

Practice Guideline 6A

Target Capital (Life, General and Health Insurance)

Explanatory Memorandum

1 April 2022

1. About this Explanatory Memorandum

This Explanatory Memorandum has been prepared by a cross-practice Target Capital Working Group (TCWG) to assist Members in understanding the new Practice Guideline 6A Target Capital (Life, General and Health Insurance) (PG 6A). This PG replaces the Target Capital Information Note (2016) and the Target Capital Discussion Note (2016).

PG 6A applies to any Member developing or reviewing target capital policies for life insurance, general insurance or health insurance companies.

2. Background

The key drivers of the need for this PG include:

- The previous Information Note needed review and has been restructured and enhanced to improve usability for Members.
- This PG now applies to health insurers which were not covered by the Information Note.
- In December 2018, the International Actuarial Association (IAA) Council adopted International Standard of Actuarial Practice (ISAP) 6, covering Enterprise Risk Management and IAIS Insurance Core Principles. This PG reflects the requirements of Section 2.5 Own Risk and Solvency Assessment (ORSA) of ISAP 6.
- This PG reflects industry learnings from recent events such as COVID-19, including regulator commentary.

The previous Information Note has been strengthened into a Practice Guideline for the following reasons:

- The need to reflect the approach in Section 2.5 of ISAP 6, given the Institute's intention is to adopt these ISAPs to the extent possible.

- Whilst Target Capital by its nature cannot be prescriptive, there are areas where guidelines are useful (e.g. dealing with stressed scenarios).

3. Key items covered in PG 6A

The key items covered in the PG include:

- Establishing a target capital framework – covers how target capital is defined, regulatory considerations, framework for how target capital is set and review process.
- Quantifying target capital – covers modelling approaches, allowance for management actions and validating target capital via stress and scenario testing.
- Using target capital as a management tool – including capital triggers, responding to capital depletion and allocating target capital through the company.

4. Degree of Convergence between Section 2.5 of ISAP 6 and PG 6A

Section 2.5 of ISAP 6 applies to an “actuary responsible for, or significantly involved in, developing, implementing, maintaining an ORSA for an insurer”.

Whilst an ORSA does not apply in the Australian context, Australian insurers are subject to an Internal Capital Adequacy Assessment Process (ICAAP), which operates on similar principles. PG 6A covers off the principles of each of the requirements of Section 2.5 of ISAP 6.

However, given that the ORSA does not directly apply in Australia, the extent of convergence between PG 6A and Section 2.5 of ISAP 6 can be classed as “medium” convergence (the local standard covers the same essential scope and content as the international model standard).

It should be noted that compliance with this PG will not necessarily result in compliance with Section 2.5 of ISAP 6. Therefore, where a Member is required to perform work in conformity with ISAP 6 (e.g. as the work is being undertaken in an overseas jurisdiction where ORSA applies), the Member should refer to the specific requirements of ISAP 6.

5. Relationship to Practice Guideline 1 (PG 1)

Compliance with PG 1 (General Actuarial Practice) (the Australian adaptation of ISAp1) is necessary to comply with PG 6A. This is appropriate given that the preface of ISAP 6 states that “If an actuarial standard-setting body wishes to adopt or endorse this ISAP, it is essential to ensure that existing standards are substantially consistent with ISAP 1 as this ISAP relies upon ISAP 1 in many respects. Likewise, any customization of this ISAP, or modification of existing standards to obtain substantial consistency with this ISAP, should recognize the important fact that this ISAP relies upon ISAP 1 in many respects”. In addition, Section 1.4 of ISAP 6 states that

“Compliance with ISAP 1 is a prerequisite for compliance with this ISAP”.

Whilst the nature of target capital means that it is set using feedback from multiple stakeholders, as opposed to solely being determined under advice from a Member, it is appropriate that PG1 apply to the portion of the work carried out by the Member.

6. Consultation Process

PG 6A was drafted by the TCWG and reviewed by the relevant Practice Committees and the Professional Standards Committee. The feedback from the Committees was taken into account in finalizing the Exposure Draft. The Exposure Draft was issued to Members for consultation. Following this, any relevant comments were incorporated. The final version was then approved by the Professional Standards Committee and then by Council.

7. Commencement Date

PG 6A is effective for relevant services provided on or after 1 April 2022.

End of Explanatory Memorandum