

<b>GUIDELINE:</b>	<b>APPOINTED ACTUARY</b>
<b>DATE:</b>	<b>SEPTEMBER 2014</b>
<b>DISTRIBUTION:</b>	<b>BC INCORPORATED INSURERS AND RECIPROCAL EXCHANGES</b>

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## PURPOSE

The purpose of this letter is to inform BC incorporated insurers and reciprocal exchanges of the Financial Institutions Commission's (FICOM) intent to adopt *Guideline E-15: Appointed Actuary – Legal Requirements, Qualifications and Peer Review* issued by the federal Office of the Superintendent of Financial Institutions (OSFI). The guideline sets out expectations with regards to the role of the Appointed Actuary of authorized insurers.

## BACKGROUND INFORMATION

In 2003, OSFI published *Guideline E-15* outlining expectations for the role of the Appointed Actuary (AA) of a federally-regulated insurance company. The guideline was comprised of three sections:

1. Legal Requirements of the Appointed Actuary
2. Qualifications Required
3. External Review of the Work of the Actuary

FICOM did not adopt this guideline at the time. Instead, provisions regarding the appointment and use of Appointed Actuaries were developed to be added to the *Financial Institutions Act* (FIA). These provisions were proclaimed in 2010 and subsequently added to the FIA in 2013 as Division 2.1 to Part 4; the new provisions aligned with much of the content of sections 1 and 2 of OSFI's *Guideline E-15*.

In recent years, the concept of an external review (or "peer review") has become generally accepted by insurance companies and the actuarial profession, including the Canadian Institute of Actuaries (CIA). OSFI published an update to its guideline in 2012 to further clarify the purpose and process of actuarial peer review, improve the effectiveness of the review as a supervisory tool, and reduce or eliminate overlaps with the role of the external auditor.

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FICOM relies on the work done by the AA and supports initiatives that ensure that work is of high quality and consistent with professional standards and practices. FICOM considers that the adoption of peer review will provide significant benefit to the AA, the insurance company, and FICOM. As such, it will be used to assist FICOM on deciding the frequency and depth of onsite examinations and inquiries.

## **ISSUES**

The work of the AA is critical in ensuring the safety and soundness of an insurance company, as the AA has responsibility for the valuation of policy liabilities in financial statements and future financial condition reporting.

Actuarial valuations and reporting should be carried out in a manner consistent with accepted actuarial practice as established in standards set by the CIA and the Actuarial Standards Board. Peer review is expected to improve this consistency.

The selected peer reviewer should be sufficiently independent from the firm in order to provide maximum benefit to the insurance company and the AA in the form of consistency, objectivity, consultation advice, and professional development.

Although external auditors also assess financial statements which contain amounts determined by actuarial calculations, the scope of this audit is generally limited to ensuring that statements are free from material misstatement. The actuarial peer review requires a review of the appropriateness of assumptions and methodologies for each valuation model, and therefore must be conducted by an experienced external actuary rather than an auditor.

FICOM generally supports OSFI's peer review expectations in section 3 of the guideline, but seeks to understand the concerns of stakeholders, in particular regarding frequency of peer reviews. FICOM does not intend to adopt OSFI's requirement for a limited annual review or report where there have been no material changes affecting the valuation of policy liabilities and ceded reinsurance assets.

## **OBJECTIVES**

FICOM intends to adopt OSFI *Guideline E-15*, in particular its provisions surrounding peer review of the work of the AA, in order to address the following objectives:

- ensure that the important actuarial work conducted by AAs for BC incorporated insurers is consistent and of a high quality;
- assist FICOM in assessing the safety and soundness of insurance companies and inform FICOM on deciding the frequency and depth of onsite examinations and inquiries;

- assist the company by ensuring that it can rely on the work of the AA allowing greater certainty to its decision making regarding rates, capital management, and risk mitigation;
- strengthen the confidence of the public, the company, and FICOM in the work of the AA;
- benefit the AA by providing a source of independent consultation advice and an additional source of professional education to the quality of actuarial work; and
- align with overall industry and federal supervisory expectations.

## **OPTIONS AND ASSESSMENT**

### Option 1: Adopt OSFI *Guideline E-15* in Full

This option would have FICOM fully adopt the guideline with no modifications to the peer review process described in section 3. Although this option would ensure the highest level of consistency between federal and provincial expectations, the frequency of peer review as currently advocated by OSFI may not be appropriate for BC insurers and reciprocal exchanges.

### Option 2: Do Not Adopt OSFI *Guideline E-15*

This option would retain the status quo. The majority of the content in sections 1 and 2 of the guideline would still apply where it corresponds to existing provisions in Section 126 of the FIA; however, peer review would continue to be excluded from FICOM's expectations for the AA. FICOM believes the peer review process to be of sufficient benefit to justify requiring it for reasons outlined earlier in "Objectives".

### Option 3: Adopt OSFI *Guideline E-15*, with Peer Review Conducted on a Less Frequent Basis

This option would have FICOM adopt OSFI's current guideline with modifications to section 3 that reduce the expected frequency of peer review.

FICOM would require the full review every three years, but remove the requirement to conduct a limited annual review in cases where there have been no material changes in the previous year affecting the valuation of policy liabilities and ceded reinsurance assets. Where such changes have taken place, an annual review would still be expected.

FICOM considers that eliminating the annual review where no material changes have occurred still fulfills the overall objectives above and preserves the valuable oversight, consultation, and educational benefits to be gained through peer review.

## **RECOMMENDATION**

FICOM supports Option 3: Adopting OSFI *Guideline E-15*, with peer review conducted on a less frequent basis.

**CONSULTATION**

FICOM is seeking comments on a confidential basis from BC incorporated insurers on FICOM's intention to adopt OSFI *Guideline E-15* until October 15, 2014. FICOM will review all comments before deciding what guidelines FICOM will adopt or otherwise amend for adoption purposes.

**IMPLEMENTATION**

If adopted, *Guideline E-15* will be implemented and become effective immediately, with the first peer review cycle under the new guideline expected to begin for actuarial statements prepared for the year-end of 2015. FICOM will issue communication to the system regarding the implementation process once the guidance is released in final form.