MEMBERSHIP

We are pleased to announce that Danny Shuttleworth has been formally appointed a member of the Board. Danny is National Manager, Life Insurance with Coopers & Lybrand. His practical experience of life insurance matters is extensive, and is complemented by his involvement with The Institute of Actuaries of Australia (IAA) including most recently as Convenor of the Life Insurance Practice Committee (LIPC).

PROGRESS ON THE STANDARDS

Introduction

The Board is in a unique position at the date of issue of this Newsletter - a position it has not been in since the release of its first discussion draft for the Due Process.

The Board currently has no documents - discussion draft or exposure drafts - out for exposure.

As a consequence, the Board does have three important standards - the Valuation, Solvency and Capital Adequacy Standards - to be finalised and released as actuarial standards over the next 2 to 3 months. Despite extensive consultation and multiple releases of draft documents, there are always issues which arise in respect of each new draft, and accordingly the process of finalisation of the standard is not an insignificant one.

Given this, and the priority which the Board believes must be given to these three standards, certain other scheduled tasks will be deferred.

The following provides an update on the current status of the various actuarial standards.

The Surrender Value Standard

The exposure period on the Discussion Draft of the Surrender Value standard closed on 30 June 1996 - 17 individual submissions were received. These submissions, taken together with the feedback received through the Workshop held in April, provide considerable material for consideration in progressing to the next stage of an Exposure Draft.

The Board has always been conscious, in respect of this standard, that the development process is starting from an embryonic stage (relative to that of the other standards). In the case of the Valuation Standard, Solvency Standard and Capital Adequacy Standard, the Board has benefited greatly from the existence of well developed IAA positions and detailed technical documentation of that position.

While there is a mood of broad support for the principles the Board is proposing for the Surrender Value Standard, the technical detail for, and practical implications of, achieving those principles suffers from the lack of any previous detailed consideration and therefore requires greater consultation both within the actuarial profession, and with the broader stakeholder group, including consumer interest groups.

The Board has worked to tight time frames in the development of all actuarial standards. However, to achieve those schedules at the risk of compromising the quality and integrity of the actuarial standards, would not be contemplated.

Accordingly, the Board has determined it best to defer the implementation of the Surrender Value Standard for a period of 12 months. The surrender value standard will apply from 31 December 1997.

The Board will take advantage of this deferral in the following ways:

- seeking professional and technical advice (through IAA and practitioners) in developing the detailed provisions of the standard
- extended exposure periods, to allow fuller consideration and a more productive consultation process with a range of interested
parties. (The Board will consider two Exposure Draft processes.)

- an extended lead-time for implementation, to provide for necessary administrative and system implications.

It is noted that as a consequence of the deferred implementation of the Surrender Value Standard, application of the current provisions - the Transitional Provisions for the Calculation of Paid Up Values and Surrender Values - will be extended. This will be appropriately formalised in due course.

**The Valuation Standard**

Following the exposure process which ended on 21 June 1996, the Board has worked closely with the Life Insurance Practice Committee of the IAA, in reviewing issues of technical detail raised in the submissions, and refining the wording of the standard to ensure accurate reflection of those details.

Further, legal opinion on the draft actuarial standard has been sought, from within the ISC, on the robustness of the document as a legislative instrument.

The Board is looking forward to a milestone of releasing its first new methodology standard - the Valuation Standard - within a month.

**The Solvency and Capital Adequacy Standards**

The exposure period for the Exposure Drafts of these standards has recently ended (10 September.) Some 20 submissions have been received. Over the next month the Board will be working through these submissions, towards finalisation of the standards, and their release in early November.

**Date of Application**

One issue which has arisen from the consultation process can be clarified at this stage. It relates to the date of application of the capital requirements imposed by these standards - that is, when do companies need to have the required capital?

**The capital requirements apply prospectively,** from the date of first application of the standard to a company. That is, for a 31 December balancing company, the requirements apply from that date. For a 30 June balancing company, the requirements will apply from 30 June 1997. For companies with other than 31 December balance dates, the Transitional Provisions continue to apply in the interim.

**Investment Performance Guarantee Standard**

While the Board has commenced its considerations on the requirements of this standard, and has held discussions on the basis of a preliminary concept paper with representatives of the LIPC, other priorities mean that progress on this standard will be delayed.

The Investment Performance Guarantee Standard will not be significantly progressed until the first quarter of 1997. A discussion draft is planned for release in early December.

Accordingly, the Transitional Provisions in respect of investment performance guarantees will continue to apply until 31 December 1997; again this will be formalised in due course.

**VALUATION STANDARD - POLICY ISSUES**

The Board exposed in its Exposure Draft of the Valuation Standard, certain policy decisions which reflected a change of position relative to that in the Discussion Draft (which was taken as the relevant IAA professional standard - PS201).

On the eve of final release of the actuarial standard, the opportunity is taken to explore the reasoning behind two of these policy decisions:

- the determination of cost of bonus ; and
- the treatment of losses on new business.

**Cost of Bonus**

The actuarial standard will reflect a basis for determination of the cost of bonus which adopts cash value, or surrender value of that bonus at the valuation date.

The IAA, in its own development processes, canvassed a number of alternative approaches to the determination of cost of bonus. From the theoretical to the practical, the options vary in their resultant patterns of release of profit over the term of the business. More particularly, the cost of bonus is a critical determinant of the timing of release of profits (via dividends) to the shareholders.

Given the complexity of this issue - and the reality that no purely correct option was achievable - the Board’s assessment of the relative merits of the various options resulted in a preference for the cash value approach.

There is an inherent logic in this approach. The release to shareholders at any time is directly
related to the release to policy owners, where that release is a disclosed and measurable value. Arguably, the value of bonuses as at a date is the cash that the owner could get for those bonuses at that date.

The Board acknowledges that by adopting this pragmatic approach to the determination of cost of bonus, there are resultant discontinuities between the policy liability pre and post bonus declaration. It is also noted though that such discontinuities would exist, to a greater or lesser extent, had the alternative approaches been adopted.

**Treatment of New Business Losses**

The Board has taken a position in respect of the treatment of losses on new business which provides an option to the Actuary.

Much consideration has gone into this decision.

The Valuation Standard provides, in the determination of profit margins and losses, for the grouping of products to a Related Product Group level. Accordingly, within that group there will be cross subsidisation between products.

Within that Related Product Group, then, how should the standard provide for cross subsidisation over time?

The circumstances of each case determine the appropriateness of the treatment adopted. There is no single correct answer. The level at which losses should be measured and/or recognised is one which requires some measure of judgement (in fact it is afforded that judgement in the determination of Related Product Groups.)

In coming to a final position on this issue, the Board took into account similar accounting treatments in other contexts, which supported:

- provision of discretion within standards in respect of grouping of business for the purposes of profit/loss recognition; and
- reliance on the objectivity of the audit process to facilitate consistency of approach within companies and across the industry.

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**NOTICE BOARD**

**COMPLETED**

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**UPCOMING**

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<td>Investment Performance Guarantee</td>
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**NOTE:** The implementation date of both the Surrender Value Standard and the Investment Performance Guarantee Standards has been deferred to 31 December 1997, allowing proper time for the development of, and consultation on, these documents.