Discussion Note

The Role of the Risk Function in Life Insurance Product Sustainability

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Disability Insurance Taskforce of the Actuaries Institute

Actuaries Institute

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About the Authors

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Contents

1. Executive Summary

Since 2019, there has been heightened attention from the life insurance industry to issues of product sustainability. This discussion note ("Note") has been prepared to assist life insurance Chief Risk Officers (CROs) and risk functions with guidance as to their roles in product sustainability and is intended to be useful to all practitioners, regardless of professional background. It has been written anticipating that CROs may choose to share it or parts of it with their key stakeholders, including Boards of life insurers.

This Note has sought to distinguish between the role of the life insurance CRO and the Appointed Actuary (AA) in relation to product sustainability, as well as to provide suggestions and guidance with respect to the Risk Appetite Statement (RAS) and risk management related activities across the value chain. While this note is primarily focused on direct insurers, which design and distribute products, it is relevant for reinsurers, which have an influence on insurers and are also exposed to product sustainability risk.

This Note is intended to be applicable across all main product lines sold by life insurers.

Life insurers are not uniform and so it is expected that each user will tailor the information in this Note to their company's specific circumstances.

In this Note, as in the Actuaries Institute "IDII – the sustainability guide"[1], the words sustainable and sustainability should be read in the following context:

- Products that perform as expected by customers, with features that, compared with the past:
  - a) better meet their needs without frills, and reflect their insurable interests – both on policy inception and subsequently, and at individual and community levels; and
  - b) provide more certain outcomes and are more readily understood.
- Prices for customers that are more stable and predictable over time, better understood and more consistent with underlying risk, compared with the present situation;
- Product features and underwriting that:
  - c) promote alignment between customer and insurer through appropriate consideration of each customer's insurable interests; and
  - d) support loss minimisation at time of claim.
- Financial outcomes for insurers that ensure a sustained ability to pay claims and that are sufficient to ensure insurers will continue to compete and provide valuable products to the market; and
- Community confidence as to the enduring value and fairness of life insurance.

The Role of the CRO and AA in Product Sustainability

Both the CRO and AA have important roles in promoting product sustainability and overlaps in activities can emerge in practice. The extent of any overlap will vary by life insurer. Given there is no one right structure for all life insurers, this Note suggests that the CRO and AA discuss and clarify their respective responsibilities in a variety of practical situations and that the Board, to whom they are responsible, has clarity over roles. Appendix B sets out a view of possible high-level responsibilities for the CRO and the AA across key areas of product sustainability.

1 See, Disability Insurance Taskforce of the Actuaries Institute: Individual Disability Income Insurance Sustainability Guide (2022).

Suggestions and Guidance

The following suggestions and guidance have been provided.

Risk Appetite Statement

Insurers often face a tension between product designs that meet sustainability goals on the one hand and are commercially viable in a competitive market on the other. The Risk Appetite Statement (RAS) could be used to define product sustainability (from a consumer and insurer perspective) and clarify the Board-approved risk appetite. This will assist to ensure that both sides of this tension are given suitable weight in the decision-making process and the Board's product sustainability appetite is considered when making product sustainability decisions. CROs should consider appropriate statements, metrics and limits to propose for the Board to include in the RAS and an approach to assessing product sustainability risk.

Product Sustainability within the Value Chain

Responsibility for risk management actions and decisions rests with the business and the CRO and risk function should focus on the oversight, review and challenge of product sustainability risk as part of the life insurer's Risk Management Framework (RMF). In relation to product sustainability, this Note considers good practice for key areas of the value chain and the specific actions a risk function may take to improve product sustainability decision making. These actions are considered across the value chain as well as specific actions within each component of the value chain.

The parts of the value chain considered in this Note are:

1. The Product Development and Pricing Cycle
2. Reviewing of Experience and Setting Assumptions
3. Underwriting
4. Claims Management.

Reporting and monitoring practices in relation to product sustainability are also covered.

Conclusion

While there has been significant attention by life insurers to improving practices around management of product sustainability risks, there remains the need for an uplift in practices. Risk professionals can assist the business to take an enterprise-wide view of product sustainability. In providing challenge, advice, and review of business activities specific to product sustainability, they can help ensure that the life insurance industry continues to provide a valued service to the community in sustainably protecting consumers from uncertain future events.

2. Background

2.1 Purpose

In the last few years there has been heightened attention from the life insurance industry to issues of product sustainability. This Note has been prepared by the Actuaries Institute, via the Disability Insurance Taskforce (DITF) Chief Risk Officer Working Group ("the Working Group"), to assist life insurance Chief Risk Officers and risk functions with guidance as to their role in product sustainability. It is intended to be useful to all practitioners, regardless of professional background as well as directors of life insurers, who have ultimate responsibility for the life insurer's RMF. The Note is primarily focused on direct insurers, which design and distribute products, however there is relevance for reinsurers, which have an influence on insurers and are also exposed to product sustainability risk.

A comprehensive process to engage with those with an interest in this topic has been followed and this helped formulate the views in this document. The Risk Management Practice Committee of the Actuaries Institute will be responsible for the maintenance of this Note to continue to be a useful guide to life insurance risk professionals and is interested in feedback on the content and usage of the Note.

2.2 Context

Disability Income Insurance products in Australia provide critical cover for many members of the community who may suffer loss of income because of disability. It is provided both as Individual Disability Income Insurance (IDII, usually distributed by financial advisers) and through group policies (usually as part of superannuation).

Over time, the IDII product had become more complex and experienced higher claims costs that could not be addressed through price increases. Insurers lost large sums on IDII business and in 2019, following a thematic review of these products, APRA wrote to life companies detailing four key themes where "greater attention and action are needed by life companies". One of those themes was strategy and risk governance, with the others being pricing and product design, data, and resourcing.

In response to the chronic issues with IDII and APRA's expressed concerns regarding the sustainability of IDII products, the Actuaries Institute established the Disability Insurance Taskforce (DITF) in 2019 to conduct a comprehensive review of issues within IDII. The DITF engaged extensively with the different parties in the IDII ecosystem and in April and May 2021, with a subsequent update in December 2022, released good practice principles-based guidance to the actuarial profession and set out recommendations for change. The DITF's recommendations in respect of CROs and the Risk Function was set out in Section 10.1: "Ensure adequate support for breadth of CRO role: The Actuaries Institute should consider consulting with APRA, CROs and AAs to develop a discussion note on good practice….." [2]. The Working Group was tasked with developing this Note on good practice.

APRA's intervention in relation to IDII product sustainability has been significant, but the problem to solve remains with the life insurance industry. This problem is not isolated to IDII and life insurers should apply product sustainability considerations more broadly across the product portfolio. Life insurers need to find ways of meeting the needs of consumers, with certainty of coverage and premium stability, whilst also being financially viable over the long term without the need for cross subsidies from other product categories.

2 See, Findings and Recommended Actions for IDII, Disability Insurance Taskforce of the Actuaries Institute, (2022).

2.3 Discussion Note Scope

This Note provides:

- A distinction between the role of the life insurer CRO and AA in product sustainability (refer to Section 3 and Appendix B); and
- Suggestions and guidance on:
  a) product sustainability in the RAS (Section 4); and
  b) how the CRO and Risk Function can fulfil their roles to review, challenge and oversee[3] processes and actions undertaken by business functions within the value chain, to assist the life insurer to improve product sustainability (Section 5 and Appendix C).

Although the DITF's findings and recommendations were limited to IDII, given product sustainability should be an objective across product lines, this Note is intended to be applicable across all main product lines sold by life insurers.

Life insurers and reinsurers are not uniform and so it is expected that the user will tailor the suggestions to the specific circumstances of their respective companies; considering the size, mix and complexity of business and staff responsibilities, capabilities, and organisational model.

2.4 Target Audience

This Note attempts to be useful to all practitioners involved in product sustainability risk management, regardless of professional background, including:

- CROs and their risk functions;
- AAs (and other actuaries who provide advice);
- senior executives who receive advice or support CROs and AAs; and
- life insurer Boards who are ultimately responsible for an entity's RMF.

3 The word "oversee' and 'oversight' is used extensively throughout this Note. In this Note, 'oversight' of an issue/risk is not intended to convey ownership of ultimate responsibility for management and rectification – that is a first line responsibility. It is used in the context of being across (understanding) a particular issue/risk and have carried out sufficient challenge to be comfortable it is understood and being responded to (where necessary).

3. The Roles of the CRO and AA in Life Insurance

While the requirement for entities to maintain adequate risk management systems was first legislated in the Corporations Act in 2001, the requirement to have a designated CRO, who heads the risk function, was only instigated in 2015 for life insurers with the introduction of CPS 220.

Over the last few years, the role of the life insurer CRO has continued to evolve and expand. In 2019, following the IDII thematic review, APRA specifically called out the role of the risk function within product sustainability.

The role of the AA in life insurers has a longer history and is a requirement of the Life Insurance Act 1995 (and its predecessor, the Life Insurance Act 1945 required "an actuary" to fulfil various functions for a life insurance company). APRA's *Prudential Standard CPS 320 Actuarial and Related Matters* and its prudential practice guide CPG 320 outline the purpose of the AA role is to ensure Board and senior management have unfettered access to expert and impartial actuarial advice and review. APRA released these revised final standards in 2019, following a thematic review of the AA function. In its letter to insurers[4], APRA stated that "The revised prudential standards are expected to improve prudential outcomes by focusing the Appointed Actuary on key decisions that impact the financial condition of the insurer."

While the role of review, challenge and oversight of non-financial risks clearly sits with the CRO, the evolution of the AA and CRO roles has created the potential for overlap of this role for financial risks. This is acknowledged in APRA's May 2019 letter: "While responsibilities of the CRO and Appointed Actuary (AA) relating to the management of financial risks may overlap, APRA considers it unacceptable for the CRO to disregard oversight of financial risks or seek to 'outsource' the oversight to the AA."[5]

Both the CRO and AA have important roles in promoting product sustainability and the extent of any overlap will vary by life insurer. Given there is no one right structure for all life insurers, this Note suggests that the CRO and AA discuss and clarify their respective responsibilities in a variety of practical situations. The discussion itself may assist the organisation in better understanding both roles. This could be documented to avoid misunderstanding in the future and provide clarity to others in the organisation (including the Board). APRA's May 2019 letter specifically references the 'oversight' of financial risks, and in documenting responsibilities the CRO should be aware of both APRA's expectation but also the importance of not 'owning' the risk. Given the requirement for the life insurer to maintain an Actuarial Advice Framework, one option is for this document to capture the role of actuarial advice in relation to product sustainability.

If there are instances where it is not possible to clearly articulate a boundary in respective responsibilities (or to do so would create the risk of a material gap in responsibilities), then it is accepted that there could be overlaps (as per APRA's May 2019 letter). In these situations, it is better to identify these overlaps in the documented responsibilities.

Appendix B sets out a view of the high-level responsibilities for the CRO and the AA with respect to product sustainability. This could be taken as strawman and adapted by CROs and AAs (and their respective functions) for their insurer-specific circumstances.

4 See APRA Industry Letter, (2018).
5 See APRA Industry Letter, (2019).

4. Bringing Product Sustainability into the RAS

4.1 Product Sustainability in the Risk Appetite Statement

The RAS addresses all components of insurance risk, but product sustainability has a longer time horizon and good practice would be to articulate the life insurer's definition of product sustainability from consumer and company perspectives and appetite specifically. From a consumer point of view, the sustainability risks relate to meeting expectations around future premiums, affordability of premiums and coverage. From a life insurer's point of view, the sustainability risks relate to meeting expected financial outcomes as a result of the issuance and management of the products.

CPS 220 requires[6] that, for each material risk, the RAS specifies the maximum level of risk that the insurer is willing to operate within, expressed as a risk limit.

Given this Note considers product sustainability across all life insurer product lines, CROs could consider including statements within the RAS as to the insurer's appetite for product sustainability across all product lines and develop an approach to assessing product sustainability risk.

Example appetite statements could be:

- the Board expects ABC Life to offer (reinsure) insurance benefits that provide cover to customers at an affordable, stable, and profitable price over the long term; or
- the Board has a high appetite to offer (reinsure) profitable products with clearly understood benefits at prices that are expected to be stable in the long term and no appetite for offering (reinsuring) products to customers that do not meet sustainability targets.

It can be challenging to come up with metrics that encapsulate all the different aspects of product sustainability and approaches can range from extremely detailed to the more high-level. Examples include:

- Detailed: Reporting the sustainability assessment 'score' as outlined in the DITF Sustainability Guide[7] against a target state risk limit (and possible tolerance);
- Medium-Level: Progress of various project streams or functions towards achieving the target state against set timeframes;
- High-Level: reporting to the Board that the annual sustainability assessment has been undertaken and its outcome.

The detailed approach should not necessarily be considered superior as higher-level approaches may refer to successful completion of very detailed processes. What is important is that any metric accurately reports to the Board progress (or otherwise) that is being made towards improving product sustainability, or evidence that product sustainability is being achieved or maintained. It is up to the CRO to determine what approach fits better by considering the approaches taken for the other material risk RAS metrics.

In line with other metrics, the RAS could set out an appropriate product sustainability risk tolerance and limit. Again, it would be dependent on how the insurer's RAS has been constructed whether to state in the RAS the explicit actions to be taken when appetite (or limit) is breached.

6 See CPS 220, paragraphs 27 & 28

7 See Disability Insurance Taskforce of the Actuaries Institute: Individual Disability Income Insurance Sustainability Guide December 2022 Version

4.2 APRA's Risk Appetite Recommendations

In APRA's May 2019 letter to life insurers, APRA recommended insurers:

- translate their risk appetites by establishing meaningful operational limits to enable business function staff to understand the risk boundaries they can operate within;
- clearly specify in the RAS the areas they have no appetite for (e.g., having no appetite for certain design features); and
- establish and monitor performance against specific KPIs and KRIs for individual DII and report on them to the Board and management (where relevant).

While APRA has called out the need for detailed metrics at a product level, the RAS is a high-level document and cannot capture all the various granular metrics of product sustainability. These metrics could be captured in specific reporting to senior management and the Board and referenced in the RAS. Consistency between these metrics and the RAS metrics would be essential.

4.3 Product Sustainability RAS Reporting

Once included in the RAS, it is important that regular and appropriate reporting be established that enables the Board to assess how the current sustainability risk profile compares to its risk appetite and be satisfied that management's actions are maintaining the sustainability of the products within appetite.

The CRO should be satisfied that:

- relevant business functions have understood the approach to sustainability risk;
- the Board's appetite is appropriately communicated by management; and
- the Board's risk appetite is adhered to when making key decisions (especially around product design).

If this is not the case, then the CRO should report this to the Board.

Insurers often face a tension between product designs that meet sustainability goals on the one hand and are commercially viable in a competitive market on the other. The RAS can be used to ensure that both sides of this tension are given suitable weight in the decision-making process. Whilst all insurers will have commercial objectives that their product designs need to support, insurers with more ambitious growth plans are particularly exposed. There is no 'right' decision when it comes to product sustainability but the decisions a life insurer makes in determining their sustainability should be transparent and communicated to the Board and their customers (where appropriate).

5. Good Practice Suggestions for Improving Product Sustainability

The DITF released a Sustainability Guide[8] ('Guide') for IDII which was last updated in December 2022. The Guide is intended to be a principles-based framework that could be adopted by actuaries and other interested parties to assess, measure and monitor the sustainability of their insurer's IDII product.

Accountability and risk ownership rests with the business functions (the first line of defence in the Three Lines of Defence model) and the Risk Function (second line of defence) focuses on the review, oversight and challenge of actions and decisions impacting product sustainability to ensure they are consistent with the Board-approved RMF. The CRO and Risk Function (referred to for the remainder of this section collectively as the 'Risk Function') performs this role at an enterprise-wide level as well as within each component of the value chain.

This section sets out the role of the risk function, across the value chain, followed by a section for each component of the value chain split by:

- good practice to improve product sustainability that could be undertaken by the business function itself; and
- additional guidance, beyond what is done across the value chain, on specific actions a risk function may take to assist the business function to improve sustainability.

The suggestions should not be considered a 'required' list of activities. Any suggestions adopted are likely to require some degree of adaptation to be practically implemented within a life insurer.

5.1 The Role of the Risk Function across the Value Chain

While the risk function is not expected to consist of subject matter experts, they are required to have 'sufficient technical capabilities to cover the breadth of risks, both financial and non-financial, to which life insurers are exposed in IDII and more generally'[9] and so should have sufficient financial and non-financial expertise to understand the key issues involved in managing product sustainability. In circumstances where this is not the case, the risk function should consider sourcing or developing the necessary expertise.

The risk function has an enterprise-wide view and sees the whole value chain impacting product sustainability. Across the value chain, a risk function has a role across both financial and non-financial risk management which may include to:

- provide an independent review and challenge of business decisions being made around product sustainability;
- monitor the business functions' adherence to the RMF when managing risks impacting product sustainability and in particular the Board's risk appetite;
- assist with identifying the key issues and risks that require escalation;

8 See, Actuaries Institute Disability Insurance Taskforce of the Actuaries Institute: Individual Disability Income Insurance Sustainability Guide (2022).

9 See, APRA Industry Letter (2019).

- provide advice to the business functions on how to develop and implement regular reporting of key risk and early warning indicators, including Key Risk Indicators (KRIs);
- share relevant risk insights across business functions and encourage those business functions to communicate with each other to share their function specific insights;
- educate to uplift risk management capability across the value chain;
- ensure complaints information is effectively used as a source of insights on product sustainability issues; and
- examine key governance documents and processes to see whether there is sufficient consideration of long-term sustainability (both from a customer and life insurer perspective). This could be a desktop review but may be more productive to conduct as a workshop or during a one-on-one meeting with the process/document owner. The workshop approach allows a clearer understanding and more opportunity to challenge.

The degree of the risk function's involvement should be deliberately considered. A risk-based approach is more efficient, with greater and more senior involvement of the risk function depending on the likely importance and complexity of the proposed action or change.

While this Note does not cover risk culture, a good risk culture is imperative for the risk function to perform its role. A life insurer with a good risk culture will be open to the review, challenge and oversight from the risk function.

The Board is ultimately responsible for having a RMF and is responsible for the oversight of its operation by management[10]. The Board looks to the CRO to give it comfort that reasonable steps were taken with regards to product sustainability, in particular given the inherent product/price competitive tensions and the uncertainty involved in offering long-term products. The Board relies on the risk function to escalate risk management issues to identify where they need to take steps to remedy. The Board will expect the CRO to challenge the decisions made regarding product sustainability and help the Board understand the effectiveness of the life insurer to manage all material risks, including product sustainability.

5.2 The Product Development and Pricing Cycle

Description of Good Practice

The product development and pricing process ('the process') has a critical impact on product sustainability. Examples of good practice include:

- operation of the process is well-documented through approved governance documents that are part of the insurer's RMF and governance framework;
- a sustainability framework being an integral part of the process and should show the Board and senior management how the proposed changes relate to the target state;
- the involvement of all impacted functions in the proposed development;
- the involvement of relevant external parties with consideration of the role of reinsurers in the process, benefiting from their global experience and perspective. This may be particularly important for smaller insurers;
- access to data required to design and assess the sustainability of a given product feature. Smaller insurers with less in-house data may need to identify alternative sources;
- products are reviewed post-launch to ensure that they continue to meet customer needs, are performing as expected and remain sustainable in line with the insurer's risk appetite;

10 See, Prudential Standard CPS 220 Risk Management.

- the insurer's pricing philosophy should be appropriately documented and could consider the following sustainability related aspects:
  - expectations for the level of adverse outcomes that can be borne before there is a need to alter pricing or product terms and conditions (or for closing products and launching alternative re-designed products);
  - target margins and acceptable deviations from these;
  - the insurer's risk appetite;
  - management of cross-subsidies: at what level does the business aim to achieve target margins and where will it permit cross-subsidisation, e.g., benefit, gender, occupation, benefit period, and/or risk rating levels; and
  - in what situations there is a rationale for pricing assumptions to deviate from valuation assumptions.
- clarity over the insurer's approach to pricing for uncertainty[11]. Some examples of that could include:
  - setting of and inclusion of risk margins in pricing to allow for uncertainty of future experience;
  - how the interactions between price and factors such as economic conditions, consumer behaviour and claims experience are taken into account; and
  - given a potential approach to have lower risk margins in pricing (and therefore a reliance on being able to increase future prices or alter terms in future for in-force customers), the consideration of the potential impact on future in-force customers in regard to changes that might be required.

The process is not the sole concern of the product management and actuarial teams; rather it requires collaboration and clear ownership (i.e., relevant components owned by appropriate stakeholders) of all key activities of the business to improve sustainability outcomes.

Role of the Risk Function

Product Development

The risk function may be involved in key steps of individual product developments providing appropriate challenge to the business' intended changes and actions. The risk function ideally would be involved throughout the product development process as it allows early review and challenge that can shape the product development more efficiently. If the engagement is left to the end, then the risk function's review and challenge may not be able to add value and can be seen as an obstacle and compliance hurdle.

Documenting the roles of the business function and risk function would be regarded as good practice. A product governance framework may be an appropriate place to document the role of the risk function or potentially the Actuarial Advice Framework (as it already considers the materiality of the product change and degree of advice that is required).

We note that documenting the risk function's involvement in development of a specific product can be difficult as the review and challenge often occurs throughout the development process and is often in meetings where only actions (rather than the discussion) are recorded. This can be addressed by documenting, at the end of the process, the involvement of the risk function, including their points of challenge, as well as the specific risks considered and addressed as a result.

11 See, DITF Sustainability Guide December (2022).

Pricing

The risk function is not expected to re-perform technical pricing work but rather their role is to have sufficient technical capabilities to enable them to be able to review, challenge and oversight the pricing process and decisions.

Good practice may be for the risk function to be involved in the pricing meetings and to be part of the internal review process. The business may include in pricing reports (or an alternative report):

- the key risks that have been identified (ideally by the business) and mitigating controls or actions;
- the degree of the involvement of the risk function, including their points of challenge; and
- an opinion from the CRO (or member of the risk function who has provided the challenge) that the business has considered the risks (including sustainability) in line with the RMF.

Reinsurers may find themselves in the situation of having to balance their own commercial considerations with the need to challenge cedants' product design and pricing plans, especially if their involvement is delayed until the end of the cedant's process. Risk functions at reinsurers can play a role in ensuring there is adequate challenge and control mechanisms as part of the reinsurer's decision-making process such that commercial and risk considerations are each given appropriate weight.

5.3 Reviewing Experience and Setting Assumptions

Description of Good Practice

It is normal practice to review a portfolio's experience and many established financial and actuarial techniques continue to be applicable when considering a product or portfolio from a sustainability viewpoint. The control cycle remains a key tool and control. Good practice for sustainability could include greater focus on:

- specific consideration of relevant information regarding previously identified areas of uncertainty;
- identifying emerging trends in both the company's own and broader industry data;
- identifying lead indicators for longer-term, more material changes;
- understanding how future exposure periods may be different from historic periods (that are often used to set assumptions), for example, impacts of product changes the company (or competitors) may have made in the recent past and may make in future or regulatory changes;
- adjusting for expected changes in exposure and experience over historic periods: this would include allowance for trends in emerging experience and discrete changes (such as those caused by specific product or regulatory changes);
- investment in data collection to support future analysis that will generate broader insights (e.g., impact of replacement ratio on incident and termination rate, claim interactions and possible linkage to termination rate, etc.);
- taking a wider view that includes customer and adviser behaviour assumptions, for example, assuming customers will act to maximise their benefits (e.g., explicit allowance for selection and anti-selection that is against the interest of the insurer); and
- acknowledging where there is more uncertainty in an assumption set and using appropriate contingency margins.

If data permits and historic exposure periods are believed to be still relevant, it may be better to consider the historic variations in experience to establish expected standard deviations for assumptions. This helps in focusing on deviations that are more extreme and not the result of natural variation in existing and understood experience.

When setting assumptions for sustainable pricing, it remains good practice to start from the most recent company and industry experience investigations and have a consistent assumption set for pricing and valuation. From a sustainability perspective the pricing assumptions might:

- allow for expected changes in the exposure and experience between historic (that the assumptions are based on) and future periods;
- consider how the proposed product changes may alter the experience or customer behaviour;
- assume that there is a change in experience: where possible the adjustments would be data-driven with analytical work to support the changes (e.g., step down in replacement ratio would be supported by analysis of morbidity incidence and termination rates by replacement ratio). Where this is not possible then it should be clearly stated and the rationale for the assumption change explained; and
- include additional margins for the increased uncertainty of assumptions in respect of new features.

Role of the Risk Function

The risk function should take a risk-based approach and focus its review and challenge on the assumptions that have the most material impact on the likely outcomes and where they are different to the normal valuation assumptions. This would mean a focus on the material assumptions with the highest level of uncertainty regarding future outcomes. Reviewing any sensitivity testing performed by the business can be useful here to understand what the key assumptions are and where effort and resources could be directed.

Again, the risk function is not expected to reperform the technical work required for assumption setting. They should have sufficient technical capabilities to enable them to add value from their review and challenge of the assumption setting process and testing the control effectiveness. Examples of these controls may be the peer review process, technical review process and implementation of assumption changes in the model. Whilst the investigation process should consider these elements, sometimes the technical aspects can dominate, and so a wider perspective of the context within which these assumptions are set can add value.

The final choice of assumptions to recommend to the Board rests with the first line of defence (e.g., AA for valuation or product manager for pricing) but, as mentioned earlier, the value of the independent review and challenge increases when it is focused on the material assumptions where it is assumed that experience will be different from the past or where there is significant uncertainty.

For these assumptions the risk function could:

- challenge the business to consider what could happen if experience does not play out in line with the assumption;
- suggest and/or review the use of scenario and stress testing to understand potential severity and investigate possible responses; and
- advise and discuss with the business on mitigating actions that may be taken.

5.4 Underwriting

Description of Good Practice

Underwriting is one of the key controls to prevent adverse selection and maintain the profitability and health of a life insurer's portfolio. The underwriting process allows the life insurer to assess that the characteristics of an individual applicant for a policy are not adversely out of line with that implicitly assumed in pricing the products. This should cover both exposure to risk from a medical perspective as well as meeting insurability principles from a financial perspective. A lax or poorly resourced approach to underwriting will mean that an insurer's business is not sustainable in the long run.

The right to underwrite is essential to maintain long-term portfolio health and this is dependent on being able to demonstrate that underwriting criteria are factually based with supporting statistics. It is important that not only are underwriting policies followed but that they are the result of an accessible evidence base present at the time of underwriting. Good practice would be for the technical underwriting team to assemble and maintain the data-basis for the underwriting policies.

Medical understanding and practice are changing rapidly, and to have a sustainable business the underwriting area needs to be forward looking, keeping up to date on developments[12], looking for changes in the risks accepted and open to changing practices as a result. Similarly, customer financial information for use in financial underwriting has become more directly accessible (with permissions), potentially avoiding the need to rely on customer statements about their financial situation and history.

Better practice that is emerging involves the access to real-time data and using it in aspects of management of the underwriting function, including:

- review of claims data and decisions against underwriting decisions at an individual policy level and also against the broader underwriting framework;
- benchmarking of underwriting limits and requirements across local competitors and also against international approaches. This can be facilitated by global reinsurers and research houses, for example, using publicly available information; and
- ongoing access to customer health, activities and/or financial information post-purchase to potentially allow ongoing financial and/or medical 'underwriting' and a change in the nature of the products and customer interactions.

An important area of development is in the better use of data (analytical techniques, machine learning, etc.). While bias from past data needs to be taken into account, better use of data can be applied to:

- more efficiently identify risk within insurance policy applications;
- provide a timely quality assurance process;
- monitor business mix e.g., straight through processing levels, mix and type of exclusions, loading levels, etc.; and
- determine the effectiveness of underwriting questions and tests.

Companies normally have a strong focus on understanding reasons for underwriting declines, however damage can be done to the risk profile when accepting business and so the focus should extend to reviewing the risks being accepted and the potential impact on future experience.

Having underwriting processes and decisions that are well-understood by customers and intermediaries is also good practice. These attributes should lead to underwriting decisions that are more likely to be accepted by customers, therefore supporting product sustainability.

12 See ALUCA issued in 2022 IDII Financial Underwriting & Claims Better Practices White Paper

Reinsurers have their own underwriting functions, which are subject to most of the same considerations as those of insurers. In addition, reinsurers are exposed to the practices and capabilities of their cedants' underwriting functions. Good practice for reinsurers also requires them to have adequate understanding of these practices and capabilities. This can be achieved through:

- building relationships, as part of the reinsurance arrangement, between key reinsurer and insurer underwriting staff to facilitate an open and constructive sharing of information and insights;
- formal review of cedant underwriting processes, with suitable constructive and consultative feedback mechanisms; and
- sharing of emerging best practices from other markets in which the reinsurer operates.

Role of the Risk Function

For underwriting specifically, the risk function may:

- be consulted for review, advice or challenge of any material change to the insurer's underwriting rules/philosophy;
- have oversight of underwriting quality assurance results (reinsurance and internal);
- review, advise and challenge the resourcing and quality assurance framework;
- provide independent risk monitoring of underwriting processes and procedures; and
- encourage and support research into emerging risks including attendance at underwriting forums that discuss emerging medical risks.

Additionally, for reinsurers, the risk function can play a role in ensuring reporting is provided on cedant underwriting reviews and follow-up activities and ensuring suitable underwriting risk controls are built into treaty wording, including remedies for inadequate underwriting practices.

5.5 Claims Management

Description of Good Practice

Like underwriting, claims management is one of the key controls of a life insurer. It is also an excellent, albeit lagging, indicator of whether issues are emerging and can provide greater insight into the reasons for deterioration in claims experience. An integrated and involved claims area is an essential source of information for good practice risk management and a sustainable approach to managing insurance products.

While products are designed by specialist product teams, it is the claims managers that apply the product terms and definitions to customers in real-life situations. Claims management has deep insight into the challenges of applying theoretically 'good' product terms to actual customers and claim situations: they are the first to appreciate if new and unexpected claim trends are emerging, how policy terms are interpreted by advisers and policyholders at claims time or how interpretations by courts or external complaint bodies (or new approaches by claim litigants and claimants) impact product terms.

To leverage this insight, for good practice it is important that:

- regular meetings on individual claims occur with representatives from the product and underwriting functions, to check that insurance risk acceptance is in line with the way claims are being managed (and vice versa);
- complaints data is reviewed to identify key themes e.g., policy terms being interpreted differently;

- regular forums that include product and underwriting exist to monitor, analyse, discuss, and take actions on claim risks and issues – including unclear or problematic product terms, difficult individual claims, trends in adviser and policyholder expectations at claims time, etc.;
- data is effectively captured from the claims process in a form that is readily analysed to provide further business insights; and
- insights into product wording and terms and conditions from the practical application of these at claims time is fed back to other relevant parts of the business.

It is also good practice for the claims area to be forward looking and willing to try new approaches to manage claims and support the customer. Managing the relationship with the customer (and adviser) and treating medical professionals is important to achieve better return to health outcomes. As an example, the increasing prevalence of mental health (as both a primary and secondary cause of claim) has changed experience and shows how previous practices lose their effectiveness. Learnings from other industries (such as Workers Compensation) or overseas jurisdictions may also be useful; however, it is important to also recognise there are differences and not to transfer practices without suitable consideration for the local regulatory environment.

Similar to underwriting, reinsurers are exposed to the practices and capabilities of their cedants' claims functions, that the reinsurer should seek to understand through, for example:

- building relationships, as part of the reinsurance arrangement, between key reinsurer and insurer claims staff to facilitate an open and constructive sharing of information and insights;
- formal review of cedant claim processes, with suitable constructive and consultative feedback mechanisms; and
- sharing of emerging best practices from other markets in which the reinsurer operates.

Role of the Risk Function

The risk function can assist in similar ways to those outlined for underwriting through:

- review, advice, or challenge of material change to the life insurer's claims management process or claims philosophy;
- oversight of claims quality assurance results including reinsurer audit results;
- review and challenge claims management KRIs, e.g., acceptance, declines, return to health, duration, etc.;
- review, advise and challenge the resourcing and quality assurance framework;
- provide independent risk monitoring of claims management processes and procedures;
- attendance at forums where specific claims are discussed, and promoting not just the technical interpretation of policy terms, but also the wider customer and community expectations, and the reputational considerations that form part of the company's risk appetite; and
- monitoring acceptance and declinature rates through ASIC/APRA reporting and challenging the business as to whether it is an outlier compared with other participants.

Additionally, for reinsurers, the risk function can assist in ensuring reporting is provided on cedant claim reviews and follow-up activities and ensuring suitable claim controls are built into treaty wording, including remedies for inadequate claim practices.

5.6 Reporting and Monitoring

Description of Good Practice

Given the long-term nature of life insurance, it is critical that information is available on risks around sustainability of in force products and those currently open for sale. To inform decisions this information needs to be timely, at an appropriate level of detail and shared at the appropriate level within the company. While good practice would be to vary with the size and complexity of the business, broadly there are three audiences that reporting can be tailored to:

- business area – the most frequent and detailed reporting;
- management committee or forum – generally similar frequency to the department reporting but with more summarised metrics; and
- Board or Board committee – normally more infrequent and at a high-level but with a focus on key insights.

Examples of good practice reporting for each audience are included in Appendix C.

The scale (breadth and depth) of management committees is likely to depend upon the size and level of business complexity. The establishment of management committees with appropriate charters and metric oversights can facilitate appropriate and serious review of Key Performance Indicators (KPIs) and Key Risk Indicators (KRIs). Subject Matter Expert (SME) accountability for reviewing and commenting on the metrics is important for ensuring that they are not merely noted but lead to insights and potential responses. In larger companies, regular cross-function forums (with attendees from claims management, product, pricing and underwriting functions) are required to ensure that the right stakeholders are informed and consulted. For example:

- claims forum to discuss emerging trends and challenges in managing claims (illustrated by specific cases);
- regular (monthly) profit meetings so portfolio experience (including any deterioration) is understood across all parts of the value chain; and
- annual/biennial review of product definitions, with specific focus on changing medical practice and difficulties that claims management have with problematic definitions.

The difficulty with Board reporting is to appropriately balance detail and insight. A strong governance structure of management committees and other forums can help drive a process where issues are discussed in more detail and then escalated in appropriate detail to the Board. More complex or new issues may be better addressed through Board workshops to allow for more discussion time. The presence of the head of underwriting, product, claims management at Board (or committee) meetings permits directors to question the directly responsible manager and also to share the director's views and risk appetite directly.

Reporting should not be 'set and forget' — as business issues arise or the environment changes, the nature, detail and type of metrics required will change.

Role of the Risk Function

A key attribute of a stronger risk function is that they are embedded at various levels of governance in the business and can bring together and challenge issues across the value chain. This helps reduce the risk of silos and it provides the Board with greater comfort that risks are considered across the entire business.

The risk function's role is to provide operationally independent risk reporting to management and the Board (and Board Risk Committee) on the life insurer's risk status, including product sustainability. Product sustainability reporting, in its own right, is the role of the relevant business areas.

The risk function provides oversight and review across the reporting and monitoring framework and provides its view of product sustainability to the Board and Board Risk Committee via the CRO report. The risk function can also challenge whether:

- clear governance structures are in place that are appropriate for the business for the material risks of the life insurer to be reported to;
- appropriate metrics are included in key governance documents and reporting, such as the RAS;
- reporting that senior management and the Board receive convey an accurate view of the key risks; and
- issues are being reported to the Board in a balanced way with appropriate level of detail across the portfolio in relation to where risks might lie, e.g., in force vs new business, new to market products, changes in practices, regulatory impacts.

6. Conclusion

A heightened attention to the need for changes in the management of pricing for customers and financial outcomes for life insurers in respect of IDII products has resulted in a focus on the topic of product sustainability in life insurance, across all product lines. There is no single approach but the decisions each life insurer makes in effecting product sustainability should be deliberate, and should be transparent to all stakeholders including the Board, management and customers.

At least in part prompted by APRA, but also through direct action by life insurers, reinsurers and the professionals that work in the industry, there has been significant enhancement in the explicit management of product sustainability. However, this remains an area for continuing development and attention, particularly in a competitive market.

CROs and the risk function play critical roles in helping life insurers to continue to improve their management of product sustainability through their enterprise-wide view and review, challenge and oversight of processes and decision making within the product sustainability value chain. They also should continue to work alongside management and AAs to enhance clarity and communication over the risks that insurers are prepared to and able to take on and the effectiveness of business risk management practices to do so. In this way, they will help manage the ongoing tensions between:

- offering an attractive and competitive product; and
- ensuring that, for both the consumer and the insurer, the product has sustainable pricing and terms and conditions.

Improvements in product sustainability management can help ensure that the life insurance industry continues to provide a valued service to the community in sustainably protecting consumers from uncertain future events.

Appendix A:
Glossary of Abbreviations

Abbreviation	Term
AA	Appointed Actuary
AAF	Actuarial Advice Framework
ALUCA	Australian Life Underwriting and Claims Association
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
AvE	Actual vs Expected
CPS	Cross Prudential Standard
CRO	Chief Risk Officer
DITF	Actuaries Institute Disability Insurance Taskforce
Guide	DITF's Sustainability Guide
KRIs	Key Risk Indicators
Note	This Discussion Note
RAS	Risk Appetite Statement
RMF	Risk Management Framework
The Working Group	Actuaries Institute Disability Insurance Taskforce Chief Risk Officer Working Group

Appendix B:
Guide to the Respective Roles of CRO and AA

Areas of Product Sustainability	Chief Risk Officer role[13]	Appointed Actuary role	Comments
RMF	**Develop**, **Implement** and **Maintain** the RMF which includes the RAS to ensure it supports product sustainability. **Advise** on, **Review** and **Challenge** of: • activities to ensure that the RMF is being complied with; and • the functions within the product control cycle to ensure resources, frameworks and governance are in place to support product sustainability. **Review** and **Challenge** that the target exposure is within Board's risk appetite.	**Review** the overall RMF, with a specific focus on those that impact product sustainability. **Consider** providing **advice** on RAS financial metrics and financial Key Risk Indicators (KRIs) specific to product sustainability.	• Historically the risk function focused on operational and strategic risks and left financial/insurance risks to be considered by the AA. • APRA's guidance in its May 2019 letter is this may not be adequate. • The risk function needs to review and challenge both financial and non-financial risks.
Actuarial Advice Framework (AAF)[14]	Activities for the CRO as/if set out in the AAF.	**Provide advice as required by the** AAF including on the AAF appropriateness itself.	AAF should document actuarial role in product sustainability but it is likely there may be other documents more appropriate for documenting the CRO role in product sustainability.

13 The role of the CRO only considers the risk management responsibilities and not compliance responsibilities.

14 CPS 320 Paragraph 22: "An insurer must have a board-approved framework for the provision of actuarial advice (actuarial advice framework) that enables the Appointed Actuary to perform the functions of the role and that complies with the applicable prudential requirements. Before approving the actuarial advice framework, the board must consider advice provided by the Appointed Actuary in relation to the actuarial advice framework."

CPS 320 Paragraph 23: "The actuarial advice framework must be appropriately documented and: … (b) identify areas where the advice of an actuary is required, having regard to the materiality policy and the minimum matters to be included in the actuarial advice framework for each type of insurer as set out in the Attachments, as applicable; … (f) set out the insurer's approach to seeking actuarial advice on reviews of the: (i) risk management framework;…"

Areas of Product Sustainability	Chief Risk Officer role[13]	Appointed Actuary role	Comments
Product Design and Pricing **(Retail and Group product)**	**Review** and **challenge** of risks from major changes affecting product sustainability which includes product design (incl TMD) and pricing for Retail and Group insurance. Where the AA manages the pricing team, the CRO may consider that a further **review** may be required. This should be reflected in the AAF. **Advise**, **review** and **challenge** of the framework and metrics in place for monitoring product sustainability, e.g., covering need for repricing, customer outcomes from products, clarity of benefits to customers.	**Review** product design and price setting. Consider the impact on customers (including fairness to customers on different products), meeting the organisation's pricing philosophy, competitiveness, and sustainability of the product. Depending on the size of the organisation, the AA may also manage the pricing team (but not be responsible for pricing decisions). In this case the AA could then **develop** the pricing assumptions. In some organisations, perform an AvE analysis and **inform** on the need for repricing of amending terms and conditions based on experience or external changes.	• Where pricing work is prepared by a separately managed pricing function with advice subsequently provided by the AA, the CRO has traditionally considered that to be sufficient separation under the RMF. APRA's May 2019 letter clarifies that this is not acceptable. • The CRO could leverage the AA's opinion to form their own review on product sustainability risks.
Underwriting	**Review** and **challenge** of: • any risk from major changes affecting underwriting; and • underwriting quality assurance results (reinsurance and internal). Provide independent risk **monitoring** of underwriting processes and procedures. **Encourage** and support research into emerging risks, including attendance at underwriting forums that discuss emerging medical risks.	For material underwriting rule or philosophy changes, be **informed** and **review** the financial implications. **Review** the suitability of the underwriting philosophy and execution for the product design and pricing.	

Areas of Product Sustainability	Chief Risk Officer role[13]	Appointed Actuary role	Comments
Claims Management	**Review** and **challenge** of: • any risk from major changes to claims management; • Claims management KRIs, e.g., acceptance, declines, return to health, duration, etc.. Oversight of claims quality assurance results including reinsurer audit results. Provide independent risk monitoring of: • claims management processes and procedures; and • acceptance and declinature rates through ASIC/APRA reporting and challenging the business as to whether it is an outlier compared with other participants.	For material philosophy or process changes, be **informed**. **Review** the suitability of the claims management approach and execution for the product design and premium adequacy, e.g., the ability to rely on historical experience in setting assumptions requires an understanding of the claims management dynamic, resourcing areas of focus, etc. over time.	
Reinsurance	**Review** and **challenge** of the assessment performed by the business on: • the third-party risks from engaging the reinsurer; and • the suitability of the reinsurance arrangements. The risk of short term guarantees on reinsurance prices for longterm guarantees in product and the impact on sustainability.	**Advise** on the suitability and adequacy of the reinsurance strategy. **Advise** on changes to the reinsurance strategy, new reinsurance arrangements, or changes to existing reinsurance contracts, specifically advising on the likely consequences of taking such action.	

Areas of Product Sustainability	Chief Risk Officer role[13]	Appointed Actuary role	Comments
Capital Management	**Review** and **challenge** of the ICAAP, including the impacts of adverse product and pricing outcomes on capital.	**Consider** the ICAAP, including the ICAAP Summary Statement in their assessment of current and future capital adequacy[15]. **Assess** the ICAAP via the ICAAP Report and ICAAP Summary Statement, including the impacts of adverse product outcomes and how these are managed through the capital management processes and where gaps might arise.	
Stress and Scenario Testing	**Advise** on the risk factors for the development and choice of scenarios and stresses, in the context of the RMF and the product sustainability objectives.	**Advise** on the technical actuarial and financial input for the development and choice of scenarios and stresses, including those relating to specific product risks that might impact sustainability. **Implement** stress and scenario testing of capital position (and of product profitability where not performed by the pricing teams).	
Stakeholder interests	**Review** and **challenge** to ensure the business considers all stakeholder interests and the impact of actions on reputational, regulatory, and legal risks is managed.	**Review** and **challenge** of the life insurer's management of policyholder versus shareholder interests.[16]	

15 CPS 320 Paragraph 30: "A general or life insurer must arrange for its Appointed Actuary to: … (b) for a life company, calculate the value of the capital base and prescribed capital amount for each of the funds of the life company; …"

16 CPS 320 sets out the functions of the Appointed Actuary role and makes the following purpose statement: "The purpose of the Appointed Actuary role is to ensure that the board and senior management have unfettered access to expert and impartial actuarial advice and review. The role is intended to assist with the sound and prudent management of an insurer and ensure that the insurer gives appropriate consideration to the protection of policyholder interests."

Appendix C:
Examples of Reporting to Different Audiences

	Product Development & Pricing	Reviewing Experience & Setting Assumptions	Underwriting	Claims Management
Department	• Business mix – across occupation, location, sex, age, size, option take-up, etc.. • Competitor product positioning – rating of product by research houses. • Internal frameworks for assessing competitive position. • Analysis of pricing comparatives across key segments. • Product financial outcomes assessments – in force and new business. • Assessments against pricing philosophy. • Sales and profitability reviews.	• Profitability KPIs – revenue, margins, loss ratios, return on capital. • A full source of profit (net and gross of reinsurance) at a granular level to permit material deviations to be identified and investigated. • Annual experience investigation reports for each major line of business examining persistency, mortality, morbidity incidence and morbidity termination experience. • Complaints and incidents – captured by theme with trend analysis.	• Caseloads per underwriter – split by benefit type and experience level (senior assessor vs standard assessor). • Quality assurance results by underwriter. • Potential fraud/non-disclosure indicators such as clean-skin rates by advisor. • Resourcing plan capturing both capacity and capability required to manage expected new business volumes. • Loadings and exclusions. • Suspense levels. • Withdrawal from underwriting process. • Reporting against LICOP targets. • Turn-around times, SLAs and other operational efficiency and customer metrics.	• Caseloads per assessor – split by benefit type, complexity, and experience level (senior assessor vs standard assessor). • Quality assurance results by assessor. • Time to decision and claim acceptance rates - with triggers for further analysis if these fall outside risk tolerance (both sides). • Ex-gratia claims numbers and amounts. • Resourcing plan capturing both capacity and capability required to manage current and expected claim volumes. • Reporting against LICOP targets. • Turn-around times, SLAs and other operational efficiency and customer metrics. • External dispute resolution decisions overturning claims decisions (and impact this may have claims management or underwriting approach).

	Product Development & Pricing	Reviewing Experience & Setting Assumptions	Underwriting	Claims Management
Management Committee/ Forum	• Summarised competitive positioning. • Actuarial advice pertaining to any proposed product changes in accordance with the business' Actuarial Advice Framework.	• A monthly summarised sources of profit by portfolio with key deviations and proposed actions highlighted. • Dashboard focused on products where there is current concern. • Monitoring company's own experience against industry. • An annual paper summarising the experience and the recommended assumption changes (including impact on profit margins and annual profitability).	• Summarised form of the department reporting. • Reinsurer underwriting audits as a comparative benchmark of a company's underwriting function.	• Summarised form of the department reporting. • Reinsurer claim audits as a comparative benchmark of a company's claims management function. • APRA/ASIC claims statistics – although these should be approached with caution as differing results can be driven by different business mixes or product definitions. • Regular reporting of claims team.

	Product Development & Pricing	Reviewing Experience & Setting Assumptions	Underwriting	Claims Management
Board/Board Committee	• Actuarial advice pertaining to material proposed product changes in accordance with the business' Actuarial Advice Framework.	• A more summarised sources of profit at each Board – with key concerns and experience deviations. • RAS metrics around key product performance metrics such as persistency and loss ratios. • Dashboard focused on products where there is current concern. • An annual paper summarising the experience and the recommended assumption changes. Better practice would be to hold a dedicated Board workshop.	• RAS metrics around capability and capacity of underwriting function (e.g., caseloads and quality assurance results). • An annual report on the underwriting team's performance and emerging risks and issues.	• RAS metrics around capability and capacity of claims management (e.g., caseloads and quality assurance results). • An annual report on the claims team's performance and challenges faced managing claims.

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