

NOVEMBER 1996

Actuarial Standard 3.01
CAPITAL ADEQUACY STANDARD

TABLE OF CONTENTS

INTRODUCTION

	PAGE
The Standard	2
How to use the Capital Adequacy Standard	3
Application of the Capital Adequacy Standard	3

PART A - PRINCIPLES

Section 1:	The Capital Adequacy Standard	5
Section 2:	Scenarios of Adverse Experience	6
Section 3:	The Liability Risks	8
Section 4:	The Capital Adequacy Assumptions	11
Section 5:	Asset Risks	16
Section 6:	Application of Discretions	19
Section 7:	The New Business Reserve	22

PART B - METHODOLOGIES

Section 8:	Determination of the Capital Adequacy Requirement	23
Section 9:	The Capital Adequacy Liability	24
Section 10:	Current Termination Value	25
Section 11:	The Inadmissible Assets Reserve	26
Section 12:	The Resilience Reserve	29
Section 13:	The New Business Reserve	34
Section 14:	Materiality	36

PART C - ACTUARY'S STATEMENT

Section 15:	Statement Relating to the Determination	38
-------------	---	----

ATTACHMENTS

Attachment 1:	Capital Adequacy Assumptions	39
Attachment 2:	Definitions	41

INTRODUCTION The Standard

The Capital Adequacy Standard is established under the Life Insurance Act 1995, and is an integral component of the new financial reporting regime for life insurance companies introduced by that Act.

The Act establishes a two tier capital requirement on the statutory funds of the life company with each tier considering the capital requirements in a different set of circumstances. The first tier is intended to ensure the solvency of the company. The second tier is intended to secure the financial soundness of the company as a going concern. It is expected in most circumstances that this second tier will provide an additional buffer of capital above this minimum requirement. However it will not always transpire that an additional buffer is necessary.

This standard looks at the second tier capital requirement.

The stated purpose of the capital adequacy standard in the Act is:

“to ensure, as far as practicable, that there are sufficient assets in each statutory fund of a life company to provide adequate capital for the conduct of the business of the fund in accordance with this Act and in the interests of the owners of policies referable to the fund.”

Therefore, the purpose of the Capital Adequacy Standard is to prescribe the capital requirement of a statutory fund to ensure that the obligations to, and reasonable expectations of, policy owners and creditors are able to be met under a range of adverse circumstances, in the context of a viable ongoing operation.

This capital requirement - the Capital Adequacy Requirement - is not required to be disclosed in the financial statements of the company. It will, however, be disclosed to the Insurance and Superannuation Commission (on a confidential basis) and will be used as an important indicator of the longer term financial position of the company, and a trigger for closer regulatory monitoring in respect of short term solvency.

This Standard adopts a less prescriptive approach (than the Solvency Standard) to the determination of the Capital Adequacy Requirement in recognition of the differing business strategies of the companies. Reliance is placed on the professionalism of the Actuary for appropriate assessment of

the Capital Adequacy Requirement of a company in accordance with the principles of this Standard.

How to use the Capital Adequacy Standard

The legislative requirements prescribed in this actuarial Standard are shown in bold type.

The Capital Adequacy Standard is a legislative instrument in accordance with section 101(3) of the Act.

Commentary is shown in normal print directly following the sections of the Capital Adequacy Standard to which it relates.

Some sections of the Capital Adequacy Standard are also preceded by an overview - shown in normal print - intended as a plain English introduction to the principles which are developed in greater detail in the relevant section.

The Capital Adequacy Standard adopts a Please Note facility as a means of emphasising special messages to the practitioner readers.

The commentary, overview and Please Note facility can be used as an aid to interpretation, and to the intent of the Standard.

Application of the Capital Adequacy Standard

The Capital Adequacy Standard is made for the purposes of section 70 of the Life Insurance Act 1995.

It applies:

- a) in respect of all life insurance business of a registered life company other than that written in a statutory fund which includes only business written overseas in one or more Approved Countries; and**
- b) at all times during all periods from the first reporting date of the company which occurs on or after 31 December 1996.**

Approved Country is a defined term for the purpose of this Standard (see Definitions).

The Capital Adequacy Standard was made on 15 November 1996, having been through the due process of the Life Insurance Actuarial Standards board (LIASB) for exposure

and consultation. The Standard is a disallowable instrument and will accordingly have been through the parliamentary processes. Notice of the making of the Standard was published in the Commonwealth Government Notices Gazette on 20 November 1996.

It is noted that the Standard has been written in the context of Australian legislation and bases of taxation. Appropriate adjustment should be made, for example to allow for different bases of taxation, where this Standard is being applied to overseas business.

PART A - PRINCIPLES

SECTION 1 The Capital Adequacy Standard

Overview

The Solvency Standard requires that the statutory fund of a life company has available a minimum level of capital in excess of Best Estimate Liabilities - the Solvency Requirement - to provide for the security of the policy owners' guaranteed entitlements under a range of adverse conditions.

However, the prudent regulation of the life insurance industry requires that the level of security offered to policy owners exceed that of a standard which secures solvency. The Capital Adequacy Standard requires that the statutory fund have available capital sufficient to provide confidence in the longer term financial strength of the fund. A capitally adequate fund would have the ability to write new business, in an unfettered manner, with the expectation of remaining solvent into the future.

The Capital Adequacy Requirement is determined by considering the various risks which could impact the longer term security of the policy owners' entitlements, and requiring the provision of a prudent level of reserve against such risks.

These risks, and an assessment of the prudent provision, are considered in the context of an ongoing operation; a fund open to new business and meeting policy owner expectations in a competitive market.

A statutory fund that meets the Capital Adequacy Requirement would be considered by the Insurance and Superannuation Commission a financially strong fund - however this does not imply an absolute guarantee of security to policy owners.

1.1 At any time, the value of the assets of the statutory fund of a life company must be of an amount considered sufficient to allow the company to continue to meet, into the future, its:

- a) obligations to, and the reasonable expectations of, policy owners referable to the fund; and**
- b) obligations to creditors referable to the fund.**

This is referred to as the Capital Adequacy Requirement.

1.2 The Actuary, in determining the Capital Adequacy Requirement must consider, in respect of both existing and expected future policy owners, the company's liability in respect of :

- a) the guaranteed benefits under the policy in accordance with the policy document; and**
- b) any additional guarantees or obligations implied by the promotional material of the company; and**
- c) the reasonable expectations of the policy owners in respect of benefits under the policy in accordance with past practice of the company.**

1.3 The Actuary, in determining the Capital Adequacy Requirement, must make an assessment of the effect of the company's realistic new business plans on the future solvency of the statutory fund.

1.4 The Capital Adequacy Requirement is an assessment of the financial strength of the fund on the basis of an ongoing operation. The Capital Adequacy Requirement must be at least sufficient to ensure the ongoing solvency of the fund for the next three years, assuming future experience during that period in accordance with Best Estimate Assumptions (including best estimate levels of new business).

1.5 Existing reserves in the statutory fund - the Profit Margins which are additional to the Best Estimate Liability, and the additional reserves which combine to meet the Solvency Requirement - are available to contribute towards the Capital Adequacy Requirement.

PLEASE NOTE

The value of an asset is the value as determined in accordance with the Act; that is, net realisable market value.

SECTION 2 Scenarios of Adverse Conditions

Overview

In assessing the Capital Adequacy Requirement of a statutory fund consideration is given to:

- the risks which may affect the value of the liabilities under policies; and

- the risks which may affect the value of the assets supporting those liabilities.

The Capital Adequacy Requirement broadly comprises the following components:

- the Capital Adequacy Liability;
- the Other Liabilities;
- the Resilience Reserve;
- the Inadmissible Assets Reserve; and
- the New Business Reserve.

The Capital Adequacy Liability

A calculation of the value of the liabilities under the policies on the basis of assumptions which are more conservative (anticipate a more adverse experience) than best estimate assumptions.

The Other Liabilities

The value of the liabilities of the statutory fund to other creditors, but excluding subordinated debt arrangements.

The Resilience Reserve

Mismatching of asset and liability exposures necessitates the provision of a reserve for adverse movements in the investment markets to the extent they will not be matched by a corresponding movement in the liabilities.

The Inadmissible Assets Reserve

A reserve against the risks associated with:

- holdings in associated financial entities; and
- concentrated asset exposures.

The New Business Reserve

Provision for planned new business over a prescribed future period of three years, with the intention of securing the continued solvency of the fund over that period.

2.1 The Capital Adequacy Requirement must provide for a value of the liabilities of the statutory fund in respect of obligations to policy owners and creditors, on a basis more conservative than best estimate.

2.2 The Capital Adequacy Requirement, in considering scenarios of adverse experience, must provide for risks associated with both the valuation of the policy liabilities and the valuation of the assets.

2.3 The methodologies for determining the Capital Adequacy Requirement recognise the diversity of the life insurance industry, in particular the diversity of the business plans/strategies of companies. The Capital Adequacy Standard provides some flexibility in determination, while preserving the objectives of simplicity and comparability of the results across companies. This is achieved by the prescription of a range of margins in respect of the various parameters, and providing guidance on the important considerations in determining position within that range.

PLEASE NOTE

While both asset and liability risks are considered, all reserves against these risks are held as an additional liability. The value of the assets is not directly impacted by the Capital Adequacy Standard.

SECTION 3 The Liability Risks

3.1 The Capital Adequacy Liability

3.1.1 The Capital Adequacy Liability must make provision for the risks pertaining to each element in respect of which an assumption is required in valuing the policy liabilities. The assumptions, including this margin, are referred to as the Capital Adequacy Assumptions.

3.1.2 The margin for risk included in each Capital Adequacy Assumption is to be determined by the Actuary as the appropriate level within the quantitative range prescribed. The Actuary is to determine the appropriate margin after consideration of the qualitative factors. (See section 4).

3.1.3 The Capital Adequacy Assumption must not be less than the minimum in the prescribed range, but may be less than the corresponding Solvency Assumption. The Capital Adequacy Assumption may be greater than the high margin in the prescribed range.

3.1.4 Allowance for Discretions

In assessing the amount of the Capital Adequacy Liability the Actuary must only assume the application of discretions available under policies where the application is considered:

- a) appropriate and justifiable under the adverse conditions being assumed; and
- b) appropriate having regard to the principles in paragraph 1.2.

3.1.5 Allowance for Reinsurance

In determining the Capital Adequacy Liability the Actuary must make proper allowance for reinsurance as follows:

- a) where reinsurance arrangements are through companies registered under the Act, the Actuary may reduce the liabilities in respect of policies by taking full account of the reinsurance arrangements; and
- b) where reinsurance arrangements in respect of overseas business are through a Reinsurer which is:
 - i) a Reinsurer in the same country as that in which the business is written; and
 - ii) is the parent or sister company of a Specialist Reinsurer;

the Actuary may reduce the liabilities in respect of policies by taking full account of the reinsurance arrangements; and

- c) subject to paragraph 3.1.6, for other reinsurance arrangements the arrangements are to be ignored when calculating the liabilities in respect of policies.

3.1.6 In determining the Capital Adequacy Liability of a Specialist Reinsurer, where retrocession by that Specialist Reinsurer is to its overseas parent company, the Actuary may reduce the liabilities in respect of policies by taking full account of the reinsurance arrangements.

Termination Value Minimums

3.2 The Capital Adequacy Requirement must provide that, for a Related Product Group, a minimum value is held in respect of the Capital Adequacy Liability of the total Current Termination Value for all policies in the group.

3.3 Capital Adequacy Liability

3.3.1 The risks pertaining to each element include the risk of mis-estimation of the mean, the risk of deterioration of the assumed mean, the risk of adverse statistical fluctuations about the mean and the risk of unexpected changes in the underlying distribution of experience.

3.3.2 Whilst, in general, assumptions used in assessing the Capital Adequacy Requirement will be more conservative than those used in assessing the Solvency Requirement, this is not required for all assumptions. The more prescriptive nature of the Solvency Standard will, at times, generate assumptions for particular companies which are more conservative than is required by the Capital Adequacy Standard.

Discretions

3.3.3 The types of discretions in policies by which companies may mitigate the effects of the liability risks typically fall into one of the following categories:

- reductions in Bonuses or Discretionary Additions;
- increases to expense charges where the maximum level is linked to an inflation index;
- quantum (one-off) increase to expense charges, subject to the contractual maximum; and
- increases to premium rates, either in line with insurance claims experience or at the company's discretion (including rider premiums on unbundled contracts).

3.3.4 The application of discretions should be consistent with maintaining the ongoing viability of the company, protecting its strategic position within the market and appropriately reflecting the company's future business plans.

More guidance on the application of discretions is provided in section 6.

Termination Values

3.4 The Capital Adequacy Liability is a measure of the company's liability in respect of the reasonable expectations of the policy owners, on the basis of a set of conservative assumptions as to future experience. It is not appropriate that, for a Related Product Group, this measure be considered adequate if it does not secure the total Termination Value on the basis current at that date for those policies.

SECTION 4 The Capital Adequacy Assumptions

4.1 Quantitative Range for Margins

4.1.1 The quantitative range prescribed in respect of the margins for risk to be included in each of the Capital Adequacy Assumptions is set out in Attachment 1.

4.1.2 The margin must be applied such as to produce a more conservative estimate of the liability than best estimate.

4.1.3 The Capital Adequacy Assumption for inflation in respect of Maintenance Expenses must be consistent with the Capital Adequacy Assumption for investment earnings.

4.1.4 Allowance for tax must be made appropriate to the Capital Adequacy Assumption for gross investment earnings.

4.2 Investment-Linked Policies

4.2.1 A risk margin must be included to reflect the additional risks that may be borne by the company in conducting investment-linked business.

4.2.2 The prescribed range for the margin for investment-linked business is set out in Attachment 1.

Quantitative Range for Margins

4.3 The prescribed margins are expressed as a percentage adjustment to the base assumption - normally the Best Estimate Assumption. The adjustment may be an addition or reduction, depending on the particular assumption and its effect on the Capital Adequacy Liability.

4.4 Qualitative Factors for Assessing Margins

4.4.1 Investment Earnings

The qualitative factors to be considered in assessing the margin for investment earnings are:

The more the following conditions exist, the closer the margin should be to the High Margin:

- The best estimate rate is not explicitly derived from an allocation of assets and investment return.
- Asset allocations have varied significantly over time.
- Investments include items other than government securities.
- Non-linked liabilities are substantially backed by equity type investments with running yields substantially below prevailing fixed interest returns.
- The investment policy is not clearly defined or not adhered to.
- Products are based on market anomalies, eg. favourable tax arrangements which may be readily removed.

The more the following conditions exist the closer the margin may be to the Minimum Margin:

- The assets are high quality and highly liquid and are appropriate to the liabilities they support.
- Asset allocations are expected to be stable.
- Asset and liability cash flows are expected to be stable.

4.4.2 Servicing Expenses

The qualitative factors to be considered in assessing the margin for Servicing Expenses are:

The more the following conditions exist, the closer the margin should be to the High Margin:

- There are different forms of distribution which utilise different compensation arrangements which result in different financial effects or risks, whether by value or timing; the distribution of in-force amounts is unstable amongst these distribution groups and could alter unit costs.
- A change is likely in the distribution of in-force business between lines of business or products which could alter unit costs.
- The expense study used to determine servicing expense assumptions is obsolete or incomplete.
- The assumed rate of increase in servicing expenses is less than the average rate of increase in servicing expenses in recent years.
- The trend in past expense levels has not been stable.
- There are inadequate budgeting and control processes for expenses.

The more the following conditions exist the closer the margin may be to the Minimum Margin:

- The distribution of in-force business is expected to be stable by product line over time.
- Servicing expense assumptions have been set by line of business and by product and are based on a recent internal study of expense allocations.
- The rate of voluntary discontinuance of policies has been stable over recent past years.
- The assumed rate of increase in servicing expenses is at least the rate of return on 10 year national government guaranteed securities less 3 % pa.

PLEASE NOTE

The risk margin for Servicing Expenses should not be applied to any component of those expenses which is contractually agreed for the life of the policy, for example, renewal commission.

4.4.3 Insurance Claims

The qualitative factors to be considered in assessing the margin for those contingencies on which the payment of a claim is based are:

The more the following conditions exist, the closer the margin should be to the High Margin:

- The product being valued includes a new type of benefit or is being sold in a new form and by a new method of distribution.
- The credibility of the company's experience is low.
- The reliability of the company's experience investigations is poor.
- The rate of voluntary discontinuance of the product is high.
- The expected number of claims per year in the statutory fund using Best Estimate Assumptions is less than 25.
- The average maximum benefit period, in the case of disability income, is greater than 5 years.

The more the following conditions exist the closer the margin may be to the Minimum Margin:

- The company has credible experience data for the product.
- The characteristics of the insured lives are very similar.
- The underwriting policy is defined, adhered to and consistent with the product pricing assumption.
- The expected number of claims per year in the statutory fund using Best Estimate Assumptions is more than 1000.

4.4.4 Voluntary Discontinuances

The qualitative factors to be considered in assessing the margin for voluntary discontinuances are:

The more the following conditions exist, the closer the margin should be to the High Margin:

- There are different forms of distribution which utilise different compensation arrangements; the distribution of in-force amounts is unstable amongst these distribution groups or the product being valued is being sold by a new method of distribution.
- The Termination Value at a future date for business other than risk business is less than the Current Termination Value after allowance for future premium payments.
- Little or no credible company voluntary discontinuance experience is available.
- The historical voluntary discontinuance experience of the company has shown significant variability.
- The product is new for the company or the market.

The more the following conditions exist the closer the margin may be to the Minimum Margin:

- The product is one for which the company has significant volumes of data on historical experience and this data is relevant to the current and expected future market and economic environment.
- The product is one for which the historic experience has been stable.
- The distribution system is stable with low turnover of distributors.
- An option is available to policy owners at a future date which is of significant value.

4.4.5 Options Provided To Policy Owners

The qualitative factors to be considered in assessing the margin for options provided to policy owners are:

The more the following conditions exist, the closer the margin should be to the High Margin:

- Little or no credible experience available.
- The option is a new type for the company or the market.
- The historical take-up rates have shown significant variability.

The more the following conditions exist the closer the margin may be to the Minimum Margin:

- The option is one for which the company has significant volumes of data on historical experience and this data is relevant to the current and expected future market and economic environment.

4.5 Investment-Linked Policies

4.5.1 A company may bear additional risks in respect of investment-linked business, including:

- Redemption Risks: units are redeemed when asset prices are below unit prices, or the allowance for selling costs and/or deferred tax provisions in unit prices are insufficient; and
- Realisation Risks: the redemption of units in amounts large enough to cause difficulties in the realisation of sufficient assets.

4.5.2 The qualitative factors to be considered in assessing the margin for investment-linked business are:

The more the following conditions exist, the closer the margin should be to the High Margin:

- Policy transactions are processed using the last unit price.
- Approximations are introduced in the determination of the unit price.
- The underlying assets of the investment fund comprise significantly large and potentially illiquid investments.
- The company is reliant upon a small number of independent distributors to market its products.

The more the following conditions exist the closer the margin may be to the Minimum Margin:

- The company has the ability to reflect unforeseen events in the unit prices for remaining unitholders.
- Policy transactions are processed using the next unit price.
- Unit prices are determined allowing for the actual cash-flow of the investment fund and the associated transaction costs related to that cash flow.
- Reconciliations are achieved at least weekly between the assets in the accounts, the policy data file and the unit pricing system.
- The tax provisions are calculated without any discount for timing or policy documents do not restrict immediate movement to an undiscounted basis.

SECTION 5 **Asset Risks**

Overview

The risks associated with the assets supporting the liabilities are discussed below.

Adverse Market Movements

To the extent that the value of liabilities is not directly linked to the value of the underlying assets, an adverse movement in the value of the assets effectively reduces the level of reserves supporting the liabilities. It is prudent that a company recognise this risk and hold sufficient reserves such that the obligation to policy owners and creditors would still be able to be met following an adverse market movement.

Holdings in Associated Financial Entities

The value taken for such a holding should not double count the legislated capital requirement of the entity itself.

Asset Concentration

Diversification is an accepted principle of prudent investment. To the extent the asset exposure of a statutory fund is excessively concentrated in a particular asset, or with a particular obligor, a reserve is established against the part of the value of that exposure considered excessive.

Credit Risks

While no explicit provision is made for credit risk, it is considered that the market value of the assets shown in the balance sheet would reflect appropriate consideration of default and marketability/liquidity risks.

Liquidity Risks

The Actuary's general responsibility in assessing and advising management on the financial operations of the company would include consideration of liquidity risks.

It is not the intention of these reserves to limit the investment practices of life companies. Rather it is to ensure that the risks associated with particular investment strategies are appropriately assessed and provided for.

5.1 Reserve for Inadmissible Assets

5.1.1 The Capital Adequacy Requirement must provide a reserve - the Inadmissible Assets Reserve - in respect of

- a) holdings in an associated entity which is a financial institution, itself subject to legislated minimum capital requirements; and**
- b) the risks arising from asset concentration.**

5.1.2 Holdings in Associated and Subsidiary Entities which are Financial Institutions

Where the associated entity is a financial institution subject to prudential regulation which requires the maintenance of minimum capital, the Actuary must establish a reserve to the extent the value of the asset includes some value in respect of that capital.

5.1.3 Asset Concentration Risks

The Capital Adequacy Requirement must provide a reserve against the adverse impact of a concentration of funds in a particular asset or with a particular obligor.

5.2 Resilience Reserve

5.2.1 The Actuary must assess the resilience of the statutory fund and provide for an appropriate reserve - the Resilience Reserve.

5.2.2 In this context, resilience is assessed as the ability of the statutory fund to sustain shocks to the economic environment in which it operates and which are likely to result in an adverse movement in the value of the assets relative to the value of the liabilities.

5.2.3 In determining the value of liabilities in the post shock environment the Actuary must only assume the application of discretions available under the policies where the application is considered:

- a) appropriate and justifiable under the adverse conditions being assumed; and**
- b) appropriate having regard to the principles in paragraph 1.2.**

5.3 Asset Exposure

5.3.1 The Actuary in assessing the asset risks, must:

- a) **take account of the effective exposure of the fund to various asset classes, regardless of the physical asset holdings of the fund; and**
- b) **consider exposure to counterparty risks including, but not limited to, futures and options contracts, swaps, hedges, warrants, forward rate and repurchase agreements; and**
- c) **take account of the underlying exposure of the fund to assets by adopting a “look through” approach in respect of investment entities. For this purpose, an investment entity is an entity whose assets are solely investments, where the sole purpose of the entity is investment activities and where the investor investing in that entity has security directly linked to those assets.**

5.4 Inadmissible Assets

Holdings in Associated and Subsidiary Financial Entities

5.4.1 It is the intention that the integrity of the capital requirements of the separate entities be maintained. It is not appropriate that assets being held in respect of one institution's capital requirements be double counted in meeting the capital requirements of another.

5.4.2 It is recognised that the methods for valuing financial entities, in particular the minimum capital requirements thereof, vary depending on the nature of the financial institution, the assets backing its capital requirement and the circumstances of the association. Accordingly, the responsibility for appropriate reserving in this respect is placed with the Actuary.

Asset Concentration

5.4.3 Notwithstanding the prescribed limits (refer to section 11.3), if in the opinion of the Actuary the overall portfolio of assets of the statutory fund has too little diversification, is too illiquid or has too great an exposure to one obligor of low credit standing, the Actuary should add to the reserve for inadmissible assets an amount considered necessary to adequately protect the interests of the policy owners.

Resilience Reserve

5.5 An assessment of the resilience of the statutory fund, while targeting the assessment of an asset related risk, involves consideration of the movements in both the value of assets and the value of liabilities under the prescribed scenario of adverse market movement.

Asset Exposure

5.6 As an example of the asset exposure to be adopted in assessing asset risks, an unlisted unit trust or a securitised mortgage instrument would generally be considered an investment entity and the Actuary's assessment of asset risks should be based on the underlying assets of the trust/instrument. However, in practice, examples exist of arrangements where the security of the investor is not directly linked to the underlying assets, but is subordinated to the interests of a third party. In this case, it would not be appropriate to base the assessment on the underlying assets.

SECTION 6 Application of Discretions

6.1 When Discretions may Be Applied

6.1.1 Discretions may be applied at various stages of the determination of the Capital Adequacy Requirement:

- in the process of calculating the Capital Adequacy Liability (section 3 and 9); and
- in the process of determining the Resilience Reserve (section 5 and 12).

6.1.2 In both cases the valuation is being performed under an assumed scenario of adverse experience: in the former case under the Capital Adequacy Assumptions and in the latter case under the prescribed change in the economic environment.

6.1.3 The discretions assumed to be applied should be consistent with the scenario of adverse experience and the stage of the calculation process being considered.

6.1.4 The following paragraphs provide further guidance on the application of discretions. The application will always be a matter of professional judgement - that judgement should be made in accordance with the principles of this standard.

6.2 Reduction in Bonuses

6.2.1 The Actuary is expected to assess appropriate levels of future Bonuses to be allowed for at the various stages of determination of the Capital Adequacy Requirement. In each stage (calculating the Capital Adequacy Liability or determining the Resilience Reserve), the Actuary should consider the level of Bonuses which could be reasonably expected by policy owners taking account of the assumptions being projected.

6.2.2 The consistent addition of Bonuses over a period of years may give rise to expectations by policy owners of similar additions in future, given a continuation of the past experience. Where the company is unable to pay future Bonuses at this expected level, the market perception of its viability may be reduced. This perception should be reflected by the Actuary in the experience basis being projected. For example, where it is assumed future Bonuses are to be reduced, consideration should be given to whether there would be an alteration in the company's voluntary discontinuance experience.

6.2.3 The amount and timing of the reduction in Bonuses assumed should be consistent with normal company practice. For example, reductions in Bonuses or crediting rates may involve some component of smoothing and hence lag the actual investment experience. This type of timing or magnitude difference should be taken into account in the assessment of the Capital Adequacy Requirement.

6.2.4 Approximate methods may be used to determine levels of future Bonuses under the assumed scenarios of adverse experience.

6.3 Increases to Expense Charges - Inflation Linked

6.3.1 Where the company has the discretion to increase policy expense charges in line with the changes in an inflation index and where the company has regularly utilised such discretions in the recent past (say 3-5 years) it is appropriate to allow for inflation-linked increases to charges.

6.3.2 The amount and timing of the indexation of charges assumed in the projection should be consistent with normal company practice. For example, some indexation of policy fees may generally be delayed 6 months on average, or generally be 0.5% less than the actual inflation rate. This type of timing or magnitude difference should be taken into account in the assessment of Capital Adequacy Requirement.

Quantum (one-off) Increase to Expense Charges

6.4 Where the company has a discretion to increase policy expense charges, other than as covered by paragraph 6.3.1, and it is likely that the discretion would be exercised under the scenario of adverse experience proposed for assessing the Capital Adequacy Requirement, then it is appropriate to allow for the exercise of the discretion.

6.5 Premium Rate Increase

6.5.1 Where premium rates may be increased to reflect any increase in actual claims experience, and it is likely that the discretion would be exercised under the scenario of adverse experience proposed, then it is appropriate to allow for the exercise of the discretion. The timing and extent of the discretion applied should be consistent with normal company practice.

6.5.2 In certain circumstances there may be no need to generate projections using assumptions inclusive of risk margins.

6.5.3 In determining the Capital Adequacy Requirement, the Actuary should consider the unexpired risks, the guaranteed renewal options, the effect of anti-selection exercised by discontinuing policy owners, the delays in claims reporting and the time lags involved in assessing experience and making the subsequent changes to premium rates.

Reductions in Termination Values

6.6 If Current Termination Values exceed Minimum Termination Values, then the company has a safety margin that may be called upon in particular circumstances. The Actuary may make an allowance for this safety margin, if appropriate, in the determination of the Resilience Reserve component of the Capital Adequacy Requirement.

PLEASE NOTE

It is not appropriate to assume application of discretions in respect of Termination Values in the processes for assessing liability risks (that is, in the processes detailed in paragraph 3.2.)

For Non-Participating Benefits which have an entitlement to discretionary additions, the reference to Bonuses in this section should be read as a reference to Discretionary Additions.

SECTION 7 The New Business Reserve

7.1 The Capital Adequacy Requirement must provide for a reserve in respect of any additional capital likely to be required to ensure that, if experience during the next three years is in accordance with Best Estimate Assumptions, the statutory fund will be able to meet the Solvency Requirement over those three years.

7.2 The Capital Adequacy Liability secures the company's liability in respect of existing policy owners. In the context of an ongoing operation, it is appropriate to anticipate expected levels of new business and hence the liabilities in respect of future policy owners. The writing of new business normally requires the availability of capital within the statutory fund. It is inappropriate that such capital requirements be borne at the expense of the security of policy owners' entitlements.

7.3 In considering the future (3 year) viability of the fund, it is appropriate to assume that the experience of the fund over that period will be in line with the Actuary's best estimates at the reporting date. The Solvency Requirement which it is necessary to meet into the future is, however, determined in accordance with the Solvency Standard, with appropriate allowance for experience more adverse than best estimate.

PLEASE NOTE

The New Business Reserve, in ensuring the funds ability to meet the Solvency Requirement over the next three years, must by implication secure the Solvency Requirement as at the reporting date.

PART B - METHODOLOGIES

SECTION 8 Determination of the Capital Adequacy Requirement

8.1 The Capital Adequacy Requirement for a statutory fund is to be calculated as follows:

(a) CALCULATE CAPITAL ADEQUACY LIABILITY
Subject to paragraph 8.2, for each policy in force, determine the Capital Adequacy Liability and aggregate this across all policies in the Related Product Group.

(b) CALCULATE CURRENT TERMINATION VALUE
Subject to paragraph 8.3, for each policy in force, determine the Current Termination Value and aggregate this across all policies in the Related Product Group.

(c) MINIMUM OF CURRENT TERMINATION VALUE
Determine the greater of the amount in (a) and the amount in (b) and aggregate across the statutory fund.

(d) ADD OTHER LIABILITIES
Increase the amount determined in (c) by the Other Liabilities of the statutory fund.

(e) ADD RESILIENCE RESERVE
Determine the Admissible Assets of the statutory fund, and on the basis of these assets, increase the amount determined in (d) by the Resilience Reserve for the statutory fund.

(f) ADD RESERVE FOR INADMISSIBLE ASSETS
Increase the amount determined in (e) by the reserve for Inadmissible Assets for the statutory fund.

(g) ADD NEW BUSINESS RESERVE
Increase the amount determined in (f) by the additional capital requirements for new business in respect of the statutory fund.

8.2 Where the Actuary is satisfied that the total Capital Adequacy Liability for a Related Product Group will be less than the total Current Termination Value, no calculation in part (a) of paragraph 8.1 is required.

8.3 Where the Actuary is satisfied that the total Current Termination Value for a Related Product Group will be less than the total Capital Adequacy Liability, no calculation in part (b) of paragraph 8.1 is required.

8.4 The performance of each subsequent step in the calculation process described in paragraph 8.1 must not reduce the progressive result from its amount at the completion of the previous step.

PLEASE NOTE

In many cases in practice, the calculation process outlined in this Part will be able to be simplified as the Actuary recognises that certain components in the calculation will dominate for certain types of business.

The Capital Adequacy Requirement of the statutory fund will be at least as great as the Solvency Requirement of the fund, by consequence of the New Business Reserve.

Allowance should be made by the Actuary in each of the steps in the above calculation process, as appropriate, for claims which have been incurred but not reported (IBNRs) and claims which have been reported but not admitted (RBNAs).

SECTION 9 The Capital Adequacy Liability

9.1 The Capital Adequacy Liability is determined by using the methods used to determine the Best Estimate Liability, as prescribed in the Valuation Standard, but:
a) allowing for current and future Bonuses; and
b) adopting Capital Adequacy Assumptions.

9.2 Details of the future Bonuses to be incorporated, given the application of discretions, are set out in section 6.

9.3 Details of the assumptions to be used - the Capital Adequacy Assumptions - are set out in section 4.

PLEASE NOTE

This calculation is normally performed using a projection methodology (refer to the Valuation Standard). However the Valuation Standard recognises an accumulation approach as appropriate in certain circumstances and in this case, such an approach may be used to calculate the Capital Adequacy Liability.

SECTION 10 Current Termination Value

10.1 The Current Termination Value must be determined as the Termination Value on the reporting date.

10.2 Where the Termination value is determined as the amount paid on voluntary termination, the Actuary must have regard for the reasonable expectations of policy owners based on the company's current practice at the reporting date.

10.3 The Current Termination Value must not be less than the Minimum Termination Value determined in accordance with the Solvency Standard.

10.4 If the company's obligation under the policy involves:

- a) deferred payment of the termination value;**
- b) payments by instalment over a period; or**
- c) payment in the form of an income stream;**

then the Termination Value must be determined as the present value of those future payments, using assumptions consistent with this Standard.

10.5 If there is an unsettled lump sum insurance claim on a policy, the best estimate of the amount potentially payable should be counted as the Termination Value. Claims settlement costs such as medical evidence or potential legal costs of disputed claims should be taken into account if appropriate. Amounts payable should be reduced by potential reinsurance recoveries, in accordance with the principles in paragraphs 3.1.5 and 3.1.6.

PLEASE NOTE

Where appropriate, the determination of the Termination Value at the reporting date should include allowance for Bonuses declared as at that date.

To ensure no omission or duplication of liabilities, consistency between the treatment of outstanding claims as accounting liabilities or policy liabilities should be established.

SECTION 11 The Inadmissible Assets Reserve

11.1 The Inadmissible Assets Reserve for the statutory fund is determined as the sum of:

- a) the reserve prescribed in respect of holdings in associated and subsidiary entities which are financial institutions; and**
- b) the reserve prescribed in respect of asset concentration risks.**

Holdings in Associated and Subsidiary Financial Entities

11.2 The prescribed reserve in respect of holdings in associated and subsidiary entities which are financial institutions is to be determined by the Actuary as the extent to which the market value of the entity includes a component of value in respect of the prudential capital requirement of the entity.

11.3 Asset Concentration Risks

11.3.1 The prescribed reserve for asset concentration risks is determined as the amount by which the value of any single asset or single credit exposure exceeds:

- a) Where the asset or credit exposure concerned is guaranteed by a national government, being the national government of the country in whose currency the liabilities of the statutory fund are denominated, 100% of the value of the assets of the statutory fund.**
- b) Where the asset or credit exposure concerned is guaranteed by an Australian State government, 100% of the value of the assets of the statutory fund.**
- c) Where the asset or credit exposure concerned is guaranteed by an overseas provincial government, being a government in the country in whose currency**

the liabilities of the statutory fund are denominated, the greater of:

- i) 25% of the value of the assets of the statutory fund; and**
 - ii) \$5 million.**
- d) Where the assets or credit exposure concerned is secured by bank bills, the greater of:**
- i) 25% of the value of the assets of the statutory fund; and**
 - ii) \$5 million.**
- e) Where the asset or credit exposure concerned is secured by bank deposits, the greatest of:**
- i) 50% of the value of the assets of the statutory fund less the value of the assets of the fund secured by bank bills ; and**
 - ii) 25% of the value of the assets of the fund; and**
 - iii) \$5 million.**
- f) Where the asset or credit exposure concerned is a first mortgage, the amount of the mortgage not exceeding 70% of market value, 5% of the value of the assets of the statutory fund.**
- g) Where the asset or credit exposure concerned is a mortgage, other than a mortgage in (f) above, or an unsecured borrowing, 1% of the value of the assets of the statutory fund.**
- h) For any other asset or credit exposure, 5% of the value of the assets of the statutory fund or such lesser proportion as the Actuary considers appropriate.**

11.3.2 Where the policy liabilities are in respect of investment-linked benefits and the Actuary is satisfied that there has been full disclosure to policy owners of the risks to which they are exposed, no reserve is required under paragraph 11.3.1.

11.3.3 Where the asset or credit exposure is in respect of an amount of claims recovery for a Specialist Reinsurer, and that amount is recoverable from the overseas parent of that Reinsurer, no reserve is required under paragraph 11.3.1.

11.3.4 Where the reserve in respect of inadmissible assets is reduced by deferred tax provisions or other liabilities relevant to the inadmissible portion of the asset, the

reduction must only be to the extent those provisions/liabilities are assessed as likely to be realised.

PLEASE NOTE

In assessing the Inadmissible Asset Reserve requirements, asset risks should be assessed on the basis of effective asset exposures and adopting a 'look through' approach in accordance with the principles set out in paragraph 5.3.

In assessing the assets concentration risks the Actuary should have a general regard for issues of asset quality and liquidity (see subparagraph 5.4.3).

Assets used in the Conduct of Business

11.4 As the reserves for the Capital Adequacy Requirement are being determined in the context of an ongoing operation, it is inappropriate to include a component in the Inadmissible Assets Reserve in respect of the risks associated with assets used in the conduct of the business. It is recognised that, as a consequence, the Inadmissible Assets Reserve under this Standard may be of lesser amount than the Inadmissible Assets Reserve under the Solvency Standard.

11.5 Holdings in Associated and Subsidiary Financial Entities

11.5.1 Where the entity is a financial institution subject to prudential regulation which requires the maintenance of minimum capital levels, it is not appropriate that, in determining the Capital Adequacy Requirement of the statutory fund, credit be taken for the capital already securing those minimum capital requirements.

11.5.2 Where a part of the capital requirement of the entity is externally sourced - for example, by a subordinated debt arrangement - the market value of the entity should not recognise this debt as a net asset, and accordingly it is not necessary to further reduce that market value in respect of that part of the capital requirement.

11.5.3 Where the entity is an Australian registered life company, the prudential capital requirement should be taken to be the Capital Adequacy Requirement.

Asset Concentration

11.6 The need for a reserve against asset concentration risks is mitigated where the policy liability carries direct asset exposure risk, as may be the case with investment-linked benefits, provided the policy owners have been fully informed of the risk to which they are exposed.

SECTION 12 The Resilience Reserve

12.1 The Resilience Reserve is determined as the additional amount that needs to be held before the happening of a prescribed set of changes in the economic environment, such that after the changes the company is able to meet the policy and other liabilities, including the assessed liability risks in accordance with this Standard.

12.2 The Resilience Reserve is determined by reference to the Admissible Assets of the statutory fund. It is permitted to hypothecate the Admissible Assets to particular liabilities of the statutory fund.

12.3 Where hypothecation is applied it must be applied to the subcategory level within the fund. Hypothecation to a lower grouping than subcategory is not permitted.

12.4 The Resilience Reserve allows explicitly for the beneficial implications for asset risks of diversification across asset sectors. Where hypothecation is applied, diversification should be applied at the hypothecated group level.

12.5 Determination of Resilience Reserve

12.5.1 The Resilience Reserve, where hypothecation is applied, is determined in accordance with the following formulae:

Resilience Reserve determined as:

$$L + RR = \dot{a} (L_t' \times 1/f_t)$$

where

RR = resilience reserve

L = the liability held for the statutory fund for capital adequacy purposes to reflect all liability

risks (including other liabilities) prior to the prescribed change (and equals $\dot{a} L_t$)

L_t = the liability held for the subcategory t for capital adequacy purposes to reflect all liability risks (including other liabilities) prior to the prescribed change

L_t' = value of that liability after the prescribed change

f_t = A_t' / A_t

A = value of admissible assets of the statutory fund prior to the prescribed change (and equals $\dot{a} A_t$)

A_t = value of admissible assets of the subcategory t prior to prescribed change

A_t' = value of those assets at the Adjusted Yield and further reduced by the Adverse Exchange Movement factor

Adjusted Yield determined as:

Current Yield + DF_t x Prescribed Yield Change

where

$$DF_t = \{ \ddot{O}(E_t^2 + P_t^2 + F_t^2 + I_t^2) \} / (E_t + P_t + F_t + I_t)$$

where

DF_t = the diversification factor for subcategory t

E_t, P_t the proportionate holding of assets in subcategory t, in the asset sectors Equities and Property respectively each multiplied by the factor for that sector:
(Increase in Yield / Current Yield)

F_t, I_t the proportionate holding of assets in subcategory **t**, in the asset sectors **Interest Bearing and Indexed Bonds** respectively each multiplied by the factor for that sector: **{ (Asset Value at Current Yield / Asset Value at Yield after prescribed increase) - 1 }**

- Note**
- 1. DF_t is determined in the scenario of an increase in yields, and is used to determine the Adjusted Yield in that and all other scenarios.**
 - 2. In determining F_t , cash is included in the interest bearing sector.**

12.5.2 Where no hypothecation is applied, the above formulae for determination of the Resilience Reserve must be applied as if there is a single subcategory being the statutory fund itself.

12.5.3 The Resilience Reserve of the statutory fund must not be less than zero. Where hypothecation has been applied, the Resilience Reserve determined for a particular subcategory may be negative.

12.6 Determination of A'

12.6.1 The prescribed changes to the economic environment, subject to paragraph 12.6.2, are:

INVESTMENT SECTOR	ADVERSE CHANGE IN YIELD %
Equities	0.50 + (0.4 x Yield)
Property	2.50
Interest Bearing	1.00 + (0.2 x Yield)
Indexed Bonds	1.00

CURRENCY	ADVERSE EXCHANGE MOVEMENT
All	15% reduction in the value of assets exposed to a denomination other than that of the liabilities.

12.6.2 The adverse change in yield must not be less than the prescribed adverse change in yield for the respective investment sector in accordance with the Solvency Standard.

PLEASE NOTE

In assessing the Resilience Reserve requirements, asset risks should be assessed on the basis of effective asset exposures and adopting a 'look through' approach in accordance with the principles set out in paragraph 5.3.

In assuming the application of discretions in the determination of L', the principles of paragraph 5.2.3 must be applied, and the guidance of section 6 considered.

12.7 Hypothecation of Assets

12.7.1 Hypothecation of assets is considered appropriate in the context of the Capital Adequacy Standard, as it reflects the manner in which the business will be managed on a going concern basis. While accepted in principle, it is necessary that the application of hypothecation be in accordance with a set of requirements which will facilitate consistency of application and minimise scope for manipulation. For these reasons reliance is placed on the concepts of categorisation of business within the Act as the basis for hypothecation. Hypothecation, where applied, must be applied to the level of subcategories within the statutory fund, where the financial recording and reporting requirements of the Act are met in respect of these subcategories.

12.7.2 The Act allows there to exist within a statutory fund one or more clear subcategories in respect of certain types of business (eg annuity portfolio) and a remaining subcategory in respect of the balance of the business of the fund. This latter subcategory may include the Other Liabilities and/or other capital reserves of the statutory fund.

12.8 Determination of A'

12.8.1 It should be assumed that a scenario of adverse change applies consistently to all business of the subcategory. Asset revaluations, in response to the prescribed change in economic environment may be performed at subcategory level.

12.8.2 Where the policy owner liabilities of the subcategory move in harmony with the assets supporting them, the Resilience Reserve in respect of those liabilities can be zero. A Resilience Reserve may be required, however, in respect of the Other Liabilities of the fund (whether in the same or their own subcategory). It is appropriate in these circumstances to use approximate methods in determining A', subject to considerations of materiality.

12.9 Determination of Yield

12.9.1 Yield, as referred to in the above table, is determined in respect of the holdings of the statutory fund and should be taken to mean:

- for Equities, dividend yield;
- for Property, rental yield;
- for Interest Bearing Securities, redemption yield (running yield in the case of irredeemable securities); and
- for Indexed Bonds, real yield.

12.9.2 Dividend yield should be based on the dividend yield under the 50 Leaders Index as at the valuation date, unless the Actuary justifies a dividend yield based on the most recent dividend distributions in force. For overseas equities, an appropriate application of the above requirements is to adopt the 50 Leaders Index as the yield and the prescribed yield change for equities.

12.9.3 Imputation credits in relation to dividends should be ignored.

12.9.4 Rental amounts should be net of expenses and based on most recent leases in force.

12.9.5 Where rental payments on owner occupied and/or vacant properties are imputed in the statutory fund's accounts, the imputation basis should be used. Where not imputed, the Actuary should determine a reasonable rental amount.

12.10 Determination of L'

12.10.1 The required Resilience Reserve is determined by assuming changes in the economic environment which cause asset values to vary. In certain circumstances, these changes also cause both policy benefits and the bases of determining liabilities to vary. Such changes to the value of the liabilities should be allowed for in determining the overall impact of the changes.

12.10.2 In determining the Resilience Reserve required, other liabilities such as provisions for deferred taxation, should be adjusted in a manner consistent with the action the company would take were asset values to change by the prescribed amount.

Diversification Factor

12.11 While for the determination of A' an adverse yield change should be assumed, in determining the diversification factor, the dynamics of that formula require that an increase in yield be used (regardless of the fact that for certain classes of business this may not reflect an adverse change in yield.)

SECTION 13 The New Business Reserve

13.1 The New Business Reserve is determined as;

- a) the additional amount required to ensure that the Solvency Requirement of the statutory fund will be able to be met over the next three years, allowing for capital emerging over that period from the existing business of the fund;**
less
- b) the New Business Capital.**

13.2 Subject to paragraph 13.3, New Business Capital is the aggregate of :

- a) existing, binding arrangements for the external raising of capital specific to the financing of new business within the statutory fund; and**
- b) capital (existing or emerging) in any other statutory fund which is in excess of the Capital Adequacy Requirements of that fund at that time; and**
- c) Statutory Capital, to the extent not already committed in meeting the Expense Reserve requirements of the Solvency Standard.**

13.3 New Business Capital must not be recognised to the extent it would reduce the New Business Reserve below the level required to cover the Solvency Requirement of the statutory fund as at the reporting date.

13.4 The New Business Reserve must not be less than zero.

13.5 A statutory fund should not be considered capital adequate where a projection of the business of that fund over the next three years, assuming future experience during that period in accordance with Best Estimate Assumptions, and reflecting realistic (best estimate) planned levels of growth in new business, reveals a breach of the Solvency Standard.

13.6 It can be argued that it is onerous to require the advance commitment of capital to a statutory fund, where the actual need for that capital may not emerge for a number of years. However, as the required capital is a consequence of the business plans of the fund, it is felt appropriate that the source of that capital be committed. Accordingly it is appropriate to recognise capital, whether internally (shareholders capital, existing and/or emerging profits) or externally sourced, to the extent that capital has been committed to the new business requirements of the particular statutory fund.

13.7 It is considered appropriate to count, for this purpose, capital residing in or emerging from the business of other statutory funds, to the extent it is not committed in meeting the Capital Adequacy Requirement of those funds.

13.8 It is necessary for solvency purposes that capital be immediately available in the relevant statutory fund. The New Business Reserve must provide for adequate capital at the reporting date to meet the Solvency Requirement at that date. Further, while recognition of various sources of capital is permitted in the determination of the New Business Reserve in respect of meeting future Solvency Requirements, availability of this capital in the relevant statutory fund will be necessary at the time it is required to meet the Solvency Requirement.

PLEASE NOTE

Approximate methods for projecting the Solvency Requirement of the statutory fund are adequate, given full disclosure in the Actuary's statement (see section 15.)

Statutory Capital is defined for the company. In determining the New Business Reserve, the excess available may be applied as considered appropriate across the statutory funds of the company.

SECTION 14 Materiality

Overview

Particular values or components are considered material to the overall result of a calculation when their mis-statement or omission would cause that result to be misleading to the users of the information.

Materiality tests assess the significance of the particular value/component by relating it to the amount of the overall result to which it contributes.

14.1 The Capital Adequacy Requirement determined in accordance with this standard is subject to materiality standards applied at a statutory fund level.

14.2 The base amount for materiality purposes is the difference between the assets of the statutory fund and the Solvency Requirement of that fund.

14.3 In applying the materiality standard described in paragraphs 14.1 and 14.2, the Actuary should consider the materiality relative to the base amount of both:

- the major individual components of the Solvency Requirement; and
- the overall cumulative effect of those individual components.

14.4 In applying the materiality standards described in paragraphs 14.1 and 14.2:

- it is appropriate to use as the base amount for materiality purposes a rolling average of the base amount, provided that the average so derived is a function of not less than

three and not more than five years experience and is reflective of the current and anticipated future experience; and

- it is appropriate, as the base amount approaches zero, for alternative key indicators to be used in establishing materiality.

14.5 The following paragraph provides guidance, through the definition of quantitative thresholds which may be used as a base in the judgement of materiality. Materiality will always be a matter of professional judgement - that judgement should be made in accordance with the standards.

14.6 Judgement may be based on the following:

- variations in amounts of 10% or more of the base amount may be presumed material; and
- variations in amounts of 5% or less of the base amount may be presumed immaterial.

14.7 Materiality applies to all aspects of the determination and covers the acceptability of grouped data, modelled projections and approximate valuation methods.

PLEASE NOTE

The Actuary should consider at each valuation, whether a full individual policy valuation needs to be performed to demonstrate the continued appropriateness of any approximate methods.

While the Capital Adequacy Requirement is not disclosed in the financial statements of the company, and hence not subject to that audit process, materiality standards still apply.

It is intentional that the same base amount be applied for materiality purposes in the Solvency and Capital Adequacy Standard.

PART C - ACTUARY'S STATEMENT

SECTION 15 Statement Relating to the Determination

15.1 In respect of any determination of the Capital Adequacy Requirement the Actuary must provide in the investigation report required by section 113 or 115 of the Act, details of the calculation processes and the assumptions used in deriving the results.

15.2 The details of calculation method should include details of:

- any discretions the Actuary has assumed will be exercised;
- the determination of the Inadmissible Assets Reserve;
- the determination of the Resilience Reserve;
- the determination of the New Business Reserve; and
- the construction of Related Product Groups.

15.3 The details of assumptions should include such of the following items as are appropriate :

- the assumptions adopted in determining the Capital Adequacy Liability;
- rates of Bonus and/or Discretionary Addition; and
- Termination Value basis, or a sample of Termination Values on current bases.

15.4 Where benefits form part of a Related Product Group which is immaterial, abbreviated details are appropriate.

ATTACHMENT 1 - CAPITAL ADEQUACY ASSUMPTIONS

	BASE TO WHICH MARGIN APPLIED	QUANTITATIVE RANGE for MARGIN	
		Minimum Margin	High Margin
Servicing Expenses	See Note 1	2.5%	20.0%
Investment Earnings	Best Estimate Assumption	40 basis points	300 basis points
Insured Lives	Best Estimate Assumption	10.0%	40.0%
Annuitants			
- Base	Best Estimate Assumption	2.5%	10.0%
- Improvements pa	see Note 2		
age <75		2.0%	5.0%
age >74		1.0%	2.5%
Total Permanent Disability	Best Estimate Assumption	20.0%	50.0%
Disability Income			
- Active Lives	Best Estimate Assumption	40.0%	80.0%
Disabled Lives			
- Claims in Payment	Best Estimate Liability	20.0%	35.0%
Trauma	Best Estimate Assumption	30.0%	60.0%
Other Insured Events	Best Estimate Assumption	30.0%	60.0%
Voluntary Discontinuance	Best Estimate Assumption	25.0%	100.0%
Options	Best Estimate Assumption	10.0%	40.0%
Investment-Linked Risks	Capital Adequacy Liability - see Note 3	0.5%	2.5%

Notes

- (1) In determining the Capital Adequacy Assumption for Servicing Expenses, the margin is to be applied to the greater of the unit costs required to cover:**
- **the actual cost of servicing each policy in the twelve months prior to the valuation date; and**
 - **the expected costs, on Best Estimate Assumptions, of servicing each policy in the twelve months subsequent to the valuation date.**
- (2) The allowance for annuitant mortality improvements is applied as a percentage per annum improvement in the Capital Adequacy Assumption used in the first year.**
- (3) This is the Capital Adequacy Liability as determined immediately prior to the inclusion of the margin for investment-linked risks.**

ATTACHMENT 2 - DEFINITIONS

Terminology used in this Standard, to the extent it is not specifically defined, takes the same meaning as that in the Act.

This is intended as a consolidated list of definitions, incorporating terminology used in all actuarial standards - some terms may not be relevant to this Standard.

Acquisition Expenses: The fixed and variable costs of acquiring new business.

Acquisition Expense Recovery Carrier: A financially measurable indicator of the element of a product group designed or intended to recover Acquisition Expenses.

Acquisition Expense Recovery Component: A financially measurable component of some income item which is used to recover Acquisition Expenses.

Admissible Assets: The total assets of the statutory fund excluding those assets, or the parts of those assets, prescribed as inadmissible for the purposes of the Solvency or Capital Adequacy Standard.

Actuary: An appointed actuary as defined under the Act.

Approved Country: An overseas country having capital requirements in respect of life insurance business comparable to those in the Act. The business of such countries, when written in a separate statutory fund, is excluded from the capital requirements of the Act. The Approved Countries are UK, USA, Canada.

Best Estimate Assumptions: Assumptions about future experience which are made using professional judgement, training and experience and having regard to available statistical and other evidence and are neither deliberately overstated nor deliberately understated.

Best Estimate Liability: The amount expected on Best Estimate Assumptions to be required to the end of the benefit period to meet future benefits and expenses related to past transactions for the business in force. The calculation process will take into account all factors which are known to be material, including future investment earnings, taxation, any options under the policies and future premiums, where relevant to the calculation.

Best Estimate Bonus: The maximum level of Bonus which (on Best Estimate Assumptions and taking into account the company's profit distribution philosophy, including shareholder entitlements) can be added to a Participating Benefit over its benefit life without supplementary income from other sources, including policy owner retained profits.

Best Estimate Discretionary Addition: The level of discretionary addition which it is expected (on Best Estimate Assumptions and taking into account the company's crediting philosophy) can be added to a Non-Participating Benefit over its benefit life without supplementary income from other sources.

Best Estimate Shareholder Profit: The maximum level of Shareholder Profit which (on Best Estimate Assumptions and taking into account the company's profit distribution philosophy, including policy owner entitlements) can be attributed to shareholders without supplementary income from other sources, including shareholder's retained profits.

Bonus: An amount added at the discretion of the company (including additions in respect of investment experience) to the benefits due under a Participating Benefit, but excluding any guaranteed rate of addition also applicable to the benefit.

Capital Adequacy Assumptions: Assumptions about future experience made in the context of the more adverse experience prescribed for the purposes of capital adequacy.

Capital Adequacy Liability: An intermediate component in the determination of the Capital Adequacy Requirement, which reflects the assessed liabilities in respect of policies on the basis of Capital Adequacy Assumptions.

Capital Adequacy Requirement: the capital requirement calculated in accordance with the Capital Adequacy Standard, as prescribed by the Life Insurance Actuarial Standards Board, in accordance with section 70 of the Act.

Capital Adequacy Standard: the actuarial standard for the capital adequacy of a statutory fund as prescribed by the Life Insurance Actuarial Standards Board, in accordance with section 70 of the Act.

Commencement: the inception of a policy being the point at which Profit Margins are, or would be, first determined.

Current Termination Value: The Termination Value of a policy at the reporting date.

Discretionary Addition: An amount added to a Non-Participating Benefit, at the discretion of the company, to reflect the investment experience of the assets backing the benefit, but excluding any guaranteed rate of addition also applicable to the benefit. For this definition an amount added to a benefit is defined to mean any change to the previously applying contractual conditions that is beneficial to the policy owner.

Establishment Fee: A fee received at the Commencement of a policy which is intended to go towards meeting Acquisition Expenses.

Expense Reserve: A component of the determination of the Solvency Requirement.

Experience Profit: The profit arising from the difference between actual experience and expected experience.

Investment Management Expenses: The fixed and variable costs of managing the investment portfolio.

Maintenance Expenses: The fixed and variable costs of
a) administering policies subsequent to their sale; and
b) administering the general operations of the life insurance company.

Maintenance expenses include all operating costs and expenses other than Acquisition Expenses and Investment Management Expenses.

Minimum Termination Value: The greater of, at the reporting date:

- a) the lowest Termination Value that the company is obliged to pay; and
- b) the amount calculated in accordance with the Surrender Value Standard.

National Government Guaranteed Securities: Securities secured by the national government of the country in whose currency the liabilities of the statutory fund are denominated.

Net Policy Liability: The Policy Liability calculated after allowing for reinsurance premiums as an expense and reinsurance recoveries as income.

New Business Capital: Capital recognised within the context of the Capital Adequacy Standard as an appropriate offset against the new business capital requirements of the statutory fund.

New Business Reserve: A component of the determination of the Capital Adequacy Requirement, which reflects any additional capital requirements of the statutory fund arising from future new business.

Non-Participating Benefit: a non-participating benefit in accordance with section 15 of the Act.

Operating Profit: operating profit in accordance with section 58 of the Act.

Other Liability: A liability according to general accounting concepts, which is referable to the statutory fund, other than a Policy Liability or Subordinated Debt.

Participating Benefit: A participating benefit in accordance with section 15 of the Act.

Policy Liability: A liability calculated in accordance with the Valuation Standard in connection with the determination of earned profit.

Policyowner Profit Share: the entitlement of the policy owner to share in the profits emerging from the benefits.

Profit Carrier: A financially measurable indicator of the provision of a service or related income.

Profit Margin: A percentage of a Profit Carrier, determined in accordance with the Valuation Standard.

PS 201: The professional standard of the Institute of Actuaries of Australia issued June 1995 and titled “Professional Standard 201: Determination of Life Insurance Policy Liabilities.”

Reinsurance: Refers to all arrangements where some part of individual or aggregate insurance risks are ceded to another company or companies and includes cessions of direct writing companies to reinsurance companies or other direct writing life companies and parent companies as well as retrocessions of Reinsurers to their parent companies or other Reinsurers.

Reinsured Policy Liability: The Policy Liability calculated by considering as premiums only reinsurance premiums and considering as benefits only reinsurance recoveries.

Reinsurer: Any company providing reinsurance cover, whether a parent life company, direct writing company or reinsurance company.

Related Product Group: A grouping of products where those products are considered by the Actuary to exhibit benefit characteristics and pricing structures sufficiently similar as to justify grouping for the purposes of profit margin calculation, loss recognition or reporting. A Related Product Group must not extend over subcategories, where a subcategory is defined in the Act.

Resilience: The ability of a statutory fund to withstand shocks to the economic environment in which it operates and which are likely to cause a sudden reduction in asset values or a requirement to assess liabilities using reduced investment earning rates.

Servicing Expenses: The combination of Maintenance and Investment Management Expenses.

Shareholder Profit Share: The entitlement of the shareholder to share in the profit emerging from the benefits.

Shareholder Profits: An amount of profits attributable to the shareholder.

Solvency Assumptions: Assumptions about future experience made in the context of the more adverse experience prescribed for the purposes of solvency.

Solvency Liability: An intermediate component in the determination of the Solvency Requirement, which reflects the assessed liabilities in respect of policies on the basis of Solvency Assumptions.

Solvency Requirement: the capital requirement calculated in accordance with the Solvency Standard, as prescribed by the Life Insurance Actuarial Standards Board, in accordance with section 65 of the Act.

Solvency Standard: an actuarial standard for the solvency of a statutory fund as prescribed by the Life Insurance Actuarial Standards Board, in accordance with section 65 of the Act.

Specialist Reinsurer: a registered life company under the Act, the predominant business of which is Reinsurance business.

Statutory Capital: capital required by the company to comply with section 23 of the Act, to the extent the capital is secured by liquid assets invested with entities which are not related, directly or indirectly, to the company and does not exceed \$5 million.

Subordinated Debt: An instrument approved as such by the Insurance and Superannuation Commission.

Surrender Value Standard: an actuarial standard for the minimum surrender value in respect of a life policy as prescribed by the Life Insurance Actuarial Standards Board, in accordance with section 207 of the Act.

Termination Value: The Termination Value of a policy is either:

- a) the amount that would be paid on the basis used in practice from time to time in the event of voluntary termination; or
- b) where no amount would be paid, the discounted present value of the unexpired risks, future payments and/or contractual premium refunds.

Value of Supporting Assets: The value of assets determined in accordance with the Valuation Standard as being available to support benefits entitled to Bonuses or Discretionary Additions.

Valuation Standard: the actuarial standard for the valuation of policy liabilities as prescribed by the Life

**Insurance Actuarial Standards Board, in accordance with
section 114 of the Act.**