NEW ZEALAND SOCIETY OF ACTUARIES

PROFESSIONAL STANDARD No. 13

LIFE INSURERS - FINANCIAL CONDITION REPORT

INDEX

1 INTRODUCTION

1.1 Application

1.1.1 This Professional Standard applies to Appointed Actuaries producing a Financial Condition Report (FCR) under the Solvency Standard for Life Insurance Business made under Section 55 of the Insurance (Prudential Supervision) Act 2010 or under any other Reserve Bank of New Zealand (RBNZ) standard applicable to the Life Insurer.

1.1.2 Where the Entity carries on insurance business that is not life insurance business, that is subject to the requirements of another solvency standard relevant to that non-life insurance business, as set out in paragraph 5 of the Solvency Standard, the Appointed Actuary must also take into account the requirements of that other solvency standard and of the Society's Professional Standard 12 – *Non-Life Insurers – Financial Condition Report,* with respect to preparation of the FCR.

1.2 Purpose

1.2.1 The purpose of this Professional Standard is to provide Appointed Actuaries with principles and directions that must be followed with regard to an impartial assessment of an Entity's financial condition and preparation of the FCR.

1.2.2 The assessment includes discussing, and quantifying where practicable, the implications of Material risks to the financial condition of the Life Insurer identified during the assessment and, where these implications are adverse, making recommendations as to how to address these risks.

1.3 Previous Versions

Professional Standard 1 previously covered all reporting for life insurance entities. This Professional Standard takes precedence over Professional Standard 1 in regards to the preparation of a Financial Condition Report.

1.4 Legislation

1.4.1 From 7 September 2010, the Act provides for the RBNZ to issue prudential standards, regulating the activities of and imposing requirements on Insurers.

1.4.2 The Solvency Standard mandates that the Appointed Actuary must prepare an FCR in accordance with Section 56(d) of the Act.

1.4.3 If there is a difference between this Professional Standard and the applicable legislation, the legislation takes precedence. In this context, legislation includes the Regulations, any applicable standards issued under the authority of the Act, and any material incorporated by reference under Section 58 of the Act.

2 EFFECTIVE DATE

This Professional Standard takes effect on balance dates from and including 30 September 2013.

3 DEFINITIONS

Unless the context otherwise requires:

“Act” means the Insurance (Prudential Supervision) Act 2010.

“Actual Solvency Capital” has the meaning given in the Solvency Standard.

“Appointed Actuary” has the meaning as defined in the Act.

“Board” means the directors of an Entity, or equivalent.

“Entity” means the Insurer or group of Insurers which is the subject of the FCR.

“Entity’s Plans” means the plans of the Entity, current at the Report Date, including but not limited to budgetary, business, strategic and capital management plans.

“FCR” means Financial Condition Report having the meaning given in the Solvency Standard.

“Insurer” means a licensed insurer as defined in the Act.

“Life Fund” has the meaning given in the Solvency Standard

“Life Insurer” has the meaning as defined in the Act.

“Material” means significant in the professional judgement of the Appointed Actuary. “Materiality” and “Materially” have a consistent meaning to Material. The Appointed Actuary must have due regard to the definition of Materiality in the Solvency Standard.

“Minimum Solvency Capital” has the meaning given in the Solvency Standard.

“NZ IFRS 4” means the New Zealand equivalent of International Financial Reporting Standard 4, issued by the External Reporting Board (an independent Crown Entity, established under section 22 of the Financial Reporting Act 1993, and subject to the Crown Entities Act 2004, which is responsible for developing and issuing accounting standards in New Zealand).

“Participating Business” has the meaning given in the Regulations.

“Policy Liability” means a liability calculated in accordance with the requirements of NZ IFRS 4 and the Society’s Professional Standard 3 – Determination of Life Insurance Policy Liabilities.

“Policy Liability Valuation” means a valuation of Policy Liabilities.

“Professional Standard” means a professional standard of the Society.

“RBNZ” means the Reserve Bank of New Zealand.

“Regulations” means the Insurance (Prudential Supervision) Regulations 2010.

“Report Date” means the Entity’s financial year end to which the FCR relates (or any other date to which the FCR relates if not a financial year end).

"Society" means The New Zealand Society of Actuaries.

"Solvency Margin" has the meaning given in the Solvency Standard.

"Solvency Standard" means the RBNZ Solvency Standard for Life Insurance Business made under Section 55 of the Act and includes any conditions imposed by the RBNZ specific to the Entity and any alternative RBNZ standard applicable to the Life Insurer.

4 MATTERS TO CONSIDER AND REPORT

4.1 Statements by the Appointed Actuary

4.1.1 The Appointed Actuary must identify the Entity that is subject of the FCR and the Report Date and must sign and state the date of completion of the FCR.

4.1.2 The Appointed Actuary must state their opinion as to whether:

(a) The Policy Liabilities have been calculated in accordance with the requirements of NZ IFRS4 and the Society's Professional Standard 3: Determination of Life Insurance Policy Liabilities

(b) The policy information used to obtain the valuation of insurance liabilities is Materially accurate

(c) All assumptions and methods used are appropriate for use in this investigation and for the Entity's insurance contracts

(d) All actuarial work in determining the Solvency Margin was carried out in accordance with the Solvency Standard and all Professional Standards issued by the Society

(e) In their opinion and from an actuarial perspective, the Entity is maintaining the Solvency Margin that applies under its licence

(f) The Entity is likely to maintain the Solvency Margin that applies under its licence at all times within the next three years, taking account of their forward looking assessment of the solvency position, the Entity's business plans, risk management practices and the external environment

(g) The Entity needs to consider reporting to the RBNZ under section 24 of the Act

(h) The steps taken by the Entity to address the Material risks that pose a threat to its ability to meet the Solvency Standard now and in the future are adequate

(i) The FCR has been prepared in accordance with this Professional Standard.

4.1.3 In addition to the contents of this Professional Standard, in deciding on the content and the level of detail for reporting, the Appointed Actuary must have regard to the reporting requirements given in the Society's Professional Standard 9.

4.2 Information

4.2.1 The Appointed Actuary must advise the Entity of the additional information that they do not have access to in the normal course of their work that is required to prepare the FCR. Information includes data and reports that the Appointed Actuary will need, as well as information obtained from staff and relevant contractors of the Entity with whom the Appointed Actuary will need to consult.

4.2.2 The Appointed Actuary must document in the FCR the steps taken to verify to the extent possible the consistency, completeness and accuracy of the information provided by the Entity. Material discrepancies that cannot be resolved with the Entity must be reported in the FCR, together with the consequent limitations of the FCR.

4.2.3 Where the Entity does not provide adequate and timely access to Material information (including data and reports) and staff as required by the Appointed Actuary, and the information cannot otherwise be practically obtained, the Appointed Actuary will need to determine whether the issue is serious enough that they should not complete the FCR or should qualify the FCR.

4.2.4 The Appointed Actuary may need to deal with issues that are not within the relevant skills and experience of the Appointed Actuary. In this situation the Appointed Actuary will need to utilise the skills and experience of others and may rely on other relevant experts provided adequate disclosure is included on the nature of that reliance.

4.3 Materiality and Material risks

4.3.1 The Appointed Actuary must take Materiality into account when preparing the FCR. Whether something is Material or not will be a matter requiring the exercise of the Appointed Actuary's judgement.

4.3.2 The level of detail to be provided in the FCR will depend on the size and complexity of the operations of the Entity and considerations of Materiality.

4.3.3 If, in the opinion of the Appointed Actuary, a matter that is required by this Professional Standard to be commented on poses no Material risks to the financial condition of the Entity, now and in the future, the Appointed Actuary may note this in the FCR and no further reporting is required in respect of this matter.

4.3.4 If the Appointed Actuary identifies additional Material matters not detailed in this Professional Standard the Appointed Actuary must include such matters in the FCR.

4.4 Level of detail

4.4.1 The Appointed Actuary should address each matter for consideration (as detailed in section 4.5) separately for each Life Fund.

4.4.2 Unless otherwise required by the RBNZ, a single FCR may be produced for an insurance group. Where the FCR is produced for an insurance group, this single FCR must address separately the operations of each Entity within that insurance group authorised to carry on insurance business.

4.5 Matters for Consideration

4.5.1 Business and operations

(a) The FCR must include general background information about the corporate structure and operations of the Entity. It must also include relevant information about the external environment in which the Entity operates.

(b) General background information includes relevant information about the Entity's Plans, including any conditions imposed on the Entity by the RBNZ, the nature, terms and conditions of the contracts in force and currently being sold with particular reference to all options and guarantees, and the scope for adjusting the terms and conditions in the light of emerging experience.

(c) The Appointed Actuary must comment on Material risks to the financial condition of the Entity, now or in the future, arising from the Entity's Plans and any Material risks that directly relate to the ongoing management of the Entity at the Report Date.

(d) In preparing the FCR, the Appointed Actuary must comment on whether they are aware of any potential for other parts of the corporate group to which the Entity belongs, to Materially affect the Solvency Margin of the Entity now or in the future.

(e) In preparing the FCR, the Appointed Actuary must comment on whether they are aware of any operational risk matters that have the potential to Materially affect the Solvency Margin of the Entity now or in the future.

4.5.2 Participating Business

(a) Participating Business is written on the basis that the benefits may be varied. This may enable an Entity to accept risks more confidently in the knowledge that adjustments can be made as experience unfolds. A purchaser of such a policy shares the risk to some extent and is entitled to be treated equitably in the light of that experience.

(b) The expression "reasonable benefits" describes benefits which fall within a range which could reasonably be held to recognise the risk sharing features of this business.

(c) The Appointed Actuary must comment on:

- the equity of the allocation of profit to, and within classes of, Participating Business;
- the equity of any apportionment of cashflows to, and within classes of, Participating Business;
- the surrender value basis, its equity and sustainability;
- current bonus rates compared to historical and long term supportable bonus rates;
- the ability of the Entity to provide reasonable benefits to its policyholders going forward; and
- the Material risks associated with the ability to provide reasonable benefits and the actions the Entity is taking to mitigate those risks.

4.5.3 Unit Pricing

(a) The Appointed Actuary must comment on the extent to which the unit pricing system determines a unit price so that new, continuing and terminating policy owners are treated equitably and in accordance with policy terms and conditions.

(b) The Appointed Actuary must comment on the robustness of the unit pricing approach and system, including the segregation of assets, asset valuation and the processes in place to identify and rectify errors.

(c) The Appointed Actuary must comment on the discretions that the Entity has in determining unit prices and on the equity and the manner in which the Entity proposes to exercise those discretions.

4.5.4 Recent experience

(a) The Appointed Actuary must comment on the past performance of the Entity, both from a financial reporting and a solvency point of view, including consideration of significant features or trends in the Entity's recent experience, over a period of at least the three years immediately preceding the Report Date, to the extent that information about that recent experience is available.

(b) Deviations of actual experience from the expected experience in the Entity's Plans over at least the period since the previous balance date must also be discussed, including an assessment of the reasons for these deviations.

(c) The Appointed Actuary must comment on the steps taken, or proposed to be taken, by the Board or senior management of the Entity to address any areas of Material adverse experience.

(d) The Appointed Actuary must provide an analysis of both the profit reported and solvency surplus emerging that identifies the key drivers of the emerging profit/surplus over the year and the ramifications for future potential profit and solvency results.

4.5.5 Assumptions

(a) The Appointed Actuary must set out and discuss in the FCR all the Material actuarial assumptions used in the investigation, including the process used to determine the assumptions.

(b) The Appointed Actuary must set out and discuss in the FCR any Material risks and issues identified during the investigation relating to the actuarial assumptions used in the investigation, including sensitivity analysis.

(c) The Appointed Actuary must discuss the financial significance of changes in assumptions made since the previous investigation and the reasons why the changes were made.

4.5.6 Insurance Risk

(a) The Appointed Actuary must outline and comment on Material risks arising from the Entity's underwriting and claim management practices.

(b) The Appointed Actuary must comment on premium adequacy.

(c) The Appointed Actuary must comment on Material risks arising from exposure to large claims, claims variation and events such as catastrophes or pandemics.

(d) The Appointed Actuary must comment on Material risks arising from exposure to policy discontinuances.

4.5.7 Policy Options and Guarantees

(a) The Appointed Actuary must comment on any policy options and guarantees, including the likely risks associated with providing for these features if Material.

(b) Any potential impact on the current or future financial condition resulting from any policy options or guarantees should be specifically noted.

4.5.8 Insurance and other liabilities

(a) The FCR must include a summary of the Policy Liabilities and Material considerations arising from the Policy Liability Valuation.

(b) The Appointed Actuary must comment on the Material risks arising from the Entity's other liabilities.

4.5.9 Investments and other assets

(a) The Appointed Actuary must comment on the Entity's approach to asset management, state its investment philosophy and summarise the asset allocation.

(b) The Appointed Actuary must take into account the relationship between the nature and term of the Entity's assets and corresponding liabilities and comment on Material risks arising from the Entity's:

- mismatching of assets and liabilities (if any);
- liability profile and liquidity needs;
- credit policy;
- investment assets;
- other assets;
- investment guarantees;
- methods for valuing assets and non-insurance liabilities, particularly changes in those methods since the previous valuation; and
- treatment of derivatives and the impact on the Solvency Margin.

4.5.10 Reinsurance arrangements

(a) The Appointed Actuary must examine and report upon the Entity's reinsurance strategy.

(b) The Appointed Actuary must outline and comment on Material risks arising from the use of the Entity's specified reinsurance strategy, having regard to the Entity's liability profile.

(c) The Appointed Actuary must outline and comment on Material risks arising from the Entity's reinsurance arrangements, having regard to the documentation and extent of placement of reinsurance arrangements, obligations to pay future reinsurance premiums, the degree of certainty of the Entity's ability to make reinsurance recoveries under these arrangements, the termination conditions of the arrangements and the degree of risk transfer.

4.5.11 Solvency and Capital management

(a) The Appointed Actuary must describe and comment on Material risks arising from the Entity's approach to setting and monitoring capital resources over time, including dividend policy and needs for future capital to support the Entity's Plans.

(b) The Appointed Actuary must comply with the requirements of the Solvency Standard with respect to matters that must be included in the FCR. The requirements that are current as at the date this Professional Standard was issued are in Appendix B.

(c) The Appointed Actuary must summarise the solvency calculations at the Report Date by Life Fund.

(d) The Appointed Actuary must comment on trends in the Entity's compliance with the Solvency Margin imposed under its licence, and its capital targets, for the last three years, if available. The Appointed Actuary must comment on the extent of, and reasons for, identified breaches of the Entity's Solvency Margin or of its capital targets since the previous FCR, and the actions that were taken by the Entity to rectify such breaches.

4.5.12 Capital adequacy

(a) The Appointed Actuary must report and comment on the Insurer's projected Solvency Margin over the three year period starting from the Report Date. The forward looking assessment of the Solvency Margin must take account of:

- the Entity's business plans;
- the Entity's risk management practices;
- the external environment; and
- variations in key assumptions.

(b) The Appointed Actuary must consider and comment on the Entity's capacity to meet the Solvency Margin imposed under its licence and its capital targets over at least the next three years.

(c) The Appointed Actuary must comment on the adequacy of the projected Solvency Margin. The Appointed Actuary must note the basis used to carry out the forward looking assessment of the Solvency Margin.

4.6 Conclusions and recommendations

4.6.1 The Appointed Actuary must provide a general statement as to their opinion of the financial condition of the Entity.

4.6.2 The Appointed Actuary must comment on any steps being carried out by the Entity to mitigate the Material risks identified and provide recommendations to further address these risks, if required.

4.6.3 The Appointed Actuary must state the recommendations set out in the previous FCR and comment on the extent to which the Entity has addressed them.

Appendix A

Matters for Consideration Checklist

The Appointed Actuary must consider each of the matters listed below, with consideration as at the Report Date of historical analysis and future implications, where applicable:

(a) business and operations;

(b) participating business;

(c) unit pricing;

(d) recent experience;

(e) assumptions;

(f) insurance risk;

(g) policy options and guarantees;

(h) insurance and other liabilities;

(i) investments and other assets;

(j) reinsurance arrangements;

(k) solvency and capital management; and

(l) capital adequacy.

Appendix B

Paragraph 151 of the Solvency Standard states the following:

"The appointed actuary must prepare a Financial Condition Report in accordance with Section 56(d) of the Act which must, inter alia:

(a) identify and describe the Material risks (of which it is reasonable to expect the appointed actuary to be aware) facing a licensed insurer that, in the appointed actuary's opinion, pose a threat to the licensed insurer's ability to meet the solvency standard now and in the future, and where practicable quantify such risks;

(b) comment on the steps taken or proposed to be taken by the licensed insurer to address the risks identified in (a);

(c) comment on where the licensed insurer has issued any instruments that form part of Actual Solvency Capital but that may not be both of a permanent nature and freely available to meet losses, comment on the implications for current and future compliance with the solvency standard;

(d) advise the licensed insurer on the appropriate treatment, for solvency purposes, of any insurance business with risk characteristics not adequately covered by this solvency standard;

(e) advise the licensed insurer, if relevant, on the treatment of derivatives and the approximate impact on the Asset Risk Capital Charge over the course of the year and at the date of calculation of the Solvency Margin;

(f) comment on the adequacy of the Resilience Risk Capital Charge including the risks involved with mismatching of assets and liabilities;

(g) detail all assumptions used in the calculation of the Solvency Margin, separately distinguishing assumptions made on the following bases:

   i. best estimate;

   ii. solvency assumptions made to arrive at the Insurance Risk Capital Charge, both prescribed and any other assumptions made including discretions;

   iii. all assumptions made to arrive at the Resilience Risk Capital Charge, including discretions assumed; and

(h) describe how all the principles supporting the Resilience Risk Capital Charge have been met (refer paragraph 71);

(i) identify those assumptions to which the licensed insurer's Solvency Margin is most sensitive ("key sensitivities") and quantify those key sensitivities;

(j) describe the insurance contracts which are deemed to be health insurance, and details of assets that are set aside or attributed to such contracts and any movements in those assets to or from the assets attributed to contracts of insurance that are not health insurance contracts. If there is no direct attribution of specific assets to such contracts then full details of how assets are apportioned to such insurance contracts must be given; and

(k) advise the licensed insurer on whether, in the appointed actuary's opinion, the licensed insurer needs to consider reporting to the Bank under Section 24 of the Act, taking account of the licensed insurer's forward looking assessment of the solvency standard and the appointed actuary's assessment of the licensed insurer's business plans, its enterprise risk management practices and the external environment."

Note: Paragraph 151, as set out above, is from the version of the Solvency Standard that is current as at 31 March 2013. It will be the Appointed Actuary's responsibility to ensure that they keep themselves updated on any amendments to the Solvency Standard.