



South African Reserve Bank
Prudential Authority

Statement* of the need for, intended operation and expected impact of the proposed prudential standards on audit requirements for insurers and controlling companies

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1. Introduction

- 1.1 Prior to making a regulatory instrument in terms of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) (FSR Act), the Prudential Authority (PA) is required to publish: a draft of the regulatory instrument; a statement explaining the need for and the intended operation of the regulatory instrument as well as a statement of the expected impact of such a regulatory instrument.
- 1.2 In line with the requirements under the FSR Act, the PA has prepared this Statement of the need for, intended operation and expected impact of the proposed prudential standards on audit requirements for insurers and controlling companies (the Statement). The Statement is in respect of the five sets of prudential standards (proposed Standards) on audit requirements for insurers, insurance groups, microinsurers, Lloyd's, as well as branches of foreign reinsurers.

2. Background

- 2.1 Insurance Core Principle¹ (ICP) 9 requires that supervisors establish documented requirements for the submission of regular qualitative and quantitative information on a timely basis from all insurers operating in their jurisdictions. In addition, ICP 9 also requires that an external audit opinion is provided on annual financial statements.
- 2.2 On 1 July 2018, South Africa introduced a new risk-based solvency framework, known as Solvency Assessment and Management (SAM) for the insurance industry. This framework was implemented through the Insurance Act, 2017 (Act No. 18 of 2017) (Insurance Act) and aligned the South African insurance industry with the international standards. The primary objective of the SAM framework is to ensure that there is protection of policyholders and beneficiaries of insurers as well as to assist in the maintenance of financial stability.
- 2.3 The SAM framework is based on a three-pillar structure of; capital adequacy (Pillar 1), governance and supervision (Pillar 2), and reporting and disclosures

¹ Insurance Core Principles by the International Association of Insurance Supervisors (IAIS)

(Pillar 3). Reporting and disclosure is an important pillar of the SAM framework under which the proposed Standards fall. Pillar 3 requires insurers and controlling companies to publish details of their capital adequacy, the risks facing their operations, as well as how they intend to manage such risks.

2.4 The reporting and public disclosure requirements (Pillar 3) seek to enhance transparency of insurers and controlling companies by complementing Pillar 1 and Pillar 2 requirements and through harnessing market discipline. This will in turn decrease the information asymmetry between the managers and the policyholders² as well as strengthen the integrity of the information reported and disclosed by the insurers and controlling companies.

2.5 As a member of the group of twenty (G-20) countries, South Africa is committed to implementing and complying with the international standards and best practice such as ICP 9. The proposed Standards aim to assist in achieving this objective.

3. Statement of the need — Context and definition of policy problem

3.1 In terms of section 47(1) of the Insurance Act, an insurer (other than a branch of a foreign reinsurer (branch), Lloyd's underwriter or Lloyd's) or a controlling company of an insurance group (controlling company) is required to have certain quantitative information and the annual financial statements of the insurer or a controlling company audited before submission to the PA.

3.2 Section 47(2) of the Insurance Act requires that the audited annual financial statements of an insurer or a controlling company must be submitted to the PA and made available to the public within a prescribed period after its financial year-end. The proposed Standards prescribe a period of 4 months.

3.3 Furthermore, a branch and Lloyd's are required to have certain information as well as security held in trust audited. This requirement is in accordance with section 47(3) of the Insurance Act.

² *A Critical Analysis of the Solvency II Proposals*, The Geneva Papers on Risk and Insurance - Issues and Practice, April 2008, Volume 33, Issue 2, pp 193–206, René Doff

3.4 The Insurance Act requires the PA to prescribe audit requirements for insurers and controlling companies through a prudential standard. It is against this background that the proposed Standards on audit requirements have been drafted and released for public consultation.

4. Objective of the proposed Standards

4.1 The proposed Standards set out the information that insurers must have audited within a specified period in line with the requirements of section 47 of the Insurance Act. The audited information establishes and enhances the credibility of the insurers' and controlling companies' information with the PA, policyholders and other interested stakeholders.

4.2 The audit requirements are meant to provide comfort that the information reported for supervisory purposes is complete, consistent and can be relied upon to be presenting a true and fair view of the business of the insurers and controlling companies.

5. Salient features of the proposed Standards

5.1 The five separate proposed Standards contain specific details on audit requirements for insurers (other than microinsurers, Lloyd's and branches), microinsurers, Lloyd's, controlling companies as well as branches. The proposed Standards are as follows:

- Prudential Standard: Audit Requirements for Insurers;
- Prudential Standard: Audit Requirements for Insurance Groups;
- Prudential Standard: Audit Requirements for Microinsurers;
- Prudential Standard: Audit Requirements for Lloyd's; and
- Prudential Standard: Audit Requirements for Branches of Foreign Reinsurers.

5.2 The proposed Standards require the audit reports issued to be approved by the Independent Regulatory Board for Auditors (IRBA) in order to ensure that these reports are in line with the relevant international auditing pronouncements.³ This

³ The exception is the audit report for Lloyd's as this is very specific to one entity only.

is similar to the requirements for the banks' regulatory audit reports required in terms of regulation 46 of the Regulations relating to Banks.

5.3 The Standards will be accompanied by a Guidance Notice on Audit Requirements (Guidance Notice) aimed at assisting insurers and controlling companies in complying with the requirements outlined in the five Standards indicated above. The Guidance Notice will be issued in terms of section 141 of the FSR Act.

5.4 While the Standards are regulatory instruments that establish a set of minimum requirements with which insurers and controlling companies must comply, the Guidance Notice only provides guidance and is not intended to create additional or binding requirements. Insurers and controlling companies will only need to demonstrate that they have met the requirements of the Standards.

6. Statement of expected impact — Costs, benefits of proposed Standards

6.1 The shift towards a risk-based regulatory regime implies that the deployment of resources, time, and effort is proportionate to ensure that the compliance burden on insurers and controlling companies reflects the nature, scale and complexity of the risks they face. Smaller and comparatively less complex insurers will have simpler audits which will also mean a lower compliance burden on these industry players.

6.2 Prior to the commencement of the Insurance Act, audit requirements were imposed on solo insurers and Lloyd's under the then short-term and long-term insurance legislation. In particular for solo insurers, while the proposed revised audit requirements will add some additional reporting requirements with regard to cell captives and reinsurance providers, most of the remaining proposed requirements are not new. Accordingly, the impact of the proposed audit requirements in respect of solo insurers and Lloyd's is expected to be minimal given that insurers and Lloyd's have in the past been required to comply with some form of audit requirements which have simply been enhanced.

- 6.3 The audit requirements are new for branches, controlling companies and microinsurers, since the type of entity did not exist until the enactment of the Insurance Act, and their impact cannot be fully ascertained at this point in time. Accordingly, the PA would welcome the industry's inputs in this regard. It should be noted that the quantitative reporting template (QRT) for microinsurers is simpler than that of solo insurers and it follows that the proposed audit requirements for microinsurers are expected to be simpler, proportionate to the nature, scale and complexity of the regulated entities.
- 6.4 Audit requirements enhance the credibility of the reported information and provide comfort that the information reported can be relied upon. Audit requirements enhance reporting requirements which in turn increase transparency and confidence about an insurers' or controlling companies' exposure to risk, the overall adequacy of their regulatory capital and risk management strategies.

7. Consultation

- 7.1 The PA has collaborated with all key stakeholders in developing the Standards. The PA established an industry task group for determining the audit requirements for insurers (the task group), consisting of audit firms, insurance industry representatives, the IRBA and the South African Institute of Chartered Accountants (SAICA).
- 7.2 The task group met to discuss the audit requirements for the QRT and to draft the illustrative audit reports that will be issued by the IRBA after going through its various governance structures.

8. Statement of intended operation — Implementation and evaluation

- 8.1 These Standards apply to all insurers and controlling companies licensed under the Insurance Act. The Standards are envisaged to commence with effect from 1 September 2020, subject to the completion of the process required for making prudential standards under the FSR Act. The accompanying audit reports will be presented at IRBA's Committee for Auditing Standards (CFAS) meeting in May

2020. However, the reports will only be issued by CFAS once the Standards are made.

- 8.2 Insurers and controlling companies whose financial year-end is after the commencement date of the proposed Standards will be required to comply with the Standards and will be required to submit certain audited quantitative information to the PA within a period of four months after their financial year-end.
- 8.3 The board of directors, representatives of Lloyd's or branches, as the case may be, are ultimately responsible for ensuring that an insurer or controlling company complies with the principles and requirements of the Standards.
- 8.4 Following the implementation of the Standards, the PA will continue to monitor and evaluate any concerns and unintended consequences emanating from the implementation of the Standard and ensure that such unintended effects are mitigated.
- 8.5 In order to simplify the process, the Standards will be accompanied by a Guidance Notice to assist insurers and controlling companies to comply with the requirements outlined in the Standards.
- 8.6 The Guidance Notice sets out which sections of the return templates should be audited to satisfy the requirements under the Standards.

9. Conclusion

- 9.1 Subsequent to the public consultation process, the PA will carefully consider all the comments received, particularly to get a better sight of any potential unintended consequences of the proposed Standards in their current form.
- 9.2 This Statement and the proposed Standards will be revised, taking into consideration the comments received during the consultation process, to ensure that the proposed Standards properly give effect to the objectives sought to be achieved and that any unintended consequences that might arise from the implementation of the Standards are mitigated.