

EXPOSURE DRAFT OF PROFESSIONAL STANDARD 600

FINANCIAL CONDITION REPORTS FOR PRIVATE HEALTH INSURERS

November 2016

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1. INTRODUCTION

1.1 Application

- 1.1.1 This Professional Standard applies to a Member preparing a Financial Condition Report for an Insurer.
- 1.1.2 Work performed under this Professional Standard is Prescribed Actuarial Advice. Members' attention is directed towards the requirements of the Code in relation to Prescribed Actuarial Advice, as well as to Practice Guideline 199.01 (Prescribed Actuarial Advice Reporting).

1.2 Classification

- 1.2.1 This Professional Standard has been prepared in accordance with the Institute's Policy for Developing Documents to Guide and Regulate Professional Practice. It must be applied in the context of the Code.
- 1.2.2 This Professional Standard is binding on Members of the Institute in respect of all work covered by the Professional Standard.
- 1.2.3 Non-compliance with this Professional Standard by a Member engaged in work covered by the Professional Standard may constitute Actionable Conduct and may lead to penalties under the Institute's Disciplinary Scheme.
- 1.2.4 This Professional Standard in itself defines the requirements of the Institute in respect of all work covered by the 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 the Professional Standard. Apart from legislation or prudential standards, 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.
- 1.2.5 A Member who finds that he or she cannot carry out work in a manner that complies with this Professional Standard must decline to carry out the work, or terminate his or her agreement to do so.

1.3 Background

- 1.3.1 Section 106 of the Act requires each Insurer to have an Appointed Actuary. The role of the Appointed Actuary, and the requirement for the Appointed Actuary to prepare an annual Financial Condition Report, commenced 1

July 2004 at the direction of the Private Health Insurance Administration Council.

- 1.3.2 HPS 320 states that "the Appointed Actuary must provide an assessment of the overall financial condition of the private health insurer on an annual basis. In particular, the Appointed Actuary must prepare a Financial Condition Report and provide this report to the company". A copy of the Financial Condition Report must be submitted to APRA by the Insurer.
- 1.3.3 Sections 8 to 16 of this Professional Standard relate solely to the Fund and section 17 relates to any business conducted by the Insurer outside of the Fund.
- 1.3.4 The Financial Condition Report is a formal documentation of the Appointed Actuary's ~~independent and objective~~ assessment of the financial condition of the Insurer, with a particular focus on the Fund. It documents an analysis of the experience of the Insurer and Fund, provides an overview of the key financial issues and risks facing the Insurer and Fund, and forms a significant input to Board and management decision-making. ~~Members who are unable to be independent and objective in performing this assessment should consider their circumstances. This may require Members to seek legal or other professional advice.~~

1.4 Purpose

The purpose of this Professional Standard is to direct Members in performing the work referred to in clause 1.1.1.

1.5 Previous versions

This version of the Professional Standard replaces the first version, which was issued in June 2011. Prior to that, guidance for the preparation of the Financial Condition Report was provided in Guidance Note 670.

1.6 Legislation and other requirements

- 1.6.1 From 1 July 2015, the Act provides for APRA to issue prudential standards regulating the activities of, and imposing requirements on, registered private health insurers.
- 1.6.2 HPS 320 mandates that an Appointed Actuary "on request by the private health insurer, prepare a Financial Condition Report in respect of each financial year". In addition, HPS 320 requires that the report be prepared in accordance with this Professional Standard (PS 600).

- 1.6.3 Communications issued by the Department of Health or APRA may also be relevant to this Professional Standard.
- 1.6.4 This Professional Standard must be considered in the context of applicable legislation. If there is a conflict between this Professional Standard and any applicable legislation, then the legislation takes precedence, and any differences must be documented in the Financial Condition Report. In this context, legislation includes regulations, prudential standards, subordinate standards, rules issued by government authorities and standards issued by professional bodies which have the force of law.
- 1.6.5 A reference to legislation or a legislative provision in this Professional Standard includes any regulatory modification, or substitution of that legislation or legislative provision and any subordinate legislation issued under that legislation or legislative provision. Similarly, a reference to a Professional Standard includes any modification or replacement of such.

2. COMMENCEMENT DATE

This Professional Standard applies to Financial Condition Reports with an Effective Date of 30 June 2017 or later.

3. DEFINITIONS

- 3.1 In this Professional Standard:

'Act' means the Private Health Insurance (Prudential Supervision) Act 2015 (Cth).

'APRA' means the Australian Prudential Regulation Authority (or its successors).

'Appointed Actuary' means a Member appointed under section 106(1) of the Act.

'Board' means the board of directors of an Insurer.

'Central Estimate' is intended to be an unbiased estimate of the mean (statistical expectation) of the outstanding claims liability or future claims liability.

'Claims' means benefit payments to, or on behalf of, the claimant under a health insurance policy.

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

'Department of Health' means the Australian Government's Department of Health (or its successors).

'Effective Date' means the date at which the financial condition is being considered, generally the end of the financial year, as specified in HPS 320.

'Financial Condition Report' has the same meaning as 'financial condition report' in clause 28 of HPS320.

'Fund' has the same meaning given to 'health benefits fund' in section 131 - 10 of the Private Health Insurance Act 2007 (Cth). For the purposes of this Professional Standard, 'Fund' can also be taken to refer to multiple health benefits funds.

'HPS 100' means APRA's Prudential Standard HPS100 Solvency.

'HPS 110' means APRA's Prudential Standard HPS 110 Capital Adequacy.

'HPS 320' means APRA's Prudential Standard HPS 320 Actuarial and Related Matters.

'Insurer' has the same meaning given to 'private health insurer' in the Act.

'Material' means either important or essential in the opinion of the Member, in the context of the Insurer's or Fund's circumstances. For this purpose, 'Material' does not have the same meaning as in Australian accounting standards.

'Policy holder' means a holder of a policy that is referable to the Fund.

- 3.2 A word that is derived from a defined word has a corresponding meaning.
- 3.3 Other capitalised terms used in this Professional Standard have the same meaning as set out in the Code.

4. MATERIALITY

- 4.1 The Member must take Materiality into account when preparing a Financial Condition Report. In determining whether something is Material, the Member must take into account the purpose of the Financial Condition Report. Whether something is Material or not will always be a matter requiring the exercise of the Member's professional judgment.
- 4.2 If the Member has formed the opinion that a matter required to be considered under this Professional Standard is not Material to the Financial Condition Report in the circumstances, the Member must document that the matter is not Material and provide reasons for forming that opinion, but does not have to further consider that matter. Furthermore:
- (a) if the matter is not Material because it is not relevant to the Insurer's or Fund's circumstances, the matter may be omitted from the Financial Condition Report; or

- (b) if the matter is relevant to the Insurer's or Fund's circumstances, but is not Material because it is neither important nor essential in the Member's opinion, the Member must state in the Financial Condition Report that the matter is not Material and provide reasons for such opinion.

5. SCOPE OF FINANCIAL CONDITION REPORT

5.1 The Financial Condition Report 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;
- (c) insurance liabilities;
- (d) assets;
- (e) projections of financial position;
- (f) premium rates;
- (g) regulatory capital;
- (h) capital management;
- (i) risk management; and
- (j) any additional Material matters not covered above.

6. ASSUMPTIONS

6.1 In any projections or calculations that are performed where:

- (a) legislation, accounting standards, APRA guidelines or other rulings require the Member to use specific assumptions or methods;
- (b) an interpretation of legislation, accounting standards, APRA guidelines or other rulings supplied by the Insurer or its advisers is being relied upon; or
- (c) the Insurer requires the Member to use specific assumptions or methods,

the Member must:

- (a) clearly state the circumstances;
- (b) discuss whether or not the assumptions and methods are reasonable and consistent with this Professional Standard or any other relevant Professional Standard of the Institute; and

- (c) discuss the implications of any divergence from this Professional Standard or from any other relevant Professional Standard of the Institute.
- 6.2 If, in the Member's opinion, they are unable to practically assess the reasonableness of the Material assumptions, the Member must comment accordingly.

7. DATA

- 7.1 The Member must ask the Insurer to provide:
 - (a) all relevant information required for preparation of the Financial Condition Report, including data and reports; and
 - (b) access to staff and/or contractors of the Insurer.
- 7.2 If the appropriate information is not provided, the Financial Condition Report must comment on any information that was requested but not provided and the likely impact on the assessment of the financial condition of the Insurer and Fund.
- 7.3 The Member must take reasonable steps to verify and document the completeness and accuracy of the information, including data and reports, provided by the Insurer against the Insurer's financial and other records. Material discrepancies that cannot be resolved with the Insurer must be outlined, together with any consequent limitations of the Financial Condition Report.
- 7.4 The degree to which the Member relies upon information, including data and reports provided by the Insurer, or upon testing of the data or other information by the Insurer's auditor or other third parties, must be explained and an assessment provided of any consequent limitations of the Financial Condition Report.

8. BUSINESS OVERVIEW

- 8.1 A Financial Condition Report must include general background information about the corporate structure, operations of the Insurer and the Insurer's business plans including any Material changes to the Insurer's rules for its Fund.
- 8.2 The Member must describe the general characteristics of the Fund's policyholders and products that may have a Material bearing on the liabilities and future profitability of the Fund.

- 8.3 Where Material, the Member must consider:
- (a) the diversification activities of the Fund and the extent of any associated explicit and implicit guarantees given by it; and
 - (a) the support given or likely to be given to the Fund by any parent or associated body, including both explicit and implicit guarantees.

9. RECENT EXPERIENCE

- 9.1 The Member must discuss any recent industry developments which could have a Material impact on the Fund's future financial position.
- 9.2 The Member must identify and comment upon any Material features or trends in the Fund's recent experience to the extent that such experience exists.
- 9.3 In relation to any Material experience items, deviations of actual experience from the projected experience of the Fund over the period, since the previous balance date, must also be discussed, including an assessment of the reasons for these deviations and the associated risks.

10. INSURANCE LIABILITIES

- 10.1 The Member must comment on the appropriateness or otherwise of the methodology and valuation of the insurance liabilities of the Fund at the Effective Date for inclusion in the Insurer's annual financial statements.
- 10.2 The Member 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 two years prior to the Effective Date if data exists.
- 10.3 The Member must comment on any Material issues relevant to the estimation of insurance liabilities, including those arising from the comparison of actual and expected experience.

11. ASSETS

- 11.1 The Member must report and comment on:
- (a) mix of assets by sector type;
 - (b) quality of assets, including asset default / credit risks (level of security);
 - (c) asset concentrations by investment type;
 - (d) liquidity of assets;

- (e) any financial derivative exposures held; and
- (f) asset and liability matching.

- 11.2 The responsibility for investment policy rests with the directors of the Insurer. The Member must comment whether, in his or her judgment, the investment policy pursued by the directors is, or could become, inappropriate having regard to the nature and term of the Fund's liabilities.
- 11.3 The responsibility for the values to be placed on the assets in the Fund's balance sheet rests with the directors. The Member must consider and comment on the methods by which those values have been obtained and their appropriateness for the purpose of his or her investigation. The Member must consider and comment on any significant changes in the method of valuation of the assets over the 12 months prior to the Effective Date.

12. PROJECTIONS OF FINANCIAL POSITION

- 12.1 In order to comment on the financial condition of the Fund, the Member must review or perform projections of the financial position of the Fund for a period of at least three years from the Effective Date. The projections of financial position must include forecasts of the Fund's business volumes, profitability, solvency and capital adequacy. These projections must be performed with a starting date no more than 12 months prior to the Effective Date. The Member must specify whether he or she has performed the relevant projections.
- 12.2 The Member must comment on the suitability of all Material assumptions about expected future experience for the purposes of the projections used for the Financial Condition Report and their appropriateness in the context of the Fund's experience and business plans.
- 12.3 The Member must discuss and, where he or she considers it appropriate, analyse, the range of potential profit and capital outcomes for the Fund over the projection period which the Member considers are plausible and relevant to the Fund's circumstances.

13. PREMIUM RATES

- 13.1 In assessing the current and future financial condition of the Fund, the Member must comment on the following matters in relation to the changes in premiums assumed for the purposes of the Insurer's projections in Section 12 of this Professional Standard:
- (a) their sufficiency, in terms of regulatory capital and internal capital targets; and

- (b) their potential or likely financial consequences on the Insurer's business plans in respect of the Fund.

13.2 The Member must discuss whether expected future profitability is consistent with the Insurer's business plans in respect of the Fund.

14. REGULATORY CAPITAL

14.1 The Financial Condition Report must include the Insurer's calculations which demonstrate whether it complies with HPS 110 at the Effective Date in respect of its Fund, and the projections demonstrating whether the Insurer is expected to comply with HPS 110 over at least the period in clause 12.1 of this Professional Standard.

14.2 The Member must consider and comment on the Insurer's compliance with HPS 110 in respect of its Fund. The Member must specifically include comment on:

- (a) the insurance liabilities valuation methodology which is used by the Insurer for the purposes of preparing returns of financial information to APRA;
- (b) the reasonableness of the methodology and amount of uncertainty allowed for by the Insurer in calculating the stress test amount under HPS 110; and
- (c) the Insurer's processes and controls to monitor and ensure compliance with HPS 110.

14.3 The consideration and commentary above relates to both:

- (a) the four quarters ended at the Effective Date; and
- (b) any future projections of the relevant items over the period covered in clause 12.1 of this Professional Standard.

15. CAPITAL MANAGEMENT

15.1 The Member must consider and comment on the Insurer's approach to setting, measuring and monitoring the Fund's capital resources over time. The Member must specifically include comment on:

- (a) the Insurer's approach, as set out in its capital management plan, to setting and monitoring the Fund's capital resources and capital needs allowing for residual risk over time, including (if relevant) dividend policy;
- (b) key risks arising from that approach to additional capital resources that may impact the Fund's need for capital support;

- (c) the Insurer's approach, as set out in its liquidity management plan, to setting and monitoring the Fund's liquidity levels; and
 - (d) key risks arising from that approach to managing liquidity risk, and the Insurer's processes and controls to monitor and comply with HPS 100.
- 15.2 In order to provide an understanding of the Fund's ability to withstand adverse scenarios, the Member must consider and comment on the capital management implications of the range of potential future capital outcomes discussed in clause 12.3. Additionally, the Member must comment on the potential impact on the Fund's capital position of specific adverse scenarios chosen by the Member which are relevant to the circumstances of the Fund.

16. RISK MANAGEMENT

16.1 The Member must:

- (a) identify and discuss the Material risks that could adversely affect the financial condition of the Fund, including, where he or she considers it appropriate, discussion of their likelihood and potential severity; and
- (b) comment on the treatment of Material financial risks in the Insurer's risk management framework in respect of the Fund.

17. NON-FUND BUSINESS

- 17.1 The Member must include commentary and analysis on any Material business conducted by the Insurer outside of the Fund which may impact the financial condition of the Fund. In doing so, he or she should be guided by section 4 on Materiality, and the principles in sections 8 to 16 above.
- 17.2 The Member must provide commentary on any identified Material financial and non-financial risk(s) the non-Fund businesses may have on the financial condition of the Fund.

18. CONCLUSIONS AND RECOMMENDATIONS

- 18.1 The assessment of the financial condition of the Insurer must include a discussion of the implications of all identified Material risks and issues.
- 18.2 The Member must consider whether any specific actions by the Insurer are warranted to address the identified Material risks and issues and, if so, the Member must make specific recommendations to the Board within the Financial Condition Report.

- 18.3 The Member must provide information to support any recommendations.
- 18.4 Where recommendations have been made in previous Financial Condition Reports, the Member must comment on:
- (a) progress by the Insurer's Board and management in addressing those recommendations; and
 - (b) the consequences of any lack of progress in addressing those recommendations.
- 18.5 The Member must consider whether any matter(s) in the Financial Condition Report warrant the specification of an event by the Member as a 'notifiable circumstance' within the meaning of the HPS 320.

19. RELIANCE ON OTHERS

- 19.1 If, in performing work under this Professional Standard, a Member wishes to rely on someone else's (including another Member's) work, then the Member must:
- (a) inform the other person that the Member is relying on his or her work, as applicable; and
 - (b) assess the appropriateness of the other person's work for that purpose.
- 19.2 If, following the Member's assessment under clause 19.1, the Member determines that it is not appropriate to rely on the other person's work, the Member must do his or her own alternative, or supplementary, analysis and must document that analysis.
- 19.3 In the [FCR Financial Condition Report](#), the Member must:
- (a) state what the Member has relied on that has been provided by another person; and
 - (b) record details of the steps the Member took to determine whether it was appropriate to rely on the other person's work.

20. CONSULTATION AND DISCUSSION

- 20.1 In preparing the Financial Condition Report, the Member must consult with the Insurer's management.
- 20.2 The Member must consider whether to consult with management or the Board or both, as appropriate, in relation to any recommendations.

- 20.3 The Financial Condition Report is a formal document which must be submitted to the Board of the Insurer. As such, the Member must seek to discuss the Financial Condition Report with the directors of the Insurer at a meeting of its Board or of the Board's audit committee.

21. REPORTING AND RECORD-KEEPING

- 21.1 The Member must sign and state the date of completion of his or her written Financial Condition Report.
- 21.2 The Financial Condition Report must include a statement that it has been prepared in accordance with this Professional Standard.
- 21.3 The Member must exercise judgment in the amount of detail to be included in respect of advice already given during the period under review. If the Member considers it inappropriate to include all the details of previous advice, then a summary of the Material advice given throughout the period (including any reports in relation to any notifiable circumstances that have occurred during the relevant period) and the outcomes must be included.
- 21.4 Where matters are limited in scope, or if the Insurer has not provided information that the Member considers necessary for the preparation of the Financial Condition Report, this must be highlighted.

END OF PROFESSIONAL STANDARD 600