ALL ACTUARIAL STANDARDS NOW RELEASED

The LIASB released the following standards on 22 October 1997:

Actuarial Standard 4.01 Minimum Surrender Values and Paid-up Values
Actuarial Standard 5.01 Cost of Investment Performance Guarantees

AS 4.01 applies to all calculations made on or after 30 June 1998. AS5.01 applies at all times on or after 31 December 1997.

With the release of these two actuarial standards, the LIASB has issued all actuarial standards explicitly required by the Life Insurance Act 1995.

ACKNOWLEDGMENT OF INDUSTRY EFFORTS

The LIASB was faced with an onerous schedule for the development of the first three actuarial standards to provide for their application to balance dates on and after 31 December 1996. The support received by the LIASB from industry in the development process - through considered and constructive submissions - was integral to the timely release of the standards.

Now, a year later, the LIASB would again like to acknowledge the efforts of the life insurance industry. The ISC advises that nearly all companies have lodged financial statements reflecting the requirements of the standards. The general response to the disclosed information has been positive - the fundamental objectives of transparency and consistency of financial reporting have been largely achieved.

The burden for companies in undertaking this significant change is not underestimated by the LIASB - and the professional manner in which the process was undertaken is acknowledged.

The Chairman of the LIASB stated:

“...benefits both for the companies individually and for the industry as a whole, which more than justify those initial costs.”

The progress made in Australia, when considered as part of the international agenda for reform in financial reporting for life insurance industries, is significant and reflects well on the actuarial and accounting professions and the life industry.

REVIEW OF THE STANDARDS

Introduction

With the release of the final actuarial standards required under the Life Insurance Act 1995, the LIASB will turn its efforts in 1998 to the review of the first three actuarial standard released in late 1996:

- AS1.01: Valuation of Policy Liabilities
- AS2.01: Solvency Standard
- AS3.01: Capital Adequacy Standard

In undertaking this review program, it is not the intention of the LIASB to introduce significant change to the standards. Rather the program is intended to ‘fine tune’ the standards in the light of industry experience with the interpretation and application of those standards in practice.

Process
The early stages of the review program will emphasise consultation and identification of issues.

Some preliminary steps have already been taken in these respects:

- at the July meeting of the LIASB, representatives of the Life Insurance Practice Committee (LIPC) of The Institute of Actuaries of Australia, discussed their proposals for producing supplementary materials in support of the actuarial standards.
- at the October meeting of the LIASB, a representative group of Auditing Actuaries presented their experiences with the application of the actuarial standards.
- at the November meeting of the LIASB, a representative group of Auditors presented their experiences with the application of the actuarial standards.
- the LIASB has sought written submissions from industry practitioners (through this and earlier Newsletters).

A continuity of these forms of consultation is expected in the early part of 1998, with possible target groups including company appointed actuaries, analysts (of life company financial statements) and life company senior executives.

The latter stages of the process cannot be firmly established until the first stage - identification of issues - is well progressed. However, early indications support the LIASB’s position that major change is not warranted.

Further, the LIASB has always stated a strong preference in respect of its standards to emphasising the principles underlying the required calculations, and allowing the use of professional judgement to operate practically within those principles. It is not expected that the review process will alter this fundamental approach.

The LIASB will look to using vehicles such as its Newsletter to highlight the simpler issues of interpretation of the standards. The role of the LIPC is seen as integral to the provision of guidance and support to the actuarial profession in the detailed application of the standards.

The auditing process, with its overlaps and peer reviews, is expected to also create a tendency towards consistency of interpretation and judgement.

Should an issue arise which it is considered warrants more detailed and/or technical analysis - the LIASB will consider alternative courses of action, including the establishment of specialist task forces and the commissioning of research.

**MATTERS ARISING FROM THE CONSULTATION PROCESSES TO DATE**

The consultation sessions which the LIASB has undertaken to date have highlighted a number of issues which were consistently presented as areas requiring some clarification.

Some of these issues can most appropriately be addressed, directly by the LIASB, through the provision of clarification as to the intent of the requirement in this Newsletter. The latter sections of this Newsletter address a number of these issues.

There are of course other issues which, by their very nature, require more considered analysis before the LIASB is in a position to determine the appropriate response. Significant issues of this type which have arisen, are listed below for two reasons. Initially, to illustrate the types of issues which the LIASB is hoping to identify through its consultations. Secondly, and importantly, to keep practitioners informed of the issues being considered by the LIASB and to allow them the opportunity to contribute (through written submission or otherwise) to the debate.

1. **Discount rates.** The appropriate discount rate to apply in the determination of policy liabilities, and the significance of this assumption to the emerging results.

   The LIASB has noted this as an issue which requires further consideration and consultation.

2. **The volatility of profits on Risk Business where the policy liability is negative.** The appropriate treatment of a change in the best estimate assumption for investment earnings, which for such business, can result in a gearing effect on the emerging profit for the period.

   The LIASB has undertaken some preliminary discussions on this matter. It is acknowledged as a particularly complex matter, the implications of which may extend beyond the specific circumstances of risk business where the policy liability is negative.
However, given the potential material impact on reported profits, the LIASB has determined to provide some comfort to industry as to the interpretation of the standard in these circumstances - in doing so the LIASB does not consider its analysis of the issue to be complete. Formal amendment of AS1.01 may be required in due course.

It is the current view of the LIASB that, for a related product group the policy liability of which has a negative value, the provisions of paragraph 1.8(b) should be taken as not appropriate. The logic is that, as there are no investments backing the liabilities, the principles of matching of values (which underlie paragraph 1.8(b)) are of limited relevance.

CLARIFICATION OF THE STANDARDS

AS1.01 - Maintenance Expense Assumption

In principle, the valuation standard prescribes best estimate assumptions for all contingencies. However, in the case of the maintenance expense assumption, it is the intent of the standard to not allow, as a matter of course, the anticipation of improvements, over time, in the future best estimate assumptions for maintenance expenses.

AS2.01 - Investment Earnings Assumption

It is the intent of the solvency standard to prescribe a set of assumptions which include a margin of prudence over the best estimate level. Due to the prescriptive nature of the standard, there may be cases where a particular assumption does not achieve this intent. For instance, the prescribed investment earnings assumption of AS2.01 may not be provide a margin on best estimate in a particular set of circumstances. Where this is the case, and the impact of the assumption is material, compliance with the intent of the standard (in providing a prudent margin of a level consistent with the other prescribed margins) would be expected.

AS2.01 and AS3.01 - margins on IBNR

As described above, it is the intention of the solvency and capital adequacy standards, in the determination of the respective liabilities, to apply pricing margins to the determined best estimate of the policy liabilities. While not explicitly stated in the standards, it is the expectation that pricing margins should be applied to any calculated IBNRs (Incurred But Not Reported reserves) or similar reserves, on a basis consistent with the other prescribed margins.

AS2.01 and AS3.01 - Unsecured Borrowings for Asset Inadmissibility

The inadmissible asset reserve requirements of the solvency and capital adequacy standards prescribe percentage limits on the exposure to an asset class or obligor. In most instances the limit is 5%; for certain acknowledged lower risk asset classes, higher limits have been defined. A lower limit of 1% has been prescribed for higher risk mortgages and unsecured borrowings. In this particular respect, the terminology “unsecured borrowing” has proven confusing. The intention of the standards is to apply the lower limit to unsecured loans, directly negotiated between the borrower and the life company (or associated companies). It is not considered appropriate that an unsecured borrowing with the following features - publicly offered, credit rated and readily exchangeable - be exposed to lower limits than equity in the same institution.

AS3.01 - Definition of Current Termination Value

The structure of the definitions of current termination value (CTV) and minimum termination value (MTV) in the capital adequacy standard, as they apply to investment-linked business, has caused some confusion. The confusion arises due to the operation of the investment-linked margin on the respective termination values, in combination with the capital adequacy CTV being defined as subject to a minimum of the solvency MTV. It is the intention of the standard, in this regard, that the solvency MTV minimum be that MTV prior to the application of the 0.25% investment-linked margin. This interpretation is consistent with the principle that the investment-linked margin may be embedded in the CTV for capital adequacy purposes (refer Newsletter No.5).
**NOTICEBOARD**

**UPCOMING**

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<th>Submissions to the LIASB on the Review of AS1.01, AS2.01 and AS3.01</th>
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Note: Newsletter No.9 stated, in respect of the review of the standards, “the LIASB would be happy to commence receiving submissions in respect of the valuation, solvency and capital adequacy standards”. In order to formalise this process, and allow the LIASB to plan the review program, a close date for provision of submissions has been set.