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

As published in May 2020 and
minor revisions made in June 2021

*This statement is prepared and published in accordance with and in fulfilment of the requirements under section 98(1) and 103 of the Financial Sector Regulation Act, No. 9 of 2017

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1. Introduction

1.1 Before 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 Principle[1] (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 the 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 policyholders[2] 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 practices such as ICP 9. The proposed Standards aim to assist in achieving this objective.

3. Statement of the need — Context and definition of the 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 Section 47(4) of the Insurance Act requires that the audit of the security held in trust by Lloyd's and branches must be submitted to the PA within the prescribed period after the audit. The proposed Standards prescribe a period of 5 business days.

3.5 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 were drafted and released for public consultation and are now being submitted to Parliament.

4. The objective of the proposed Standards

4.1 One of the objectives of an audit in terms of the International Standards on Auditing is for the auditor to obtain reasonable assurance about whether the financial information, as a whole, is free from material misstatement whether due to fraud or error. An audit also enables auditors to express an opinion on whether the financial information is prepared, in all material respects, in accordance with the applicable financial reporting framework.

4.2 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 accuracy, relevance, credibility and reliability of the insurers' and controlling companies' information with the PA, policyholders and other interested stakeholders.

4.3 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 auditors to use the illustrative audit reports issued by the Independent Regulatory Board for Auditors (IRBA) to ensure that these reports are in line with the relevant international auditing pronouncements.[3] This 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, controlling companies and their auditors in complying with the requirements outlined in the five Standards indicated above.

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

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

6.2 Before 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 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 these types of entities did not exist until the enactment of the Insurance Act. Inputs on the expected impact were solicited from the industry and from the comments that were received, no insurer or controlling company raised the issue of compliance costs or any other unintended consequences. The comments received were generally supportive of the proposed Standards.

6.4 The specific audit requirements for each type of insurer and controlling company are contained in paragraph 6.5 of the proposed Standards. The audit of the items under paragraph 6.5 of the proposed Standards will result in 'reasonable assurance' reports from the auditors. Reasonable assurance is the highest level of assurance that auditors provide.

6.5 Some items will require a 'limited assurance' report from the auditors. Such items are listed in paragraph 6.6 of the Standards. Limited assurance is a lower form of assurance than reasonable assurance and involves less work by the auditor. Less work will translate to a reduction in the cost of audits and the overall compliance costs of the insurers and controlling companies.

6.6 'Limited assurance' will be required for subcategories where the relevant total amount is subject to 'reasonable assurance'. It was also chosen for some of the less critical information in the quantitative reporting template (QRT) and where the cost and effort would not outweigh the benefits of 'reasonable assurance'. All these initiatives will assist in reducing the cost of audits and therefore the compliance burden of insurers and controlling companies.

6.7 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.

8. Statement of intended operation — Implementation and evaluation

8.1 These Standards apply to all insurers and controlling companies licensed in terms of the Insurance Act and their auditors. The Standards are envisaged to commence with effect from 1 October 2021 or any later date that will be determined by the PA, subject to the completion of the process required for making prudential standards under the FSR Act. The accompanying audit reports were presented at IRBA's Committee for Auditing Standards (CFAS). 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 audited quantitative information to the PA within 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 or unintended consequences emanating from the implementation of the Standards and ensure that such unintended effects are addressed.

8.5 The Standards will be accompanied by a Guidance Notice to assist insurers, controlling companies and their auditors 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.

8.7 The insurers, controlling companies and their auditors are not obliged to adopt the guidance and are free to demonstrate that the requirements of the Standards are met.

9. Conclusion

The proposed Standards and this Statement are prepared in terms of section 98(1) of the FSR Act and were published for public consultation in terms of section 98(2) of the FSR Act. Following the public consultation process, the PA made the necessary changes to the proposed Standards and this Statement, taking into account all submissions that were received. A revised set of Standards and updated Statement together with other documents required in terms of the FSR Act will be submitted to Parliament for 30 days while Parliament is in session.