HARMONISATION OF THE ACTUARIAL STANDARDS

Background

In April, the LIASB issued a discussion paper on the Harmonisation of Actuarial Standards under the Life Insurance Act. The intention of the LIASB to initiate this harmonisation process was highlighted at the time of release of the transitional standards for friendly societies (July 1999) – the process was recognised then as being in accordance with the policy of the government and APRA.

The purpose of the discussion paper was to commence a consultation process with industry on the issues of philosophy and principles to underly the harmonisation process. The paper followed significant consideration by the LIASB of the issues and consultation with APRA to confirm the proposed approach as consistent with broader policy intentions.

The Due Process

The discussion paper incorporated a level of detail in terms of the provisions of the various standards. This was done to provide insight to the considerations of the LIASB, to provide clarity of the proposals in the paper and in this way to facilitate a meaningful consultation process.

The inclusion of a level of detail was not intended to imply any degree of finality or conclusiveness to the proposals in the paper.

On the contrary, the LIASB had issued this paper as an additional step in its normal, formal due process for developing standards in acknowledgement of the complexity of the issues involved.

Only after appropriate consideration of the submissions on this paper will the LIASB issue a first draft of the actuarial standards. This Discussion Draft will be the first in two (at least) formal rounds of exposure prior to the issue of final actuarial standards.

Submissions on the Discussion Paper

The LIASB has received, to date, 9 submissions on the discussion paper.

It is acknowledged by the LIASB that the issue of the discussion paper came at a time when the industry faced the challenges of change in a number of areas. Accordingly, the time period for submissions was relaxed for those seeking additional time.

Cogniscant of the importance of obtaining as much information and understanding as possible at this early stage of the development process, the LIASB is happy to accept further submissions from the industry on the discussion paper, and would invite you to take the opportunity to put in writing any concerns or issues.

As a consequence of the extension on receiving submissions, and in accordance with the LIASB’s desire to give due consideration to all issues raised in submissions, the timetable for the harmonisation process (as issued with the discussion paper) will need to be be revisited.

The release of Discussion Drafts of harmonised actuarial standards is now not expected prior to October 2000.

The Classification of a Self-Help Entity

An aspect of the discussion paper which has generated substantial industry comment are the proposed criteria for classification of an entity as a self-help entity.

The feedback to the preliminary proposals in the attachment to the paper have been useful in advancing policy development in this regard.

APRA has been actively considering the characteristics to be used in classifying friendly societies and has issued a draft paper, for
consultation with industry. (The paper is available on the APRA website.)

RESILIENCE RESERVE CALCULATIONS UNDER THE EXISTING SOLVENCY AND CAPITAL ADEQUACY STANDARDS

We now turn to two technical matters to do with the existing capital standards for life insurance companies that are not friendly societies.

Background

When the Solvency Standard was recently revised, one of the issues clarified was that the resilience reserve diversification factor should be applied to asset yields only, and should not be applied to the liability yield. The LIASB has become aware of concerns arising among practitioners in this regard as follows:

(i) In a mixed statutory fund (e.g. annuity portfolio and traditional participating portfolio in a single fund) each segment of the business may be matched in its own right suggesting a zero resilience reserve requirement. However, for the fund as a whole, the application of the diversification factor to the asset yields leads to a resilience reserve for the fund.

(ii) Some practitioners interpret the standard to require the use of the undiversified yield change for determining the change in unit linked liabilities in the resilience scenario. This can have the effect of creating large resilience reserves for matched unit linked business.

When the Resilience Reserve is a function of a scenario involving a decrease in yields, the inclusion of the diversification factor in the Resilience Reserve formulae can cause the Resilience Reserve to increase. This outcome is counter-intuitive, since asset diversification should lead to a reduction in asset risk. It is also counter to the intent of the standards which state: “The Resilience Reserve allows explicitly for the beneficial implications for asset risks of diversification across asset sectors” (section 12.3 of AS2.02 and section 12.4 of AS3.02).

The LIASB considers that the intent of the standards in relation to diversification implies that the diversification factor should be set to one in the above situations. This will be clarified in the wording of the standards when they are next reissued.

Resilience Reserve for Unit Linked Business

AS2.02 and AS3.02 both contained a clarification of the Resilience Reserve calculation basis, namely that the change in asset values should be based on the adjusted yield change and the change in liability values should be based on the prescribed yield change. A number of practitioners have queried the treatment of unit linked business under this basis - in particular, whether the change in policy unit values should be based on the adjusted yield change or the prescribed yield change.

Policy unit values for unit linked business are typically a function of the value of a defined portfolio of assets. For the purposes of determining the Resilience Reserve, the change in asset values would be determined using adjusted yield. This change would in turn flow through to policy unit values in accordance with the company’s normal practices for linking asset values and policy unit values. Hence, typically, the change in policy unit values would be based on adjusted yield. However, other aspects of the policy liability calculation for Resilience Reserve purposes would be based on prescribed yields.

Resilience Reserve Diversification Factors under AS2.02 and AS3.02