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Actuarial Advice Framework

Prepared by Cross-Practice Actuarial Advice Framework Working Group

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CROSS-PRACTICE ACTUARIAL ADVICE FRAMEWORK WORKING GROUP

Strawman Actuarial Advice Framework

10 May 2018

This strawman Actuarial Advice Framework is intended to help facilitate discussions amongst Members of the Actuaries Institute regarding the development of an Information Note on Actuarial Advice Frameworks. While it provides some examples of the range of matters that could be included in an Actuarial Advice Framework, it should be considered as illustrative only. In particular, its content presumes a particular business model and corporate structure – alternative models/structures would be expected to lead to differences in the Actuarial Advice Framework.

Overview	The Actuarial Advice Framework sets out the Entity's approach to preparing and using actuarial advice to advance its stakeholders' interests.
Objective	Actuarial advice is sought by decision-makers to enable them to make better informed decisions with the end aim of protecting the interests of customers and enhancing shareholder value.
Scope	All Entity staff
Policy Owner	Appointed Actuary
Policy Approver	Entity Board
Effective Date	1 January 2019
Review Date	31 December 2019

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1. Background

1.1 Regulatory requirements

The Australian Prudential Regulation Authority (APRA) has issued *Prudential Standard CPS 320 Actuarial and Related Matters* (CPS320), which requires each general insurer, life insurer and private health insurer to establish a framework for the provision of actuarial advice. This document sets out the Entity's actuarial advice framework (AAF), and satisfies the requirement in CPS320 that the AAF be appropriately documented.

1.2 Principles underlying the AAF

This document sets out the framework for how the Entity seeks, prepares and uses actuarial advice.

The Entity uses actuarial advice to advance its stakeholders' interests, both customers and shareholders. Actuarial advice is sought by decision-makers to enable them to make better informed decisions with the end aim of protecting the interests of customers (which includes both direct policyholders and other beneficiaries of policies) and enhancing shareholder value.

In preparing actuarial advice, the actuary is to provide an impartial and unbiased assessment of the issue at hand. All actuarial advice provided under this framework must comply with relevant regulatory and professional body standards and guidance.

1.3 Interaction with related documents

The Entity's Risk Appetite Statement sets out the high-level parameters guiding the level of risk that the Entity is willing to take in pursuing its business strategy as set out in the Business Plan. Actuarial advice should be cognisant of both the Entity's risk appetite and business strategy, and consider how a proposal supports the business strategy and the implications of the proposal on the Entity's risk profile.

Business decisions are made by those with delegated authority to do so as set out in the Entity's Delegations of Authority Register. While an individual may have authority to make decisions on behalf of the Entity, this AAF sets out requirements for actuarial advice to be considered before such decisions are made.

2. Roles and responsibilities

2.1 Business decision-makers

Ultimately, it is the responsibility of business decision-makers to pro-actively seek actuarial advice. However, this does not prevent actuarial advice being provided on any issue even if such advice has not been sought.

It is the responsibility of the relevant business decision maker to appropriately consider the advice provided. Where the advice contains any explicit recommendations on a material matter, the decision maker should document how the Entity will respond to those recommendations.

There is no obligation for the Entity to adopt the recommendations contained in any actuarial advice, but the reasons for not adopting the recommendations should be documented or recorded in the appropriate system and made available to the Appointed Actuary.

2.2 Appointed Actuary

APRA prudential standards and specific legislation require the Appointed Actuary to provide advice on specific matters. These remain prescribed obligations of the Appointed Actuary and responsibility may not be delegated regardless of materiality.

The Appointed Actuary may be an internal or external party. In some cases, temporary Appointed Actuaries may also be appointed.

2.3 Other actuaries

Other advice required under this framework may, depending on materiality, be provided by other actuaries, as set out in Section 4. Apart from the Appointed Actuary, actuarial advice may be provided by but is not limited to the following parties (the Advising Actuary):

- the Group Actuary;
- another actuary within the Entity; or
- an external actuary.

The Appointed Actuary or Advising Actuary may rely on the work of another actuary or delegate the provision of advice having consideration to:

- the complexity and materiality of the matter requiring advice;
- the capability and experience of the that actuary;
- the validation or peer review process that may be undertaken;
- relevant Entity, Group or regulatory requirements; and
- potential conflicts of interest (refer to Section 6).

It is the responsibility of the actuary providing advice under this framework to clearly state where the nature and materiality of the advice provided warrants escalation of the issue to a more senior decision-maker.

It is the responsibility of any actuary asked to provide advice under this framework to consider whether he or she has relevant expertise or is suitably qualified to provide the required advice. Where there is doubt, the actuary should seek a substitute.

2.4 Appointing actuaries to roles that provide advice

Each line manager or is primarily responsible for appointing, monitoring and replacing direct reports (both internal members of staff and external consultants). Appointment criteria for roles that may be required to provide advice under this framework include but are not limited to the following:

- the complexity and materiality of the matter/s upon which the actuary may be required to provide advice;
- the level of capability and experience of the team supporting that actuary;
- the impartiality or independence of the actuary; and
- regulatory requirements including fit and proper requirements.

The AAF is based on roles rather than individuals. Where there is a new individual appointed to an actuarial role, the line manager should confirm to the Appointed Actuary that the appointee has the necessary skills and experience to provide advice appropriate to the role.

3. Areas where advice should be sought

3.1 The focus of actuarial advice

The Risk Appetite Statement provides clear guidance in respect to the level of risk by type that the Entity is prepared to accept, including risks for which there is no appetite, in the pursuit of the Entity's Business Strategy.

The purpose of actuarial advice is to ensure the Entity is clear on the financial implications of any material decisions, the potential returns, risks and how these risks will be best managed in order to achieve the objectives. This will focus on the optimisation of risk taking, protecting the financial condition of the company, protecting customer benefit expectations, and ensuring adequate security of customer benefits.

The Delegation of Authority Policy sets out appropriate decision-making and responsibility levels. Consistent with that policy, the issues that may require actuarial advice (subject to the materiality levels set out in Section 4) are those related to:

- policyholder protection: issues that impact crediting and bonus rate declarations, policyholder reasonable expectations, or equity between different cohorts of policyholders;
- strategic plans;
- capital: issues that impact capital levels, future planned dividends, future capital needs;
- investment policy;
- product design and the related service offerings and customer propositions: issues that relate to the sustainability of product pricing and terms and conditions;
- profitability and value: issues that impact on business value or risks to ongoing profitability; and
- reinsurance strategy.

Other areas where actuarial advice is required prior to final decisions being taken include any change in the corporate structure, proposed Merger and Acquisitions or divesting any product line or portfolio.

Engagement of the relevant actuarial advice provider should occur as early as possible in the development of any proposal or initiative.

3.2 Mandatory Actuarial Advice

There are also specific areas requiring Actuarial Advice under APRA's requirements. While there is some duplication with Section3.1, they are also noted here for the avoidance of doubt.

3.2.1 Reserving and capital management

Actuarial advice for the purpose of setting reserves or provisions for future adverse experience should consider and document the following:

- the assumptions used in the determination of any reserves or provision (including capital provision), and the level of adequacy to which they have been determined (i.e. best estimate, 1 in 200, etc.);
- the methodology for determining the reserve or provision;
- any sensitivity analysis or stress testing carried out and its implications such as catastrophic risks and mitigation strategies; and
- the liability profile and the subsequent investment strategy appropriate.

3.2.2 Product strategy and pricing policy

Actuarial advice is required on the various product risk exposures and the appropriate pricing of these risks and ongoing management requirements. The following are required in the provision of actuarial advice in respect to product pricing and management:

- an assessment of the underlying product risks, those for which charges are levied and those managed through underwriting or subsequent monitoring and subsequent management action;
- advice in respect to the product pricing and how it supports product strategy; and
- separate advice is required for the review of all pricing assumptions, modelling and suitability of premiums, terms and conditions in the context of the corporate strategy.

Umbrella advice may be provided covering Corporate schemes below $Xm of annual premium with standard terms and conditions. Any umbrella advice must be reviewed no less frequently than every two years subject to acceptable portfolio performance.

3.2.3 Policyholder profit distribution and expense allocation

An assessment is to be made of the impact of proposed policyholder profit distributions on the following:

- equity between policyholder cohorts, including reference to their asset shares;

- ongoing capital needs of the participating fund; and
- reasonable policyholder benefit expectations.

Similarly, expense allocations to participating portfolios must have reference to the cost of administering the portfolio based upon historic expectations of an ongoing open portfolio having regard however for any expense synergies created through specific shareholder investment.

3.2.4 Risk management framework

An assessment is to be made of the suitability and adequacy of the risk management framework.

3.2.5 Reinsurance strategy

In setting the reinsurance strategy, the business is to seek actuarial advice in respect to the appropriateness of the strategy with respect to the following factors:

- catastrophic risk protection;
- interaction of the reinsurance strategy with the capital management strategy;
- aggregate net product risk exposures relative to risk appetite including cost relative to other risk mitigation strategies; and
- appropriate recapture provisions and other safeguards to ensure individual reinsurance treaties remain appropriate for the business over time.

3.3 Other

While actuarial advice is formally required in the circumstances of Sections 3.1 and 3.2, there may be other issues where it is in the interests of the company or its stakeholders that actuarial advice be commissioned. It is expected that the relevant decision-maker will exercise suitable judgement in raising such issues with the appropriate actuary.

4. Materiality policy

4.1 Introduction

For the purposes of the AAF, the materiality policy is to be used to determine, for any matter related to an area where advice should be sought:

- whether the matter is material enough that it requires actuarial advice;
- levels of materiality that define who provides actuarial advice (where it is required);
- levels of materiality that define who receives actuarial advice (where it is required), including when the advice should be provided to the Board.

Requirements related to the recipient(s) of the advice are set out in the Entity's Product Management Policy, Underwriting & Claims Management Policy, Reinsurance Management Policy and the Asset-Liability Committee Charter.

In general terms, the thresholds for determining whether actuarial advice is required, and who should provide it, will mirror the thresholds set out in the policies above for the receipt and consideration of any advice required to be provided.

4.2 Product management

Product management includes pricing and product design, including underwriting and claims management, for new and existing products, and new product types and new distribution arrangements.

Actuarial advice should be provided by the Appointed Actuary in the following cases:

- before a new product type is issued;
- before a new pricing basis is established, or a material change to an existing pricing basis is proposed;
- before a new distribution channel is established, or a material change to an existing channel occurs; and
- before a binding quotation for an industry fund group life scheme is issued.

Actuarial advice should be provided by the relevant Senior Actuary in the following cases:

- before a new policy is issued under an existing pricing basis, or changes to existing policies under an existing pricing basis are proposed; and
- before a binding quotation is issued, under a group pricing basis, where credibility rating for self-experience occurs, and/or where discounts or concessions are available under the pricing basis for competitive reasons.

Actuarial advice should be provided by an appropriate Actuary in the following cases:

- before the updating of factors and parameters within an existing pricing basis. (e.g. frequency loadings etc dependent on interest rates); and
- as part of product management before there are non-minor deviations from underwriting, claims management and/or minor concessions relating to error correction.

4.3 Reinsurance management

Actuarial advice should be provided by the Appointed Actuary in the following cases:

- before a new reinsurance treaty is entered into, or there is a material change to an existing reinsurance treaty.

Administrative changes to existing reinsurance treaties that do not impact the risk transfer mechanisms of the treaty do not require actuarial advice.

4.4 Investment management

Actuarial advice should be provided by the Appointed Actuary in the following cases:

- prior to changes in investment strategy impacting asset-liability management relating to participating business and investment account business.

Actuarial advice should be provided by the relevant Senior Actuary in the following cases:

- prior to changes in investment strategy impacting asset-liability management relating to other business; and
- quarterly reporting to ALCO on asset-liability management.

4.5 General

In all other areas where the advice of an actuary is required, such advice will be provided by the Appointed Actuary, unless the Appointed Actuary determines that the nature of the issue is such that the provision of advice can be delegated.

Notwithstanding the criteria above, the Appointed Actuary or the relevant Actuary nominated in this Materiality Policy may determine that advice should be provided in particular cases. The following situations may be relevant to such a determination:

- there is an aggregation of small issues that individually may be immaterial but where, in the judgement of the actuary, the combination may be material; or
- where a product is not meeting Company minimum profitability targets, as highlighted in the latest FCR, and small changes are proposed that further exacerbate this situation.

4.6 Reporting of advice and approvals

All advice provided under this policy, together with evidence of the appropriate approval of the proposal to which the advice relates, is to be reported to the Management Risk Committee. Membership of this Committee will include the Appointed Actuary.

All relevant matters that are assessed as being immaterial, and therefore not requiring actuarial advice, need to be appropriately documented by the relevant decision-maker, and be presented in a summary tabular format for noting at the next Management Risk Committee.

5. Provision of advice

5.1 Matters to be addressed when providing advice

When providing advice, the actuary should consider and document:

- the purpose of the advice and perspective taken;
- to whom the advice is addressed (and who can rely on it);
- any limitations on the scope of the advice and the assumptions upon which they are based;
- the financial metrics on which the advice was formed;

- how the advice fits within the AAF including reference to the appropriate level of delegation;
- impacts on customers; and
- impacts on the business plan and capital management plan.

Other items may be relevant for a particular situation and the actuary should use professional judgement to decide if an additional section is required.

The financial metrics will vary by circumstances of the advice provided and line of business, but could include the impact on:

- revenue and variable product expenses both on an annual basis and over future planning periods;
- management expenses including change in contribution to fixed overheads both on an annual basis and over future planning periods;
- present value of profit margins;
- value of new business, embedded value and / or economic value;
- internal rate of return;
- return on capital;
- change in capital requirements (regulatory and target);
- new business or in-force premium;
- inflows, outflows and funds under management; and
- lapse rates and any change in amortisation of deferred acquisition costs.

This list should not be taken as exhaustive (or required in all circumstances) and the actuary must use professional judgement to decide what are the appropriate metrics.

5.2 Form of advice

Formal actuarial advice should be provided in written form.

Where oral advice is given (which should be expected to occur in the normal course of business), and subsequently such oral advice informs a business decision, then that advice must be subsequently documented in writing.

6. Conflicts of interest

Identification and management of real and perceived conflicts of interest is a key component of the company's risk management framework. The Board Conflicts of Interest Policy sets out the company's overall approach to management of this risk. This section sets out the specific process to manage conflicts of interest under the AAF.

6.1 Identification of conflicts of interest

All actuarial advice subject to Prudential Requirements must be impartial.

The AAF recognises that there may be perceived or actual conflicts of interest or duty in the role of any actuary providing advice under this framework. Delivery of impartial advice is dependent on the identification and management of any such conflicts.

Examples of potential conflicts identified in the operation of this framework are set out below.

- The Appointed Actuary typically performs first line, second line and third line functions. This may result in the Appointed Actuary being required to review and challenge decisions based on the Appointed Actuary's own advice.
- The Appointed Actuary may perform other roles or duties for the organisation that may lead to a conflict in the responsibilities and objectives, for example if the Appointed Actuary also holds the role of Chief Financial Officer.
- Performance objectives, remuneration structures or business reporting lines for actuaries providing advice under this framework may create a conflict.

6.2 Management of conflicts of interest

A number of strategies are contemplated under the AAF for the management of conflicts of interest. These include:

- disclosure of the nature of the potential conflict;
- separation of roles;
- internal peer review;
- external/independent peer review; and
- in some circumstances, declining to provide advice.

It is the responsibility of the Appointed Actuary or Advising Actuary to document identified conflicts that could raise doubts as to the impartiality of the advice, along with the actions taken to manage these conflicts.

It is the role of the recipient of the advice to consider the adequacy of the disclosures made in respect of identification and management of conflicts in their acceptance of the advice provided.

The level of detail included in the disclosure of conflicts and extent of management actions taken should consider the materiality of the advice and the nature and significance of the potential conflict.

Irrespective of the discretions contemplated above, the following actions are required for specific advice:

Nature of Advice	**Advice Prepared by:**	**Review requirements**
Policy liabilities and capital recommendations	Appointed Actuary (where AA is also the CFO)	External review
Material product pricing	Pricing actuary reporting to Head of Product.	Peer review – Appointed Actuary

7. Attachment: Alternative presentation format

Business Area	Advice Type	Materiality	Advice Detail	Actuarial Metrics	Who
Product Management	Issuing Binding Group Quote (Experience Rated)	Current Annual Premium < $2.5m	Short	Profit, Expense Margin	Group Risk Pricing Actuary
		$2.5m < Current Annual Premium < $7,5m	Medium	Profit, Expense Margin Return on Capital	Senior Group Risk Pricing Actuary
		Current Annual Premium > $7.5m	AA determined	Profit, Expense Margin Change in Capital Return on Capital	Appointed Actuary
	Issuing a New Product	None	AA determined	Profit margins Expense allowances Capital Requirements Return on Capital / IRR Range of sensitivities	Appointed Actuary
	New Pricing Basis (Existing Product)	None	AA determined	……	Appointed Actuary
	Revision to Pricing Basis	PV Margin Change < 1% existing margins	Short	………	Product Actuary
		PV Margin change < 10% Existing PV Margins	Medium	…….	Senior Product Actuary

		PV Margin change > 10% Existing PV Margins	AA determined	…….	Appointed Actuary
	Benefit Changes	PV Margin Change (accumulated changes over 24 months) < 5% existing margins	Medium	………	Senior Product Actuary
		PV Margin Change (accumulated changes over 24 months) > 5% existing margins	AA determined	…….	Appointed Actuary
Reinsurance Management	Administr ative Changes	PV Margin Change < 0% existing margins (i.e. administrative)	None	…..	None
	Changes in Existing Terms	PV Margin Change < 10% existing margins (.e	Medium	…..	Senior Product Actuary
		PV Margin change > 10% Existing PV Margins	AA determined	…..	Appointed Actuary

	New Treaty	None	AA determined	……	Appointed Actuary
Investment Management	Quarterly Reporting to ALCO		Short		Investment Actuary
	Investment Strategy	Participating	AA determined		Appointed Actuary
		Capital Guaranteed non-participating	Medium		Investment Actuary
		Unit Linked	None		None