MEMBERSHIP of the LIASB

The LIASB is pleased to welcome Mr Peter Hodgett as its newest member. Peter is the Chief Actuary at the AMP Society and has an excellent reputation within the actuarial profession and the life insurance industry. Peter has been a significant contributor to the activities of the Institute of Actuaries of Australia relevant to life insurance issues. He further brings to the LIASB significant international experience in life insurance.

CHANGE OF ADDRESS

Please note the office of the Secretariat of the Life Insurance Actuarial Standards Board (LIASB) has moved. The new contact details are:

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EXPOSURE DRAFT OF THE SURRENDER VALUE STANDARD

Introduction

The LIASB released the exposure draft of the Surrender Value Standard on 29 May 1997; the exposure period for the draft closed 25 July 1997.

The LIASB received 10 submissions.

The LIASB has been considering the submissions during the months of August and September, and expects to be in a position to release the actuarial standard early in October.

The following discussion addresses the significant issues raised through this final consultation process. It is intended to provide the background to the considerations of, and hence an insight into the position to be taken by, the LIASB in the final actuarial standard.

1. Non Commutable Income Stream Products

An issue was raised, in the context of proposed (1997-8 Budget Statement) changes to the Social Security means test treatment of retirement income stream products, about the requirement to provide commutation (surrender) values on certain income stream products. In principle, the LIASB was supportive of the concerns raised - agreeing that it would not be appropriate for means test treatment to be adversely effected by the requirement for minimum surrender values on otherwise eligible income stream products.

However, a recent press release by the Government (26 August) serves to clarify the policy position in this regard. The press release makes it clear that commutation of an income stream product will be permissible where that commutation value is used to purchase another eligible income stream product. Accordingly, there is no impediment from this perspective on the LIASB prescribing minimum surrender values for such products.

The actuarial standard has not been altered in this regard.

2. Application to Overseas Business
The application of the standard to overseas business written in a mixed statutory fund (with Australian business) was reconsidered in detail by the LIASB given concerns expressed in a number of submissions.

It is noted that the existence of mixed statutory funds is a grandfathered provision under the Life Act, and hence a circumstance of limited application.

Despite this, the LIASB has decided to retain the current application of the standard. It is the view that to do otherwise would, in the circumstances of insolvency of such a mixed fund, potentially undermine the security of the Australian policy owners. It is not clear that in such circumstances a judicial manager would be able to apply differential treatment to groups of policy owners within the statutory fund. Accordingly, a stronger solvency standard applied to Australian policy owners only could, in the circumstances of insolvency, effectively subsidise the benefit position of the overseas policy owners.

The LIASB does acknowledge the practical difficulties of calculating minimum surrender values on the prescribed basis for overseas business where the purpose of these calculations is limited to their application in determining the solvency requirement of the fund. The actuarial standard will address this issue specifically, providing for approximate methods to be employed where the minimum surrender value has no relevance to the benefit entitlements of the individual policy owner.

3. Unbundled Investment Business

A common request in the submissions received was for greater prescription in respect of the detailed application of the requirements for Unbundled Investment Business.

The LIASB has previously communicated its position in this regard in respect of all the actuarial standards - the standards are intended to provide, as a framework, the principles underlying the particular calculation process. Some greater detail is provided in the form of guidance or commentary in the standard, intended to support the principles and assist in the interpretation of those principles in a range of circumstances. It is not possible, nor desirable, for the standards to address, explicitly, all circumstances of product or other variation.

The Surrender Value Standard, with particular regard to section 4, has been similarly developed. In this way the standard remains flexible to the needs of the current market and the potential future market. In the application of the provisions in practice, reliance is placed on the professional role of the actuary, and the ability of the actuary to adopt the principles of the standard and appropriately reflect the circumstances of a particular product or environment.

The Recovery Component

The concept of the ‘recovery component’ as it applies to certain unbundled investment products is a particular example of the above stated reliance on the role of the actuary.

In the final actuarial standard, the responsibility for the determination of the quantum of the recovery component has been placed with the actuary.

A recommendation made in a number of submissions was for the period over which the recovery component applies to be similarly determined by the actuary. The LIASB initially supported this recommendation. However, further consideration of the workings of the recovery component process highlighted that, if determined actuarially, the period of application would vary depending on the size and/or term of the individual policy. As such complexity was considered unwarranted, the pragmatism of a prescribed period of application has been retained in the standard, but with that period being linked to the term of the individual policy.

4. Prescribed basis for Income Stream Business providing a return of capital

A number of submissions questioned the appropriateness of the prescribed basis for determining the minimum surrender value of a lifetime annuity providing a return of capital on death. In certain circumstances, it is possible that the determined surrender value would exceed the actuary’s best estimate of the liability to the policy owner.

While acknowledging the potential for this situation to occur, the LIASB believes the required combination of circumstances would be relatively uncommon in practice. Further the proposed amendments to the basis introduced an element of complexity not considered warranted by the consequential financial impact on the resulting surrender value.

5. Non Retrospectivity of Application

While some measure of non retrospectivity of application was provided in the draft actuarial standard, a number of submissions sought an
extension of this provision to prescribed classes of business written prior to 1 July 1998, and in some cases to all classes of business (particularly unbundled investment business.)

The requirement for minimum surrender value standards is set by the Life Act - and this Act commenced 1 July 1995. While prescribed bases may not have existed for all types of business, the LIASB did issue a transitional actuarial standard in respect of minimum surrender values which applied from 1 July 1995. It is not considered appropriate to extend the non retrospection provisions beyond those proposed in the exposure draft.

It is noted that in respect of unbundled investment business while full non retrospection of application has not been extended, the basis has been refined, in respect of the prescribed charges, to provide appropriate transition to the new surrender value regime.

Revisions in Summary

In summary, as a consequence of the submissions received from the exposure draft process, the following amendments will be reflected in the final actuarial standard AS4.01 when released in October:

- correct application of the prescribed dollar amount administration or transaction charge, and differential charges by class of business.
- provision for approximate methods in determining the MSV where required for Solvency purposes only.
- delegation to the actuary of the determination of the recovery component, both quantum and period of application, in accordance with the pricing basis of the business.
- provision of non retrospectivity of the recovery component processes for business in force at 1 July 1998.
- provision of transitional application of the prescribed establishment charge, for business in force at 1 July 1998.
- revision of the definition of wholesale business.
- exclusion of accident only business from the definition of Long Term Risk business.

The LIASB acknowledges that other issues were raised in the submissions. While having received the due consideration of the LIASB, these will not result in amendment of the actuarial standard. The reasons for not adopting proposals generally fall into one of the following categories:

a) the proposal is in conflict with the legislative framework of the Life Act, and hence beyond the scope of the LIASB’s responsibilities

b) the proposals reflect issues of too detailed or technical a level to be incorporated in the standard. The LIASB prefers to rely on the professionalism of the actuary and the role of the IAA in providing education, support materials for its membership.

EXPOSURE DRAFT OF THE INVESTMENT PERFORMANCE GUARANTEE STANDARD

The LIASB released the exposure draft of the Investment Performance Guarantee Standard on 20 June 1997; the exposure period for the draft closed 29 August 1997.

The LIASB received 4 submissions.

All submissions were supportive of the draft actuarial standard. Accordingly, the LIASB will issue the actuarial standard in October - the standard will be unaltered from the version issued as the exposure draft.

SOLVENCY STANDARD - CLARIFICATION

Pricing Assumption for Disability Income Business

The LIASB has become aware of a concern amongst practitioners in respect of the solvency assumptions prescribed in AS2.01 for disability income business.

The first matter of concern relates to the application of the prescribed assumption for claims in payment and results from an error in the drafting of the standard. To clarify this matter, it is noted that the solvency margin (20%) in respect of the claims in payment should be applied to the liability resulting from application of the prescribed Defined Table, rather than to the rates in that Table.

The second matter relates to the appropriateness of the prescribed assumption. It was the view of the LIASB, in preparation of the standard, that the solvency assumptions in AS2.01 should be conservative ones. The termination rate assumption implicit in the prescribed Defined Table (IAD89-93) is acknowledged as being based on limited industry experience. It is, however, the most recent
published table available, and the basis recommended by the IAA’s Disability Committee.

The actuary would be expected to use professional judgement in the adoption of this prescribed assumption only if it is believed to be conservative, given a detailed knowledge and understanding of the profile and experience of a particular block of business.

REVIEW OF THE STANDARDS

The LIASB met with representatives of The Institute of Actuaries of Australia’s (IAA’s) Life Insurance Practice Committee (LIPC) and Financial Reporting Subcommittee.

The objective of the meeting was to commence a process of structured liaison between the LIASB and IAA, with a view to co-ordinating the ongoing efforts of each in supporting the appropriate and consistent application of the LIASB’s actuarial standards.

The LIASB understands that the LIPC will be undertaking the development of supplementary materials to assist the membership in the interpretation and practical implementation of the actuarial standards. The form of those materials may vary with the nature of the subject covered, but may include discussion papers, issues papers, workshops and professional guidance notes. The LIASB is supportive of the initiatives of the LIPC in this regard.

The LIASB will be commencing its own formal program of review of the standards early in 1998, upon completion of the two outstanding actuarial standards. The process for undertaking this review has not been considered in any detail by the LIASB at this stage.

However in acknowledgment of the intention to review the standards, and to assist in estimating the potential scope of that review, the LIASB would be happy to commence receiving submissions in respect of the valuation, solvency and capital adequacy standards. Without limiting the content of those submissions, the LIASB would prefer an emphasis on the following issues:

- appropriateness of the principles;
- difficulties of interpretation of the principles; or
- concerns with practicalities of application.

In providing such submissions it must be recognised that there is no undertaking by the LIASB to respond to individual submissions, nor to commence the review process in response to these submissions, or otherwise, earlier than the first quarter 1998.

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**NOTICEBOARD**

**UPCOMING**

- **Surrender Value Standard**
  - To be Released October 1997
  - To Commence Application 1 July 1998

- **Investment Performance Guarantee**
  - To be Released October 1997
  - To Commence Application 31 December 1997

- **Review of Issues Arising from Standards in Practice**
  - Commencing early 1998