



**EXPLANATORY MEMORANDUM TO
SECOND EXPOSURE DRAFT OF PROFESSIONAL STANDARD 300**

VALUATIONS OF GENERAL INSURANCE CLAIMS

November 2009

A. About this Explanatory Memorandum

1. This Explanatory Memorandum has been prepared to assist Members in understanding, and responding to, proposed changes to PS 300 as set out in the Second Exposure Draft of the standard.

B. Background

2. Professional Standard 300 – Valuations of General Insurance Claims (“PS 300”) was substantially amended in August 2007. Following its release, some issues were raised by Members concerning the application of the revised standard. It was apparent from the issues raised that there had been unintended consequences flowing from the revised PS 300 and which it was desirable to address.
3. The General Insurance Practice Committee formed the PS 300 Working Group to undertake a review of the issues raised by some Members. Recent regulatory changes by APRA to GPS 310 and GPS 311 regarding the preparation of Insurance Liability Valuation Reports reinforced the need for a review. The members of the PS 300 Working Group are:

Elaine Collins (Convenor)
Nick Allsop
Peter Hardy
Andrew Houltram
Blair Nicholls (alternating, where required, with Elaine Yang)
Adam Searle
Bruce Watson
Anne Peters (Institute representative)

4. Following the formation of the PS 300 Working Group, all Members were invited – through media such as the General Insurance Practice Committee Newsletter, Actuary Australia and the Institute Information Bulletin – to provide comments on the August 2007 standard and raise any difficulties or issues Members had experienced in applying the standard for further consideration.



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5. This input formed the basis of an Issues Brief released to Members in August 2008. A series of 17 questions were posed, and member comment invited, on specific issues with respect to PS 300. A total of nine submissions in response to the Issues Brief were received.
6. Following this, the PS 300 Working Group released an Exposure Draft of proposed changes to the standard for Member comment. A total of 13 submissions were received. The PS 300 Working Group found the submissions very useful in formulating this Second Exposure Draft of the standard and thanks Members for their comments.
7. The balance of this Explanatory Memorandum provides an overview of the key changes made in the Second Exposure Draft (Section C), as well as an outline of changes submitted by Members which were not accepted by the PS 300 Working Group (Section D). Section E of this Explanatory Memorandum provides clarifications as to the intention of the standard in certain respects in response to some submissions.

C. Principal changes between the Exposure Draft and the Second Exposure Draft

8. Most of the proposed changes – which are marked up in the Second Exposure Draft – are self-explanatory. The following changes, however, are drawn to Members' attention:
 - (a) clause 1.2.5 – this has been deleted as it essentially duplicates clause 1.6.1;
 - (b) clause 1.6.2 – the references to Level 2 Insurance Groups have been included to make it abundantly clear that relevant valuations performed for such groups fall within the scope of the standard;
 - (c) clause 6.3 – with the broadening of the scope of PS 300, some submitters commented that there were now instances where the standard stipulated something which would not be appropriate for certain valuations (for example, valuations for a portfolio sale where a discount rate, other than one based on the redemption yields of a Replicating Portfolio, might be required by the purchaser to meet their own internal decision-making purposes, but which might otherwise give rise to non-compliance with clause 10.2 of the standard). The PS 300 Working Group considered that it would not be feasible readily to craft exceptions from PS 300's scope in order to cover all eventualities. As such, it has made certain changes to clause 6.3 in order to address this issue. The PS 300 Working Group also draws to Members' attention that the clause not only covers the items listed in clauses 6.1 and 6.2, but also applies to "any aspect of a matter covered in



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this Professional Standard", giving a very broad scope to the application of clause 6.3;

- (d) clause 10.9.1 – this clause has been deleted as it was considered either unnecessary or was covered elsewhere in the standard; and
- (e) clause 13.2.3 – this clause has been added in response to comments on the first Exposure Draft that were received from Members. Its intent is to require a high level review of the adequacy of the FCL estimate made at the Previous Valuation. The PS 300 Working Group recognises that for the FCL, the quantification required by clause 13.2.1 for the OCL will often be impractical. Consequently, an explicit statement has been incorporated to confirm that such quantification is not required.

For example, in circumstances where the FCL has been estimated by application of a loss ratio to an unearned premium value, it is the PS 300 Working Group's intention that clause 13.2.3 can generally be satisfied by comparing:

- ▶ the loss ratio that was applied to the unearned premium at the Previous Valuation with
- ▶ the ultimate loss ratio that is implied by the outstanding claims liability estimate for the most recent accident period at the current Valuation.

- 9. The issue of dealing with changes in experience and defining appropriately the different types of experience which would be relevant at the different cut-off points was one of the issues most commented upon by submitters.
- 10. A number of changes have been proposed to clauses 11.1.1(b) and 11.1.2 as a result of the comments received. Generally, the changes proposed require Members to allow for Material changes in experience prior to the valuation date. Where a Member becomes aware of an extreme event which occurs after the valuation date but before the Member signs the Actuarial Report, the standard would require either:
 - (a) if time reasonably permitted, that the Member allow for the event in his or her valuation; or
 - (b) if time did not reasonably permit, that the Member disclose in his or her Actuarial Report that such event has occurred and comment on the impact on results in the Actuarial Report.
- 11. The PS 300 Working Group also notes that:
 - (a) generally, submitters favoured the use of the word "extreme", though there was a difference of view as to whether:



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- a list of factors for Members to consider in determining whether an event was extreme should be included; or
- the word "extreme" should be defined; or
- it should be left as a matter of professional judgment to determine if an event is "extreme".

On balance, the PS 300 Working Group adopted the latter approach for consistency in moving towards a more "principles-based" standard; and

- (b) a function of a Professional Standard is to set out a minimum set of requirements, departure from which would be unprofessional. There is nothing to prevent a Member, if he or she so chooses or considers it appropriate in a particular case, from adopting a higher level of disclosure in an Actuarial Report than would be required under the Professional Standard (for example, taking into account Material events which occur after the valuation date but before the Member signs the Actuarial Report). Again, the PS 300 Working Group has taken the view that Members can be expected to exercise professional judgment in such cases.

D. Changes not made

- 12. Various submitters made comments which have not been adopted in the Second Exposure Draft. It is beyond present scope to cite all such comments. However, the key such comments are summarised below.

D.1 Submissions made and beyond present review scope

- 13. Various suggestions were made for changes which the PS 300 Working Group considered were beyond the scope of the more limited purpose of the present review (namely, to address unintended consequences flowing from the current August 2007 issue of PS 300 and to address changes made by APRA to GPS 310 and GPS 311). These included:
 - (a) when considered in conjunction with PS 100, the potential for there to be a conflict between the requirements imposed on, or discretion accorded to, valuing and reviewing actuaries. The PS 300 Working Group has endeavoured to make the standard as consistent with PS 100 as possible and also notes that PS 100 is currently being reviewed;
 - (b) definition of "Central Estimate" and the possible practical effect of requiring actuaries to misrepresent a scenario projection as intended to be a mean of the Outstanding Claims Liability or Future Claims Liability;



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- (c) clause 5.1.1 – based on a preference for PS 300 to be more of a principles-based standard, a submission was received suggesting that a Member’s judgment should be relied upon to determine when a report should be produced that satisfies all of the requirements laid down in clause 5.2;
- (d) clause 10.2.2 re the use of discounted rates – the issue of risk-free discount rates is currently being considered by another Taskforce formed by the Institute; and
- (e) clause 10.9.2 (clause 10.9.1 in the Second Exposure Draft) – potential confusion as to whether the Central Estimates need sensitivity analyses.

D.2 Other submissions

14. With respect to other submitters’ comments which were not taken up by the PS 300 Working Group:

- (a) concerns were expressed that clause 5.1.1(a) appeared to require a fully PS 300-compliant report in respect of a valuation of the retained liability of an insured entity under liability claims (that is, the gross liability and the liability net of insurance). The submitter commented that such valuations already appear to be a requirement under IAS 37 and likely to become more explicitly so as the IASB’s Insurance Contracts Project moves into policyholder accounting. Concerns were expressed that the proposed changes to PS 300 might exclude actuaries from this potentially expanding market.

On balance, however, the PS 300 Working Group considered that, whilst the risk of some loss of potential business might exist, the interests of the profession lay more strongly in favour of guarding against a repetition of the experience with recent high profile valuations of liabilities for entities which are not general insurers under the Insurance Act 1973 (Cth). The emphasis on covering such situations is reinforced by the changes proposed to the definitions of “Entity” and “General Insurance Claims”;

- (b) on clause 11.2.4, one submitter commented that the requirement for comparison to Case Estimates should be contingent on the existence of Case Estimates. As discussed further in paragraph 15(c) below, a lack of Case Estimates would mean that, in the PS 300 Working Group’s view, it was not practicable to do the thing otherwise required by that clause and that, therefore, the Member would not be required to document the relevant comparisons; and
- (c) on clause 13.2.1, one submitter commented on the issue of presentation of reconciliations, given the difficulties of splitting between change in



experience and valuation basis. The PS 300 Working Group appreciates that the presentation of reconciliations will be done differently by different Members but took the view that, provided Members show some separation of the items referred to in the clause, the standard would be considered to have been met. However, the PS 300 Working Group also notes that a number of Members did prefer the drafting presented in the Exposure Draft over the requirement in the existing standard.

E. Clarification of drafting intention

15. Some submitters sought clarification of the intention of some of the drafting in the first Exposure Draft. This clarification is provided in this Explanatory Memorandum for the benefit of all Members:

- (a) the meaning or definition of "valuation" and whether, for example, PS 300 applies to an allocation of reserves to sub-classes (for example, underwriting branches), within a class of business where a valuation has already been carried out in accordance with PS 300: the PS 300 Working Group has taken the view that it is not appropriate to define a "valuation" but instead continues to consider that it is a matter for a Member's professional judgment as to whether the work he or she is performing is a "valuation". In the example given, the PS 300 Working Group would not expect PS 300 to apply;
- (b) ASIC annual statements are considered to fall within the definition of "Regulatory Report" and therefore be within the scope of clause 5.1.1(a). As such, compliance with PS 300 would be required in undertaking valuations which are intended to be used in, or as part of, an ASIC annual statement;
- (c) on the use of the phrases "where practicable" and "if practicable" in the standard, in the context of a quasi-legal document such as a standard, the phrase has an equivalent meaning to phrases such as "if feasible", "if possible in practice", "if realistic" or "if viable". In other words, if the thing is capable of being done by the exertion of a reasonable degree of effort and care given the circumstances, then it must be done. If the effort required (for example, human or financial) within the time constraints would be considered unreasonable by a reasonable member of the profession, or the data were simply not available for whatever reason, then PS 300 would not require that thing to be done. In order to provide greater clarity for Members, the phrases have been amended to read "where reasonably practicable and "if reasonably practicable", where appropriate; and
- (d) clause 11.3.4 is not intended to refer solely to the Liability Adequacy Test.



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F. Consultation

16. The PS 300 Working Group would appreciate Members' views on the proposed further changes to PS 300 set out in the Second Exposure Draft. Comments and views should be sent by the *close of business on Tuesday, 24 November 2009* to:

Anne Peters
Director – Governance and Regulation
Institute of Actuaries of Australia
Level 7, 4 Martin Place
Sydney NSW 2000

Email: anne.peters@actuaries.asn.au

Fax: (02) 9233 3446