PROFESSIONAL STANDARD 200
ACTUARIAL REPORTS AND ADVICE
TO A LIFE INSURANCE COMPANY

APPLICATION

Appointed Actuaries of life insurance companies

There are likely to be other matters or situations not directly referred to in this standard, whether or not referenced by the Act, in which the appointed actuary's advice will be sought or should be given to the management or the Board of the life company. In such circumstances, the actuary should take account of the general considerations in this standard along with relevant provisions of the Code of Conduct.

While this standard is meant to provide direction or guidance on the application of the Act to the work of the appointed actuary, the actuary should comply with the Act at all times and seek legal opinion if in doubt.

LEGISLATION

Life Insurance Act 1995

FIRST ISSUED

This standard was first issued in June 1982 as Professional Standard "Life Insurance Companies: Financial Condition Investigations" and subsequently titled Professional Standard No. 1.

REVISIONS

A major revision was made in 1986.

Various parts were amended and reissued in April 1993 although effective from May 1992. This standard, previously Professional Standard No.1, was also amended to conform with the revised format for standards implemented in 1992 and hence was renumbered Professional Standard No. 200.

This latest revision was required in order to bring the standard into alignment with the requirements of the Life Insurance Act 1995 and to delete all reference to friendly societies.

This standard is effective from 31 December 1996.

INDEX

1	INTRODUCTION		4
2	DEFINITIONS		5
3	GENERAL ADVICE AND PRINCIPLES		6
	3.1	Written Advice	6
	3.2	Actuarial Principles	6
	3.3	Statements and Reports	8
	3.4	Reporting to the Commissioner	9
4	PRODUCT ADVICE		9
	4.1	General	9
	4.2	Premium Rates and Charges	10
	4.3	Other Policy Terms and Conditions	14
	4.4	Surrender Basis	15
	4.5	Unit Pricing	15
	4.6	Reinsurance Arrangements	16
	4.7	Commission	16
5	APPORTIONMENTS		17
	5.1	General	17
	5.2	Equity	17
	5.3	Interaction with Auditor	18
	5.4	Intergroup apportionments and outsourcing	18
	5.5	Expenses	19
	5.6	Investment Income	19
	5.7	Taxation	20
6	FINANCIAL CONDITION INVESTIGATIONS		20
	6.1	General	20
	6.2	Experience Analyses	22
	6.3	Data	22
	6.4	Assets	22
	6.5	Breaches of Capital Adequacy	23
	6.6	Liabilities	24
	6.7	Premium Rates and Charges	24
	6.8	Reinsurance	25
	6.9	Business Risks	25
	6.10	New Business Assumptions	25
7	DISTRIBUTIONS OF PROFITS AND CAPITAL		25
	7.1	General	25
	7.2	Equity	26
Attachment A		PRODUCT ADVICE CHECK LIST	28
Attachment B		FINANCIAL CONDITION REPORTS CHECK LIST	31

1 INTRODUCTION

1.1 The manner in which appointed actuaries discharge their responsibilities can have a significant impact upon the financial soundness of life insurance business as well as the reputation of the actuarial profession. As a result it is incumbent on appointed actuaries to ensure, to the extent of their authority, that Australian life insurance business is conducted on sound financial principles.

1.2 The appointed actuary is required, in respect of specific statutory duties, to provide the company with written advice or to provide the 'directors of the company' with written advice. In doing so, the appointed actuary must bear in mind the object of the Act as stated in sub-section 3(1) '... to protect the interests of the owners and prospective owners of life insurance policies in a manner consistent with the continued development of a viable, competitive and innovative life insurance industry'.

1.3 Actuaries who, in the course of their employment or consulting contract, give advice to the appointed actuary of a registered life company must bear in mind the basic objective of the Act and the position as noted in paragraph 1.2 above.

1.4 The statutory duties of the appointed actuary in relation to the giving of advice to the company are specified in the Life Insurance Act 1995. These duties are:

- **Product Advice:** to provide the company written advice before the company issues policies of a certain type about the proposed terms and conditions, the surrender basis and the unit pricing method. Advice on proposed reinsurance arrangements must also be provided before they are entered into. (Section 116);

- **Apportionments:** to provide the directors written advice regarding the equity and suitability of the proposed basis for the apportionment of income and outgo (Section 80);

- **Financial Condition Investigations:** to prepare a written report to the directors on the investigation into the financial condition of the company at the end of each financial year (or at other times as may be required) which is to include a valuation of the company's life insurance liabilities (Section 113); and

- **Distributions of Profit and Capital:** to provide the directors written advice regarding the consequences of a proposed distribution of retained profits or shareholders' capital (Sections 62 and 63).

2 DEFINITIONS

For the purpose of this standard, the following terms will be used with the meanings indicated:

the Act – the Life Insurance Act 1995 including its Regulations.

Actuary – an appointed actuary of a life insurance company as defined under the Act.

capital – unless otherwise specified, 'capital' or 'capital base' refers to share capital, share premium, retained earnings and subordinated debt approved for capital purposes by the ISC.

Commissioner's Rules – the rules issued by the Insurance and Superannuation Commissioner from time to time in accordance with the Act.

Discretionary Investment Benefit – any participating benefit or non-participating benefit where the benefit is increased to reflect the investment experience of the assets backing the benefit, and where the amount of the increase in the benefit to reflect the investment experience is either subject to a smoothing formula or at the discretion of the company. For the purposes of this definition, the allowance for a certain rate of investment return in determining the premiums for a benefit does not imply that the benefit reflects the investment experience of the assets backing the benefit.

Reasonable Benefits – Under participating and Discretionary Investment Benefit policies either the premium or the benefits may be varied. This may enable a company to accept risks more confidently in the knowledge that adjustments can be made as experience unfolds. A purchaser of such a policy shares the risk to some extent and is entitled to be treated equitably in the light of that experience. The expression "reasonable benefits" is used in connection with such policies to describe benefits which fall within a range which could be reasonably held to recognise these features and all the matters described in paragraph 7.2.2.

Standards – standards issued by the LIASB or Institute including guidelines that the Institute may issue from time to time to deal with specific and relevant matters.

3 GENERAL ADVICE AND PRINCIPLES

3.1 Written Advice

3.1.1 Written advice given under the Act should be clearly identified as such.

3.1.2 The Actuary should consult with management and the Board as appropriate, and make all efforts necessary in order to reach an understanding before putting final advice in writing.

In this respect, the Actuary is advised to refer to the Code of Conduct for possible guidance.

3.1.3 The Actuary should include with his/her advice the reasons for giving the advice, any conditions or limitations that should be imposed, and any significant commercial factors or financial risks that the company and policy owner would be exposed to. In particular, should the advice be over a major or controversial matter, then the Actuary should also indicate the consequences of following or not following the advice as appropriate.

Reference should be made to other documents, if any, that may have been relied upon in providing the advice.

3.1.4 To assist the reader of the written advice, the Actuary should consider effective ways to communicate the important conclusions or recommendations of the report such as providing an executive summary at the front of the report.

3.1.5 The Actuary should ensure that the Board or management's response to the advice is recorded in a suitable manner along with any consequent actions recommended and taken.

3.2 Actuarial Principles

3.2.1 In carrying out his/her responsibilities, the Actuary, among other things:

(a) must comply with the requirements of the Act, Standards and Commissioner's Rules and other relevant legislation;

(b) must satisfy the Articles of Association or other by-laws constituting the company;

(c) should seek to ensure, within the bounds of reasonable probability, the long term financial soundness of the life insurance business of the company; and

(d) should seek to achieve equity in the allocation of profits to participating policy owners in general, non-participating Discretionary Investment Benefit policy owners, between different groups of such policy owners, and to shareholders - refer to paragraph 7.2.1.

3.2.2 The Actuary should ensure that the company is made aware that the responsibilities of an appointed actuary cannot be properly carried out unless it makes available adequate and relevant information. If necessary, the company's attention should be drawn to Section 97 of the Act which gives certain powers to the Actuary in relation to access to company information in order to carry out his/her duties.

In this regard the needs of the Actuary should be specified and, if the appropriate information is not forthcoming, the actuarial report or advice should be qualified or state the Actuary's inability to give advice as the case may be. The Actuary would then need to give consideration to invoking the provisions of Section 98 of the Act - refer to paragraph 3.4.

3.2.3 When providing advice in terms of this standard, the Actuary should consider all relevant items below and any other matters considered relevant:

(a) the premium rates and charges on which existing business has been, and current new business is being, written;

(b) the nature, terms and conditions, and disclosures of the contracts in force and currently being sold with particular reference to all options and guarantees, and the scope for adjusting the terms and conditions in the light of emerging experience;

(c) the existing investments, the continuing investment policy and likely future investment experience;

(d) the business plans, in particular the expected volumes and costs of sales;

(e) the current and likely future experience of expenses and taxes;

(f) the current and likely future experience in respect of the risk elements;

(g) the current and likely future experience in respect of lapse and surrender rates;

(h) the arrangements for reinsurance

3.2.4 In seeking to protect the ongoing financial soundness of the life insurance business of the company the Actuary should also have regard to:

(a) the extent of the company's capital, its position in the various statutory funds, the ability to transfer it between them, and additional capital which the company is able and willing to add in further support; and

(b) the need to preserve sufficient capital in the company for the ongoing support of the continuing business, both existing and new, especially taking account of the likely new business strain which may arise from the company's business plans.

3.2.5 A company may conduct business other than life insurance business external to the company's statutory funds. The well being of the life insurance business depends, in some part, on the well being of the company as a whole. The Actuary must also consider in general the effect other business the company conducts may have on the life insurance business.

3.2.6 While the Actuary should seek the advice or guidance of others including experts in circumstances set out in the Code of Conduct, and may delegate as he/she sees fit many or most of the tasks required of this standard, the Actuary remains ultimately responsible both under the Act and professionally.

3.3 Statements and Reports

3.3.1 In providing written advice in terms of the Act, the Actuary will, except for financial condition investigations, not necessarily need to prepare a full formal report but should, as a minimum, prepare a statement which includes references to relevant supporting documents or files. However, the Actuary should make and keep sufficient written notes about relevant matters to enable a formal report to be prepared later if required.

3.3.2 Such modelling or other work that has been carried out should be adequately documented and preserved for future reference.

3.4 Reporting to the Commissioner

3.4.1 Section 98 of the Act imposes a responsibility on the Actuary to draw certain matters to the attention of the company and, in certain circumstances, to report to the ISC. The Actuary should consider how best to manage his/her responsibilities in terms of the identification of matters that might fall within the scope of this Section of the Act.

3.4.2 In particular, the Actuary should consider in the context of Section 98:

(a) whether the expression 'the interests of owners of policies' applies (in general or in the particular circumstances of a matter) to individual policy owners, groups of policy owners within a statutory fund, all policy owners in a statutory fund, or all policy owners in the company;

(b) that the terms 'reasonable grounds', 'reasonable time', 'affect significantly', and 'reasonably necessary' are not easily defined, and their interpretation may depend upon the individual circumstances at the time;

(c) in what manner the directors of the company will be informed of any action to be taken and the implications of that action; and

(d) whether, in the light of the auditor's equivalent responsibility under Section 88 of the Act, the auditor should be consulted before any action is taken.

3.4.3 The Actuary's attention is also drawn to the words of the Application section at the beginning of this standard and to general provisions in the Code of Conduct.

4 PRODUCT ADVICE

4.1 General

4.1.1 Section 116 of the Act requires the Actuary to provide advice to the company on "policies of a particular kind" before they can be issued. The advice must cover proposed "terms and conditions" - which includes premium rates, fees and charges - surrender bases and unit pricing. Advice must also be given on the likely consequences of proposed reinsurance arrangements before they are entered into. As well as advising on policy terms and conditions for new business, where existing policies have terms and conditions which are subject to variation the Actuary should be satisfied as to their continuing suitability.

4.1.2 With respect to the reference to "company" in Section 116, the Actuary, by reference to the Articles of Association, other by-laws of the company and with the Board itself, must clearly establish to whom in practice the advice should be directed. For example, the advice may be required to be given to the Board itself, a sub-committee of the Board, or, by a delegation of the Board, the life company chief executive or other executives (who may have the power to delegate further: the advice may form part of an integrated product development and approval process which incorporates sign-offs from all interested parties within the company).

If the Actuary considers it necessary in particular circumstances, the advice should be directed to the Board.

4.1.3 Attachment A provides a detailed check list of the matters the Actuary would normally consider in giving advice on product terms and conditions but it should not be considered comprehensive; the circumstances of the particular company must be taken into account.

4.2 Premium Rates and Charges

4.2.1 When providing advice on premium rates and charges, the Actuary should make a statement on their "suitability" or "adequacy" in terms of meeting corporate pricing standards, contributing to marginal and overhead expenses and financing capital. The statement of their suitability cannot be an absolute statement - it is inevitably a probability statement because it depends on the future experience of such things as mortality, morbidity, the return on investments, tax, and expenses of administration. The adequacy or otherwise of premium rates and charges cannot, therefore, be other than a matter of judgement. The required judgement will, of course, need to be based on the use of sound techniques. It should specifically take into account the complex matters involved in contracts containing various options or guarantees.

4.2.2 In particular, apart from any general advice that the Actuary provides, if the premium rates and charges for a product are considered unsuitable or inadequate, the Actuary should state precisely why that opinion is held and indicate the potential or likely financial consequences of their adoption by the company. The Actuary may also indicate other actions the company should take to counteract the potential financial risks.

Assumptions about Future Experience

4.2.3 The Actuary should be satisfied as to the suitability of all material assumptions about the expected future experience. If appropriate, the Actuary should take account of the recent experience of the company including the "best estimate" assumptions derived for valuation purposes. Available published experience and trends from Australia and perhaps overseas which are considered relevant should also be taken into account. The Actuary may take into account any other material which is considered relevant.

4.2.4 Experience is not static and changing trends should be taken into account. The longer the period of the contract, the less likely it is that the experience as it emerges will match the assumptions. As a result making assumptions can be problematic, for example:

(a) particular difficulties are involved in reaching an opinion about likely future investment earnings allowing for taxation in the longer term;

(b) expense levels are particularly affected by inflation as well as the size and number of policies involved;

(c) mortality improvements are important in relation to annuities;

(d) morbidity is affected by social attitudes and economic conditions as well as basic health issues.

4.2.5 Insurance is a commercial service and innovation should be encouraged.

The undertaking of new types of risk should not be prevented because no specific past experience exists. In determining an opinion as to the likely future experience in such circumstances the Actuary should take into account such statistics relating to similar events or conditions as can be obtained and are considered relevant. The Actuary should exercise judgement with great care. The Actuary should comment on any limitations that apply to the terms and conditions of policies while experience is being gained. Where appropriate, and quite apart from any general monitoring that the Actuary undertakes for risks, the Actuary should specify that close monitoring of experience of new risks is required. Risks can be reduced if contracts allow the insurer to adjust premiums for existing policies in the light of emerging experience.

4.2.6 The various elements in the assumptions will have experienced more or less stability in the past and confidence about the likely future will vary according to that and other considerations. The Actuary should consider the degree of uncertainty in each of the assumptions and the potential effects of experience being relatively adverse. The Actuary should consider the company's capacity to finance such adverse experience. The greater the volatility or uncertainty the greater the need for contingency margins and contingency reserves.

Equity

4.2.7 In the case of a participating policy a buyer will be entitled to a share of the profits made by the company during the life of the policy. In the case of a non-participating Discretionary Investment Benefit, a buyer pays premiums for benefits where one or more of the elements can be varied during the life of the policy at the discretion of the company. In both these cases, equity may be less of a consideration at the time the initial premium rates or benefits are established than it is when the experience emerges and the Actuary advises the company as to how the discretion should be exercised.

4.2.8 In the case of a non-participating policy, which has no provision for the terms to be varied, consideration of equity may have regard to the fact that potential buyers can choose whether to buy the product or a competing product based on the terms being offered.

4.2.9 In the cases outlined above, the Actuary, at the time of advising on the initial premium rates and benefits, should try to ensure that the maintenance of equity during the life of the policy will not present undue practical difficulty. This may involve considerations of, and advice to the company, in relation to:

(a) the manner in which a suitable asset structure may be maintained relative to the premiums and benefits;
(b) a practical manner by which emerging profit can be allocated and distributed to entitled policies;

(c) where asset structures or profit distribution methods already in use in the company are not appropriate for a new product and new ones are required, the degree of difficulty and the costs likely to be experienced in maintaining equity between the old and the new.

Finance

4.2.10 Benefits paid plus expenses incurred plus the required increase in reserves to be held in respect of the future liabilities may exceed premiums received in certain circumstances, for example, in the early years of a policy. Where this is the case the Actuary should consider:

(a) the amount and incidence of the estimated required finance;

(b) the capacity of the company to meet this requirement for finance and the source of this finance; and

(c) any constraints which should be imposed on the volume of new business, the period for which it may be written, size of policy, or otherwise.

Tests of Suitability

4.2.11 The Actuary will normally test the suitability of premium rates and charges by using "profit testing" projection methods with all reasonable contingencies taken into account together with the valuation basis expected to be adopted for capital adequacy requirements. In using such methods the Actuary will normally test not only on the future experience considered most likely but also on a range of variations from that most likely scenario. However there may be occasions when it is not necessary to adopt a "profit testing" approach.

4.2.12 In considering the suitability of premium rates and charges the Actuary will make a number of assumptions about items listed in paragraph 3.2.3. Investigations may be carried out or the Actuary may refer to other investigations which may have been carried out previously and which are considered relevant.

4.2.13 The range of matters to be taken into account when considering suitability may well vary with the particular circumstances. In each case the Actuary should be in a position to justify any decision to limit the range. For example:

(a) in the case of a new product, thorough investigations and a consideration of all or most of the items listed in paragraph 3.2.3 will normally be required;

(b) in the case of the revision of an existing product, last reported on recently, it may be appropriate to consider only those matters relevant to the revision;

(c) in the case of a review of existing premium rates under changed circumstances, it may be appropriate to consider only those matters relevant to the changes.

4.3 Other Policy Terms and Conditions

4.3.1 The Actuary advising a company on the structure of a life insurance product needs to consider all policy terms and conditions, not just the adequacy or otherwise of premium rates and charges. Apart from items listed below, the company needs to be aware of the financial impact or risks of the proposed policy definitions, any guarantees and options, and any other matter the Actuary considers relevant. Risks can be reduced if contracts allow the insurer to adjust policy terms and conditions in the light of emerging experience.

4.3.2 The Actuary should review all documentation and promotional material related to the product as well as associated administration procedures to ensure that they are suitable for the terms and conditions of the policy.

4.4 Surrender Basis

4.4.1 Section 116 requires the Actuary to provide advice on the proposed basis for determining the surrender values, if appropriate.

4.4.2 When reporting on the surrender value basis for a Life Insurance product, the Actuary must consider the impact the proposed basis would have on the solvency of the Life Company. Whilst it may be appropriate or unavoidable to incur losses on some surrenders, the company should be advised if surrenders could cause serious loss. If the surrender value basis is guaranteed, the extent of this guarantee and its possible financial effect should be commented on.

4.4.3 The Actuary, when recommending a surrender value basis, needs to consider equity between surrendering and continuing policy owners, and practical implementation issues, as well as any Standards required under the Act.

4.5 Unit Pricing

4.5.1 Section 116 requires the Actuary to provide advice on the proposed unit pricing system, if applicable.

4.5.2 The aim of the unit pricing system is to determine a unit price for redeeming and purchasing units under life insurance contracts issued by the company. A fair and equitable unit pricing system will ensure that transactions into and out of the fund are conducted at an appropriate price, so that new, continuing, and terminating units are treated fairly and in accordance with policy terms and conditions. For example, the unit price before and after the processing of unit transactions should normally be the same.

The Actuary should comment on the extent to which this aim has been achieved under a proposed unit pricing system.

4.5.3 Any potential financial impacts should be commented on. For example, if it is proposed to use the current unit price for processing transactions, the Actuary would need to highlight to the company the necessity to be able to reprice quickly in a rapidly falling market. Comment should also be made on any significant questions of equity between new, continuing and terminating policy owners.

4.5.4 The Actuary should also comment on the way allowance is made for income and capital gains tax, the way buying and selling costs are to be treated, and any other issue that is considered important.

4.6 Reinsurance Arrangements

4.6.1 Section 116 requires the Actuary to provide advice on proposed reinsurance arrangements where appropriate.

4.6.2 The main reasons for reinsurance are:

(a) to protect the short term solvency of the life company;

(b) to guard against a high probability of large fluctuations in profits for distribution to policy owners or shareholders; and

(c) to assist the life insurance company in the financing of new business.

4.6.3 When commenting on the reinsurance arrangements the Actuary should consider the issues listed above in paragraph 3.2.3, and the financial impact of the proposed reinsurance and retention limits.

4.7 Commission

4.7.1 In this section "commission" has the same meaning as that used by the ISC for disclosure requirements.

4.7.2 The Actuary will have regard to all expenses when advising on product terms and conditions, but special attention may need to be paid to commission arrangements. The Actuary should provide advice, in terms of the financial risks the commission terms may impose, on the appropriateness of the proposed commission arrangements including the total commission allowed for in the pricing of a product.

4.7.3 Consideration should be given to the recoverability of commission in the case of early termination of policies. If appropriate, the risks associated with a high level of policy termination, and a subsequent failure to realise the assumed recoverability of commission should be highlighted.

5 APPORTIONMENTS

5.1 General

5.1.1 A number of items must be apportioned between different accounts of a life company. The Actuary is required by the Act to give written advice to the board before any apportionments can be made in the accounts of the company.

5.1.2 Sections 78 and 79 of the Act require a company to apportion income and outgoings relating to mixed business of two or more statutory funds, classes, categories or sub-categories of business. Section 80 requires that any apportionment be on an equitable basis and according to generally accepted accounting principles. The Actuary must provide written advice as to whether the apportionment is appropriate and the auditors must state that the apportionment has been made on an equitable basis and according to generally accepted accounting principles.

5.1.3 In preparing the advice, the Actuary should give consideration to the nature of the item being apportioned and the business to which it relates to ensure that apportionments to a statutory fund relate to the business of the fund. This is required by Sections 36 and 38 of the Act regarding payments to and expenditure and application of statutory funds.

5.1.4 As well as the requirement of the Act, further apportionments may be required for taxation purposes or for determining assumptions for calculating policy liabilities or premium rates.

5.1.5 As well as the requirements of the various laws, the Actuary should also consider the following principles:

(a) promoting the financial soundness of the life company;

(b) promoting the meaningful disclosure of the conduct of the business of the fund;

(c) consistency of treatment between reporting periods; and

(d) achievement of equity - refer to next paragraph.

5.2 Equity

5.2.1 Apportionments are required in cases where it is not possible to allocate the item directly and hence will be a matter of judgement.

Equity of the apportionment is also a matter of judgement for the Actuary after considering all relevant factors. The Actuary is expected to consider the following factors:

(a) The nature of the item being apportioned should relate in some tangible way to the conduct of the business of the fund or account to which it is allocated.

(b) The apportionment basis should be objective where practical to ensure consistency of treatment from one period to the next and to avoid significant changes in basis resulting from differences in opinion of the person making the apportionment. Objectivity does not prevent a method from being adjusted over time to meet changing circumstances where appropriate.

(c) The apportionment method should relate to the magnitude of the effect of the item being apportioned on the fund. For example, it would be inequitable to apportion audit fees equally amongst funds where some funds are very small and require little audit work.

(d) Materiality. It is acceptable for a simplistic basis to be used for apportionment of small items where the financial effect on any fund or account is not significant.

5.3 Interaction with Auditor

5.3.1 The Actuary should discuss relevant accounting principles and standards with the auditor to ensure any apportionment complies where appropriate. This is particularly relevant to expenses.

5.3.2 The Actuary should discuss the apportionment basis with the auditor.

5.4 Intergroup apportionments and outsourcing

5.4.1 Intercompany apportionments may occur because the life company is a part of a group of companies sharing the same resources. While these are outside the scope of Section 80 of the Act, the Actuary's written advice should consider whether the net result of such apportionments to the life company and to statutory funds is equitable and appropriate for the services received or provided. In this context, the Actuary should keep in mind the provisions of Section 30(d) of the Act.

5.4.2 Outsourcing to intergroup companies represents another area where attention is required by the Actuary to ensure Section 30(d) of the Act is not breached. This commonly includes investment management, distribution and data processing.

In general, the Actuary should be satisfied that the outsourcing arrangement is on "arms length" commercial terms. In this regard, the Actuary is also reminded of the requirements of Section 98 of the Act and the guidance provided in section 3.4 of this standard.

5.5 Expenses

5.5.1 The major item to be apportioned will be expenses. Where expenses relate to a specific fund category or sub class, they should be allocated directly. Indirect expenses should be allocated on an objective basis using the principles outlined above. This may involve a variety of techniques including:

- activity based costing results
- in proportion to business parameters such as number of policies, premium receipts, funds under management, claim payments etc
- results of time surveys etc
- the level of detail involved will vary depending on the financial systems available to produce results.

5.5.2 Expenses must also be split between acquisition and maintenance for determination of assumptions for calculation of policy liabilities and profit margins. The split between acquisition and maintenance has a direct effect on the profit of the company and particular attention should be paid to it. Consistency of treatment from year to year is particularly important to avoid distortion of results. Reference should be made to the valuation standards for further guidance.

5.5.3 The treatment of expenses for tax purposes would generally be expected to be consistent with the treatment for accounting purposes although it is acknowledged that a different apportionment may be appropriate to comply with the requirements of the tax legislation.

5.6 Investment Income

5.6.1 Where separate assets are maintained for particular blocks of business, then investment income relating to these assets should be allocated directly. Where separate assets are not maintained, then investment income should be allocated allowing for cash flows and assets invested unless the policy document requires otherwise.

5.7 Taxation

5.7.1 In many cases, it is not possible to charge tax directly to a statutory fund or component of the fund and apportionments must be made. The tax treatment of expense deductions in particular can present difficulties when allocating tax liabilities.

5.7.2 The apportionment basis for taxation should be clearly specified and make allowances for the method of taxing investment income in funds with more than one class of business, treatment of expense deductions and imputation credits. Where imputation credits earned by one block of business are passed on to other blocks of business or shareholders, this should be done on a consistent basis.

6 FINANCIAL CONDITION INVESTIGATIONS

6.1 General

6.1.1 The following paragraphs set down those matters which the Institute considers the Actuary should address in examining and reporting on the financial condition of a life insurance company. They may well go beyond the requirements of the Act.

6.1.2 Section 113(1) of the Act requires every life company to "arrange for its Actuary to:

(a) investigate the financial condition of the company as at the end of every financial year of the company; and

(b) give the company a written report of the results of the investigation."

Section 113(2) states that the "investigation must include:

(a) the making of a valuation of the company's liabilities in respect of its life insurance business; and

(b) an assessment, in relation to each statutory fund of the company, of the extent to which the company has complied, during the financial year concerned, with the Solvency Standard and the Capital Adequacy Standard ..."

6.1.3 The Actuary is not only determining the solvency and capital adequacy position of the company over the past year and as at the date of the valuation but is also concerned with the company's continuing ability to remain solvent and capital adequate, and to deal equitably between policy owners and, where applicable, shareholders. The Actuary should consider the position of the company over both the short and long term and should also consider the need to undertake sensitivity tests over and above those necessary to meet the requirements of the Standards.

6.1.4 The Actuary's investigation would normally be on an open-to-new business basis but consideration should also be given to the possibility that the company might be closed to new business.

In particular, the Actuary should consider the liabilities, the corresponding assets, and their inter-relationship. This should be done from two points of view - the solvency and capital adequacy positions of the company and its ability to provide Reasonable Benefits to its participating and Discretionary Investment Benefit policy owners. The Actuary should consider the possibility of insolvency or the company being unable to provide Reasonable Benefits to its policy owners. This may arise from factors within and outside the control of the company. Where appropriate, the Actuary could recommend a course of action for the company to adopt.

6.1.5 It is accepted that the financial condition report, which is produced annually, will be only one of a number of reports (which may or may not be of an actuarial nature) prepared throughout the year for the information of the management and/or directors of a company. In these circumstances, the financial condition report represents an important opportunity to draw together all significant investigations and their implications, and to present a consolidated picture to the management and/or directors.

6.1.6 The Actuary should exercise judgement in the amount of detail included in the financial condition report in respect of advice already given during the period under review. If he/she considers it inappropriate to include all the details, then a summary of the main advice given throughout the year, and the outcomes should be included in the financial condition report.

In examining and reporting on the financial condition of the company in terms of this standard the Actuary should give consideration to materiality in relation to the company.

6.1.7 Attachment B provides a detailed check list of the matters the Actuary would normally consider in making a financial condition investigation but it should not be considered comprehensive; the circumstances of the particular company must be taken into account.

6.2 Experience Analyses

6.2.1 The Actuary should identify and comment upon any significant trends or deviations in the experience items. The report should include comments on steps which are proposed to be taken by the company to address any areas of adverse experience.

6.2.2 Actual experience should be compared and analysed at least against that anticipated at the previous valuation, for example best estimate assumptions, and other benchmarks as considered appropriate by the Actuary, such as product pricing assumptions.

6.3 Data

6.3.1 The Actuary should state what precautions were taken to ensure the accuracy of the data in carrying out the investigation.

6.3.2 The Actuary should comment on any of the operations or systems that are likely to have an impact upon the accuracy of the data. Where necessary, the risks involved because of any data inaccuracy should be quantified and appropriate reserves established in accordance with the Standards.

6.4 Assets

6.4.1 Subject to any statutory regulations, the responsibility for investment policy rests with the directors of the company. However, the Actuary should decide whether, in his/her judgement, the investment policy pursued by the directors is, or could become, inappropriate having regard to the nature and term of the company's liabilities. The Actuary should, in the report to the company, advise of the constraints on investment policy which he/she regards as necessary to protect policy owners.

6.4.2 The financial condition of a life insurance company depends fundamentally on the relationship between the nature and term of the assets and the corresponding liabilities. In considering this relationship and to the extent not already reported on in the valuation report required by the Standards or Commissioner's Rules (which may form a part of this report), the Actuary must assess and report on the financial consequences of:

(a) the mismatching of assets and liabilities;

(b) any guarantees and options (including surrender) available under policies and the likely effect of the exercise of these options on the company;

(c) the marketability of the assets in circumstances when they may be called upon to meet policy proceeds, especially when exercised under a guarantee or option;

(d) any asset default risks; and

(e) any financial derivative exposures held.

The Actuary should also report and comment on:

- the inadmissible assets (for valuation purposes) of each statutory fund
- the mix of assets by sector type for each statutory fund
- the mix of assets by quality (level of security)
- the mix of assets by category and sub-category

having regard to the nature of the liabilities.

Reserves to cover any of the above should be in accordance with the requirements of the Standards.

6.4.3 As in the case of investment policy, the responsibility for the values to be placed on the assets in the company's balance sheet rests with the directors. The Actuary should consider and comment on the methods by which those values have been obtained and their appropriateness for the purpose of his/her investigation. The Actuary should comment on any significant changes in the method of valuation of the assets. Where the Actuary considers that the values are unsuitable in any respect, reasons should be given and an appropriate reserve established in accordance with the Standards .

6.5 Breaches of Capital Adequacy

6.5.1 Where the Actuary's projections, including new business, reveal that a deficit against the Capital Adequacy Standard may result under reasonable adverse assumptions (or where such a deficiency currently exists) comment should be made on:

(a) the reasons for the deficiency;

(b) the proposed management actions to eliminate the deficiency, and the likely effect of these actions.

6.5.2 Sections 70 and 71 of the Act imply that Capital Adequacy Standard must be maintained at all times. The Actuary should therefore comment on the level of and reasons for any breaches of the Capital Adequacy Standard during the past year and the subsequent actions that were taken by the company.

6.6 Liabilities

6.6.1 The Actuary should value the liabilities in accordance with the Standards.

6.6.2 The Actuary should make appropriate provisions for reserves to meet adverse contingencies that are not specified in the method of calculation of the valuation liabilities as prescribed in the Standards or the Act.

The Actuary should in respect of each such contingency:

(a) describe the contingency with explanation of the purpose of making a provision;

(b) describe how the amount of the provision has been determined; and

(c) identify where these provisions are held.

This does not preclude the Actuary from establishing non-specific contingency reserves above the prescribed level of reserves to meet regulatory requirements.

6.7 Premium Rates and Charges

6.7.1 The Actuary should provide an opinion as to whether the premium rates and fees 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).

6.7.2 In this regard, the Actuary should address all aspects of advice previously provided under Section 116 of the Act as well as providing an opinion as to whether the commission arrangements are, or could become, unsustainable.

6.8 Reinsurance

6.8.1 The Actuary should examine and report on the company's existing reinsurance arrangements both risk related and financial support arrangements.

6.8.2 The Actuary should describe in general terms all arrangements in-force, their purpose, and comment on the adequacy, effectiveness and administration of the arrangements. Description must include the identity of the reinsurer, the nature of cover and the circumstances, if any, under which the reinsurer can terminate the arrangement for in-force business.

6.8.3 The Actuary should comment if in his/her judgement, any reinsurance arrangements undertaken by the company are, or could become, inappropriate.

6.9 Business Risks

6.9.1 The Actuary should consider, in the circumstances of the particular company being advised, whether comment needs to be made upon the more general business or legal risks that the company faces (such as dishonesty, fraud, disasters, compliance) and which could impact the financial security of the policy owners, and how well the company is managing such risks.

6.10 New Business Assumptions

6.10.1 The Actuary should make him/herself aware of the purposes for which the latest business plans of the company have been formulated and the new business assumptions underlying those plans.

6.10.2 The Actuary should consider whether, for the purposes of satisfying actuarial standards, modifications should be made to those assumptions.

7 DISTRIBUTIONS OF PROFITS AND CAPITAL

7.1 General

7.1.1 The directors are responsible for deciding the distribution of retained profits and shareholders' capital after receiving written advice from the Actuary as required by the Life Insurance Act. In addition, company by-laws may impose additional constraints on the distribution and/or requirements on the Actuary.

7.1.2 Advising as to likely consequences of a distribution of retained profits or shareholders' capital is complex and requires considered judgement. The legal and professional framework within which the Actuary should exercise this judgement is set out in section 3.

7.1.3 The written advice as to the likely consequences of the distribution of retained profits or shareholders' capital should give the reasons upon which the advice is based and should also report on the short term outlook for future distributions to policy owners and transfers between statutory funds and shareholders' funds. Significant trends in profit or the capital adequacy or solvency position should be interpreted and the impact of any subordinated debt should be considered.

7.1.4 In advising in relation to overseas business the Actuary should also consider the requirements of the relevant overseas regulatory requirements.

7.2 Equity

7.2.1 There is no universally agreed definition of equity and a decision about it can only be a matter of judgement. In making judgement the Actuary should give consideration to the following:

(a) the sources of the profit disclosed, the relative contribution to it by the different groups of policy owners and by the shareholders, and the release of capital previously committed to support existing business;

(b) the relative risks taken by the participating and Discretionary Investment Benefit policy owners in paying premiums for benefits either of which may be varied, by profits being retained on their behalf, and by the shareholders in contributing capital;

(c) the need to maintain the overall viability of the company for existing and future policy owners; and

(d) prevailing practices within the actuarial profession.

7.2.2 Likewise a decision about Reasonable Benefits for the different groups of participating and Discretionary Investment Benefit policy owners can only be a matter of judgement. In making judgement, the Actuary should give consideration to each of the following points (and the inter-relationships between them):

(a) the terms and conditions including the premium rates, options and guarantees on which the policies were issued;

(b) the information conveyed by the company to the policy owners in connection with the sale and subsequently;

(c) the experience of the company, subsequent to the issue of the policies, in relation to each of the elements relevant to the policy such as mortality, morbidity, the return on investments, tax and expenses of administration, lapse and surrender experience; and

(d) the need, if any, for each policy to make a contribution, from the profit it generates, to the company's capital base in recompense for and appropriate to the support it may have received from the capital base and the company generally.

Attachment A

PRODUCT ADVICE CHECK LIST

1. General

1.1 Date of report
1.2 Class and category of policy
1.3 Statutory fund
1.4 Description of policy provisions

2. Assumptions

2.1 Insurance risks by age, sex, duration and smoking status as appropriate

- (a) Mortality
- (b) Morbidity
- (c) Disability claim termination
- (d) Trauma
- (e) Accident
- (f) Unemployment

2.2 Investment earnings
- (a) Nature of Assets
- (b) By anticipated duration
- (c) Income
- (d) Capital
- (e) Taxation

2.3 Expenses
- (a) Maximum commission, rebate or other benefits to be paid including definition
- (b) Allocation of costs
- (c) Size of policy
- (d) By anticipated duration
- (e) Inflation

2.4 Termination of contract
- (a) Surrender and forfeiture rates
- (b) Surrender values
- (c) Partial surrenders of investment contracts
- (d) Regular premium dormancy

2.5 Marketing
- (a) Volume of Business

(b) Distribution
(c) Policy size
(d) Constraints

2.6 Allocation and Distribution of profits
(a) Philosophy
(b) Solvency and Capital Adequacy reserving

3. Profit and Contingency Margins

3.1 Required benchmarks
3.2 Contingency margins

4. Policy Terms and Conditions

4.1 Options and guarantees
(a) Contingencies
(b) Periods of application
4.2 Minimum and maximum ages of entry
4.3 Termination ages or duration limits

5. Finance

5.1 Amount and incidence
5.2 Company capacity from:
(a) Shareholder retained earnings
(b) Policy owner retained earnings
(c) Additional capital
(d) Otherwise
5.3 Effect of capital adequacy reserves
5.4 Constraints on marketing

6. Suitability

6.1 Tests
6.2 Limits to approval of suitability
(a) Minimum viable volumes
(b) Average policy size
(c) Actual expenses

7. Taxation

7.1 On income
7.2 On capital
7.3 Deductible expenses
7.4 Other items

8. Unit Pricing Mechanism

9. Reinsurance

10. Marketability

10.1 Comparison with competition

11. Administration Systems

12. Disclosure and Code of Practice

12.1 Policy documents
12.2 Promotional material
12.3 Benefit illustrations
12.4 Benefit statements
12.5 Sales techniques

Attachment B

FINANCIAL CONDITION REPORTS CHECK LIST

1. 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
3.7 Impact of other classes of business

4. Policy Guarantees

4.1 Premiums
4.2 Charges
 (a) Managed funds
 (b) Investment account and investment linked policies
4.3 Sum insured and bonuses
4.4 Surrender values
4.5 Options
4.6 Other

5. Reinsurance Arrangements

5.1 Description

5.2 Suitability

6. Experience – Recent and Expected

6.1 Mortality
6.2 Morbidity
6.3 Investment earnings
(a) Income
(b) Capital
(c) Tax
6.4 Expenses
(a) Initial
(b) Other
(c) Inflation
6.5 Termination of policies
(a) Lapse
(b) Surrender (and partial surrender)
(c) Transfer
(d) Cancellations
(e) Premium dormancy
6.6 Product mix
(a) Proportion of with profit policies

7. Information Systems

7.1 Policy processing systems
7.2 Unit pricing system
7.3 Claims processing
7.4 Reinsurance processing

8. Assets

8.1 Veracity of data
8.2 Summary by type
8.3 Derivatives
8.4 Past investment returns
8.5 Term
8.6 Suitability to liabilities
8.7 Value
8.8 Tax
8.9 Method of obtaining values of assets
8.10 Mismatching and default risks
8.11 Admissibility
8.12 Statements or comment required by the ISC

9. Investment Policy

9.1 Current policy and trend
9.2 Impact on future returns
9.3 Suitability to current and future liabilities
9.4 Statements or comment required by the ISC

10. Adequacy of Premium Rates and Charges

10.1 Existing policies
10.2 New policies
10.3 Underwriting practices and standards

11. Valuation of Liabilities

11.1 Veracity of data
11.2 Methods and assumptions
- (a) Summary description
- (b) Details of changes from previous valuation
- (c) Reasons for changes
- (d) Quantification of changes
- (e) Suitability and implications
- (f) Adherance to statutory and professional standards

11.3 Details and purpose of contingency reserves
11.4 Summary of results
11.5 Analysis of movements in liabilities
11.6 Statutory statements and information

12. Operating Earnings

12.1 Analysis of movements
12.2 Trends

13. Solvency and Capital Adequacy

13.1 Current levels
13.2 Analysis of movements
13.3 Levels during past year
13.4 Future capital requirements
13.5 Results of additional projections
13.6 Future sources of capital
13.7 Obligations under Act to notify

14. Retained Profits

14.1 Allocation

14.2 Availability for distribution
- (a) Policy owners
- (b) Shareholders

14.3 Distribution
- (a) Equity
- (b) Methods
- (c) Amounts

14.4 Transfers
- (a) Statutory funds
- (b) Subdivision of funds
- (c) Reserves

14.5 Unallocated funds

14.6 Outlook
- (a) For policy owners
- (b) For shareholders

END OF PROFESSIONAL STANDARD 200