



## PROFESSIONAL STANDARD 200

### ACTUARIAL ADVICE TO A LIFE INSURANCE COMPANY OR FRIENDLY SOCIETY

March 2008

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## **1. INTRODUCTION**

### **1.1 Application**

- 1.1.1 This Professional Standard applies to Appointed Actuaries of life insurance companies and friendly societies registered under the Act in the provision of advice as required under the Act. This Professional Standard also applies to Members who support the Appointed Actuary in providing such advice.
- 1.1.2 There are likely to be other matters or situations not directly referred to in this Professional Standard, whether or not referenced by the Act, in which the Actuary's advice will be sought or must be given to the management or the Board of the life insurance company or friendly society. In such circumstances, the Actuary must take account of the general considerations in this Professional Standard along with relevant provisions of the Code.
- 1.1.3 While this Professional Standard is meant to provide direction on the application of the Act to the work of the Appointed Actuary, the Actuary must comply with the Act at all times and seek legal opinion if in doubt.

### **1.2 Classification**

- 1.2.1 This Professional Standard has been prepared in accordance with the Institute's Policy for Drafting Professional Standards, as varied from time to time. It must be applied in the context of the Code.
- 1.2.2 This Professional Standard is binding on Members, 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 Members who find that they cannot carry out the work in a manner that complies with this Professional Standard must decline to carry out the work, or terminate their agreement to do so.



### **1.3 Background**

- 1.3.1 The Appointed Actuary is required, in respect of specific statutory duties under the Act, to provide the Entity or the 'directors of the Entity' with written advice. In doing so, the Appointed Actuary must bear in mind the principal object of the Act as stated in sub-section 3(1) thereof, namely "... to protect the interests of the owners and prospective owners of life insurance policies in a manner consistent with the continued development of a viable, competitive and innovative life insurance industry".
- 1.3.2 Members who, in the course of their employment or consulting contract, assist the Appointed Actuary of a registered life company or friendly society must bear in mind the basic objective of the Act and the position as noted in paragraph 1.3.1.

### **1.4 Purpose**

The purpose of this Professional Standard is to set out the principles to be observed by Actuaries in providing advice that is consistent with, and contributes to, the sound financial conduct of life insurance or friendly society business.

### **1.5 Previous versions**

- 1.5.1 This Professional Standard was first issued in June 1982 as Professional Standard "Life Insurance Companies: Financial Condition Investigations" and subsequently titled Professional Standard No 1.
- 1.5.2 A major revision was made in 1986.
- 1.5.3 Various parts were amended and reissued in April 1993 although effective from May 1992. This Professional Standard, previously Professional Standard No 1, was also amended to conform to the revised format for standards implemented in 1992 and was consequently renumbered Professional Standard No 200.
- 1.5.4 The Professional Standard was revised in 1996 in order to bring the standard into alignment with the requirements of the Act and to delete all reference to friendly societies.
- 1.5.5 This latest revision was required in order to ensure that the Professional Standard is drafted in accordance with the Institute's Policy for Drafting Professional Standards and to incorporate advice to friendly societies.

### **1.6 Legislation**

- 1.6.1 The statutory duties of the Appointed Actuary in relation to the giving of advice to the Entity are specified in the Act. These duties include:



- ▶ **Product Advice:** to provide the Entity with written advice before the Entity issues policies of a particular kind about the proposed terms and conditions, the surrender basis and the unit pricing method. Advice on proposed reinsurance arrangements must also be provided before they are entered into (Prudential Standard LPS310);
- ▶ **Apportionments:** to provide the directors of the Entity with written advice regarding the appropriateness of the proposed apportionment of relevant income and outgoings (section 80 of the Act);
- ▶ **Financial Condition Investigations:** to prepare a written report to the Entity on the investigation into the financial condition of the Entity at the end of each financial year (or at other times as may be required) which is to include a valuation of the Entity's policy liabilities and an assessment of its solvency and capital adequacy position (Prudential Standard LPS310); and
- ▶ **Distributions of Profit and Capital:** to provide the directors with written advice on the likely consequences of a proposed distribution of retained profits or shareholders' capital (sections 62 and 63 of the Act).

1.6.2 An Appointed Actuary has legal obligations to report certain matters, information or opinions to the Entity (including a director or officer of the Entity) or APRA (as relevantly set out in the Act). These obligations are referred to as "whistleblowing". The obligations, details about what must be reported, related powers and protections are provided in sections 98, 98A and 99 of the Act. Members need to understand the obligations that apply to them in their circumstances. This may require Members to seek legal or other professional advice.

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

## 2. COMMENCEMENT DATE

This Professional Standard takes effect from 31 March 2008.

## 3. DEFINITIONS

'Act' means the Life Insurance Act 1995 (Cth) including its Regulations and APRA Rules established under the Act.

'Actuary' has the same meaning as defined in the Code.

'Appointed Actuary' means an Actuary holding an appointment by the



Entity under section 93 of the Act.

**'APRA'** means the Australian Prudential Regulation Authority.

**'APRA Rules'** means the Prudential Rules, Prudential Standards, Prudential Practice Guidelines and Reporting Standards issued by APRA from time to time in accordance with the Act.

**'Capital'** or **'Capital Base'** means (unless otherwise specified) share capital, share premium, retained profits and subordinated debt approved for capital purposes by APRA.

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

**'Discretionary Investment Benefit'** means any participating benefit or non-participating benefit where the benefit is increased to reflect the investment experience of the assets backing the benefit, and where the amount of the increase in the benefit to reflect the investment experience is either subject to averaging over time or at the discretion of the Entity. For the purposes of this definition, the allowance for a certain rate of investment return in determining the premiums for a benefit does not imply that the benefit reflects the investment experience of the assets backing the benefit.

**'Entity'** means the legal entity registered under the Act as the life insurance company, as the friendly society or otherwise, as the context requires. Reference in the Professional Standard to advice to the Entity includes advice to the board of directors of the Entity as the context requires under the Act.

**'General Fund'** means, in accordance with the APRA Rules, the shareholders fund in the context of the life insurance company (other than a friendly society) or the management fund in the context of a friendly society.

**'Institute'** means The Institute of Actuaries of Australia (ABN 69 000 423 656).

**'Material'** means important or essential in the opinion of the Actuary. For this purpose, 'Material' does not have the same meaning as in Australian accounting standards. 'Materiality' and 'Materially' have meanings consistent with 'Material'.

**'Member'** means a Fellow, Accredited, Associate or Affiliate (including student) Member of the Institute.

**'Policy owner'** means the owner of a life policy as defined in the Act, and includes reference to a member of a benefit fund of a friendly society as the context requires.

**'Professional Standard'** is a document setting out practice requirements in a particular situation or area that has been: (1) prepared in accordance with the Institute's Policy for Drafting Professional Standards; and (2) issued



by the Institute.

**'Reasonable Benefits'** – Under participating and Discretionary Investment Benefit policies either the premium or the benefits may be varied. This may enable an Entity to accept risks more confidently in the knowledge that adjustments can be made as experience unfolds. A purchaser of such a policy shares the risk to some extent and is entitled to be treated equitably in the light of that experience. The expression "reasonable benefits" is used in connection with such policies to describe benefits which fall within a range which could reasonably be held to recognise these features and all the matters described in Section 6.2 of this Professional Standard.

**'Statutory Fund'** means, as the context requires, the statutory fund or benefit fund (or approved benefit fund) of a life insurance company (that is a friendly society or otherwise), as defined under the Act.

## 4. OVERALL PRINCIPLES

### 4.1 Written advice

- 4.1.1 Written advice given under the Act must be clearly identified as such.
- 4.1.2 The Actuary must include with his or her advice the reasons for giving the advice, any conditions or limitations imposed on the use of that advice, and any significant commercial factors or risks to which the Entity and policy owners would be exposed. In particular, should the advice be over a major or controversial matter, then the Actuary must also indicate the consequences of following or not following the advice as appropriate.
- 4.1.3 Reference must be made to other documents, if any, that may have been relied upon in providing the advice. Where the Member relies on work undertaken by other Members, the Member must communicate this to the other Members, verifying the reasonableness of the investigations undertaken, and results obtained, by the other Members. Where the Member cannot form an opinion as to reasonableness, alternative analyses must be undertaken, documented and explained.
- 4.1.4 In providing written advice in terms of the Act, the Actuary will, except for financial condition investigations, not necessarily need to prepare a full formal report but must, at a minimum, prepare a statement which includes references to relevant supporting documents or files. The Actuary must make and keep sufficient written notes about relevant matters to enable a formal report to be prepared later if required.
- 4.1.5 Such modelling or other work that has been carried out in support of finalised advice must be adequately documented.



## 4.2 Matters for consideration

4.2.1 In carrying out his or her responsibilities, the Actuary must, among other things:

- (a) comply with the requirements of the Act and other relevant legislation;
- (b) satisfy the Constitution or Articles of Association or other by-laws constituting the Entity;
- (c) provide advice that aims to ensure, within the bounds of reasonable probability, the long term financial soundness of the life insurance business of the Entity; and
- (d) provide advice that seeks to achieve equity in the allocation and distribution of profits or benefits to participating policy owners in general, non-participating Discretionary Investment Benefit policy owners, between different groups of such policy owners, and to shareholders (refer to Section 8.2 of this Professional Standard).

4.2.2 The Actuary must ensure that the Entity is made aware that the responsibilities of an Appointed Actuary cannot be properly carried out unless it makes available adequate and relevant information. If necessary, the Entity's attention must be drawn to section 97 of the Act which gives certain powers to the Appointed Actuary in relation to access to Entity information in order to carry out his or her duties.

In this regard the needs of the Actuary must be specified and, if the appropriate information is not forthcoming, the actuarial report or advice must be qualified or state the Actuary's inability to give advice as the case may be. Where relevant, the Appointed Actuary would then need to give consideration to invoking the provisions of section 98 of the Act.

4.2.3 When providing advice in terms of this Professional Standard, the Actuary must consider all relevant items below and any other matters considered relevant:

- (a) the premium rates and charges on which existing business has been, and current new business is being, written;
- (b) the nature, terms and conditions, and disclosures of the contracts in force and currently being sold with particular reference to all options and guarantees, and the scope for adjusting the terms and conditions in the light of emerging experience;
- (c) the existing investments, the continuing investment policy and a range of plausible future investment experience;
- (d) the business plans, in particular the expected volumes and net capital demands of sales;



- (e) the current and a range of plausible future experience of expenses and taxes;
  - (f) the current and a range of plausible future experience in respect of the risk elements;
  - (g) the current and a range of plausible future experience in respect of lapse and surrender rates;
  - (h) the arrangements for reinsurance and other risk mitigation strategies and arrangements; and
  - (i) the operational capability of the Entity to effectively administer the business.
- 4.2.4 In seeking to protect the ongoing financial soundness of the life insurance business of the Entity, the Actuary must also have regard to:
- (a) the extent of the Entity's capital, its position in the various statutory funds, the ability to transfer it between them, and additional capital which the Entity is able and willing to add in further support; and
  - (b) the need to preserve sufficient capital in the Entity for the ongoing support of the continuing business, both existing and new, especially taking account of the likely new business strain which may arise from the Entity's business plans.
- 4.2.5 An Entity may conduct business other than life insurance business external to the Entity's statutory funds. The ongoing financial soundness of the life insurance business depends, in some part, on the wellbeing of the Entity as a whole. The Actuary must also consider in general the effect other business the Entity conducts may have on its life insurance business.
- 4.2.6 While an Actuary may delegate certain tasks required under this Professional Standard, the Actuary nonetheless remains ultimately responsible for the advice provided.

## **5. PRODUCT AND REINSURANCE ADVICE**

### **5.1 Principles of product and reinsurance advice**

- 5.1.1 The following paragraphs set down those matters which the Actuary must address in providing advice on products and reinsurance. These matters may well go beyond the requirements of APRA Rules.
- 5.1.2 APRA Rules (Prudential Standard LPS310) require the Appointed Actuary to provide advice to the Entity on 'policies of a particular kind' before they can be issued. The advice must cover proposed 'terms and conditions' -



which includes premium rates, fees and charges - surrender bases and unit pricing.

- 5.1.3 The Actuary must provide product advice when there are proposed changes in terms and conditions or when he or she recognises that there is a change in circumstances relating to the product that has Material financial implications.
- 5.1.4 Where existing policies have terms and conditions which are subject to variation, then when providing advice on proposed new terms and conditions or changes to terms and conditions of similar policies, the Actuary must comment on the impact of those proposals on the business already issued.
- 5.1.5 With respect to the reference to 'company' in Section 20 of Prudential Standard LPS310, the Actuary, by reference to the Constitution or Articles of Association, other by-laws of the Entity and with the Board itself, must clearly establish to whom in practice the advice must be directed.

## **5.2 Premium rates and charges**

- 5.2.1 When providing advice on premium rates and charges, the Actuary must make a statement on their 'suitability' or 'adequacy' in terms of meeting corporate pricing standards, contributing to marginal and overhead expenses and return on financing capital. The statement of their suitability cannot be an absolute statement - it is inevitably a probability. The adequacy or otherwise of premium rates and charges cannot, therefore, be other than a matter of judgment. The required judgment must be based on the use of sound techniques and take into account the complex matters involved in contracts containing various options or guarantees.
- 5.2.2 In particular, apart from any general advice that the Actuary provides, if the premium rates and charges for a product are considered unsuitable or inadequate, the Actuary must state why that opinion is held and indicate the potential or likely financial consequences of their adoption by the Entity. The Actuary must indicate actions the Entity could take to counteract the potential risks.

### **Assumptions about future experience**

- 5.2.3 The Actuary must be satisfied as to the suitability of all Material assumptions about the expected future experience.
- 5.2.4 The undertaking of new types of risk should not be prevented solely because no specific past experience exists or is available. In determining an opinion as to the likely future experience in such circumstances, the Actuary must take into account such statistics relating to similar events or conditions as can be obtained and are considered relevant. The Actuary must comment on any limitations that apply to the terms and conditions of



policies while experience is being gained. Where appropriate, and quite apart from any general monitoring that the Actuary undertakes for risks, the Actuary must specify that close monitoring of experience of new risks is required.

- 5.2.5 The various elements in the assumptions may have experienced volatility in the past and confidence about the likely future will vary according to that and other considerations. The Actuary must consider the degree of uncertainty in each of the assumptions and the potential effects of experience being relatively adverse. The Actuary must consider the Entity's capacity to finance such adverse experience.

### **Equity**

- 5.2.6 In the case of a participating policy, a buyer will be entitled to a share of the profits made by the Entity during the life of the policy. In the case of a non-participating Discretionary Investment Benefit, a buyer pays premiums for benefits where one or more of the elements can be varied during the life of the policy at the discretion of the Entity. In both these cases, equity may be less of a consideration at the time the initial premium rates or benefits are established than it is when the experience emerges and the Actuary advises the Entity as to how the discretion should be exercised.
- 5.2.7 In the case of a non-participating policy, which has no provision for the terms to be varied, consideration of equity may have regard to the fact that potential buyers can choose whether to buy the product or a competing product based on the terms being offered.
- 5.2.8 In the cases outlined above, the Actuary, at the time of advising on the initial premium rates and benefits, must try to ensure that the maintenance of equity during the life of the policy will not present undue practical difficulty.

### **Finance**

- 5.2.9 Benefits paid plus expenses incurred plus the required increase in reserves to be held in respect of the future liabilities may exceed premiums received in certain circumstances, for example, in the early years of a policy. Where this is the case, the Actuary must consider:
- (a) the amount and incidence of the estimated required finance;
  - (b) the capacity of the Entity to meet this requirement for finance and the source of this finance; and
  - (c) any constraints which should be imposed on the volume of new business, the period for which it may be written, size of policy, or otherwise.



### **Tests of suitability**

- 5.2.10 The Actuary will normally test the suitability of premium rates and charges by using 'profit testing' projection methods with all reasonable contingencies and the cost of capital taken into account. In using such methods the Actuary will normally test not only on the 'best estimate' view of future experience but also on a range of plausible variations from that best estimate. However there may be occasions when it is not necessary to adopt a 'profit testing' approach.
- 5.2.11 For each variation in the view of future experience, the Actuary will make a number of assumptions about items listed in paragraph 4.2.3 of this Professional Standard.
- 5.2.12 The range of matters to be taken into account when considering suitability may well vary with the particular circumstances. In each case, the Actuary must be in a position to justify any decision to limit the range of the scenarios tested.

### **5.3 Other policy terms and conditions**

- 5.3.1 The Actuary advising an Entity on the structure of a life insurance product must consider all policy terms and conditions, not just the adequacy or otherwise of premium rates and charges. The Actuary must give advice on the financial impact or risks of the proposed policy definitions, any guarantees and options, and any other matter the Actuary considers relevant.
- 5.3.2 The Actuary must satisfy himself or herself that the documentation and promotional material related to the product and prepared by the Entity is consistent with the terms and conditions of the policy.

### **5.4 Surrender basis**

- 5.4.1 APRA Rules (Prudential Standard LPS310) require the Appointed Actuary to provide advice on the proposed basis for determining the surrender values, if applicable.
- 5.4.2 When reporting on the surrender value basis for a life insurance product, the Actuary must consider the impact the proposed basis would have on the solvency of the Entity. Whilst it may be appropriate or unavoidable to incur losses on some surrenders, the Entity must be advised if surrenders could cause serious loss. If the surrender value basis is guaranteed, the extent of this guarantee and its possible financial effect must be commented upon.
- 5.4.3 The Actuary, when providing advice on a surrender value basis, must consider equity between surrendering and continuing policy owners, and practical implementation issues, as well as the requirements of any APRA



Rules applicable.

## **5.5 Unit pricing**

- 5.5.1 If policies provide benefits by reference to units, APRA Rules (Prudential Standard LPS310) require that an Entity must not issue policies of a particular kind unless the Appointed Actuary has provided written advice on the proposed means by which unit values are determined.
- 5.5.2 The Actuary must comment on the extent to which the unit pricing system determines a unit price so that new, continuing and terminating policy owners are treated equitably and in accordance with policy terms and conditions.
- 5.5.3 The Actuary must comment on the robustness of the unit pricing approach and system.
- 5.5.4 The Actuary must comment on the discretions that the Entity has in determining unit prices and on the equity and the manner in which the Entity proposes to exercise those discretions.

## **5.6 Reinsurance arrangements**

- 5.6.1 APRA Rules (Prudential Standard LPS310) require that an Entity must not enter into a reinsurance arrangement unless the Appointed Actuary has provided written advice on the proposed reinsurance arrangement.
- 5.6.2 When commenting on the reinsurance arrangements, the Actuary must consider the issues listed above in paragraph 4.2.3 where relevant, and the financial impact of the proposed reinsurance and retention limits.
- 5.6.3 The Actuary must comment on the circumstances under which the reinsurance arrangements, in his or her judgment, could become inappropriate.

## **5.7 Commission**

- 5.7.1 The Actuary must have regard to all expenses when advising on product terms and conditions. The Actuary must provide advice on the financial risks that the commission terms may impose and on the appropriateness of the proposed commission arrangements (including the total commission allowed for in the pricing of a product).
- 5.7.2 Consideration must be given to the recoverability of commission in the case of early termination of policies. If appropriate, the risks associated with a high level of policy termination, and a subsequent failure to realise the assumed recoverability of commission, must be highlighted.



## **6 APPORTIONMENTS**

### **6.1 Principles of apportionments**

- 6.1.1 A number of items must be apportioned between different accounts of an Entity. The Act requires that the Board of the Entity receive written advice from the Appointed Actuary before an apportionment is made in the accounts of the Entity.
- 6.1.2 Sections 78 and 79 of the Act require an Entity to apportion income and outgoings relating to the mixed business of two or more statutory funds, classes, categories or sub-categories of business. Section 80 of the Act requires that any apportionment be made on an equitable basis and according to generally accepted accounting principles. The Appointed Actuary must provide written advice as to whether the apportionment is appropriate.
- 6.1.3 In preparing the advice, the Appointed Actuary must give consideration to the nature of the item being apportioned and the business to which it relates to ensure that apportionments to a statutory fund relate to the business of the fund.
- 6.1.4 As well as the requirement of the Act, further apportionments may be required for taxation purposes or for determining assumptions for calculating policy liabilities or premium rates.
- 6.1.5 As well as the requirements of the various laws, the Actuary must also consider the following principles:
- (a) promoting the financial soundness of the Entity;
  - (b) promoting the meaningful disclosure of the conduct of the business of the statutory fund;
  - (c) consistency of treatment between reporting periods; and
  - (d) the equitable treatment between policy owners and shareholders.

### **6.2 Equity**

Equity of the apportionment is a matter of judgment for the Actuary after considering all relevant factors. The Actuary must consider the following factors:

- (a) the relationship between the nature of the item and the conduct of the business of the statutory fund or account to which it is allocated;
- (b) the objectivity of the basis. Where practical the basis should result in consistent treatment from one period to the next and avoid significant



changes in basis resulting from differences in opinion of the person making the apportionment. Objectivity does not prevent a method from being adjusted over time to meet changing circumstances where appropriate;

- (c) the magnitude of the effect of the item being apportioned on the statutory fund or account. For example, it would be inequitable to apportion audit fees equally amongst funds where some funds are very small and require little audit work;
- (d) Materiality. It is acceptable for a simplistic basis to be used for apportionment of small items where the financial effect on any statutory fund or account is not Material; and
- (e) the existence of discretionary or participating business, and the impact that the proposed apportionment between such business and other non-participating business would have on the implicit allocation of income and expenditure between policy owners and shareholders.

### **6.3 Intergroup apportionments and outsourcing**

6.3.1 Intergroup apportionments may occur because the Entity is a part of a group of companies sharing the same resources. While these are outside the scope of section 80 of the Act, the Actuary's written advice must consider whether the net result of such apportionments to the Entity and to statutory funds are reasonable and commercial for the services received or provided. In this context, the Actuary must keep in mind the provisions of section 30(d) of the Act.

6.3.2 Outsourcing to intergroup companies represents another area where attention is required by the Actuary to ensure section 30(d) of the Act is not breached. This commonly includes investment management, distribution and data processing.

6.3.3 In general, the Actuary must be satisfied that the outsourcing arrangements are on reasonable and commercial terms. In this regard, the Actuary is also reminded of the requirements of section 98 of the Act.

### **6.4 Expenses**

6.4.1 A major item to be apportioned will be expenses. Where expenses relate to a specific fund, class, category or sub category, they must be allocated directly. Indirect expenses must be allocated on an objective basis using the principles outlined above.

6.4.2 The level of detail involved in the apportionment process will vary depending on the financial systems available to produce results.

6.4.3 Expenses must also be split between acquisition and maintenance for



determination of assumptions for calculation of policy liabilities and an assessment of the solvency and capital adequacy requirements. The split between acquisition and maintenance has a direct effect on the reported profit of the Entity and particular attention must be paid to it. Consistency of treatment from year to year is particularly important to avoid distortion of results.

## **6.5 Investment income**

Where separate assets are maintained for particular blocks of business, then investment income relating to those assets must be allocated directly. Where separate assets are not maintained, then investment income must be allocated allowing for cash flows and assets invested unless the associated policy documents require otherwise.

## **6.6 Taxation**

6.6.1 In many cases, it is not possible to charge tax directly to a statutory fund or component of the fund and apportionments must be made. The tax treatment of expense deductions in particular can present difficulties when allocating tax liabilities.

6.6.2 The apportionment basis for taxation must be clearly specified and make allowances for the method of taxing investment income in funds with more than one class of business, treatment of expense deductions and imputation credits. Where imputation credits earned by one block of business are passed on to other blocks of business or shareholders, this must be done on a consistent basis.

## **7. FINANCIAL CONDITION INVESTIGATIONS**

### **7.1 Principles of financial condition investigations**

7.1.1 The following paragraphs set down those matters which the Actuary must address in examining and reporting on the financial condition of an Entity. They may well go beyond the requirements of the Act.

7.1.2 APRA Rules (Prudential Standard LPS310) require the Appointed Actuary to provide advice on the financial condition of the Entity including an assessment of the Entity's solvency and capital adequacy position.

7.1.3 The Actuary must consider the solvency and capital adequacy position of the Entity over both the short and long term and must comment on the Entity's continuing ability to deal equitably between policy owners and, where applicable, shareholders.

7.1.4 The Actuary must advise on the financial impact of plausible and adverse scenarios on the solvency and capital adequacy position of the Entity.



- 7.1.5 The Actuary's investigation would normally be on an open-to-new business basis (other than in the case of an assessment of the solvency requirement), however, the Actuary must also consider the possibility that the Entity might be closed to new business.

In particular, the Actuary must consider the liabilities and reserves, the corresponding assets, and their inter-relationship. In the event that the Actuary considers that there is a significant possibility that the Entity may breach its capital adequacy requirement, or the Entity may be unable to provide Reasonable Benefits to its policy owners, the Actuary must recommend a course of action for the Entity to adopt.

- 7.1.6 In examining and reporting on the financial condition of the Entity in terms of this Professional Standard, the Actuary must give consideration to Materiality in relation to the Entity.

## **7.2 Data**

- 7.2.1 The Actuary must state what processes and procedures have been adopted to test or establish the quality of, and to minimise potential inaccuracies in, the data used in carrying out the investigation.

- 7.2.2 The Actuary must comment on any of the operations or systems that are likely to have an impact upon the accuracy of the data. Where necessary, the risks involved because of any data inaccuracy must be quantified and appropriate liability provisions and capital reserves established in accordance with the APRA Rules.

## **7.3 Experience analysis**

- 7.3.1 The Actuary must identify and comment upon any Material and significant features or trends in the Entity's recent experience, over a period of at least three previous years, to the extent that such experience exists.

- 7.3.2 In relation to any Material experience items, deviations of actual experience from the expected experience of the Entity over the last period since the previous balance date must also be discussed, including an assessment of the reasons for these deviations.

- 7.3.3 The report must include comments on steps taken, or proposed to be taken, by the Board or senior management of the Entity to address any areas of adverse experience.

## **7.4 Assets**

- 7.4.1 Subject to any statutory regulations, the responsibility for investment policy rests with the directors of the Entity. However, the Actuary must decide 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 Entity's liabilities. The Actuary must, in the report to the Entity, advise what constraints on investment policy he or she regards as necessary to protect policy owners.

7.4.2 The financial condition of an Entity depends fundamentally on the relationship between the nature and term of the assets and the corresponding liabilities. In considering this relationship, the Actuary must assess and report on the financial consequences of:

- (a) the mismatching of assets and liabilities;
- (b) any guarantees and options (including surrender) available under policies and the likely effect of the exercise of these options on the Entity;
- (c) the marketability/liquidity of the assets in circumstances when they may be called upon to meet policy proceeds, especially when exercised under a guarantee or option;
- (d) any asset default/credit risks; and
- (e) any financial derivative exposures held.

7.4.3 The Actuary must also report and comment on:

- (a) the inadmissible assets (for capital purposes) of each statutory fund;
- (b) the mix of assets by sector type for each statutory fund; and
- (c) the mix of assets by quality (level of security),

having regard to the nature and term of the liabilities.

The Actuary must comment on the reserves to cover any of the above and must comment on whether or not those reserves have been determined in accordance with the requirements of the APRA Rules.

7.4.4 As in the case of investment policy, the responsibility for the values to be placed on the assets in the Entity's balance sheet rests with the directors. The 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 Actuary must comment on any significant changes in the method of valuation of the assets. Where the Actuary considers that the values are unsuitable in any respect, reasons must be given and an appropriate liability adjustment and capital reserve established in accordance with the APRA Rules.

## **7.5 Policy liabilities**

7.5.1 The Actuary must review the Material risks reflected in the policy and other



liabilities of the Entity and discuss the principal means by which those risks are managed and/or controlled. This analysis must, *inter alia*, address exposure to large claims, claims variation and potential liability "shock" events (for example, catastrophes), liability options or guarantees, claims run-off management, expense risks and risks associated with other experience items.

7.5.2 The Actuary must value the policy liabilities in accordance with the APRA Rules.

7.5.3 The Actuary must discuss the financial significance of changes in assumptions made since the previous valuation and the reason(s) why the changes were made.

7.5.4 The Actuary must provide an analysis of the emerging profits that identifies the key drivers of the emerging profit over the year and the ramifications for future potential profit results. Where the Entity has Material participating business, a corresponding analysis must be produced in respect of policy owner profit emergence.

## **7.6 Solvency and capital adequacy**

7.6.1 The Actuary must assess the solvency and capital adequacy requirements of each statutory fund in accordance with the APRA Rules. The Actuary must also assess the management capital requirement of the General Fund.

7.6.2 The Actuary must make appropriate provisions for reserves to meet adverse contingencies that have been identified and are not specified in the method of calculation of the solvency, capital adequacy and management capital requirements as prescribed in the APRA Rules.

In respect of each such contingency, the Actuary must:

- (a) describe the contingency and explain the purpose of making a provision;
- (b) describe how the amount of the provision has been determined; and
- (c) identify where these provisions are held.

7.6.3 The Actuary must advise, not only on the solvency and capital adequacy position of the Entity over the past year and as at the date of the valuation, but also on the Entity's continuing ability to remain solvent and capital adequate.

7.6.4 When advising on the Entity's ability to remain solvent and capital adequate, the Actuary must review and comment on:

- (a) the management of capital resources in excess of capital adequacy;



- (b) the sensitivity of capital levels to adverse experience;
- (c) the level of capital needed as excess over the capital adequacy requirement; and
- (d) the sources and availability of future capital.

7.6.5 Where the Actuary's projections, including new business, reveal that a deficit against the capital adequacy requirement may result under reasonable adverse assumptions (or where such a deficiency currently exists), the Actuary must comment on:

- (a) the reasons for the deficiency; and
- (b) the proposed management actions to eliminate the deficiency, and the likely effect of these actions.

7.6.6 The Act requires an Entity to comply with the solvency standard, capital adequacy standard and management capital standard at all times. The Actuary must comment on the level of, and reasons for, any breaches of the capital adequacy requirement during the past year and the subsequent actions that were taken by the Entity.

## **7.7 Premium rates and charges**

The Actuary must provide an opinion as to whether the premium rates and fees charged by the Entity are, or could become, unsuitable. If a review of premium rates is recommended, it need not be completed as a part of a financial condition report.

## **7.8 Reinsurance**

7.8.1 The Actuary must examine and report on the Entity's existing reinsurance arrangements, including both risk related and financial support arrangements.

7.8.2 The Actuary must describe in general terms all arrangements in-force, their purpose, and comment on the adequacy, effectiveness and administration of the arrangements. The description must include the identity of the reinsurer, the nature of cover and the circumstances, if any, under which the reinsurer can terminate the arrangement for in-force business.

7.8.3 The Actuary must comment if, in his or her judgment, any reinsurance arrangements undertaken by the Entity are, or could become, inappropriate.



## **7.9 Business risks**

- 7.9.1 The Actuary must comment on the effectiveness of the Entity's controls and procedures surrounding the unit pricing processes and other processes that determine benefits payable to policy owners and premiums, fees and charges payable by policy owners.
- 7.9.2 The Actuary must comment on the likely consequences and financial impact in the event of a failure in these controls and procedures.
- 7.9.3 The Actuary must consider, in the circumstances of the particular Entity being advised, whether comment needs to be made upon the more general business or legal risks that the Entity faces (such as dishonesty, fraud, disasters, compliance) and which could impact the financial security of the policy owners, and how well the Entity is managing such risks.

## **7.10 Risk management**

The Actuary must include an assessment of the suitability and adequacy of the risk management framework as part of the financial condition report.

## **7.11 New business assumptions**

- 7.11.1 The Actuary must satisfy himself or herself of the reasonableness of the new business assumptions underlying the Entity's business plans.
- 7.11.2 The Actuary must consider whether, for the purposes of satisfying actuarial standards, modifications must be made to those assumptions.

# **8. DISTRIBUTIONS OF PROFITS AND CAPITAL**

## **8.1 Principles of distributions**

- 8.1.1 The directors are responsible for deciding the distribution of retained profits and shareholders' capital after receiving written advice from the Appointed Actuary as required by the Act. In addition, Entity by-laws and benefit fund rules may impose additional constraints on the distribution and/or requirements on the Actuary.
- 8.1.2 Advising as to likely consequences of a distribution of retained profits, surplus or shareholders' capital is complex and requires considered judgment. The legal and professional framework within which the Actuary must exercise this judgment is set out in Section 4 of this Professional Standard.
- 8.1.3 The written advice as to the likely consequences of the distribution of



retained profits or shareholders' capital must give the reasons upon which the advice is based and must also report on the short term outlook for future distributions to policy owners and transfers between statutory funds and shareholders' funds. Significant trends in profit or the capital adequacy or solvency position must be interpreted and the impact of any subordinated debt must be considered.

- 8.1.4 In advising in relation to overseas business, the Actuary must also consider the relevant overseas regulatory requirements.

## **8.2 Equity**

- 8.2.1 There is no universally agreed definition of equity and a decision about it can only be a matter of judgment. In making this judgment, the Actuary must give consideration to:

- (a) the sources of the profit disclosed, the relative contribution to it by the different groups of policy owners and by the shareholders, and the release of capital previously committed to support existing business;
- (b) the relative risks taken by the participating and Discretionary Investment Benefit policy owners in paying premiums for benefits either of which may be varied, by profits being retained on their behalf, and by the shareholders in contributing capital;
- (c) the need to maintain the overall viability of the Entity for existing and future policy owners; and
- (d) prevailing practices within the actuarial profession.

- 8.2.2 Likewise, a decision about Reasonable Benefits for the different groups of participating and Discretionary Investment Benefit policy owners can only be a matter of judgment. In making this judgment, the Actuary must give consideration to each of the following (and the inter-relationships between them):

- (a) the terms and conditions including the premium rates, options and guarantees on which the policies were issued;
- (b) the information conveyed by the Entity to the policy owners in connection with the sale and subsequently;
- (c) the experience of the Entity, subsequent to the issue of the policies, in relation to each of the elements relevant to the policy such as mortality, morbidity, the return on investments, tax and expenses of administration, lapse and surrender experience;
- (d) the Entity's past practices; and
- (e) the need, if any, for each policy to make a contribution, from the profit



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it generates, to the Entity's capital base in recompense for, and appropriate to, the support it may have received from the capital base and the Entity generally.

**END OF PROFESSIONAL STANDARD 200**