AASB 13-14 April 2005
Agenda paper 8.3

Institute of Actuaries of Australia

6 April 2005

Mr David Boymal
Australian Accounting Standards Board
PO Box 204
Collins St West
Victoria 8007

Dear David

Invitation to Comment on Liability Adequacy Test in AASB 1023 General Insurance Contracts, dated March 2005

The Institute of Actuaries of Australia appreciates the opportunity to comment on the Liability Adequacy Test (LAT) in AASB 1023 General Insurance Contracts, as set out in your invitation to comment dated March 2005.

We support the initiatives:

1. to require the LAT to be performed at an entity level rather than a class of business level, and

2. to allow a different Probability of Adequacy (POA) to be adopted in the Outstanding Claims Liability (OCL) and LAT, subject to appropriate disclosure.

Prima facie, the amended wording of AASB 1023 is satisfactory, and no issues arise with the AASB's discussion in relation to 1. However, the commentary relating to the POA to be used in the Liability for Future Claims (LFC) is not consistent with the stated intention. Specifically, paragraph (b) at the bottom of page 7 is of concern to us. In its entirety, this paragraph suggests that a different POA for the LFC will not be allowed in practice, for the reason set out below:

- The statement that "an entity would be expected to have the same or similar POA for its OCL and LFC where it has consistent quality of data across its classes of business" suggests that the only acceptable reason for having different POAs would be variation in the quality of data.

- We believe, however, that different quality of data cannot be a sound basis for adopting a different POA. While the subsequent comments to the effect that inferior quality of data leads to greater inherent uncertainty are true, this situation should be reflected in a different Coefficient of Variation (COV), and not a different POA.

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If the wording noted above in any way survives as guidance in preparing financial statements, we believe that companies would in practice be forced to adopt a single POA. We understand that this may not have been the intended effect of these comments.

We believe that there are other more supportable reasons for allowing different POAs which do not rely on data quality. The following appear to us to be relevant considerations that could, on pragmatic grounds if not on theoretically rigorous grounds, be used to support a different POA:

1. The present revisions to AASB 1023 may turn out to be temporary, depending on when and how Phase II of the International Accounting Standards Board's (IASB) Insurance Project is implemented. There would appear to be merit in avoiding, as far as possible, making changes that may need to be reversed in response to Phase II.

2. While still uncertain, it is our understanding that there is an expectation that the IASB's Insurance Project will focus on Fair Values. Market value margins incorporated in Fair Values have a different rationale from risk margins. One might argue that risk margins are an imperfect proxy for market value margins. Therefore, a different POA might be argued suitably to reflect the Fair Value of premium liabilities.

3. The intention behind the introduction of the LAT is to underpin the liabilities, particularly where under-pricing is practised. One might argue that a reasonable provision does not necessarily require the same POA target.

We note the disclosure requirements to justify the reasons for adoption of a different POA for the LFC, and suggest that no further guidance or commentary would be required.

We hope that our response will be of assistance to the AASB. We would be pleased to provide more detail on any aspect of the response or discuss any issues as required. Inquiries should be directed to Catherine Baldwin, Chief Executive of the Institute by email at catherine.baldwin@actuaries.asn.au or phone (02) 9239 6106.

Yours sincerely

Andrew Gale

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