this information should be disclosed in the same format as the QRT.
- The format for the presentation of qualitative information is not prescribed. Where the required information is not in the

QRT, the insurer must disclose the required information in a format that is most suitable to present the qualitative information that is consistent with the principles above.

The following are possible further considerations to enhance the ease of access, usefulness and understanding of the information:

- Require a **standardised report structure**. Solvency II specifies the structure of the report (level 1 and level 2 headings). This makes it easier to compare reporting between insurers and from one period to the next. If information is not applicable, this should be explicitly stated. Where the required information is available in other published documents (e.g. AFS), some Solvency II insurers have simply referenced these documents in the SFCR rather than copying the information in the SFCR. This has frustrated some SFCR users in needing to refer to multiple documents.
- **Avoid unnecessary generic wording**. Insurers should provide firm specific information. Where it is necessary to include generic wording, the PA may want to consider prescribing standard wording to accompany certain quantitative information.
- Use of **machine-readable format** will make it easier for users to perform analyses on the information. At the very least, any quantitative extracts of the QRT included in the public disclosures should be made available in XBRL or Microsoft Excel format, as is also required under Solvency II.
- One of the significant uses of the public disclosures is to perform comparative industry analyses. Therefore a **central repository** on the PA’s website with all insurers’ public disclosures will allow market participants easier access to this information. Some Solvency II member states have this in place.
- Set a **minimum time period for the public disclosures to be available**. Often users of the information will want to look at the history of the insurer. Therefore it would be useful to have access to prior reporting. Solvency II is proposing a five-year period.

If the information is sufficiently valuable to justify the effort of creating reports and publishing it, then it should be packaged in a way to be efficiently analysed.

PROPRIETARY AND/OR CONFIDENTIAL INFORMATION CONCERNS

The draft PDI requires detailed information. We expect many insurers to be concerned with some of this being commercially sensitive. This was observed in the feedback from the recent ICP 20 consultation process. There may be stronger pushback from the local industry given that the PA appears to have elevated the ICP 20 guidance (recommendation or suggestions) to requirements in the draft PDI.

The draft PDI does however make provision for insurers to apply to the PA for non-disclosure of any information required

that the insurer deems proprietary or confidential. No information has been provided on how this will be assessed—insurers should look to get clarity from the PA on this before the PDI is finalised.

Depending on where the final PDI lands, there could be some initial approval burden for insurers and the PA.

There is also the possibility of moving some of the information considered too commercially sensitive into the annual Qualitative Reporting Requirement (QRR) that is submitted to the PA—to the extent this is considered necessary information for supervisory purposes.

BALANCING VALUE WITH ADDITIONAL WORK AND COST

There will be a cost to establishing the public reporting process as well as ongoing costs to perform the reporting including the audit and independent review.

Listed insurers will likely have the least effort to establish the public disclosure reporting. They will be able to leverage existing internal and external reporting processes and automation.

Smaller, unlisted insurers will likely have more work and costs to set up, and many of these costs are fixed and therefore will not scale down to their smaller size. This will place greater financial and resource burdens on smaller insurers. While this may be justified if the access to information is beneficial, we expect pushback from smaller insurers in general, and on whether a smaller unlisted insurer should need to produce the same extent of information as a larger listed insurer. Unfortunately, smaller insurers are also less likely to commit resources to comment on draft regulation. This may lead to late complaints and poorly planned projects to implement the final requirements.

LIKELY INITIAL PRESSURE ON REPORTING TEAMS

Insurers are required to provide the public reporting within four months of their year-end. Insurers will need to ensure they are able to accommodate the additional work in their existing reporting, internal review, and external audit timetables.

The public disclosures will leverage existing reporting such as the annual QRT, AFS and the Own Risk and Solvency Assessment (ORSA) report. Therefore, insurers will also need to carefully manage reporting dependencies, version control and allow for audit and review time.

With insurers also preparing for IFRS 17 (effective 1 January 2023), it may be a few years before insurers get into a business-as-usual reporting cycle.

REFINEMENTS TO TAILOR TO SOUTH AFRICAN INDUSTRY

Some refinement of the wording in the draft PDI may be required to ensure it is consistent with SAM. For example, the draft PDI references “risk adjustment” rather than “risk margin” under technical provisions methodology.

Conclusion

Finalising the PDI is long overdue to address the lack of public information which can inform stakeholders, promote market discipline and promote capital market efficiencies.

The draft PDI has set the bar high. We expect some further refinements following the public consultation process. Some likely areas of challenge, potential pushback and areas of further consideration include:

- Balancing different stakeholder needs
- Clarity on audit and review requirements
- Further considerations on availability and format
- Concerns on proprietary/confidential information
- Balancing value with the additional work and cost
- Initial pressure on reporting teams
- Refinements to tailor to South African industry

Developments internationally should also provide useful insights while considering local market needs.

Careful consideration is needed of what information is required for each stakeholder, the format, reliability and ease of access. This is also an opportunity to push towards electronic interchange formats to ensure the potential value to stakeholders of information can be realised.

There are going to be costs to establishing the required reporting and ongoing production. However, this should be an overall positive outcome for the industry provided the information meets the required objectives.

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