



PROFESSIONAL STANDARD 305

FINANCIAL CONDITION REPORTS AND REVIEW OF RUN-OFF PLANS FOR GENERAL INSURANCE

March 2013

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1. INTRODUCTION

1.1 Application

- 1.1.1 This Professional Standard applies to an FCR produced for an Entity authorised to carry on general insurance business under the Act.
- 1.1.2 If a report is produced for a Run-off Insurer detailing an impartial review of its run-off plan, then the relevant parts of this Professional Standard are applicable, to the extent that these are within any relevant legislation and/or any formal request made by the Entity to the Member.
- 1.1.3 If similar reports are prepared for other Entities providing general insurance coverage, such as self-insurers or accident compensation schemes, then the relevant parts of this Professional Standard are applicable, to the extent that these are within any relevant legislation and/or any formal request made by the Entity to the Member.
- 1.1.4 This Professional Standard does not seek to replicate or override the requirements of the Institute's Professional Standard 300 (Valuations of General Insurance Claims).
- 1.1.5 Work performed under this Professional Standard is Prescribed Actuarial Advice. Members' attention is directed towards the requirements of the Code in relation to Prescribed Actuarial Advice, as well as to Practice Guideline 199.01 (Prescribed Actuarial Advice Reporting).

1.2 Classification

- 1.2.1 This Professional Standard has been prepared in accordance with the Institute's Policy for Drafting Professional Standards. It must be applied in the context of the Code.
- 1.2.2 This Professional Standard is binding on Members of the Institute in respect of all work covered by the Professional Standard.
- 1.2.3 Non-compliance with this Professional Standard by a Member engaged in work covered by this 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 this 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 this Professional Standard. Apart from legislation or regulatory standards, no other document, advice or consultation (including Practice Guidelines of the Institute) can be taken to modify or interpret the requirements of this Professional Standard.

- 1.2.5 A Member who finds that he or she cannot carry out work in a manner that complies with this Professional Standard must decline to carry out the work, or terminate his or her agreement to do so.

1.3 Background

- 1.3.1 The subject of an FCR being prepared for a general insurer was raised in a July 2002 submission by the Institute to the HIH Royal Commission. In his April 2003 final report, the Commissioner recommended to the Government that APRA require the annual production of such a report, akin in concept to the FCR prepared by Appointed Actuaries in the life insurance industry. The Federal Government accepted the recommendation.
- 1.3.2 In December 2002, the Council of the Institute established an FCR Taskforce to supervise the drafting of an Institute Professional Standard on the subject of an FCR. This taskforce produced a number of drafts of this Professional Standard in the period from November 2003 for comment by Institute members and the industry.
- 1.3.3 In November 2003, APRA released a Discussion Paper, which listed the elements to be included in an FCR. This incorporated and extended the requirement for the Appointed Actuary to undertake an Insurance Liability Valuation. In May 2005, APRA released a further Discussion Paper, which provided more detail on the FCR proposal, and required that regard must be taken of relevant Institute Professional Standards. The relevant legislation is described in section 1.6.
- 1.3.4 This version of this Professional Standard was released in response to, principally, outcomes from the review by APRA of capital standards for general and life insurance, inclusion of material relating to review of run-off plans for run-off insurers and changes to the Code since the previous version.

1.4 Purpose

The purpose of this Professional Standard is to provide Members with principles and directions that must be followed with regard to the work described in Section 1.1.

1.5 Previous versions

This Professional Standard was first issued in March 2006.

1.6 Legislation and other requirements

- 1.6.1 From 1 July 2002, the Act provides for APRA to issue prudential standards regulating the activities of, and imposing requirements on, authorised general insurers.

- 1.6.2 GPS 320 mandates that an Appointed Actuary “undertake an investigation to enable the preparation of ... [a] Financial Condition Report (FCR) ...” and that, as a general rule, an FCR must be completed in respect of each authorised general insurer. In addition, GPS 320 requires that regard be taken of relevant Institute Professional Standards.
- 1.6.3 There may be other legislation that requires an FCR to be provided to Entities not regulated by APRA.
- 1.6.4 This Professional Standard must be considered in the context of applicable legislation. If there is a conflict between this Professional Standard and any applicable legislation, then the legislation takes precedence, and any differences must be documented in the FCR. In this context, legislation includes regulations, prudential standards, subordinate standards, accounting standards, rules issued by government authorities and standards issued by professional bodies which have the force of law. Clauses 1.6.1 to 1.6.3 indicate specific examples of such legislation that may affect the work undertaken under this Professional Standard.
- 1.6.5 A reference to legislation or a legislative provision in this Professional Standard includes any statutory modification, or substitution of that legislation or legislative provision and any subordinate legislation issued under that legislation or legislative provision. Similarly, a reference to a Professional Standard includes any modification or replacement of such.

2. COMMENCEMENT DATE

This Professional Standard takes effect for an FCR applicable to an Effective Date of 1 January 2013 or later on or after 31 March 2013.

3. DEFINITIONS

- 3.1 In this Professional Standard:

‘**Act**’ means the Insurance Act 1973 (Cth).

‘**Appointed Actuary**’ means the person appointed by an authorised general insurer under section 39(1)(b) of the Act.

‘**APRA**’ means the Australian Prudential Regulation Authority (or its successors from time to time).

‘**Board**’ means the directors of an Entity or equivalent.

‘**Central Estimate**’ has the meaning given in PS 300.

‘**Class of Business**’ has the meaning given in PS 300.

‘**Code**’ means the Code of Professional Conduct of the Institute.

'Effective Date' means the valuation date of the corresponding Insurance Liability Valuation.

'Entity' means one or more companies, corporations or other bodies with a liability to pay insurance claims, or with a liability to compensate other parties.

'Entity's Plans' means the plans of the Entity, current at the Effective Date, including but not limited to budgetary, business, strategic and capital management plans.

'FCR' means a financial condition report prepared pursuant to GPS 320. Where a Member is preparing a report on the review of a run-off plan of a Run-off Insurer, references in this Professional Standard to an 'FCR' are to be read as if those references were to the report of the Member's review of the run-off plan.

'GPS 001' means APRA's Prudential Standard GPS 001 (Definitions).

'GPS 110' means APRA's ~~General~~ Prudential Standard GPS 110 (Capital Adequacy).

'GPS 116' means APRA's ~~General~~ Prudential Standard GPS 116 (Capital Adequacy: Insurance Concentration Risk Charge).

'GPS 230' means APRA's ~~General~~ Prudential Standard GPS 230 (Reinsurance Management).

'GPS 320' means APRA's ~~General~~ Prudential Standard GPS 320 (Actuarial and Related Matters).

'ICAAP' means the Entity's Internal Capital Adequacy Assessment Process as defined in GPS 110.

'ICRC' means the Insurance Concentration Risk Charge as defined in GPS 116.

'Insurance Liability Valuation' means the actuarial valuation by the Member of the general insurance liabilities of one or more Classes of Business.

'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.

'PCA' has the same meaning as 'prescribed capital amount' in GPS 110.

'PCR' has the same meaning as 'Prudential Capital Requirement' in GPS 110.

'Probable Maximum Loss' has the same meaning as in GPS 116.

'Prudential Requirements' means requirements under Commonwealth, State or Territory legislation in Australia, including regulations, prudential standards, subordinate standards and rules governing Professional Services.

'PS 300' means the Institute's Professional Standard 300 (Valuations of General Insurance Claims).

'Reinsurance Arrangements Statement' has the same meaning as in GPS 230.

'Reinsurance Management Strategy' has the same meaning as in GPS 230.

'Risk Margin' has the meaning given in PS 300.

'Run-off Insurer' ~~means an Entity that is closed to new business and has not written renewal business for a period of at least 12 months~~ has the same meaning as in GPS 001.

3.2 A word that is derived from a defined word has a corresponding meaning.

3.3 Other capitalised terms used in this Professional Standard have the same meaning as set out in the Code.

4. MATERIALITY

4.1 The Member must take Materiality into account when preparing an FCR. In determining whether something is Material, the Member must take into account the purpose of the FCR. Whether something is Material or not will always be a matter requiring the exercise of the Member's professional judgment.

4.2 If the Member has formed the opinion that a matter required to be considered under this Professional Standard is not Material to the FCR in the circumstances, the Member must document that the matter is not Material and provide reasons for forming that opinion, but does not have to further consider that matter. Furthermore:

- (a) if the matter is not Material because it is not relevant to the ~~Insurer's~~ Entity's circumstances, the matter may be omitted from the FCR; or
- (b) if the matter is relevant to the ~~Insurer's~~ 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 FCR that the matter is not Material and provide reasons for such opinion.

5. SCOPE OF FCR

5.1 Matters for consideration

5.1.1 Subject to clauses 5.1.2 and 5.1.3, an FCR must include each of the matters listed below, with consideration at the Effective Date of historical analysis and future implications, where applicable:

- (a) business overview;
- (b) recent experience and profitability;
- (c) Insurance Liability Valuation;
- (d) adequacy of past estimates of insurance liabilities;
- (e) pricing and premium adequacy;
- (f) asset and liability management;
- (g) capital management and capital adequacy;
- (h) reinsurance arrangements; and
- (i) risk management.

5.1.2 Notwithstanding that the purpose of the FCR is to provide an assessment of the Entity's overall financial condition, the impact or influence of Classes of Business on the matters in clause 5.1.1 must be considered, where Material and applicable.

5.1.3 If the Member identifies additional Material matters, not detailed in clause 5.1.1, the Member must include such matters in the FCR.

5.2 Corporate group considerations

5.2.1 In preparing an FCR, the financial position of the corporate group to which the Entity belongs must be considered and in particular, the potential of that corporate group to Materially affect the position of the Entity. Similarly, the potential of exposure and relationships within a corporate group to Materially affect the position of the Entity must be considered.

5.2.2 Unless otherwise required by APRA, a single FCR may be produced for an insurance group. Where an FCR is produced for an insurance group, this single FCR must consider and address the operations of each Entity authorised to carry on general insurance business within that insurance group.

5.3 Foreign insurer considerations

- 5.3.1 For foreign insurers, the FCR must be prepared in respect of the Australian branch operation that is authorised to carry on general insurance business, but with consideration given to the financial position of the head office and, in particular, its potential to Materially affect the position of the branch operation.
- 5.3.2 Where information cannot be obtained, owing to the structure of the branch operation or other aspects of the foreign insurer, an explanation of the lack of information must be provided in the FCR, together with an assessment of the consequent limitations of the FCR.

6. REPORTING REQUIREMENTS

The FCR must include the matters set out in this section.

6.1 Statements by Member

- 6.1.1 The Member must sign and state the date of completion of the written FCR.
- 6.1.2 Statements must be provided setting out who commissioned the Member's reporting, the scope of and purpose of the FCR, the specific terms of reference and any restrictions or limitations placed upon the Member.
- 6.1.3 A statement must be provided that the Member's reporting has been prepared in accordance with this Professional Standard.
- 6.1.4 In addition to the contents of this Professional Standard, in deciding on the content and the level of detail for reporting, the Member must comply with any reporting requirements given in the Code. The level of detail to be provided in an FCR will depend on the size and complexity of the operations of the Entity and considerations of Materiality.

6.2 Information requirements

- 6.2.1 The Member must advise the Entity of the information required, including data and reports that the Member will need, as well as the staff and relevant contractors of the Entity with whom the Member will need to consult, in order to prepare the FCR. The Member must identify in the FCR all information upon which he or she has placed Material reliance in preparing the FCR.
- 6.2.2 The Member must take reasonable steps to verify and document the consistency, completeness and accuracy of the information, including data and reports, provided by the Entity against the Entity's financial and other records. Material discrepancies that cannot be resolved with the Entity must be outlined in the FCR, together with the consequent limitations of the FCR.

- 6.2.3 The degree to which the Member relies upon information, including data and reports provided by the Entity, or upon testing of the data or other information by the Entity's internal auditor or other third parties, must be explained in the FCR, together with an assessment of the consequent limitations of the FCR.
- 6.2.4 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 FCR.
- 6.2.5 Where the Entity does not provide adequate and timely access to information, including data, reports and staff, as required by the Member, and the information cannot otherwise be practically obtained, the Member may omit from the FCR analysis that is dependent on that information, but must provide an explanation as to why it has been omitted and an assessment of the consequent limitations of the FCR.
- 6.2.6 Where the Member places reliance upon others to provide information required, and this information is limited or not forthcoming, the Member must note this in the FCR, together with an assessment of the consequent limitations of the FCR.

6.3 Business overview

- 6.3.1 An FCR must include general background information about the Entity. General background information includes relevant information about the Entity's corporate structure, operations, the Entity's Plans, including forward projections, and about any Prudential Requirements imposed on the Entity by APRA, in writing, that do not form part of the Act or prudential standards.
- 6.3.2 An FCR must outline, consider and comment on Material risks arising from the Entity's Plans and operations at the Effective Date, including sales, underwriting and claim management practices.

6.4 Recent experience and profitability

- 6.4.1 An FCR must identify and comment on the past profitability of the Entity, including consideration of 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. This assessment must consider premiums, claims, expenses, commissions, investment return and profits/losses, including any abnormal features.
- 6.4.2 Deviations of actual experience from the expected experience in the Entity's Plans over at least the year since the previous balance date must also be discussed, including an assessment of the reasons for these deviations.

- 6.4.3 An FCR must comment on the steps taken, or proposed to be taken, by the Board or senior management of the Entity to address areas of deviation and/or adverse experience.

6.5 Insurance Liability Valuation

- 6.5.1 An FCR must include a summary of the key results of, and considerations arising from, the Insurance Liability Valuation prepared at the Effective Date, prepared in accordance with PS 300 and, for an APRA-regulated Entity, GPS 320. The FCR must make reference to the Insurance Liability Valuation report, which can either be a separate report or included in the FCR.
- 6.5.2 An FCR must outline, consider and comment on Material issues arising from or disclosed by the Insurance Liability Valuation.

6.6 Adequacy of past estimates of insurance liabilities

- 6.6.1 An FCR must include an assessment of the adequacy of past Central Estimates of either outstanding claim liabilities or all insurance liabilities against the subsequent actual claims experience over a period of at least three years if experience exists.
- 6.6.2 An FCR must include comments on any Material implications for the adequacy of current estimates of insurance liabilities, both including and excluding Risk Margins, arising out of the review of historical estimates.

6.7 Pricing and premium adequacy

- 6.7.1 An FCR must outline, consider and comment on Material risks arising from the Entity's pricing processes. If reasonably practical and appropriate, this may include (but is not limited to):
- (a) the process for establishing the rates charged, including any variations from technical or book rates;
 - (b) the links between underwriting and pricing and between valuation and pricing; and
 - (c) monitoring of achieved prices and how the Entity responds to the outcomes of that monitoring.
- 6.7.2 An FCR must consider and comment on the recent and forecast adequacy of premiums, including whether expected future profitability indicated by the assessment of premium adequacy is Materially in line with the Entity's Plans.

6.8 Asset and liability management

- 6.8.1 An FCR must outline, consider and comment on Material issues arising from the Entity's approach to asset and liability management.

6.8.2 In undertaking this assessment, the Member must outline, consider and comment on Material risks arising from:

- (a) the Entity's liability profile and liquidity needs;
- (b) the Entity's investment assets, in particular its investment strategy and the nature, quantum and performance of those assets;
- (c) the Entity's other assets, in particular reinsurance and non-reinsurance recoveries;
- (d) the Entity's insurance liabilities;
- (e) the Entity's non-insurance liabilities;
- (f) the Entity's net assets; and
- (g) the methods for valuing assets and non-insurance liabilities, particularly, changes in those methods.

6.9 Capital management and capital adequacy

6.9.1 Having regard to (where relevant) the Entity's ICAAP, ICAAP summary statement and ICAAP report, an FCR must comment on Material risks arising from the Entity's capital management plans. In undertaking this assessment, the Member must consider and document:

- (a) the Entity's approach to setting and monitoring capital resources over time;
- (b) the processes and controls which the Entity has in place to monitor and ensure compliance with regulatory capital requirements, including the PCR;
- (c) the Entity's compliance with its capital targets since the previous FCR (including any regulatory capital requirements) and, where the Entity identified any breaches of such during that time, the actions taken by it to rectify those breaches. Where there is no previous FCR, the relevant period is to be the past year;
- (d) the Entity's capacity to meet its capital targets over at least the next three years (including any regulatory capital requirements), taking into account the Entity's:
 - (i) current capital position;
 - (ii) ability to access additional capital;
 - (iii) dividend policy; and
 - (iv) Plans and planned changes in risk profile.

6.9.2 In addition, for Entities regulated by APRA, the Member must:

- (a) discuss the Entity's ICAAP;
- (b) document the assumptions and methodologies used in determining the Entity's PCA and capital base, including the components of the Entity's PCA, and comment on their reasonableness;
- (c) document any supervisory adjustment determined by APRA; and
- (d) assess and document the adequacy of the calculation of the Entity's ICRC, including an assessment of the impact of multiple events in a year for an Entity with exposures to other accumulations.

6.10 Reinsurance arrangements

6.10.1 An FCR must comment on Material issues arising from the use of the Entity's specified reinsurance strategy, and from its actual current and past reinsurance arrangements, having regard to the Entity's liability profile. Reference must be made to the Entity's Reinsurance Management Strategy and to the Reinsurance Arrangements Statements submitted to APRA in accordance with GPS 230.

6.10.2 In undertaking this assessment, the FCR must consider intra-group reinsurance arrangements and relationships between the Entity and other Entities or institutions within the corporate group.

6.10.3 The Member must outline, consider and comment on Material risks arising from the Entity's reinsurance arrangements, having regard to:

- (a) the documentation and extent of placement of reinsurance arrangements;
- (b) the certainty of the Entity's ability to make reinsurance recoveries under these arrangements;
- (c) the sufficiency of the reinsurance arrangements to cover the Entity's Probable Maximum Loss;
- (d) the sufficiency of the reinsurance arrangements to cover the likelihood of multiple events impacting on the Entity;
- (e) obligations to pay future reinsurance premiums; and
- (f) nature and sufficiency of reinstatement arrangements.

~~For Entities regulated by APRA, the Member must comment on the sufficiency of the reinsurance arrangements to cover the Entity's Probable Maximum Loss.~~

- 6.10.4 The FCR must outline, consider and comment on Material risks arising from use of limited risk transfer products, such as financial reinsurance or purported reinsurance (whether financial or otherwise). Reference must be made to any approval by APRA of limited risk transfer arrangements under GPS 230.

6.11 Risk management

The Entity's risk management framework, comprising the Entity's risk management policies and procedures, processes and controls, as well as its risk management strategy that has been submitted to APRA in accordance with APRA's ~~General~~-Prudential Standard GPS 220 (Risk Management), is intended to identify the risks that may affect the financial condition of the Entity. The Member must comment on the Material risks that could adversely affect the financial condition of the Entity including, where he or she considers it appropriate, discussion of their likelihood and potential severity. The Member must also provide, in the FCR, an assessment of the suitability and adequacy of the Entity's risk management framework.

6.12 Conclusions and recommendations

- 6.12.1 The assessment of the financial condition of the Entity must include a discussion of the implications of Material risks and issues identified during the assessment of the financial condition of the Entity. For an APRA-regulated Entity, this discussion must be placed in the context of its current APRA authorisation.
- 6.12.2 Where the Member identifies Material risks with adverse implications for the Entity's overall financial condition, the Member must include in the FCR, recommendations intended to address these risks and, for an APRA-regulated Entity, in the context of its current APRA authorisation.
- 6.12.3 The Member must also comment on the extent to which the Entity has addressed recommendations provided in the previous FCR, and, if the previous FCR was not at the balance date, on recommendations provided in the FCR at the last balance date.

7. REVIEW OF AN ENTITY'S RUN-OFF PLAN

- 7.1 The Appointed Actuary of a Run-off Insurer is required by GPS 320 to review the run-off plan of the Run-off Insurer. The Member must provide a report which includes a conclusion as to whether the run-off plan and the supporting financial projections are reasonable and adequate having regard to the nature of the Run-off Insurer, its historical performance and expected future trends in the industry.
- 7.2 In undertaking this review, the Member must consider and document the items in this Professional Standard, as applicable to the Run-off Insurer, which have led to the conclusions. Where the Member believes the assumptions made in the Run-off Insurer's run-off plan and ~~and~~or the supporting financial

projections are neither reasonable nor adequate, the Member must propose recommendations designed to address the issues.

- 7.3 The report of the Member's run-off plan review must contain statements confirming that the Member has considered all the matters set out in Attachment A to APRA's ~~General~~ Prudential Standard GPS 220 (Risk Management).

END OF PROFESSIONAL STANDARD 305