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# Guideline Impact Analysis Statement

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## E-15 - Appointed Actuary: Legal Requirements, Qualifications and External Review

November 2006

### 1. Background

Guideline E-15, introduced in August 2003, addresses three topics:

- **Legal Requirements**, which summarizes all the legal requirements to which an Appointed Actuary (AA) is subject. This includes rules relating to the appointment of an AA and to the AA's role and duties. It is within this section that OSFI requires an annual DCAT report.
- **Qualifications Required**, which lists the qualifications a person must have to be an AA.
- **External Review of the Work of the Actuary**, which describes the OSFI requirement that there be an independent external review of the AA's work.

External review has generally been accepted by the industry and is regarded as fulfilling a useful role in narrowing the range of actuarial practice and maintaining and strengthening industry and public confidence in the work of the AA. It is also playing a role in providing additional professional education for the AA.

### 2. Problem Identification

As an offshoot of the movement to strengthen the controls around financial statements (e.g., Sarbanes Oxley Act), the CICA has issued the Assurance and Related Services guideline AuG-43 (which updates and replaces AuG-15) regarding the audit of insurance company financial statements. The auditor is no longer able to use the work of the AA, as was previously allowed by the Joint Policy Statement. The auditor will have to undertake substantive work since, under AuG-43, "the auditor may use 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."<sup>1</sup> This work includes examining whether the assumptions and methodology used by the AA to calculate the policy liabilities meet actuarial standards. The work also includes some re-calculation of liabilities.

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<sup>1</sup>AuG-43, paragraph 53.



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AuG-43 is effective for financial statements for periods beginning on or after January 1, 2006.

The industry is concerned that the increased work the auditor will be doing under AuG-43 will duplicate work that is required by the external review requirements in the 2003 version of Guideline E-15. OSFI agrees that duplication of work is not desirable; therefore, Guideline E-15 has been revised accordingly.

However, the requirements under AuG-43 do not cover everything that Guideline E-15 currently requires for the review of policy liabilities. Some examples include:

- The auditor must ensure that the assumptions are within the range allowed by CIA standards. The auditor does not have to opine that the assumptions are at the proper point in the range given the characteristics of the business. External review under Guideline E-15 requires the reviewer to opine on this.
- The auditor has to opine that the reserves in total are sufficient, not that each assumption is appropriate. Guideline E-15 requires that the reviewer opine on the appropriateness of each assumption in isolation.
- The auditor can allow one product line to be conservative and another to be less than sufficient, as long as, in total, the reserves are adequate.

In addition to changes required by the revision to AuG-43, there are a number of other minor changes to the revised Guideline E-15.

### 3. Objectives

To address industry concerns that overlap between expectations of Guideline E-15 and the requirements of CICA Auditing Guideline 43 would have led to duplication of work.

### 4. Identification and Assessment of Options

*Option 1: Make no changes to the 2003 version of Guideline E-15.*

The 2003 version of Guideline E-15 generally accomplished what OSFI had intended. While maintaining the status quo would minimize the resources used by OSFI relative to other options, it would result in duplication of effort by the companies, with accompanying higher costs to the industry.

*Option 2: Remove external review of policy liabilities from Guideline E-15.*

AuG-43 requires the actuarial specialist working for the auditor in verifying policy liabilities to undertake more analysis than was previously the case. However, this additional work is not as extensive as that required under OSFI's Guideline E-15. Therefore, the resources required of the industry would potentially be less than those under Option 1. However, making AuG-43 the minimum standard could result in an inconsistent level of work being performed by the actuarial specialist. For example, some auditors may expand the work

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beyond the minimum requirement, while others may not. OSFI looks for a consistent level of analysis, as outlined in Guideline E-15. Option 2 may also not achieve as effectively as Option 3 the goal of providing additional professional education for the AA.

Further, with the audit under AuG-43 not requiring verification of each assumption in the policy liabilities, OSFI may be required to increase actuarial resources to conduct more detailed verification of assumptions where this is deemed necessary.

*Option 3: Modify Guideline E-15 to ensure there is no duplication of work.*

The wording of Guideline E-15 has been changed to recognize the additional work being done by the auditor and our reliance on that work, but without losing the more detailed verification of assumptions and the educational direction of the Guideline.

Such a revision would also include the following minor changes:

- Include in all scenarios any material actual experience in the current year if the DCAT is presented to the board of directors in the second half of the year;
- Add opinions for the MCCSR/TAAM to the actuarial requirements listed in section 1 (the CIA has introduced such opinions);
- Include in section 2 the requirement for the Practice Certificates being developed by the CIA; and
- Include the new references in Bill C-57 (*An Act to Amend Certain Acts in Relation to Financial Institutions – “The Corporate Governance Bill”*) to AA requirements for participating and adjustable products.

This option ensures that the goals of E-15 will continue to be met (unlike Option 2), while limiting duplication of work with AuG-43 (which would not be achieved by Option 1).

## **5. Consultations**

The topic of whether Guideline E-15 would be revised as a result of AuG-43 was raised at the three CIA meetings held in 2005. OSFI had met with representatives of several actuarial consulting firms (not audit firms), who indicated the current external review should be modified, but not dropped. OSFI also hosted a meeting of representatives of the large auditing firms, actuarial consulting firms and the CIA in December to discuss this subject. OSFI indicated that it intended to avoid duplication. The draft revised version of Guideline E-15 was released for industry comment on March 31, 2006. A number of changes were made based on the comments received.