PRACTICE GUIDELINE 499.01

SELF INSURANCE FOR SUPERANNUATION FUNDS

June 2008

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1 INTRODUCTION

1.1 Application

This Practice Guideline applies to Actuaries appointed to provide advice to superannuation funds on self insurance.

1.2 Classification

1.2.1 This Practice Guideline has been prepared in accordance with Council's Policy for Drafting and Developing Practice Guidelines, as varied from time to time. It must be applied in the context of the Institute's Code of Professional Conduct.

1.2.2 This Practice Guideline is not mandatory.

1.2.3 Nevertheless, if the Professional Services provided by a Member are covered to any extent by this Practice Guideline, a Member should consider explaining any significant departure from this Practice Guideline to the Principal, and document such explanation.

1.3 Background

1.3.1 This Practice Guideline has been drafted in response to APRA's stated intention to more closely regulate the self insurance arrangements of superannuation funds.

1.3.2 APRA has indicated that the financial management of self insurance arrangements must include:

(a) for Defined Benefit Funds, ongoing actuarial oversight; and

(b) for Accumulation Funds, maintenance of adequate Segregated Insurance Reserves which are subject to actuarial oversight.

1.4 Purpose

1.4.1 The purpose of this Practice Guideline is to assist Actuaries in their oversight of self insurance arrangements and in advising superannuation fund trustees on the financial management of self insurance arrangements. This Practice Guideline reflects generally accepted practices and techniques in this regard.

1.4.2 It is noted that self insurance may exist as a consequence of funding or other issues, even when it is intended that a superannuation fund be fully externally insured. This "unintended" self insurance may be at levels or over periods of time

which are not considered Material in relation to the overall funding issues of the fund. Examples of this are:

(a) where a short term funding deficit means that assets plus external insurance are not completely covering the Insurable Benefits; or

(b) the formula for external insurance cover includes an estimate of the actuarial reserve such that the actual Insurable Benefit is slightly more or less than the external insurance formula from time to time.

1.4.3 So long as the unintended self insurance is considered by the Actuary to be either not Material (in relation to overall funding issues) or of a short term nature, (and in the case of the latter is being rectified by appropriate actions), then long term actuarial oversight within the guidance of this Practice Guideline would generally be considered unnecessary. Nonetheless, it is considered important that the Actuary make the trustee of a fund aware of any unintended self insurance exposure at the time it is identified and following subsequent reviews of Materiality.

1.4.4 Self insurance arising solely due to a fund being in an Unsatisfactory Financial Position is not covered by this Practice Guideline.

1.4.5 There may also be cases where some level of self insurance arises due to other (often external) influences - for example, where insurance cover cannot be obtained for, or limited exclusions have been applied to, a small number of members within a large fund. The self insurance in these and similar cases may also not be considered Material by the Actuary in relation to overall funding issues.

1.4.6 In determining the Materiality of self insurance in relation to overall funding issues, the Actuary would generally consider both the underlying benefit structure (defined benefit, accumulation or a hybrid) and the potential impact of claims (at expected, higher than expected or catastrophic levels) on the employer and/or members. Materiality may also change over time so that the determination of such is usually to be reviewed at appropriate intervals.

1.4.7 Importantly, it is not generally the amount of self insurance that is Material or not, but rather its potential impact on members and funding.

1.4.8 Under standard actuarial practice, 'actuarial oversight' is taken to include (as a minimum):

(a) quantification of the extent of self insurance, and the potential risk this poses to members' benefits and the fund's overall financial position;

(b) identification of self insurance costs for funding purposes (for example, for inclusion in employer contributions), to be met by deductions from member contributions/accounts or other appropriate funding;

(c) regular analysis of relevant claims experience (compared with the expectations underlying the pricing recommendations) and the impact of this experience on funding and/or solvency; and

(d) for Accumulation Funds, advice and recommendations regarding the adequacy (and ongoing management) of Segregated Insurance Reserves in light of actual and expected future claims experience.

1.4.9 The application of actuarial oversight in relation to self insurance generally encompasses:

(a) the funding obligations underlying the self insurance arrangements (that is, whether the company or member bears the insurance funding risk). This funding obligation is generally quite different between Defined Benefit Funds (in which the employer sponsor is usually liable to meet the cost of benefits) and, say, Accumulation Funds (where premiums are often debited from members' accounts);

(b) the risks associated with the funding obligations (for example, the company's present circumstances to the extent these can be reasonably assessed by the Actuary and the reasonable expectations of those circumstances in the event of a catastrophe and the potential impact on membership of increased premium rates);

(c) the need, if any, for conservatism in setting insurance funding levels and the need for protection against potential catastrophe, as determined by the trustee of a fund based on discussions with the Actuary; and

(d) the impact this has on the requirement to hold Segregated Insurance Reserves.

1.5 Previous versions

There are no previous versions of this Practice Guideline.

1.6 Legislation

1.6.1 The Superannuation Safety Amendment Act 2004 (Cth) required superannuation trustees to become licensed by APRA by 30 June 2006. In order to become licensed, trustees needed to develop a risk management plan which was acceptable to APRA. APRA requires that the management of self insurance arrangements be included in a fund's risk management plan.

1.6.2 Actuaries may need to assist trustees in addressing a number of aspects of their risk management plans. This Practice Guideline provides guidance on the generally accepted practices and techniques appropriate to the financial management of self insurance arrangements.

1.6.3 APRA has initially specified the following conditions in relation to self insurance:

(a) self insurance will be permitted for Non-Public Offer Funds only, unless it exists already in a Public Offer Superannuation Fund (that is, an exemption previously granted in respect of a legally quarantined self-insured sub-fund). Note though, no new self insured sub-funds may be added to a Public Offer Superannuation Fund;

(b) trustees of funds containing multiple, often unrelated employers, whether holding an extended public offer licence or not, need to demonstrate effective segregation of assets and liabilities to protect members who are not self insured from the risks of self insurance; and

(c) adequate Segregated Insurance Reserves must be held and must be overseen by an Actuary and a decision to commence to self insure must have been made with appropriate due diligence.

1.6.4 Actuaries providing advice to Public Offer Superannuation Funds which have self insurance under an exemption previously granted by APRA are nonetheless encouraged to consider this Practice Guideline. This is because the APRA exemption allows the self insurance arrangement to continue, but the Actuary remains bound by the Code which imposes a continuing duty on Members to maintain professional knowledge and skill at a level required to ensure that a Principal receives the advantage of competent Professional Services, based on current legislation and generally accepted practices and techniques.

1.6.5 If there is a difference between this Practice Guideline and the applicable legislation, the legislation takes precedence. In this context, legislation includes regulations, prudential standards and subordinate standards and rules.

1.6.6 A reference to legislation or a legislative provision in this Practice Guideline includes any statutory modification, or substitution of that legislation or legislative provision and any subordinate legislation issued under that legislation or legislative provision.

1.6.7 Sections 129 to 130C of the SIS Act (inclusive) impose certain obligations on Actuaries. Members need to understand the obligations that apply to them in their circumstances. This may require Members to seek legal or other professional advice.

2 COMMENCEMENT DATE

This Practice Guideline commences on 24 June 2008.

3 DEFINITIONS

'Accumulation Fund' has the same meaning as set out in Regulation 1.03 of the SIS Regulations.

'Actuary' has the same meaning given in the Code.

'APRA' means the Australian Prudential Regulation Authority.

'Code' means the Code of Professional Conduct of the Institute.

'Defined Benefit Fund' has the same meaning as set out in Regulation 1.03 of the SIS Regulations. For the avoidance of doubt, in this Practice Guideline, the term also includes any fund from which defined benefit pensions are paid, where those pensions are not fully backed by annuity contracts or otherwise fully insured.

'IBNR' refers to a claim from an event that has already occurred, but which has not yet been reported to the fund at the investigation date.

'Institute' means The Institute of Actuaries of Australia (ABN 69 000 423 656).

'Insurable Benefit' means:[1]

(a) in the case of lump sum death, invalidity or disablement benefits:

(i) nil, if the benefit payable on death, invalidity or disablement is the same as the benefit payable on voluntary cessation of service; and

(ii) otherwise, the benefit payable to a superannuation fund member or their dependants on death, invalidity or disablement, less the member's share of fund assets (where their equitable share of fund assets reflects the available assets distributed in a manner deemed appropriate by the Actuary having regard to the member's equitable share as determined by the Actuary for other purposes, but no greater than the greater of the actuarial reserve and vested benefit);

(b) in the case of salary continuance cover or long term disability benefits:

(i) the value of the instalments payable in the event of invalidity or disablement plus, if applicable, the cost of any continuation of benefit accrual not funded by ongoing employer contributions (for

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[1] By adopting the following definition, it is intended that the Insurable Benefit does include any funding deficit within a Defined Benefit Fund caused by actual funding experience being different from that expected.

example, if retirement benefits continue to accrue but employer contributions cease during periods of such disability).

The amount of insurable benefit may then be reduced by the greater of the actuarial reserve and vested benefit. However, there is no reduction if retirement/resignation benefits continue to accrue during the period of invalidity or disability, as in such a case the reserve/vested benefit continues to fund the retirement/resignation benefit and is not available to help fund the salary continuance or long term disability benefit.

'Insurance Reserve' means the specific funding of an insurance risk by allocation of assets, not necessarily segregated.

'Material' means important or essential in the opinion of the Actuary. For this purpose, 'Material' does not have the same meaning as in Australian accounting standards. 'Materiality' and 'Materially' have meanings consistent with 'Material'.

'Member' has the same meaning as set out in the Code.

'Non-Public Offer Fund' means a fund that is not a Public Offer Superannuation Fund.

'Principal' has the same meaning as set out in the Code.

'Professional Services' has the same meaning as set out in the Code.

'Public Offer Superannuation Fund' has the same meaning as set out in section 18 of the SIS Act.

'Segregated Insurance Reserve' exists when an Insurance Reserve is required to be established and consists of a specifically allocated asset amount. APRA requires that such reserves must be monitored by the Actuary from time to time.

'Self insurance' exists where an Insurable Benefit is not fully insured through a licensed insurer. The amount of self insurance is the Insurable Benefit less any external insurance of that Insurable Benefit.

'SIS Act' means the Superannuation Industry (Supervision) Act 1993 (Cth).

'SIS Regulations' means the Superannuation Industry (Supervision) Regulations 1994 (Cth).

'Unsatisfactory Financial Position' has the same meaning as set out in Regulation 9.04 of the SIS Regulations.

4 SELF INSURANCE ANALYSIS

4.1 To be able to provide the required advice, it is generally accepted that the Actuary needs to carry out a thorough analysis in respect of self insured benefits at the investigation date. This is required irrespective of the underlying structure of the fund (that is, defined benefit, accumulation or hybrid) and should usually encompass the following, for each type of self insured benefit separately:

(a) calculation of the self insured liabilities for the fund, and within any relevant sub-groups (for example, benefit/membership categories), and how this may change over time (for example, salary increases);

(b) analysis of past claims experience (claim numbers and claim amounts) to identify trends or potential future risks. Such analysis would usually include:

(i) selection of an optimal analysis period giving due consideration to statistical credibility of the experience and stability of the membership profile;

(ii) consideration of the quality of claims data and allowance for any possible under-reporting of claims;

(iii) consideration of appropriate treatment for claims reported but not yet paid (that is, claims still in assessment/payment process), either assuming all are payable or adopting a "decline ratio" based on past experience; and

(iv) determination of whether the fund size and claim numbers are insufficient to be statistically reliable;

(c) estimation of the IBNR claims, based on past experience in reporting delays;

(d) analysis of expenses associated with self insurance (including insurance administration, underwriting and claim assessment costs);

(e) details of any changes in the claims assessment process;

(f) estimation of expected future self insurance claims (numbers and amounts), and the likely volatility in claims amounts from year to year. Estimation includes consideration of:

(i) the size of the fund;

(ii) the earlier analysis of past claims experience (including any statistical limitations on that analysis);

(iii) how self insurance claims (numbers and amounts) are expected to change over time (for example, for salary increases, membership growth, and so forth); and

(iv) other relevant data, such as industry/population statistics, competitive premium rates, occupational impacts, changes to self insurance arrangements and/or changes to the membership profile;

(g) estimation of likely future expenses associated with self insurance;

(h) identification of funding (and, where appropriate, the calculation of amounts) earmarked to meet the cost of self insured benefits in the current financial year;

(i) calculation or identification of Insurance Reserves resulting from past contributions or premiums (net of expenses and relevant benefit payments), to the extent that Segregated Insurance Reserves are maintained for the fund; and

(j) details of any applicable insurance arrangements covering the Insurable Benefits of the fund (for example, partial group life insurance, stop-loss insurance or catastrophe insurance).

4.2 Based on this information several areas of risk are generally considered:

(a) the **pricing risk** is usually assessed by considering whether the expected cost of self insured claims and claim costs for the period (as identified in paragraphs 4.1(f) and 4.1(g) above) is covered by the amounts to be set aside, where applicable, during the period to meet those costs (referred to in paragraph 4.1(h) above); and

(b) the **self insurance risk** is usually assessed by considering the following cases:

(i) assessment of the impact of a single catastrophic event or events. This is necessarily an estimate, but the intention is to focus the trustee on what types of events pose the greatest risks to the financial position of the fund and the extent to which insurance features may mitigate this risk (for example, geographical distribution). Here, risk includes the possible impact on both the fund and the ability of the employer to provide future funding, as some events may not only incur high claim costs but may also have a severe impact on the employer's business, jeopardising the funding of the insurance shortfall and future benefit accruals;

(ii) assessment of the financial impact of short term increases in claim rates or amounts, as may be expected as a result of normal claim volatilities, including significantly adverse experience;

(iii) assessment of the financial impact of adverse changes to the underlying claim rate or claim amount expectations over the longer term;

(iv) the impact of skewing of claim patterns and the extent of cross-subsidies amongst sections of members, for example if all the claims were from the higher self insured benefit amounts (this has a more significant impact if there is a wide range of self insured benefit amounts); and

(v) if there are insurance options available to members, the risk of selection (to the extent it is not prevented by underwriting) is also usually assessed by considering both moderate and extreme selection impacts and the extent that it has been embedded in past experience. The scenarios considered will be specific to a particular fund based on, for example, fund design, membership requirements, choices available and underwriting applied.

4.3 After considering the risks associated with pricing and self insurance, the Actuary would normally also consider the fund's overall tolerance for insurance losses over both the short and longer term, including:

(a) the funding obligations of employers and members in relation to self insured benefit, that is, who ultimately bears the insurance risk. Is it the employer via their obligation to meet funding shortfalls in a Defined Benefit Fund? Is it the employer or member via specific premium payments in an Accumulation Fund? Ultimately, it is the member if the employer is unwilling or unable to make required payments;

(b) the fund's ability to obtain additional finance from the employer if required (and how this may be compromised by a "risk" specific event);

(c) the impact of insurance losses on the overall financial status of the fund (for example, the risk of technical insolvency or Unsatisfactory Financial Position). This is affected by:

(i) the fund's funding position (for example, surplus assets would allow the fund to bear greater claim volatility than if no surplus were available); and

(ii) structure (for example, self insurance of a small sub-fund within a large fund with adequate assets overall);[2] and

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2 Note, this considers technical solvency positions at a point in time only. It does not necessarily suggest that fund assets available to assess solvency be used to subsidise insurance losses. However, such fund assets may provide temporary funding of losses

(d) the impact of insurance losses on members' benefits, including the risk posed by self insurance to members whose benefits are not self insured. (This latter issue may require legal advice on the treatment of assets in the case of the winding up of a fund.)

4.4 The above analysis will generally enable the Actuary to assess how much self insurance risk a fund can accept and how the fund will deal with those years where claims exceed expected levels.

5 THE INTERACTION OF PRICING AND RESERVING

5.1 The issues of pricing and reserves for self insurance arrangements are usually interconnected, with the decisions on one often affecting the decisions to be made regarding the other. For example, an assessment that the Insurance Reserve in an Accumulation Fund is more than adequate may permit the trustee to adopt lower premium rates to determine members' insurance costs. Conversely, an inadequate reserve in the same fund may require premium rates to be increased in order to restore the reserve levels.

5.2 Further, whilst it may appear to be reasonable to consider reserves before pricing, so that any inadequacy in reserves can be resolved via pricing decisions, this is not always the case – particularly if there are restrictions on how pricing or funding can be altered. For example, if conservative pricing is adopted (possibly due to difficulties in changing pricing in future), then the assessment of adequacy in relation to reserves will take this fact into account.

5.3 Irrespective of which issue is addressed first, both issues would usually be reviewed for consistency and interaction in relation to the final advice and recommendations.

6 PRICING

6.1 The ongoing viability of self insurance arrangements depends on adequate funding (that is, the contributions or allocations used to provide the benefits).

6.2 Defined Benefit Funds

6.2.1 For Defined Benefit Funds arrangements, the self insurance analysis described in Section 4 of this Practice Guideline feeds into the development of assumptions and solvency calculations for the overall funding assessments (for example, regular triennial actuarial investigations). As a result, actuarial recommendations for employer

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expected to arise from normal claim volatility – subject to the trustee being made aware of this happening.

contributions appropriately allow for the funding of self insured benefits and no specific pricing advice is required.

6.2.2 Nonetheless, there may be circumstances within Defined Benefit Funds where specific pricing for self insured benefits is required, such as if additional voluntary self insured benefits are provided to members on a user-pays basis (that is, funded by debits from members' benefits). In this case, the considerations outlined below in respect of Accumulation Funds would generally apply.

6.3 Accumulation Funds

6.3.1 For Accumulation Funds, pricing advice is required specifically for the self insurance arrangements. In these cases, it is generally accepted that the Actuary considers:

(a) the period for which the pricing applies (generally a financial year);

(b) the expected cost of claims over the relevant period;

(c) other funding allocations available to meet the expected cost of claims; and

(d) the adequacy of reserves available to meet variations in the cost of claims from that expected.

6.3.2 From the above considerations, the Actuary can determine the adequacy of the pricing, which is usually determined by comparing the net premium/contribution income with the expected claim amounts, allowing for any transfer from the Insurance Reserve (that is, a pricing decision).

6.3.3 To the extent that pricing is not "adequate", that is premiums/contributions do not meet expected claims and there is insufficient Insurance Reserve available to fund the difference of the coming year, the Actuary's considerations would normally include:

(a) the ability of the fund to increase premiums to an "adequate" level; or

(b) the ability of the employer to contribute, or the trustee to transfer other reserves, to the Insurance Reserve.

7 INSURANCE RESERVES

7.1 Defined Benefit Funds

7.1.1 Within Defined Benefit Funds the funding of self insured benefits forms part of the overall benefit funding and therefore Segregated Insurance Reserves are not generally required.

7.1.2 Nonetheless, there may be specific circumstances where the Actuary may consider it appropriate for a Defined Benefit Fund to maintain Segregated Insurance Reserves, such as:

(a) the Actuary assesses the self insurance risk to be a Material influence in determining overall benefit funding;

(b) additional self insured benefits exist which are funded by specific member deductions; and

(c) an allowance for IBNR claims is considered Material for the assessment of solvency.

7.2 Accumulation Funds

Accepted practice is that the Actuary would recommend that Segregated Insurance Reserves be established and maintained where self insurance applies within an Accumulation Fund (or sub-fund).

7.3 Segregated Insurance Reserve

7.3.1 In order for a Segregated Insurance Reserve established as a result of the Actuary's recommendation to generally be considered "segregated", it should consist of a clearly identified amount set aside specifically for the funding of insurance risks, which amount is not available for other funding purposes. An exception to this is when the insurance risk no longer exists (for example, if the fund winds up or the self insurance arrangements cease). Generally, it should not be assumed that self insurance losses can be made up by subsidies (such as reductions in earnings) from either members who are not self insured or additional employer contributions.

7.3.2 In addition, the Actuary's recommendations would normally include:

(a) the need to recognise the Insurance Reserve in the fund's financial statements;

(b) the need, in the case of a single employer fund or a multi-employer fund that pools self insurance experience, for the reserves required for self insurance to be reported separately by the Actuary and not mingled with other assets or other reserves. There is, however, no requirement currently to physically segregate assets; and

(c) the requirement, in a fund with more than one employer where the self insurance arrangements are not pooled, for each employer with self insured benefits to have distinct self insurance reserves as set out above, and the process outlined above applied to each employer separately.

7.4 Types of Reserve

7.4.1 Where Insurance Reserves are required, accepted practice is that the Actuary considers the various components of those reserves.

7.4.2 An Insurance Reserve is used to manage the risks associated with pricing and insurance by providing financial protection to the fund in the event of expected and extreme claim volatility and/or longer term changes in claim patterns.

7.4.3 The Insurance Reserve is the accumulation over time, with interest, of the premiums/contributions allocated to the self insurance arrangements, less self insurance claim payments and costs of administration, underwriting and claims.

7.4.4 The Insurance Reserve may be supplemented from time to time by allocations from other fund assets (for example, transfers from surplus) or injections of monies by the employer in order for the Insurance Reserve to be maintained at an adequate level. The Insurance Reserve may also have amounts transferred from it to general fund surplus if it is considered more than adequate. Any recommendations regarding transfers to or from the Insurance Reserve would normally only be made after considering possible cross-subsidies such transfers may incur and the reasonableness and/or legality of such cross-subsidies.

7.4.5 The Actuary may also consider the need (but is not required) to establish specific reserves (forming part of the overall Insurance Reserve) within the overall insurance arrangements for at least the following:

(a) Premium Reserve – this reserve holds the incoming premiums and/or contributions being made to pay for self insured benefits for the current financial/fund year, and it will be used to pay self insured benefits arising in that same period. This reserve is

necessary in order to segregate the insurance profits and losses from other parts of the fund.

The difference between claims and premiums are accumulated within the encompassing Insurance Reserve, with an appropriate allocation to the IBNR, at the close of each financial/fund year;

(b) Pricing Reserve – this reserve is used to support specific pricing decisions. The pricing reserve is in addition to the premium reserve - that is, it allows the expected cost of claims to exceed the net value of premiums charged to members, or insurance contributions paid by the employer, as applicable.

The targeted level for pricing reserve is normally such that it is expected to be sufficient to meet the pricing shortfall for at least one year (that is, the premium reserve plus the pricing reserve is at least equal to the expected self insured benefits arising in the relevant financial/fund year).

Recommendations about the use of fund assets for a pricing reserve would normally consider any cross-subsidies this may incur and the reasonableness and/or legality of such cross-subsidies; and

(c) IBNR Reserve – this reserve is established to meet the difference between the current value of reported claims, and the expected ultimate cost of those claims when all claims are finalised. This reserve is identified and allowed for within both the premium reserve (particularly when comparing premium and claim experience) and the overall insurance reserves (when accumulating the premiums and claims over time) as the IBNR claims relate to both prior claim years and the current claim year.

The adequacy of Insurance Reserves to withstand future claim volatility or extreme experience is usually calculated net of the IBNR reserve, reflecting that this reserve represents an estimated additional liability and is not just a contingency reserve. Similarly, and as noted in paragraph 7.5.1 below, solvency assessments also make allowance for the IBNR reserve.

The targeted level for the IBNR reserve is a level such that, if the fund were to be wound up at the calculation date, the IBNR reserve is expected to be sufficient to meet all IBNR claims arising in future as a result of self insurance prior to that date.

7.4.6 Whilst the Actuary is not required to establish these specific reserves (forming part of the overall Insurance Reserve), consideration is usually given to the underlying issues (that is, expected premium/contribution

income for the financial/fund compared to expected benefits, any available pricing/reserve support and IBNR claims).

7.5 Reserves and solvency

7.5.1 As noted above, when determining fund solvency, the IBNR is generally considered a liability and hence the IBNR reserve is deducted from the net realisable value of the assets used in the solvency calculations.

7.5.2 The treatment of the remaining Insurance Reserves for solvency determinations is dependent on whether that solvency is being considered in the context of fund termination or assuming the fund is ongoing.

7.5.3 If a fund is terminated, wound-up or all members leave at once, the Insurance Reserves (other than the IBNR reserve) become redundant as the risk such reserves are helping to finance ceases. Therefore, in this situation, the reserves are available for the purposes of meeting benefit liabilities and hence can be included in the net realisable value of assets for solvency ratios, and so forth.

7.5.4 If a fund is ongoing, the Insurance Reserves are required to continue to finance the insurance risk and hence are not available to meet benefit liabilities. In this case, the solvency position is generally considered after deducting the Insurance Reserves from the net realisable value of the assets.

7.6 Adequacy of Insurance Reserves

7.6.1 It is generally intended that the Insurance Reserve, together with expected self insurance funding, be "adequate" to meet self insurance claims and associated expenses, allowing appropriately for the self insurance risk.

7.6.2 When assessing the "adequacy" of Insurance Reserves, the Insurance Reserves excluding the IBNR reserve are usually considered.

7.6.3 It is generally considered important that any cross-subsidies between different sub-funds/employers occurring as a result of self insurance profits and losses be identified by the Actuary and an assessment of the appropriateness of such cross-subsidies made. In some cases, cross-subsidies between sub-funds (in the case of multiple employers) is considered acceptable, such as where the self insurance is on a pooled basis across multiple employers. Normal practice is that such profits or losses not affect members' benefits or the fund's overall solvency. This means that the self insurance arrangement would usually need to be financially self sufficient over the longer term.

7.6.4 As noted above, depending on the overall financial position of the fund, it may be possible to have short term losses temporarily funded by other assets.

7.6.5 In setting the overall reserve requirements (that is, in determining what amount of reserve is adequate) the Actuary generally considers the insurance risks identified earlier (refer paragraphs 4.2(a) and 4.2(b) above), and the fund's overall tolerance to insurance losses (refer section 4.3). The Actuary also generally has regard to:

(a) the ability of the trustee to increase premiums and/or to reduce self insurance benefits to provide adequate reserves (and the speed with which this could be done);

(b) the ability (to the extent that the Actuary can reasonably determine) of the employer to contribute additional amounts (either as a lump sum or ongoing contributions) to improve the adequacy of reserves, noting that this ability may be compromised by:

(i) events causing adverse claim experience; or

(ii) legislative requirements, such as Regulation 7.2 of the SIS Regulations which requires employer contributions to Accumulation Funds to be allocated to members within 28 days of the end of the month (or such longer period as is reasonable in the circumstances);

(c) the ability to transfer assets from other reserves (for example, surplus assets) to improve the adequacy of reserves;

(d) the availability of temporary funding of losses by other assets (without requiring an actual transfer of those assets to the Insurance Reserve); and

(e) the immediate and longer term consequences of inadequate reserves.

7.6.6 The Insurance Reserve is often expressed as a multiple of the expected annual claim amount (or annual premium, if this represents the annual claim amount). In determining an appropriate multiple, the Actuary's considerations should generally include the issues outlined above.

8 ONGOING MANAGEMENT OF SELF INSURANCE ARRANGEMENTS

8.1 Where insurance pricing is applied and Insurance Reserves established, the following applies in relation to the ongoing management and monitoring of the related self insurance arrangements.

Frequency of reviews and monitoring

8.2 The Actuary's recommendations may include that the trustee undertake a review of the adequacy of insurance pricing and Insurance Reserves at least every three years, or within such shorter period as the Actuary determines is appropriate in the circumstances or is otherwise required by APRA.

8.3 The Actuary may also recommend reviews on a more regular basis and/or the need for monitoring of actual experience between reviews. In determining a recommendation for more frequent reviews and/or for the need for interim monitoring, the Actuary would normally consider:

(a) the type of fund (that is, defined benefit or accumulation) and any associated legislative requirements re funding (for example, triennial investigations for Defined Benefit Funds);

(b) the size of the fund;

(c) the size of the self insurance and pricing risk relative to other risks;

(d) expected claim volatilities;

(e) the possible short term financial impact of adverse experience; and

(f) the existing "adequacy" of pricing and reserves (that is, more frequent monitoring is required for funds where adequacy is at risk or shortfalls are being restored).

8.4 The review of pricing and reserves would normally encompass the issues outlined in this Practice Guideline.

Advice following review and/or monitoring

8.5 Where the reserves fall below the targeted levels, the Actuary may make recommendations about appropriate actions to restore them to those levels. In making such recommendations, the Actuary's considerations generally include:

(a) the reasons for the reserve being below recommended levels (for example, adverse experience or newly established self insurance arrangements);

(b) the impact on the overall financial position, and any statements issued by APRA, either generally or specifically in relation to the fund, where short term solvency is impacted; and

(c) the available means of restoring reserves to their targeted levels, including increased funding (via employer contributions, member paid premiums or other alternatives) or reduced self insurance benefits, recognising any legal or regulatory restrictions which may apply.

8.6 Where self insurance costs identified for funding purposes are increased as a result of the review, the Actuary's recommendations normally include an indication of how this funding is to be attributed to either employer contributions, member paid premiums or other funding alternatives.

Reporting of results of review and/or monitoring

8.7 Accepted practice is that the Actuary prepares a report to the trustee on the results of the review and/or monitoring and includes in that report – in addition to the mandatory requirements under the Code – comments on:

(a) self insurance experience since the last review;

(b) any assumptions adopted as part of the review (for example, in relation to future experience);

(c) any remedial actions recommended to restore reserves to the targeted levels;

(d) any identified changes in the self insurance cost identified for funding purposes and how that change impacts the employer or the members; and

(e) recommendations regarding the timing of the next review and any interim monitoring.

END OF PRACTICE GUIDELINE 499.01