Current Regulatory Issues for Life Insurers

David Rush
General Manager, AMIRS
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Industry Background

Key Outcomes for 2006

- Life Insurance Assets up 9.1% to $240B
- Revenue up 10.6% to $38B
- Risk Insurance Premiums up 11.8% to $5.7B
- Investment Linked business >60% of all premiums
- Superannuation business:
  - nearly 90% of life assets
  - only 21% of total superannuation assets

Market Share

- Top 6 companies account for 85% of all assets
- Bank owned (or jointly owned) life company assets account for nearly 50% of all assets (up from 10% ten years ago)
- Market Share is less concentrated in risk insurance
- Only significant movements due to acquisition

Market Share – Assets @ 31/12/06

	Group	$ billion	Share (%)
1	**AMP**	**70.3**	**29.3**
2	**National Aust/MLC**	**51.8**	**21.6**
3	**ING/ANZ**	**28.8**	**12.0**
4	**Colonial/CBA**	**22.1**	**9.2**
5	**National Mutual / AXA**	**17.3**	**7.2**
6	**Westpac**	**14.0**	**5.8**
7	**Aviva**	**5.4**	**2.3**
8	**Suncorp Life & Super**	**4.9**	**2.0**
9	**Zurich Life**	**4.9**	**2.0**
10	**Tower Life**	**3.4**	**1.4**

Source: APRA Prudential Rules 26 collections

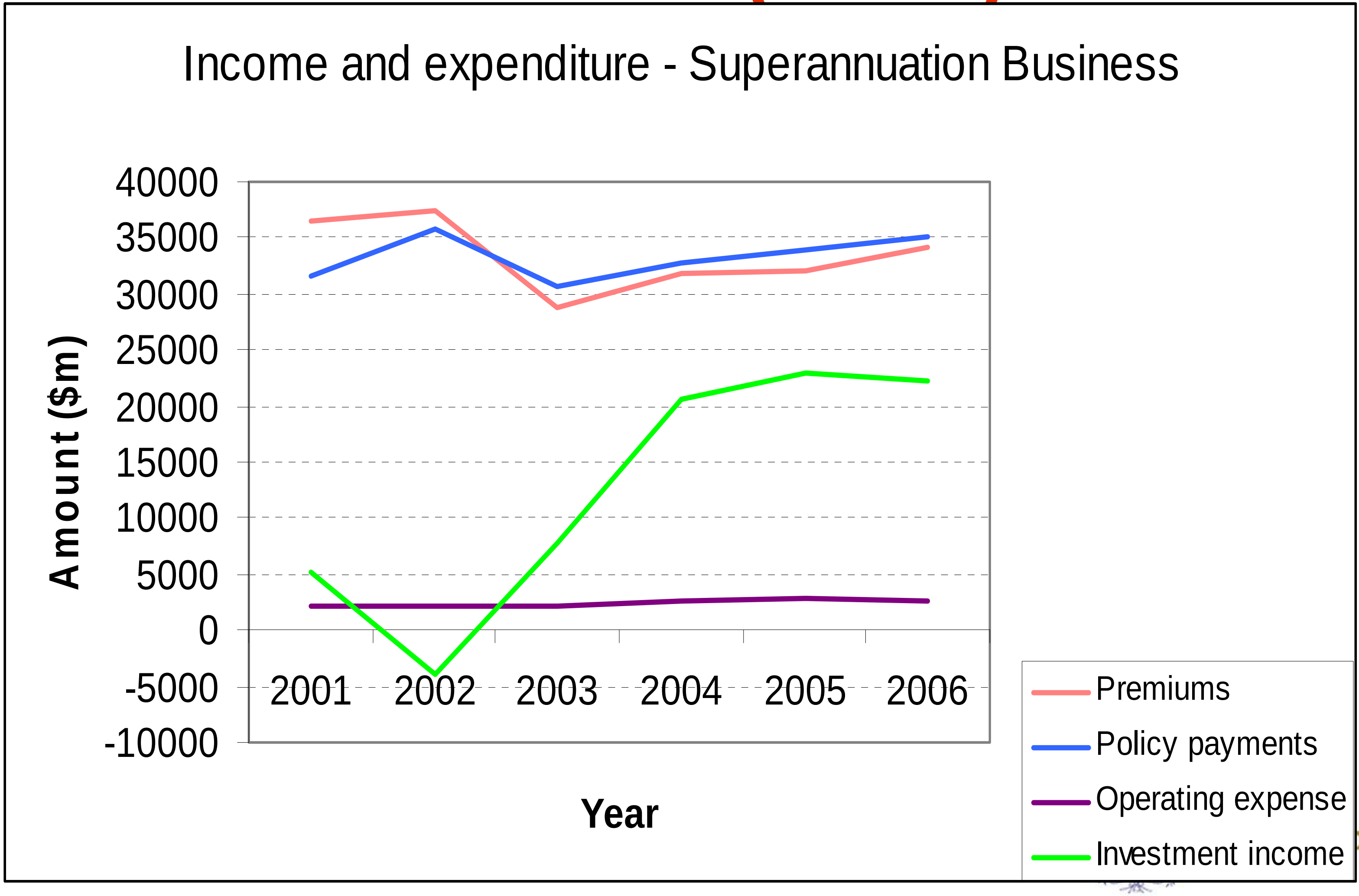
Market Share – Risk Premiums 2006

	Group	$ million	Share (%)
1	**Colonial / CBA**	**820.8**	**14.4**
2	**National Aust / MLC**	**726.7**	**12.8**
3	**ING / ANZ**	**699.1**	**12.3**
4	**Tower Life**	**610.5**	**10.7**
5	**National Mutual / AXA**	**577.0**	**10.1**
6	**AMP**	**559.3**	**9.8**
7	**Promina**	**351.8**	**6.2**
8	**AIG**	**262.7**	**4.6**
9	**Westpac**	**249.8**	**4.4**
10	**Aviva**	**169.0**	**3.0**

Cash Flow

- Over the last 5 years, net cash flow for industry has been either negative or marginally positive
- Asset growth has been entirely driven by investment returns

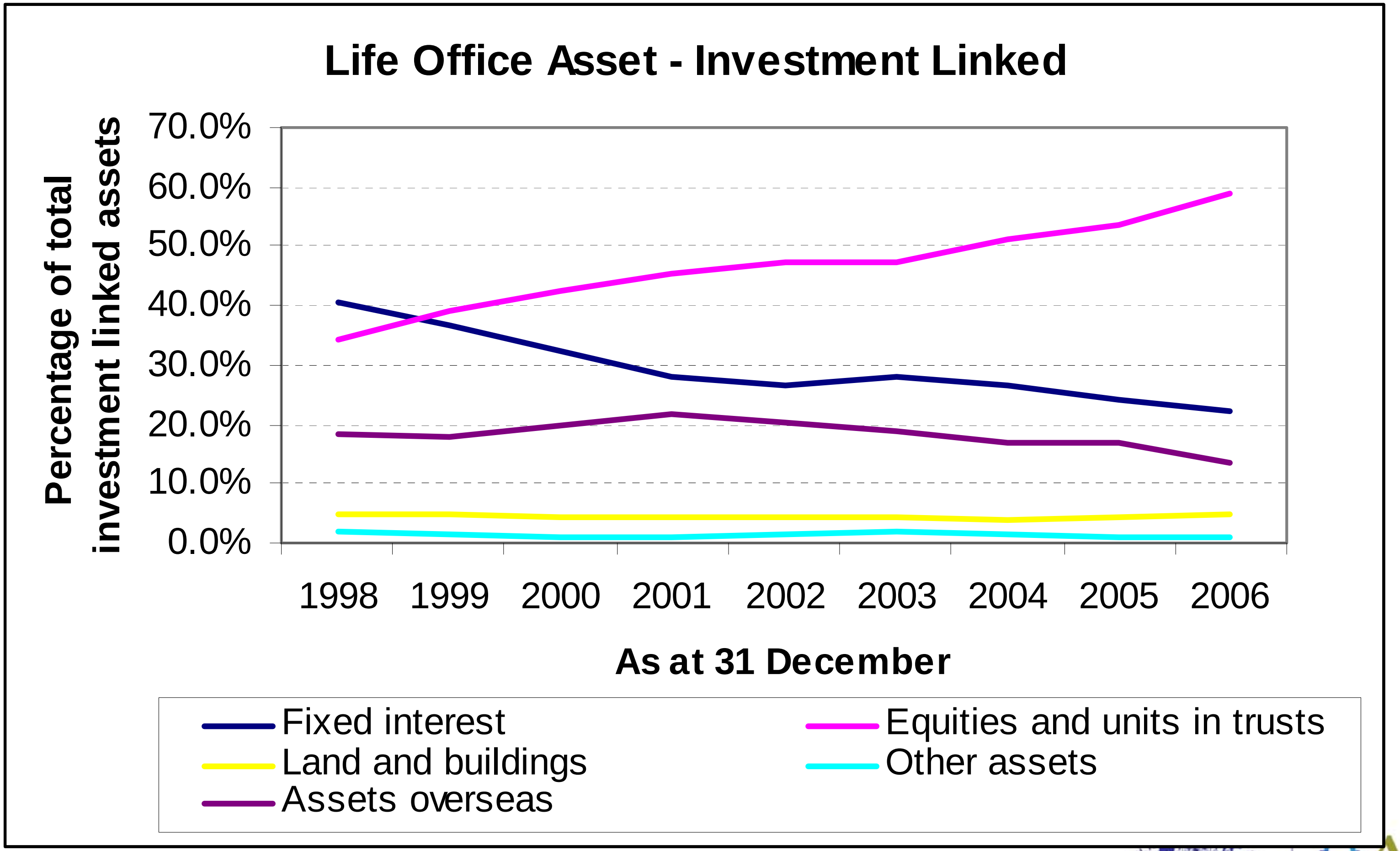
Cash Flow (Cont.)



Changing Asset Mix

- Significant change in asset mix over last few years
- All has occurred in investment linked business which is largely superannuation business
- Reflects increased risk profile in the superannuation asset choice in products where policyholders bear the investment risk

Changing Asset Mix (Cont.)



Profitability

- Total Profit increased by 5.4% in 2006 but shareholder's profit increased only marginally (<1%)
- The majority of profits still emerge from traditional risk or conventional business
- Investment Linked business accounts for over 70% of assets but less than 30% of shareholder's profit
- Over 30% of shareholder's profit comes from investment earnings on retained profits and remains very volatile.

Profitability (Cont.)

Source of Profits - All Statutory Funds by Type of Contract (year to 31 Dec 2006)

($ million)	*Life Insurance Contracts*	*Investment Linked Contracts*	*Other Life Investment Contracts*	*Total Statutory Funds*
Investment earnings on assets in excess of policy liabilities	753	122	-4	871
Emergence of planned profits				
Policy owner	1,180	0	2	1,182
Shareholder	903	148	33	1,085
Experience profit	280	32	50	362
Operating profit from other sources	11	-3	0	8
Financial instrument profit	0	227	21	248
Management services profit	0	198	1	200
Change in valuation methods and assumptions	38	0	1	39
Operating profit after income tax	3,165	725	105	3,995
Policy owner	1,484	0	4	1,488
Shareholder	1,681	725	101	2,507

Solvency & Capital Adequacy

- Industry capital well in excess of regulatory requirements
- In many cases in excess of target surplus measures
- Investment linked business accounts for 75% of policy liabilities but only 7% of reserves
- Greater consideration being given to capital management – e.g. securitisations - but few deals completed

Solvency & Capital Adequacy (Cont.)

Solvency and Capital Adequacy (year to 31 December)

($ million)	2000	2001	2002	2003	2004	2005	2006
Investment Linked Statutory Funds							
Base liabilities	115,896	118,157	113,809	116,632	131,400	149,629	168,124
Assets available for solvency reserve	1,677	1,578	1,633	1,555	1,462	1,770	1,901
Solvency reserve	645	630	567	471	440	666	757
Assets available for capital adequacy	1,677	1,578	1,633	1,555	1,462	1,770	1,901
Capital adequacy reserve	733	670	632	585	459	734	842
Non-investment Linked Statutory Funds							
Base liabilities	57,985	57,160	56,861	56,713	57,366	56,098	55,500
Assets available for solvency reserve	14,340	13,723	11,058	11,137	13,445	14,836	14,135
Solvency reserve	8,020	7,936	6,771	5,985	6,732	8,404	7,655
Assets available for capital adequacy	14,340	13,723	11,058	11,137	13,445	14,836	14,135
Capital adequacy reserve	10,535	9,922	8,260	7,841	8,235	11,175	11,427

Prudential and Regulatory Issues

- Legislative and Regulatory Reform
- Life Industry Statistical Collection
- Product Rationalisation (Product Complexity and Operational Risk)
- Unit Pricing Issues
- Risk Insurance Premium Cycles and Experience Studies
- Pandemic Planning and Stress Tests
- Other

Legislative and Regulatory Reform

- Statement of Intent:
  - Regulation that is principles based
  - Supervision that is risk based
- Harmonised standards and associated guidance:
  - LPS510 / LPG510 Governance – from 1 October 2006
  - LPS520 / LPG520 Fit and Proper – from 1 October 2006
  - LPS231 / PPG231 Outsourcing – from 1 April 2007

Legislative and Regulatory Reform

- New standards/guidance on risk management & BCM
- Issued March 2007 to apply from 1 January 2008
- LPS220 Risk Management
  - LPG200 Risk Management
  - LPG230 Operational Risk
  - LPG240 Life Insurance Risk and Life Reinsurance Risk
  - LPG250 Asset and Liability Management Risk
  - LPG260 Conflicts of Interest under Section 48
- LPS232 Business Continuity Management
  - LPG232 Business Continuity Management
- Also replace outdated FS standards

APRA

Legislative and Regulatory Reform

- Streamlining Prudential Regulation - legislation passed through both houses last week!
- Life Act simplified and made less prescriptive – key elements of interest take effect on 1 January 2008
  - remove provisions better placed in APRA's prudential standards
  - simplify appointment processes for auditors and actuaries
  - responsibility for actuarial standards transferred from LIASB to APRA
  - simplify the range of legislative instruments
- Accompanying standards exposed in August 2007 – initially maintain existing provisions

Life Industry Statistical Collection

- Data collected for supervision and statistical publication
- Old collections outdated
- Informal discussions with industry in November 2006
- Proposal:
  - Under FSCODA rather than Life Act
  - Using D2A internet based technology
  - 15 new forms replacing 53 old forms
  - Move to quarterly collection – including profit and capital
  - More detailed analysis by product group
  - To start from Q1 2008
- Formal consultation April to June 2007

Life Industry Statistical Collection

- Response:
  - Removing 2 forms
  - Converting 2 forms (at product group level) from quarterly to annual
  - Extending deadlines for annual submission
  - Allowing transitional extended deadlines for first 2 submissions
  - Reinstating some regular premium movement statistics
  - Streamlining of other forms and clarification of requirements
  - Addressing sensitivity issues
  - Only annual returns to be audited
  - No cost data supplied

Product Rationalisation

- Operational risk created by legacy products
- Treasury Issues Paper released in June 2007
- To be followed by Options Paper and consultation
- Mechanism must not weaken protection for policyholders
- Policyholders need fair compensation for contract breach
- Need independent, knowledgeable decision maker
- Must be accompanied by industry efforts at:
  - reducing complexity
  - "future proofing"
- Impact of Metlife/Challenger case?

Unit Pricing Issues

- A recurring problem over many years – not confined to life insurers
- Problems still arising – e.g. through (lack of) integration of systems inherited via acquisition
- Compensation and rectification costs well into 9 figures
- Joint APRA/ASIC Guide – catalyst for improvements in risk management and control framework
- Systems becoming more robust
- Boards and management more conscious of their responsibility
- Crediting rates

Risk Insurance

- Trend from individual to group insurance
- Robust pricing and risk management needed in face of competitive pressures
- Evidence of an “insurance cycle”
- Potential complacency in group market under benign economic conditions
- Impact of rating houses - unsustainable benefits (particularly DI)?
- Lack of experienced underwriting and claims management staff – need for training
- Effect of automated underwriting?

APRA

Experience Studies

- An industry issue
- Would expect there to be actuarial involvement
- Increasing capital requirements is not a palatable alternative
- APRA may have to become directly involved (??)

Pandemic

- APRA working to ensure that financial system can cope
- Pandemic planning different from BCP in terms of duration and impact - separate guidance – PPG233
- Stress testing exercise for insurers – consistent estimation of impact of prescribed scenarios
  - Gauge level of pandemic that would cause financial difficulty
  - Greatest impact on reinsurers and direct writers of risk business
  - Being considered by Risk Business Capital Taskforce
- APRA has also developed its own pandemic plans

Other

- Disqualification processes and merits review
- S116 reports:
  - Reinsurance
  - Group insurance
  - Some quality issues – data analysis for assumptions
- Risk based capital developments:
  - Resilience – separate IAAust taskforce
  - Risk Business Capital – separate IAAust taskforce
- Peer Review – will gauge impact on GI first
- IASB Phase II – links with IAAust, AASB, IAIS
- International Solvency – IAIS, Solvency II

Biennial Convention 2007

Adventures in Risk

23-26 September 2007 • Christchurch, New Zealand

Institute of Actuaries of Australia

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