
PROFESSIONAL STANDARD 200

ACTUARIAL ADVICE TO A LIFE INSURANCE COMPANY OR FRIENDLY SOCIETY

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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 by the regulatory regime. 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 regulatory regime, in which the Member'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 Member must take account of the general considerations in this Professional Standard along with relevant provisions of the Code.
- 1.1.3 Work performed under this Professional Standard by an Appointed Actuary 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).
- 1.1.4 While this Professional Standard is meant to provide direction on the application of the regulatory regime to the work of the Appointed Actuary, the Member must comply with the regulatory regime at all times and seek legal opinion if in doubt.

1.2 About this standard

- 1.2.1 This Professional Standard:
 - (a) has been prepared in accordance with the Institute's Policy for Developing Documents to Guide and Regulate Professional Practice;
 - (b) must be applied in the context of the Code;
 - (c) binds Members of the Institute when they perform work that the Standard covers; and
 - (d) defines the Institute's requirements for all work the Standard covers.
- 1.2.2 If a Member believes that this Professional Standard is ambiguous or wishes to seek clarification of it, then they may consult the Institute's Professional Standards Committee for an interpretation.
- 1.2.3 If a Member finds that they cannot carry out their work in a way that complies with this Professional Standard then they must either:
 - (a) decline to carry out the work; or
 - (b) end their agreement to do so.

- 1.2.4 If a Member does not comply with this Professional Standard, then that may constitute Actionable Conduct under the Institute's Disciplinary Scheme.

1.3 Other relevant documents

- 1.3.1 This Professional Standard must be applied in the context of the relevant law, and relevant accounting and auditing standards.
- 1.3.2 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. Similarly, a reference to a Professional Standard includes any modification or replacement of that Professional Standard.
- 1.3.3 Apart from the Code, from legislation or from this Professional Standard, 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.
- 1.3.4 If there is a conflict between this Professional Standard and any legislation, then the legislation takes precedence. 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.

1.4 Background

- 1.4.1 The Appointed Actuary is required, in respect of specific statutory duties under the regulatory regime, 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".
- 1.4.2 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 clause 1.4.1.

1.5 Legislation

- 1.5.1 The statutory requirements relating to the Appointed Actuary's advice to the Entity are specified in the regulatory regime. The relevant regulatory regime for the purposes of this Professional Standard is:
- (a) the Act;
 - (b) the Life Insurance Regulations 1995 (Cth); and
 - (c) APRA Standards.

1.5.2 The statutory requirements include, but are not limited to:

- ▶ **Product Advice:** before the Entity issues or modifies a policy, written advice about the proposed terms and conditions, the surrender basis and the unit pricing method. Advice on proposed reinsurance arrangements must also be received before such arrangements are entered into, modified or terminated (LPS 320);
- ▶ **Apportionments:** written advice to the directors regarding the appropriateness of the proposed apportionment of relevant income and outgoings (section 80 of the Act);
- ▶ **Financial Condition Report:** 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) (LPS 320);
- ▶ **Reinsurance Report:** a written report to the Entity on reinsurance arrangements and the administration of these arrangements at the end of the financial year (LPS 230); and
- ▶ **Distributions of Profit and Capital:** written advice to the directors on the likely consequences of a proposed distribution of retained profits or shareholders' capital (sections 62 and 63 of the Act).

1.6 Professional responsibilities

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, 98B and 99 of the Act, paragraphs 112 and 113 of APRA Prudential Standard CPS 510 Governance and paragraphs 44 to 49 of APRA Prudential Standard CPS 520 Fit and Proper. These are onerous obligations and underline the importance of the Appointed Actuary acting independently and professionally in performing his or her duties. Members need to understand the obligations that apply to them in their circumstances. This may require Members to seek legal or other professional advice.

2. COMMENCEMENT DATE

This Professional Standard applies to any relevant advice or Report given to an Entity on or after 1 July 2015.

3. DEFINITIONS AND INTERPRETATION

3.1 In this Professional Standard:

'Act' means the Life Insurance Act 1995 (Cth).

'Appointed Actuary' means a Member holding an appointment by the Entity under section 93 of the Act.

'APRA' means the Australian Prudential Regulation Authority.

'APRA Standards' means the Prudential Standards and Reporting Standards issued by APRA from time to time in accordance with the Act.

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

'Capital base' is as defined in LPS 112.

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

'CPS 220' means APRA Prudential Standard CPS 220 Risk Management.

'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 regulatory regime.

'General Fund' means, in accordance with the APRA Standards, 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.

'ICAAP' means the Internal Capital Adequacy Assessment Process of an Entity, as required under LPS 110.

'LPS 001' means APRA Prudential Standard LPS 001 (Definitions).

'LPS 100' means APRA Prudential Standard LPS 100 Solvency Standard.

'LPS 110' means APRA Prudential Standard LPS 110 Capital Adequacy.

'LPS 112' means APRA Prudential Standard LPS 112 Capital Adequacy: Measurement of Capital.

'LPS 320' means APRA Prudential Standard LPS 320 Actuarial and Related Matters.

'LPS 360' means APRA Prudential Standard LPS 360 Termination Values, Minimum Surrender Values and Paid-up Values.

'LPS 370' means APRA Prudential Standard LPS 370 Cost of Investment Performance Guarantees.

'Material' means relevant to the Entity'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.

'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.

'Prescribed capital amount' is as defined in LPS 110.

'Prudential Capital Requirement' is as defined in LPS 110.

'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 clause 6.2 of this Professional Standard.

'Report' means a report or written advice prepared by a Member under this Professional Standard.

'Statutory Fund' means, as the context requires, the statutory fund or benefit fund, as defined under 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 performing work under this Professional Standard. In determining whether something is Material, the Member must take into account the purpose of the actuarial advice being given. Whether something is Material or not will always be a matter requiring the exercise of the Member's professional judgment.

4.2 If a Member has formed the opinion that a matter required to be considered under this Professional Standard is not Material to the actuarial advice in the circumstances, then:

- (a) 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; and
- (b) if the matter is not relevant to the Entity's circumstances, the matter may be omitted from the applicable Report; or
- (c) if the matter is relevant to the Entity's circumstances, but is not Material because it is neither important nor essential in the Member's opinion, the Member must state in the applicable Report that the matter is not Material and provide reasons for such opinion.

5. OVERALL PRINCIPLES

5.1 Written advice

- 5.1.1 Written advice required by the regulatory regime must be clearly identified as such.
- 5.1.2 The Member 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 Member must also indicate the consequences of following or not following the advice as appropriate.
- 5.1.3 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.
- 5.1.4 In providing written advice required by the regulatory regime, the Member 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 Member must make and keep sufficient and appropriate documentation about relevant matters to enable a formal Report to be prepared later if required.
- 5.1.5 Such modelling or other work that has been carried out in support of finalised advice must be adequately documented.
- 5.1.6 LPS 320 requires the Member's employer to retain working papers and other documentation in relation to an Entity's prudential requirements for a period of seven years. The Member must assist their employer by identifying the relevant supporting documents and files.

5.2 Matters for consideration

- 5.2.1 In carrying out his or her responsibilities, the Member must, among other things:

- (a) comply with the requirements of the regulatory regime;
- (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;
- (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 clause 8.2 of this Professional Standard); and
- (e) comply with the relevant provisions of the Code.

Information requirements

- 5.2.2 The Member 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 Member must be specified and, if the appropriate information is not forthcoming, the 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.

Entity's business and operations

- 5.2.3 When providing advice in terms of this Professional Standard, the Member 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;
- (i) the Entity's risk management framework; and
- (j) the operational capability of the Entity to effectively administer the business.

Capital and financial soundness

- 5.2.4 In considering the ongoing financial soundness of the life insurance business of the Entity, the Member must also have regard to:
- (a) the Entity's ICAAP;
 - (b) 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
 - (c) 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.
- 5.2.5 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 health of the Entity as a whole. The Member must also consider in general the effect other business the Entity conducts may have on its life insurance business.

Responsibility for advice given

- 5.2.6 While a Member may delegate certain tasks required under this Professional Standard, the Member nonetheless remains ultimately responsible for the advice provided.

Conflicts of interest

- 5.2.7 When giving advice, the Member must disclose actual or potential conflicts of interest as required by section 4.5 of the Code. This could particularly be relevant when reviewing the Entity's Risk Management Framework or ICAAP, which the Member may have helped develop.

6. PRODUCT AND REINSURANCE ADVICE

6.1 Principles of product and reinsurance advice

- 6.1.1 The following clauses set down those matters which the Member must address in providing advice on products and reinsurance. These matters may well go beyond the requirements of APRA Standards.
- 6.1.2 LPS 320 requires written advice from the Appointed Actuary to the Entity before a policy can be issued. The advice must cover proposed terms and conditions (which includes premium rates, fees and charges), surrender bases and unit pricing.
- 6.1.3 Written advice from the Appointed Actuary is also required when there are proposed modifications in terms and conditions, or when the Member recognises that there is a change in circumstances relating to a group of policies that has Material financial implications. When the Member considers that a proposed change in terms and conditions is not Material, the Appointed Actuary must advise the Entity of this view.
- 6.1.4 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 Member must comment on the impact of those proposals on the business already issued.
- 6.1.5 With respect to the reference to 'company' in paragraphs 24 and 26 of LPS 320, the Member, by reference to the Board-approved policy required by paragraph 27, must clearly establish to whom in practice the advice must be directed.

6.2 Premium rates and charges

- 6.2.1 When providing advice on premium rates and charges, the Member 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.
- 6.2.2 In particular, apart from any general advice that the Member provides, if the premium rates and charges for a product are considered unsuitable or inadequate, the Member must state why that opinion is held and indicate the potential or likely financial consequences of their adoption by the Entity. The Member must indicate actions the Entity could take to counteract the potential risks.

Assumptions about future experience

- 6.2.3 The Member must be satisfied as to the suitability of all Material assumptions about the expected future experience.

- 6.2.4 In providing an opinion as to the likely future experience of new types of risk where no specific past experience is available, the Member must take into account such statistics relating to similar events or conditions as can be obtained and are considered relevant. The Member 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 Member undertakes for risks, the Member must specify that close monitoring of experience of new risks is required.
- 6.2.5 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 Member must consider the degree of uncertainty in each of the assumptions and the potential effects of experience being relatively adverse. The Member must consider the Entity's capacity to finance such adverse experience.

Equity

- 6.2.6 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 policy, 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 Member advises the Entity as to how the discretion should be exercised.
- 6.2.7 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.
- 6.2.8 In the cases outlined above, the Member, 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

- 6.2.9 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 Member 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

- 6.2.11 The Member 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 Member 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.
- 6.2.12 For each variation in the view of future experience, the Member will make a number of assumptions about items listed in clause 5.2.3 of this Professional Standard.
- 6.2.13 The range of matters to be taken into account when considering suitability may well vary with the particular circumstances. In each case, the Member must be in a position to justify any decision to limit the range of the scenarios tested.

6.3 Other policy terms and conditions

- 6.3.1 The Member 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 Member must give advice on the financial impact or risks of the proposed policy definitions, any guarantees and options, and any other matter the Member considers relevant.
- 6.3.2 The Member 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.

6.4 Surrender basis

- 6.4.1 LPS 320 requires the Appointed Actuary to provide advice on the proposed basis for determining the surrender values, if applicable.
- 6.4.2 When reporting on the surrender value basis for a life insurance product, the Member must consider the impact the proposed basis would have on the capital position 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.
- 6.4.3 The Member, 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 Standards applicable.

6.5 Unit pricing

- 6.5.1 If policies provide benefits by reference to units, LPS 320 requires 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.

- 6.5.2 The Member 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.
- 6.5.3 The Member must comment on the robustness of the unit pricing approach and system.
- 6.5.4 The Member 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.

6.6 Reinsurance arrangements

- 6.6.1 LPS 320 requires that an Entity must not enter into, modify or terminate a reinsurance arrangement unless the Appointed Actuary has provided written advice on the likely consequences of taking such action.
- 6.6.2 When commenting on the reinsurance arrangements, the Member must consider the issues listed above in clause 5.2.3 where relevant, and the financial impact of the proposed reinsurance and retention limits.
- 6.6.3 The Member must comment on the circumstances under which the reinsurance arrangements, in his or her judgment, could become inappropriate.

6.7 Commission

- 6.7.1 The Member must have regard to all expenses when advising on product terms and conditions. The Member 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).
- 6.7.2 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.

7. APPORTIONMENTS

7.1 Principles of apportionments

- 7.1.1 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.
- 7.1.2 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.

- 7.1.3 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.
- 7.1.4 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.
- 7.1.5 As well as the requirements of the various laws, the Member 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.

7.2 Equity of apportionments

Equity of the apportionment is a matter of judgment for the Member after considering all relevant factors. The Member 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.

7.3 Intergroup apportionments and outsourcing

- 7.3.1 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 Member'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 Member must keep in mind the provisions of section 30(d) of the Act.
- 7.3.2 Outsourcing to intergroup companies represents another area where attention is required by the Member to ensure section 30(d) of the Act is not breached. This commonly includes investment management, distribution and data processing.
- 7.3.3 In general, the Member must be satisfied that the outsourcing arrangements are on reasonable and commercial terms. In this regard, the Member is also reminded of the requirements of section 98 of the Act.

7.4 Expenses

- 7.4.1 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.
- 7.4.2 The level of detail involved in the apportionment process will vary depending on the financial systems available to produce results.
- 7.4.3 Expenses must also be split between acquisition and maintenance for determination of assumptions for calculation of policy liabilities and an assessment of the capital base and prescribed capital amount. 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.

7.5 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.

7.6 Taxation

- 7.6.1 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.
- 7.6.2 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.

8. FINANCIAL CONDITION INVESTIGATIONS

8.1 Principles of financial condition investigations

- 8.1.1 The following clauses set down those matters which the Member must address in examining and reporting on the financial condition of an Entity. They may well go beyond the requirements of the regulatory regime.
- 8.1.2 LPS 320 requires the Appointed Actuary to provide advice on the financial condition of the Entity including an assessment of the Entity's capital base and prescribed capital amount.
- 8.1.3 The Member must consider the capital base and prescribed capital amount 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.
- 8.1.4 The Member must advise on the financial impact of plausible and adverse scenarios on the capital base and prescribed capital amount of the Entity.
- 8.1.5 The Member's investigation would normally be on an open-to-new business basis, however, the Member must also consider the possibility that the Entity might be closed to new business.
- 8.1.6 In particular, the Member must consider the liabilities and reserves, the corresponding assets, and their inter-relationship. In the event that the Member considers that there is a significant possibility that the Entity may breach its Prudential Capital Requirement, the Member must recommend a course of action for the Entity to adopt.
- 8.1.7 In examining and reporting on the financial condition of the Entity in terms of this Professional Standard, the Member must give consideration to Materiality in relation to the Entity.

8.2 Data quality

- 8.2.1 The Member 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.
- 8.2.2 The Member 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 Standards.

8.3 Experience analysis

- 8.3.1 The Member 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.
- 8.3.2 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.
- 8.3.3 The Financial Condition 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.

8.4 Assets

- 8.4.1 Subject to any statutory regulations, the responsibility for investment policy rests with the directors of the Entity. However, the Member 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 Member must, in the Financial Condition Report to the Entity, advise what constraints on investment policy he or she regards as necessary to protect policy owners.
- 8.4.2 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 Member 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.
- 8.4.3 The Member must also report and comment on:
- (a) the assets of each statutory fund which are either designated as regulatory adjustments to the net assets (as defined under LPS 112) or which incur an asset concentration capital charge for capital purposes;
 - (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 Member 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 Standards.

- 8.4.4 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 Member 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 Member must comment on any significant changes in the method of valuation of the assets. Where the Member 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 Standards.

8.5 Policy liabilities

- 8.5.1 The Member 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, among other things, 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.
- 8.5.2 The Member must provide advice to the Entity regarding the valuation of the policy liabilities in accordance with the APRA Standards.
- 8.5.3 The Member must discuss the financial significance of changes in assumptions made since the previous valuation and the reason(s) why the changes were made.
- 8.5.4 The Member 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.

8.6 Capital base and prescribed capital amount

- 8.6.1 The Member must provide advice to the Entity regarding the calculation of the solvency requirement, the capital base and the prescribed capital amount of each statutory fund and the General Fund in accordance with the APRA Standards.
- 8.6.2 The Member must advise, not only on the capital base and the prescribed capital amount of the Entity over the past year and as at the date of the valuation, but also on the Entity's continuing ability to meet the Prudential Capital Requirement.
- 8.6.3 When advising on the Entity's ability to meet the Prudential Capital Requirement, the Member must review and comment on:

- (a) the management of capital resources in excess of the Prudential Capital Requirement;
- (b) the sensitivity of capital levels to adverse experience;
- (c) the level of capital needed as excess over the Prudential Capital Requirement;
- (d) a projection of the expected level of capital relative to the Prudential Capital Requirement; and
- (e) the sources and availability of future capital.

8.6.4 Where the Member's projections, including new business, reveal that a deficit against the Prudential Capital Requirement may result under reasonable adverse assumptions (or where such a deficiency currently exists), the Member must comment on:

- (a) the reasons for the potential or actual deficiency; and
- (b) the proposed management actions to reduce the risk of the potential deficiency, and the likely effect of these actions.

8.6.5 The regulatory regime requires an Entity to comply with LPS 100 and the Capital Adequacy Standards (as defined in LPS 001) at all times. The Member must comment on the level of, and reasons for, any breaches of the Prudential Capital Requirement during the past year and the subsequent actions that were taken by the Entity. The Member must also comment on any breaches of directions or conditions of registration applicable to the Entity under the Act.

8.7 Premium rates and charges

The Member 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.

8.8 Reinsurance

8.8.1 The Member must examine and report on the Entity's existing reinsurance arrangements, including both risk related and financial support arrangements, as per the requirements of APRA's Prudential Standard LPS 230 (Reinsurance).

8.8.2 The Member 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.

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

8.9 Business risks

- 8.9.1 The Member 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.
- 8.9.2 The Member must comment on the likely consequences and financial impact in the event of a failure in these controls and procedures.
- 8.9.3 The Member 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.

8.10 Risk management framework

The Member must include an assessment of the suitability and adequacy of the risk management framework as part of the Financial Condition Report.

8.11 ICAAP

The Member must include an assessment of the Entity's ICAAP as part of the Financial Condition Report.

8.12 Surrender and paid-up values

The Member must include an assessment of whether, over the financial year concerned:

- (a) the payment of surrender values has been at least the amount calculated under LPS 360; and
- (b) there has been compliance with the requirements in respect of paid-up values.

8.13 Investment performance guarantees

The Member must include an assessment of whether the Entity has complied with LPS 370 in respect of each relevant statutory fund during the financial year concerned.

8.14 Information and data

- 8.14.1 The Member must summarise in the Financial Condition Report all Material information relied upon in preparing the Report.
- 8.14.2 Material data discrepancies that cannot be resolved with the Entity must be outlined in the Report, together with the consequent limitations of the Report.

- 8.14.3 The degree to which the Member relies upon information, including data, policies and reports provided by the Entity, or upon testing of the data or other information by the Entity's auditor or other third parties, must be explained in the Report, together with an assessment of the consequent limitations of the Report.
- 8.14.4 Where the Member relies on work carried out by other Members, the Member must be satisfied as to the suitability of the work. Where the Member is not satisfied, alternative analyses must be undertaken and explained in the Report.
- 8.14.5 Where the Entity does not provide adequate and timely access to information (including data and reports) and staff, as required by the Member, and the information cannot otherwise be practically obtained, the Member may omit from the Report analysis that is dependent on that information, but must provide:
- (a) an explanation as to why it has been omitted;
 - (b) details of any assumptions made as a result of the information limitations; and
 - (c) an assessment of the consequent limitations of the Report.
- 8.14.6 Where the Member places reliance upon others to provide any information required, and this information is limited or not forthcoming, the Member must state this in the Report, together with an assessment of the consequent limitations of the Report.

8.15 Material risks

- 8.15.1 The Member must set out in the Financial Condition Report:

- (a) any Material risks and issues identified during the investigation that are associated with the actuarial assumptions used in the investigation; and
- (b) any Material risks that directly relate to the ongoing management of the Entity, and must include a discussion of these Material risks.

- 8.15.2 Where:

- (a) the Member identifies that a Material risk in clause 8.15.1 has potential adverse implications for the Entity's overall financial condition; and
- (b) in the Member's opinion, action (or further action) should be taken or considered by the Entity to mitigate the risk,

then the Financial Condition Report must include the Member's recommendations as to the action (or further action) that should be taken or considered by the Entity to mitigate the relevant risk. It would be sufficient for the Member to recommend that the Entity considers seeking further advice regarding management of the relevant risk.

8.16 Recommendations

This Professional Standard requires the Member to include certain matters and may require the Member to make recommendations in the Financial Condition Report. The Member must also comment on the extent to which the Entity has addressed recommendations provided in the previous Report (if any).

9. DISTRIBUTIONS OF PROFITS AND CAPITAL

9.1 Principles of distributions

- 9.1.1 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 regulatory regime. In addition, Entity by-laws and benefit fund rules may impose additional constraints on the distribution and/or requirements on the Member.
- 9.1.2 Advising as to likely consequences of a distribution of retained profits, surplus or shareholders' capital is complex and requires considered judgment. The professional framework within which the Member must exercise this judgment is set out in this Professional Standard.
- 9.1.3 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 position must be interpreted and the impact of any subordinated debt must be considered.
- 9.1.4 In advising in relation to overseas business, the Member must also consider the relevant overseas regulatory requirements.

9.2 Equity of distributions

- 9.2.1 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 Member 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.

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

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