Office of the Superintendent of Financial Institutions Canada | Bureau du surintendant des institutions financières Canada

Guideline

Subject: **Appointed Actuary: Legal Requirements, Qualifications and External Review**

Category: **Sound Business and Financial Practices**

No: E-15 **Date: August 2003**
Revised: November 2006

Introduction

This Guideline describes the role of the Appointed Actuary in federally regulated insurance companies[1] and sets out some of OSFI's expectations with respect to that role. The Guideline is divided into three parts. The first part summarizes the major responsibilities of the actuary as described in the *Insurance Companies Act* (ICA) and the related Guidelines and Memoranda published by OSFI[2]. The second part deals with the actuary's qualifications to carry out the Appointed Actuary's role, and the third part sets out OSFI's expectations with respect to external review of the Appointed Actuary's work and reports.

Other OSFI Guidelines and Memoranda[3] contain additional information related to the responsibilities of the Appointed Actuary. Particularly important in this regard is the annual Memorandum to the Appointed Actuary. Separate versions are issued to actuaries of life insurance companies and to actuaries of property and casualty insurance companies.

[1] In this Guideline, federally regulated insurance companies means Canadian insurance companies, including fraternal benefit societies and provincial companies (as that term is defined in subsection 2(1) of the *Insurance Companies Act*) and Canadian branches of foreign insurance companies, including foreign fraternal benefit societies.

[2] The legislative summary in this Guideline is not intended to be a substitute for provisions of the ICA. The reader is advised to refer to the provisions of the ICA and not to rely on the interpretation of those provisions contained in this Guideline.

[3] e.g., *Memorandum to the Appointed Actuary on the Report on the Valuation of Life Insurance Policy Liabilities, Memorandum for the Actuary's Report on Property and Casualty Insurance Business*, Guideline A: *Minimum Continuing Capital and Surplus Requirements for Life Insurance Companies*, Guideline E-12: *Inter-Segment Notes for Life Insurance Companies, Guideline D-9: Sources of Earnings Disclosure (Life insurance companies).*

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Section 1: Legal Requirements of the Appointed Actuary

This part summarizes a number of sections in the ICA (the applicable sections of the ICA are shown in brackets) that relate to the appointment and role of the Appointed Actuary, as well as key provisions of related Guidelines and Memoranda published by OSFI. It also sets out the Superintendent's expectations regarding the annual reporting of companies' expected future financial condition. The ICA refers to the *actuary of the company*. In this Guideline, in keeping with common usage in the insurance industry, this person is referred to as the *Appointed Actuary* (AA).

a. Appointment of an Actuary

Each company[4] must appoint an actuary of the company (49(1), 165(2)(i), 623(1), 660(1)(a)) and notify the Superintendent, in writing, of the appointment (357, 623(2)). The AA must be a Fellow of the Canadian Institute of Actuaries (FCIA) (2(1)).

The chief executive officer or the chief operating officer (or a person performing like functions) of a Canadian company or society or of a provincial company, or the chief agent of a foreign company, may not be appointed as AA unless authorized in writing by the Superintendent (359.1(1), 624.1(1)). In the case of a Canadian or provincial company, the chief financial officer or a person performing like functions may not be appointed as AA unless the audit committee of the company has provided a written statement to the Superintendent and the appointment is authorized by the Superintendent (359.2).

The directors of a company or, in case of a foreign company, the company itself, may revoke the appointment of the AA. If this happens, the company must notify the Superintendent, in writing, of the revocation (360, 625). An AA who resigns or whose appointment is revoked shall submit to the Superintendent and to the directors of a Canadian or provincial company or to the chief agent of a foreign company a written statement that includes the circumstances and reasons for the resignation or why, in the actuary's opinion, the appointment was revoked (363, 627(1)).

Where an AA resigns or their appointment is revoked, no person shall accept an appointment or consent to be appointed as AA before requesting and receiving from the previous company actuary the written statement that was submitted to the directors or the chief agent and to the Superintendent (364(1), 627(2)). An appointment may be accepted if no reply is received within fifteen days after a request was made (364(2), 627(3)).

[4] When unmodified, the term "company" refers to Canadian insurance companies, provincial companies (as that term is defined in subsection 2(1) of the *Insurance Companies Act*), fraternal benefit societies and Canadian branches of foreign insurance companies and foreign fraternal benefit societies.

b. Role and Duties of the Appointed Actuary

The AA is required to value the actuarial and other policy liabilities as at the end of a financial year, and any other matters specified by the Superintendent. The AA's valuation is required to be in accordance with accepted actuarial practice, with such changes and any additional directions that may be made by the Superintendent (365, 629). The AA's report in the annual financial statement must opine that the policy liabilities are valued in accordance with accepted actuarial practice (367). It is expected that the valuation includes the selection of appropriate assumptions and methods, where each separate assumption is expected to be appropriate. It should be noted that the Superintendent may appoint an actuary to value certain liabilities or other matters if the Superintendent is of the opinion that it is necessary (365.1(1), 629.1(1)).

The liabilities shown in the annual return are required to include as a reserve the value of the actuarial and other policy liabilities (667(1)). The AA is required to make, and the company to file with its annual return, the Appointed Actuary's Report (AAR) on the policy liabilities and on any other matters the Superintendent may specify in a form determined by the Superintendent (667(2)). OSFI's annual Memorandum to the Appointed Actuary contains up-to-date instructions on the form and content of this report. Also, the AA shall, not less than twenty-one days before the date of the annual meeting of a Canadian or provincial company, make a report on the valuation of the liabilities to the shareholders and policyholders. The AA shall state whether, in the AA's opinion, the annual statement presents fairly the results of the valuation (367).

The AA is also required in each financial year to meet with and report to the directors or the chief agent on the company's financial position. When directed by the Superintendent, the AA must also report on the company's expected future financial condition (368, 630). A report on the company's expected future financial condition is normally prepared as described in the Canadian Institute of Actuaries (CIA) standard of practice on Dynamic Capital Adequacy Testing.

The Superintendent expects that a report on the company's expected future financial condition will be prepared annually in compliance with the CIA standards. A DCAT report shall be based on the prior year end financial position or a more recent position. If the DCAT report is presented to the board of directors in the second half of the financial year, then it shall include material changes in experience and in financial position up to the period of 90 days before the date of presentation. It is expected that the projection period for studies of P&C companies will be for at least three years. A copy of the report will be filed with OSFI within thirty days of presentation to the company's directors, but no later than the end of the calendar year.

The AA is required to report, in writing, to the chief executive officer and the chief financial officer or to the chief agent of the company any matters that, in the AA's opinion, have material adverse effects on the financial condition of the company and that require rectification. The AA must supply a copy of this report to the board of directors. Where, in the opinion of the AA, suitable action is not being taken to rectify these matters, the AA shall send a copy of the report to the Superintendent and advise the directors or the chief agent of the company that this has

been done (369, 631).
When a company maintains a participating account (456), the directors of a company must establish a policy for determining the dividends and bonuses to be paid to the participating policyholders and a policy respecting the management of each of the participating accounts (165(2)(e)) and (165(2)(e.1)). The AA is required to report to the directors in writing on the fairness to participating policyholders of any policy established or amended under 165(2)(e) and 165(2)(e.1) and report at least once a year on its continuing fairness (165(3.1) and 165(3.2)).

The AA is required to report, in writing, to the directors on the fairness to participating policyholders of a proposed dividend, bonus or other benefit and whether it is in accordance with the dividend or bonus policy. The directors must consider the actuary's report before declaring the dividend, bonus or other benefit (464(2)).

The AA is required to provide the company with a written opinion on whether the method selected for allocating investment income or losses and expenses to the participating account is fair and equitable to the participating policyholders (457, 458). The company must file a copy of the AA's written opinion with the Superintendent (459), together with a description of the allocation method.

Each year, the AA must report, in writing, to the directors on the fairness and equitableness of the allocation method used by the company (460). The AA is also required to report on whether payment to shareholders or a transfer to an account from which payments can be made to shareholders from the profits of the participating account would materially affect the company's ability to comply with its dividend or bonus policy or to maintain the level of dividends paid to participating policyholders (461(c)).

The directors of a company must establish criteria for changes made by the company to the premium or charge for insurance, amount of insurance or surrender value in respect of its adjustable policies (165(2)(e.2)). The AA is required to report to the directors in writing on the fairness to adjustable policyholders of the criteria established or amended under 165(2)(e.2)) and report at least once during each financial year on their continuing fairness (165(3.3)).

The AA is required to report, annually and in writing, to the directors on whether the changes the company made in respect of its adjustable policies during the preceding 12 months are in accordance with the criteria established under paragraph 165(2)(e.2) and are fair to the adjustable policyholders (464.1(1)).

For life insurance companies, OSFI's Guideline *Minimum Continuing Capital and Surplus Requirements* (MCCSR) and the Test of Adequacy of Assets in Canada and Margin Requirements (TAAM) sets out requirements for the test of capital adequacy (515, 608). The MCCSR and TAAM returns require the AA's confirmation that the instructions pertaining both to the MCCSR and TAAM Guidelines and to the annual return have been followed. OSFI also expects an opinion signed by the AA and a memorandum, both covering the areas where the calculation required discretion or where significant technical calculations, methodologies and judgements were applied.

Section 2: Qualifications Required

As previously noted, the AA is required to be an FCIA. The AA is, therefore, subject to the CIA's Rules of Professional Conduct. Rule 1 requires the AA to act honestly and to perform professional services with integrity, skill and care. Rule 2 requires a CIA member to perform professional services only when the member is qualified to do so and meets applicable qualification standards. Professional services performed by a CIA member must, under Rule 4, meet applicable standards of practice. The CIA has some specific qualification standards for obtaining an Appointed Actuary Certificate.

When Canadian and provincial companies are subject to conditions of subsection 678.1(1) of the ICA, they must provide the Superintendent with information about senior officers, including the AA. The Superintendent may disqualify or remove a senior officer if the Superintendent is of the opinion that the senior officer is not suitable to hold the position (678.1).

In assessing the suitability of an AA, the Superintendent expects that the AA has each of the following qualifications:

1. has appropriate Canadian practical experience, which is defined as Work in Canada[5] for at least three of the last six years, of which at least one year was performing valuation of Canadian actuarial liabilities of an insurance company;
2. has experience with the CIA's Standards of Practice and relevant insurance legislation and regulation;
3. is up to date with respect to the CIA's Continuing Professional Development requirement;
4. if the CIA in future requires an Appointed Actuary's Certificate, is in possession of an up-to-date Appointed Actuary Certificate from the CIA; and
5. has not been the subject of an adverse finding by a CIA Disciplinary Tribunal. Where there has been such a finding, the Superintendent may nevertheless conclude that the AA is a suitable person if the circumstances of the case and other information support such a conclusion.

[5] "Work in Canada" is as defined in the CIA standards.

Section 3: External Review of the Work of the Actuary

a. Background

OSFI believes that regular external review of certain work by the AA, and the resulting provision to the AA of additional professional education, would be of significant benefit to a company's stakeholders by contributing to the safety and soundness of insurance companies, as described in the general objectives below. Consequently, OSFI expects that all federally regulated insurance companies will appoint external reviewers to implement external review processes consistent with the OSFI criteria described below. The external review should be made in accordance with accepted actuarial practice as specified in the CIA's *Standards of Practice*, in particular with section 1640 of these standards and any related educational note.

b. General Objectives

In calling for external review of the work of the AA, OSFI has the following objectives:

- providing significant professional education for the AA;
- narrowing the range of practice by AAs;
- improving the quality of the AA's work; and
- maintaining and strengthening confidence in the work of the AA by the public, by insurance company management and directors and by supervisory authorities.

c. Work to be Reviewed

In accordance with section 1640 of the CIA's *Standards of Practice*, the reviewer is expected to:

1. ascertain that the work of the AA is within the range of accepted actuarial practice, as established by the CIA, and is consistent with any objectives or requirements established by OSFI in Regulations, Guidelines or the Memorandum to the AA (Note that the external review work is not intended to duplicate the work of the external auditor. See Section 3d below.);
2. review the adequacy of procedures, systems and the work of others relied on by the AA, to the extent that these are not reviewed by the external auditor. This includes checks on data integrity and checks on procedures and methodologies used to validate the calculations and results;
3. discuss with the AA the appropriateness of each of the assumptions made and the methods employed in the valuation of actuarial policy liabilities and ascertain that the assumptions are at the appropriate point in the range of accepted actuarial practice, given the circumstances of the company;
4. determine whether the AAR accurately describes the assumptions and methodology employed by the AA;

5. review and discuss with the AA the methodology, assumptions and scenarios used for future financial condition reporting as required by the Superintendent in Section 1 of this Guideline, usually based on Dynamic Capital Adequacy Testing (DCAT);
6. for Canadian insurance companies, (i) review the appropriateness of the allocations of investment income and expenses to participating accounts, (ii) review the AA's opinion to the directors on the fairness to participating policyholders of any dividend policy established or amended, and annually report on its continuing fairness, (iii) review the AA's opinion on the fairness of a proposed dividend, bonus or other benefit and whether it is in accordance with the dividend policy, and (iv) review the AA's report to the directors on the fairness of changes made to adjustable policies;
7. for life insurance companies' MCCSR/TAAM returns, review the work of the AA in the areas that require actuarial assumptions and calculations and ensure the work is consistent with the opinion accompanying these filings;
8. produce a written report documenting the findings of the external review.

The external reviewer is not required to perform any detailed recalculations, as long as the reviewer determines that the controls and procedures used by the AA are adequate to identify potential errors.

The AA and management of the company should co-operate fully with the external reviewer when the review is being carried out. Best efforts should be used to provide the reviewer with access to any required documents and to provide any additional explanations that may be relevant to the external review.

d. External Review and External Audit

The Canadian Auditing and Assurance Standards Board has replaced AuG-15 with a new Assurance and Related Services Guideline AuG-43, *Audit of Policy Liabilities of Insurance Companies*. The guideline applies to insurance company financial statements for periods beginning on or after January 1, 2006. Under the new guideline, the auditor may consider the work of the appointed actuary. However, "corroborative evidence is required such that the auditor's work (including the work of the actuarial specialist on the engagement team) provides the principal evidence for the auditor's opinion."[6] As such, with the implementation of AuG-43, OSFI expects that audit procedures undertaken by the actuarial specialist on the external audit team will be greatly expanded relative to the previous audit requirements.

It is not OSFI's intention that the requirements for the external review work duplicate the work of the external auditor. However, as the objective and the scope of an external audit differs from the objective of an external review, the audit work done to satisfy the audit requirements of AuG-43 will not be sufficient to fully address the external review requirements under this guideline. To satisfy OSFI's expectations under this Guideline, work in addition to the audit work described in AuG-43 guidance should be performed.

[6] AuG-43, paragraph 53.

Where the auditor's actuarial specialist on the engagement team is not an FCIA, the external reviewer should take extra care to verify that all CIA standards are met by the AA, and should not rely totally on the external audit work as would otherwise be the case. OSFI recommends that auditing firms hire an FCIA to be the auditor's actuarial specialist.

e. Selecting a Reviewer

An external reviewer is expected to meet the same qualification standards as are outlined in Section 2 of this Guideline with respect to the AA, including the Superintendent's minimum requirements for suitability. A reviewer is to be selected by the company, and, like the AA, must be an FCIA who meets the criteria in Section 2 of this Guideline.

It is good practice for the audit committee of the company's board of directors, in the case of a Canadian or provincial company, or the chief agent, in the case of a foreign company, to be advised of the terms of the external review and the selection of the reviewer before the review is undertaken.

OSFI expects a reviewer to have sufficient experience with respect to the type of work to be reviewed. The reviewer's prior experience should include exposure to two or more unrelated insurance companies in order that the reviewer be familiar with the range of practices and assumptions used by actuaries in Canada. Knowledge of industry best practices is needed to ensure the review process appropriately fulfils its educational objectives. This experience could be gained while serving as an external reviewer.

It is essential to the integrity of the external review process that a reviewer be, and be seen to be, objective. The reviewer should, therefore, have no relationship with the insurer or with the AA that would in any way impair objectivity. The reviewer is expected to follow the CIA *Standards of Practice* as well as any additional OSFI requirements. In practice, without limiting the generality of the foregoing, OSFI believes that the following criteria should be applied in determining the objectivity of a reviewer:

- A reviewer may not be an employee of the company or any affiliated companies, and may not have been employed by the company or served as AA of the company less than three years from the date of the work being reviewed. A reviewer formerly employed by the company is expected to have had exposure to at least two insurers unrelated to the company.
- A reviewer must not be a shareholder of, or have a financial investment (other than as a policyholder, beneficiary or insured) in the company.
- If the AA is a consultant, another actuary in the same consulting firm may not be a reviewer of that actuary's work.
- If a member of a consulting firm participates in the actuarial work being reviewed, another member of the same firm may not be a reviewer. In this context, "actuarial

work" includes deciding on methodology, selecting assumptions and producing results.

- It is acceptable, and in fact expected, that the AA will be in contact with the external reviewer during the course of the year to discuss the potential acceptability of changes in methodologies and assumptions that the AA is considering. However, the reviewer should only provide advice with respect to these changes as part of the external review work. This is similar to the interaction of a company with its external auditor.
- More than one external reviewer may be engaged to review the AA's work in a particular period. The areas of work to be reviewed may be divided among the reviewers in a manner that reflects their particular competencies. In this event, all requirements in this Guideline respecting an external reviewer should be understood to apply to each of the reviewers engaged.

An external reviewer may be an actuary working in the company's external audit firm, including the actuary used as the audit specialist. OSFI regards an actuary working for the external audit firm to be sufficiently independent to be an external reviewer. However, as noted in subsection 3(h), if this is the case, the external review of any work that is subject to audit should be completed prior to the issuance of the audit opinion. In addition, this external review work should be performed under a stand-alone engagement that is separate from the audit engagement.

Note that the criteria for objectivity for external review purposes are not as restrictive as those found in OSFI's Guideline E-14, *Role of the Independent Actuary,* i.e., rules required for amalgamations of companies or buying/selling of blocks of business. In the latter case, the Independent Actuary represents, in the transaction, policyholders who rely on the Independent Actuary. In the case of external review, policyholders, management, shareholders and supervisors continue to rely on the AA.

f. Changing a Reviewer

To enhance the external reviewer's objectivity and increase the educational value of the review process, a regular change or rotation of reviewers is encouraged. This would allow the AA to obtain different perspectives from different reviewers. Therefore, OSFI expects that a reviewer will be changed at least once every two cycles (i.e., every six years). The company has the option of making more frequent changes.

If an external reviewer is a member of a consulting firm, another member of the same consulting firm may be acceptable as a new external reviewer. In this case, a previous reviewer may be reappointed to this role after a period of at least one cycle (i.e., at least three years).

g. Reporting

In the case of a Canadian or provincial insurance company, the external reviewer's written report, or a summary of it, should be made available to the audit committee of the company's board of directors. In the case of a Canadian branch of a foreign insurance company, the report goes to the Chief Agent. For a pre-release external review of work subject to external audit, the external review report should be submitted to the audit committee or to the Chief Agent on, or shortly before, the date the AA reports on any work.

The complete external review report and any summary of it should be made available to OSFI on a confidential basis. Copies of the report and of any summary should be forwarded to OSFI within thirty days of its transmission to the audit committee or to the Chief Agent. A copy of the report should also be provided to the company's external auditor.

The external review report should describe the extent of the work done by the external reviewer and his or her conclusions with respect to the AA's compliance with accepted actuarial practice and with any objectives or requirements established by OSFI in Regulations, Guidelines or Memoranda to the AA.

The external review report should include a description of any changes to previously employed methods or assumptions that were made as a result of the review. Any summary of the report should indicate the nature of these changes. If no changes were made as a result of the review, this should be stated explicitly in the report.

The external review report and summary should describe any instances where there is a remaining difference of opinion between the AA and the reviewer.

Where the reviewer is an actuary working in the company's external audit firm, the external review report is expected to describe the difference in the audit work required by AuG-43 and the external review requirements of this Guideline. The report is expected to describe the additional work that was done in excess of the AuG-43 guidance.

h. Timing of the External Review Report

Each item of the AA's work described in subsection 3(c) should be reviewed at least once every three years, either all at once or in phases over a three-year cycle. However, a material change in an item should be reviewed in the year in which the change is made.

For the external review of work subject to external audit, OSFI encourages companies to seek an external review prior to releasing or reporting on the work that is subject to such review. To qualify as a pre-release external review, the reviewer must prepare the report and sign his or her opinion on, or shortly before, the date the AA reports on any work.

If the circumstances of the case require a post-release review, then the reviewer's report should be submitted no later than three months after release of the AA's report on the work reviewed. OSFI should be consulted if that is not practical.

If a member or employee of the insurer's external audit firm reviews work by the actuary that is subject to audit, OSFI expects that the review will be completed prior to the issuance of the audit opinion.

i. Coordination with OSFI Examinations

It would be desirable for a company to have the review undertaken in conjunction with the normal cycle for regular OSFI examinations of the company or of a block of business within the company.

- END -