MEMBERSHIP of the LIASB

Mr Peter Vinson finished his term as the inaugural Chairman of the LIASB on 30 June 1998. The achievements of the LIASB during its first three years have been significant, and can to a substantial extent be attributed to Peter’s personal commitment and strength of leadership.

The other original members of the LIASB, Mr Tim Jenkins, Mr Mike Hughes and Mr Bill Bartlett, have agreed to serve for another term. This will provide for continuity of operations and consistency of principles, as the LIASB enters this important phase of review of its first three standards. Mr Tim Jenkins is currently acting in the role of Chairman.

The LIASB is pleased to welcome Mr Clive Aaron as its newest member. Clive is a consulting actuary with Tillinghast and brings to the LIASB not only significant experience in all aspects of life insurance actuarial practice but an important link to the developments taking place on the international arena.

CURRENT MEMBERSHIP:

Mr Tim Jenkins (Acting Chairman)
Mr Clive Aaron
Mr Bill Bartlett
Mr Bob Glading
Mr Peter Hodgett
Mr Mike Hughes
Mr Danny Shuttleworth

REVIEW OF THE ACTUARIAL STANDARDS
AS1.01, AS2.01 and AS3.01

Introduction

In Newsletter No.10, the LIASB reported on its intended review of the actuarial standards:

- AS1.01 Valuation Standard
- AS2.01 Solvency Standard
- AS3.01 Capital Adequacy Standard

The Newsletter formally sought submissions from the industry on the review of the standards, with a closing date for submissions of 15 March 1998.

Progress on the review of the standards has been delayed by two other projects, each of which involved substantial consideration by the LIASB. The first was in responding to the Australian Accounting Standards Board (the AASB) in respect of their draft accounting standard ‘Financial Reporting of Life Insurance Business’. The second was in developing the Expense Standard discussion draft – dealing with the principles for allocation of the expenses of a statutory fund as between the categories of acquisition, maintenance and investment expense.

The LIASB has now been able to consider the submissions received in respect of the review of the actuarial standards. The discussion below highlights some of the issues arising out of that process and the LIASB’s current views thereon. These should be considered to supplement earlier comments of a similar nature included in Newsletter No.10.
Matters Arising From the Submission Process

The LIASB received 8 written submissions on the review of the actuarial standards. The submissions highlighted a number of issues where clarification of the standards or further guidance could usefully improve the consistency of application in practice. However, in general, the submissions were not sharply critical of any aspect of the standards. There was a general tenor to the submissions, and to the consultations the LIASB undertook in late 1997, that significant change to the standards is not appropriate at this stage of their evolution, nor is it warranted.

The most significant issues arising were:

**AS1.01 – Valuation Standard**

**Discount rates:**

A number of submissions queried the philosophy underlying the determination of the discount rate for the purposes of AS1.01. It was suggested in these submissions that the discount rate should be the riskless return determined independently of the assets backing the liabilities.

It is the view of the LIASB that the philosophy underlying AS1.01 in this regard remains appropriate. The standard prescribes principles and methodologies for profit reporting on a realistic, best estimate basis. Within such a framework the expected return should be consistently reflected in liability values.

However consideration of the issue is not limited to the implications under AS1.01. The totality of the actuarial standards regime must be considered. In this context, the requirements of AS2.01/AS3.01 impose appropriate capital requirements, with the solvency requirement being based on the riskless return with resilience reserves for mis-matching risk.

That said, the LIASB is aware that emerging thinking in the international arena may support the criticism of this aspect of the AS1.01 approach. However, this thinking is preliminary and does not at this stage justify a change in philosophy. International developments will continue to be monitored by the LIASB.

**Volatility of Profits:**

The Life Insurance Practice Committee of the Institute of Actuaries of Australia (LIPC) provided a comprehensive submission on the issue of volatility of profits, identifying a number of ‘sources’ of such volatility and proposing appropriate application of the standard in each case.

It was the general position of the LIPC submission that the principles of AS1.01 did not need change in this respect. Rather, it is the application of those principles in the different circumstances which requires clarification through further guidance material. The LIPC has undertaken to prepare appropriate guidance material in consultation with the LIASB.

A particular circumstance of volatility of profit was discussed in Newsletter No.10 – volatility associated with a change in best estimate assumptions for investment earnings for a related product group with a negative policy liability. While the LIASB view on the intended profit outcome in this circumstance has not changed, our view on the most appropriate way to achieve that outcome which appropriately reflects the different management practices of companies has developed.

An amendment to the principles of section 1.8 of AS1.01, in retrospect, may be a heavy-handed way of addressing the issue. An alternative, which the LIASB will look to progress with the LIPC, is to clarify the determination of the discount rate for such related product groups. The actuary should determine a discount rate on a consistent basis over time where that basis reflects the overall philosophy of the company for managing this business and the investment strategy implicit in that philosophy.

**Maintenance Expense Assumption**

Again, Newsletter No.10 provided comment on this issue. However, some further clarification of that comment is warranted.

It is the intent of the standard that the best estimate assumption for maintenance expenses applies in respect of the year following the reporting date and each subsequent year (subject to the application of an inflation assumption as appropriate). It may be appropriate to use the company’s budgeted expenses for this purpose where considered realistic by the actuary and sufficient to cover the expected costs in the following year (as required).

Anticipation of improvements in expenses over time was not generally intended by the standard. Only in extraordinary circumstances, and subject to the professional judgement of the actuary, would such an approach be appropriate.

**Change in Other Economic Assumptions:**
The standard provides explicitly for the treatment of changes in the best estimate assumption of investment earnings due to changes in market conditions. Consistent treatment should extend to those other economic assumptions which should be consistent with the assumption for investment earnings, for example inflation.

**AS2.01- Solvency Standard**  
**AS3.01- Capital Adequacy Standard**

**Expense Reserve**

In the special circumstances of direct mail business, it would be appropriate that Non Commission Acquisition Expenses (for the purposes of determining the Expense Reserve) be taken to exclude those direct printing and distribution costs of a mailing campaign.

**Resilience Scenario Testing**

Clarification has been sought of the extent of scenario testing intended by the standards for the purpose of resilience reserve determinations.

It is the intent of the standards that all combinations of adverse market movement by sector be considered in arriving at the most adverse scenario for the portfolio of business. It is noted that there is explicit provision in the resilience reserve determination for the effects of diversification across those sectors.

**CTV for Investment-Linked Business**

The unit price used in determining the CTV for investment-linked business seems an aspect of the standards where different approaches are taken in practice. It was the LIASB’s intention that CTV reflect the published unit price on the date of valuation. There is clearly a need to clarify this intention in the standards. Submissions proposed that ‘valuation’ unit price (that is, the price adjusted to reflect the value of the assets in the financial statements as at that date) would be more appropriate.

The LIASB remains of the view, at this stage, that their intended approach under AS2.01/AS3.01 in this regard is the correct one. The purpose of the CTV floor in both standards is to secure the disclosed entitlements of members at that current date. Further, buffers exist in the build up of the capital requirements – for example, the investment-linked risk margin – such that the floor of CTV is not considered to be an onerous one in practice.

The LIASB is, however, willing to reconsider this position on the basis of numerical illustrations from the industry if these demonstrate that the practical implications are, in fact, more significant than we understand to be the case.

**Process for Amendment of Standards**

It was anticipated at the commencement of the review process that amendment of the respective actuarial standards, albeit not significant, may be required. It was further anticipated that the provisions being developed in the expense standard would be most appropriately incorporated into the relevant sections of the relevant standards.

However, at this stage of the review process, the LIASB considers that amendment of the standards may not be the most appropriate course.

The review process has not yielded any substantial issues, which would warrant change of the standards; rather, some additional guidance on intent or interpretation seems sufficient.

Further, the provisions of the expense standard are substantially self contained and may be most appropriately incorporated in the standard AS1.01 by way of separate attachment.

The LIASB therefore proposes to produce a consolidated set of guidance notes to support the actuarial standards (including consolidating various issues discussed in Newsletters to date) and to make limited amendments to the standards themselves. The guidance notes are expected to be released in exposure draft form in October.

**NOTICEBOARD**

**UPCOMING**

Valuation Standard ) Exposure Draft of Guidance Note
Solvency Standard ) due October 1998
Capital Adequacy Standard )

NOTE: The LIASB is willing to consider the basis for determination of CTV for investment-linked business in the light of illustrations from industry as to the practical implications of the current approach. Any such submissions should be provided by 18 September 1998 to facilitate the above schedule.