MEMBERSHIP of the LIASB

Mr Bob Glading finishes his term as the inaugural Government member of the LIASB on 31 December 1998. Bob was integral to the initiative which resulted in the establishment of the LIASB, and during his four year membership, has made a major contribution to the achievements of the LIASB.

Mr Tom Karp, Executive General Manager, Insurance and Superannuation with APRA, replaces Bob as the Government member. Tom has been a member of the Secretariat of the LIASB since its commencement in 1995, and therefore brings with him a substantial understanding of the operations of the LIASB to date.

Mr Tim Jenkins, who has acted as Chairman since the departure of Mr Peter Vinson, has been confirmed as the Chairman of the LIASB. One of the original members of the Board, Tim brings significant background, as well as a wealth of industry experience to the role.

Mr Craig Thorburn, Chief Manager, Life Insurance with APRA will join the Secretariat of the LIASB.

CURRENT MEMBERSHIP:

Mr Tim Jenkins (Chairman)
Mr Clive Aaron
Mr Bill Bartlett
Mr Peter Hodgett
Mr Mike Hughes
Mr Tom Karp
Mr Danny Shuttleworth

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

Introduction

The process of review of the actuarial standards:

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

has continued over the last few months. Most issues have been considered by the LIASB, and the process is nearing completion. It is expected that exposure draft material will be released in March of 1999 – this material will include revised versions of the respective standards, where those revisions cover the incorporation of the Expense Standard provisions.

This Newsletter provides further comment on the review process, highlighting 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 Newsletters No.10 and No.11.

IAA Guidance Material

The LIASB welcomes and supports the role the IAA is taking in the development of guidance material for its members on the detailed matters of practice within the framework of the actuarial standards (particularly AS1.01).

It has always been the position of the LIASB that the standards should concentrate on issues of principles and, while making some provision on the methods of implementation of those principles, should not attempt to provide for all circumstances which may arise in practice.
The recently released exposure drafts of the IAA includes guidance material on the following issues:
- Discount Rates
- Volatility of Profits

These issues were identified in Newsletter No.11 as significant issues arising from the submissions on the Review of the Standards.

While the LIASB has formally responded to the IAA in response to the exposure draft documents. The guidance material is considered to be consistent with the principles of the actuarial standard in most respects.

The one notable exception relates to the choice of discount rate to determine liabilities for benefits which have large asset support but are independent of those underlying assets. AS1.01 currently reflects the philosophy that profit reporting should be based on releasing liabilities that are expected values of expected cash flows. The adoption of a form of ‘riskless rate’ for discounting (as proposed in the draft guidance note) involves a shift in this philosophy which the LIASB does not currently support.

**Inadmissible Assets**

In identifying the issues raised in the submission process in earlier Newsletters, the LIASB was remiss in omitting issues relevant to the inadmissible asset provisions of the capital standards.

A number of submissions raised issues with the interpretation or application of the asset concentration requirements as they apply in quite specific circumstances.

The LIASB has now considered these issues, following recommendations received from a group of practitioners (established for this purpose). The existing provisions in AS2.01 and AS3.01 in this regard, were similarly developed after receiving the advice of a taskforce of relevant practitioners.

The outcomes of the process are as follows:

- In relation to assets or credit exposures secured by bank deposit or bank bills, the following conventions in terminology are considered appropriate. A bank bill includes a bank accepted bill and a bank deposit includes a certificate of deposit. A bank includes an authorised bank in Australia or, in respect of overseas banks, in an Approved Country (consistent with the treatment in the standards in respect of overseas life insurance business.)
- Where the standard refers to an asset or credit exposure secured by or guaranteed by the provider, the intention is that the security or guarantee be direct (on the face of the balance sheet of the provider) and be over both income and capital.
- The recognition afforded assets or credit exposures with governments or banks, in terms of their security, could arguably be extended to other prudentially regulated entities. It is the view of the LIASB that the provisions of AS2.01 and AS3.01 should be extended to allow an exposure of 25% to assets or credit exposures secured by policies of a life insurance company. A life insurance company includes a regulated life company in Australia or, in respect of overseas companies, in an Approved Country.

It is noted that while stating the intended direction of the LIASB, certain of the proposals above go beyond guidance, and requires the amendment of existing provisions in the actuarial standards. To this extent, such amendment can only occur following appropriate due process. In the meantime, the existing provisions of the standard will prevail.

**Solvency Assumption – Disability Income Business**

The appropriateness of the pricing assumption in AS2.01 (and by consequence AS3.01) in respect of disability income business has been an issue on the agenda of the LIASB since prior to the formal commencement of this review process. The issue was discussed in Newsletter No.9 as follows:

“**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 .........................

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
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.

As part of the review process, the LIASB sought further advice from the IAA’s Disability Committee in regard to the range and pattern of industry experience (relative to the prescribed table). On the basis of that advice, the LIASB proposes to reflect a more conservative assumption in AS2.01. The prescribed assumption for Disability Income, Individual and Group, Claims in Payment for Australian business, would be of the form:

140% of the Defined Table

OR, IF HIGHER

140% of Best Estimate Assumption.

Given a prescribed Solvency Assumption of this form, there is considered no need to alter the prescribed band for the respective Capital Adequacy Assumption.

The proposal is intended to recognise the diversity of experience in the industry, and to impose a more conservative basis where appropriate while not penalising those companies with ‘good’ experience.

The LIASB would welcome written submissions from practitioners on the proposal for the prescribed Solvency Assumption. Given the intended timetable for completion of the review of the standards, June balancing companies may want to consider the implications of this proposal for their Solvency position.

CTV for Investment-Linked Business

The LIASB received 5 submissions on the issue of determination of the Current Termination Value (CTV) for investment-linked business (as sought in Newsletter No.11).

The submissions were unanimous in their support of a ‘valuation’ unit price being used in the determination of CTV (that is, a unit price which reflects adjustment from the ‘published’ unit price on account of discretions available in the pricing method and/or errors identified in the asset valuation used for that purpose.)

The LIASB’s considerations on this matter have been comprehensive, in full acknowledgement of the practicalities of the business, and hence the reasonableness of the approach supported in the submissions.

However, the LIASB is also conscious of the original philosophy underlying the development of the capital standards, and in particular the philosophy underlying the inclusion of a CTV minimum value on the determined value of liabilities for the purposes of the Solvency Standard. As stated in that standard at section 3.6.2:

“Before assessing the risks associated with the assets supporting the liabilities, sufficient reserves should be provided to cover the policy liabilities and the associated liability risks……. It is not appropriate, under this measure, that a statutory fund be considered solvent unless the Termination Value on the basis current at that date – the Current Termination Value– is secured.”

It was the clear intent of the LIASB in developing the standard, that the CTV for the purpose of this provision (and supported by other relevant section in the standard) should be the CTV determined on the unit price published or promulgated on that date.

Having reconsidered the issues, the LIASB has not been dissuaded from this original position. The robustness of the philosophy of the standard is considered the paramount concern in this regard. It is considered difficult to justify to the lay person a minimum value of the liabilities at a particular date, which is less than the publicly disclosed (‘published’) value.
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<thead>
<tr>
<th>Standard</th>
<th>Status</th>
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<tbody>
<tr>
<td>Expense Standard</td>
<td>Exposure Draft released 13 November 1998</td>
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<td>(Submissions close 15 January 1999)</td>
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<tr>
<td>Valuation Standard</td>
<td>Exposure Draft (Guidance Note and/or Revised Standards)</td>
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<tr>
<td>Solvency Standard</td>
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<tr>
<td>Capital Adequacy Standard</td>
<td>due March 1999</td>
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NOTE: The LIASB is willing to accept written submission on the proposed Solvency Assumption for Disability Income Business. Any such submissions should be provided by 29 January 1999 to facilitate the above schedule.