
EXPLANATORY MEMORANDUM TO PROFESSIONAL STANDARD PS 102 FINANCIAL CONDITION REPORT

June 2019

A. About this Explanatory Memorandum

This Explanatory Memorandum has been prepared to assist Members in understanding the rationale underlying the new Professional Standard 102 Financial Condition Report (PS 102).

PS 102 is a professional standard that is cross practice, applying to the preparation of a Financial Condition Report (FCR) for life companies including friendly societies (hereafter in this Explanatory Memorandum referenced as life companies), general insurance companies and private health insurance companies.

PS 102, is one of five professional standards to address the requirements under the Australian Prudential Regulation Authority's (APRA's) Prudential Standard CPS 320 Actuarial and Related Matters which comes into effect 1 July 2019 (CPS 320). The five new standards are as follows:

- ▶ PS 102 Financial Condition Report - cross practice standard addressing the production of Financial Condition Reports – the subject of this Explanatory Memorandum.
- ▶ PS 103 Actuarial Review -cross practice standard addressing actuarial reviews required by APRA.
- ▶ PS 201 Actuarial Advice to a Life Insurance Company or Friendly Society.
- ▶ PS 202 Actuarial Valuations for Life Insurance Companies (Including Friendly Societies and Eligible Foreign Life Insurance Companies).
- ▶ PS 302 Valuations of General Insurance Claims.

Currently, professional standards for advice, in particular in relation to the financial condition of a company, to life insurers, general insurers and private health insurers are set out in their respective practice standards being:

- ▶ Life insurance companies: Professional Standard 200 Actuarial Advice to a Life Insurance Company or Friendly Society (PS 200), which was most recently issued in July 2015;
- ▶ General insurance companies: Professional Standard 305 Financial Condition Reports and Review of Run-off Plans for General Insurers (PS 305), which was most recently issued in March 2013;
- ▶ Private health insurance companies: Professional Standard 600 Financial Condition Reports for Private Health Insurers (PS 600), which was most recently issued in March 2017.

B. Feedback on Exposure Draft

The Exposure Draft for PS 102 was released for member consultation during the period 19 February 2019 to 22 March 2019. Five pieces of written feedback were received, detailed feedback from two large consulting firms and shorter feedback from individual members.

On 5 March 2019 an Actuaries Institute Insight session presented on the new professional standards. This included a summary of the work done to produce the standards, the specific issues relevant for each practice area, and the key questions on which feedback was sought.

A summary of the main points raised through the session and the written feedback is as follows:

- ▶ The standards should not contain excessive use of “must” and “disclose”, which could be detrimental either in terms of requiring an increase in the length of a formal report or not being appropriate in all circumstances.
- ▶ There was a request for clarity on the commencement date of the standards, particularly for companies with an annual balance date of 30 June 2019.
- ▶ There were suggestions that there was a need to consider “customer value” or customer needs when giving actuarial advice and discussion of whether this should be mandated in professional standards or addressed through other guidance.
- ▶ There was a suggestion to include an option to seek APRA guidance when Members were unsure of or require specific guidance regarding their legal obligations.
- ▶ There was a suggestion to include commentary to better support the aim of making the Appointed Actuary’s role more strategic in an organisation.

This resulted in the following significant changes for PS 102:

- ▶ Inclusion of commentary on what is meant by an Entity’s financial condition (clause 1.1.1).
- ▶ A new clause 1.1.2, indicating that where a Member is asked to prepare a FCR for a body other than an Entity they should take account of the general considerations in PS102.
- ▶ Additional wording in clause 1.3.7 to include seeking regulator clarification if required;
- ▶ Further clarification of the terms ‘disclose’ and ‘record’ (clause 3.1) as outlined in Section D below.
- ▶ Clarification in clause 6.6.3 that the risk of premium rates and charges becoming inadequate must be disclosed only if this is likely to occur.
- ▶ The Risk Management Framework section (clause 6.10) has been changed to better reflect the new Appointed Actuary requirements, i.e. to provide general observations on the overall framework, focussed on financial and non-financial risks that could have a Material

adverse effect on the financial condition of the Entity.

- ▶ Additional guidance provided for Appointed Actuaries of General Insurance companies in run-off (clause A.3.4), including whether the run-off plan and supporting financial projections are reasonable and adequate.
- ▶ Change to the commencement date (clause 2), as discussed in Section E below.

In response to the feedback that there was a need to consider “customer value”, additional wording has been included in clause 6.6.2 to specify that, when undertaking an assessment of pricing, consideration must include the likely outcome for the customer. More broadly, there is support for the notion that the profession has an obligation to have a strong focus on customer treatment going forward, and each Practice Committee will be considering how best to give guidance to Members on this.

In response to feedback that certain mandatory aspects of the standard were too onerous, each instance highlighted was reviewed. It is important for Members to note that all work performed under the standard is subject to the Materiality considerations set out in clause 4. Given this, in most instances it was concluded that changes were not warranted. However in a number of instances the wording was altered, for example, to clarify that an Appointed Actuary is not required to consider **all** aspects of a matter (and, hence, by implication can apply Materiality considerations).

Other minor grammar corrections have also been made which do not change the obligations on Members.

C. Background to PS 102

As part of its regulation of insurers, APRA issued CPS 320 in June 2018. It will replace LPS 320 Actuarial and Related Matters (LPS 320) for life insurers, GPS 320 Actuarial and Related Matters (GPS 320) for general insurers and HPS 320 Actuarial and Related Matters (HPS 320) for private health insurers. LPS 320, GPS 320 and HPS 320 all had requirements for a financial condition report.

Similar to CPS 320, under GPS 320, there is already a requirement for separate financial condition and actuarial valuation reports. However, under LPS 320 separate reports were not required, and life insurers traditionally had one report covering both. It should be noted that a financial condition report is required for private health insurers but there is no requirement for an actuarial valuation report under either CPS 320 or HPS 320 for private health insurers.

As the prudential requirement for a financial condition report applies across all insurance practice areas, PS 102 has been produced to provide consistent cross-practice professional requirements. In particular, this Standard has been developed by actuaries across all three practice areas, taking into account current content in PS 200, PS 305 and PS 600, as it relates to the financial condition report. The structure of PS 102 reflects the structure of CPS 320 and the order in which different aspects of the work are usually completed.

D. Key additions and differences to PS 200, PS 305 and PS 600

Key differences in PS 102 compared to the current requirements in PS 200, PS 305 and PS 600, where applicable to the financial condition report are set out below.

It should be noted that, while some of the main additions and differences in PS 102 from PS 200, PS 305 and PS 600 are set out below, a reading of PS 102 in its entirety is needed to fully understand the differences.

Section 1 Introduction

PS 102 applies to Appointed Actuaries and Members supporting the Appointed Actuary in providing advice on the financial condition of the entity.

The introduction has a consistent structure and content as other professional standards.

PS 102 must be applied in the context of the relevant legislation, relevant accounting and auditing standards, and the actuarial advice framework.

Clauses 1.3.3, 1.3.4 and 1.3.5 outline the requirements where a Member finds that they cannot carry out their work in a way that complies with PS 102.

Clause 1.3.6 outlines the requirements where work performed is Prescribed Actuarial Advice.

Later clauses provide further detail on what is meant by 'cannot carry out the work', for example, clause 6.2.2 allows the Member to omit analysis in some situations subject to providing reasons as to why, detailing the limitations and providing an assessment of the consequences.

Section 3 Definitions

There are 2 important new definitions that Members should be aware of:

- **'To disclose'** means to include information within a written communication, such as a Report where one is prepared.
- **'To record'** means to include information within working papers or other documentation, but this information does not need to be included in written Reports or similar communication.

Previous professional standards across practice areas were not always clear on what was meant when information had to be 'documented'. All standards being released in June 2019 introduce the terms 'disclose' and 'record' to clarify expectations of Members when carrying out actuarial work. PS 102 introduces these terms to indicate when the Member has to include information in a Report when giving actuarial advice (i.e. **disclose**) or when the information need only be recorded in working papers (i.e. **record**).

Section 4 Materiality

The Materiality definition has not changed from PS 200.

In producing PS 102, there was debate whether the definition of materiality for actuarial advice must be in accordance with any relevant requirements of the Actuarial Advice Framework. It was decided that, while Members giving advice should be aware of the materiality set within the Actuarial Advice Framework, Members should not always be bound by this in carrying out their duties.

Section 5 Scope of FCR

Clause 5.1.1 has specified that the criteria used for assessing the financial condition must be stated, including a summary of the reasons in reaching the assessment. It also specifies that the assessment can be both financial and non-financial; to the extent that non-financial risks may impact on future financials of the entity, they should be considered in reaching the financial condition conclusion.

The matters that must be included in the FCR are stated in clause 5.1.2 and are consistent with CPS 320.

Section 6 Reporting requirements of the FCR

6.2 and 6.3 (Data/Information Requirements and Reliance on Others) sets out requirements where the Member places reliance on others to provide information required. This includes options and requirements where the Member is not satisfied with the work performed.

6.4 (Business Overview) has made an explicit requirement for the FCR to consider any developments in the entity's operating environment that may materially impact on its future financial position. This is to broaden the considerations made by the Appointed Actuary, in line with APRA's intention for the Appointed Actuary to continue being a strategic adviser for the business.

6.5 (Valuation of insurance liabilities) provides a summary of the key results from the Actuarial Valuation Report or Insurance Liability valuation which should be included in the FCR.

6.6 (Pricing) has been broadened, with respect to the requirements under CPS 320, for the pricing assessment to include both the suitability and adequacy of premiums.

6.7 (Reinsurance arrangements), encompasses reinsurance and other risk mitigation strategies. For example, health insurers may consider risk equalisation instead of reinsurance.

For 6.10 (Risk management framework) and 6.11 (Capital management), the member is only required to make general observations per the requirements of CPS 320.

6.12 (Current and future profitability and capital adequacy) includes a requirement to assess the current and future capital position with respect to previous capital targets, where these

exist. Practice-specific considerations have been expanded further in the respective Appendices.

6.15 (Actuarial Advice Framework) (AAF) is a new section per the requirements of CPS 320. This requires observations on the AAF including its effectiveness, operation, and material concerns if any.

E. Commencement date

This Professional Standard applies to any relevant advice or Report given to an Entity in respect of an Effective Date on or after 1 July 2019 unless an Entity adopts CPS 320 from an earlier date. If an Entity adopts CPS 320 from an earlier date, including the option of adopting for a 30 June 2019 balance date, then this Professional Standard will apply from this adoption date. The option of adopting for a 30 June 2019 balance date is consistent with APRA guidance issued on 8 April 2019, namely that “insurers with a 30 June 2019 balance date may elect to comply with the FCR and AVR requirements set out in either CPS 320 or in the prudential standard relevant to the insurer (Prudential Standard GPS 320 Actuarial and Related Matters, Prudential Standard LPS 320 Actuarial and Related Matters or Prudential Standard HPS 320 Actuarial and Related Matters).”

The aspects of PS 200, PS 305 and, PS 600 relevant to the matters covered by PS 102 will be withdrawn at the time that PS 102 becomes effective.

END OF EXPLANATORY MEMORANDUM