



PROFESSIONAL STANDARD 305

**FINANCIAL CONDITION REPORTS FOR
GENERAL INSURANCE**

INDEX

1	INTRODUCTION	2
1.1	Application	2
1.2	Classification	2
1.3	Background	2
1.4	Purpose	3
1.5	Previous Versions	3
1.6	Legislation	3
2	COMMENCEMENT DATE	3
3	DEFINITIONS	3
4.1	Matters for consideration	4
4.2	Materiality	5
4.3	Corporate group considerations	5
4.4	Foreign insurer considerations	5
5	REPORTING REQUIREMENTS	5
5.1	Statements by Actuary	5
5.2	Information requirements	6
5.3	Business overview	6
5.4	Recent experience and profitability	6
5.5	Insurance Liability Valuation	7
5.6	Adequacy of past estimates of insurance liabilities	7
5.7	Pricing and premium adequacy	7
5.8	Asset and liability management	7
5.9	Capital management and capital adequacy	8
5.10	Reinsurance arrangements	8
5.11	Risk management	8
5.12	Conclusions and recommendations	9

1 INTRODUCTION

1.1 Application

- 1.1.1 This Professional Standard applies to a Financial Condition Reports (FCR) produced for an Entity authorised to carry on general insurance business under the *Insurance Act 1973*.
- 1.1.2 If similar reports are prepared for other Entities providing general insurance coverage, such as self-insurers or accident compensation schemes, then the relevant parts of this Professional Standard are applicable, to the extent that these are within any relevant legislation and/or any formal request made by the Entity to the Actuary.
- 1.1.3 This Professional Standard does not seek to replicate or override the requirements of the Institute's Professional Standard 300.

1.2 Classification

- 1.2.1 This Professional Standard has been prepared in accordance with the Institute's *Policy for Drafting Professional Standards* as varied from time to time. This Professional Standard must be applied in the context of the Institute's Code of Professional Conduct.
- 1.2.2 This Professional Standard is binding on Members of the Institute of Actuaries of Australia in respect of all work covered by the Professional Standard. Non-compliance with this Professional Standard by a Member engaged in work covered by this Professional Standard is or may be *prima facie* Actionable Conduct and may lead to penalties under the Institute's Disciplinary Scheme.
- 1.2.3 This Professional Standard in itself defines the requirements of the Institute in respect of all work covered by this Professional Standard. If a Member believes that the Professional Standard is ambiguous or for some other reason wishes to seek clarification of it, that Member may consult the Institute's Professional Standards Committee for guidance as to the interpretation of this Professional Standard. Apart from legislation (including regulations, prudential standards, subordinate standards and rules), no other document, advice or consultation (including Practice Guidelines of the Institute) can be taken to modify or interpret the requirements of this Professional Standard.
- 1.2.4 Members who find that they cannot carry out work in a manner that complies with this Professional Standard must decline to carry out the work or terminate their agreement to do so.

1.3 Background

- 1.3.1 The subject of an FCR being prepared for a general insurer was raised in a July 2002 submission by the Institute to the HIH Royal Commission. In his April 2003 final report, the Commissioner recommended to the Government that APRA require the annual production of such a report, akin in concept to the FCR prepared by Appointed Actuaries in the life insurance industry. The Federal Government accepted the recommendation.
- 1.3.2 In December 2002, the Council of the Institute established an FCR Taskforce to supervise the drafting of an Institute Professional Standard on the subject of an FCR. This taskforce produced a number of drafts of this Professional Standard in the period from November 2003 for comment by Institute members and the industry.
- 1.3.3 In November 2003, APRA released a Discussion Paper, which listed the elements to be included in an FCR. This incorporated and extended the requirement for the Approved Actuary to undertake an Insurance Liability Valuation. In May 2005, APRA

released a further Discussion Paper, which provided more detail on the FCR proposal, and required that regard must be taken of relevant Institute Professional Standards. The relevant legislation is described in section 1.6.

1.4 Purpose

- 1.4.1 APRA Prudential Standard GPS 310, *Audit and Actuarial Reporting and Valuation*, “aims to ensure that the Board and senior management of a general insurer are provided with impartial advice in relation to its operations, financial condition and insurance liabilities”. The requirement for an FCR plays a key part in meeting this aim.
- 1.4.2 The FCR is intended to provide an impartial assessment of an Entity’s financial condition and, for a general insurer authorised by APRA, in the context of its current APRA authorisation.
- 1.4.3 The assessment of the financial condition of the Entity, and, for a general insurer authorised by APRA, in the context of its current APRA authorisation, includes discussing the implications of Material risks identified during the assessment, and, where these implications are adverse, making recommendations as to how to address these risks.

1.5 Previous Versions

There are no previous versions of this Professional Standard.

1.6 Legislation

- 1.6.1 From 1 July 2002, the *Insurance Act 1973*, as amended by the *General Insurance Reform Act 2001*, (the Act) provides for APRA to issue prudential standards, regulating the activities of and imposing requirements on authorised general insurers.
- 1.6.2 APRA Prudential Standard GPS 310, *Audit and Actuarial Reporting and Valuation*, mandates that an Approved Actuary “undertake an investigation to enable the preparation of ... [a] Financial Condition Report (FCR)...” and that, as a general rule, an FCR must be completed in respect of each authorised general insurer. In addition, GPS 310 requires that regard be taken of relevant Institute Professional Standards.
- 1.6.3 There may be other legislation that requires an FCR to be provided to Entities not regulated by APRA.
- 1.6.4 If there is a difference between this Professional Standard and the applicable legislation, the legislation takes precedence. In this context, legislation includes regulations, prudential standards, subordinate standards and rules.

2 COMMENCEMENT DATE

This Professional Standard takes effect for an FCR applicable to an Effective Date from 30 June 2006.

3 DEFINITIONS

‘**Actuarial Advice**’ has the meaning given in the Institute’s Code of Professional Conduct.

‘**Actuary**’ means a Fellow or Accredited Member of the Institute.

‘**Approved Actuary**’ means the person appointed by an authorised general insurer and approved by APRA under sections 39 and 40 of the Insurance Act 1973.

'APRA' means the Australian Prudential Regulation Authority.

'Board' means the directors of an Entity, or equivalent.

'Central Estimate' has the meaning given in the Institute's Professional Standard 300.

'Class of Business' has the meaning given in the Institute's Professional Standard 300.

'Effective Date' means the valuation date of the corresponding Insurance Liability Valuation.

'Entity' means a company, corporation, or other body with a liability to pay insurance claims, or with a liability to compensate other parties.

'Institute' means The Institute of Actuaries of Australia.

'Insurance Liability Valuation' means the actuarial valuation by the Actuary of the general insurance liabilities of one or more Classes of Business.

'Entity's Plans' means the plans of the Entity, current at the Effective Date, including but not limited to budgetary, business, strategic and capital management plans.

'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'.

'Prudential Requirements' means requirements under Commonwealth, State or Territory legislation in Australia, including regulations, prudential standards, subordinate standards and rules governing Actuarial Advice.

'Risk Margin' has the meaning given in the Institute's Professional Standard 300.

4 SCOPE

4.1 Matters for consideration

4.1.1 Subject to 4.1.2 and 4.1.3, an FCR must include each of the matters listed below, with consideration at the Effective Date of historical analysis and future implications, where applicable:

- a) business overview;
- b) recent experience and profitability;
- c) Insurance Liability Valuation;
- d) adequacy of past estimates of insurance liabilities;
- e) pricing, including premium adequacy;
- f) asset and liability management;
- g) capital management and capital adequacy;
- h) reinsurance arrangements; and
- i) risk management.

- 4.1.2 Notwithstanding that the purpose of the FCR is to provide an assessment of the Entity's overall financial condition, the impact or influence of Classes of Business on the matters in 4.1.1 must be considered, where Material and applicable.
- 4.1.3 If, in the opinion of the Actuary, a matter referred to in paragraph 4.1.1 is not relevant to the operations of the Entity, the matter may be omitted from the FCR. In that event, the Actuary must state that the matter is not relevant and provide reasons for forming this opinion. If the Actuary identifies additional Material matters, not detailed in 4.1.1, the Actuary must include such matters in the FCR.

4.2 Materiality

- 4.2.1 The Actuary must take Materiality into account when preparing an FCR. Whether something is Material or not will always be a matter requiring the exercise of the Actuary's judgement.
- 4.2.2 The level of detail to be provided in an FCR will depend on the size and complexity of the operations of the Entity and considerations of Materiality.

4.3 Corporate group considerations

- 4.3.1 In preparing an FCR, the financial position of the corporate group to which the Entity belongs must be considered and in particular, the potential of that corporate group to Materially affect the position of the Entity. Similarly, the potential of exposure and relationships within a corporate group to Materially affect the position of the Entity must be considered.
- 4.3.2 Unless otherwise required by APRA, a single FCR may be produced for an insurance group. Where an FCR is produced for an insurance group, this single FCR must consider and address the operations of each entity authorised to carry on general insurance business within that insurance group.

4.4 Foreign insurer considerations

- 4.4.1 For foreign insurers, the FCR must be prepared in respect of the Australian branch operation that is authorised to carry on general insurance business, but with consideration given to the financial position of the head office and, in particular, its potential to Materially affect the position of the branch.
- 4.4.2 Where information cannot be obtained, owing to the structure of the branch operation or other aspects of the foreign insurer, an explanation of the lack of information must be provided in the FCR, together with an assessment of the consequent limitations of the FCR.

5 REPORTING REQUIREMENTS

The FCR must include the matters set out in this section.

5.1 Statements by Actuary

- 5.1.1 The Actuary must sign and state the date of completion of his or her written FCR.
- 5.1.2 Statements must be provided setting out who commissioned the Actuary's reporting, the scope of and purpose of the FCR, the specific terms of reference and any restrictions or limitations placed upon the Actuary.
- 5.1.3 A statement must be provided that the Actuary's reporting has been prepared in accordance with this Professional Standard.

- 5.1.4 In addition to the contents of this Professional Standard, in deciding on the content and the level of detail for reporting, the Actuary must have regard to the reporting requirements given in the Institute's Code of Professional Conduct.

5.2 Information requirements

- 5.2.1 The Actuary must advise the Entity of the information required, including data and reports that the Actuary will need, as well as the staff and relevant contractors of the Entity with whom the Actuary will need to consult, in order to prepare the FCR. The Actuary must identify in the FCR all information upon which he or she has placed Material reliance in preparing the FCR.
- 5.2.2 The Actuary must take reasonable steps to verify and document the consistency, completeness and accuracy of the information, including data and reports, provided by the Entity against the Entity's financial and other records. Material discrepancies that cannot be resolved with the Entity must be outlined in the FCR, together with the consequent limitations of the FCR.
- 5.2.3 The degree to which the Actuary relies upon information, including data and reports provided by the Entity, or upon testing of the data or other information by the Entity's internal auditor or other third parties, must be explained in the FCR, together with an assessment of the consequent limitations of the FCR.
- 5.2.4 Where the Actuary relies on work carried out by other actuaries, the Actuary must be satisfied as to the suitability of the work. Where the Actuary is not satisfied, alternative analyses must be undertaken and explained in the FCR.
- 5.2.5 Where the Entity does not provide adequate and timely access to information, including data and reports, and staff, as required by the Actuary, and the information cannot otherwise be practically obtained, the Actuary may omit from the FCR analysis that is dependent on that information, but must provide an explanation as to why it has been omitted and an assessment of the consequent limitations of the FCR.
- 5.2.6 Where the Actuary places reliance upon others to provide information required, and this information is limited, or not forthcoming, the Actuary must note this in the FCR, together with an assessment of the consequent limitations of the FCR.

5.3 Business overview

- 5.3.1 An FCR must include general background information about the corporate structure and operations of the Entity.
- 5.3.2 General background information includes relevant information about the Entity's Plans, including forward projections, and about any prudential requirements imposed on the Entity by APRA, in writing, that do not form part of the Act or prudential standards.
- 5.3.3 An FCR must outline, consider and comment on Material risks arising from the Entity's Plans at the Effective Date.

5.4 Recent experience and profitability

- 5.4.1 An FCR must identify and comment on the past profitability of the Entity, including consideration of significant features or trends in the Entity's recent experience, over a period of at least three previous years, to the extent that such experience exists. This assessment must consider premiums, claims, expenses, commissions, investment return, and profits/losses, including any abnormal features.
- 5.4.2 Deviations of actual experience from the expected experience in the Entity's Plan over at least the year since the previous balance date must also be discussed, including an assessment of the reasons for these deviations.

- 5.4.3 An FCR must comment on the steps taken, or proposed to be taken, by the Board or senior management of the Entity to address areas of deviation and/or adverse experience.

5.5 Insurance Liability Valuation

- 5.5.1 An FCR must include a summary of the key results of, and considerations arising from, the Insurance Liability Valuation prepared at the Effective Date, prepared in accordance with the Institute Professional Standard PS 300 and, for an APRA regulated Entity, APRA Prudential Standard GPS 310, *Audit and Actuarial Reporting and Valuation*. The FCR must make reference to the Insurance Liability Valuation report, which can either be a separate report or included in the FCR.
- 5.5.2 An FCR must outline, consider and comment on Material issues arising from or disclosed by the Insurance Liability Valuation.

5.6 Adequacy of past estimates of insurance liabilities

- 5.6.1 An FCR must include an assessment of the adequacy of past Central Estimates of either outstanding claim liabilities or all insurance liabilities against the subsequent actual claims experience over a period of at least three years if experience exists.
- 5.6.2 An FCR must include comments on any Material implications for the adequacy of current estimates of insurance liabilities, both including and excluding Risk Margins, arising out of the review of historical estimates.

5.7 Pricing and premium adequacy

- 5.7.1 An FCR must consider the adequacy of premiums, and must outline, consider and comment on Material issues arising from the Entity's pricing processes and underwriting and claim management practices.
- 5.7.2 An FCR must consider whether expected future profitability arising from the assessment of premium adequacy is Materially in line with the Entity's Plans.

5.8 Asset and liability management

- 5.8.1 An FCR must outline, consider and comment on Material issues arising from the Entity's approach to asset and liability management.
- 5.8.2 In undertaking this assessment, the Actuary must outline, consider and comment on Material risks arising from:
- a) the Entity's liability profile and liquidity needs;
 - b) the Entity's investment assets, in particular its investment strategy and the nature, quantum and performance of those assets;
 - c) the Entity's other assets, in particular reinsurance and non-reinsurance recoveries;
 - d) the Entity's insurance liabilities;
 - e) the Entity's non-insurance liabilities
 - f) the Entity's net assets; and
 - g) the methods for valuing assets and non-insurance liabilities, particularly, changes in those methods.

5.9 Capital management and capital adequacy

- 5.9.1 An FCR must outline the Entity's approach to setting and monitoring capital resources over time, including dividend policy, and the processes and controls in place to monitor and ensure compliance with the Minimum Capital Requirement as determined in accordance with APRA Prudential Standard GPS 110, *Capital Adequacy* (MCR).
- 5.9.2 The Actuary must consider and comment on that approach, as well as Material risks arising from its application, having regard to the Entity's MCR and needs for future capital to support the Entity's Plans, including target and trigger capital adequacy ratios used by the Entity.
- 5.9.3 An FCR must include the Entity's MCR calculated in accordance with APRA Prudential Standard GPS 110, *Capital Adequacy*.
- 5.9.4 An FCR must outline, consider and comment on trends in the Entity's compliance with its MCR and its capital targets at least in the last three years at quarterly intervals, taking into account the impact of Material seasonal variation in the MCR. The FCR must comment on the extent of, and reasons for, identified breaches of the Entity's MCR or of its capital targets during the past year, and the actions that were taken by the Entity to rectify such breaches.
- 5.9.5 The Actuary must consider and comment on the Entity's capacity to meet its MCR and its capital targets over at least the next three years.

5.10 Reinsurance arrangements

- 5.10.1 An FCR must comment on Material issues arising from the use of the Entity's specified reinsurance strategy, and from its actual current and past reinsurance arrangements, having regard to the Entity's liability profile. Reference must be made to the Entity's Reinsurance Management Strategy (REMS) and to the Reinsurance Arrangements Statements submitted to APRA in accordance with APRA Prudential Standard GPS 230, *Reinsurance Management*.
- 5.10.2 In undertaking this assessment, the FCR must consider intra-group reinsurance arrangements and relationships between the Entity and other Entity's or institutions within the corporate group.
- 5.10.3 An FCR must assess the method used to calculate the Entity's Maximum Event Retention (MER) and comment on whether the method is appropriate to the operations of the Entity.
- 5.10.4 The Actuary must outline, consider and comment on Material risks arising from the Entity's reinsurance arrangements, having regard to the documentation and extent of placement of reinsurance arrangements, obligations to pay future reinsurance premiums, and the certainty of the Entity's ability to make reinsurance recoveries under these arrangements.
- 5.10.5 The FCR must outline, consider and comment on Material risks arising from use of limited risk transfer products, such as financial reinsurance or purported reinsurance (whether financial or otherwise). Reference must be made to any approval by APRA of limited risk transfer arrangements under APRA Prudential Standard GPS 230, *Reinsurance Management*.

5.11 Risk management

- 5.11.1 The Entity's risk management framework, comprising the Entity's risk management policies and procedures, processes and controls, is intended to identify the risks that may affect the financial condition of the Entity. The Actuary must comment on Material risks arising from the risk management framework of the Entity. Where there

are limitations on such commentary, particularly those caused by the Actuary's limited exposure to, and interaction with, the Entity's risk management strategy and practice, the Actuary must note this in the FCR, together with an assessment of the consequent limitations of the FCR.

- 5.11.2 An FCR must make reference to the Entity's Risk Management Strategy (RMS) that has been submitted to APRA in accordance with APRA GPS 220 *Risk Management*. The RMS is intended to identify the elements of the Entity's risk management framework. The Actuary must comment on Material risks arising from the use of the RMS, including the extent of implementation of the Entity's risk management framework. Where there are limitations on such commentary, particularly those caused by the Actuary's limited exposure to, and interaction with the Entity's risk management strategy and practice, the Actuary must note this in the FCR, together with an assessment of the consequent limitations of the FCR.

5.12 Conclusions and recommendations

- 5.12.1 The assessment of the financial condition of the Entity must include a discussion of the implications of Material risks and issues identified during the assessment of the financial condition of the Entity. For an APRA regulated Entity, this discussion must be placed in the context of its current APRA authorisation.
- 5.12.2 Where the Actuary identifies Material risks with adverse implications for the Entity's overall financial condition, the Actuary must include in the FCR, recommendations intended to address these risks and, for an APRA regulated Entity, in the context of its current APRA authorisation.
- 5.12.3 The Actuary must also comment on the extent to which the Entity has addressed recommendations provided in the previous FCR, and, if the previous FCR was not at the balance date, on recommendations provided in the FCR at the last balance date.

END OF PROFESSIONAL STANDARD 305