THE INSTITUTE OF ACTUARIES OF AUSTRALIA

31st May 1982

Professional Standard No.1

LIFE INSURANCE COMPANIES:
FINANCIAL CONDITION INVESTIGATIONS

1. These guidelines set down those matters which the Institute considers an actuary should address in examining and reporting on the financial condition of a life insurance company. They may well go beyond the requirements of Division 5 (Sections 48, 49 and 50) of the Life Insurance Act.

2. The actuary should report each year on

   (a) the liabilities of the company,
   (b) the assets of the company
   (c) the solvency of the company,
   (d) any surplus disclosed by the investigation and its distribution where applicable,
   (e) premium rates and
   (f) the outlook for policyholders and/or shareholders

3. The actuary should deal with the company as a whole and separately with each of the statuory funds operated by the company. Further sub-divisions may be necessary, for example when

   (a) a single statutory fund covers

      (i) liabilities in more than one currency, or
      (ii) both ordinary and superannuation business, or

   (b) some liabilities of a statutory fund should be related to values of part of the assets of that fund.

Valuation of Liabilities

4. In fixing the valuation bases and methods the actuary should have regard to

   (a) solvency,
   (b) overall reserves to meet adverse contingencies,
   (c) the need to allow for the future emergence of surplus,
   (d) the value placed on assets, and
   (e) policy guarantees and options

5. All material valuation assumptions, whether explicit or implicit, should be stated and the actuary should be satisfied as to their suitability in relation to the recent and expected experience of the company. Attention should be given to the suitability of the assumed rates of earnings on investments having regard to the values placed on assets and the investment policy of the company.

6. The Actuary should comment on the main features of the valuation methods and assumptions. Where a valuation method or assumption differs from generally accepted practice the difference should be justifies

7. If there has been any change in valuation methods or assumptions from the preceding investigation, the reasons for the change should be explained and, unless the actuary is satisfied they are not material, the effects of the change on the valuation results should be quantified.

Assets

8. The actuary should consider the suitability of the values placed on the assets of the company in the balance sheet. He should comment and make recommendations accordingly if he considers those values unsuitable in any respect for the purpose of the valuation.

9. The actuary should comment if in his judgement the investment policy pursued by the company is inappropriate to the term or nature of the policy liabilities.

Surplus

10. The major components of surplus since the previous investigation should be identified.

11. Where the actuary recommends the distribution of surplus to policyholders and/or shareholders he should give reasons for his recommendations.

12. The actuary should report on the short term outlook for surplus distributions to policyholders, and transfers between statutory funds and shareholders' funds.

Premiums

13. The actuary should comment if in his judgement the premium rates charged by the company are, or could become, unsuitable. (If a review of premium rates is recommended, it need not be completed as a part of a financial condition report).

Benefit Illustrations

14. The actuary should indicate the rates of bonus or investment performance results which he considers it would be reasonable for the company to use in illustrating policy benefits to policyholders.

Division 5 (Section 48, 49 and 50) of the Life Insurance Act 1945

15. Section 48(1) of the Act requires every company to "cause an actuary to make an investigation into its financial condition, including a valuation of its liabilities in respect of its life insurance business, and to furnish it with a written report of the results of the investigation."

16. It is noted that a valuation of liabilities reported in the Second Schedule to the Act forms part of an investigation under Section 48. While the form of the Second Schedule to the Act envisages a net premium valuation method, the actuary should adopt for all or part of the life insurance business whichever valuation methods he considers most appropriate to the policies concerned.

17. In terms of the Act the actuary must satisfy himself that the value placed upon the aggregate liabilities of a statutory fund in respect of policies is not less than the value calculated on the minimum basis set out in the Fourth Schedule and that the basis of valuation is such as to ensure that no policy is treated as an asset.

18. The Act does not recognise some important types of policies. The Institute is of the opinion that the actuary should satisfy himself as to the value placed on the aggregate liabilities of policies recognised by the Act, as required by Section 49(3) of the Act and that for the remainder of the policies a proper value should be placed on the liabilities pursuant to Section 49(2).

19. It is noted that Section 50(2) of the Act refers to the valuation balance sheet incorporating the balance of revenue account (which may be adjusted in terms of Section 49(5)).

LIFE INSURANCE COMPANIES:
FINANCIAL CONDITION INVESTIGATIONS - CHECK LIST

1. REPORT IDENTIFICATION

1.1 Name of Company
1.2 Date of Investigation
1.3 Name of Actuary
1.4 Relationship to Company
1.5 Date of Report
1.6 Last previous report - Name of Actuary
- Date

2. GENERAL COMMENT ON NATURE OF BUSINESS

2.1 Structure of Company
2.2 Countries and currencies of operation
2.3 Main lines of life insurance policies
2.4 Risks underwritten other than life
2.5 Marketing methods

3. IDENTIFICATION OF STATUTORY AND OTHER FUNDS

3.1 List all funds
3.2 Any subdivision of funds
3.3 Purpose of fund or subdivision
3.4 Tax status
3.5 Any reserve funds and their purpose
3.6 Currency

4. POLICY GUARANTEES

4.1 Premiums
4.2 Charges
- 4.2.1 Managed funds
- 4.2.2 Investment account and investment linked policies

4.3 Sums insured and bonuses
4.4 Surrender Values
4.5 Options
4.6 Other

5. REINSURANCE ARRANGEMENTS

6. EXPERIENCE - RECENT AND EXPECTED

6.1 Mortality
6.2 Morbidity
6.3 Investment Earnings
- 6.3.1 Income
- 6.3.2 Capital
- 6.3.3 Tax

6.4 Expenses
- 6.4.1 Initial
- 6.4.2 Other
- 6.4.3 Inflation

6.5 Termination of policies
- 6.5.1 Lapse
- 6.5.2 Surrender
- 6.5.3 Transfer

6.6 Product mix
- 6.6.1 Proportion of with profits policies

7. ASSETS

7.1 Veracity of data
7.2 Summary by type
7.3 Investment return
7.4 Term
7.5 Suitability to liabilities
7.6 Value
7.7 Tax

8. INVESTMENT POLICY

8.1 Current policy and trend
8.2 Impact on Return
8.3 Suitability to liabilities

9. ADEQUACY OF PREMIUM RATES

9.1 Existing policies
9.2. New policies

10. VALUATION OF LIABILITIES

10.1 Veracity of data
10.2 Methods and assumptions
    10.2.1 Summary description
    10.2.2 Changes from previous valuation
    10.2.3 Suitability and implications
10.3 Quantification of changes
10.4 Summary of results
10.5 Overall contingency margins
10.6 Statutory certificates

11. SURPLUS

11.1 Main Sources
11.2 Availability for distribution
    11.2.1 Policyholders
    11.2.2 Shareholders
11.3 Distribution
    11.3.1 Equity
    11.3.2 Methods
    11.3.3 Amounts
11.4 Transfers
    11.4.1 Statutory funds
    11.4.2 Subdivision of funds
    11.4.3 Reserves
11.5 Unallocated surplus
11.6 Outlook
    11.6.1 For policyholders
    11.6.2 For shareholders

12. BENEFIT ILLUSTRATIONS

12.1 For existing policies
12.2 For new policies