



Institute of Actuaries of Australia

PROFESSIONAL STANDARD 600

FINANCIAL CONDITION REPORTS FOR PRIVATE HEALTH INSURERS

June 2011

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1. INTRODUCTION

1.1 Application

- 1.1.1 This Professional Standard applies to an Appointed Actuary preparing an FCR for an Insurer.
- 1.1.2 Work performed under this Professional Standard is Prescribed Actuarial Advice. Members' attention is directed towards the requirements of the Code in relation to Prescribed Actuarial Advice, as well as to Practice Guideline 199.01 (Prescribed Actuarial Advice Reporting).

1.2 Classification

- 1.2.1 This Professional Standard has been prepared in accordance with the Institute's Policy for Drafting Professional Standards. It must be applied in the context of the Code.
- 1.2.2 This Professional Standard is binding on Members of the Institute in respect of all work covered by the Professional Standard.
- 1.2.3 Non-compliance with this Professional Standard by a Member engaged in work covered by the Professional Standard may constitute Actionable Conduct and may lead to penalties under the Institute's Disciplinary Scheme.
- 1.2.4 This Professional Standard in itself defines the requirements of the Institute in respect of all work covered by the Professional Standard. If a Member believes that the Professional Standard is ambiguous or for some other reason wishes to seek clarification of it, that Member may consult the Institute's Professional Standards Committee for guidance as to the interpretation of the Professional Standard. Apart from legislation or regulatory standards, no other document, advice or consultation (including Practice Guidelines of the Institute) can be taken to modify or interpret the requirements of this Professional Standard.
- 1.2.5 A Member who finds that he or she cannot carry out work in a manner that complies with this Professional Standard must decline to carry out the work, or terminate his or her agreement to do so.

1.3 Background

- 1.3.1 The Act requires each Insurer to have an Appointed Actuary. In so requiring, PHIAC's stated objective is to ensure that expert and impartial advice is available to support the Board and management of an Insurer.
- 1.3.2 The statutory duties of an Appointed Actuary for an Insurer include providing the Board with an annual FCR. A copy of the FCR is provided to PHIAC by the Insurer.



1.3.3 The FCR is a formal documentation of the Appointed Actuary's assessment of the financial condition of the Insurer. It documents an analysis of the experience of the Insurer, provides an overview of the key financial issues and risks facing the Insurer, and forms a significant input to Board and management decision-making. The obligations of the Appointed Actuary with respect to the FCR underline the importance of the Appointed Actuary acting objectively and professionally in performing his or her duties. Members need to understand the obligations that apply to him or her in his or her circumstances. This may require Members to seek legal or other professional advice.

1.4 Purpose

The purpose of this Professional Standard is to direct Members in performing the work referred to in clause 1.1.

1.5 Previous versions

This Professional Standard replaces Guidance Note 670 (Financial Condition Reports for Private Health Insurers).

1.6 Legislation and other requirements

1.6.1 The legislation relevant to this Professional Standard is:

- (a) the Act;
- (b) the Private Health Insurance (Health Benefits Fund) Administration Rules 2007; and
- (c) the Private Health Insurance (Insurer Obligations) Rules 2009.

1.6.2 Some circulars issued from time to time by PHIAC and the Department of Health and Ageing may also be relevant to this Professional Standard.

1.6.3 This Professional Standard must be considered in the context of applicable legislation. If there is a conflict between this Professional Standard and any applicable legislation, then the legislation takes precedence, and any differences must be documented in the FCR. In this context, legislation includes regulations, prudential standards, subordinate standards, rules issued by government authorities and standards issued by professional bodies which have the force of law.

1.6.4 A reference to legislation or a legislative provision in this Professional Standard includes any statutory modification, or substitution of that legislation or legislative provision and any subordinate legislation issued under that legislation or legislative provision. Similarly, a reference to a Professional Standard includes any modification or replacement of such.



2. COMMENCEMENT DATE

This Professional Standard applies to FCRs with an Effective Date of 30 June 2011 or later.

3. DEFINITIONS

3.1 In this Professional Standard:

'Act' means the Private Health Insurance Act 2007 (Cth).

'Appointed Actuary' means a Member appointed under section 160.1 of the Act.

'Board' means the board of directors of an Insurer.

'Claims' means benefit payments to, or on behalf of, the claimant under a health insurance policy.

'Code' means the Code of Professional Conduct of the Institute.

'Department of Health and Ageing' means the Australian Government's Department of Health and Ageing (or its successors from time to time).

'Effective Date' means the date at which the financial condition is being considered, generally the Insurer's balance date.

'FCR' has the same meaning as 'financial condition report' in clause 10 of Schedule 2 of the Private Health Insurance (Insurer Obligations) Rules 2009.

'Insurer' has the same meaning given to 'private health insurer' in Schedule 1 to the Act.

'Material' means relevant to the Insurer's circumstances and is either important or essential in the opinion of the Member. For this purpose, 'Material' does not have the same meaning as in Australian accounting standards.

'Outstanding Claims' at a valuation date is an estimate of the value of Claim payments and related Risk Equalisation transfers and management expenses to be made after the valuation date in respect of Claims which arose on or before the valuation date for which the Insurer is expected to be liable. It includes Claims that have been:

- (a) reported and have not yet been paid; and
- (b) incurred but not yet reported (IBNR),

and includes allowance for future adjustments of paid Claims.



'**PHIAC**' means the Private Health Insurance Administration Council (or its successors from time to time).

'**PHIAC Standards**' means Schedule 2 – Solvency Standard and Schedule 3 – Capital Adequacy Standard of the Private Health Insurance (Health Benefits Fund) Administration Rules 2007.

'**Policyholder**' means the owner(s) of a policy that provides health insurance cover for one or more persons.

'**Risk Equalisation**' means the arrangements described under Division 318 of the Act.

- 3.2 A word that is derived from a defined word has a corresponding meaning.
- 3.3 Other capitalised terms used in this Professional Standard have the same meaning as set out in the Code.

4. MATERIALITY

- 4.1 The Member must take Materiality into account when preparing an FCR. In determining whether something is Material, the Member must take into account the purpose of the FCR. Whether something is Material or not will always be a matter requiring the exercise of the Member's professional judgment.
- 4.2 If the Member has formed the opinion that a matter required to be considered under this Professional Standard is not Material to the FCR in the circumstances, the Member must document that the matter is not Material and provide reasons for forming that opinion, but does not have to further consider that matter. Furthermore:
- (a) if the matter is not Material because it is not relevant to the Insurer's circumstances, the matter may be omitted from the FCR; or
 - (b) if the matter is relevant to the Insurer's circumstances, but is not Material because it is neither important nor essential in the Member's opinion, the Member must state in the FCR that the matter is not Material and provide reasons for such opinion.

5. SCOPE OF FCR

The FCR must include each of the matters listed below, with consideration at the Effective Date of historical analysis and future implications (where applicable):

- (a) business overview;
- (b) recent experience;



- (c) insurance liabilities;
- (d) assets;
- (e) projections of financial position;
- (f) premium rates;
- (g) statutory capital;
- (h) capital management;
- (i) risk management; and
- (j) any additional Material matters not covered above.

6. ASSUMPTIONS

6.1 In any projections or calculations that are performed where:

- (a) legislation, accounting standards, PHIAC guidelines or other rulings require the Appointed Actuary to use specific assumptions or methods;
- (b) an interpretation of legislation, accounting standards, PHIAC guidelines or other rulings supplied by the Insurer or its advisers is being relied upon; or
- (c) the Insurer requires the Appointed Actuary to use specific assumptions or methods,

the Appointed Actuary must:

- (d) clearly state the circumstances;
- (e) discuss whether or not the assumptions and methods are reasonable and consistent with this Professional Standard or any other relevant Professional Standard of the Institute; and
- (f) discuss any resulting implications of any divergence from this Professional Standard or from any other relevant Professional Standard of the Institute.

6.2 There must be sufficient experience analysis, in the Appointed Actuary's opinion, to assess the appropriateness of the Material assumptions. If such experience analysis is not practical, the Appointed Actuary must comment accordingly.



7. DATA

- 7.1 The Appointed Actuary must ensure that the Insurer is aware that preparation of the FCR requires the provision of appropriate and adequate data in a timely manner. In this regard, the Appointed Actuary must specify to management the data and information requirements. If the appropriate information is not provided, the FCR must comment on any information that was requested but not provided and the likely consequent impact on the assessment of the financial condition of the Insurer.
- 7.2 The Appointed Actuary must take reasonable steps to verify and document the completeness and accuracy of the information, including data and reports, provided by the Insurer against the Insurer's financial and other records. Material discrepancies that cannot be resolved with the Insurer must be outlined, together with any consequent limitations of the FCR.
- 7.3 The degree to which the Appointed Actuary relies upon information, including data and reports provided by the Insurer, or upon testing of the data or other information by the Insurer's auditor or other third parties, must be explained, together with an assessment of any consequent limitations of the FCR.

8. BUSINESS OVERVIEW

- 8.1 An FCR must include general background information about the corporate structure and operations of the Insurer, including any Material changes to the Insurer's rules for its health benefit fund(s).
- 8.2 The Appointed Actuary must describe the general characteristics of the Insurer's Policyholders and products that may have a Material bearing on the liabilities and future profitability of the Insurer.
- 8.3 Where Material, the Appointed Actuary must consider:
- (a) the diversification activities of the Insurer and the extent of any associated explicit and implicit guarantees given by it;
 - (b) the support given or likely to be given to the Insurer by any parent or associated body, including both explicit and implicit guarantees.

9. RECENT EXPERIENCE

- 9.1 The Appointed Actuary must discuss any recent industry developments which could have a Material impact on the Insurer's future financial position.
- 9.2 The Appointed Actuary must identify and comment upon any Material features or trends in the Insurer's recent experience to the extent that such experience exists.
- 9.3 In relation to any Material experience items, deviations of actual experience from the projected experience of the Insurer over the period since the



previous balance date must also be discussed, including an assessment of the reasons for these deviations.

- 9.4 The Appointed Actuary must:
- (a) specifically draw to the attention of the Board any areas of Material adverse experience;
 - (b) discuss the risks associated with such Material adverse experience;
 - (c) where he or she considers it appropriate, recommend actions to address such Material adverse experience; and
 - (d) comment on progress by the Insurer's management in addressing any such areas.

10. INSURANCE LIABILITIES

- 10.1 The Appointed Actuary must comment on the appropriateness or otherwise of the method used to determine the insurance liabilities at the Effective Date for inclusion in the Insurer's annual financial statements.
- 10.2 The adequacy of the Outstanding Claims provision for at least the two years prior to the Effective Date must be assessed against subsequent Claims experience.
- 10.3 The Appointed Actuary must comment on any Material issues relevant to the estimation of insurance liabilities, including those arising from the comparison of actual and expected experience.

11. ASSETS

- 11.1 The Appointed Actuary must report and comment on:
- (a) inadmissible assets (for statutory capital purposes);
 - (b) mix of assets by sector type;
 - (c) quality of assets, including asset default / credit risks (level of security);
 - (d) asset concentrations by investment type;
 - (e) liquidity of assets;
 - (f) any financial derivative exposures held; and
 - (g) asset and liability matching.
- 11.2 The responsibility for investment policy rests with the directors of the Insurer. The Appointed Actuary must comment whether, in his or her judgment, the



investment policy pursued by the directors is, or could become, inappropriate having regard to the nature and term of the Insurer's liabilities.

- 11.3 The responsibility for the values to be placed on the assets in the Insurer's balance sheet rests with the directors. The Appointed Actuary must consider and comment on the methods by which those values have been obtained and their appropriateness for the purpose of his or her investigation. The Appointed Actuary must consider and comment on any significant changes in the method of valuation of the assets over the 12 months prior to the Effective Date.

12. PROJECTIONS OF FINANCIAL POSITION

- 12.1 In order to comment on the financial condition of the Insurer, the Appointed Actuary must review or perform projections of the financial position of the Insurer for a period of at least three years from the Effective Date. The projections of financial position must include forecasts of the Insurer's business volumes, profitability, solvency and capital adequacy. These projections may be those performed by the Insurer with a starting date no more than 12 months prior to the Effective Date. The Appointed Actuary must specify whether he or she has performed the relevant projections.
- 12.2 The Appointed Actuary must comment on the suitability of all Material assumptions about expected future experience for the purposes of the projections used for the FCR and their appropriateness in the context of the Insurer's experience and the Insurer's business plans.
- 12.3 The Appointed Actuary must discuss and, where he or she considers it appropriate, analyse, the range of potential profit and capital outcomes for the Insurer over the projection period which the Appointed Actuary considers are plausible and relevant to the Insurer's circumstances.

13. PREMIUM RATES

- 13.1 In assessing the current and future financial condition of the Insurer, the Appointed Actuary must comment on the following matters in relation to the changes in premiums assumed for the purposes of the Insurer's projections in Section 12 of this Professional Standard:
- (a) their sufficiency, in terms of regulatory capital and internal capital targets; and
 - (b) their potential or likely financial consequences on the Insurer's business plans.
- 13.2 The Appointed Actuary must discuss whether expected future profitability is Materially in line with the Insurer's business plans.



14. STATUTORY CAPITAL

- 14.1 The FCR must include the Insurer's calculations which demonstrate its compliance with the PHIAC Standards at the Effective Date, and the projections demonstrating the Insurer's compliance with the PHIAC Standards over at least the period in clause 12.1 of this Professional Standard.
- 14.2 The Appointed Actuary must consider and comment on the Insurer's compliance with the PHIAC Standards. The Appointed Actuary must specifically include comment on:
- (a) the Insurer's insurance liability valuation methodology which is used by the Insurer for the purposes of preparing returns of financial information under the PHIAC Standards;
 - (b) the reasonableness of any discretionary margin adopted by the Insurer for the purposes of preparing returns of financial information under the PHIAC Standards; and
 - (c) the Insurer's processes and controls to monitor and ensure compliance with the PHIAC Standards.
- 14.3 The consideration and commentary above relates to both:
- (a) the four quarters ended at the Effective Date; and
 - (b) the future projections of the relevant items over the period covered in clause 12.1 of this Professional Standard.

15. CAPITAL MANAGEMENT

- 15.1 The Appointed Actuary must consider and comment on the Insurer's approach to setting and monitoring its additional capital resources (that is, capital resources in excess of the capital which the Insurer requires to comply with the PHIAC Standards) over time. The Appointed Actuary must specifically include comment on:
- (a) the Insurer's approach to setting and monitoring the Insurer's additional capital resources and capital needs allowing for residual risk over time, including (if relevant) dividend policy; and
 - (b) key risks arising from that approach to additional capital resources that may impact the Insurer's need for capital support.
- 15.2 In order to provide an understanding of the Insurer's ability to withstand adverse scenarios, the Appointed Actuary must consider and comment on the capital management implications of the range of potential future capital outcomes discussed in section 12.3. Additionally, the Appointed Actuary must comment on the potential impact on the Insurer's capital position of specific adverse scenarios chosen by the Appointed Actuary which are relevant to the circumstances of the Insurer.



16. RISK MANAGEMENT

The Appointed Actuary must:

- (a) identify and discuss the Material risks that could adversely affect the financial condition of the Insurer, including, where he or she considers it appropriate, discussion of their likelihood and potential severity; and
- (b) comment on the treatment of Material financial risks in the Insurer's risk management framework.

17. RECOMMENDATIONS

- 17.1 The Appointed Actuary must consider whether any specific actions by the Insurer are warranted and, if so, the Appointed Actuary must make specific recommendations to the Board within the FCR.
- 17.2 The Appointed Actuary must provide information to support any recommendations.
- 17.3 Where recommendations have been made in previous FCRs, the Appointed Actuary must comment on:
 - (a) progress by the Insurer's Board and management in addressing those recommendations; and
 - (b) the consequences of any lack of progress in addressing those recommendations.
- 17.4 The Appointed Actuary must consider whether any matter(s) in the FCR warrant the specification of an event by the Appointed Actuary as a 'notifiable circumstance' within the meaning of the Private Health Insurance (Insurer Obligations) Rules.

18. RELIANCE ON OTHERS

- 18.1 If, in performing work under this Professional Standard, a Member wishes to rely on someone else's (including another Member's) work, then the Member must:
 - (a) inform the other person that the Member is relying on his or her work; and
 - (b) assess the appropriateness of the other person's work for that purpose.
- 18.2 If, following the Member's assessment under clause 18.1, the Member determines that it is not appropriate to rely on the other person's work, the Member must do his or her own alternative, or supplementary, analysis and must document that analysis.



- 18.3 In the FCR, the Member must:
- (a) state what the Member has relied on that has been provided by another person; and
 - (b) record details of the steps the Member took to determine whether it was appropriate to rely on the other person's work.

19. CONSULTATION AND DISCUSSION

- 19.1 In preparing the FCR, the Appointed Actuary must consult with the Insurer's management.
- 19.2 The Appointed Actuary must consider whether to consult with management or the Board or both, as appropriate, in relation to any recommendations.
- 19.3 The FCR is a formal document which must be submitted to the Board. As such, the Appointed Actuary must seek to discuss the FCR with the directors of the Insurer at a meeting of its Board or of the Board's audit committee.

20. REPORTING AND RECORD-KEEPING

- 20.1 The Appointed Actuary must sign and state the date of completion of his or her written FCR.
- 20.2 The FCR must include a statement that it has been prepared in accordance with this Professional Standard.
- 20.3 The Appointed Actuary must exercise judgment in the amount of detail to be included in respect of advice already given during the period under review. If the Appointed Actuary considers it inappropriate to include all the details of previous advice, then a summary of the Material advice given throughout the period (including any reports in relation to any notifiable circumstances that have occurred during the relevant period) and the outcomes must be included.
- 20.4 Where matters are limited in scope, or if the Insurer has not provided information that the Appointed Actuary considers necessary for the preparation of the FCR, this must be highlighted.

END OF PROFESSIONAL STANDARD 600