MEMBERSHIP OF LIASB

It is with regret that we accepted the resignation of Mr Ted Rudge as a member of the Life Insurance Actuarial Standards Board (LIASB) this month. Ted is taking up the position of Chief Actuary, AXA and hence relocating to Paris. We extend our congratulations to Ted on this prestigious and challenging appointment and our thanks for his contributions to the LIASB over his 12 month period of membership.

DISCUSSION DRAFT OF THE INVESTMENT PERFORMANCE GUARANTEE STANDARD

Introduction

The LIASB released the discussion draft of the Investment Performance Guarantee Standard on 24 March 1997. (The exposure period for the discussion draft closes 9 May.)

The objectives of this actuarial standard are new, introduced with the commencement of the Life Insurance Act 1995 (the Act). The mechanisms for achieving the objectives are somewhat untested. Accordingly, in releasing the discussion draft, the LIASB was conscious of the need to clearly communicate the objectives of the standard (in the context of the objectives of the Act), and the reasoning behind the mechanisms proposed in the draft for achieving those objectives. A comprehensive Introductory Paper, released in conjunction with the draft Standard was intended to contribute to that communication process.

However, it is felt that the consultation process on this discussion draft would benefit from further explanatory comment.

Paramount in an assessment of the proposed methods in the draft standard is an acknowledgment of the pragmatism intentionally adopted by the LIASB. This approach derives from our understanding of the purpose of the section 42 requirements; that purpose being to ensure the integrity of the investment-linked statutory fund as providing predominantly market linked liabilities.

The Act prescribes a limit (albeit set somewhat arbitrarily) on the extent of guarantees which may be provided in the investment-linked fund. It is stressed that this is not a limit on the extent of guarantees which may be provided, merely on the statutory fund which accepts the risks associated with those guarantees.

In accordance with this broad intention, it was determined by the LIASB that only practical and pragmatic methods for testing against the prescribed limit were warranted.

The Cost of the Guarantee

The approach proposed in the draft Standard is premised on the ‘cost of the guarantee’ being the cost to the shareholder of providing that guarantee - which is primarily the cost to the shareholder of providing the required capital to support the guarantee. (It is presumed that the cost associated with the potential benefit extended by the guarantee is a cost passed on to the policy owner in the pricing of the product.)

Importantly, this definition results in the cost of the guarantee being independent of the quantum of capital residing in the statutory fund. The capital adequacy of the fund - and hence security of policy owners’ entitlements - is an issue provided for by a separate actuarial standard. It is not considered a relevant issue in the context of the Investment Performance Guarantee Standard, where the concern is with the extent of guarantees provided in a particular type of statutory fund, not the security of those guarantees.
Reliance on the Resilience Reserve Mechanism

It is acknowledged that there are many techniques available in the market for costing forward guarantees - and that these techniques extend beyond the strictly actuarial. In accordance with the desire for practicality, the existing methods developed for purposes of the resilience reserve requirements were recognised as appropriate.

The determined resilience reserve is, very broadly, a determination of the capital considered necessary to support liability guarantees under a presumed scenario of adverse experience.

Adopting a pre existing technique, provides benefits of:

• its derivation having been subject to the scrutiny of the industry;
• being a well accepted and understood method; and
• being able to be practically applied within pre existing processes and systems.

The 50% Factor

Accepting that the resilience reserve is a proxy for the required capital - the cost to the shareholder of providing that capital is what we set out to calculate.

Under a typical actuarial determination, calculation of this cost could involve the discounting of future cash flows with assumptions about appropriate terms and discount rates. Again, in this respect, the LIASB has chosen a pragmatic approach. The application of a factor of 50% has been proposed as a simple, albeit approximate, mechanism for determining this cost.

Practical Impact

Many forms of guarantee exist in the market place. A heavy reliance is being placed on the practitioner to fully consider the implications of the proposals on their business - both in terms of appropriateness of the proposed measure and practicality of application. We look forward to receiving feedback and guidance through your submissions.

THE DISCUSSION DRAFT OF THE SURRENDER VALUE STANDARD

Introduction

The period for submissions on the second discussion draft of the Surrender Value Standard closed 28 February. The LIASB received 13 submissions.

While the submissions provided encouraging acknowledgment of the improvements made in this second draft, there are still issues of some significant concern to the industry.

Unbundled Investment Business

The predominant area of concern is in respect of the proposals for unbundled investment business. A part of the concern remains with the practical implications of the proposed methods - the importance of which the LIASB does not disregard. However, a more fundamental concern has been highlighted with the philosophical approach being adopted and the equity of that approach as between different companies and different products dependent on charging structure and practices.

The LIASB considers it important that the next release of the standard - the exposure draft - present a position which seeks to address both of these concerns. In this respect some useful suggestions included in the submissions received are being pursued and developed in conjunction with the submitters.

Revised Timetable

The consequence of this process, however, is a delay in the timetable for development of the standard. To allow proper consideration of these issues, and incorporation in the redraft of what may be changes to the fundamental philosophy, the release of the Exposure Draft will be deferred for 4 to 6 weeks.

Further, to allow companies an appropriate lead time for implementation of the new requirements, the application of the standard will now commence on 30 June 1998.
Amendments to the Act

Submissions further highlighted the issue of the limitation on payment of minimum surrender values during the first three years of a policy to regular premium policies only.

The Insurance and Superannuation Commission (ISC) has requested the LIASB, in clarifying this matter, to disclose a proposed amendment to the Life Act. The proposed amendment will clarify the application of section 207(1) as limited to regular premium policies. The ISC has explained that the extension of this provision, in practice, to single premium policies was never envisaged and certainly not intended.

REVIEW OF THE STANDARDS

It is our understanding that the Institute of Actuaries of Australia (IAA) is planning a series of workshops on the Valuation, Solvency and Capital Adequacy Standards over the next few months. The workshops will be targeted at the practitioner and offer a forum for raising and discussing aspects of interpretation and application of the Standards.

The LIASB will be interested to receive feedback from this process, to facilitate its own processes for reviewing the application of the Standards in practice. It is stressed that there is no intention at this stage for amendment of the Standards in the short term. Amendment will be a long term and deliberate process involving the normal consultations.

Rather, from an assessment of the ‘success’ of application of the Standards, consideration will be given to the need for further supporting/guidance material from the LIASB, to the extent not provided by the IAA or ISC.

NOTICEBOARD

UPCOMING

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