



EXPLANATORY MEMORANDUM TO

PROFESSIONAL STANDARD 310: ACTUARIAL CERTIFICATION OF PREMIUM RATES UNDER THE NSW MOTOR ACCIDENTS SCHEME

June 2010

A. Introduction

On 1 March 2006, the Institute issued a Policy for Drafting Professional Standards (the "Policy") which was subsequently amended in June 2006. The Policy is designed to ensure that all Professional Standards use consistent and objective terminology such that mandatory duties and requirements for members are clearly defined and understood.

As a result, all existing Professional Standards and Guidance Notes are to be re-drafted in accordance with the Policy as either a Professional Standard or Practice Guideline.

Under the Policy, a Professional Standard:

- ▶ details mandatory practice requirements (including the duty to exercise a discretion and a duty to properly explain an exercise of such discretion) in an area; and
- ▶ contains principles and/or directions from which it would be unprofessional to depart.

Given that:

- ▶ the role of the actuary in premium rate certification is provided for by legislation;
- ▶ Guidance Note 351 covered technical aspects of actuarial work; and
- ▶ compliance with Guidance Note 351 was mandatory,

the General Insurance Practice Committee ("GIPC") formed the view – endorsed by both the Professional Standards Committee and Council – that it would be appropriate to convert Guidance Note 351 to a Professional Standard. This would clarify the responsibilities of the actuary, which would both enhance the actuarial profession and help to protect the public interest.



As such, in late 2006, the GIPC established a drafting committee consisting of Paul Driessen,¹ Richard Mayo, Aaron Cutter, Stewart McCarthy and Adrian Gould² to develop a proposed PS 310 to convert existing Guidance Note 351 in accordance with the Policy and to update the standard generally. PS 310 replaces Guidance Note 351.

B. Consultation process

In November 2009, an Exposure Draft of the proposed PS 310 was released for member comment. Two submissions were received and considered, and some changes made since the Exposure Draft version as a consequence. These changes may be found in the definition of 'Average Premium' in section 3 and in section 4.2.5. The only other substantive change since the Exposure Draft was to the form of wording in the actuarial certifications set out in the Attachment to PS 310.

C. Key issues considered in drafting PS 310

This section sets out the key issues which were considered in developing PS 310.

C.1 Premium Filing Reports

Traditionally within the CTP industry, Premium Filing Reports have been referred to as the Actuarial Report. This has created some confusion as to what Guidance Note 351 referred. To clarify, the Premium Filing Report is a report issued by the insurer to justify the set of premium rates that the insurer wishes to charge.

While distinctly actuarial in content, it is not necessarily the work of an actuary, it is not required to be signed by an actuary (or usually anyone else), and it does not constitute Prescribed Actuarial Advice under the Institute's Code of Professional Conduct. The contents of the Premium Filing Report are prescribed by the MAA.

The Professional Standard is directed purely at the certification provided by the external Certifying Actuary.

C.2 Investment returns

While professional standards such as PS 300 have prescribed that risk free rates be used to discount future claim payments, this has not been the case with the discount rates chosen for CTP rate filings. Insurers have been free to choose any rate they like which is consistent with their investment strategy, although in practice any departures from risk free rates have been minor in recent years. PS 310 is not any more prescriptive in this respect than in the past.

¹ Paul Driessen left the committee in July 2008.

² Adrian Gould originally joined the committee as a representative of the NSW Motor Accident Authority (MAA), but fully participated in the drafting process.



C.3 Profit / return on capital

Guidance Note 351 was quite vague on how the profit margin in the Average Premium rate in a rate filing should be assessed.

The requirement is for the Certifying Actuary to assess the return on capital implied by the profit margin in the Average Premium rate. In undertaking this assessment, the Certifying Actuary is required to consider the amount of capital required to support this class of business with reference to APRA's Prescribed Method for calculating the minimum capital requirement for CTP, contained in Prudential Standard GPS 110.

The Certifying Actuary is further required to consider the adequacy of the return on capital implied by the profit margin with reference to the return on a Replicating Portfolio (that is, the "risk free" rate) and the risks specific to the insurer's own portfolio.

C.4 Comparisons to industry

Guidance Note 351 prescribed that there must be an assessment of industry experience, then the insurer's own experience, and then a judgment on the insurer's own future experience. However, there are some insurers whose size is such that comparisons to the industry are unnecessary to form a credible view of claims costs. As such, this blanket requirement has been removed and left as a matter of discretion as to whether, in the case of a particular insurer, there needs to be a comparison to industry or not. The Certifying Actuary must consider whether the insurer's own data is sufficiently credible to disregard industry experience.

C.5 Replicating Portfolio

It is noted, in respect of the definition of "Replicating Portfolio" and references to such in PS 310, that this definition repeats that found in PS 300 (as issued in February 2010). Although a minor change was made to the definition during the course of the last review of PS 300, this definition has not, in developing PS 310 or the revised PS 300, been reviewed or materially changed. However, following the completion of other Institute projects considering a possible more universal cross-practice view of risk free discount rates, this definition may be reviewed further.

D. Commencement date

PS 310 takes effect for premium certifications on premiums to be written from 1 October 2010.

END OF EXPLANATORY MEMORANDUM