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Educational Note

Role of the Appointed Actuary Under IFRS 17

Committee on the Appointed/Valuation Actuary

December 2022

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The actuary should be familiar with relevant educational notes. Educational notes are not binding; rather they are intended to illustrate the application of the standards of practice. A practice that an educational note describes for a situation is not necessarily the only accepted practice for that situation nor is it necessarily accepted practice for a different situation. Responsibility for ensuring that work is in accordance with accepted actuarial practice lies with the actuary. As accepted actuarial practice evolves, an educational note may no longer appropriately illustrate the application of standards. To assist the actuary, the CIA website contains a reference of pending changes to educational notes.

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MEMORANDUM

To: All Members

From: Dean Newell, Chair
Actuarial Guidance Council

Wally Bridel and Phil Watson, Co-Chairs
Committee on the Appointed/Valuation Actuary

Date: December 14, 2022

Subject: **Educational Note: Role of the Appointed Actuary Under IFRS 17**

Over the past few years, two designated groups of the Actuarial Standards Board (ASB) reviewed the impact on the CIA Standards of Practice (SOP) of replacing IFRS 4 with IFRS 17, recommending a number of changes. This educational note supplements the SOP, explains some of the rationale for the changes that were made to the SOP, and addresses questions Appointed Actuaries (AAs) may ask when fulfilling their duties and responsibilities under the new Standards.

Following an introduction, this educational note is structured as follows:

- Section 1 – The responsibilities of the AA that have not changed, namely the duty and responsibilities of the AA under the *Insurance Companies Act* or other applicable regulations and the CIA SOP
- Section 2 – How to approach "use and take responsibility for the work of others" and reporting with and without reservation
- Section 3 – How the opinion is affected, and how the broader presentation and disclosures in the IFRS financial statements affect the AA's work to support the opinion
- Section 4 – Additional considerations for valuation work that is not subject to IFRS 17
- Appendix – Case studies

A preliminary version of this educational note was shared with the following committees and stakeholders for their review and comments, and was also presented to the Actuarial Guidance Council (AGC) in the months preceding its approval:

- All AAs
- Committee on Life Insurance Financial Reporting
- Property and Casualty Insurance Financial Reporting Committee
- Committee on Risk Management and Capital Requirements

- Office of the Superintendent of Financial Institutions (OSFI)
- Autorité des marchés financiers (AMF)

The drafters are satisfied that they have sufficiently addressed comments received from the various committees, stakeholders and the AGC. The creation of this memorandum and educational note has followed the AGC protocols for the adoption of educational notes. In accordance with the CIA's *Policy on Due Process for the Approval of Guidance Material other than Standards of Practice and Research Documents*, this educational note has been prepared by representatives of the Committee on the Appointed/Valuation Actuary and has received approval for distribution from the AGC on December 13, 2022.

The actuary should be familiar with relevant educational notes. Educational notes are not binding; rather they are intended to illustrate the application of the standards of practice. A practice that an educational note describes for a situation is not necessarily the only accepted practice for that situation nor is it necessarily accepted practice for a different situation. Responsibility for ensuring that work is in accordance with accepted actuarial practice lies with the actuary. As accepted actuarial practice evolves, an educational note may no longer appropriately illustrate the application of standards. To assist the actuary, the CIA website contains a reference of pending changes to educational notes.

The Committee on the Appointed/Valuation Actuary would like to acknowledge the contribution of Ralph Ovsec, Rachel Li, Nicolas Lévesque, Félix Patry and Lesley Thomson, as well as comments and suggestions received by members of the Committee on the Appointed/Valuation Actuary throughout the drafting of this educational note.

Questions or comments regarding this educational note may be directed to the Co-Chairs of the Committee on the Appointed/Valuation Actuary (noted above) at guidance.feedback@cia-ica.ca.

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Introduction

The actuarial valuation performed for Canadian generally accepted accounting principles (GAAP) reporting has for years been the sole valuation needed in Canada for public and regulatory reporting purposes, with the accounting profession ceding control of the valuation to the actuarial profession. With the introduction of IFRS 17, the accounting profession now sets the rules/framework for the GAAP valuation, with the measurement of insurance contract liabilities specified in IFRS 17. The new GAAP valuation will continue to be used both for public and regulatory reporting purposes in Canada, so the Appointed Actuary (AA) remains responsible for providing an opinion on the valuation. IFRS 17 will become effective with annual reporting periods beginning on or after January 1, 2023, in Canada.

IFRS 17 introduces fundamentally new approaches to valuation methods and assumptions for many types of insurance contracts, as well as important changes to presentation and disclosure in the financial statements. Two designated groups of the Actuarial Standards Board (ASB) reviewed the impact on the CIA Standards of Practice (SOP) of replacing IFRS 4 with IFRS 17, recommending a number of changes. Both the SOP that apply under IFRS 4 and the revised SOP that will apply from January 1, 2023, are available on the CIA website. This educational note supplements the new SOP, explaining the rationale for the changes that were made and addressing questions AAs may ask when fulfilling their duties and responsibilities. One important change to the SOP was the adoption in Section 2300 of the International Standards of Actuarial Practice (ISAP) for IFRS 17, which applies to both life and health and P&C valuations, replacing the separate Life and Health (2300) and P&C (2200) sections of the Standards. Section 2100 continues to apply to both life and health and P&C valuations, and Section 2200 now covers Canadian-specific considerations for valuation. This educational note applies to AAs for both life and health and P&C valuations.

Though measurement of insurance contract liabilities will still require actuarial skill and judgment in selecting and applying appropriate methods and assumptions and managing model risk, some aspects of the IFRS 17 valuation may be set by others. Though it will vary from company to company, finance or other management areas may set some accounting policies or methods or assumptions in the valuation. If so, the AA will be in the position of deciding whether to “use and take responsibility” for this work when providing their opinion. If the AA is unable to take responsibility for aspects of the valuation set by others but the company nonetheless reports on that basis, the AA would report with reservation.

This educational note covers the changes to the wording of the AA’s opinion in the SOP. The AA’s opinion reflects the continued importance of the skill, expertise and judgment of the AA in the valuation. The AA’s opinion is not limited to compliance with accounting standards; it says that the amount of liabilities is appropriate for inclusion in the financial statements prepared in accordance with IFRS and that the valuation conforms to accepted actuarial practice in Canada.

Finally, though the AA’s opinion that the financial statements fairly present the results of the valuation is maintained, the scope of that opinion is much broader under IFRS 17 than IFRS 4, as items in the IFRS 17 financial statements and disclosures related to the valuation are more

extensive than under IFRS 4. The broader presentation in the financial statements is discussed in detail in this educational note.

The following items are not considered in this educational note:

- Valuation of investment contracts (IFRS 9)
- Valuation of service contracts (IFRS 15)
- External peer review of the AA's valuation
- The impact of IFRS 17 on financial condition testing (FCT)
- Life Insurance Capital Adequacy Test/Minimum Capital Test

Though the AA also has a role in all of these topics, they are not covered in this educational note because there are no changes to the related CIA SOP with the introduction of IFRS 17. The CIA Committee on Risk Management and Capital Requirements is updating the FCT educational note in 2022 to reflect IFRS 17 considerations.

Finally, this educational note will not duplicate technical or other content that is covered by other CIA educational notes. The reader would refer to the CIA website for other notes as needed.

1. What has not changed

Responsibilities of the Appointed Actuary

The AA will continue to be a reserved role as defined in the *Insurance Companies Act* (Canada) (ICA), the Québec *Insurers Act* (QIA) or other provincial Act. The requirements and responsibilities of the AA outlined in these Acts have not changed. For example, the AA will require formal appointment, and a description of the role of the AA in the financial statements is required by the ICA.

The AA will continue to opine on the valuation of policy liabilities reported to regulators, and in the GAAP financial statements of insurance entities regulated by the ICA.[1] The AA, therefore, will continue to maintain a vital role in providing assurance to the public, regulators and other stakeholders that the policy liabilities have been prepared in accordance with accepted actuarial practice in Canada.

"Policy liabilities" is a defined term in the CIA SOP and, importantly, is what the Acts require the AA's valuation and opinion to cover. Policy liabilities extend beyond insurance contract liabilities (IFRS 17), including some investment contracts (IFRS 9) and service contracts (IFRS 15), but not liabilities for contracts written outside regulated insurance entities. The focus of this educational note is on policy liabilities measured under IFRS 17 (i.e., insurance contract liabilities in regulated insurance entities).

The AA will continue to use and take responsibility for the work of others, and notwithstanding the changing roles, others will continue to use the work of the AA, including external auditors.

[1] And some provincial Acts. Notably, the AA's opinion in the financial statements is not required under the QIA.

However, though it will vary from company to company, it is possible that the AA will use the work of others more extensively than before.

The AA will continue to produce a formal report for the relevant regulator, as required by OSFI's *Memorandum to the Appointed Actuary*,[2] AMF's *Actuary's Guide to Reporting on P&C Insurers' Policy Liabilities* and *Actuary's Guide Regarding the Liability Report for Insurers of Persons*, and applicable guidance from other provincial regulators. Though the content of these has changed to reflect IFRS 17 considerations, they are not covered in this educational note.

2. Using and taking responsibility for the work of others

Under IFRS 17, finance or other management areas may set some accounting policies or methods or assumptions used in the measurement of liabilities. Though this will vary from company to company, the AA may be in the position of deciding whether to use and take responsibility for the work of others more often than had been the case under IFRS 4.

It is noted that the AA does not often "rely" on the work of others, as relying on the work of others implies using but not taking responsibility for that work, leading to a report with reservation. To report without reservation, the AA must be able to use and take responsibility for any accounting policies or methods or assumptions set by others.

The updated Paragraph 2210.05 of the CIA SOP states the following:

> When the principal or another party sets or prescribes an assumption or methodology used by the actuary in performing actuarial services in connection with IFRS 17, it is to be treated as the actuary's use of another person's work as described in subsection 1510. The actuary would not 'take responsibility' for such work:
>
> - If the assumption or methodology set or prescribed by the principal or another party conflicts with what would be appropriate for the purpose of the actuarial services; or
> - The actuary is unable to judge the appropriateness of the assumption or methodology set or prescribed by the principal or another party without performing a substantial amount of additional work beyond the scope of the assignment, or the actuary is not qualified to judge the appropriateness.

Subsection 1510 of the CIA SOP provides guidance on how and when to use and take responsibility for the work of others. In particular:

- 1510.01 – The actuary may use and take responsibility for another person's work if such actions are justified. If the actuary uses but does not take responsibility for another person's work, the actuary should so report.
- 1510.06 – If the actuary does not take such responsibility, the actuary reports with reservation and the user would seek alternative assurance that the other person's work is appropriate, which may or may not be practical.

[2] Separate Memorandums for Life & Health and P&C.

- 1510.07 – The actuary may use and take responsibility for another person's work, given confidence that such actions are justified as a result of considerations such as the following:
  - Early and periodic communication with the other person;
  - Confidence in the other person's qualifications, competence, integrity, and objectivity;
  - The other person's awareness of how the actuary intends to use the other person's work;
  - Communication to the other person of any information known to the actuary that may affect the other person's work, and vice versa, and;
  - Study of any report by the other person and discussion of it with the other person, especially of any reservation in the report.
- 1510.12 – If the actuary uses but does not take responsibility for another person's work, the actuary would nevertheless examine the other person's work for evident shortcomings and would either report the results of such examination or avoid use of the work. For clarity, even though the other person may use a model in his or her work, the actuary is not considered to have used that model.

A few examples of accounting policies or methods or assumptions that may be set by others include:

- **Discount rates**: e.g., whether a bottom-up or top-down approach is used.
- **Insurance contract classification**: e.g., assessment of "significant" insurance risk.
- **Contract boundary**: e.g., assessment of "practical ability" to reset the terms of a contract at a renewal date.
- **Coverage units for amortization of contractual service margin (CSM)**: e.g., whether to discount or not.
- **Level of aggregation**: e.g., threshold for groups with "no significant possibility of becoming onerous."
- **Risk adjustment for non-financial risk (RA)**: e.g., assessing the "compensation required by the entity" for taking non-financial risk.
- **Directly attributable expenses**: e.g., identifying directly attributable expenses.
- **Deferred acquisition expenses**: e.g., criteria for testing recoverability of deferred acquisition expense assets.
- **Eligibility for premium allocation approach (PAA)**: e.g., criteria and testing.
- **PAA accounting policy choices**: e.g., recognition of acquisition expenses, discounting.
- **Application of variable fee approach (VFA)**: e.g., qualification criteria, use of risk mitigation option.

- **Reinsurance contracts held**: e.g., grouping, discount rate, RA.

This list is not meant to be exhaustive, and the items set by others will vary from company to company. It is possible that accounting policies or methods or assumptions set by others will differ from what the AA would have chosen; however, that does not necessarily lead to a report with reservation.

2.1 Deciding whether to take responsibility for items set by others

The AA may find it helpful to consider some or all of the following questions when deciding whether to take responsibility for the work of others and report without reservation.

Q1 Is the policy or method or assumption that has been set by another party consistent with a reasonable interpretation of the IFRS 17 standard?

Compliance with IFRS is a necessary condition for the AA to report without reservation. Discussion with accounting professionals, auditors or the external peer reviewer may help to resolve any questions. If a policy or method or assumption has been approved by the auditor, the AA can likely accept that it is a reasonable interpretation of IFRS; however, acceptance is not automatic. If the AA has reason to believe the item is not in compliance with IFRS, it would be appropriate to report with reservation.

Q2 Is the policy or method or assumption that has been set by another party consistent with accepted actuarial practice in Canada?

Discussion with actuarial professionals, peer reviewers or the chairs of CIA practice committees may help to resolve any questions. However, if the policy or method or assumption is not changed and the AA believes it is not consistent with accepted actuarial practice in Canada, it would be appropriate to report with reservation.

Q3 Are the recommendations in Subsection 1510 of the CIA SOP for “use and take responsibility for” satisfied (i.e., the actuary has confirmed the other person’s qualifications, competence, integrity and objectivity, and the other person is aware of how the actuary intends to use that person’s work)?

The AA would consider the recommendations in Subsection 1510 of the CIA SOP. However, if this is not possible for some reason, perhaps because the individual who set the policy or method or assumption is no longer acting in that role and discussions with that person’s successor do not address the AA’s questions, then it may be appropriate for the AA to report with reservation.

Q4 Is the policy or method or assumption similar to what the AA would have chosen?

If the policy or method or assumption is similar to what the AA would have chosen or would not produce a materially different outcome, the AA would likely be comfortable using and taking responsibility for the item. If it is not similar and might produce a materially different outcome, the AA would assess whether the item is a reasonable choice within the range of accepted actuarial practice in Canada. If uncertain, the AA may consider testing the alternative policy or method or assumption to assess the significance of the difference to help decide whether reporting with reservation is appropriate.

The AA need not independently derive their own set of policies, methods and assumptions, but would look more closely at policies or methods or assumptions that might not be within the range of accepted actuarial practice in Canada.

Q5 Is the AA able to judge the appropriateness of the policy or method or assumption set by another party without performing a substantial amount of additional work beyond the scope of the assignment?

If not, then per Paragraph 2210.05 of the CIA SOP, the AA would not take responsibility and would report with reservation.

2.2 Reporting with reservation

Paragraphs 2230.19-.29 of the CIA SOP present examples of situations where it may be appropriate to report with reservation:

- **New appointment**: Where the newly appointed AA uses but is unable to take responsibility for a predecessor AA's work.
- **Impracticality of restatement**: Where restating the preceding year valuation to be consistent with the current year valuation would be appropriate but not practical.
- **Takeover of insurer with insufficient records**: Where the AA is unable to judge the appropriateness of a predecessor AA's work.
- **Liabilities different than those calculated by the actuary**: Where the financial statements of an insurer report policy liabilities that are materially different from those calculated and reported to the regulator by the AA.
- **Change in assumption or methodology affecting disclosure items**: Where an item valued by the actuary is materially affected by a change in assumption or methodology that is not disclosed in the financial statements.

Paragraphs 2230.20-.29 of the CIA SOP contain information for assessing each of these situations, as well as revised opinion wording that can be used.

It is possible that a new appointment or takeover may lead to a reservation in reporting more often than under IFRS 4. For example, the CSM is a roll-forward from contract issue (or transition to IFRS 17), and the AA may not be able to review past information to allow them to opine that the total IFRS 17 liabilities (including CSM) are appropriate. Where possible, the AA would discuss the policies, methods and assumptions with the previous AA and report without reservation when there is no reason to believe the previous AA's work was inappropriate. However, this could initially lead to reporting with reservation until such time as the AA is able to vet to their satisfaction.

3. The opinion

The standard wording of the AA's opinion under IFRS 4 is as follows:[3]

[3] Per Paragraph 2130.16 of the CIA SOP, and applies to both life and health and P&C.

> To the policyholders [and shareholders] of [the ABC Insurance Company]:
>
> I have valued the policy liabilities [and reinsurance recoverables] of [the Company] for its [consolidated] [statement of financial position] at [31 December XXXX] and their change in the [consolidated statement of income] for the year then ended in accordance with accepted actuarial practice in Canada including selection of appropriate assumptions and methods.
>
> In my opinion, the amount of policy liabilities [net of reinsurance recoverables] makes appropriate provision for all policy obligations and the [consolidated] financial statements fairly present the results of the valuation.

This opinion needed to be revised because some of the words no longer apply. The scope paragraph has been revised to reflect the description of the new financial statements and the fact that the role of the AA in controlling the valuation has changed. The opinion paragraph has been revised to more clearly reflect the changed role while still providing comfort that the AA has applied professional expertise to the valuation and followed accepted actuarial practice in Canada. The revised opinion wording is as follows:

> To the policyholders [and shareholders] of [the ABC Insurance Company]:
>
> I have valued the policy liabilities of [the Company] for its [consolidated] financial statements prepared in accordance with International Financial Reporting Standards for the year ended [31 December xxxx].
>
> In my opinion, the amount of policy liabilities is appropriate for this purpose. The valuation conforms to accepted actuarial practice in Canada and the [consolidated] financial statements fairly present the results of the valuation.

The following paragraphs set out some observations and implications regarding the revised wording of the AA opinion:

"I have valued the policy liabilities of [the Company] for its [consolidated] financial statements prepared in accordance with International Financial Reporting Standards for the year ended [31 December XXXX]."

This statement sets out the scope and purpose of the valuation, namely, that the valuation is for the purpose of inclusion in financial statements prepared in accordance with IFRS. Therefore, in order to give the opinion that the valuation is appropriate for this purpose, the valuation must be in compliance with applicable accounting standards.

This aspect of the AA's opinion (i.e., that the valuation is in compliance with applicable accounting standards) has not changed. However, under IFRS 4, the rules/framework for the valuation of insurance contract liabilities were ceded to the actuarial profession by the accounting profession, and as a result, the AA's opinion that the valuation is in "accordance with accepted actuarial practice" automatically implies that it is consistent with applicable accounting standards.

Under IFRS 17, the rules/framework for the valuation of insurance contract liabilities are outlined in IFRS 17. In opining that the amount of policy liabilities is appropriate for the purpose of inclusion in financial statements prepared in accordance with IFRS, the AA is opining that the

valuation of insurance contracts complies with IFRS 17, the valuation of investment contracts complies with IFRS 9 and the valuation of service contracts complies with IFRS 15.

"The valuation conforms to accepted actuarial practice in Canada"

This wording replaces "I have valued the policy liabilities in accordance with accepted actuarial practice in Canada," but there is no change to the substance of the wording.

"including selection of appropriate assumptions and methods"

This clause in the AA's opinion was removed because it is redundant, and to avoid any possible confusion when a method or assumption is set by another party and the AA is using and taking responsibility for the work of another.

"the amount of policy liabilities is appropriate for this purpose"

This wording replaces "makes appropriate provision for all policy obligations." The context of the opinion has changed with IFRS 17, in that the AA will no longer be opining that the liabilities make "appropriate provision for all policy obligations," nor that they are "adequate" or "sufficient,"[4] as was sometimes the objective of the valuation under IFRS 4.

As described earlier, the AA is opining that the amount of policy liabilities is appropriate for the purpose of inclusion in financial statements that have been prepared in accordance with IFRS. This means that the valuation complies with applicable accounting standards and accepted actuarial practice in Canada.

"the [consolidated] financial statements fairly present the results of the valuation"

Although the wording of this section of the AA's opinion has not changed, the scope of "fairly present" is broader than under IFRS 4, as the presentation and disclosure requirements of IFRS 17 include more information about insurance contract liabilities, and more line items in the financial statements (e.g., insurance contract revenue) are derived from the AA's valuation. The new items required under IFRS 17 that would be considered by the AA in opining that the financial statements fairly present the results of the valuation include the following (where relevant):

- Statement of financial position:
  - Split of total insurance contract liabilities by portfolios of:
    - Insurance contracts issued that are assets
    - Insurance contracts issued that are liabilities
    - Reinsurance contracts held that are assets
    - Reinsurance contracts held that are liabilities
- Statement of financial performance:
  - Insurance revenue:
    - Expected claims and expenses (excluding investment components and amounts allocated to loss component)

[4] Sufficiency of liabilities and required capital would be considered in FCT.

    - Release of risk adjustment for the period (excluding amounts allocated to loss component)
    - CSM recognized for insurance contract services provided
    - Revenue for contracts measured under the PAA

  - Insurance service expenses:

    - Allocations to loss components
    - Allocations of insurance acquisition cash flows (revenue and expense)

  - Insurance finance income or expenses:

    - Effect of the time value of money
    - Effect of financial risk and change in financial risk
    - Effect of measuring changes in fulfilment cash flows at current discount rates but adjusting CSM for changes measured at locked-in discount rates
    - Application of the risk mitigation option

  - Amounts for reinsurance contracts held (either as a single amount, or separately for reinsurance premiums paid and amounts recovered from the reinsurer)

  - Other comprehensive income related to insurance contract liabilities (if elected)

- Other financial statement notes/disclosures:

  - Reconciliations (analysis of change in liabilities):

    - By component (present value of future cash flows, RA, CSM), each split by past/current/future service
    - By liability for remaining coverage (LRC)/liability for incurred claims (LIC); including loss component in LRC and LIC split by present value of future cash flows vs. RA for contracts measured under PAA
    - By insurance contracts issued and reinsurance contracts held

  - Amounts for contracts initially recognized in the period; in total and for onerous contracts only; separately for insurance contracts issued and reinsurance contracts held

  - Amounts for contracts in force at transition to IFRS 17; separately for groups measured using the full retrospective/modified retrospective/fair value approach to establishing the CSM

  - Discount rates used in the valuation

  - Confidence level of RA

4. Additional considerations for valuation work that is not subject to IFRS 17

Paragraph 2110.04 of the CIA SOP effective January 1, 2023, states:

> Where the valuation of insurance contracts and other obligations is not in accordance with IFRS 17, Sections 2200 and 2300 do not apply to the valuation and the valuation would be in accordance with any applicable accounting standards if the valuation is to be used for financial reporting, or the terms the actuary's engagement or as mandated by law or as prescribed by practice-specific standards.

When working on a mandate that falls in the category described in the above paragraph, the AA must first identify which standards and/or guidance/laws are applicable to the engagement (e.g., other IFRS standards or guidelines, or other [non-IFRS] accounting standards). The AA may want to seek help from other stakeholders (auditors, accountants, management) to help with this task. Then, the AA would follow the valuation parameters that are defined and/or mandated by any applicable accounting standards, by the terms of the engagement, by laws or by practice-specific standards.

When there are no applicable accounting standards for a valuation of insurance contracts, the AA may choose to follow IFRS 17 or follow the general section of the CIA SOP and, if applicable, the guidance presented in the educational note *Actuarial Considerations Related to Property and Casualty Valuation Work Not Subject to IFRS 17*, which corresponds to pre-IFRS 17 valuation guidance (claims and premiums liabilities are discounted with provisions for adverse deviations).

Appendix: Case studies

This appendix provides several case studies to illustrate potential situations the AA could face and the thought process the AA might follow, and whether these could lead to the AA reporting with reservation in the financial statements. This appendix is not intended to provide case studies on every situation the actuary might face, and is not intended to mandate what the AA would do in a specific situation. For each case study, not all of the questions raised in Section 2 of this educational note are addressed; rather, the focus is on the questions that may be most relevant to that particular case study. It is assumed that the AA is able to judge the appropriateness of the accounting policies or methods or assumptions set by others.

Case Study #1 – Discount rates/Illiquidity premium

Scenario: The entity backs illiquid insurance contract liabilities with liquid assets. Using a discount rate consistent with illiquid contracts means the liabilities could be insufficient to discharge the entity's obligations under the contracts. What would the AA do?

Q1 Is the approach to setting discount rates consistent with IFRS 17?

Sufficiency, or adequacy of liabilities, is not a requirement under IFRS 17. Under a bottom-up approach, discount rates would be determined independent of the assets backing the liabilities. Under a top-down approach, the entity would identify a reference portfolio of assets, the yield of which would be adjusted to eliminate factors not relevant to the insurance contracts (e.g., credit and market risks), with an adjustment for illiquidity if the liquidity characteristics of the reference portfolio are not consistent with the liquidity characteristics of the insurance contracts.

IFRS 17 does not require a particular technique for determining the illiquidity premium. However, the illiquidity premium would reflect the liquidity characteristics of the insurance contracts, which are not necessarily those of the assets supporting those liabilities.

Q2 Is the approach to setting discount rates consistent with accepted actuarial practice?

The AA would assess whether the method used to derive the discount rates is consistent with the CIA educational notes *IFRS 17 Discount Rates for Life and Health Insurance Contracts*, *IFRS 17 Discount Rates and Cash Flow Considerations for Property and Casualty Insurance Contracts* and *Application of IFRS 17 Insurance Contracts* ("IFRS 17 Application EN"). If so, the AA would likely conclude that the discount rates are consistent with accepted actuarial practice. If not, the AA would investigate further to understand the reason for the difference, and report with reservation if the conclusion is that discount rates are outside the range of accepted actuarial practice.

Q3 Are the discount rates similar to what the AA would have chosen?

In theory, where insurance contracts are highly illiquid, the discount rates could be set at a rate that is higher than the current yield or market return on a portfolio of (more liquid) assets. The AA would understand the implications of setting discount rates that create a negative bias in investment results. However, any threat to the financial condition of the company due to choosing more liquid assets to support insurance contract liabilities would be addressed in FCT

analysis, not by choosing discount rates that are not consistent with the IFRS 17 standard or that are outside the range of accepted actuarial practice.

As in any situation where reporting with reservation might be appropriate, the AA would be encouraged to discuss the issue with company management and auditors to ensure the issue is acknowledged and understood and, if possible, resolved.

Case Study #2 – Grouping

Scenario: Management is using a set of contracts (“set-based”) approach to grouping, and the AA is told that all contracts in a newly developed product are priced with the same profitability level and therefore would be in the same group. However, when the AA runs the numbers, they find that issue ages 60-65 appear to be onerous. For the sake of this case study, let’s assume that there are only two possible groups: onerous and non-onerous. What would the AA do?

Q1 Is the set-based approach to grouping consistent with IFRS 17?

IFRS 17 does not require a particular technique/approach for allocating newly issued contracts into groups. However, IFRS 17.17 highlights the key principles to follow when performing such allocation:

> If an entity has reasonable and supportable information to conclude that a set of contracts will all be in the same group applying paragraph 16, it may measure the set of contracts to determine if the contracts are onerous (see paragraph 47) and assess the set of contracts to determine if the contracts have no significant possibility of becoming onerous subsequently (see paragraph 19). If the entity does not have reasonable and supportable information to conclude that a set of contracts will all be in the same group, it shall determine the group to which contracts belong by considering individual contracts.

It is important to note that the set-based approach to grouping is only appropriate if there is reasonable and supportable information that sets of contracts are all in the same group. In this case study, the AA’s testing suggests that this is not the case, so the AA would investigate to understand why there is a difference.

Q2 Is the set-based approach to grouping consistent with accepted actuarial practice?

Under IFRS 17, the allocation to groups is performed on each individual contract. The set-based approach may be used only if contracts are grouped appropriately. The AA would review the relevant sections of the IFRS 17 Application EN (e.g., questions 5.15, 5.19).

There are various elements that could explain why contracts for issue ages 60-65 might appear to be onerous. In order to judge the appropriateness of the set-based approach, the AA would review any work done to confirm that the set-based approach is appropriate. If the AA is not satisfied, they could further test the assumptions (especially the granularity of assumptions), review pricing calculations or discuss with management.

A full discussion of the rationale justifying the use of a set-based approach is out of scope of this educational note. However, some key aspects that the AA may consider would include:

- Are there any legal constraints to pricing (e.g., unisex)?
- Are the assumptions used in the individual contract calculations set at a higher level of aggregation than the pricing assumptions, which could create a bias in the results?
- Are the contracts onerous due to seasonal factors?
- Is the number of onerous contracts insignificant, and the impact immaterial?

Q3 Are there any legal constraints to pricing?

IFRS 17.20 provides a key consideration for grouping policies:

> If, applying paragraphs 14–19, contracts within a portfolio would fall into different groups only because law or regulation specifically constrains the entity's practical ability to set a different price or level of benefits for policyholders with different characteristics, the entity may include those contracts in the same group. The entity shall not apply this paragraph by analogy to other items.

For example, if pricing is unisex (by law or regulation) and there is different expected experience between males and females, then males and females could be included in the same group even though one or the other is onerous when measured separately.

Q4 Are the assumptions used in the individual contract calculations set at a higher level of aggregation than the pricing assumptions, which could create a bias in the results?

As stated in IFRS 17.17, the entity shall determine the group to which contracts belong by considering individual contracts unless it has reasonable and supportable information to conclude that a set of contracts will all be in the same group. This being said, valuation assumptions may be set at a higher level than pricing assumptions, leading to a situation where an individual contract appears to be onerous using the valuation assumptions but would not be onerous using the more granular pricing assumptions.

Similarly, expense assumptions that are set as a level amount per contract may lead to a situation where a small contract appears to be onerous, but would not be onerous if expense assumptions were set as a level amount per thousand of coverage.

Q5 Are the contracts onerous due to seasonal factors?

Another reason that could explain why issue ages 60-65 appears to be onerous is seasonality factors such as acquisition expenses. For example, policies could be priced using expected acquisition expenses on a quarterly basis (i.e., same as the entity's reporting basis), but that there is seasonality in those expenses from month to month that could lead to some contracts appearing to be onerous at issue. If the assessment is performed on actual results on a monthly basis and expenses are higher than expected due to seasonality for a certain month but revert back to expected over the quarter, then the AA might judge that the entity's set-based approach is appropriate.

Q6 Is the number of onerous contracts insignificant, and the impact immaterial?

The AA could assess the appropriateness of the set-based approach considering the number and size of contracts that might be allocated to the wrong group.

In the event that the due diligence above proves to be sufficient, the AA would be able to report without reservation. If the AA is not able to accept the approach above, or results of the analysis are inconclusive, the AA would consider discussing the matter with management to try to make the appropriate changes to the grouping and allocate contracts for issue ages 60-65 to the onerous group. In that case, the valuation would be in accordance with IFRS 17 and the AA would report without reservation.

Case Study #3 – Reinsurance (risk adjustment)

Scenario: The entity has set the compensation it requires for bearing uncertainty related to the mortality risk assumption (e.g., +10% of best estimate assumption). This level of compensation was set on a net basis and takes into account the fact that the entity reinsures a significant portion of its mortality risk. For simplicity and convenience, the entity has also indicated that this compensation would be similar for direct business. However, the AA thinks it is possible that the entity would require a higher compensation on its direct business if it did not reinsure its mortality risk (e.g., +15% of the best estimate assumption). What would the AA do?

Q1 Is the risk adjustment for non-financial risk consistent with IFRS 17?

IFRS 17 does not require a particular technique for determining the level of risk adjustment for non-financial risk. However, paragraphs 37 and 64 of IFRS 17 highlight the key principles to follow when performing such assessment:

1. Direct: An entity shall adjust the estimate of the present value of the future cash flows to reflect the compensation that the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk.
2. Reinsurance: Instead of applying paragraph 37, an entity shall determine the risk adjustment for non-financial risk so that it represents the amount of risk being transferred by the holder of the group of reinsurance contracts to the issuer of those contracts.

Under IFRS 17, the compensation required for bearing non-financial risk is from the entity's point of view. IFRS 17 allows for the possibility that the compensation required by the entity is influenced by reinsurance of that risk; however, the AA would have to understand the details of the entity's requirements to come to a conclusion about whether using 10% on direct business is appropriate.

Although the AA suspects that a higher compensation for the direct contract may better reflect the entity's view, the question in this case study is whether the AA can accept that the compensation the entity requires is lower on account of the reinsurance of mortality risk. "Simplicity and convenience" are not sufficient justification for setting the risk adjustment at a level that is inconsistent with the compensation required by the entity.

The AA would review any relevant documentation and discuss their concerns with management and obtain further support and rationale for the view that the compensation required by the entity is 10% when the amount of risk transferred through reinsurance is taken into account.

Q2 Is the risk adjustment for non-financial risk consistent with accepted actuarial practice?

The AA would refer to the CIA guidance on risk adjustments as it pertains to reinsurance, as provided in the educational notes *IFRS 17 Risk Adjustment for Non-Financial Risk for Life and Health Insurance Contracts*, *IFRS 17 Risk Adjustment for Non-Financial Risk for Property and Casualty Insurance Contracts*, *IFRS 17 Actuarial Considerations Related to Reinsurance Contracts Issued and Held*, and the IFRS 17 Application EN.

Case Study #4 – Splitting of a reinsurance treaty

Scenario: The entity holds a reinsurance treaty that covers two types of coverages (e.g., personal property and commercial property contracts for P&C insurer, life insurance and disability insurance contracts for a life and health insurer), which are in separate portfolios. Legally, the treaty is a single contract. Management decides that it would be convenient from a systems/reporting perspective to split the treaty into two contracts so that each direct portfolio has its own reinsurance contract. Would the AA accept the decision to split the reinsurance treaty?

Q1 Is the identification of contracts consistent with IFRS 17?

Under IFRS 17, single (legal) contracts are separated into more than one insurance contract if required to reflect the substance of the contract. Guidance on applying judgment in the separation and combination of contracts can be found in the discussions of the Transition Resource Group (TRG) of the International Accounting Standards Board (February 2018 and May 2018). Of particular interest for this case study are paragraphs 20 and 21 of the TRG Staff Paper titled *Separation of insurance components of a single insurance contract* from their February 2018 discussions:

> 20. It is expected that entities would usually design contracts in a way that reflects their substance. Therefore a contract with the legal form of a single contract, unless artificially constructed this way, would generally be considered a single contract in substance. The staff observe that this is consistent with the contract being the lowest unit of account used under IFRS 17.
>
> 21. The staff acknowledge that there might be circumstances where the legal form of a single contract would not reflect the substance of its contractual rights and contractual obligations and therefore there might be justification in overriding the presumption of the contract being the lowest unit of account under IFRS 17.

Therefore, the AA would judge whether the two types of coverages are – in substance – separate contracts.

Q2 Is the identification of contracts consistent with accepted actuarial practice?

Guidance on applying judgement in the separation and combination of contracts can be found in questions 1.7, 1.8, 1.19, 5.8 and 5.9 of the IFRS 17 Application EN. Though there is no specific guidance for the situation presented in this case study, the principles discussed may provide some help in judging whether the contract should be separated.

Q3 Is the identification of contracts what the AA would have chosen?

The answer to this question will depend on whether the AA accepts the proposal of management that the reinsurance treaty should be split. If the AA is convinced that keeping the treaty as a single contract is required, the AA would discuss with management and the auditor to try to resolve the issue. If it persists, the AA may assess the materiality of the difference before deciding whether reporting with reservation is appropriate.

Case Study #5 – PAA earned revenue

Scenario: For a group of contracts valued under the PAA, management chooses to allocate revenue to reporting periods based on the passage of time for simplicity. The AA believes that the release of risk is not uniform over the contract boundary (e.g., warranty, snowmobile, catastrophe coverage, travel insurance).

Q1 Is the allocation of revenue consistent with IFRS 17?

IFRS 17.B126 states:

> When an entity applies the premium allocation approach in paragraphs 55–58, insurance revenue for the period is the amount of expected premium receipts (excluding any investment component and adjusted to reflect the time value of money and the effect of financial risk, if applicable, applying paragraph 56) allocated to the period. The entity shall allocate the expected premium receipts to each period of insurance contract services:
>
> > (a) on the basis of the passage of time; but
> >
> > (b) if the expected pattern of release of risk during the coverage period differs significantly from the passage of time, then on the basis of the expected timing of incurred insurance service expenses.

Based on this, the passage of time is a valid basis of allocating revenue to reporting periods unless significantly different than the expected pattern of release of risk. Therefore, the AA would judge whether the difference is significant, perhaps by estimating the impact of the difference. If the difference is significant, the AA would discuss their concern with management, the auditor and/or the external peer reviewer to attempt to resolve the issue.

If the issue is not resolved and management uses the “passage of time” despite it being significantly different that the expected pattern of release of risk, reporting with reservation may be appropriate.

Q2 Is the allocation of revenue consistent with accepted actuarial practice in Canada?

Question 7.12 of the IFRS 17 Application EN provides guidance on the topic of this case study, including a discussion of the meaning of “significant” in this context.