



Actuarial Standards Board  
Conseil des normes actuarielles

# Standards of Practice

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**1000—GENERAL**

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## 1100 INTRODUCTION

### 1110 DEFINITIONS

- .01 Each term set over dotted underlining has the meaning given in this section and has its ordinary meaning otherwise (e.g., external user).
- .02 Accepted actuarial practice is the manner of performing work in Canada in accordance with the Rules and these Standards of Practice. Standards of Practice are the responsibility of the Actuarial Standards Board and approval of standards and changes to standards is made through a process that involves consultation with the actuarial profession and other interested parties. Unless the context requires otherwise, references to accepted actuarial practice refer to accepted actuarial practice for work in Canada. [*pratique actuarielle reconnue*]
- .03 Actuarial cost method is a method to allocate the present value of a plan's obligations to time periods, usually in the form of a service cost and an accrued liability. [*méthode d'évaluation actuarielle*]
- .03.1 Actuarial evidence work is work where the actuary provides an expert opinion with respect to any area of actuarial practice in the context of an actual or anticipated dispute resolution proceeding, where such expert opinion is expected or required to be independent. A dispute resolution proceeding may be a court or court-related process, a tribunal, a mediation, an arbitration, or a similar proceeding. Actuarial evidence work may include the determination of capitalized values in respect of an individual, or the provision of an expert opinion with respect to a dispute involving an actuarial practice area, such as pensions or insurance, or questions of professional negligence. [*travail d'expertise devant les tribunaux*]
- .04 Actuarial present value method is a method to calculate the lump sum equivalent at a specified date of amounts payable or receivable at other dates as the aggregate of the present values of each of those amounts at the specified date, and taking into account both the time value of money and contingent events. [*méthode de la valeur actuarielle*]
- .04.1 Actuary, as it is used in these standards, means anyone bound by these standards for work in Canada. [*actuaire*]
- .05 Anti-selection is the tendency of one party in a relationship to exercise options to the detriment of another party when it is to the first party's advantage to do so. [*antisélection*]
- .06 Appointed actuary of an entity is an actuary formally appointed, pursuant to legislation, by the entity to monitor the financial condition of that entity. [*actuaire désigné*]
- .07 Appropriate engagement is one that does not impair the actuary's ability to conform to the rules. [*mandat approprié*]
- .08 Benefits liabilities are the liabilities of a plan in respect of claims incurred on or before a calculation date. [*obligations liées aux prestations*]
- .09 Best estimate means without bias, neither conservative nor unconservative. [*meilleure estimation*]
- .09.1 Bylaws means the bylaws of the Canadian Institute of Actuaries, as amended from time to time. [*Statuts administratifs*]

- .10 Calculation date is the effective date of a calculation; e.g., the balance sheet date in the case of a valuation for financial statements. It usually differs from the report date. [*date de calcul*]
- .11 Case estimate at a calculation date is the unpaid amount of one of, or a group of, an insurer's reported claims (perhaps including the amount of claim adjustment expenses), as estimated by a claims professional according to the information available at that date. [*évaluation du dossier*]
- .12 Claim adjustment expenses are internal and external expenses in connection with settlement of claims. [*frais de règlement des sinistres*]
- .13 Claim liabilities are the portion of insurance contract liabilities in respect of claims incurred on or before the balance sheet date. [*passif des sinistres*]
- .14 Contingent event is an event which may or may not happen, or which may happen in more than one way or which may happen at different times. [*éventualité*]
- .15 Contribution is a contribution by a participating employer or a plan member to fund a benefits plan. [*cotisation*]
- .15.01 Contribution principle is a principle of policyholder dividend determination whereby the amount deemed to be available for distribution to policyholders by the directors of a company is divided among policies in the same proportion as policies are considered to have contributed to that amount. [*principe de contribution*]
- .15.1 Credibility is a measure of the predictive value attached to an estimate based on a particular body of data. [*crédibilité*]
- .16 Definitive means permanent and final. [*décision définitive*]
- .17 Development of data with respect to a given coverage period is the change in the value of those data from one calculation date to a later date. [*matérialisation*]
- .18 Domain of actuarial practice is the measurement of the current financial implications of future contingent events. [*domaine de la pratique actuarielle*]
- .19 Early implementation means the implementation of new standards before their effective date. [*mise en œuvre anticipée*]
- .20 Earnings-related benefit is a benefit whose amount depends on the recipient's earnings. [*régime salaire de carrière*]
- .21 External user is a user who is not an internal user. [*utilisateur externe*]
- .22 External user report is a report whose users include an external user. [*rapport destiné à un utilisateur externe*]
- .23 Financial condition of an entity at a date is its prospective ability at that date to meet its future obligations, especially obligations to policy owners, members, and those to whom it owes benefits. Financial condition is sometimes called "future financial condition". [*santé financière*]
- .24 Financial position of an entity at a date is its financial state as reflected by the amount, nature, and composition of its assets, liabilities, and equity at that date. [*situation financière*]
- .25 To fund a plan is to dedicate assets to its future benefits and expenses. Similarly for "funded" and "funding". [*provisionner*]

- .25.1 Funded status is the difference between the value of assets and the actuarial present value of benefits allocated to periods up to the calculation date by the actuarial cost method, based on a valuation of a pension plan or post-employment benefit plan. [*niveau de provisionnement*]
- .26 Going concern valuation is a valuation which assumes that the entity to which the valuation applies continues indefinitely beyond the calculation date. [*évaluation en continuité*]
- .27 Indexed benefit is a benefit whose amount depends on the movement of an index like the Consumer Price Index. [*prestation indexée*]
- .27.01 Indicated rate is the best estimate of the premium required to provide for the corresponding expected claims costs, expenses, and provision for profit. [*taux indiqué*]
- .27.1 Insurance contract is a contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder. Insurance contract includes group insurance, third party contracts where the owner of the contract and the person who is compensated (the policyholder) differ, and all like arrangements substantively in the nature of insurance.<sup>1</sup> [*contrat d'assurance*]
- .27.2 Insurance contract liabilities in an insurer's statement of financial position are the liabilities at the date of the statement of financial position on account of the insurer's insurance contracts, including commitments, which are in force at that date or which were in force before that date. [*passif des contrats d'assurance*]
- .28 Insurer is the party that has an obligation under an insurance contract to compensate a policyholder if an insured event occurs. Insurer includes a fraternal benefit society and the Canadian branch of a foreign insurer, but does not include a public personal injury compensation plan.<sup>1</sup> [*assureur*]
- .29 Internal user is the actuary's client or employer. Internal user and external user are mutually exclusive. [*utilisateur interne*]
- .30 Internal user report is a report all of whose users are internal users. [*rapport destiné à un utilisateur interne*]
- .31 Margin for adverse deviations is the difference between the assumption for a calculation and the corresponding best estimate assumption. [*marge pour écarts défavorables*]
- .32 New standards means new standards, or amendment or rescission of existing standards. [*nouvelles normes*]
- .33 Periodic report is a report that is repeated at regular intervals. [*rapport périodique*]

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<sup>1</sup> The wording of the first sentence of this definition is identical to the corresponding definition appearing in IFRS 4 Appendix A, as of November 2009. The second sentence is explanatory and not part of that definition.

- .34 Plan Administrator is the person or entity with overall responsibility for the operation of a benefit plan. [*administrateur d'un régime*]
- .35 Policy liabilities in an insurer's statement of financial position are the liabilities at the date of the statement of financial position on account of the insurer's policies, including commitments, which are in force at that date or which were in force before that date. Policy liabilities consist of insurance contract liabilities and liabilities for policy contracts other than insurance contracts. [*passif des polices*]
- .35.1 Policyholder is a party that has a right to compensation under an insurance contract if an insured event occurs.<sup>2</sup> [*titulaire de police*]
- .36 Practice committee means the committee or committees of the Canadian Institute of Actuaries, either standing or ad hoc, to which the Practice Council of the Canadian Institute of Actuaries has assigned responsibility for the practice area or areas to which particular Standards of Practice apply. [*commission de pratique*]
- .37 Premium liabilities are the portions of insurance contract liabilities that are not claim liabilities. [*passif des primes*]
- .38 Prescribed means prescribed by these standards. [*prescrit*]
- .38.1 Property and casualty insurance is insurance that insures individuals or legal persons
- having an interest in tangible or intangible property, for costs arising from loss of or damage to such property (e.g., fire, fidelity, marine hull, warranty, credit, legal expense and title insurance), or
  - for damages to others or costs arising from the actions of such persons (e.g., liability and surety bonds) and for costs arising from injury to such persons (e.g., automobile accident benefits insurance). [*assurances IARD*]
- .39 Provision for adverse deviations is the difference between the actual result of a calculation and the corresponding result using best estimate assumptions. [*provision pour écarts défavorables*]
- .40 Public personal injury compensation plan means a public plan
- whose primary purpose is to provide benefits and compensation for personal injuries,
  - whose mandate may include health and safety objectives and other objectives ancillary to the provision of benefits and compensation for personal injuries, and
  - that has no other substantive commitments.

The benefits and compensation provided under such public plans are defined by statute. In addition, such public plans have monopoly powers, require compulsory coverage except for those groups excepted by legislation or regulation, and have the authority to set assessment rates or premiums. [*régime public d'assurance pour préjudices corporels*]

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<sup>2</sup> The wording of this definition is identical to the corresponding definition appearing in IFRS 4 Appendix A, as of November 2009.



- .41 Recommendation means an italicized recommendation in these standards. Similarly for “recommend”. [*recommandation*]
- .41.1 Related experience includes premiums, claims, exposures, expenses, and other relevant data for events analogous to the insurance categories under consideration other than the subject experience and may include established rate levels or rate differentials or external data. [*expérience connexe*]
- .42 Report is an actuary’s oral or written communication to users about his or her work. Similarly for “to report”. [*rapport*]
- .43 Report date is the date on which the actuary completes the report on his or her work. It usually differs from the calculation date. [*date du rapport*]
- .43.1 Reinsurance recoverables in an insurer’s balance sheet are the assets at the balance sheet date on account of reinsurance treaties, including commitments, which are in force at that date or which were in force before that date. [*sommes à recouvrer auprès des réassureurs*]
- .44 Report pursuant to law is a report for which the law requires an actuary’s opinion. [*rapport en vertu de la loi*]
- .45 Rule means a rule in the Canadian Institute of Actuaries’ Rules of Professional Conduct. [*règle*]
- .46 Scenario is a set of consistent assumptions. [*scénario*]
- .47 Service cost is that portion of the present value of a plan’s obligations which an actuarial cost method allocates to a time period, excluding any amount for that period in respect of unfunded accrued liabilities. [*cotisation d’exercice*]
- .48 Standard reporting language is standard language for an external user report. [*libellé du rapport type*]
- .48.1 Subject experience includes premiums, claims, exposures, expenses, and other data for the insurance categories under consideration. [*expérience visée*]
- .49 Subsequent event is an event of which an actuary first becomes aware after a calculation date but before the corresponding report date. [*événement subséquent*]
- .49.1 Trend is the tendency of data values to change in a general direction from one coverage period to a later coverage period. [*tendance*]
- .50 Use means use by the actuary, usually in the context of use of another person’s work. [*utilisation*]

- .51 User means an intended user of the actuary's work. [*utilisateur*]
- .52 Virtually definitive means to become definitive upon completion of one or more actions which are seen as formalities. [*pratiquement définitive*]
- .53 Work means the actuary's work within the domain of actuarial practice and usually includes  
acquisition of knowledge of the circumstances of the case,  
obtaining sufficient and reliable data,  
selection of assumptions and methods,  
calculations and examination of the reasonableness of their result,  
use of other persons' work,  
formulation of opinion and advice,  
reporting, and  
documentation. [*travail*]

## 1120 INTERPRETATION

### Recommendations

- .01 These standards are binding on Fellows, Associates and Affiliates of the Canadian Institute of Actuaries for work in Canada and for members of bilateral organizations, as defined in the bylaws, when those members are practising in Canada.
- .02 The standards consist of recommendations and other guidance.
- .03 A recommendation is the highest order of guidance in the standards. Unless there is evidence to the contrary, there is a presumption that a deviation from a recommendation is a deviation from accepted actuarial practice.
- .04 Each recommendation is in *italicized text*, followed by its effective date in square brackets.

### Other guidance

- .05 The other guidance supports and expands upon the recommendations and is in roman text. The other guidance consists of definitions, explanations, examples, and useful practices.

### Effective date of recommendations

- .06 The effective date is usually unrelated to the report date. A superseded recommendation may continue in effect if work is delayed. The notice of adoption would discuss such a case.
- .07 The following four paragraphs (subject to the notice of adoption of new standards in a particular case) describe the application of the effective date to a recommendation in new standards.
- .08 For work related to a fiscal period or periods, a recommendation applies if the first day of the fiscal period is on or after the recommendation's effective date. For example, a recommendation applies
- to work on financial statements if the accounting period of the financial statements begins on or after the recommendation's effective date,
  - to advice on funding a benefits plan during periods which begin on or after the recommendation's effective date, and
  - to dynamic capital adequacy testing if the opening day of the related forecasts is on or after the recommendation's effective date.

- .09 For work related to an event, a recommendation applies if the date of the event is on or after the recommendation's effective date. For example, a recommendation applies
- to work on the wind-up of a benefits plan if the wind-up is effective on or after the recommendation's effective date, and
  - to work on the transfer of policies from one insurer to another if the transfer is effective on or after the recommendation's effective date.
- .10 For calculation of a capitalized value, a recommendation applies if the calculation date is on or after the recommendation's effective date. Examples are the capitalized value of pension plan benefits for a marriage breakdown or a commuted value payable upon termination of membership in a pension plan.
- .11 For other work, a recommendation applies if the report date is on or after the recommendation's effective date.

### **General standards and practice-specific standards**

- .12 The standards consist of general standards and practice-specific standards. With the exception noted below, the general standards apply to all areas of actuarial practice. In addition, the standards in part 4000 apply to all areas of actuarial practice if the actuary's work in an area meets the definition of actuarial evidence work.
- .13 Usually, the intent of the practice-specific standards is to narrow the range of practice considered acceptable under the general standards. For example, the practice-specific standards for selection of a margin for adverse deviations for valuation of the insurance contract liabilities of an insurer narrow the range of practice which would be acceptable under the corresponding general standards.
- .14 In exceptional cases, however, the intent of practice-specific standards is to define as acceptable a practice that would not be acceptable under the general standards, in which case that intent is specifically noted by words in a practice-specific recommendation like: “*Notwithstanding the general standards, the actuary should...*”, followed by a description in roman text for the exception.

### **Drafting**

- .15 “Should” is the strongest mandating word in the standards, appearing only in recommendations, often in the expression, “The actuary should...”
- .16 “Would” is a suggestive word appearing in the roman text, often in the expression, “The actuary would...”, and is less forceful than the mandative “should”.

.17 “May” is a permissive word, appearing in both recommendations and the roman text, often in the expression, “The actuary may...” and often with conditions attached. It defines a safe harbour. For example: in paragraph 1610.01, the recommendation is that “*The actuary may use and take responsibility for another person’s work if such actions are justified.*” and the roman text describes steps which constitute justification. The actuary who is satisfied that the actions are justified has done all that may be reasonably expected and has therefore complied with accepted actuarial practice, even if the use turns out not to be well-founded.

.18 Repealed

.19 The examples are often simplified and are not all-inclusive.

### **Lay readers of the standards**

.20 The standards are drafted as much as possible in ordinary business terminology rather than technical actuarial terminology, so that non-actuaries familiar with business terminology may understand them. For example, the standards refer to “insurance contract liabilities” rather than to “reserves” because, in financial reporting, “reserve” can mean an appropriation of surplus rather than a liability.

### **1130 JUDGMENT**

.01 *The actuary should exercise reasonable judgment in applying the standards. A judgment is reasonable if it is objective and takes account of*

*the spirit and intent of the standards,*

*the Canadian Institute of Actuaries’ Guiding Principle No. 1,*

*the rules,*

*common sense, and*

*constraints on time and resources. [Effective December 1, 2002]*

### **Need for judgment**

.02 While the standards are drafted so that they are, as much as possible, understandable by lay persons, the judgment of the actuary is necessary for their application.

.03 The need for judgment is so pervasive that its continual mention is impractical, and so is understood in the drafting. Here are three examples of how recommendations are drafted and how they are to be understood:

Drafted: “*Deviation from a particular recommendation or other guidance in the standards is accepted actuarial practice if the effect of doing so is not material.*”

Understood: “*Deviation from a particular recommendation or other guidance in the standards is accepted actuarial practice if, in the actuary’s judgment, the effect of doing so is not material.*”

Drafted: “*The actuary may use and take responsibility for the work of another person if such actions are justified.*”

Understood: “*The actuary may use and take responsibility for the work of another person if the actuary is reasonably satisfied that such actions are justified.*”

Drafted: “*When working with respect to an entity, the actuary should have knowledge of the circumstances of the case which is needed for the work.*”

Understood: “*When working with respect to an entity, the actuary should have reasonable knowledge of the circumstances of the case which is needed for the work.*”

.04 The exercise of judgment is not clear cut, except perhaps in hindsight. A judgment which is reasonable at its making is not made unreasonable by later hindsight.

.05 A judgment which is completely subjective would not be reasonable even though it may be based on honest belief. A reasonable judgment would be objective and demonstrably take account of the criteria listed in the recommendation and discussed below.

### **Spirit and intent**

.06 An actuary who has a question about the standards in a particular case can sometimes answer the question by

considering the Canadian Institute of Actuaries’ Guiding Principle No. 1 (“In carrying on its activities and programs, the Institute holds the duty of the profession to the public above the needs of the profession and its members”),

considering the rules, especially Rule 1 (Professional Integrity) (“A member shall act honestly, with integrity and competence, and in a manner to fulfil the profession’s responsibility to the public and to uphold the reputation of the actuarial profession.”), and

posing the question, “If I had to defend my work to my peers, could I persuade them that I had sound reasons underlying my judgment?”

.07 An actuary who has a question about the spirit and intent of the Standards of Practice in a particular case may also consult in confidence with the chairperson or vice-chairperson of the Practice Council of the Canadian Institute of Actuaries or of an appropriate practice committee.

.08 An actuary who has a question about the spirit and intent of the Standards of Practice in a particular case may also consult another actuary. It is expected that the other actuary will, as a professional courtesy, offer reasonable assistance. Such consultation would be made with consideration to Rule 13 (Collateral Obligations).

**Guiding Principle No. 1, rules, and common sense**

- .09 A strained interpretation of a rule or recommendation is inappropriate.
- .10 An outlandish result or a seeming impossibility of applying the standards would indicate either a misinterpretation of the standards or their inapplicability to the situation.
- .11 Certain recommendations call for the actuary to obtain information relevant to the circumstances of the case; for example: see subsections 1450 and 1520, and paragraph 1730.06.
- .12 The actuary would conform to the “integrity”, and “skill and care” requirements of Rule 1 (Professional Integrity) by making a reasonable effort to obtain that information. The actuary is not responsible if that effort fails because the information is obscure or is withheld.

**Constraint on time and resources**

- .13 The actuary would normally conduct work in compliance with accepted actuarial practice. In some circumstances within the scope of an appropriate engagement, however, the actuary’s work may be constrained by available time and resources. In such circumstances the actuary would adopt an interpretation and application that strikes a reasonable balance between compliance and modifications due to the constraints, after consideration of accepted actuarial practice with respect to materiality and the use of approximations. The actuary would report to the user any deviation from accepted actuarial practice.

## 1200 APPLICATION

### 1210 ACCEPTED ACTUARIAL PRACTICE

- .01 *The actuary should conform to accepted actuarial practice except when it conflicts with law or the terms of an appropriate engagement. A user of the actuary's work may assume that it is in accordance with accepted actuarial practice except when the actuary reports otherwise. [Effective December 1, 2002]*
- .02 The rules and the standards are the only explicit articulation of accepted actuarial practice for work in Canada. Explanation, examples, and other useful guidance may also be found in new standards, not yet effective but whose early implementation is appropriate, Educational Notes, actuarial principles, exposure drafts, historical records, and Canadian and international actuarial literature.
- .03 Their applicability and their relative importance in a particular case is a matter for judgment, but the rules are the Canadian Institute of Actuaries' highest order of guidance, deviation from the rules is professional misconduct, and there is a presumption that a deviation from a recommendation is a breach of accepted actuarial practice, so that the onus for justification of that deviation is on the actuary.
- .04 Accepted actuarial practice is sometimes called "generally accepted actuarial practice" (for example, in the federal Insurance Companies Act) or "generally accepted actuarial principles".
- .05 The actuary usually reports having done his or her work in accordance with accepted actuarial practice in Canada, which is the norm and which, in the absence of disclosure of a deviation, is the expectation of users of actuaries' work. The permitted deviations are for conflict with law and with the terms of an appropriate engagement.



## 1220 EDUCATIONAL NOTES

- .01 *The actuary should be familiar with relevant Educational Notes and other designated educational material.* [Effective December 1, 2002]
- .02 Educational Notes and other designated educational material describe but do not recommend practice in illustrative situations.
- .03 A practice that the Educational Notes describe for a situation is not necessarily the only accepted practice for that situation and is not necessarily accepted actuarial practice for a different situation.
- .04 The Educational Notes are intended to illustrate the application (but not necessarily the only application) of the standards, so there should be no conflict between them. By comparison, research papers and task force reports may or may not be in compliance with the standards. In any case, the Educational Notes are not binding.

## 1230 SCOPE

- .01 *The standards apply to work in Canada.*
- .02 *The application of any recommendations beyond their scope should take account of relevant circumstances.* [Effective December 1, 2002]

### Work in Canada vs. work in another country

- .03 The distinction between work in Canada and work in another country depends primarily on the ultimate purpose of the work. It does not depend on where the actuary lives or where the actuary happens to be when doing the work.
- .04 Work in compliance with the laws or customs of a country or a particular region within that country is work in that country. Here are examples for financial reporting, taxation, and litigation:

If the work relates to financial reporting in accordance with U.S. generally accepted accounting principles, then the work is work in the U.S.A. Thus, a valuation of the liabilities of a pension plan of a Canadian subsidiary of a U.S. multinational for the consolidated financial statements of the multinational is work in the U.S.A.

If the work relates to taxation under the U.S. *Internal Revenue Code*, then the work is work in the U.S.A. Thus, a valuation of the policy liabilities of the U.S. branch of a Canadian insurer for the insurer's U.S. income tax return is work in the U.S.A.

If the work relates to litigation under U.S. law before a U.S. court, then the work is work in the U.S.A. Thus, a report to the lawyer of a Canadian defendant insured by a Canadian insurer on a claim for damages litigated under U.S. law in a U.S. court is work in the U.S.A.

- .05 There may be cases when the distinction is not clear; for example, advice to a Canadian insurer on products to be sold outside Canada. In some of those cases, accepted actuarial practice may be the same in both countries, so the distinction does not matter. If the distinction matters, the actuary would, if practical, agree with the user and report on the appropriate practice and, failing agreement, would report the implications of the distinction.

### **Work outside Canada**

- .06 The best guidance for work in another country is the accepted actuarial practice for work in that country. This encompasses the formal guidance, analogous to the rules and standards, which the actuarial profession in that country gives to its members. An example is the standards of practice developed by the Board for Actuarial Standards of the Financial Reporting Council in the United Kingdom. If that guidance does not exist or is limited, then these standards may provide useful guidance. The general standards are more likely to provide useful guidance than the practice-specific standards: in either case, however, the actuary would take account of differences between the laws and customs of the other country and those of Canada.
- .07 In some cases, the applicability of foreign guidance to Canadian Institute of Actuaries members is formal. The Canadian Institute of Actuaries has reciprocal agreements with its counterpart professional organizations in certain other countries under which the Canadian Institute of Actuaries deems the formal guidance which the counterpart gives to its members to be applicable to Fellow(s), Associate(s) and Affiliate(s) of the Canadian Institute of Actuaries for work in that country. One of the purposes of the International Actuarial Association is to promote such reciprocal agreements.
- .08 For example, for work in the U.S.A., Fellows, Associates and Affiliates of the Canadian Institute of Actuaries are bound by
- the Code of Professional Conduct of the American Academy of Actuaries,
  - the Actuarial Standards of Practice and the Actuarial Practice Guidelines of the Actuarial Standards Board of the U.S.A., and
  - the Qualification Standards of the American Academy of Actuaries.

### **Extension of scope**

- .09 The standards applicable to a particular situation do not necessarily provide useful guidance in a second, similar situation for which there are no standards. If they do provide useful guidance in the second situation, then the actuary would consider what modification is necessary in order to take account of the difference between the two situations.
- .10 If the standards for the first situation are silent about the second situation, and if the actuary's work in the second situation is in accordance with those standards, appropriately modified, then the actuary would so report. If the standards for the first situation specifically exclude the second situation from their scope, and if it is, either by coincidence or convenience, appropriate for the actuary's work in the second situation to be in accordance with a modification of those standards, then the actuary would report the work without reference to those standards.

- .11 For example, consider the practice-specific standards that apply to the work of the appointed actuary of an insurer.

They include standards for valuation of the insurer's insurance contract liabilities. Those standards apply to the work of an appointed actuary. They also apply, under circumstances set out therein, to the work of an actuary, who is not an appointed actuary, who is responsible for the valuation of the insurance contract liabilities of an insurer.

They also include standards for reporting an adverse condition that requires rectification. The standards explicitly exclude an actuary of an insurer who is not an appointed actuary from their scope because that actuary would not have the necessary authority and legal immunity. Extension of the scope of those standards would not be appropriate.

- .12 Application of standards to work outside Canada is always an application beyond their scope, as the standards apply only to work in Canada. However, such applications may be appropriate when the local profession provides no guidance.
- .13 Extension of the scope of the general standards is more likely to be appropriate than extension of the scope of the practice-specific standards.

## **1240 ASSOCIATES**

- .01 “Associate” means a person enrolled as an associate of the Canadian Institute of Actuaries, pursuant to Section 5 of the bylaws.
- .02 The Canadian Institute of Actuaries does not expect an Associate to take responsibility for work. An Associate doing so, however, is as accountable as an actuary for that work and may not plead limited qualification or inexperience as an extenuating circumstance for a breach of accepted actuarial practice. The standards therefore apply to that Associate, with “Associate” substituted for “actuary”, but without any implication that the Associate is an actuary.

## 1300 PERMITTED DEVIATIONS

### 1310 CONFLICT WITH LAW

- .01 *If accepted actuarial practice conflicts with the law, then the actuary should comply with the law, but should report the conflict and, if practical, useful and appropriate under the terms of the engagement, report the result of applying accepted actuarial practice. [Effective July 1, 2011]*
- .02 On occasion, accepted actuarial practice may conflict with applicable law, in which case the law governs. For example,
- the amount required to fund a registered pension plan may exceed the amount which the *Income Tax Act* permits a contributor to contribute, or
- regulation may preclude the use of present values in valuing an insurer's insurance contract liabilities.
- .03 If the law merely requires a practice, or limits practice to a range, that is within the range of accepted actuarial practice, then accepted actuarial practice does not conflict with the law.
- .04 If accepted actuarial practice conflicts with a practice that the law permits, but does not require, and if the terms of the actuary's engagement call for that practice, then the actuary would be guided by the recommendation in subsection 1320, Conflict with terms of engagement.
- .05 Description of the conflict and disclosure of its effect is useful in order to
- disclose that the work deviates from accepted actuarial practice,
- disclose that the work, insofar as the conflict is concerned, is in accordance with the requirements of the legislator or regulator, which vary by jurisdiction, rather than accepted actuarial practice, which is uniform across Canada, and
- promote eventual adoption of accepted actuarial practice into law.
- .06 The actuary may report the result of applying accepted actuarial practice either qualitatively or quantitatively. A quantitative report provides better information but requires more work.
- .07 It is practical to report the result of applying accepted actuarial practice unless the work to do so is onerous or the needed data are unobtainable. If a quantified result is not practical, then a verbal description of the result is better than no report.
- .08 The usefulness of reporting the result may vary among users. The criterion of usefulness is, therefore, usefulness to any user.

### **1320 CONFLICT WITH TERMS OF ENGAGEMENT**

- .01 *If accepted actuarial practice conflicts with the terms of an appropriate engagement, then the actuary may comply with the terms of that engagement, but should report the conflict and, if practical, useful and appropriate under the terms of that engagement, report the result of applying accepted actuarial practice. [Effective July 1, 2011]*
- .02 The recommendation permits no deviation from the rules but may permit deviation from a particular recommendation or other guidance in the standards.
- .03 Usually, the actuary is responsible for all aspects of his or her work and performs it in accordance with accepted actuarial practice. The engagement to which the recommendation applies is usually one in which one or more aspects of work are omitted or are stipulated by the client or employer or the terms of a benefits plan. Examples of such an engagement are situations where
- the actuary uses, but does not take responsibility for, the data, the software system, or the work, of the staff of the client or employer, and
- the client or employer or the terms of a benefits plan stipulates a method or an assumption that is not in accordance with accepted actuarial practice.
- .04 Conflict between accepted actuarial practice and the law is not the same as conflict between accepted actuarial practice and the terms of an engagement. In the case of conflict with law, the actuary has no discretion; the law calls for a report by an actuary and stipulates the performance of one or more aspects of the needed work. In the case of an engagement whose terms call for deviation from accepted actuarial practice, the actuary has discretion to accept or not to accept the engagement.
- .05 The practicality and usefulness of reporting a result in accordance with accepted actuarial practice are the same as for subsection 1310, Conflict with law.

### **1330 UNUSUAL AND UNFORESEEN SITUATIONS**

- .01 *Deviation from a particular recommendation or other guidance in the standards is accepted actuarial practice for an unusual or unforeseen situation for which the standards are inappropriate. The actuary should disclose, in confidence, that situation to the chairperson or vice-chairperson of the appropriate practice committee or of the Practice Council of the Canadian Institute of Actuaries. [Effective July 1, 2011]*

- .02 An unusual or unforeseen situation could arise because it is neither practical nor useful to anticipate every situation when drafting the standards. Disclosure of such a situation gives the Actuarial Standards Board of Canada an opportunity to decide whether the standards need to be revised to cater to it, which results in better standards, or whether the situation is so exceptional that the standards cannot reasonably be expected to cater to it. The purpose of the recommended disclosure is not to decide whether or not the actuary's conduct was in accordance with accepted actuarial practice. The actuary may therefore make that disclosure in confidence, either before or after the event. It is not appropriate for the actuary to limit that disclosure to a report that the Canadian Institute of Actuaries may not see.
- .03 Accepted actuarial practice evolves. The standards are not intended to inhibit research and discussion that contribute to that evolution. In an unusual or unforeseen situation, they may produce an inappropriate result and are therefore no substitute for sound judgment.
- .04 The chairperson or vice-chairperson to whom the situation is disclosed would follow the procedures set out in Rule 13 (Collateral Obligations).
- .05 Usually, the actuary would report without reservation when deviating from a particular recommendation or other guidance in the standards in accordance with this subsection 1330, but it may sometimes be appropriate to describe and justify the deviation in the report.

### **1340 MATERIALITY**

- .01 *Deviation from a particular recommendation or other guidance in the standards is accepted actuarial practice if the effect of so doing is not material.* [Effective December 1, 2002]
- .02 Judgment about materiality pervades virtually all work and affects the application of nearly all standards. The words “materiality” and “material” seldom appear in the standards, but are understood throughout them. For example, the recommendation that approximation is appropriate if it does not affect the result means that it does not materially affect the result.
- .03 “Material” has its ordinary meaning, but is judged from the point of view of a user, having regard for the purpose of the work. Thus, an omission, understatement, or overstatement is material if the actuary expects it materially to affect either the user's decision making or the user's reasonable expectations. When the user does not specify a standard of materiality, judgment falls to the actuary. That judgment may be difficult for one or more of these reasons.

The standard of materiality depends on how the user uses the actuary's work, which the actuary may be unable to foresee. If practical, the actuary would discuss the standard of materiality with the user. Alternatively, the actuary would report the purpose of the work as precisely as possible, so that the user is warned of the risk of using the work for a different purpose with a more rigorous standard of materiality.

The standard of materiality may vary among users. The actuary would choose the most rigorous standard of materiality among the users.

The standard of materiality may vary among uses. For example, the same accounting calculations may be used for a pension plan's financial statements and the financial statements of its participating employer. The actuary would choose the more rigorous standard of materiality between those two uses.

The standard of materiality depends on the user's reasonable expectations, consistent with the purpose of the work. For example, advice on winding-up a pension plan may affect each participant's share of its assets, so there is a conflict between equity and practicality. The same is true for advice on a policy dividend scale.

.04 The standard of materiality also depends on the work and the entity that is the subject of that work. For example,

a given dollar standard of materiality is more rigorous for a large than for a small entity,

the standard of materiality for valuation of an insurer's policy liabilities is usually more rigorous for those in its financial statements than for those in a forecast in dynamic capital adequacy testing,

the standard of materiality for data is more rigorous for calculating an individual benefit (such as in a pension plan wind-up) than for a valuation of a group benefits plan (such as a going concern valuation of a pension plan), and

the standard of materiality for work involving a threshold, such as a regulatory capital adequacy requirement calculation of an insurer or a statutory minimum or maximum funding level for a pension plan would become more rigorous as the entity approaches that threshold.

.05 The actuary would not report an immaterial deviation from a particular recommendation or other guidance in the standards except if doing so assists a user to decide whether the standard of materiality is appropriate for that user.

.06 The recommendation applies to both calculation and reporting standards.

### Calculation standards

- .07 The result of applying a recommendation may not differ materially from the result of a simpler practice requiring less time and expense. For example, the practice-specific recommendations for valuation of insurance contract liabilities for term life insurance have little effect on an insurer whose volume of term life insurance is trivial. To ignore them in that situation is accepted actuarial practice if it helps the actuary to concentrate time and resources on material items.
- .08 In considering materiality, it is not appropriate to net items that are reported separately. For example, if simple practices requiring less time and expense than those in the recommendations materially overstate the premium liabilities and materially understate its claim liabilities, but do not materially affect their sum, then the understatement and overstatement are each material if the two items are reported separately. In considering materiality, it is, however, appropriate to net components within a separately reported item. To continue the example, it would be appropriate to net the overstatement of premium liabilities with the understatement of claim liabilities if only the sum of the two (i.e., the insurance contract liabilities) is reported.
- .09 The effect of using a simpler practice requiring less time and expense than those in the recommendations may be conservative or not conservative. Usually, the criterion of materiality is the same in both cases.

### Reporting standards

- .10 The result of applying a recommendation may provide information that is not useful. For example, disclosure of a material change in the basis for valuing the liabilities with respect to a material class of a benefits plan's members is not useful if that class was trivial at the previous valuation. Also, description of immaterial provisions of a benefits plan is not useful. To ignore the recommendation is accepted actuarial practice in that situation.



## 1400 THE ENGAGEMENT

### 1410 ACCEPTING AND CONTINUING AN ENGAGEMENT

- .01 *In accepting an engagement, the actuary should*  
*agree on its terms with the client or employer,*  
*be satisfied that it is an appropriate engagement, and*  
*have reasonable assurance of time, resources, information, access to officers and staff, access to documentation, and the right to communicate information, as may be necessary for the work.*
- .02 *The actuary should consider consultation with the predecessor actuary, if any, to determine whether there is any professional reason not to accept the engagement. The predecessor actuary should cooperate with the actuary who seeks to determine whether there is any professional reason not to accept the engagement.*
- .03 *In performing the engagement, if the actuary becomes aware of information which, if known beforehand, would have been an impediment to acceptance of the engagement, then the actuary should*  
*renegotiate the engagement to remove the impediment,*  
*discontinue the engagement, or*  
*provided that the engagement continues to be an appropriate engagement, report the impediment and its implications. [Effective December 1, 2002]*

#### **Terms of the engagement**

- .04 The likelihood that work is satisfactory to all users concerned is enhanced by a clear understanding between the actuary and the client or employer on the terms of the engagement. Detailed identification of the time and resources involved, especially if they are substantial, and of the information needed to be communicated to and by the actuary, especially if it is sensitive or confidential, will avoid misunderstanding.

#### **Appropriateness of engagement**

- .05 An appropriate engagement is one that does not impair the actuary's ability to conform to the rules and in particular to Rules 1 (Professional Integrity), 2 (Qualification Standards), 5 (Conflict of Interest), and 6 (Control of Work Product). An engagement that leads to deviation from any rule is not appropriate. An engagement that leads to deviation from a particular recommendation or other guidance in the standards and even to a deviation from accepted actuarial practice may be an appropriate engagement in the circumstances.

.06 The following guidance is useful in judging if the engagement is an appropriate engagement.

An engagement is prima facie appropriate if there are practice-specific standards which apply to it, especially if it does not call for a deviation from accepted actuarial practice.

An engagement's appropriateness is not likely affected if the actuary's client or employer selects particular assumptions as part of the terms of the engagement and the report describes the assumption and identifies the source, or chooses a value for certain assumptions from within a range selected by the actuary.

An engagement to report on alternative scenarios or "What if?" questions is appropriate, given appropriate disclosure.

An engagement is less likely to be appropriate if it denies reasonable opportunity for an external user to question the actuary about his or her report.

.07 An engagement may involve a duty of confidentiality that conflicts with a recommendation on disclosure in reporting. That engagement would be appropriate, however, and the duty of confidentiality would supersede (at least temporarily) the duty of disclosure, if

confidentiality is necessary for the legitimate business objective of the client or employer,

the extent of the information to be kept confidential is reasonable,

the length of time for which it is to be kept confidential is reasonable, and

the duty of confidentiality permits reasonable exceptions; for example, if the actuary is permitted to disclose the information to, and to discuss the engagement with, an auditor or a regulator.

.08 For example, the engagement may be appropriate if the actuary temporarily withholds knowledge of

a mistake that favours his or her client in the report of the actuary engaged by the other side in litigation,

the imminent closure of a participating employer's Canadian operations and the consequent job loss and winding-up of the plan in giving advice on its funding, but the actuary would consider the need for an early revaluation or wind-up valuation, or

an insurer's imminent acquisition by new shareholders who will alter its business plan in reporting in the insurer's financial statements, but the actuary would consider the implications of the new business plan in reporting to the insurer's directors on financial condition.

- .09 That engagement would not be appropriate, however, if the information is to be kept confidential in order to conceal improper business conduct, or to withhold information from users of the actuary's work who may reasonably expect the actuary to report it to them.
- .10 Any duty of confidentiality would give way to a duty of disclosure if disclosure is required by law, or if disclosure is required in order to comply with the bylaws or rules.
- .11 Whether an engagement is appropriate depends on the actuary as well as on the engagement. For example, an actuary would be in breach of the rules by accepting an engagement  
to be an insurer's appointed actuary without having the requisite special qualifications, experience, and knowledge, or  
that involves a conflict of interest that falls outside of the permitted scope of Rule 5 (Conflict of Interest).

### **Subsequent information**

- .12 While performing the engagement, the actuary may become aware of information that, if known beforehand, would have been an impediment to acceptance of the engagement. For example,  
the actuary's understanding of the engagement differs from that of the client or employer,  
the data are not sufficient or not reliable and cannot be remedied, or  
promised resources are not forthcoming and a substitute for them is not practical.
- .13 Renegotiation that removes the impediment would usually be the preferred alternative. Discontinuance would be the only alternative if the new information reveals the engagement not to be appropriate and renegotiation to make it so is impractical, which would be the case, for example, if an appointed actuary is denied access to needed information.
- .14 Failing renegotiation or discontinuance, the actuary would deal with the impediment by reporting it and its implications. Description of the implications would include both qualitative and quantitative aspects and their effect on the actuary's opinion.

### **1420 FINANCIAL INTEREST OF THE ACTUARY**

- .01 *The financial interest of the actuary should not influence the result of the actuary's work.*  
[Effective December 1, 2002]

- .02 The actuary's compensation for work may be fixed or may involve an incentive that is related to the result of the work. Examples of incentives are contingent fees and performance-related bonuses. Fixed compensation or an incentive that is related to efficient or timely performance of the work is not considered to be compensation that would influence the result of the actuary's work. This subsection 1420 would apply if the compensation depended on the result of the work; for example, a bonus based on an insurer's net income when the work is to value the insurer's policy liabilities. In that case, the actuary has a financial interest in the result of the work but would not permit that interest to affect the result. On the other hand, it is not inappropriate for the actuary's client in litigation to call on the actuary for calculations based on assumptions that favour its side of the litigation, given an appropriate engagement and given appropriate disclosure in the actuary's report.
- .03 In some cases, it is useful to report the financial interest of the actuary in the result of the work. The practice-specific standards deal with those cases.

### **1430 FINANCIAL INTEREST OF THE CLIENT OR EMPLOYER**

- .01 *The financial interest of the actuary's client or employer should not influence the result of the actuary's work except to the extent that the client or employer selects methods or assumptions for the work. [Effective December 1, 2002]*
- .02 The actuary's client or employer may have a financial interest in the result of the actuary's work. For example, it may be in the client's or employer's interest to maximize or minimize the result. That is usually the case when the actuary's client is one side of opposing interests; for example, the plaintiff or defendant in litigation, the purchaser or vendor in a sale, and the employer or union in labour negotiations.
- .03 In such a case, the actuary's duty of professionalism supersedes the duty of service to the client or employer.
- .04 In giving advice to a participating employer regarding the funding of a benefits plan, the actuary may first calculate a range, at any point of which funding would be appropriate. That range is the crux of the work, so a participating employer's financial interest would not influence its calculation. It is, however, appropriate and usually desirable for the actuary to consult the participating employer in the selection of the recommended funding within the range. The participating employer's financial interest – for example the participating employer's tolerance of fluctuation in the recommended rate of funding between one funding period and the next – would be taken into account in that consultation.
- .05 Note, however, that the recommendation does not preclude the actuary's use of methods or assumptions selected by the client or employer in an appropriate engagement, but the actuary would report such use.
- .06 Note also that the purpose of the work will influence the actuary's selection of methods and assumptions. The financial interest of the client or employer may shape the purpose of the work if the engagement is an appropriate engagement and the purpose is reported.

## **1440 GENERAL KNOWLEDGE**

- .01 *The actuary should have adequate knowledge of the conditions in the practice area in which he or she is working.*
- .01.1 *Where the actuary's work in a practice area meets the definition of actuarial evidence work, the actuary should have adequate knowledge of the conditions in both the practice area in which he or she is working and the actuarial evidence practice area. [Effective December 31, 2013]*
- .02 The relevant conditions may include legislation, accounting, taxation, the financial markets, family law, and court practices. The relevant legislation depends on the engagement, and may include legislation governing securities, pensions, insurance, workers' compensation, and employment standards.

## **1450 KNOWLEDGE OF THE CIRCUMSTANCES OF THE CASE**

- .01 *The actuary should have adequate knowledge of the circumstances of the case on which he or she is working. [Effective December 1, 2002]*
- .02 The relevant knowledge for a corporate entity or benefits plan is that of the operations of the entity itself and may include that of the industry in which the entity operates. Usually, the entity is the actuary's client or employer but may be a proposed acquisition or merger partner of the client or employer.
- .03 In the case of a benefits plan, the entity is the plan itself, but, depending on the engagement, knowledge of the business conditions of the participating employer(s) may also be relevant.
- .04 The relevant knowledge for calculation with respect to an individual is the demographics of the individual and the context of the calculation.
- .05 Additional conservatism in making a calculation is not a substitute for knowledge of the circumstances of the case.

**1500 THE WORK**

**1510 APPROXIMATION**

- .01 *An approximation is appropriate if it reduces the cost of, reduces the time needed for, or improves the actuary's control over, work without affecting the result.*
- .02 *If the actuary reports an appropriate approximation, then the report should avoid unintended reservation.*
- .03 *If the appropriateness of an approximation is doubtful, then the actuary should report its use with reservation. [Effective December 1, 2002]*
- .04 Like materiality, to which it is related, approximation pervades virtually all work and affects the application of nearly all standards. The words “approximation” and “approximate” seldom appear in the standards, but are understood throughout them.
- .05 Approximation permits the actuary to strike a balance between the benefit of precision and the effort of arriving at it.

**Approximation in selection of a model**

- .06 Reality is complex. A simple model reduces not only the time and expense of work but also the risk of calculation and data error.
- .07 The appropriateness of a simplification depends on the circumstances of the case and the purpose of the work. For example, in selecting a model for advice on funding a pension plan, it may be appropriate to allow for indexing by modifying the assumption for a contingency of which the model takes account, such as the investment return assumption, to arrive at a appropriate composite assumption.

**Approximation in the selection of assumptions**

- .08 Simplification of an assumption may be an appropriate approximation. For example,
- deaths occur continuously over a year; for simplicity, assume that they all occur at the middle of the year,
- members of a pension plan with early retirement reductions that approximate full actuarial reductions retire at various rates between, say, ages 55 and 65; for simplicity, assume that they all retire at, say, age 62, and
- if the members of a pension plan who die before retirement are entitled to a benefit which is roughly the same as the present value of the retirement benefit; for simplicity, assume that death rates before retirement are equal to zero.

- .09 To make no assumption about a contingency is usually tantamount to assuming a zero rate for that contingency, which is rarely appropriate in itself, but may be appropriate when combined with an adjustment to a related assumption. For example, in some circumstances, the calculation of the liabilities in a benefits plan using an explicit wage and price inflation assumption may be approximated by calculating the liabilities without an explicit wage and price inflation assumption and using a lower liability discount rate assumption representative of the real rate of return.

### **Approximation by sampling**

- .10 A well-chosen sample avoids the extra work of an examination of the entire universe.

### **Approximations respecting data**

- .11 Data may be defective. For example, a benefit plan's records may lack the date of birth of certain members. In some cases there is an appropriate approximation, for example, sampling, or extrapolation from similar situations for which data are available.

### **Approximation vs. assumption**

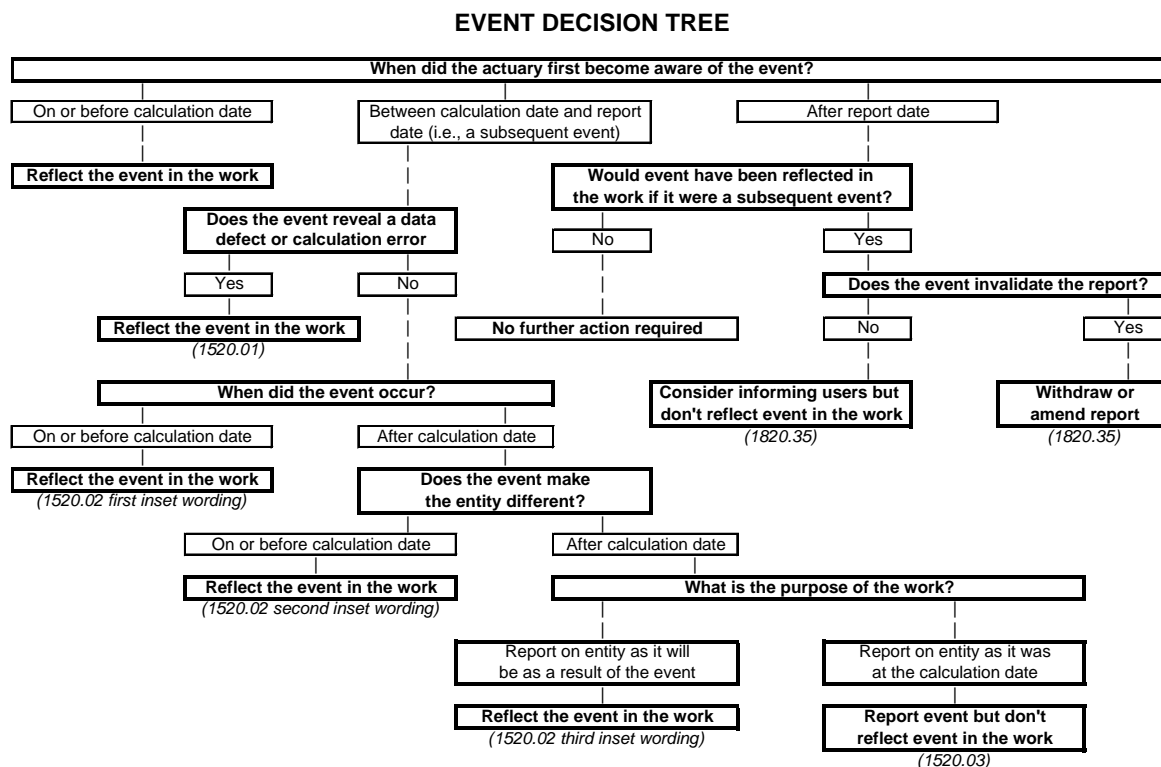
- .12 A criterion of the appropriateness of an approximation is its effect on the result. If the actuary approximates but is unable to assess the resulting error, then the approximation becomes, in effect, an assumption. For example, data are missing and it is not practical to get them. The actuary would consider whether their lack is so important that a report with reservation is necessary but in any case is obliged to make an assumption about them in order to do the work.

### **Reporting approximations**

- .13 To report appropriate approximations in a longer report may provide information useful to users, but such reporting would avoid unintended reservation, as the use of approximations is a usual part of work. The pervasiveness of approximations in work makes their complete reporting impractical.
- .14 If the actuary reports an implicit assumption used as an approximation, then he or she would also report the corresponding explicit assumption or assumptions. Similarly, if an actuary reports approximations for two offsetting assumptions that result in the same net effect as the underlying explicit assumptions, the actuary would also report the explicit assumptions.
- .15 The actuary would not usually use an approximation whose appropriateness is doubtful. That may be unavoidable, however, if data are insufficient or unreliable or if needed resources are lacking. If the engagement is an appropriate engagement, then the actuary would report with reservation the use of the approximation, so that a user is aware of a limitation to the actuary's work.

## 1515 EVENT

- .01 The following decision tree may assist an actuary in deciding how to reflect an event in the work, if the actuary determines that the event makes the entity different.



## 1520 SUBSEQUENT EVENTS

- .01 *The actuary should correct any data defect or calculation error that is revealed by a subsequent event.*
- .02 *For work with respect to an entity, the actuary should take a subsequent event into account (other than in a pro forma calculation) if the subsequent event*  
*provides information about the entity as it was at the calculation date,*  
*retroactively makes the entity different at the calculation date, or*  
*makes the entity different after the calculation date and a purpose of the work is to report on the entity as it will be as a result of the event.*
- .03 *The actuary should not take the subsequent event into account if it makes the entity different after the calculation date and a purpose of the work is to report on the entity as it was at the calculation date. Nevertheless, the actuary should report that subsequent event. [Effective December 1, 2002]*



### **Classification**

- .04 A subsequent event is relevant to the recommendation if it reveals an error, provides information about the entity, or is a decision that makes the entity different.
- .05 The actuary would correct an error revealed by a subsequent event. The actuary would classify each subsequent event other than those which reveal errors and, depending on the classification, the actuary would either
- take that event into account, or
  - report that event, but not take it into account.

### **Definitive and virtually definitive decisions**

- .06 A definitive decision means a final and permanent decision that is not tentative, provisional, or unsettled. It would be evidenced by an amendment to a benefits plan, a collective bargaining agreement, a binding exchange of letters between two contracting parties, a court order, a legislative bill that has been proclaimed, or the like. A virtually definitive decision is one that is virtually certain to become definitive, but that lacks one or more formalities like ratification, due diligence, regulatory approval, third reading, royal assent, or proclamation. However, a decision that still involves discretion at an executive or administrative level is not virtually definitive.

### **Entity**

- .06.1 Examples of entities are
- the pension plan, in the case of an actuary doing a valuation of a pension plan,
  - the block of annuity business, in the case of an actuary calculating the insurance contract liabilities for an insurance company's annuity business,
  - a combination of the pension plan and the member's specific data, in the case of the determination of a member's individual entitlement under a pension plan, and
  - the insurance company, in the case of an actuary valuing the insurance contract liabilities of an insurance company.

**Event provides information about entity as it was or retroactively makes entity different**

.07 Examples of subsequent events that provide information about an entity as it was at the calculation date are

publication of an experience study that provides information for selection of assumptions,

reporting to an insurer of a claim that was incurred on or before the balance sheet date, and

adoption of a pension plan amendment prior to the calculation date of which the actuary becomes aware after the calculation date.

.08 Repealed

.09 Repealed

.10 Examples of events that retroactively make the entity different at the calculation date are definitive or virtually definitive decisions, made after the calculation date but effective on or before the calculation date, to

wind-up a pension plan, partially or fully,

sell a portion of a participating employer's business and consequently to spin-off the corresponding members from the participating employer's pension plan,

amend the benefits of a pension plan,

transfer a portion of an insurer's policies to another insurer, or

invoke a judicial decision that nullifies or significantly modifies the law affecting insurance claims.

.11 If an event provides information about the entity as it was at the calculation date or provides information that retroactively makes the entity different at the calculation date, the effect of the subsequent event on the work is the same as if the actuary first became aware of the information on or before the calculation date and the actuary would not report the event as a subsequent event. That is, the actuary would report the event only to the extent that the event would have been reported had the actuary first become aware of the information before the calculation date.

.12 Repealed

**Event makes entity different after**

.13 If the subsequent event makes the entity different after the calculation date, then the purpose of the work determines whether or not the actuary takes the event into account.

.14 If the subsequent event makes the entity different after the calculation date and the purpose of the work is to report on the entity as it will be as a result of the event, then the actuary would take that event into account and would describe it in reporting.

- .15 If the subsequent event makes the entity different after the calculation date and the purpose of the work is to report on the entity as it was at that date, then the actuary would not take that event into account but would report the event since it would affect the entity's future operations and the actuary's subsequent calculations.

**Classification not clear**

- .16 The classification of a subsequent event may be unclear, at least a priori, although the circumstances of the case and the actuary's engagement may make it clear. The following are examples of such events.

a precipitous fall in the stock market. For financial reporting, one can argue that the stock market crash provides additional information about the entity as it was at the calculation date, because the crash is an indicator of the outlook for common share investments at that date; alternatively, one can argue that the crash makes the entity different only after the calculation date since it creates a new situation. The new situation would be reflected in the financial statements for the subsequent accounting period.

a salary freeze for employees who are members of a pension plan. If the salary freeze is a correction of excessive salaries, then it provides additional information about the entity as it was at the calculation date, because the freeze is an indicator of the outlook for salaries at the calculation date. If the salary freeze deals with a recent problem, then it indicates a change in conditions that makes the entity different after the calculation date. In either case, the actuary would consider the effect of the freeze on the employees' pension benefits. It may be that the freeze will have a lasting effect. Alternatively, it may be that the freeze will be compensated for by higher salaries later on, so that the salary inflation assumption based on historical trends continues to be valid.

default on a bond. If the default was the culmination of a gradual deterioration in its issuer's financial circumstances, most of which had occurred before the calculation date but which was not apparent until revealed by the default, then the default provides additional information about the entity as it was at the calculation date. If the default was precipitated by a catastrophe, then it provides information about a change in conditions that makes the entity different after the calculation date.

insolvency of an insurer's reinsurer. This is similar to default on a bond. If the insolvency was the culmination of a gradual deterioration in the reinsurer's financial circumstances, most of which had occurred before the calculation date but which was not apparent until revealed by the insolvency, then the insolvency provides information about the entity as it was at the calculation date. If the insolvency was precipitated by a catastrophe, then it provides information about a change in conditions that makes the entity different after the calculation date.

.17 Repealed

**Reporting**

.18 Sometimes the actuary may consider it appropriate, or the terms of the work may require the actuary, to report an alternative and opposite calculation; i.e., an alternative calculation that does not take the subsequent event into account when the main calculation does, or that takes the subsequent event into account when the main calculation does not. For example, in a province for which the calculation date for a pension valuation following marriage breakdown is the date of separation, a subsequent event may be the early retirement of the plan member at some time between the calculation date and the report date. The actuary would consider reporting values assuming that this subsequent event had been an established intention at the calculation date, instead of or in addition to retirement scenarios otherwise recommended in the practice-specific standards. In such cases, the actuary would make the same calculations regardless of the purpose of the work but the reporting thereof would depend on the purpose of the work.

## 1530 DATA

- .01 *If the actuary reports without reservation with respect to data, then the data should be sufficient and reliable for the work. If sufficient and reliable data are unobtainable but the defect in them does not negate the usefulness of the result, then the actuary should report a usual opinion with reservation in respect of data. If defects in the obtainable data preclude a useful result, then the actuary should so report or make no report.* [Effective December 1, 2002]
- .02 The work with respect to data consists of
- identifying the data needed,
  - attempting to obtain them,
  - reviewing the data obtained, and
  - assessing sufficiency and reliability of the data obtained.
- .03 If the actuary intends not to take responsibility for data, then the actuary would so report and would report any evident shortcomings in those data.
- .04 The following are examples of the usual practice.
- For a calculation of a pension value in a marriage breakdown, the actuary usually does not take responsibility for data, such as the demographics of the pensioner and the terms of the pension plan. The actuary would usually accept the data supplied by counsel and repeat it in reporting.
- For advice in funding a pension plan, the actuary usually does not take responsibility for participant data and usually accepts, without taking responsibility for, the plan's financial statements and its investment data.
- For calculating the policy liabilities of an insurer, the actuary usually takes responsibility for all data.
- .05 If the data, while usable, are not sufficient and reliable and the actuary's efforts to make them so are unsuccessful, the actuary would not take responsibility for the data and would report with reservation, even when it is usual to take responsibility for them.

### **Sufficiency and reliability**

- .06 Data are sufficient if they include the needed information for the work. For example, participants' dates of birth are needed to value the liabilities of a pension plan. Data are reliable if that information is accurate.
- .07 The actuary would usually take responsibility for the sufficiency of the data. Whether the actuary takes responsibility for the reliability of the data depends on the engagement.

.08 If the ideal data are unobtainable at reasonable cost within the available time, then the actuary would consider what, if any, alternative data are sufficient and reliable.

.09 Work usually is both data-dependent, meaning that the quality of the result depends on the sufficiency and reliability of the data, and data-intensive, meaning that the data are both voluminous and detailed.

### **Obtaining data**

.10 Usually, the actuary has neither custody of, nor control over, the data and uses data supplied by other persons. Usually, therefore, after identifying the needed data and attempting to obtain them, the actuary's task is not data creation but data validation, either personally or by using the work of other persons.

### **Reviewing data**

.11 Items to consider in reviewing data are

the procedures for, the controls over, and the qualifications of the persons responsible for, their preparation and maintenance,

their internal consistency, their consistency with comparable prior period data, and their consistency with external comparable data, such as other files with common elements,

their consistency with the governing plan documents and policy forms, and

the availability of independent confirmation.

.12 If the user is able to validate the data, then the actuary may avoid validation by reporting the data. For example, in the case of an actuarial evidence report on the valuation of a disabled person's lost income, the reported data may be either agreed by the parties to the litigation or proved in court. Such avoidance of data validation is usually not practical when the work is data-intensive or has multiple users.

### **Assessing sufficiency and reliability of data**

.13 The actuary who takes responsibility for the data would classify them as one of the following.

Sufficient and reliable, in which case the actuary reports an opinion without reservation on data. That does not imply that the data are perfect. Data are rarely perfect; especially when they are voluminous or complex.

Defective, but not so as to negate the usefulness of the result, in which case the actuary reports a usual opinion with reservation which describes the defect, describes the work done and assumptions made to cope with the defect, and, if practical, quantifies the effect of the defect on the result.

So defective as to preclude a useful result, in which case the actuary so reports or makes no report. If a report is useful or legally required, then the actuary would describe the defect, describe the work done and assumptions made to cope with the defect, quantify a result if practical, and explain that an opinion is not given because it is not possible to estimate the effect of the defect on the result. If a report is neither useful nor legally required, then the actuary would make none.

## **1540 CONTROL**

- .01 *Control procedures that detect errors and decrease the effect of errors should be performed for calculations.* [Effective July 1, 2011]
- .02 A calculation that is data-intensive, that is complex, that involves physically separate steps like manual and data processing steps or parallel data processing steps, or especially, a combination of them, is prone to error which appropriate control procedures may prevent or, failing prevention, detect. Appropriate control procedures also help to meet the need for consistency between the actuary's work and other related work; for example, a uniform cut-off date in the preparation of financial statements.
- .03 Examples of control procedures are procedures to assure that
- all steps in the calculation are co-ordinated,
  - all steps in the calculation have been performed and checked,
  - the actuary's data processing does not corrupt the data supplied to the actuary,
  - established procedures (for example, those for a prior period) are not changed inadvertently, and
  - changes in established procedures are made in an orderly manner.
- .04 Examples of control tools are
- random sampling,
  - spot checks, and
  - audit trails.

## **1550 REASONABLENESS OF RESULT**

- .01 *The actuary should examine the reasonableness of a calculation's result.* [Effective December 1, 2002]
- .02 As a result of defective data, defective computer software, an accumulation of individually biased assumptions, or the like, a calculation, especially a complex one like a valuation or financial forecast, may be prone to error which checking of the calculation's steps does not reveal but which an examination of its result may reveal. Such an examination is therefore useful and prudent.

.03 The examination would consider simple questions like the following.

How does the result compare to the corresponding result for a prior period or a similar case, or to a related but independently calculated amount? Comparison of a benchmark may be more meaningful than comparison of the result. Examples of a benchmark are the forecasted number of retirees divided by the forecasted number of active employees, the loss ratio implied by claim liabilities, and the change during the year of the result.

How does the result compare to the corresponding result of a rough approximation?

Does the result make common sense?

.04 The answers to such questions may indicate a need for more work.

## **1560 DOCUMENTATION**

.01 *The actuary should use his or her best efforts to compile and secure the retention of appropriate documentation.*

.02 *Where a successor actuary takes possession or control of documentation previously in the possession or control of a predecessor actuary, the successor actuary should use his or her best efforts to make such documentation available to the predecessor actuary, upon request by the predecessor actuary, if needed by the predecessor actuary to respond to queries about the related work.*

.03 *Where a successor actuary or an employer or client, acting on behalf of a successor actuary, requests access to documentation in the possession or control of a predecessor actuary, in order to carry on work, the predecessor actuary should use his or her best efforts to comply with the request. [Effective December 1, 2002]*

.04 Documentation is an integral part of work that affects the application of nearly all standards.

.05 Documentation consists of letters of engagement, working papers, meeting notes, memoranda, correspondence, reports, copies or excerpts of company or plan data and documents, and work plans. Appropriate documentation describes the course of the work and the actuary's compliance with accepted actuarial practice.

.06 Both professional and legal needs may affect the length of time during which documentation is to be retained.

.07 An actuary who severs connection with a client or employer (for example, an actuary who retires or changes job) may seek to secure the retention of documentation of work for that client or employer by entrusting it to another actuary, who may be the successor actuary. Said other actuary would use his or her best efforts to make the documentation available to the predecessor actuary if his or her work is questioned or challenged.

.08 In some circumstances, documentation may not be in the possession or control of an actuary, or an actuary may be unable to release the documentation, particularly in cases involving the proprietary interests of a third party (including a client or employer). In the face of such difficulties, the actuary would consider seeking further advice.



**1600 ANOTHER PERSON'S WORK**

**1610 ACTUARY'S USE OF ANOTHER PERSON'S WORK**

- .01 *The actuary may use and take responsibility for another person's work if such actions are justified.*
- .02 *If the actuary uses but does not take responsibility for another person's work, then the actuary should so report. [Effective December 1, 2002]*
- .03 *Use of the work of other persons is a usual, indeed often inevitable, part of work. The actuary uses and takes responsibility for the work of colleagues and assistants; that use is usually straightforward because the actuary is able to assess the appropriateness of their work. Use of the work of outsiders raises questions. Is their work appropriate? Should the actuary take responsibility for it?*
- .04 *To take responsibility for another person's work requires more work of the actuary and may expose the actuary to risk of legal liability, but may give the user greater confidence that the other person's work is appropriate. The actuary would not take such responsibility if doing so constitutes unauthorized practice of the other person's profession, i.e., if doing so is in direct violation of statutes or laws governing who can practice the other person's profession, or would lead a reasonable person to believe that the actuary possessed and purported to exercise the skill and learning of a duly qualified professional in that other person's profession.*
- .05 *If the actuary does not take such responsibility, then 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.*
- .06 *Whether or not the actuary takes responsibility for another person's work depends on the engagement and on the nature of the other person's work. Consider, for example, data supplied by another person.*

If the terms of the engagement call for it, then the actuary would take responsibility for data, which means that the actuary would audit the data supplied by another person. The audit would be as intense as needed for the actuary to take as much responsibility for the data as he or she would take for the calculations. Such an audit is never a small task when the data are voluminous or complex.

In other cases, it may be satisfactory if the actuary accepts and does not take responsibility for the data supplied by another person. That course avoids expense and saves time. That course would be satisfactory to the actuary's client or employer who supplies the data and who is comfortable with its sufficiency and reliability. Whether that course is satisfactory to another user of the actuary's work depends on whether that user has other assurance that the supplied data are sufficient and reliable. The actuary would report with reservation so that the limitation of his or her responsibility is disclosed.

The supplier of the data would usually be comfortable with their sufficiency and reliability.

Even when the actuary is not taking responsibility for the data, however, he or she would not accept supplied data blindly, but would make checks of reasonableness, if only to assure that the data had lost nothing in the transmission and that the actuary's understanding of the data is the same as the supplier's.

### **Use and take responsibility**

- .07 As long as doing so does not constitute unauthorized practice of another person's profession, the actuary may use and take responsibility for another person's work, given confidence that such actions are justified as a result of
- 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.
- .08 Failing such confidence, the actuary would not take responsibility for the other person's work.
- .09 The Canadian Institute of Actuaries encourages the actuary's use of auditor's work in accordance with the Joint Policy Statement of the Canadian Institute of Actuaries and the Canadian Institute of Chartered Accountants. The Joint Policy Statement also provides useful guidance if the actuary uses the work of a person other than an auditor.

- .10 In the case of use of another actuary's work,  
identification of the differences between accepted actuarial practice in Canada and the practice which the other actuary followed if the other actuary worked outside of Canada, and  
review of the other actuary's working papers  
may also be helpful.
- .11 The actuary would not usually report use of another person's work if the actuary takes responsibility for that work. To do so may imply a reservation. If it is useful, the actuary may report both the use of, and taking responsibility for, another person's work.
- Use but not take responsibility**
- .12 If the actuary uses but does not take responsibility for another person's work, then 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.
- .13 Although an actuary may take responsibility for the work of another actuary in accordance with this section, the actuary who performed the work also continues to be responsible for that work.

## **1620 AUDITOR'S USE OF AN ACTUARY'S WORK**

- .01 *The actuary should cooperate with an auditor who wishes to use the actuary's work in accordance with the Joint Policy Statement of the Canadian Institute of Actuaries and the Canadian Institute of Chartered Accountants. [Effective October 1, 2007]*

## 1630 CIA/CICA JOINT POLICY STATEMENT

The Canadian Institute of Actuaries and the Canadian Institute of Chartered Accountants agreed that each would incorporate the *Joint Policy Statement* in its standards of practice. Accordingly, the Joint Policy Statement is in the *CICA Handbook-Assurance* and in these standards of practice. Any change to the Agreement requires the consent of both Institutes. As a result, the style of this subsection differs somewhat from the style of the rest of the standards of practice.

### JOINT POLICY STATEMENT

#### CONCERNING COMMUNICATIONS BETWEEN ACTUARIES

#### INVOLVED IN THE PREPARATION OF FINANCIAL STATEMENTS AND AUDITORS

*This Joint Policy Statement effective October 1, 2007 has been approved by the Actuarial Standards Board of the Canadian Institute of Actuaries (CIA) and by the Auditing and Assurance Standards Board of The Canadian Institute of Chartered Accountants (CICA).*

#### PURPOSE AND APPLICATION

- 1 The purpose of the Joint Policy Statement is to discuss:
  - a) communications between actuaries involved in the preparation of financial statements, and auditors, regarding their respective responsibilities;
  - b) how those actuaries and auditors would interact in carrying out their respective responsibilities; and
  - c) how their respective responsibilities may be disclosed to readers of financial statements.
- 2 This Statement applies when an auditor is engaged to carry out an audit of financial statements in accordance with generally accepted auditing standards where the financial statements prepared by management include amounts determined by or with the assistance of an actuary. This Statement also applies when an actuary considers the work of an auditor in connection with conducting the actuarial valuation to determine amounts to be included in the financial statements prepared by management. This statement does not apply to communications with an auditor's actuary or an external review actuary.
- 3 The financial statements of a pension plan or post-employment benefits plan and of the sponsor of such plans, and the financial statements of an insurance enterprise, are the best examples of when this Statement applies.

DEFINITIONS

- 4 For the purposes of this Statement:
- a) “actuary involved in the preparation of financial statements” means an actuary, either an employee of the company or an independent consultant, who determines and reports on amounts to be included in the financial statements prepared by management.
  - b) “applicable professional standards” means:
    - i) when the responding professional is an actuary, the Standards of Practice and the Rules of Professional Conduct of the Canadian Institute of Actuaries; and
    - ii) when the responding professional is the auditor, the Canadian Auditing Standards in the CICA Handbook-Assurance and the relevant independence and other ethical requirements set out in the rules of professional conduct/code of ethics applicable to the practice of public accounting issued by various professional accounting bodies.
  - c) “auditor” means an auditor who has been appointed to perform an audit and report on financial statements or to perform specified procedures on data;
  - d) “auditor’s actuary” means an appropriately qualified actuary who assists the auditor in assessing risk and performing further audit procedures to respond to assessed risk;
  - e) “data” includes particulars of:
    - i) invested assets of a pension plan or post-employment benefits plan or an insurance enterprise,
    - ii) membership of a pension plan or post-employment benefits plan,
    - iii) policies of and claims against an insurance enterprise, and
    - iv) reinsurance of an insurance enterprise;
  - f) “enquiring professional” means the actuary or the auditor, as the case may be, who is considering the work of the other;
  - g) “external review actuary” means an actuary who reviews the work of another actuary at the request of a regulator and provides an opinion to the regulator as to whether the work meets applicable professional standards and accepted actuarial practice;

- h) “insurance enterprise” includes the following enterprises, including companies, branches, fraternal benefit societies and other forms of organizations:
  - i) life insurance enterprises;
  - ii) property and casualty insurance enterprises;
  - iii) reinsurance enterprises; and
  - iv) workers’ compensation enterprises.
- i) “management” refers to any person(s) having authority and responsibility for planning, directing and controlling the activities of an enterprise;
- j) “responding professional” means the actuary or the auditor, as the case may be, whose work is being considered by the other.

#### RESPONSIBILITIES WITH RESPECT TO FINANCIAL STATEMENTS

- 5 The financial statements are the responsibility of management. The representations contained in the financial statements may include amounts determined by an actuary. In determining those amounts, the actuary is responsible for assessing the sufficiency and reliability of the data used in the valuation. The actuary may consider the work of an auditor with respect to data integrity and controls. In such cases, the actuary involved in the preparation of the financial statements acts as the enquiring professional and the auditor acts as the responding professional.
- 6 The auditor, on the other hand, has a responsibility to express an opinion on the fairness with which the financial statements present the financial position, results of operations and cash flows in accordance with the applicable financial reporting framework, which will normally be generally accepted accounting principles. When the financial statements include amounts determined by an actuary, the auditor considers the work of the actuary as part of the audit evidence supporting the actuarial valuation. In such cases, the auditor acts as the enquiring professional and the actuary involved in the preparation of the financial statements acts as the responding professional.

#### CONSIDERING THE RESPONDING PROFESSIONAL’S WORK

- 7 The enquiring professional may consider the work of the responding professional provided that the enquiring professional takes reasonable care to determine that there is a basis for such consideration. This is done by communicating with the responding professional to establish an understanding of the work to be carried out by each and by considering:
  - a) the responding professional’s appointment to do the work;
  - b) whether the responding professional has followed the standards of his or her profession in carrying out the work; and
  - c) the appropriateness of the responding professional’s findings and opinion.

COMMUNICATION BETWEEN THE TWO PROFESSIONALS

- 8 Communication would be established between the auditor and the actuary involved in the preparation of the financial statements when planning their respective engagements, and further communication would take place as necessary throughout the engagement.
- 9 On a timely basis, each professional seeks from management the right to:
- a) communicate with the other professional; and
  - b) when necessary disclose any relevant information to the other professional.
- 10 The enquiring professional would:
- a) inform the responding professional of the intended consideration of his or her work in accordance with this Statement;
  - b) request confirmation from the responding professional that he or she has been engaged by the shareholders, policyholders, directors, or management to do the work that the enquiring professional intends to consider;
  - c) request confirmation from the responding professional that he or she is a professional in good standing;
  - d) request confirmation from the responding professional that he or she will carry out the work required in accordance with the applicable professional standards; and
  - e) make the responding professional aware of the enquiring professional's needs. This would include a discussion of:
    - i) the application of the concept of materiality to determine that the responding professional will be using a materiality level that is appropriate in relation to the enquiring professional's materiality level in accordance with applicable professional standards;
    - ii) subsequent events, to determine that the responding professional understands how they are to be treated and that he or she will consider the effect of matters that come to his or her attention up to the date of his or her report;
    - iii) the timing of the work to be carried out by the responding professional and the date of his or her report; and
    - iv) any questions relating to the responding professional's work.

- 11 The responding professional would provide a written response to the enquiring professional that would:
- a) confirm the expectation that he or she is available to perform the work that the enquiring professional intends to consider;
  - b) confirm that he or she has been engaged by the shareholders, policyholders, directors, or management to do the work that the enquiring professional intends to consider;
  - c) confirm that he or she is a professional in good standing;
  - d) confirm that he or she is qualified to perform the work that the enquiring professional intends to consider (including having the certifications or designations, if any, required for particular areas of practice);
  - e) confirm that this work will be carried out in accordance with the applicable professional standards;
  - f) confirm awareness of the enquiring professional's intended consideration of his or her work; and
  - g) discuss any problems expected in meeting the needs of the enquiring professional on a timely basis.

THE RESPONDING PROFESSIONAL'S QUALIFICATIONS, COMPETENCE, AND INTEGRITY

- 12 In the case of an auditor, prima facie evidence of professional qualification is membership in good standing in a professional accounting body. In the case of an actuary, prima facie evidence of professional qualification is fellowship in good standing in the Canadian Institute of Actuaries.
- 13 When the responding professional is not well known to the enquiring professional, the enquiring professional may obtain assurance as to the responding professional's reputation for competence and integrity by consulting with others who are familiar with the responding professional's work.



THE RESPONDING PROFESSIONAL'S FINDINGS

- 14 The responding professional's written response to the enquiring professional after completion of the work would:
- a) identify the purpose of the work;
  - b) identify the financial statements or data to which it relates;
  - c) identify the responding professional's relationship to the entity to which the financial statements or data pertain;
  - d) confirm awareness that the enquiring professional intends to consider the work in accordance with this Statement; and
  - e) when appropriate, include a copy of the report provided to the party who employed or engaged the responding professional that sets out the findings and, when applicable, opinions of the responding professional, including a representation that the work was performed in accordance with the applicable professional standards.
- 15 When the enquiring professional has a question about an aspect of the responding professional's work, the question would be raised with the responding professional who would provide a reasonable explanation about that aspect of his or her work. This does not, however, limit the right of the enquiring professional to any information or explanation that may be required in the performance of his or her duties in accordance with the applicable professional standards.

DISCLOSURE OF RESPECTIVE RESPONSIBILITIES TO THE READERS OF FINANCIAL STATEMENTS

- 16 When required by law or regulation, a description of the respective responsibilities of the auditor and of the actuary involved in the preparation of the financial statements would accompany the financial statements.

## 1640 REVIEW OR REPEAT OF ANOTHER ACTUARY'S WORK

- .01 In this subsection 1640,
- “first actuary” means an actuary whose work is reviewed or repeated,
- “review engagement” means an engagement to review the first actuary's work,
- “reviewer” means the actuary engaged to review or repeat the first actuary's work, and
- “repeat engagement” means an engagement to repeat all or part of the first actuary's work.
- .02 The standards in this subsection 1640 apply to a review engagement that is at the instigation of a user. They do not apply to quality control in the first actuary's firm or employer (sometimes referred to as “internal peer review” or “internal audit”), even if the reviewer is external to the first actuary's firm or employer. The standards for a review engagement also apply, *mutatis mutandis*, to a repeat engagement.
- .03 *If the terms of the first actuary's engagement so permit, then the first actuary should cooperate with the reviewer.*
- .04 *If the terms of the review engagement so permit, then the reviewer should, as soon as practical, discuss the review with the first actuary (unless the reviewer's agreement with the first actuary's work makes such discussion superfluous), and should attempt to resolve any difference between them. The reviewer should report the result of such discussion.*
- .05 *If the reviewer reports disagreement with the first actuary's work but that work is within the range of accepted actuarial practice, then the reviewer should so report.*
- .06 *If a limitation in time, information, data, or resources constrained the quality of the first actuary's work, then the reviewer should so report.*
- .07 *If discussion between the two actuaries results in improvement to the first actuary's work or, in the case of periodic reporting, to the work expected for the subsequent report, then the reviewer should so report.*
- .08 *If the first actuary's work is not within the range of accepted actuarial practice, then the reviewer should so report and should follow the procedures set out in Rule 13 (Collateral Obligations).*
- .09 *A repeat engagement is an appropriate engagement if its purpose is to identify or reduce uncertainty in the matter on which the first actuary reported. [Effective July 1, 2011]*

### Applicable rules

- .10 The rules affect a review engagement, in particular Rule 1 (Professional Integrity), on upholding the reputation of the profession; Rule 8 (Courtesy and Cooperation), on dealing with other actuaries; and Rule 13 (Collateral Obligations), on apparent material noncompliance by another member with the rules or Standards of Practice.

### Selection of reviewer

- .11 The reviewer may be engaged by a user of the first actuary's work or by the first actuary. The latter may not be appropriate if the interests of that user and the first actuary's client or employer are opposed, but otherwise has the merit of
- facilitating compliance with this subsection 1640,
  - helping to assure selection of a qualified reviewer, and
  - avoiding unnecessary duplication by the reviewer of the first actuary's work.
- .12 In selecting a reviewer or agreeing the terms of the engagement, then the first actuary would have regard to the user's objective for the review and would consult with the user as appropriate.
- .13 If an actuary is qualified to perform the work of the first actuary, then that is prima facie evidence that the actuary is qualified to be the reviewer.
- .14 The perceived objectivity of the reviewer is enhanced if the reviewer is independent of the first actuary.

### Terms of the engagement

- .15 The review may take place prior to the release of the first actuary's report ("pre-release review") or after such release ("post-release review"). A pre-release review provides the opportunity for the reviewer to suggest improvement to the work. A post-release review allows such improvement to be implemented only in future work and in some cases might require a withdrawal of the report and revision to the work. A post-release review would therefore be avoided unless the circumstances of the case require it.
- .16 It is desirable that the terms of the engagement permit timely open discussion between the two actuaries. Such discussion
- facilitates the review,
  - lessens the possibility of reviewer misunderstanding or of unwarranted damage to the first actuary's reputation,
  - reveals possible improvement to the first actuary's work, even if the work is in accordance with accepted actuarial practice, and
  - contributes to the professional development of both actuaries.

### **Difference between the two actuaries**

- .17 It is possible for two actuaries properly to arrive at different results. Avoidance of a dispute about a difference which is not material, or explanation of a difference which is material, serves users and helps to preserve the reputation of the profession.
- .18 If the reviewer has access to different data, information, or resources, or has different time constraints, then the reviewer would so report.
- .19 Insufficiency or unreliability in the data creates uncertainty for both actuaries and increases the likelihood of reviewer disagreement with the first actuary's work. If better data are likely to narrow the range of the disagreement, then the reviewer would so report.
- .20 Discussion between the two actuaries is educational to both and may reveal possible improvements to the first actuary's work. The reviewer's report of those improvements assists the user to assess the utility of the review engagement. It may not be possible to identify those improvements that result from early discussion on matters which the first actuary had not yet decided.
- .21 Review by a third actuary of the reviewer's tentative disagreement with the first actuary's work may help to put the difference between them in perspective. Depending on the extent of the difference and its implications for the users, the reviewer, the first actuary, or both of them together, may wish to consult, in confidence, with the chairperson or vice-chairperson of the Practice Council of the Canadian Institute of Actuaries or of an appropriate practice committee.
- .22 Repealed

### **Review engagement which precludes discussion between the two actuaries**

- .23 The reviewer would consider the appropriateness of a review engagement that precludes discussion with the first actuary, especially if the first actuary will not be apprised that the review is to take place. The engagement may be an appropriate engagement, for example, where
- the interests of the first actuary's client or employer and the reviewer's client or employer are opposed, especially so in the case of actuarial evidence work involving litigation or mediation.
  - the reviewer's client or employer is the police or regulatory authorities who are investigating the first actuary's conduct or the conduct of the first actuary's client or employer.
  - the review is merely preliminary to a further review in which timely open discussion between the two actuaries will be possible.
  - discretion by the users of the reviewer's report is assured.

- .24 For example, in the case of actuarial evidence work involving litigation or mediation, the reviewer may be asked to report, without discussion with the first actuary,  
results based on assumptions which differ from those in the first actuary's report, or  
alternatives to the first actuary's reported results that are within the range of  
accepted actuarial practice.
- .25 An engagement that limits or delays discussion between the two actuaries may be an appropriate engagement if the reviewer's client or employer wants to ensure that the two reports are independent of each other.

**Repeat engagement**

- .26 In order to identify or reduce uncertainty, the first actuary's client or employer may ask a second actuary to repeat the first actuary's work. A repeat engagement usually requires more time and expense than a review engagement. The second actuary may or may not have knowledge of, or access to, the first actuary's work. If the second actuary knows or suspects that the engagement is a repeat engagement, then he or she would take into account the possibility that the client or employer is "opinion shopping" when determining if it is an appropriate engagement.

## 1700 ASSUMPTIONS

### 1710 NEEDED ASSUMPTIONS

- .01 *The needed assumptions for a calculation consist of model assumptions, data assumptions, and other assumptions.*
- .02 *There is a model assumption for each of the matters that the actuary's model takes into account. Those matters should be sufficiently comprehensive for the model reasonably to represent reality.*
- .03 *Data assumptions are the assumptions, if any, needed to relieve insufficiency or unreliability in the obtainable data.*
- .04 *The other assumptions are the assumptions about the legal, economic, demographic, and social environment upon which the model and data assumptions depend. [Effective December 1, 2002]*

#### **Model assumptions**

- .05 The model assumptions are quantitative assumptions about  
contingent events,  
investment return and other economic matters, such as price and wage indices, and  
numerical parameters of the environment, such as the income tax rate.
- .06 A calculation requires a model, simple or complex, into which assumptions are set. The actuary's model depends on the purpose of the report and the sensitivity of the calculation's results to the various matters about which assumptions could be made. The actuary would strike a balance between the complexity needed for reasonable representation of reality and the simplicity needed for a practical calculation. If the model does not take into account a matter, then the result is an implicit assumption about that matter, usually an assumption of zero probability or of zero rate. The actuary may compensate for an inappropriate implicit assumption regarding a matter that the model does not take into account by altering the explicit assumption regarding a matter that the model does take into account. For example, if the model takes account of investment return but does not take account of the risk of asset depreciation, the result, as just noted, is an implicit assumption of zero depreciation. To compensate, the actuary may assume a lower investment return rate.

**Data assumptions**

- .07 The available data may be not sufficient or not reliable. For example, files of pension plan members may lack the date of birth of the members' spouses. Based on sampling, or on comparison with comparable data, it may be appropriate to assume a relationship between spouse and member ages; for example, that a male spouse's date of birth is three years before the member's, and that a female spouse's date of birth is three years after the member's.

**Other assumptions**

- .08 The other assumptions are usually qualitative, dealing with the environment; for example, legislation, like the federal Income Tax Act, student education, the medical care system, government social security systems, and international treaties.
- .09 Those assumptions are needed to the extent that the model assumptions and, in some cases, the data assumptions depend upon them. Such assumptions are numerous and it is not practical to identify all of them.

**Needed assumptions**

- .10 Examples of matters about which assumptions may be needed are

**Economic**

discount rates to calculate present values,  
investment return rates earned on the investment of positive cash flow or that affects the price at which assets are sold in order to meet negative cash flow,  
investment return rates earned on assets that support liabilities,  
risk of asset depreciation (C-1 risk),  
risk of changes in the level or term structure of interest rates (C-3 risk),  
rate of interest on member contributions to registered pension plans,  
price and wage inflation rates,  
compensation increases,  
productivity rates,

number of hours worked by employees,  
behaviour of indices to which benefits are linked,  
rate of increase in maximum allowable pensions under a registered pension plan, and  
trend rate (by type of benefit provided under the plan) – initial rate, ultimate rate and the number of years and grading pattern to reach the ultimate rate,

**Social**

family composition,  
marital status,  
age difference between spouses, and  
judicial decisions in litigation,

**Decrement**

termination of coverage voluntarily, or through job loss, death, disability, or failure to maintain eligibility,

**Benefit entitlement**

rates of death, disability, sickness, accident, unemployment, medical treatment, and early, normal, and deferred retirement,  
election of options by members and policy owners, and  
impact of benefit maxima,

**Increment**

rates of future new entrants,

**Benefit continuance**

death, disability recovery, marriage breakdown, remarriage, termination of economic dependency, and re-employment rates,  
post-retirement pension adjustments, and  
maintenance expense for a disabled person,

**Claims development**

reporting patterns,  
settlement patterns,  
reopened claims,  
initial claims cost by type of benefit and age, and  
cost-sharing arrangements (such as share of cost borne by members in the form of premiums or contributions, coinsurance, deductibles, annual and lifetime maxima, etc.),



### **Expense**

expenses of marketing, administration, claim adjustment, and investment management,

### **Taxation**

tax rates,

definition of tax base, and

limitations on the funding of registered pension plans,

### **Other**

government benefit plan provisions and their integration with private sector plans, and

portion of claims costs paid under government programs.

## **1720 SELECTION OF ASSUMPTIONS**

- .01 *The assumptions that the actuary selects or for which the actuary takes responsibility, other than alternative assumptions selected for the purpose of sensitivity testing, should be appropriate in the aggregate. These assumptions should also be independently reasonable unless the selection of assumptions that are not independently reasonable can be justified.*
- .02 *The actuary should select each needed assumption except for those, if any, which are prescribed, which are stipulated by law or which are stipulated by the terms of the engagement.*
- .03 *If the actuary does not take responsibility for an assumption, then the actuary should so report. If the actuary considers it practical, useful and appropriate under the terms of the engagement to do so, the actuary should report the result of an alternative assumption. [Effective July 1, 2011]*
- .03.1 The actuary would select independently reasonable assumptions. The following are examples.

For a typical defined benefit pension plan valuation, the actuary would adopt an explicit investment assumption, as well as an explicit expense assumption rather than using implicit assumptions incorporated within a net discount rate. However, for a small defined benefit pension plan, the actuary may choose to use approximations for the investment expenses, in accordance with subsection 1510, and

For a typical non-participating life insurance portfolio where experience is not passed on to policy owners, all assumptions would be established independently. However, for a typical participating life insurance portfolio where experience is passed on to policyholders through changes to the dividend scale, a reasonable representation of reality would be to assume that the current dividend scale and current experience persist into the future, as long as any implicit offsets in assumptions simplify the valuation and do not materially affect the amount of the valuation.

- .03.2 The requirement for independently reasonable assumptions regarding contingent events would not require a test of reasonableness within an assumption. For example, a mortality assumption would need to be reasonable only as an independent assumption in total, even though there may be offsets between ages, sex and smoking status within the assumption.
- .03.3 The reasonableness of an assumption does not depend on the manner in which an assumption is expressed as long as the assumption would be a reasonable representation of reality over the entire period to which the assumption applies. For example, a life insurance administrative expense assumption would not be reasonable if it were expressed entirely as a proportion of premium, even though it may represent the current reality but would not represent reality if all policies were to become paid up and administrative expenses were to continue to be incurred.
- .03.4 A reasonable assumption would reflect current conditions as of the calculation date but would not necessarily have to reflect current conditions persisting into the future. For example, if current interest rates are extremely high or low in relation to past rates or future expectation, it would not be unreasonable to assume that interest rates change over time.
- .03.5 The actuary's use of independently reasonable assumptions may result in the assumptions not being reasonable in the aggregate. For example,
  - if all assumptions are independently reasonable but biased in the same direction, the combined effect of all assumptions may produce an excessive overall provision, or
  - if all economic assumptions used in the valuation of a pension plan are independently reasonable but were developed based on different assumptions for price inflation, the assumptions may not be reasonable in the aggregate.

In such event, the requirement for assumptions to be appropriate in the aggregate would be more important than the requirement for independently reasonable assumptions. Certain assumptions may then be modified and may not be independently reasonable.

- .03.6 If an assumption is prescribed, is stipulated by law or regulation or is stipulated by the terms of the engagement, it would not be appropriate to compensate for this prescription or stipulation by modifying other assumptions. The remaining assumptions would be reasonable in the aggregate and to the extent possible be independently reasonable. Subsections 1310 and 1320 provide additional guidance for these situations.
- .04 If the use of assumptions that are not independently reasonable could be justified, inappropriateness in a particular assumption could be offset by the inappropriateness in another, for example if one is conservative and the other is not conservative, then they may be appropriate in the aggregate. For example, in a pension plan valuation, group annuity purchase costs may be calculated using mortality and interest rates that would be different from the rates used by an insurance company to price the annuity, but may still provide a reasonable cost for the annuity.
- .04.1 There would be justification for not using independently reasonable assumptions when the assumption
- is stipulated by law or regulation or is required by a court or by legal precedent, in which case the actuary would set assumptions as allowed by subsection 1310,
  - is in conflict with, or is impractical under, the terms of an appropriate engagement, in which case the actuary would set assumptions as allowed by subsection 1320,
  - is required in unusual or unforeseen situations, in which case the actuary would set assumptions as allowed by subsection 1330,
  - has no material impact on the results of the work, in which case the actuary would set assumptions as allowed by subsection 1340,
  - is an appropriate approximation, in which case the actuary would set assumptions as allowed by subsection 1510,
  - is a model assumption that reasonably represents reality, as described in subsection 1710, or
  - is consistent with accepted actuarial practice.
- .04.2 The use of independently reasonable assumptions implies that each assumption is explicitly defined. However, there would be no requirement to use explicit assumptions in the method for calculation, as long as the result of using that method does not produce a material error. For example, for pension valuations, use of a discount rate net of expenses may produce a value very close to the value obtained by using explicit assumptions. In this case, the actuary would disclose both the gross investment rate assumption and the expense assumption.
- .05 Use of an assumption stipulated by the terms of the engagement is use of the work of another person.

- .06 If the stipulated assumption is appropriate but near the end of the accepted range, then it may be useful, if appropriate under the terms of the engagement, to report the result of an alternative assumption near the other end of the accepted range, especially in an external user report. The same is true for a stipulated assumption that, for example, the federal Income Tax Act continues as is when an amendment to it is virtually definitive.
- .07 In assessing the utility of reporting the result of an alternative to an assumption for which the actuary does not take responsibility, the actuary would consider the dependence of external users on his or her work. For example,
- utility in actuarial evidence work would be assessed in the context of the adversarial system in tort litigation, which expects each side to develop its own case without help from the other side, or to identify and expose any flaws in the other side's case; therefore, it is consistent with that system for the actuary engaged by one side not to report the result of an alternative assumption if the lawyer for the other side is able to compel the actuary (or engage his or her own actuary) to calculate the result of a desired alternative, and
- if members of a pension plan receive a copy of the actuary's report that uses an assumption for which the actuary did not take responsibility, and if the members are identified as users in the report, the reporting of the results of using an alternative assumption may be useful to those members.

### **1730 APPROPRIATE ASSUMPTIONS**

- .01 *The appropriate model or data assumption for a matter should be the best estimate assumption of that matter, modified, if appropriate, to make provision for adverse deviations, and taking account of*
- the circumstances of the case, past experience data, the relationship of past to expected future experience, anti-selection, the relationship among matters, and*
- in the case of assumptions on economic matters for calculation of liabilities in a balance sheet, the assets which support those liabilities at the calculation date and the expected policy for asset-liability management after that date, except where the circumstances of the valuation require otherwise.*
- .02 *The appropriate assumption for a matter, other than a model or data assumption, should be continuation of the status quo, unless there is none or unless there is a reasonable expectation that it will change, and the actuary so reports. [Effective July 1, 2011]*

### **Acceptable range**

- .03 Variability in the circumstances of cases is significant and calls for a significant variation in assumptions among cases. Usually, therefore, the actuary who is familiar with the circumstances of a case makes the best selection of assumptions for that case. Two actuaries, each familiar with the circumstances of a case, may select different assumptions for that case. That is acceptable if the range of their selections is appropriately constrained by standards of practice.
- .04 In other words, the crux of the matter is the selection of assumptions appropriate to a particular case from the relatively wide range of assumptions applicable to all cases. A relatively narrow range of assumptions among actuaries is secondary to the selection of appropriate assumptions.
- .05 Sometimes, however, it is desirable that actuaries produce results within a relatively narrow range that the profession and the public perceive to be reasonable and consistent. It is then appropriate for the profession to supersede the actuary's selection by a prescription in the practice-specific standards that is within the range of assumptions otherwise considered acceptable.

### **Circumstances of the case**

- .06 An assumption about a matter would take account of the circumstances of the case if those circumstances affect that matter.
- .07 The circumstances of the case affect experience on most matters other than economic matters.

### **Familiarity with the case**

- .08 In selecting assumptions, the actuary would have knowledge of the case. That may involve consultation with the persons responsible for the functions that affect experience.
- .09 For example, if the calculation is to value the assets or liabilities of a benefits plan, then the actuary would consult the persons responsible for investments, administration, and plan provisions. If the calculation is to value the policy liabilities of an insurer, then the actuary would consult the officers responsible for investments, underwriting, claims, marketing, product design, policy dividends, and policy servicing.

### **Past experience data**

- .10 The available and pertinent past experience data are helpful in the selection of assumptions.
- .11 Other things being the same, pertinent past experience data are data
- relating to the case itself rather than to similar cases,
  - relating to the recent past rather than to the distant past,
  - that are homogeneous rather than heterogeneous, and
  - that are statistically credible.

Usually, however, those criteria conflict with each other.

- .12 Consider, for example, claims experience data of a property and casualty insurer. Homogeneous claims are those for similar policy benefits having similar  
emergence patterns (for example, property insurance claims tend to be reported more quickly than liability insurance claims),  
settlement patterns (for example, claims for glass damage tend to be settled more quickly than claims for bodily injury), and  
frequency/severity since high frequency/low severity claims tend to be more stable than low frequency/high severity claims.
- .13 Combination of data, for example a combination of the insurer's personal lines and commercial lines claims, or a combination of the insurer's claims on primary and excess coverages, make the data less homogeneous. Greater homogeneity requires separation into more groupings, each with fewer data and hence less statistical credibility.
- .14 To be statistically credible, the data may have to include data for the distant as well as the recent past. For example, as a result of periodic revisions to the insurer's policies, the available data may be for claims whose benefit dollar limits are lower than those limits for the claims being valued. Those data lack pertinence.
- .15 Similarly, the insurer's experience data may be unreliable or not statistically credible and the only available data may be intercompany experience data, which may lack pertinence to the insurer.
- .16 The actuary would be prudent in adjusting the available data to take account of the circumstances of the case. For example, without explicit justification, the actuary would not select a best estimate assumption that is more favourable than intercompany experience data in valuing an insurer's insurance contract liabilities.

### **Expected future experience vs. past experience**

- .17 To extrapolate pertinent past experience and its trend to the near future is often, but not necessarily, appropriate. The appropriateness of the extrapolation depends on the matter assumed. For example, pertinent past mortality experience is a better indicator of the outlook than is pertinent past investment return experience. Moreover, any extrapolation would take account of a change that affects the outlook. For example,
- adoption of a subsidized early retirement option in a pension plan may affect retirement rates,
  - a change in an insurer's case estimate practices may affect its claims development,
  - an insurer's discontinuance of a line of business may affect its expense rates allocable to the remaining lines, and
  - a change in judicial practice may affect the settlement of claims.

### **Anti-selection**

- .18 Each assumption would normally take account of potential anti-selection.
- .19 One party in a relationship may have the right (or the administration of the relationship may give the privilege) to exercise certain options. That party may be expected to exercise those options to the detriment of the other party in the relationship if it is to the first party's advantage to do so. The first party may be an insurer's policy owner, a benefits plan's member, a borrower, a lender, or a shareholder.
- .20 Examples are the right or privilege of a
- pension plan member to select his or her retirement date when the pensions at various retirement ages are not actuarially equivalent,
  - policy owner to renew term life insurance at its expiry for a stipulated premium,
  - mortgagor to prepay principal, or an issuer to call a bond or redeem a preferred share, and
  - shareholder to retract a share.
- .21 A particular policy owner or plan member exercising a particular option may not be sure that the chosen option is the most advantageous. It is plausible, however, and experience has shown, that policy owners and plan members who can profit from doing so tend to exercise those options to the detriment of the insurer or plan. In the above example of a policy owner's right to renew term life insurance, the stipulated renewal premium on an unhealthy life insured may be less than the premium for a new policy whose purchase is subject to underwriting, in which case the policy owner will tend to exercise the renewal option. Alternatively, the policy owner may be able to purchase replacement insurance if the life insured is healthy for less than that renewal premium, and will tend to do that.

- .22 Anti-selection also occurs when price does not take proper account of risk classification and the customer is free to buy or not, or to select among sellers. For example, the conversion at retirement of an employee's accumulated fund in a defined contribution pension plan tends to be more attractive to a female than a male if the conversion basis is the same for both. Similarly, automobile collision insurance tends to be more attractive to a young single male than to other members of the driving population if the premium is uniform.
- .23 The extent of anti-selection depends on
- the size of the advantage from each exercise of the option (for example, anti-selection is dampened if the advantage to each policy owner is small even when the aggregate potential detriment to an insurer is large),
  - the concomitance of exercise of the option (for example, election of a favourable early retirement pension may force the plan member into unwanted unemployment, or a policy owner (who is also the life insured) in ill health may be unable to afford to continue an insurance policy with a low premium),
  - the policy owner's or plan member's difficulty in making the required judgment (for example, everyone knows his or her age, but a person may be unable to gauge the effect of ill health on longevity), and
  - the sophistication of the policy owner, plan member, borrower, lender or shareholder.

### **Related assumptions**

- .24 Assumptions may be interrelated. For example,
- interest rates and inflation rates may be related,
  - investment policy affects the risk related to interest rate swings, and
  - voluntary termination rates may affect death rates through anti-selection.



### **Supporting assets**

- .25 The investments that support the liabilities at the calculation date and the expected policy for asset-liability management after that date determine matters on which assumptions are needed. The following are examples.

If those investments include bonds rated A–, then an assumption of asset depreciation of those bonds is needed. That depreciation is usually expressed as a deduction from the assumed gross yield.

If the investment policy includes purchase or sale of such bonds with a particular remaining term, then an assumption of yield on those bonds with that term is needed.

- .25.1 The circumstances of the valuation may require a discount rate not related to the assets at the calculation date and the policy for asset-liability management after that date. For example, pension solvency valuations may use external reference discount rates.

### **Indexing of benefits**

- .26 In most cases where benefits are indexed to inflation, use of an explicit gross rate of return and an explicit inflation rate would be appropriate for valuation of these benefits. In some cases, where the result of the valuation is only sensitive to the “net” or “real” rate of return, an explicit gross rate of return and an explicit inflation assumption would not be required for calculation purposes.

- .27 The indexing may be partial; for example, benefits may be indexed to inflation, subject to a maximum increase of 3% during any year. In such cases, the separate assumptions of investment return rates and of inflation or wage rates are needed in a refined assumption, but a “net” or a modified “net” assumption may be a satisfactory approximation for calculation purposes. The approximation techniques for partial indexing in the calculation of transfer values from registered pension plans may be useful.

### **Assumptions other than model and data assumptions**

- .28 Continuation of the status quo is usually the appropriate assumption for other than model and data assumptions; for example, an assumption that the fund of a registered pension plan continues not to be taxed or that the capital markets remain more or less as they are. Users may infer that assumption except where the actuary reports otherwise. The actuary would report an assumption

that is different from continuation of the status quo, and

regarding a matter for which there is no status quo, for example, a student’s assumed occupation after completion of education.

- .29 The actuary would also report an assumption of continuation of the status quo whose outlook is doubtful; for example, enactment of a change in tax rates whose proclamation is doubtful or likely to be deferred. It may be useful, if appropriate under the terms of the engagement, to report the result of two assumptions without opining on their relative appropriateness and to recommend that each user select that which meets his or her needs.
- .30 An extreme assumption may be appropriate, but in that case the actuary would also report the result of the opposite extreme.

#### **1740 PROVISION FOR ADVERSE DEVIATIONS**

- .01 In this subsection, “provision” means “provision for adverse deviations”.
- .02 *A calculation should not include a provision if the related work requires an unbiased calculation.*
- .03 *Otherwise, if a provision promotes expectations for financial security, then the calculation should include a provision that*
- strikes a balance among the conflicting interests of those affected by the calculation, and*
- takes account of the possibility to offset the effect of adverse deviations by means other than a provision.*
- .04 *The amount of that provision should*
- take account of the effect of the uncertainty of the assumptions and data for the calculation on the financial security of those affected by the calculation,*
- not take account of the possibility of catastrophe or other major adverse deviation which is implausible in usual operations, except when the calculation specifically addresses that possibility,*
- in the case of a provision in respect of uncertainty of assumptions, result from selection of assumptions that are more conservative than best estimate assumptions, and*
- in the case of a plan or program where solvency is not required at all times, recognize the financial risks specific to that plan or program and the related objectives of the entity responsible for such a plan or program.*
- .05 *The margin for adverse deviations in each assumption should reflect the uncertainty of that assumption and of any related data. [Effective July 1, 2011]*

#### **Unbiased calculations**

- .06 A provision is contrary to the purpose of the work if the work requires an unbiased calculation, as it does, for example, in splitting the value of a pension benefit fairly between two parties.

- .07 The purpose of a provision is to promote financial security, but it does not follow that there should be a provision simply because financial security is thereby promoted. For example, inclusion of a provision for one party in a calculation designed to value a benefit fairly between two parties would promote the financial security of one party at the expense of the other party.
- .08 An unbiased calculation may be described in a variety of ways, such as “neutral” or “even-handed”, or as using “best estimate assumptions” or “best estimates”.

### **Conflicting interests**

- .09 A provision in a calculation is a bias that may affect two conflicting interests in opposite ways. Hence there is a need to strike a balance.
- .10 In some cases, the conflicting interests are those of separate users of the actuary’s work. In other cases, the conflicting interests are internal to a single user of the actuary’s work. For example,
- provision in an insurer’s scale of premium rates promotes financial security of its shareholders, but any provision makes the scale less competitive in the marketplace and so militates against another interest of those shareholders, and
- provision in funding a pension plan lessens the likelihood that the contributor will be obliged later to increase contributions, but increases the likelihood of surplus emerging later in the plan that may be unavailable to the contributor.

### **Offsetting adverse deviations by other means**

- .11 There may be means other than a provision to offset the effect of adverse deviations. If they exist, those other means tend, themselves, to involve uncertainty but, to the extent that they are credible, the actuary would appropriately reduce the provision, thereby avoiding the distortion caused by the provision. Healthy skepticism is appropriate in assessing the credibility of such means.
- .12 One example of other means is a retrospective rating, when a policy owner is paying a premium calculated from best estimate assumptions but with an undertaking to reimburse the insurer for adverse deviations in experience.

### **Uncertainty**

- .13 If assumptions could be made with complete confidence, if there were no statistical fluctuations, and if data had no defect, then there would be no need for a provision. But assumptions are virtually always uncertain. The exceptions, such as the assumption of the probability of getting a head when tossing a coin, are rarely encountered in practice. Some, especially those about events long after the calculation date, may be conjectural. Even when an assumption can be made with high confidence, the result may be subject to statistical fluctuation. For example, one may not get five heads when tossing a coin 10 times.

.14 Uncertainty in an assumption results from the risk of misestimation of the best estimate assumption (sometimes referred to as “misestimation or deterioration of the mean”) in the case of all assumptions, and statistical fluctuation in the case of assumptions involving contingent events.

.15 The risk of defective data also creates uncertainty. Data, especially voluminous or complex data, are rarely without defect.

.16 That uncertainty of assumptions and data may militate against the financial security of those affected by the calculation. A provision reduces the potential adverse effect of that uncertainty.

#### **Catastrophe or other major adverse deviation**

.17 The provision would not exceed the amount needed fully to offset the effect of adverse deviations that are plausible in usual operations. The provision would offset only partially the effect of catastrophe or other major adverse deviations that are not plausible in usual operations.

.18 It is difficult to quantify the distinction between adverse deviations that are, and are not, plausible in usual operations. For each situation, the actuary would adopt a distinction that results in a provision that is not excessive. The intent of the provision is to enhance financial security, but provision for 100% security is excessive.

.19 The recommendation not to take account of the possibility of catastrophe or major adverse deviation does not apply to a calculation that specifically addresses that possibility; for example, calculation of the minimum capital that an insurer needs in order to have a satisfactory financial position, or a calculation with respect to stop-loss reinsurance, for which catastrophe is the event insured against.

#### **Selection of conservative assumptions**

.20 To make provision in respect of uncertainty of assumptions, the actuary would in some cases select assumptions that have a margin for adverse deviations applied to best estimate assumptions. Testing may be needed to assure that a contemplated assumption achieves the desired calculated amount compared to the calculated amount using the corresponding best estimate assumption.

.21 Examples of the use of assumptions that make provision in respect of the uncertainty of the assumptions are

a best estimate assumption combined with a margin for adverse deviations, and scenario testing of a range of assumptions and selection of a scenario (or a point between two scenarios) that produces a result that is toward the conservative end of the range of possible results.

- .22 One actuarial cost method may be more conservative than another. For example, other things being the same and until a certain maturity point is reached, the entry age normal actuarial cost method, when applied to a group, usually results in higher contributions to a pension plan than the unit credit actuarial cost method. If the unit credit method is the appropriate method, then it would not be appropriate to make provision for adverse deviations by using the entry age normal method and best estimate assumptions. The reason is that there is no assurance that the amount of such a provision is appropriate. The better practice is to make the provision through selection of conservative assumptions.

### **Adjustments to policy dividends, premium rates, contributions, and benefits**

- .23 Those adjustments can offset the effect of adverse deviations.
- .24 The insurer promises to declare policy dividends in accordance with experience, but does not promise a specified amount of policy dividends. An insurer's participating insurance contract liabilities include the present value of expected future policy dividends. If the insurer experiences adverse deviations and reduces policy dividends as a result, then the amount included in insurance contract liabilities corresponding to the reduction in policy dividends becomes available for other promised benefits and therefore is not needed in the provision. If the amount included for policy dividends is large, and if the insurer's management of its policy dividend practices is responsive to change in conditions, then a minimal or, in the extreme case, zero provision for adverse deviations is appropriate.
- .25 Similarly, in the event of adverse deviations, contributions may be adjusted, decreases in benefits or even winding-up of the plan may be possible, and the plan may have surplus that can substitute for contributions.
- .26 Those adjustments are rarely fully credible. For example, an insurer's legal right to adjust policy dividends may be constrained by inertia or marketplace forces; a participating employer who can afford to pay higher contributions today may be unable to do so later; substitution of surplus for contributions may be restricted, and assessment of insurer's or participating employer's ability to make the adjustment may be difficult or impractical.

### **Provision of zero**

- .27 A provision of zero is appropriate
- for work that requires an unbiased calculation, in which case, the provision of zero is always appropriate, and
- where the actuary considers a provision but concludes that a provision does not promote expectations for financial security or that there are other means that reduce or eliminate the need for the provision.

## Examples

- .28 Two important examples of provision for adverse deviations are in the valuation of the insurance contract liabilities of an insurer for its financial statements if they are prepared in accordance with generally accepted accounting principles, and the liabilities of a benefits plan if the actuary is giving advice on its funding and if the applicable law or terms of the engagement require a provision for adverse deviations.
- .29 In valuing those liabilities, the actuary would strike a balance between security of benefits promised to policy owners or plan members and equity among conflicting interests.

### Security of benefits promised

- .30 A provision in reported liabilities reduces the likelihood that the amount thereof will later prove to be inadequate. As well, if those reported liabilities (including the provision) are funded (i.e., fully supported by investments) and the provision accelerates funding, then the provision promotes security of those benefits.
- .31 On the other hand, if those liabilities are unfunded, then the provision has no explicit effect on the security of those benefits, (unless some action that improves benefit security occurs or is taken) since the actual ultimate value of the benefits has not changed and neither has the likelihood of them being paid.
- .31.1 A plan or a program where solvency is not required at all times could include plans such as a pension plan, a post-retirement benefit plan or a public personal injury compensation plan. Depending on the purpose of the valuation for such a plan, a provision for adverse deviations may be included. For example, when funding a pension plan, a provision for adverse deviations would be introduced if required by law or by the terms of the engagement.

### Generations of policy owners, shareholders or plan members

- .32 The amount of a provision increases the liabilities of an insurer or a benefits plan, and decreases its equity or surplus, or increases its unfunded liabilities, by the same amount. If the later experience is according to the best estimate assumptions, then the provision will revert to equity or surplus and be available to finance policy dividends or benefit increases or contribution decreases. That is an inequitable result if one generation of policy owners, shareholders or plan members bears the cost of making the provision, but a later generation makes a windfall from its reversion to equity or surplus. In striking a balance, the actuary may have to give financial security greater importance than equity unless the terms of the engagement suggest otherwise.

- .33 In the case of policy owners, the provision and its later reversion may affect policy dividends on participating policies and premiums and benefits on adjustable non-participating policies. It is appropriate for the insurer to manage its policy dividends and adjustments so that an unneeded provision reverts to the policy owners who made it.
- .34 In the case of shareholders of a client or employer, a provision and its later reversion could transfer share value from the current to a future group of shareholders.
- .35 In the case of benefits plan members, the provision and its later reversion may affect benefits or the members' share of contributions. In those cases, it may be difficult to strike a balance between financial security and the various generations of plan members. The importance of inter-generational interests varies, however, among plans. It tends, for example, to be a more important consideration in
- contributory plans when the members pay a percentage share of the contributions,
  - and
  - multi-employer plans with negotiated contributions.

### **Policy owners versus shareholders, and plan members versus the participating employer**

- .36 A provision tends to favour policy owners and benefits plan members at the expense of the participating employer and the insurer's shareholders. A participating employer, by establishing a benefits plan, and an insurer, by selling policies, create reasonable expectations among benefits plan members and policy owners for payment of the promised benefits. The actuary would therefore strike a balance that promotes security of promised benefits but that is not excessive. An excessive provision would militate against the willingness of participating employers to improve plan benefits and the ability of insurers to raise needed capital.

### **Reporting the provision**

- .37 The actuary would usually make the calculation including the provision. It is not necessary to report the amount of the provision itself, and in some situations, may be misleading to do so without also reporting a discussion of the related uncertainty and risk. The actuary would calculate the amount of the provision as the difference between the results of two calculations; namely, a calculation including the provision, and one not including the provision. That is practical only when the actuary selects the best estimate assumptions explicitly.
- .38 Reporting the amount of the provision would be accompanied by a discussion of the related uncertainty and risk.

### **Assumptions: margin for adverse deviations**

- .39 The standards in this subsection apply to the selection of a margin for adverse deviations in an assumption if the actuary uses that margin in order to make provision for adverse deviations. The standards do not apply when the margin in an assumption makes provision for another purpose, such as to make future benefit improvements.

- .40 A margin for adverse deviations may be expressed as one of
- the difference between the assumption used for the valuation and the best estimate assumption. (For example, if the actuary expects the interest rate to be 10% and assumes 8%, then the margin for adverse deviations is 2%. The provision for adverse deviations is the dollar amount of increase that results from a margin for adverse deviations. For example, if that 2% margin for adverse deviations in the interest rate assumption increases liabilities from \$100 million to \$120 million, then the provision for adverse deviations is \$20 million.)
  - a multiplier to the liabilities without provision for adverse deviations. (For example, if the actuary sets claim liabilities equal to 1.1 x expected claim liabilities, then the margin for adverse deviations factor is 10% and the provision for adverse deviation is 0.1 x expected claim liabilities.)
  - an addition to the liabilities without provision for adverse deviations, calculated through scenario testing.
- .41 Actual future experience will be equal to the combined effect of
- expected experience (i.e., in accordance with the best estimate assumption), and
  - deviation, favourable or adverse, from expected experience.
- .42 Deviation of actual from expected experience may result from one or more of
- error of estimation, which may be favourable or adverse. (Except in the simplest cases, it is not possible to determine expected experience with complete confidence. Past experience data may be insufficient or unreliable. Future conditions may differ from the conditions that generated the past experience.)
  - deterioration or improvement of the expected experience as a result of influences which the actuary does not anticipate,
  - statistical fluctuation, which also may be favourable or adverse.
- .43 A larger margin for adverse deviations (compared to the best estimate assumption) is appropriate if
- the actuary has less confidence in the best estimate assumption,
  - an approximation with less precision is being used,
  - the event assumed is farther in the future,
  - the potential consequence of the event assumed is more severe, or
  - the occurrence of the event assumed is more subject to statistical fluctuation.
- .44 A smaller margin for adverse deviations is appropriate if the opposites are true.



- .45 In principle, it is better to reflect an assumption's uncertainty by a margin for adverse deviations in the assumption itself rather than by adjustment to another assumption. For example, except in case of approximation, it is not accepted actuarial practice to make provision for adverse deviations in claim liabilities by assuming that the investment return rate is zero; i.e., by valuing the liabilities on an undiscounted basis.
- .46 Selection of a relatively large margin for adverse deviations for the assumption whose uncertainty most affects the calculation and a zero margin for the others may be an appropriate approximation.
- .47 The choice of the sign (+ or -) of the margin for adverse deviations (i.e., whether the assumption for the valuation is larger or smaller than the best estimate assumption) is sometimes complex, and testing may be necessary to ensure that the margin affects the calculation in the desired direction; i.e., to ensure that the margin is not a margin for favourable deviations. For example,
- in the valuation of an insurer's insurance contract liabilities, the margin for the withdrawal rate assumption may be positive at some policy durations and negative at other policy durations, and
- in the valuation of the liabilities of a pension plan, a positive margin for the early retirement rate assumption usually, but not always, increases the liabilities, so testing is needed to determine the sign of the margin.
- .48 A margin with the seemingly wrong sign in one assumption is, however, appropriate if it ensures consistency with a related assumption having a greater effect on the calculation. For example, in the valuation of liabilities, the margin in the interest rate assumption is usually negative and the margin in the inflation rate assumption is usually positive. If, however, the actuary assumes that the inflation rate is the nominal interest rate minus the real interest rate, then both margins would have the same sign to ensure consistency; i.e., negative if investment income has the greater effect, positive if expenses or inflation-indexing of benefits has the greater effect.

## **1750 COMPARISON OF CURRENT AND PRIOR ASSUMPTIONS**

- .01 *Unless the actuary reports the inconsistency, the assumptions for a calculation for a periodic report should in the aggregate be consistent with those of the prior calculation. [Effective December 1, 2002]*
- .02 The definition of consistency for the purpose of this recommendation varies among practice areas. For advice on funding a pension plan, the assumption at a calculation date is consistent with the corresponding assumption at the prior calculation date if the two are numerically the same. For example, if the investment return rate assumption is 6.5% at the current calculation date and was 7% at the prior calculation date, then the actuary would report the change even if the outlook had changed downward by 0.5% between the two dates.

- .03 For valuation of an insurer's insurance contract liabilities for its financial reporting, an assumption at a calculation date is consistent with the corresponding assumption at the prior calculation date if the two assumptions
- each reflect the conditions and outlook at their respective calculation dates in the case of a best estimate assumption,
  - each reflect the risks at their respective calculation dates in the case of a margin for adverse deviations, and
  - are located at the same point within the range of accepted actuarial practice.
- .04 The assumptions at a calculation date are in the aggregate consistent with the corresponding assumptions at the prior calculation date if
- each assumption is so consistent, or
  - there are inconsistencies among the assumptions but the result of the calculation is the same as if each assumption were so consistent.
- .05 If the assumptions are in the aggregate not so consistent, then the actuary would report the inconsistency. If practical, useful and appropriate under the terms of the engagement, the report would quantify the effect of the inconsistency.

## 1800 REPORTING

### 1810 STANDARD REPORTING LANGUAGE

- .01 *The actuary's external user report should incorporate any standard reporting language applicable to the work. [Effective December 1, 2002]*
- .02 The practice-specific standards for work describe any applicable standard reporting language.
- .03 The purpose of standard reporting language is to simplify the actuary's communication with users by creating a clear, easy to recognize, distinction between the usual situation and the unusual (sometimes problem) situation. The standard reporting language, while abbreviated, acquires precision by the convention that the situation is usual if there is no reservation. Any reservation is disclosed in a special paragraph and described either there or by reference. Standard reporting language is thus similar to the auditor's standard report on financial statements.
- .04 The standard reporting language may comprise a complete report; for example, an appointed actuary's report with respect to the financial statements of an insurer. Alternatively, it may be included in a larger report; for example, a report giving advice on funding a pension plan.
- .05 Here is the skeletal structure of standard reporting language.

Addressee, which usually identifies the client or employer.

Scope paragraph, which describes the work and its purpose and says that the work was done in accordance with accepted actuarial practice in Canada in a usual situation, or that it was done in accordance with accepted actuarial practice in Canada "except as described in the following paragraph" in an unusual situation.

Reservations paragraph (omitted in the usual situation), which either compares the particular (unusual) situation to the usual situation or refers to that comparison elsewhere.

Opinion paragraph, which reports the actuary's opinion, without reservation in a usual situation and with reference to the reservations paragraph in an unusual situation. The opinion paragraph either reports the result of the work, which is practical only if the result is short, or references its location.

Identification of the actuary.

Report date.

## **1820 REPORTING: EXTERNAL USER REPORT**

- .01 *In an external user report, the actuary should*
- identify the client or employer,*
  - describe the work, its purpose, and its users,*
  - say whether or not the work is in accordance with accepted actuarial practice in Canada and, if not, disclose the deviation from that practice,*
  - if useful, disclose any unusual application of accepted actuarial practice,*
  - disclose any aspect of the work for which the actuary does not take responsibility,*
  - disclose any assumption that is different from assumption of continuance of the status quo and, if practical, useful and appropriate under the terms of the engagement, disclose the effect of alternative assumptions,*
  - in the case of a periodic report, disclose any inconsistency between the methods and assumptions of the current and prior reports,*
  - describe any subsequent event that is not taken into account in the work,*
  - disclose any reservation,*
  - express an opinion on the results of the work,*
  - identify himself or herself and sign the report, and*
  - date the report.*
- .02 *Any description or disclosure may be in material referred to in the report and either accompany the report or plausibly be available to users.*
- .03 *Subsequently, the actuary should respond to a user's request for explanation except if that is contrary to the terms of the engagement.*
- .04 *Subsequently, the actuary should withdraw or amend the report if information comes to hand after the report date that invalidates the report.*
- .05 *A duty of confidentiality in an appropriate engagement supersedes any of the foregoing portions of this recommendation with which it conflicts, but does not supersede an actuary's obligations to the Canadian Institute of Actuaries, pursuant to the bylaws or the Rules of Professional Conduct. [Effective December 1, 2002]*

### **Description and disclosure in general**

- .06 The range of appropriate reports is relatively narrow for external user reports as compared to that for internal user reports. An external user report would be relatively formal and detailed when the actuary does not communicate directly with users or when the interests of an external user and of the actuary's client or employer are not the same.
- .07 Appropriate description and disclosure in a report strike a balance between too little and too much. Too little disclosure deprives the user of needed information. Too much disclosure may exaggerate the importance of minor matters, imply a diminution of the actuary's responsibility for the work, or make the report hard to read.
- .08 The appropriate criterion for description and disclosure is the question, "What qualitative and quantitative information best serves the user's understanding and decision-making?" The question, "What information does the user want?", is an insufficient criterion because the circumstances of a case may make the actuary aware of information needs of which the user is unaware.
- .09 Reporting the sensitivity of the results to variations in assumptions is often useful.
- .10 Disclosure need not necessarily be in the report itself except if its importance so warrants or if it cannot be referenced in material available to users. Disclosure in a short report may place undue emphasis on the information disclosed.
- .11 An unintended reservation misleads the user if it implies either that there was a deviation from accepted actuarial practice or that the actuary does not take full responsibility for the work. The following are examples.
- Approximation is a usual part of work. Even a moderately complex calculation may involve many approximations. Disclosure of an appropriate approximation may mislead the user by implying that the actuary's work falls short of accepted actuarial practice.
- Use of another person's work is also a usual part of work. If the actuary does not take responsibility for the used work, then disclosure is appropriate. Disclosure if the actuary does take responsibility for the used work may mislead the user.
- Deviation from a particular recommendation or other guidance in the standards when the result of doing so is not material is also a usual part of work and its disclosure is undesirable.
- ### **The work, its purpose, and its users**
- .12 Description of the work usually includes the calculation date and the numerical result. If the work is required by law, then citation of the law is useful.

- .13 The amount of detail depends mainly on the needs of users. A separate report may be desirable for a particular user (usually a regulator) whose desire for detail significantly exceeds that of other users.
- .14 Description of the purpose of the work and its users permits another person to assess its appropriateness to his or her needs and may thereby avoid unintended use of the work.
- .15 The users comprise the addressee(s) of the report, and any others explicitly identified in the report. Where a report has more than one user, the actuary would have regard to the information of value to each user in determining appropriate disclosure.

### **Accepted actuarial practice**

- .16 If the work is in accordance with accepted actuarial practice, then a simple statement to that effect is a powerful statement, and reassuring even to a user with a limited understanding of what accepted actuarial practice is. If the work is not in accordance with accepted actuarial practice, then a statement that it is, except for specified deviations, is a concise description.
- .17 Any deviation from accepted actuarial practice would result from either conflict with law or conflict with the terms of an appropriate engagement.
- .17.1 For work in Canada, the actuary would refer to “accepted actuarial practice in Canada”, or use other language of equivalent meaning and clarity.
- .17.2 For work outside of Canada, the actuary may choose to refer to
  - “accepted actuarial practice in [country]”, if the guidance of a foreign jurisdiction has been applied to the work,
  - “internationally accepted actuarial practice”, if the guidance of the International Actuarial Association has been applied to the work, or
  - “accepted actuarial practice in Canada”, if Canadian guidance has been applied to the work because of the absence of applicable foreign guidance.

### **Unusual application of accepted actuarial practice**

- .18 The actuary would not usually report a deviation from a particular recommendation or other guidance in the standards as a result of an unusual or unforeseen situation.

- .19 If, as is common, accepted actuarial practice for an aspect of the work encompasses a range, then the actuary usually reports the work as being in accordance with accepted actuarial practice without drawing particular attention to his or her selection within the range. Disclosure of the selection, and of the reason for selecting it, is appropriate, however, if it is

specified by law or by the actuary's client or employer,

excluded from the accepted range by an exposure draft or by approved, but not yet effective, new standards,

inconsistent with the corresponding assumption of a prior periodic report,

dependent on a special permissive feature in the law for its acceptability, or

unusual or controversial.

### **Limitation to actuary's responsibility**

- .20 Any diminution of the actuary's responsibility for the work as a result of an engagement whose terms call for a deviation from accepted actuarial practice would be disclosed.

### **Disclosure of assumptions**

- .21 Disclosure of an assumption includes its description, and, if practical, useful and appropriate under the terms of the engagement, quantification of the financial impact of alternative assumptions.

### **Subsequent event not taken into account in the work**

- .22 An example of a subsequent event not taken into account in the work is a non-retroactive increase in the benefits of a pension plan for which the actuary is advising on funding. The actuary would describe the increase, report that it was not taken into account in the current advice on funding but that it will be taken into account in future advice. If useful, the actuary would quantify its effect, for example by reporting the pro forma effect on the recommended funding if the benefit increase were effective immediately before the calculation date.

### **Reservations**

- .23 A report with reservation may be undesirable but is unavoidable in the following examples.

The actuary was obliged to use the work of another person and has doubts about the appropriateness of so doing.

The actuary was obliged to use insufficient or unreliable data.

There was an undue limitation to the scope of the actuary's work. For example, the time, information, or resources contemplated by the terms of the engagement did not materialize.

There is an unresolved conflict of interest. Rule 5 (Conflict of Interest) permits the actuary who has a conflict of interest to perform professional services if stated conditions are met. In reporting with respect to such a case, it is good practice to note the conflict and confirm that the conditions are met. If, as a result of an apparent but not actual conflict, a user might doubt the actuary's objectivity, then it is useful to report why the conflict is not real. There is no conflict of interest, however, merely because a user and the actuary's client or employer have conflicting interests.

- .24 The actuary would report any remedy, underway or expected, to the problem causing the reservation.
- .25 A serious reservation may call for consulting with another actuary or obtaining legal advice.
- .26 Barring explicit disclosure to the contrary in the report, the user is entitled to assume that the work is in accordance with accepted actuarial practice and no reservation is required,
- the actuary takes responsibility for all of the work, and
- if a periodic report, then the method is the same as that in the prior report and the assumptions are consistent with those in the prior report.

### **Opinion**

- .27 In giving an opinion, the actuary would begin with “In my opinion...” which is a signal that he or she is giving a formal, professional opinion on a matter within the domain of actuarial practice. The actuary would add appropriate qualification when giving an opinion on a matter outside that domain but on which he or she is able to comment. For example,
- “The valuation of Mrs. Smith’s life interest in Mr. Smith’s estate, and the residual value, both depend on the future value of the residential property which makes up the bulk of that estate. An assumption about future real estate values for any given property is outside the domain of actuarial practice but, in my opinion, it is reasonable to assume that property values will generally continue to increase over time at the same rate as inflation.”
- .28 It may be better to disclose an assumption selected by the client or mandated by law without giving an opinion on it; for example,
- “On your [lawyer-client’s] instruction, I have assumed that the career path of the [injured high school student] is to complete her high school education and then to obtain an undergraduate university degree.”



### Identification

- .29 For work in Canada, the actuary would usually identify himself or herself simply as “Fellow, Canadian Institute of Actuaries” (or “FCIA” if users recognize the abbreviation), especially when Fellowship in the CIA is required or expected for the work. To add additional identification, such as

the actuary’s relationship with the client or employer (e.g., “Vice-President and Actuary” or “Consulting Actuary”), or

the actuary’s other professional qualification (e.g., “Fellow of the Casualty Actuarial Society”)

may be appropriate but may create confusion about the actuary’s qualification to sign the report and about the standards governing the work, and may diminish the standing of the Canadian Institute of Actuaries.

### Report date

- .30 In reporting an opinion, the actuary would consider all available information up to the report date, including subsequent events if the report date is after the calculation date.
- .31 The report date would usually be the date at which the actuary has substantially completed the work. The remaining effort may include peer review, typing and photocopying the report, and compilation of documentation.
- .32 The date the actuary signs and delivers the report would be as soon thereafter as practical. If there is an unavoidably long delay, however, then the actuary would consider any additional subsequent events which would result from a current report date.

### Withdrawal or amendment of a report

- .33 After the report date, the actuary has no obligation to seek additional information which, if known at the report date, would have been reflected in the work, but, if additional information comes to hand, the actuary would consider if it affects the report. Additional information affects the report if it
- reveals a data defect or a calculation error,
  - provides additional information about the entity which is the subject of the report as that entity was at the calculation date,
  - retroactively makes that entity different at the calculation date, or
  - makes that entity different after the calculation date and a purpose of the work was to report on the entity as it would be as a result of the information.

- .34 That additional information consists of both external information and internal discovery of an error in the work. Its classification is similar to the classification of subsequent events. That is, if the additional information were a subsequent event, and if it would have to be taken into account in the data, methods, or assumptions for the work, then it would affect the report. It does not affect the report if it makes the entity, which is the subject of the report, different after the calculation date and a purpose of the work is to report on the entity as it was at the calculation date; for example, if the additional information changes the outlook for the entity which would lead the actuary to select different assumptions at the next calculation date for a periodic report.
- .35 If the actuary determines that the event affects the report, the actuary would determine whether the event invalidates the report. If the actuary determines that the event does not invalidate the report, then the actuary would consider whether to inform some or all of the users of the report about the event. If the actuary determines that the event invalidates the report, the actuary would withdraw or amend the report. If the actuary withdraws or amends a report, then he or she would seek agreement with the client or employer on the notification to be given to users and on the preparation of an amended or replacement report in cases where there is no legal requirement to do so. Failing such agreement, the actuary would consider seeking legal advice on the discharge of his or her responsibilities, taking consideration of the fact that, to the extent practical and useful, all users should so be informed.
- .36 The following examples are intended to assist actuaries in determining whether an event of which the actuary becomes aware after the report date may be worthy of disclosure to the users of the report or may require the report to be withdrawn or amended;
- if an event affects a report, but that report has been superseded by another report, typically no action would be taken with respect to the prior report,
  - if an event materially affects the financial position, financial condition or funded status of a pension plan, but does not materially affect the funding of the plan, it may be sufficient to disclose the event to the users of the report rather than withdraw or amend the report,
  - if an event results in a situation where an assumption used in the work is obviously erroneous, but the assumption was reasonable at the report date, the actuary would typically, not withdraw or amend the report, but would reflect the event in a subsequent report,
  - if an actuary has prepared a report that provides advice on the funding of a pension plan and, subsequent to the report date discovers an error in the report, and the funding recommendations contained in the report would change materially if the error were corrected, the actuary may determine that it is appropriate to withdraw or amend the report.

### **1830 REPORTING: INTERNAL USER REPORT**

- .01 *In the case of an internal user report, the actuary may appropriately abbreviate the recommendation for external user reports. [Effective December 1, 2002]*
- .02 The range of appropriate reports is wider for internal user reports than for external user reports. At one end of the range, a formal internal user report may differ little from an external user report. At the other end of the range, an informal, abbreviated, even oral, report may suffice for an officer with whom the actuary communicates frequently and who is well-versed in the subject of the report. To abbreviate the standards for an internal user report is efficient for both the actuary and the user provided that complete and clear communication is not thereby compromised.

### **1840 REPORTING: ORAL REPORT**

- .01 Oral reporting, especially to an internal user, is both useful and inevitable in some situations. The disadvantage of oral reporting is that the actuary and user may have differing recollections of what was reported. It is therefore good practice to confirm an oral report in writing, especially when there is an external user, or to record it in documentation.
- .02 Except for signature and report date, the standards are the same for both oral and written reports.

**2000—INSURANCE**

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**2100 INSURANCE CONTRACT VALUATION:  
ALL INSURANCE**

**2110 SCOPE**

- .01 Sections 2100, 2200 and 2300 apply to the valuation of the insurance contract liabilities and of the reinsurance recoverables in an insurer's financial statements when the intent is that those statements be in accordance with accounting principles generally accepted in Canada. Effective for financial years beginning on or after January 1, 2011, the Canadian Institute of Chartered Accountants Handbook will contain both Canadian generally accepted accounting principles applicable to publicly accountable enterprises (being International Financial Reporting Standards incorporated into the Canadian Institute of Chartered Accountants Handbook) and Canadian generally accepted accounting principles applicable to private enterprises.
- .01.1 Part 2000 does not apply to post-employment benefit plans covered by the Practice-Specific Standards for Post-Employment Benefit Plans and does not apply to personal injury compensation plans covered by the Practice-Specific Standards for Public Personal Injury Compensation Plans.
- .02 Section 2100 applies to all kinds of insurance.
- .02.1 Sections 2200 and 2300, following, apply respectively to  
property and casualty insurance, and  
life and health (accident and sickness) insurance; that is, to insurance with respect to the life and health of persons other than corporations.
- .03 Sometimes, however, techniques described in one section may be useful for the insurance to which the other section applies. For example, while a simple technique is usually appropriate for valuation of life and health insurance claim liabilities, the more sophisticated techniques for valuation of property and casualty insurance claim liabilities may be appropriate for life and health insurance whose claim development is complex. Another example is that a simple technique may be appropriate for travel insurance and other short-term policies sold by property and casualty insurers.

## 2120 EXTENSION OF SCOPE

- .01 Repealed
- .02 Repealed
- .03 Part 2000 also applies to the work of, and the report thereon prepared by, an actuary for purposes of the financial statements of an insurer that is not a publicly accountable entity, as long as the intent is that those financial statements be prepared in accordance with generally accepted accounting principles (GAAP) applicable to that insurer. The actuary would modify the standards to take account of any substantive difference between the insurer and a publicly accountable enterprise; for example the insurer's liabilities may be permitted to be less than fully funded. The actuary's report would describe the modifications to the standards and their implications.
- .04 Part 2000 also applies to the work of an actuary with respect to the valuation of policy liabilities where statutory or regulatory instructions require the actuary to do so, other than the preparation of financial statements in accordance with generally accepted accounting principles.
- .05 Since an insurer is defined as the party that has an obligation to compensate a policyholder if an insured event occurs, the legal form of the insurer is unimportant for purposes of the determination of the policy liabilities.
- .06 Part 2000 also applies to the work of, and the report thereon prepared by, an actuary with respect to the valuation of the policy liabilities of any party that
- has an obligation under a policy, and
  - has the intent to prepare financial statements in accordance with applicable Canadian generally accepted accounting principles (other than International Financial Reporting Standards).
- .07 Where an actuary is valuing, and reporting on the valuation of, policy liabilities other than in compliance with International Financial Reporting Standards, the policy liabilities may be reported net of reinsurance recoverables.

## 2130 METHOD

- .01 *The actuary should value the insurance contract liabilities and the reinsurance recoverables for the balance sheet and the changes in them for the income statement.*
- .02 *The actuary should co-ordinate the valuation with the insurer's accounting policy as respects the choice between going concern and wind-up accounting, and so that the insurance contract liabilities, reinsurance recoverables, and other items in the balance sheet*
- are consistent,*
  - avoid omission and double counting, and*
  - conform to the presentation of the income statement.*

- .03 *The relevant insurance contracts for the valuation are those that are in force, including those whose issue is then committed, at the balance sheet date, or that were in force earlier and that will generate cash flow after the balance sheet date.*
- .04 *The insurance contract liabilities, net of reinsurance recoverables, in respect of each of the relevant insurance contracts should be comprised of the cash flow after the balance sheet date from the premiums, benefits, claims, expenses, and taxes that are incurred during the term of its liabilities.*
- .05 *The cash flows that comprise the insurance contract liabilities should include the effect of*  
*retrospective premium, commission, and similar adjustments,*  
*experience rating refunds,*  
*reinsurance ceded,*  
*subrogation and salvage,*  
*the exercise of policy owner options, and*  
*the deemed termination at the end of the term of its liabilities of each policy then in force.*
- .06 *The valuation should take account of the time value of money. [Effective January 1, 2011]*
- .06.1 *The actuary should ensure that the application of margins for adverse deviations with respect to the insurance contract liabilities and the related reinsurance recoverables results in an increase to the value of the liability net of reinsurance. The provision resulting from the application of all margins for adverse deviations, in addition to increasing the net liability, should be appropriate in the aggregate. [Effective January 1, 2011]*

### **Terminology**

- .07 “Policy” includes an insurance contract and any other instrument that is substantively like a policy, such as a reinsurance agreement or an annuity contract, and includes a commitment to issue a policy.
- .08 Repealed
- .09 “Premiums” include income equivalent to premiums, such as management fees, and cost of insurance charges.



### **The insurer's accounting policy**

- .10 The preparers of the financial statements make a choice between going concern and wind-up accounting. The actuary would conform the valuation to that choice. If the actuary believes the choice to be inappropriate, then, after consultation with the auditor, he or she would so report. Going concern accounting is appropriate for an insurer that is expected to remain open to new business and in satisfactory financial position indefinitely. Going concern accounting is also appropriate for an insurer that is expected to become closed to new business, but to continue in a satisfactory financial position, either indefinitely or until an increase in capital, combination with another insurer in a satisfactory financial condition, or transfer of its policies to such an insurer brings financial relief.
- .11 Use of the terms "insurance contract liabilities", "policy liabilities", "reinsurance recoverables", "premium liabilities" and "claim liabilities" is desirable in financial statements, but the choice of the terminology and itemization is a management decision. What matters is that the actuary identify, value, and report on all of the liabilities and assets valued by the actuary, whatever they may be called in the financial statements. The differentiation between premium and claim liabilities is usually evident but is, in any case, less important than assurance that all insurance contract liabilities and reinsurance recoverable assets have been identified and valued.
- .12 Insurance contract liabilities and reinsurance recoverables consist of premium liabilities and claim liabilities. Claim liabilities are those in respect of cash flow after the balance sheet date from benefits and claims incurred on or before that date, and their related expenses and taxes; i.e., all of the cash flow, excluding the portion paid before the balance sheet date. Premium liabilities are those in respect of all other cash flow; i.e., that from premiums, benefits, claims, and their related expenses and taxes, incurred after the balance sheet date.
- .13 Insurance contract liabilities reported in the insurer's balance sheet would not be net of the value of recoveries that are expected from reinsurance ceded. The value of the reinsurance recoverables is recorded as an asset. Fair presentation of the reported insurance contract liabilities requires the amount of that asset to be appropriate. The recovery on account of reinsurance ceded would take account of not only the reinsurer's share of claims but also reinsurance commissions, allowances, retrospective premium adjustments, and the financial condition of the reinsurer.
- .14 The insurance contract liabilities reported in the insurer's balance sheet exclude deposit liabilities of segregated funds but include any related liabilities of the general fund, such as a liability for capital guarantees of amounts in segregated funds.

- .15 The insurer's accounting policy may report amounts related to the insurance contracts and the assets that support their insurance contract liabilities, such as
- deposit liabilities (for example, policy dividends on deposit),
  - incurred but unpaid items (for example, taxes incurred but not paid and policy dividends due but not paid),
  - future tax liabilities and assets (for example, those in connection with the timing differences between accounting and tax liabilities),
  - receivables from, payables to, and deposits by reinsurers,
  - amounts recoverable from policy owners,
  - asset impairment, and
  - deferred policy acquisition expenses,
- either as part of the insurance contract liabilities or as separate items in the balance sheet or as a mixture of the two. The actuary would value the insurance contract liabilities so that
- in the aggregate, the insurance contract liabilities and those separate items are consistent and avoid omission and double counting, and
  - the separate reporting of those items does not affect the insurer's capital (i.e., assets minus liabilities).
- .16 As respects consistency, the actuary would, for example, ensure that the insurance contract liabilities
- provide consistently for cash flow gross of reinsurance and reinsurance cash flow, except that reinsurance cash flow would also take account of the financial condition of the reinsurer.
- .17 As respects double counting and omission, the actuary would, for example, ensure that
- the same assets are not allocated twice to support liabilities, and
  - provision for asset depreciation (C-1 risk) in valuing the insurance contract liabilities does not duplicate any provision for asset depreciation deducted from the asset side of the balance sheet.

### **Relevant policies**

- .18 The relevant policies for the valuation are those that are in force at the balance sheet date, including those whose issue is then committed, or that were in force earlier and that will generate cash flow after the balance sheet date. There are no amounts included in insurance contract liabilities in the financial statements in respect of other policies expected to be issued after that date, whether or not they are expected to be profitable.
- .19 There usually are both premium liabilities and claim liabilities in respect of policies that are in force at the balance sheet date. There may be reinsurance recoverables in respect of insurance contracts that are in force at the balance sheet date.

- .20 There may be claim liabilities in respect of policies that are not in force at the balance sheet date as a result of outstanding claims incurred while they were in force. There may be premium liabilities in respect of those policies as a result of the right of policy owners to reinstate them, or of their unpaid
- retrospective premium, commission, and similar adjustments,
  - experience rating refunds, and
  - subrogation and salvage.

There may be reinsurance recoverables related to policies that are not in force at the balance sheet date as a result of outstanding claims incurred while they were in force.

### **Term of the liabilities**

- .21 The term of the liabilities of a property and casualty insurance policy ends at its expiry, which usually is within one year of the balance sheet date, unless for example
- the policy has been cancelled, in which case that term ends at the effective date of cancellation, or
  - the contractual term of the policy exceeds one year; for example, an extended warranty policy which provides coverage for several years after expiry of the basic warranty.

Paragraphs 2320.16 through 2320.27 provide guidance on determination of the term of the liabilities of a life or health insurance policy.

### **Cash flows comprising the insurance contract liabilities**

- .22 The insurance contract liabilities in respect of a relevant policy are comprised of all of that policy's cash flows after the balance sheet date, except for cash flows from premiums, benefits, claims, expenses, and taxes that are incurred after the term of the liability for that policy.
- .23 The tax cash flows are limited to those generated by premiums, benefits, claims, and expenses, and by the assets that support the insurance contract liabilities. The expense cash flows are limited to those generated by the relevant policies, including overhead allocations. The tax and expense cash flows exclude, for example, tax on investment income from, and the investment expense of, assets that support capital.

- .24 The cash flows of which a policy is comprised may extend beyond the term of its liabilities as a result of lag between incurral and the resultant cash flow. The extension may be prolonged, for example, for a claim payable in instalments under long-term disability insurance, and a claim under product liability insurance that has a long settlement period.

**Retrospective premium, commission, and similar adjustments**

- .25 In determining the value of a contractual right of the insurer to future premiums that depend on past claims experience, the actuary would take account of credit risk of the policy owner.

**Experience rating refunds**

- .26 The liability for experience rating refunds would take account of
- the assumptions in calculating the insurance contract liabilities in respect of those matters which determine experience rating refunds,
  - the difference between the basis for the insurance contract liabilities and the corresponding basis in the experience rating, and
  - any cross-rating across coverages in the experience rating.
- .27 The experience rating refund element of the insurance contract liabilities would include provision for adverse deviations only for
- risk of misestimation (C-2 risk) of interest rates and risk of interest rate change (C-3 risk), and
  - uncertainty in the calculation of the experience rating refund.
- .28 The experience rating refund element of the insurance contract liabilities would not be negative except to the extent that in settlement it may be offset against another liability or recovered from policy owners.
- .29 Where an insurer holds an asset for an accrued experience rating deficit, the actuary would test the appropriateness and recoverability of the receivable amount using the valuation assumptions and methodology for experience rating refunds, and make an adjustment to the insurance contract liabilities if necessary.

**Reinsurance ceded and retroceded**

- .30 The recovery on account of reinsurance ceded would take account of the financial condition of the reinsurer.
- .31 The actuary would assume that the insurer and the reinsurer each exercises its control over recapture, cancellation or commutation to its advantage.

- .32 The sign (positive or negative) of an assumption's margin for adverse deviations may depend on that assumption's effect on recapture, cancellation or commutation.

### **Subrogation and salvage**

- .33 The actuary would either net subrogation and salvage amounts against claims or value them as a separate item, depending on the insurer's accounting policy.

### **Exercise of policy owner options**

- .34 Examples of policy owner options are
- the conversion of group insurance or individual term insurance,
  - the election of a settlement option in individual life insurance,
  - the purchase of additional insurance or coverage without underwriting, and
  - the selection of the amount of premiums for universal life insurance.

### **Deemed termination of remaining policies**

- .35 The comprised cash flow in respect of a policy that is deemed to terminate at the end of the term of its liabilities would include any amount then payable by the insurer in the event of its termination, modified to take account of the fact that the termination is deemed and not actual. For example, the modification would
- forego a surrender charge deducted at an actual termination from the policy's account value to calculate its cash value,
  - forego a deduction at an actual termination from the policy's unearned premium to calculate its premium refund, and
  - anticipate a persistency bonus becoming payable at a date after the end of the term of the policy's liabilities if the policy remains in force to that date.

### **Time value of money**

- .36 In this context, "supporting assets" means the insurer's assets and asset commitments that support its insurance contract liabilities.

- .37 To take account of the time value of money is to express the year-by-year forecast of the cash flows of which the insurance contract liabilities are comprised as an equivalent single amount at the balance sheet date. There are two methods of doing so – the Canadian asset liability method and the actuarial present value method. In the Canadian asset liability method, the amount of the insurance contract liabilities is the amount of their supporting assets, which reduce to zero at the last liability cash flow in the forecast of the cash flow from the assets and liabilities. The Canadian asset liability method is a “roll forward” method applicable to any scenario. The actuarial present value method is a “pull backward” method that produces the same result as the Canadian asset liability method for a particular scenario if present value factors,  $v^t$ , exist that replicate the investment return assumptions of that scenario. Such factors do not exist for complex scenarios; for example, a scenario that includes a spike in mortgage lending rates in forecast year 5.
- .38 The discount rates or the forecast of supporting assets, as the case may be, would take account of the supporting assets at the balance sheet date and the insurer’s policy for asset-liability management after that date, and/or assumptions about investment return after the balance sheet date.
- .39 The actuary would value the insurance contract liabilities and reinsurance recoverables so that, in the aggregate, they and the other policy-related items in the balance sheet take account of the time value of money.
- .40 In some cases, applicable regulation requires insurance contract liabilities and reinsurance recoverables to be valued without taking account of the time value of money; i.e., to be valued as the sum of, rather than the present value of, the cash flow after the balance sheet date. For such a case, the actuary would make a dual valuation of insurance contract liabilities and reinsurance recoverables:
- A in accordance with accepted actuarial practice, and
  - B in accordance with accepted actuarial practice but not taking account of the time value of money, with the provision for adverse deviations appropriately reduced.
- .41 If A is acceptable under the applicable regulation (which would usually be the case if A is greater than or equal to B), then the actuary would report A without reservation on account of the regulation.
- .42 If A is not acceptable under the applicable regulation (which would usually be the case if A is less than B), then the actuary would report B with reservation.

## Margin for adverse deviations

- .43 The margin for adverse deviations reflects the degree of uncertainty of the best estimate assumption. This uncertainty results from the risk of misestimation of and deterioration from the best estimate assumption. The potential for misestimation is greater when the past experience has been more volatile and hence would justify a greater margin. However, the margin for adverse deviations would be based on a forward-looking assessment of the expected experience and would not act as a mechanism to absorb changes in observed experience, such as changes caused by statistical fluctuations.

## 2140 REPORTING

- .01 *The actuary's report should describe*
- the valuation and presentation of policy liabilities and reinsurance recoverables for the insurer's balance sheet and income statement,*
  - the actuary's opinion on the appropriateness of those liabilities and recoverables and on the fairness of their presentation, and*
  - the actuary's role in the preparation of the insurer's financial statements if that role is not described in those statements or their accompanying management discussion and analysis.*
- .02 *If*
- the financial statements (or their accompanying management discussion and analysis) describe the actuary's role in their preparation, and*
  - the actuary can report without reservation,*
- then the actuary's report should conform to the standard reporting language, consisting of*
- a scope paragraph, which describes the actuary's work, and*
  - an opinion paragraph, which gives the actuary's favourable opinion on the valuation and its presentation.*
- .03 *If not, the actuary should modify the standard reporting language to report with reservation.*  
[Effective January 1, 2011]
- .03.1 The actuary's report would conform to the requirements of relevant Canadian federal and provincial legislation that prescribe that the actuary value the policy liabilities, not only the insurance contract liabilities net of reinsurance recoverables. Policy liabilities other than insurance contract liabilities would be valued in conformity with applicable International Financial Reporting Standards and accepted actuarial practice, where the intent is that those financial statements be prepared in accordance with International Financial Reporting Standards.

### **Accounting in the balance sheet**

- .04 The amount of the insurance contract liabilities is usually the largest amount in the balance sheet, so that its itemization is desirable.
- .05 The reference to “policy liabilities”, “insurance contract liabilities” and “reinsurance recoverables” in the standard reporting language is adequate if
- the notes to the financial statements or their accompanying management discussion and analysis verbally define “insurance contract liabilities” and “reinsurance recoverables”, and the balance sheet presents their total amount as a separate item.

### **Accounting in the income statement**

- .06 The standard reporting language implies that the income statement accounts for the total change in the policy liabilities, consisting of the insurance contract liabilities and the liabilities for policies other than insurance contracts, during the accounting period, and that it accounts for the total change in reinsurance recoverables. That accounting is direct in the case of a life insurer's insurance contract liabilities and reinsurance recoverables, whose change is presented as a separate item in the income statement. That accounting may be indirect in the case of other policy liabilities, if their change is not separately presented, but is included within other items in the income statement. For example, the item, incurred claims, equals
- claims and claim expenses paid during the accounting period, plus
- claim liabilities (which are part of the policy liabilities) at the end of the accounting period, minus
- claim liabilities at the beginning of the accounting period.

### **Disclosure of unusual situations**

- .07 The items that the actuary values for the financial statements may be misleading if the financial statements do not present them fairly. The actuary's report is a signal to the reader of the financial statements that there is, or is not, fair presentation.
- .08 In an unusual situation, fair presentation may require explanation of an item that the actuary values for the financial statements. Usually, the notes to the financial statements would provide that explanation, including, where appropriate, disclosure of the situation's effect on income and capital. Failing such explanation, the actuary would provide it by a reservation in reporting.



- .09 The question, “Will explanation enhance the user’s understanding of the insurer’s financial position?” may help the actuary to identify such a situation. Unusual situations may include
- capital appropriated on the actuary’s advice,
  - off-balance-sheet obligations, for example, contingent policy liabilities in connection with market conduct,
  - restatement of items for preceding accounting periods,
  - the impracticality of restating any items that are reported in current period financial statements and that were reported inconsistently in preceding period financial statements,
  - inconsistency among accounting periods,
  - an unusual relationship between the items in current period financial statements and the expected corresponding items in future period financial statements,
  - a change in the method of valuation that does not have an effect in the current accounting period but that is expected to have an effect in future accounting periods,
  - allocation of expense or investment income to a participating account (if reported in the financial statements) other than in accordance with the method approved by the actuary and the insurer’s board of directors,
  - a subsequent event, and
  - a difference between the insurer’s present practice and that which the actuary assumed in valuing the policy liabilities.
- .10 An example of the last item is the actuary’s assumption of a policy for setting dividend scales that differs from the insurer’s current policy. The actuary would not, however, report the assumption of a dividend scale that is in accordance with an unchanged dividend policy. The same applies to a difference between current and assumed policy for setting non-guaranteed cash value scales and premium rates for adjustable policies.

### **Consistency across accounting periods**

- .11 Financial statements usually report results for one or more preceding accounting periods in addition to those for the current period. Meaningful comparability requires the financial statement items for the various periods to be consistent through the restatement of preceding period items if they were inconsistently reported in the preceding period financial statements. A less desirable alternative to restatement is disclosure of the inconsistency.
- .12 A change in the method of valuation creates an inconsistency. If a change in the assumptions for valuation reflects a change in the expected outlook, then it does not create an inconsistency although, if its effect is major, then fair presentation may require its disclosure.
- .13 A change in assumptions that results from the application of new standards may create an inconsistency.

### **Communication with the auditor**

- .14 Communication with the auditor is desirable at various stages of the actuary's work. These include
  - use of work in accordance with the CIA/CICA Joint Policy Statement,
  - the drafting of common features in the auditor's report and actuary's report,
  - the drafting of a report with reservations,
  - the presentation of the insurance contract liabilities, policy liabilities other than insurance contract liabilities, and the reinsurance recoverables, and
  - the treatment of subsequent events.

### **Description of the actuary's role**

- .15 The actuary would report a description of his or her role in the preparation of the insurer's financial statements only if the financial statements or their accompanying management discussion and analysis do not provide that description.

.16 Here is an illustrative description.

“The Appointed Actuary is

appointed by the [Board of Directors] of [the Company];

responsible for ensuring that the assumptions and methods for the valuation of policy liabilities [and reinsurance recoverables] are in accordance with accepted actuarial practice in Canada, applicable legislation, and associated regulations and directives;

required to provide an opinion on the appropriateness of the policy liabilities [net of reinsurance recoverables] at the balance sheet date to meet all policy obligations of [the Company]. The work to form that opinion includes an examination of the sufficiency and reliability of policy data and an analysis of the ability of the assets to support the policy liabilities; and

required each year to analyze the financial condition of the company and prepare a report for the [Board of Directors]. The analysis tests the capital adequacy of the company until [31 December xxxx] under adverse economic and business conditions.”

The wording of the illustrative description conforms to the requirements of relevant Canadian federal and provincial legislation that prescribe that the actuary value the policy liabilities, not only the insurance contract liabilities. Policy liabilities other than insurance contract liabilities would be valued in conformity with applicable International Financial Reporting Standards and accepted actuarial practice.

### **Standard reporting language**

.17 Here is the standard reporting language.

#### **Appointed Actuary’s Report**

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 changes 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.

[Montréal, Québec]  
[Report date]

[Mary F. Roe]  
Fellow, Canadian Institute of Actuaries

.18 The language in square brackets is variable and other language may be adjusted to conform to interim financial statements and to the terminology and presentation in the financial statements.

- .19 An auditor's report usually accompanies the financial statements. Uniformity of common features in the two reports will avoid confusion to readers of the financial statements. Those common features include:

Addressees. Usually, the actuary addresses the report to the policyholders of a mutual insurer and to both the policyholders and shareholders of a stock insurer.

Years referenced. Usually, the actuary's report refers only to the current year, even though financial statements usually present results for both the current and prior years.

Report date. If the two reports have the same date, then they would take account of the same subsequent events.

### **Reservations in reporting**

- .20 The examples that follow are illustrative.

#### **Self-insured organization that is not obligated to have an appointed actuary**

- .21 Here is an example of a report prepared for an under-funded self-insured organization that is not obligated to have an appointed actuary.

I have valued the outstanding claim liabilities of [the Self-Insured Liability Plan] for its balance sheet at [31 December XXXX] in accordance with accepted actuarial practice in Canada, including selection of appropriate assumptions and methods.

As explained in Note [XX], the [Plan's] self-insured liabilities are not fully funded.

In my opinion, and having regard for Note [XX], the amount of policy liabilities makes appropriate provision for all of the [Plan's] outstanding claims and the financial statements fairly present the results of the valuation.

Note [XX] would quantify and describe the actuary's assumptions with respect to the asset shortfall, describe the plan, if any, for its funding, and explain its implications for the financial security of participants and claimants.

### **New appointment**

- .22 A newly appointed actuary who is unable to use the predecessor actuary's work, but who has no reason to doubt its appropriateness, would modify the standard reporting language as follows:

I have valued the policy liabilities [and reinsurance recoverables] of [the Company] for its [consolidated] balance sheet at [31 December xxxx] and, except as noted in the following paragraph, their change in the statement of income for the year then ended in accordance with accepted actuarial practice in Canada, including selection of appropriate assumptions and methods.

I became the [appointed actuary] during the year and was unable to confirm the appropriateness of the valuation for the preceding year.

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. For the reason stated in the previous paragraph, I am unable to say whether or not those results are consistent with those for the preceding year.

- .23 If the actuary doubts the appropriateness of the predecessor actuary's work as a result of a review of it, then the actuary would consider a more serious reservation.

### **Impracticality of restatement**

- .24 The actuary would, if necessary, restate the preceding year valuation to be consistent with the current year valuation. If it is not practical to restate the preceding year valuation, then the actuary would modify the opinion paragraph in the standard reporting language as follows:

As explained in Note [XX], the method of valuation for the current year differs from that for the preceding year. In my opinion, except for that lack of consistency, 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.

- .25 Note [XX] would usually explain the change in the basis of valuation, explain the impracticality of applying the new basis retroactively, and disclose the effect of the change on the opening equity at the beginning of the preceding year.

**Valuation does not take account of time value of money**

.26 If a regulation that some or all of the insurer's liabilities be valued without taking account of the time value of money requires a reservation, then the actuary would modify the standard reporting language as follows:

I have valued the policy liabilities [and reinsurance recoverables] of [the Company] for its [consolidated] balance sheet at [31 December xxxx] and their change in the statement of income for the year then ended in accordance with accepted actuarial practice in Canada, including the selection of appropriate assumptions and methods, except as described in the following paragraph.

In accepted actuarial practice in Canada, the valuation of policy liabilities [and reinsurance recoverables] reflects the time value of money. Pursuant to the authority granted by the Insurance Companies Act, the Superintendent of Financial Institutions has directed that the valuation of some policy liabilities [and reinsurance recoverables] not reflect the time value of money. My valuation complies with that directive.

In my opinion, the amount of policy liabilities [net of reinsurance recoverables] makes appropriate provision for all policy obligations, except as noted in the previous paragraph, and the [consolidated] financial statements fairly present the results of the valuation.

### **Takeover of insurer with poor records**

.27 If the insurer took over another insurer with poor records, then the actuary would modify the standard reporting language as follows:

I have valued the policy liabilities [and reinsurance recoverables] of [the Company] for its [consolidated] balance sheet at [31 December XXXX] and their change in the statement of income for the year then ended in accordance with accepted actuarial practice in Canada, including selection of appropriate assumptions and methods, except as described in the following paragraph.

During the year, [the Company] took over the assets, liabilities, and policies of [WWW Insurer], whose policy records are, in my opinion, unreliable. [The Company] is making but has not completed the necessary improvements. My valuation with respect to the policies taken over from [WWW Insurer] is therefore uncertain. Their policy liabilities [net of reinsurance recoverables] comprise [N]% of the total policy liabilities [net of reinsurance recoverables] at [31 December XXXX].

In my opinion, except for the reservation in the previous paragraph, 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.

### **Liabilities greater than those calculated by the actuary**

.28 If the financial statements of an insurer report policy liabilities net of reinsurance recoverables, that are greater than those calculated and reported by the actuary, and if the notes to those financial statements do not provide sufficient disclosure of the rationale for the greater liabilities, then the actuary would report as follows:

I have valued the policy liabilities [and reinsurance recoverables] of [the Company] for its [consolidated] balance sheet at [31 December XXXX] and their change in the statement of income for the year then ended in accordance with accepted actuarial practice in Canada, including selection of appropriate assumptions and methods, except as described in the following paragraph.

In my valuation, the amount of the policy liabilities [net of reinsurance recoverables] is \$[X]. The corresponding amount in the [consolidated] financial statements is \$[Y].

In my opinion, the amount of policy liabilities [net of reinsurance recoverables] of \$[X] makes appropriate provision for all policy obligations and, except as described in the preceding paragraph, the [consolidated] financial statements fairly present the result of the valuation.

**2200 INSURANCE CONTRACT VALUATION:  
PROPERTY AND CASUALTY INSURANCE**

**2210 SCOPE**

- .01 This section 2200 applies in accordance with subsections 2110 and 2120.
- .02 Repealed

**2220 CLAIM LIABILITIES**

- .01 *The amount of the claim liabilities should be equal to the present value, at the balance sheet date, of cash flow on account of claims (and of related expenses and taxes) incurred before that date. [Effective January 1, 2003]*
- .02 The amount of claim liabilities consists of the following components
  - the amount of the case estimates,
  - a provision (which may be positive or negative) for development on reported claims, including claim adjustment expenses, and
  - a provision for incurred but unreported claims, including claim adjustment expenses.
- .03 The development on reported claims compensates for the inadequacy or redundancy in case estimates.
- .04 The incurred but unreported claims are those not yet reported to the insurer, including those reported but not yet recorded.
- .05 The development on reported claims and the incurred but unreported claims need not be calculated separately. Some valuation methods calculate only their combined amount.
- .06 The selection of valuation methods depends on the circumstances of the case. The actuary would usually consider several methods, each of which involves assumptions; e.g., an assumption that the settlement patterns of the available past claims experience are uniform and the same as those of the insurer's future claims experience. The actuary would, where practical, adjust the available past claims experience in order to recognize those assumptions.



- .07 The actuary would consider the circumstances of the case in selecting assumptions. The available past claims experience may lack pertinence for assumptions about the insurer's future claims experience as a result of internal changes, such as changes in
- the insurer's underwriting practice,
  - its claims handling practice, including case estimate practice,
  - its reinsurance,
  - its data processing, and
  - its accounting,
- and as a result of external changes, such as inflation and changes in
- the legal, regulatory, and legislative environment, or
  - residual insurers, like the Facility Association.
- .08 The past and future claims experience of a pool or association in which the insurer participates tends to be beyond the insurer's control and may differ from the insurer's own claims experience.

## **2230 PREMIUM LIABILITIES**

- .01 *The amount of the premium liabilities (after deducting any deferred policy acquisition expense asset) should be equal to the present value, at the balance sheet date, of cash flow on account of premium development and of the claims, expenses, and taxes to be incurred after that date on account of the policies in force at that date or an earlier date. [Effective January 1, 2003]*
- .02 The actuary would consider the Standards of Practice for claim liabilities in selecting assumptions about claims.
- .03 Expenses include both claim adjustment expenses and the expense of servicing policies.
- .04 Premium development includes additional premiums such as reinstatement premiums and experience adjustments for policies with retrospective pricing.

## 2240 PRESENT VALUES

- .01 The expected investment return rate for calculation of the present value of cash flow is that to be earned on the assets, taking into account reinsurance recoverables, that support the insurance contract liabilities. It depends on
- the method of valuing assets and reporting investment income,
  - the allocation of those assets and that income among lines of business,
  - the return on the assets at the balance sheet date,
  - the yield on assets acquired after the balance sheet date,
  - the capital gains and losses on assets sold after the balance sheet date, and
  - investment expenses, and losses from default (C-1 risk).
- .02 The actuary need not verify the existence and ownership of the assets at the balance sheet date, but would consider their quality.

## 2250 MARGIN FOR ADVERSE DEVIATIONS - GENERAL

- .01 *The criteria for selection of the margin for adverse deviations for an assumption are the considerations for that assumption. The selected margin for adverse deviations used in the valuation of insurance contract liabilities should tend toward a higher margin for adverse deviations to the extent that the considerations for that assumption, viewed in the aggregate but considering their individual relative importance,*
- have been unstable during the period covered by the experience data on which the selection of the corresponding expected assumption is based and the effect of that instability cannot be quantified, or,*
  - otherwise undermine confidence in the selection of the corresponding expected assumption,*
- and should tend toward a lower margin for adverse deviations to the extent that the opposite is the case.*
- .02 *The selected margin for adverse deviations should vary*
- between premium liabilities and claim liabilities,*
  - among lines of business, and*
  - among accident years, policy years, or underwriting years, as the case may be,*
- according to how those considerations so vary. [Effective December 31, 2009]*

### **Assumptions subject to a margin for adverse deviations**

- .03 The actuary would include a margin for adverse deviations in the assumptions for  
claims development,  
recovery from reinsurance ceded, and  
investment return rates.

### **Expression of a margin for adverse deviations**

- .04 The margin for adverse deviations for claims development would be a percentage of the claim liabilities excluding provision for adverse deviations.
- .05 The margin for adverse deviations for recovery from reinsurance ceded would be a percentage of the amount deducted on account of reinsurance ceded in calculating the premium liabilities or claim liabilities, as the case may be, excluding provision for adverse deviations.
- .06 The margin for adverse deviations for investment return rate would be a deduction from the expected investment return rate per year.
- .07 The actuary would not usually include a margin for adverse deviations in the other assumptions. An example of an unusual circumstances that warrants an exception is  
a salvage and subrogation assumption when presented as an asset separate from the claim liabilities.

### **Considerations**

- .08 The actuary would select and evaluate considerations for each assumption that are appropriate to the circumstances of the insurer, including  
insurer practices, for example, the guidelines for setting and reviewing case estimates,  
data, for example, the stability of claims frequency and average claim cost,  
reinsurance, for example, the history of claim and coverage disputes with reinsurers,  
investments, for example, the matching of assets and liabilities and risk of asset default, and  
the external environment, for example, the effect of regulatory change on claim settlements.

.09 A consideration for an assumption generates a lack of confidence in that assumption as a result of past or future instability of the consideration or a shortcoming in its quality, quantity, or performance. Significant considerations indicating difficulties in properly estimating the best estimate assumption would include

- instability in the guidelines for setting and reviewing case estimates possibly resulting in inconsistent development among accident years,
- the credibility of the company's experience being too low to be the primary source of data,
- future experience being difficult to estimate,
- lack of homogeneity in the cohort of risks,
- operational risks adversely affecting the likelihood of obtaining the best estimate assumption,
- past experience not being representative of the future experience and the experience possibly deteriorating, or
- the derivation of the best estimate assumption being unrefined.

Other significant considerations may exist, but would be tied to specific assumptions.

## **2260 MARGIN FOR ADVERSE DEVIATIONS - DETERMINISTIC ANALYSIS**

.01 *The actuary should select a margin for adverse deviations for an assumption that is at least as much as the amount defined by the low margin for adverse deviations and is not excessive.*  
[Effective December 31, 2009]

.02 The range of margin for adverse deviations would be,

	<u>High</u>	<u>Low</u>
claims <u>development</u>	20%	2.5%
recovery from reinsurance ceded	15%	0
investment return rates	200 basis points	25 basis points

.03 Usually, a selection above this high margin for adverse deviations would be considered excessive.

.04 A selection above this high margin for adverse deviations would be appropriate, however, for unusually high uncertainty or when the resulting provision for adverse deviations is unreasonably low because the margin for adverse deviations is expressed as a percentage and the best estimate is unusually low.

.05 A selection below the low margin for adverse deviations may be appropriate in unusual situations. For example, in a situation wherein the best estimate discount rate based on the insurer's asset portfolio is less than 0.25% per annum, a margin for adverse deviations for investment return rates below that specified in paragraph 2260.02 may be reasonable. Similarly, unique situations may support a claims development margin for adverse deviations below that specified in paragraph 2260.02, as in the cases of a reinsurer in runoff where all remaining treaties are commuted, or of an insurer with aggregate stop loss coverage that is reserved at the stop loss limit.

## **2270 MARGIN FOR ADVERSE DEVIATIONS - STOCHASTIC ANALYSIS**

.01 *The margin for adverse deviations selected based on stochastic techniques should not be less than the low margin for adverse deviations set out in paragraph 2260.02 and should not be excessive. [Effective December 31, 2009]*

.02 It is expected that margins for adverse deviations obtained using stochastic techniques would generally be consistent with the range provided in paragraph 2260.02.

.03 In addition to the circumstances described in paragraph 2260.04, a selection above the high margin for adverse deviations set out in paragraph 2260.02 may be appropriate when stochastic modeling indicates variability in estimates of insurance contract liabilities that may not be identified using deterministic analysis.

.04 A selection below the low margin for adverse deviations may be appropriate in unusual situations. For example, in a situation wherein the best estimate discount rate based on the insurer's asset portfolio is less than 0.25% per annum, a margin for adverse deviations for investment return rates below that specified in paragraph 2260.02 may be reasonable. Similarly, unique situations may support a claims development margin for adverse deviations below that specified in paragraph 2260.02, as in the cases of a reinsurer in runoff where all remaining treaties are commuted, or of an insurer with aggregate stop loss coverage that is reserved at the stop loss limit.

**2300 INSURANCE CONTRACT VALUATION:  
LIFE AND HEALTH (ACCIDENT AND SICKNESS) INSURANCE**

**2310 SCOPE**

.01 This section 2300 applies in accordance with subsections 2110 and 2120.

**2320 METHOD**

.01 *The actuary should calculate insurance contract liabilities net of reinsurance recoverables by the Canadian asset liability method. For valuation of the general account insurance contract liability associated with segregated fund guarantees, the actuary should calculate the insurance contract liability for the guarantee elements by the Canadian asset liability method using stochastic modelling. [Effective January 1, 2011]*

.02 *The amount of insurance contract liabilities using the Canadian asset liability method for a particular scenario is equal to the amount of supporting assets, including reinsurance recoverables, at the balance sheet date that are forecasted to reduce to zero coincident with the last liability cash flow in that scenario.*

.03 *The term of the liabilities should take account of any renewal, or any adjustment equivalent to renewal, after the balance sheet date if*

*the insurer's discretion at that renewal or adjustment is contractually constrained, and*

*insurance contract liabilities are larger as a result of taking account of that renewal or adjustment.*

.04 *In forecasting the cash flow expected to be generated by the insurance contract liabilities, the actuary should*

*take account of policy owner reasonable expectations, and*

*include policy dividends, other than the related transfers to the shareholders account and other than ownership dividends, in the comprised cash flow from benefits.*

.05 *The actuary should calculate insurance contract liabilities for multiple scenarios and adopt a scenario whose insurance contract liabilities make sufficient but not excessive provision for the insurer's obligations in respect of the relevant policies.*

.06 *The assumptions for a particular scenario consist of*

*scenario-tested assumptions, which should include no margin for adverse deviations, and*

*each other needed assumption, whose best estimate should be consistent with the scenario-tested assumptions and which should include margin for adverse deviations.*

- .07 *The scenario-tested assumptions should include at least the interest rate assumptions.*
- .08 *The scenarios of interest rate assumptions should comprise*  
*a base scenario, as defined under paragraph 2330.09.1,*  
*each of the prescribed scenarios in a deterministic application,*  
*ranges that comprehend each of the prescribed scenarios in a stochastic application, and*  
*other scenarios appropriate for the circumstances of the insurer. [Effective January 1, 2011]*
- .08.1 *For stochastic modelling of segregated fund guarantees, the development of scenarios of investment returns should consider*  
*selection of market indices and proxies,*  
*development of economic scenario generators and model parameters, and*  
*calibration of investment returns (i.e., equity returns, bond fund returns and money market returns).*
- .08.2 *If the bifurcated approach is used for valuation of the general account insurance contract liability associated with segregated fund guarantees, the allocation of future fee revenue between amortization of the allowance for acquisition expense and the guarantee should not change from period to period. [Effective January 1, 2011]*

### **Liability grouping and asset segmentation**

- .09 The actuary would usually apply the Canadian asset liability method to policies in groups that reflect the insurer's asset-liability management practice for allocation of assets to liabilities and investment strategy. That application is a convenience, however, that would not militate against calculation of insurance contract liabilities and reinsurance recoverables that, in the aggregate, reflect the risks to which the insurer is exposed.

### **Other methods**

- .10 For a particular scenario, another method may be equivalent to or approximate, the Canadian asset liability method. If the actuary uses that other method, then the calculation for multiple scenarios and the selection of one that makes sufficient but not excessive provision for the insurer's obligations would be the same as for the Canadian asset liability method.
- .10.1 For valuation of the general account insurance contract liability associated with segregated fund guarantees, a factor-based approach, approved by a regulator, would be considered an appropriate approximation and the actuary would not need to undertake testing to determine the appropriateness of this approximation.

- .10.2 Two approaches would be appropriate to value segregated fund policies where both additional benefits or guarantees are involved and the allowance for acquisition expense is being amortized.

For the bifurcated approach, management expense cash flow is allocated between recoverability testing of the allowance for acquisition expense and the liability for the guarantee. The portion allocated to the guarantee would generally be based on the additional charge priced into the product for that guarantee with the remainder applied to amortize the remaining unamortized allowance for acquisition expense. The insurance contract liability for the guarantee is calculated separately using the net cash flows available for the guarantee while the recoverability of the allowance for acquisition expense is tested excluding those revenues allocated to guarantee.

For the whole contract approach, all general account net cash flows associated with segregated funds are considered in calculating the total liability. This total liability will change over the reporting period as a result of market movements and other factors and, therefore, may need to be adjusted to remove any write-up to the balance of the allowance for acquisition expense.

### **Supporting assets**

- .11 In allocating assets to support liabilities, the actuary would preserve the connection between unamortized capital gains, both realized and unrealized, and the asset segments that generated them.
- .12 The value of the assets that support insurance contract liabilities at the balance sheet date would be their value in the insurer's financial statements; i.e., book value, taking account of accrued investment income and of adjustments for impairment, amortized unrealized capital gains, and amortized realized capital gains.
- .13 The forecasted cash flow of the assets would take account of any related, off-balance sheet, financial instruments.
- .13.1 For valuation of segregated fund guarantees, the value of the assets and forecasted cash flow would take account of the insurer's hedging instruments existing at the balance sheet date.
- .14 The forecast of cash flow from taxes would take account of permanent and temporary differences between the amortization of capital gains in accordance with generally accepted accounting principles and in accordance with tax law.



- .15 The assumed cash flow from policy dividends would avoid omission and double counting. For example, if the dividend scale includes distribution of a deferred realized capital gain (adjusted for any corresponding future tax asset or liability), then the assumed cash flow from policy dividends would exclude that distribution. In the opposite case, the assumed cash flow from policy dividends would provide for negative distribution of a deferred realized capital loss asset (net of any corresponding future tax liability). Such avoidance is appropriate only in the case of liabilities and would not be appropriate if the dividend scale included distribution of assets that support capital, or distribution of investment income on assets that support capital.

**Term of the liabilities**

- .16 If an element of a policy operates independently of the other elements, then it would be treated as a separate policy with its own term of liabilities. Examples are
- a flexible premium deferred annuity where the interest guarantee and cash value attached to each premium are independent of those for the other premiums, and
  - a certificate of voluntary non-contributory association or creditor group insurance.
- .17 The term of a policy's liabilities is not necessarily the same as the contractual term of the policy.
- .18 In this context,
- “renewal” means the renewal of a policy at the end of its term, with the insurer having discretion to adjust premiums or coverage for the new term,
  - “adjustment” means an insurer's adjustment to a policy's coverage or premiums equivalent to that in a renewal, and
  - “constraint” means a constraint on the insurer's exercise of discretion in renewal or adjustment that results from contractual obligations, legally binding commitments and policy owner reasonable expectations. Examples of constraint are an obligation to renew a policy unless renewal is refused for all other policies in the same class, a guarantee of premiums, a guarantee of credited interest rate, a general account guarantee of segregated fund value, and a limitation on the amount of adjustment. “Constraint” would not include a price-competitive market expected at renewal or adjustment.
- .19 The term of a policy's liabilities takes account of all renewals and adjustments before the balance sheet date. Depending on the circumstances, that term may also take account of one or more renewals or adjustments after the balance sheet date.

- .20 If the term of the liabilities is not evident, and if selection of a longer term would reduce insurance contract liabilities, then the actuary would be cautious in making such a selection. On the other hand, if selection of a longer term would increase those liabilities, then the actuary would usually select the longer term. Substance would supersede form in the selection; for example, a universal life policy that is in form an annual premium life insurance policy may be in substance a single premium deferred annuity.
- .21 The term of the liabilities of
- an insurance contract that has been cancelled by the insurer ends at the effective date of cancellation,
  - an insurance contract that has not been cancelled, but that is cancellable by the insurer at or before the date to which its premiums have been paid, ends at that date,
  - an individual annual premium life or accident and sickness insurance contract ends at the last day to which the policy owner may prolong its coverage without the consent of the insurer, and
  - a certificate of group insurance if the group insurance contract is in effect a collection of individual insurance contracts is the same as if it were an individual insurance contract, unless contributions or experience rating of the group negate anti-selection by certificate holders.
- .22 The term of the liabilities of any other insurance contract ends at the earlier of
- the first renewal or adjustment date at or after the balance sheet date at which there is no constraint, and
  - the renewal or adjustment date after the balance sheet date that maximizes the insurance contract liabilities.

An exception to the above would exist for the liabilities for guarantees of the fund value for segregated fund annuities where the contracts contain material constraints. In this situation, the term of the liability ends at the date after the valuation date which maximizes the insurance contract liabilities, consistent with the treatment for contracts with no material constraints.

- .23 The actuary would extend such term only
- to permit recognition of cash flow to offset acquisition or similar expenses,
    - whose recovery from cash flow that would otherwise be beyond such term was contemplated by the insurer in pricing the insurance contract, and
    - where the value of the additional cash flow recognized by such extension of the term cannot exceed the value of the remaining balance of acquisition or similar expenses, or
  - to permit reflection of hedging arrangements related to segregated fund guarantees by considering both the value of the liability and its associated hedge,
    - where the resulting balance sheet presentation is consistent with market movements over the reporting period, and
    - where such extension would be subject to constraints on the amount of cash flow capitalized, consistent with an unhedged position.
- .24 The balance of the allowance for acquisition expense would be written down to zero using an appropriate method. Such method would
- have a term consistent with the extended term established at inception,
  - have a write-down pattern reasonably matched with the net cash flow available to offset these expenses at inception, and
  - be locked in, so that the amount of write-down in each period will not fluctuate from the expected amount established at inception provided such balance is recoverable from the additional cash flow recognized at the balance sheet date, and where not fully recoverable at the balance sheet date, is written down to the recoverable amount, with the expected amount of write-down in each future period proportionately reduced.
- .25 That implies that the term ends at
- the balance sheet date if the policy is continually renewable or adjustable without constraint,
  - the first renewal or adjustment after the balance sheet date if there is no constraint at that renewal or adjustment, and
  - a renewal or adjustment determined by testing for any other policy. The actuary would calculate the insurance contract liabilities assuming that the term of its liabilities ends at each renewal or adjustment at or after the balance sheet date up to and including the first renewal or adjustment at which there is no constraint, and would select the term corresponding to the largest insurance contract liabilities.

- .26 A change in the outlook may provoke a change in the term of the insurance contract's liabilities. For example, the constraint of a cost of insurance guarantee that previously lengthened the term of the insurance contract liabilities may no longer do so if the outlook for mortality improves. On the other hand, the constraint of a guaranteed credited interest rate that previously was considered innocuous may become meaningful, and thereby lengthen the term of the insurance contract liabilities, if the outlook changes to one of lower interest rates.
- .27 For example, the term of the liabilities ends at
- the balance sheet date for the general account portion of a deferred annuity with segregated fund liabilities but without minimum guarantees (other than a guarantee of an annuity purchase rate); for example, with no guarantee of the segregated fund value,
  - the date after the balance sheet date that maximizes the insurance contract liabilities for guarantees of the fund value for segregated fund annuities whose contracts have no material constraints, and for consistency, for those contracts that contain material constraints,
  - the first renewal (usually one year after the previous renewal) of a group policy that insures employee benefits, unless there is a constraint at that renewal, and
  - the next renewal date or adjustment date even if there is a constraint at renewals and adjustments at and after that date, but the constraint is so weak that its operation does not increase insurance contract liabilities.

#### **Policy owner reasonable expectations**

- .28 The insurer's policies define contractually its obligations to its policy owners. The contractual definition may leave certain matters to the insurer's discretion, such as
- the determination of policy dividends, experience-rating refunds, and retrospective commission adjustments, and
  - the right to adjust premiums.
- .29 Matters left to the insurer's discretion implicitly include
- underwriting and claim practices, and
  - the right to waive contractual rights and to create extra-contractual obligations.

- .30 Policy owner reasonable expectations are the expectations that  
may be imputed to policy owners as their reasonable expectations of the insurer's  
exercise of discretion in those matters, and  
arise from the insurer's communication in marketing and administration, from its  
past practice, from its current policy, and from general standards of market  
conduct. Past practice includes the non-exercise of discretion; for example, long  
non-exercise without affirmation of a right to adjust premiums may undermine it.  
The insurer's communication includes policy dividend and investment  
performance illustrations at sale of a policy and that of intermediaries reasonably  
perceived as acting in its behalf.
- .31 In selecting assumptions for the insurer's exercise of discretion in those matters, the actuary  
would take policy owner reasonable expectations into account. Taking account of policy owner  
reasonable expectations may affect not only the amount of insurance contract liabilities but also  
disclosure in the financial statements.
- .32 The determination of policy owner reasonable expectations is straightforward when the insurer's  
practice has been clear, unvarying, consistent with its communications, consistent with general  
standards of market conduct, and the insurer does not intend to change it. The actuary would  
discuss any other practice with the insurer, with a view to clarifying policy owner reasonable  
expectations.
- .33 If the insurer makes a change that will eventually alter policy owner reasonable expectations,  
then the actuary would consider both the appropriate disclosure of the change in policy owner  
communication and the financial statements, and the time elapsed before the altered expectations  
crystallize.
- .34 A dispute over policy owner reasonable expectations may lead to class action or other litigation  
by policy owners against the insurer, which may affect insurance contract liabilities or generate  
contingent liabilities.

### **Policy dividends**

- .35 The assumed cash flow from policy dividends would be that from both periodic (usually annual)  
dividends and terminal and other deferred dividends, but excluding that from the related transfers  
from the participating to the shareholders account in a stock insurer.
- .36 The assumed cash flow from policy dividends would avoid omission and double counting with  
other elements of the insurance contract liabilities and with liabilities other than insurance  
contract liabilities. For example, if the actuary has valued the insurance contract liabilities for  
riders and supplementary benefits in participating policies as though they were non-participating  
— i.e., with provision for adverse deviations in excess of that appropriate for participating  
insurance — then the assumed cash flow from policy dividends would exclude the portion of that  
excess that is included in the dividend scale.

- .37 The selected policy dividend scales in a particular scenario would be consistent with the other elements of that scenario, but would take account of how insurer inertia, policy owner reasonable expectations, and market pressure may preclude the dividend scale from being responsive to changes assumed in the scenario. Those scales would also be consistent with the insurer's dividend policy except in a scenario which that policy does not contemplate and which would provoke a change in it.
- .38 If the current dividend scale anticipates a future deterioration in experience, then the actuary would assume continuance of that scale in response to that deterioration. If the current dividend scale does not respond to a recent deterioration in experience but the insurer's policy is to do so, and if the delay in doing so does not provoke a contrary policy owner reasonable expectation, then the actuary would assume such response.
- .39 An assumption of cash dividends to all policy owners is appropriate only if the alternative options to cash have equivalent value, failing which, the actuary would
- either adjust the cash dividends to reflect the non-equivalence or make explicit assumption about policy owner exercise of the various dividend options, and
  - provide for the anti-selection that will result from increasing exercise of the more valuable options.

#### **Forecast of cash flow**

- .40 In calculating insurance contract liabilities, the actuary would allocate assets to the liabilities at the balance sheet date, forecast their cash flow after that date, and, by trial and error, adjust the allocated assets so that they reduce to zero at the last cash flow.
- .41 Use of the work of another person may be appropriate for forecasting the cash flow of certain assets, such as real estate.

#### **Income tax and alternative tax**

- .42 This item deals with cash flow from tax based on income (herein called “income tax”) and other taxes not based on income but which interact with income tax; for example, certain capital taxes in Canada (herein called “alternative tax”).

- .43 The cash flow from such taxes would be limited to that in respect of the relevant insurance contracts and the assets that support their insurance contract liabilities, and thus, with the exception of the recoverability of future tax losses described below would ignore any interaction between that cash flow and cash flow in the rest of the insurer; e.g., it would ignore tax on investment income from assets that support the insurer's capital. For a particular scenario, forecasted income before tax is equal to zero in each accounting period after the balance sheet date. That is so because that scenario assumes occurrence of the adverse deviations for which it makes provision. If income according to tax rules were equal to income in accordance with generally accepted accounting principles, and if there were no alternative tax, then the corresponding forecasted tax cash flow would also be equal to zero. In reality, however, such tax cash flow may differ from zero because of
- differences – both temporary and permanent – between income in accordance with generally accepted accounting principles and in income in accordance with tax rules,
  - the operation of carry-forward and carry-back in the tax rules, and
  - alternative tax and the interaction between it and income tax.
- .44 An example of a temporary difference is a difference between insurance contract liabilities and the corresponding tax liabilities.
- .45 An example of a permanent difference is a preferential tax rate on the investment income on a class of assets.
- .46 The forecast of cash flow from such taxes would therefore take account of positive or negative tax as a result of permanent and temporary differences at, and arising after, the balance sheet date, and of alternative taxes incurred after the balance sheet date.
- .47 The resulting insurance contract liabilities make appropriate provision for cash flow on account of such taxes. If the insurer's balance sheet records a future tax asset or liability in respect of such taxes, then, in order to avoid double counting, the actuary would adjust the insurance contract liabilities otherwise calculated upward to reflect the existence of the future tax asset and downward to reflect the existence of future tax liability.
- .48 The realization of negative tax depends on the simultaneous availability of income that is otherwise taxable. In forecasting such income, the actuary would
- make provision for adverse deviations,
  - take into account the projected tax position of the company overall, but
  - not take account of the expected release of provisions for adverse deviations in the insurance contract liabilities because, as noted above, their calculation implicitly assumes that those adverse deviations occur.

### **Adverse deviations borne by policy owners**

- .49 The insurance contract liabilities need not make provision for adverse deviations to the extent that the insurer can offset its effect by adjustments to policy dividends, premium rates, and benefits. The insurer's contractual right of such offset may be constrained by policy owner reasonable expectations, competition, regulation, administrative delays, and the fear of adverse publicity or anti-selection.
- .49.1 In some jurisdictions, regulatory approval may be required for the application of such contractual pass-through features and, in such cases, the actuary would consider the ability to recover past losses, the clarity of any regulatory rules for approval, time delays caused by the approval process, and whether interest losses during this period can be recouped in determining an appropriate total provision.

### **Adoption of a scenario**

- .50 If the selection of scenarios is deterministic, then the actuary would adopt a scenario whose insurance contract liabilities are within the upper part of the range of the insurance contract liabilities for the selected scenarios, provided, however, that the insurance contract liabilities would not be less than those in the prescribed scenario with the largest insurance contract liabilities.
- .51 If the selection of scenarios is stochastic, then the actuary would adopt a scenario whose insurance contract liabilities are within the range defined by
- the average of the insurance contract liabilities that are above the 60<sup>th</sup> percentile of the range of insurance contract liabilities for the selected scenarios, and
  - the corresponding average for the 80<sup>th</sup> percentile.

### **Scenario-tested assumptions**

- .52 The provision for adverse deviations in respect of scenario-tested assumptions results from calculating the insurance contract liabilities for multiple scenarios and adopting a scenario whose insurance contract liabilities are relatively high.

### **Other assumptions**

- .53 The provision for adverse deviations in respect of each assumption other than the scenario-tested assumptions results from a margin for adverse deviations included in that assumption.
- .54 The assumptions unique to a particular scenario are the scenario-tested assumptions and each other assumption that is correlated with them. For example, policy dividends and the exercise of options by borrowers and issuers are strongly correlated with interest rates. Lapses may be correlated or not, depending on the circumstances. The assumption on a matter not so correlated would be common to all scenarios.



### Margin for adverse deviations

- .55 The margin for adverse deviations would be at least the average of the applicable high and low margin whenever at least one ‘significant consideration’ exists, or at least one other consideration is significant in the context of the valuation. Significant considerations vary by type of assumption and are described under subsections 2340 and 2350.

## 2330 SCENARIO ASSUMPTIONS: INTEREST RATES

### General Considerations

- .01 An interest rate scenario comprises, for each forecast period between the balance sheet date and the last cash flow,
- an investment strategy, and
  - an interest rate for each risk-free asset and the corresponding premium for each asset subject to default.
- .02 Each interest rate scenario would include an assumption with respect to the rate of inflation that is consistent with that scenario.
- .03 The interest rate scenario would be consistent among the insurer’s lines of business.
- .04 The investment strategy defines reinvestment and disinvestment practice for each type, default risk classification, and term of the invested assets that support insurance contract liabilities. Assumption of the insurer’s current investment strategy implies investment decisions of reinvestment and disinvestment in accordance with that strategy and, hence, the risk inherent in that strategy.
- .05 The investment strategy for each scenario would be consistent with the insurer’s current investment policy. The insurance contract liabilities would, therefore, make no provision for any increased risk that may result from a change in that policy.
- .06 When using non-debt instruments, the actuary would ensure that the proportion of non-debt instruments, at each duration, would be in accordance with the insurer’s current investment policy (regardless of whether net cash flows for the period are positive or negative). This review would be performed without taking into consideration any business that could be issued after the valuation date (new sales) even for a valuation done on a going concern basis as stipulated in paragraph 2130.02. In the case where the investment policy limits are set on a going concern basis, the actuary would be satisfied that the projected proportion of non-debt assets is appropriate to support only the inforce business at the valuation date, and does not explicitly or implicitly assume any future new business. This may create a situation where the actuary would have to assume that non-debt instruments would be divested. This disinvestment is not limited to non-debt instruments acquired after the valuation date.
- .07 The number of assumed terms of assets would be large enough to permit assumption of changes in the shape and steepness of the yield curve. That implies a minimum of a short, a medium, and a long term.

- .08 A scenario for a foreign country's interest rates would be formulated independently of that for Canadian interest rates unless their positive historical correlation is expected to continue.
- .09 The importance of the assumptions for a particular forecast period depends on the magnitude of the net forecasted cash flow for that period.

### **Base scenario**

- .09.1 The interest rates for investments purchased or sold would be based on the following interest rate scenario using the insurer's current investment strategy,
- risk-free interest rates effective after the balance sheet date would be equal to the forward interest rates implied by the equilibrium risk-free market curve at that date, for the first 20 years after the balance sheet date,
- at or after the 40<sup>th</sup> anniversary from the balance sheet date, risk-free interest rates would be equal to the sum of ½ of the 60-month and 120-month moving averages of historic long-term Canadian risk-free bond yields (V122544 term-to-maturity>10 years), annualized and rounded to the nearest 10 basis points, and
- between the 20<sup>th</sup> and 40<sup>th</sup> anniversary, the forward risk-free interest rates would be determined using a uniform transition,
- and the premiums for default risk at all durations, would be consistent with the current investment strategy and risk premiums available in the market at the balance sheet date.

- .09.2 The provision for adverse deviations for interest rate risk for both deterministic and stochastic applications would be measured as the difference between the reported insurance contract liabilities and the insurance contract liabilities resulting from the application of the base scenario.

### **Prescribed scenarios**

- .10 Because future investment returns and inflation rates are so conjectural, it is desirable that the calculation of insurance contract liabilities for all insurers take account of certain common assumptions. There are, therefore, nine prescribed scenarios as presented below.
- .11 The prescribed scenarios apply to debt investments acquired or sold after the balance sheet date.
- .12 For a prescribed scenario, if the net cash flow forecast for a period is positive, then the actuary would assume its application to repay the outstanding balance, if any, of borrowing in accordance with paragraph 2330.14, and then would
- assume the reinvestment of any remainder in debt investments, except that, in lieu of debt investments, the actuary may assume reinvestment in non-debt investments

not to exceed their proportion of investments at the balance sheet date if the insurer controls investment decisions and if such reinvestment is consistent with its investment policy, or

in the proportion expected to be selected by policy owners if policy owners control investment decisions.

- .13 The limitation on reinvestment in non-debt instruments is intended to apply in situations where reflecting increased utilization of these instruments would reduce the insurance contract liabilities.
- .14 For a prescribed scenario, if the net cash flow for a period is negative, then the actuary would assume an offsetting disinvestment or borrowing, or a mix of the two. For insurer controlled investment decisions, any borrowing would be in accordance with the investment policy, would be short-term, and would be expected to be soon repayable by subsequent positive forecasted net cash flow.
- .15 The prescribed scenarios provide guidance on interest rates for sale and purchase of investments and on the type and term of investments purchased, but provide no guidance on the type and term of investments sold.
- .15.1 The prescribed range of short-term Canadian risk-free interest rates for the ultimate forecast period is calculated as follows (but see also paragraph 2330.15.3 below for limitations). The lower bound of the short-term rates is determined as the lesser of 3%, and the rate determined by taking 90% of the sum of 1/2 of the 60-month and 120-month moving averages of historic 91-day Canadian risk-free interest rates. The upper bound of the short-term rates is determined as the greater of 10%, and 110% of the sum of 1/2 of the 60-month and 120-month moving averages of historic 91-day Canadian risk-free rates. These range bounds are rounded to the nearest 10 basis points. The 91-day Canadian risk-free interest rate is defined as the effective annual rate equivalent to the Short Rate: V122531 - Government of Canada 91-Day Treasury Bill Yield rate, which is compounded quarterly.
- .15.2 The prescribed range of long-term Canadian risk-free interest rates for the ultimate forecast period is calculated as follows (but see also paragraph 2330.15.3 below for limitations). The lower bound of the long-term rates is determined as the lesser of 5%, and the rate determined by taking 90% of the sum of 1/2 of the 60-month and 120-month moving averages of historic long-term Canadian risk-free bond interest rates (term-to-maturity >10 years). The upper bound of the long-term rates is determined as the greater of 12%, and 110% of the sum of 1/2 of the 60-month and 120-month moving averages of historic long-term Canadian risk-free bond interest rates (term-to-maturity >10 years). These range bounds are rounded to the nearest 10 basis points. The long-term Canadian risk-free bond interest rate (term-to-maturity >10 years) is defined as the effective annual rate equivalent to the Long Rate: V122544 - Government of Canada Benchmark Bond Yield – Long-Term rate, which is compounded semi-annually.

- .15.3 The width of the prescribed range of interest rates is exactly 7%. As a result, if the lower bound of the range is below 3% (short-term) or 5% (long-term), the upper bound of the range will be adjusted to be exactly 7% larger than the lower bound. Similarly, if the upper bound of the range is above 10% (short-term) or 12% (long-term), the lower bound of the range will be adjusted to be exactly 7% less than the upper bound.
- .16 The parameters in the prescribed scenarios apply to investments denominated in Canadian dollars. For each prescribed scenario, the actuary would determine the corresponding parameters for investments denominated in a foreign currency from the historical relationship between investments denominated in that currency and investments denominated in the Canadian dollar if the expected continuance of that relationship so permits. Otherwise the actuary would devise independent scenarios for investments denominated in that currency.
- .17 For each of prescribed scenarios 1 to 6, the insurer's reinvestment strategy for debt instruments by type and term
- at the balance sheet date is the distribution that the insurer is then purchasing,
  - at and after the 20<sup>th</sup> anniversary of the balance sheet date is risk-free coupon bonds with a term of 20 years or less, and
  - between those two dates is according to a uniform transition from the balance sheet date distribution to risk-free coupon bonds with a term of 20 years or less.

### **Prescribed scenario 1**

- .18 The risk-free interest rates for investments purchased or sold
- at the balance sheet date are those for the distribution of investments that the insurer is then making,
  - at the first anniversary from the balance sheet date are 90% of the risk-free rates at the balance sheet date,
  - at and after the 20<sup>th</sup> anniversary of the balance sheet date are the lower bounds of the short-term and long-term rates as described in paragraphs 2330.15.1 through 2330.15.3, and
  - between the last two dates are determined according to a uniform transition from the first anniversary rates to the lower bounds of the prescribed range.
- Interest rates between the short-term and long-term bounds are determined using yield rates that are appropriate for the terms of those assets, in accordance with the historic relationship between the rates of those assets and the short-term and long-term interest rates.

### **Prescribed scenario 2**

- .19 This scenario is the same as prescribed scenario 1, with the 90% replaced by 110% and with the short-term lower bound replaced by the short-term upper bound and the long-term lower bound replaced by the long-term upper bound.

### **Prescribed scenario 3**

- .20 The long-term risk-free interest rate moves cyclically in 1% steps between the long-term lower and upper bounds of the prescribed range determined in paragraphs 2330.15.1 through 2330.15.3. The first cycle is irregular; at the first anniversary of the balance sheet date, the rate is

the next step higher, such that the interest rate is an integral difference from the bounds of the range, if the actual rate at the balance sheet date is less than the long-term upper bound, with the rate at subsequent anniversaries increasing in 1% steps to the long-term upper bound, at which point the cycle continues regularly, and

the next step lower, such that the interest rate is an integral difference from the bounds of the range, if the actual rate at the balance sheet date is equal to or greater than the long-term upper bound, with the rate at subsequent anniversaries decreasing in 1% steps to the long-term upper bound, at which point the cycle continues regularly.

- .21 The short-term risk-free interest rate changes uniformly over a period, usually not more than three years, from that at the balance sheet date to 60% of the corresponding long-term interest rate, and thereafter remains at 60% of the corresponding long-term interest rate.
- .22 Other interest rates are determined using yield rates that are appropriate for the terms of those assets, in accordance with the historic relationship between the rates of those assets and the short- and long-term interest rates.

### **Prescribed scenario 4**

- .23 This scenario is the same as prescribed scenario 3, except that the first irregular cycle reaches the long-term lower bound rather than the long-term upper bound.

### **Prescribed scenario 5**

- .24 This scenario is the same as prescribed scenario 3, except that the short-term interest rate at an anniversary of the balance sheet date is a percentage of the corresponding long-term interest rate. That percentage moves cyclically in 20% annual steps from 40% to 120% and back. The first cycle is irregular; at the first anniversary, the percentage is

the next step above the actual percentage at the balance sheet date if that actual percentage is less than 120%, and

120% otherwise,

after which the cycle continues regularly.

### **Prescribed scenario 6**

- .25 As respects long-term interest rate, this scenario is the same as prescribed scenario 4.
- .26 As respects short-term interest rate, this scenario is the same as prescribed scenario 5, except that, at the first anniversary of the balance sheet date, the percentage is
- the next step below the actual percentage at the balance sheet date if that actual percentage is more than 40%, and
- 40% otherwise.

### **Prescribed scenario 7**

- .27 The interest rates for investment purchased or sold are 100% of the base scenario at the balance sheet date and 90% of the base scenario at the first anniversary from the balance sheet date and all following durations.

### **Prescribed scenario 8**

- .28 The interest rates for investment purchased or sold are 100% of the base scenario at the balance sheet date and 110% of the base scenario at the first anniversary from the balance sheet date and all following durations.

### **Prescribed scenario 9**

- .29 This scenario assumes continuance of risk-free interest rates and the premiums for default risk consistent with the current investment strategy and risk premiums available in the market at the balance sheet date.

### **Other scenarios**

- .30 In addition to the prescribed scenarios, which would be common to the calculation of insurance contract liabilities for all insurers, the actuary would also select other scenarios that would be appropriate to the circumstances of the case. If current rates are near or outside the limits of the prescribed ranges defined, then some scenarios would include rates that, in the near term, would be outside the prescribed ranges. The reasonableness of degrees of change of interest rates would be largely dependent on the period of time being considered. Other plausible scenarios would include parallel shifts up and down as well as flattening and steepening of the yield curve. The scenarios would include those in which the premiums for default risk range from 50% to 200% of the actual premiums at the balance sheet date.

- .31 The number of other interest rate scenarios would be relatively large to the extent that the pattern of forecasted net cash flow in the base scenario is such that the classification of scenarios between favourable and unfavourable is unclear, forecasted net cash flow is sensitive to the selection of interest rate scenarios, the range of present values of forecasted net cash flow is wide, suggesting exposure to mismatch risk, investment policy does not control mismatch risk, asset-liability management is loose, or flexibility to manage assets or liabilities is limited.

### **Stochastic scenarios**

- .32 If stochastic modeling is performed for other than segregated fund guarantees, the actuary would ensure that the stochastic model includes scenarios that generate insurance contract liabilities outside the range produced by application of the prescribed deterministic scenarios.

## **2340 OTHER ASSUMPTIONS: ECONOMIC**

### **Margin for adverse deviations**

- .00.1 Significant considerations indicating difficulties in properly estimating the best estimate assumption would include
- there is little relevant experience,
  - future experience is difficult to estimate,
  - operational risks adversely affect the likelihood of obtaining the best estimate assumption,
  - asset underwriting criteria are weak or poorly controlled,
  - there are liquidity concerns,
  - there is uncertainty regarding the credit enhancement techniques used,
  - the trust structure and legal responsibilities of the different parties for a securitized asset are not clearly understood in a practical and/or legal sense,
  - the asset held is from a non-passthrough structure with a repackaging of the credit risk that is difficult to understand,
  - the asset held is from a lower quality tranche of a non-passthrough structure that repackages credit risks,
  - there is uncertainty about the counterparty credit, or
  - there is no netting of the aggregate exposure with a counterparty.

.00.2 Other significant considerations indicative of a potential deterioration of the best estimate assumption would include

there is significant concentration of risks and/or lack of diversification, or  
operational risks are present such that the likelihood of continuing to obtain the best estimate assumption is adversely impacted.

**Fixed income assets: Investment return**

.01 The forecast of cash flows from a fixed income asset would be the promised cash flows over the term of the asset, modified for asset depreciation and borrower and issuer options.

**Fixed income assets: Asset depreciation**

.02 The actuary's best estimate of asset depreciation would depend on

asset type, credit rating, liquidity, term, and duration since issue,  
subordination to other debt of borrower or issuer,

the insurer's credit underwriting standards, diversification within a particular type  
of investments,

to the extent that it is indicative of the future, the insurer's own experience,  
the insurance industry's experience,

guarantees that offset depreciation, such as that in an insured mortgage, and  
potential for anti-selection by borrowers and issuers.

.03 Asset depreciation comprises that of both assets that are impaired at the balance sheet date and assets that become impaired after the balance sheet date, and includes loss of interest, loss of principal, and expense of managing default.

.04 Asset depreciation is likely to be relatively high after the forced renewal of a mortgage loan; i.e., one where the mortgagor can neither pay, nor find an alternative mortgagee for the balance outstanding at the end of its term but is able to continue its amortization. The explicit forecasting of subsequent cash flow is usually so conjectural that, to commute the cost of that asset depreciation to the end of the term of the mortgage would be an acceptable approximation unless it undermines the interest rate assumption in the scenario.



.05 The actuary would not necessarily assume that the best estimate of asset depreciation is less than the premium of an asset's investment return over the corresponding default-free interest rate.

.06 The low and high margins for adverse deviations for a scenario would be respectively 25% and 100% of the best estimate for that scenario, except that

a higher range would be appropriate where those percentages of an unusually low best estimate are not meaningful, and

zero would usually be appropriate for an Organisation for Economic Cooperation and Development (OECD) government's debt denominated in its own currency.

.07 Repealed

#### **Fixed income assets: Exercise of borrower and issuer options**

.08 Examples of borrower and issuer options are the option to prepay a mortgage loan, to extend the term of a loan, and to call a bond.

.09 The assumed exercise may depend on the interest rates in the scenario. Anti-selection by commercial borrowers and issuers would usually be intense.

.10 Forecasted cash flows would include any penalty generated by exercise of an option.

#### **Non-fixed income assets: Investment return**

.11 | Where reliable historical data is available the actuary's best estimate of investment return on a non-fixed income asset would not be more favourable than a benchmark based on historical performance of assets of its class and characteristics.

.12 | Where the best estimate is based on reliable historical data, the low and high margins for adverse deviations in the assumptions of common share dividends and real estate rental income would be respectively 5% and 20%.

.13 | Where the best estimate is based on reliable historical data, the margin for adverse deviations in the assumption of common share and real estate capital gains would be 20% of the best estimate plus an assumption that those assets change in value at the time when the change is most adverse. That time would be determined by testing, but usually would be the time when their book value is largest. The assumed change as a percentage of market value

of a diversified portfolio of North American common shares would be 30%, and

of any other portfolio would be in the range of 25% to 40% depending on the relative volatility of the two portfolios.

- .13.1 Where reliable historical information is not available for the class of assets, the actuary would select a best estimate investment return assumption and margins for adverse deviations such that the assumed return in excess of risk free interest rates, net of margins, would not exceed the assumed return in excess of risk free interest rates, net of margins, for a similar asset class for which reliable historical information is available in the same jurisdiction, or in Canada if there is no relevant reliable historical information in the same jurisdiction.
- .14 Whether the assumed change is a gain or loss would depend on its effect on benefits to policy owners. A capital loss may reduce insurance contract liabilities as a result of that effect.

### **Taxation**

- .15 The best estimate would be for continuation of the tax regime at the balance sheet date, except that the best estimate would anticipate a definitive or virtually definitive decision to change that regime. The margin for adverse deviations would be zero.

### **Foreign exchange**

- .16 The needed assumptions would include foreign exchange rates when insurance contract liabilities and their supporting assets are denominated in different currencies.
- .17 The base scenario used to develop the assumption for foreign exchange rates would be based on currency forwards. If currency forwards are not available, the forward exchange rates would be derived based on risk-free interest rate differentials where available. If neither is available, the actuary would use his or her best judgment to develop an appropriate approach.
- .18 A provision for adverse deviations would be developed from a scenario using adverse movements in the exchange rate. Such movements would reflect the historical volatility in the exchange rate over the applicable period. The provision for adverse deviations would be the excess of the insurance contract liabilities based on this adverse scenario over the insurance contract liabilities calculated using the base scenario.
- .19 A minimum provision for adverse deviations would apply. This would be the excess of the insurance contract liabilities resulting from the application of an adverse five percent margin to the projected exchange rates underlying the base scenario over the insurance contract liabilities calculated using the base scenario.

## **2350 OTHER ASSUMPTIONS: NON-ECONOMIC**

### **Margin for adverse deviations**

- .01 The actuary would select a margin for adverse deviations between a low margin and a high margin  
specified for each best estimate assumption discussed below, and  
of 5% and 20% (or -5% and -20%), respectively, of each other best estimate assumption.

- .02 If a margin for adverse deviations cannot be defined as a percentage of the best estimate assumption, then the related provision for adverse deviations would be taken as the increase in insurance contract liabilities that results from substitution of a conservative assumption for the best estimate assumption.
- .03 Significant considerations indicating difficulties in properly estimating the best estimate assumption would include
- the credibility of the company's experience is too low to be the primary source of data,
  - future experience is difficult to estimate,
  - the cohort of risks lack homogeneity,
  - operational risks adversely impact the likelihood of obtaining best estimate assumption, or
  - the derivation of the best estimate assumption is unrefined.
- .03.1 Other significant considerations indicative of a potential deterioration of the best estimate assumption would include
- a significant concentration of risks and/or lack of diversification,
  - operational risks that adversely affect the likelihood of continuing experience which is consistent with the best estimate assumption, or
  - past experience that may not be representative of future experience and the experience may deteriorate.
- Other significant considerations may exist, but are tied to specific assumptions. Where applicable, they are described below.
- .04 A selection above the high margin would be appropriate, however, for unusually high uncertainty or if the resulting provision for adverse deviations is unreasonably low because the margin is expressed as a percentage and the best estimate is unusually low.

### **Insurance mortality**

- .05 The actuary's best estimate of insurance mortality would depend on
- the life insured's age, sex, smoking habit, health, and lifestyle,
  - duration since issue of the policy,
  - plan of insurance and its benefits provided,
  - the insurer's underwriting practice (that of its reinsurer for facultative reinsurance), including, if applicable to the policy, the absence of underwriting or less stringent underwriting for a group of simultaneously sold policies,

the size of the policy, and

the insurer's distribution system and other marketing practice,

and would include the effect of any anti-selection.

- .05.1 The actuary would consider the inclusion of mortality improvement (a secular trend toward lower mortality rates) in the best estimate assumption and associated margin. The margin for adverse deviations related to the mortality improvement assumption is not restricted to the range of 5% to 20% noted in paragraph 2350.01.
- .06 If the inclusion of mortality improvement reduces the insurance contract liabilities, then the resulting reduction would be no greater than that developed using prescribed mortality improvement rates as promulgated from time to time by the Actuarial Standards Board. If, at an appropriate level of aggregation, the inclusion of mortality improvement increases the insurance contract liabilities, then the actuary's assumption would include such improvement. The resulting increase in insurance contract liabilities would be at least as great as that developed using prescribed mortality improvement rates as promulgated from time to time by the Actuarial Standards Board.
- .07 The low and high margins for adverse deviations for the mortality rates per 1,000 would be respectively an addition or subtraction, as appropriate, of 3.75 and 15, each divided by the curtate expectation of life at the life insured's projected attained age. These margins for adverse deviations are applied after mortality improvement.

.08 Repealed

### **Annuity mortality**

- .09 The actuary's best estimate assumption of annuity mortality would depend on
- the annuitant's age, sex, smoking habit, health, and lifestyle,
  - size of premium,
  - plan of annuity and its benefits provided, and
  - whether registered or not, whether structured settlement, and whether group or individual contract,
- and would include the effect of any anti-selection resulting from the annuitant's option to select the timing, form, or amount of annuity payment, or to commute annuity payments.
- .10 The insurance underwriting in a "back-to-back" insurance/annuity package may unfavourably affect the best estimate.

- .11 The mortality improvement assumption would include a best estimate assumption and an associated margin. The margin for adverse deviations related to the mortality improvement assumption is not restricted to the range of 5% to 20% noted in paragraph 2350.01. The actuary's assumption would include mortality improvement, the effect of which is to increase insurance contract liabilities, such that the resulting increase would be at least as great as that developed using prescribed mortality improvement rates as promulgated from time to time by the Actuarial Standards Board.
- .12 The low and high margins for adverse deviations for the mortality rates would be respectively a subtraction of 2% and 8% of the best estimate.
- .13 An additional significant consideration for the determination of the level of margin for adverse deviations would be the possibility of commuting survival dependent benefits after periodic payments have started.

### **Morbidity**

- .14 The actuary's best estimate of insurance morbidity would depend on
- the life insured's age, sex, smoking habit, occupation, industry, health, and lifestyle,
  - duration since issue of the policy,
  - in the case of income replacement insurance, definition of disability, unemployment levels, and, in the case of an outstanding claim, cause of disability,
  - plan of insurance and its benefits provided, including elimination period, guarantees, deductibles, coinsurance, return-of-premium benefits, and benefit limits, indexation, and offsets,
  - the insurer's underwriting practice (that of its reinsurer for facultative reinsurance), including, if applicable to the policy, the absence of underwriting or less stringent underwriting for a group of simultaneously sold policies,
  - the insurer's administration and claim adjudication practice,
  - the size of the policy,
  - seasonal variations,
  - in the case of group insurance, participation level, and
  - environmental factors, such as a change in the offset to government benefits,
- and would include the effect of any anti-selection.

- .15 If the actuary selects a higher than usual best estimate of disability incidence because of an outlook for a high level of unemployment, he or she would not necessarily select a concomitant higher than usual best estimate of disability termination.
- .16 Repealed
- .17 The low and high margins for adverse deviations would be, respectively, an addition of 5% and 20% of the best estimate of morbidity incidence rates, and a subtraction of 5% to 20% of the best estimate morbidity termination rates. The actuary's selection would reflect any expected correlation between incidence and termination rates.
- .18 Additional significant considerations to be taken into account when determining the level of margin for adverse deviations would include
- the contract wording not tight enough to protect against medical advances,
  - definitions of claim events not precise and/or not protecting against potential anti-selection, or
  - interpretation of claim event definitions by the court uncertain.

**Withdrawal and partial withdrawal**

- .19 The actuary's best estimate of withdrawal rates would depend on
- policy plan and options,
  - the life insured's attained age,
  - duration since issue of the policy,
  - method of payment and frequency of premiums,
  - premium paying status,
  - policy size,
  - the policy's competitiveness, surrender charges, persistency bonuses, taxation upon withdrawal, and other incentives and disincentives to withdrawal,
  - policy owner and sales representative sophistication,
  - the insurer's distribution system and its commission, conversion, replacement, and other marketing practices, and
  - the interest rate scenario,
- and would include the effect of any anti-selection.

- .19.1 For the valuation of segregated fund guarantees, the actuary's best estimate of withdrawal rates would also depend on
- extent to which the guaranteed values are greater or less than the market value of the funds,
  - time to maturity,
  - systematic withdrawal consistent with the contractual terms of the policies,
  - market conditions, and
  - distribution of investment income from the funds if such amounts are not automatically reinvested.
- .20 The insurer's withdrawal experience would be pertinent and usually credible. It would not be available for new products and for higher durations on recent products, which is a problem for the actuary if the insurance contract liabilities are sensitive to withdrawal rates.
- .21 The automatic payment of insurance premiums by the annuity benefit in a “back-to-back” insurance/annuity package would be a disincentive to withdrawal.
- .22 Reinsurance assumed withdrawal rates would depend on practice in the direct insurer.
- .23 A “cliff” is a sudden significant increase in the benefit available at withdrawal. That increase may result from increase in cash value, decrease in surrender charge, or availability of a maturity benefit or persistency bonus. Unless there is pertinent persistency experience data to the contrary, the actuary's best estimate withdrawal rates would grade to zero as the cliff approaches and remain at zero for an interval before the cliff is reached. The same would apply to a return of premium benefit in life insurance and to one in accident and sickness insurance, with modification in the latter case if the benefit is contingent upon zero claims or reduced by the amount of claims.
- .24 The actuary's best estimate withdrawal rate would be zero for a paid-up policy without non-forfeiture benefit.
- .25 The low and high margins for adverse deviations would be, respectively, an addition or subtraction, as appropriate, of 5% and 20% of the best estimate withdrawal rates. In order to ensure that the margin for adverse deviations increases insurance contract liabilities, the choice between addition and subtraction may need to vary by interest scenario, age, policy duration, and other parameters. In the case of partial withdrawal, two assumptions would be needed, the amount withdrawn and the partial withdrawal rate.
- .26 Additional significant considerations to be taken into account when determining the level of margin for adverse deviations in situations where a decrease in lapse rates increases the insurance contract liabilities would include
- remuneration policy encouraging persistency, or
  - cancellation of a contract being clearly detrimental to the policy owner.

- .26.1 Additional significant considerations to be taken into account when determining the level of margin for adverse deviations in situations where an increase in lapse rates increases the insurance contract liabilities would include
- remuneration policy encourages terminations,
  - cancellation of a contract would be clearly beneficial to the policy owner,
  - company's contracts have provisions where rating decreases may trigger additional withdrawals, or
  - there is no market value adjustment on withdrawals for deposits and deferred annuities.

### **Anti-selective lapse**

- .27 Strictly speaking, "lapse" means termination of a policy with forfeiture, but in the context of anti-selection has come to include any termination or the election of the extended term insurance non-forfeiture option. "Anti-selective lapse" is a tendency of policies on healthy insured lives to lapse or unhealthy insured lives not to lapse, with a concomitant deterioration in the insurer's mortality or morbidity experience. To determine whether the tendency has operated in a particular case would require either a re-underwriting of those who have lapsed and those who have not, or a study of the mortality among those who lapsed, neither of which is likely to be practical. Policy owners will, however, make decisions in their own perceived interest, so that anti-selective lapse is plausible whenever that perceived interest is for policies on unhealthy lives not to lapse or for policies on healthy lives to lapse.
- .28 It is difficult to estimate with confidence the intensity of anti-selective lapse. It is plausible for the intensity to be proportional to the intensity of policy owner perceived interest. However, anti-selective lapse is merely a tendency provoked by the policy owner's perceived interest. The policy owner may not know the true state of health of the life insured. The policy owner may imprudently favour, or be obliged by financial pressure to adopt, a short-term interest with long-term detriment; thus, a policy on an unhealthy life may lapse when the premium increases, the policy owner perceiving the policy to be no longer affordable. Through ignorance or inertia, a policy on a healthy life may be continued by a policy owner, even though it could be replaced by a superior one. Moreover, anti-selective lapse is not the unvarying effect of a decision in the policy owner's perceived interest. For instance, a policy owner may lapse a policy on an unhealthy life, if the policy is no longer needed, or the policy on a healthy life may remain in force if the policy owner perceives a continuing need. Without pertinent and reliable experience, however, the actuary would not assume that the non-lapsation of policies on healthy lives favourably affects the mortality best estimate for the persisting insurance contracts.



- .29 The actuary's assumptions would be that policy owners' decisions will tend to serve their perceived interest, and will not serve the insurer's interest unless the two run together.
- .30 Examples where the perceived interest of the policy owners of policies with healthy life insureds may be to lapse include
- premium increase at renewal of term insurance,
  - unfavourable underwriting decision at renewal of re-entry term insurance,
  - benefit decrease or premium increase of adjustable insurance,
  - premium needed to avoid termination of universal life insurance with exhausted funding,
  - reduction in policy dividend scale,
  - offer or availability of a superior replacement policy, such as by the creation of preferred underwriting class,
  - significant but temporary increase (spike) in non-forfeiture value, and
  - downgrade in the insurer's credit rating.

### **Expense**

- .31 The actuary would select a best estimate assumption that provides for the expense of the relevant policies and their supporting assets, including overhead. The insurer's other expense is irrelevant to the valuation of insurance contract liabilities. Other expense would include
- expense related to policies that, for the relevant policies, was incurred before the balance sheet date, such as marketing and other acquisition expense, and
  - expense not related to the relevant policies and their supporting assets, such as investment expense for the assets that support capital.
- .32 The assumption would provide for future expense inflation consistent with that in the interest rate scenario.
- .33 A stable insurer's expense experience is pertinent if its expense allocation is appropriate for valuation of insurance contract liabilities (or if the actuary can correct the inappropriateness, e.g., by reallocating corporate expense to operating lines of business).
- .34 A particular insurer may have an expectation of reduced expense rates, but the actuary would anticipate only a reduction that is forecasted with confidence.

- .35 Investment expense comprises
- administration expense, both internal and external,
  - expense related to investment income, such as deferred fees and commissions and direct taxes, and
  - interest on money borrowed to finance investment.
- .36 The insurer incurs neither cash rental expense nor cash rental income on real estate that it owns and occupies. The actuary would deem such expense and, if the real estate supports the insurance contract liabilities, such income at a reasonable rate in the selection of an assumption of expense and investment return.
- .37 Certain taxes are akin to expenses. The actuary would make similar provision for them in the insurance contract liabilities to the extent that they relate to the relevant insurance contracts and their supporting assets. They include both premium taxes, which are straightforward, and taxes whose basis is neither income nor net income but which may be complicated by a relationship with income tax; for example, those currently incurred may be offset against later income tax.
- .38 The low and high margins for adverse deviations would be respectively 2.5% and 10% of best estimate expense including inflation thereof. No margin for adverse deviations is needed for a tax, such as premium tax, whose history has been stable.
- .39 Additional significant considerations to be taken into account when determining the level of margin for adverse deviations would include
- distribution of general expenses by line of business, by product, or by issue and administrative expenses is not based on a recent internal expense study,
  - allocation is not an appropriate basis for the best estimate expense assumption,
  - expense study does not adequately reflect the appropriate expense drivers, or
  - future reductions in unit expenses (before inflation) are assumed.

### **Policy owner options**

- .40 Examples of policy owner options are options to  
purchase additional insurance,  
convert term to permanent insurance,  
select the extended term insurance non-forfeiture option,  
make partial withdrawal from a universal life insurance policy,  
select the amount of premium for a flexible premium policy, and  
purchase an annuity at a guaranteed rate.
- .41 The actuary would select a best estimate assumption of policy owner exercise of both contractual options and extra-contractual options of which they have reasonable expectations.
- .42 The actuary's best estimate would depend on  
life insured's attained age,  
duration since issue of the policy,  
plan of insurance and its benefits provided,  
historical premium payment patterns,  
method of premium payment,  
sophistication of the policy owner and the intermediary,  
perceived self-interest of the policy owner and the intermediary,  
policy's competitiveness, and  
insurer's distribution system and other marketing practice,  
and would make provision for anti-selection.
- .43 The actuary would make provision for adverse deviations by testing the effect on insurance contract liabilities of plausible alternative assumptions of policy owner exercise of options and adopting one with relatively high insurance contract liabilities.

### **Maturities**

- .44 For valuation of segregated fund guarantees, the actuary would assume the contract terminates on maturity unless allowing a proportion of the policy owners to roll their contracts over would increase the insurance contract liabilities. The proportion of policy owners that elect to roll their policies over would take into account the experience of the insurer. The actuary would test future maturity dates that the policy owner may elect and would use caution in setting this maturity date assumption.

### **Management expense ratios and/or charges**

- .45 For valuation of segregated fund guarantees, the actuary would select a best estimate assumption for management expense ratios (including all taxes charged to the fund such as GST) that varies by fund according to the terms of the contract and recent practice of the insurer. The actuary would not assume a change in management expense ratios in the future unless there is a clear and justifiable reason for doing so, taking into account past practices, competitive pressures and reasonable policy owner reactions.

### **Fund transfers (switching/exchanges)**

- .46 For valuation of segregated fund guarantees, the actuary would test the effect of fund transfers and shifting asset mix and would exercise caution in assuming that the status quo would be maintained indefinitely.

### **Future optional deposits**

- .47 For valuation of segregated fund guarantees, the actuary would test the effect of future optional deposits to the extent they can reasonably be anticipated and use caution in assuming that the status quo would be maintained indefinitely.

### **Ratchet and reset rates**

- .48 For valuation of segregated fund guarantees, the actuary's best estimate of rates at which ratchet and reset options are exercised by policy owners would depend on the
- extent to which the guaranteed values are greater than the market value of the funds,
  - relationship of the fund value and guaranteed benefit amounts,
  - term to maturity, and
  - growth of funds.
- .49 If resets are discretionary, the actuary would assume that some proportion of policy owners would elect to exercise the reset option when it is in their financial best interest to do so. The actuary need not assume that all policy owners would act with absolute efficiency in an economically rational manner. However, the assumptions would allow the frequency of elective resets to vary according to the current and/or historical economic environment.

### **Related Assumptions**

.50 The actuary would consider how the assumptions may be interrelated in determining the best estimate assumptions and appropriate margins. In determining these interrelationships the actuary would take account of potential anti-selection. For example, the actuary would consider

the extent to which an increase in partial withdrawals on segregated funds might lead to deferrals in benefit commencement dates, and

what the relationships among term conversions, withdrawals and mortality might be as a contract nears the end of a term renewal period.

Other examples of how potential anti-selection might affect the selection of assumptions are provided above and in section 1700.

## **2360 SCENARIO ASSUMPTIONS FOR VALUATION OF SEGREGATED FUND GUARANTEES**

### **Model calibration**

.01 *It is prescribed that the actuary's calibration of stochastic models used in the valuation of segregated fund guarantees should meet the criteria for investment returns as promulgated from time to time by the Actuarial Standards Board. [Effective January 1, 2011]*

.02 Investment returns would be generated on a gross basis, before the application of any fees or consideration of specific product features. The objective would be to model the investment returns independently of any product features. However, care would be taken to assess whether total or price returns are required for the specific segregated funds being modelled.

### **Random number generators**

.03 The random numbers generated by computer algorithms are called pseudo-random because they are not truly random. Knowing the algorithm and the seed to the sequence is sufficient to predict the next random number that will be generated. A sound pseudo-random number generator provides a sequence that is statistically indistinguishable from a truly random sequence from the given distribution. The actuary would test the random number generator to demonstrate that it provides a sequence that is statistically indistinguishable from a truly random sequence for the given distribution.

.04 It would be preferable for the results from stochastic modelling to be reproducible, so that a repeatable pseudo-random number generator would be available to an auditor.

### **Number of scenarios**

.05 The actuary would test that the number of scenarios used to calculate the insurance contract liabilities provides an acceptable level of precision that meets the standard of materiality. To increase the precision of the insurance contract liability calculation, it may be necessary to increase the number of scenarios significantly.

.06 The actuary may consider scenario reduction techniques, such as stratified sampling, to reduce the number of scenarios on a sound statistical basis.

### **Modelling period**

.07 The actuary would use a modelling period that is not longer than one month unless testing shows that the liability for segregated fund guarantees is not sensitive to the frequency of election of benefits or features.

### **Economic scenario generators**

.08 The actuary would develop stochastic models for each market index or proxy that is constructed for the segregated funds.

.09 The actuary would select economic scenario generators for stochastic models that are robust and statistically sound.

### **Model parameter estimation**

.10 The actuary would estimate model parameters based on historical market data as opposed to recent market performance. Due to the long-term nature of the segregated fund guarantee, the historical data would cover a period at least twice as long as the projection period. However, when historical data are not available or appropriate for use, adjustments may be required.

.11 The actuary would update model parameters regularly to reflect recent changes in market conditions.

.12 When market data for foreign indices are used to estimate model parameters, the foreign exchange rate would be taken into account. The actuary may consider separate parameters for the market index and for the foreign exchange rate, for example, by including an explicit currency exchange model together with using local currency data to estimate the model parameters.

.13 Parameters would take into account appropriate correlations among investment returns for all market indices and proxies that are constructed.

### **Selecting investment return assumptions for specific funds**

- .14 To develop investment returns for a specific fund, an appropriate proxy for the segregated fund would be constructed. The specific fund's investment policy, its asset allocation implied by the fund performance objective, its performance history, and its trading activities would be considered and reflected in the proxy asset composition. The proxy may take the form of a combination of recognized market indices or economic sector sub-indices or, less commonly, a well-defined set of trading rules in a specified asset universe. It would be appropriate for there to be a close relationship between the investment return proxy and the specific segregated funds.

### **Discount rates**

- .15 The actuary would select discount rates (or accumulation rates) to determine the asset balance necessary to support the liabilities using the assets allocated to support the segregated fund guarantees.

### **Base scenario**

- .16 The base scenario for calculating the provision for adverse deviations would be defined as the average of the insurance contract liabilities for all investment return scenarios.

## 2400 THE APPOINTED ACTUARY

### 2410 DEFINITIONS

- .01 In sections 2400 and 2500, “senior management” means
- in the case of a Canadian insurer, both the chief executive officer and the chief financial officer, and,
  - in the case of a foreign insurer, both the chief agent for Canada and the person designated by the insurer as having responsibility for its Canadian operation.
- .02 In this section 2400, “directors” means an insurer’s board of directors and, in the case of a foreign insurer, includes the person whom they designate as responsible for the insurer’s Canadian branch.

### 2420 SCOPE

- .01 This section 2400 applies to an appointed actuary who, pursuant to
- the federal Insurance Companies Act, is the actuary of a company or society,
  - the federal Insurance Companies Act, is the actuary of the Canadian branch of a foreign company, or
  - a provincial Act, has the access to information, protection against civil liability, and duties in an insurer, that are substantially the same as those of the appointed actuary in the federal Act.

### 2430 EXTENSION OF SCOPE

- .01 This section 2400 does not apply to an actuary who is not an appointed actuary unless that actuary has the access to information and protection against civil liability equivalent to that which the federal Insurance Companies Act grants to an appointed actuary.

### 2440 ACCEPTING AND CONTINUING AN ENGAGEMENT

- .01 *Section 1400 applies rigorously to the engagement.* [Effective January 1, 2003]



### **Qualifications, experience, and knowledge**

- .02 As respects Rule 2 (Qualification Standards), the necessary qualifications, experience, and knowledge go beyond technical understanding and include the awareness that comes with maturity, communications with other actuaries, discussions at Institute meetings, and familiarity with conditions both internal and external to the insurer, and include communications skills.
- .03 An actuary accepting an engagement for the first time may wish to arrange professional, formal, and timely access to another actuary with experience as an appointed actuary.
- .04 It is important that the insurer's directors understand and accept the actuary's role and its requirements for time, resources, and access to information. The actuary may wish written confirmation of the understanding and acceptance unless the role is part of the insurer's corporate culture.

### **Information needed**

- .05 The information necessary for the work consists of the records, accounts, documents, and oral briefings which provide an understanding of the insurer's operations, its obligations and the resources available to meet those obligations. That information includes
- files of in force policies and outstanding claims, including their reinsurance,
  - policy provisions and other communications with policy owners,
  - past experience data,
  - past financial data,
  - communications with auditors and regulators,
  - pricing practice,
  - underwriting practice,
  - claims settlement practice (including case estimate practice) and cost,
  - asset-liability management practice, and
  - capital management practice.

- .06 The process to identify and assure timely receipt of that information includes  
an understanding of the insurer's decision making,  
continual communication with members of management who can supply information,  
and  
continual communication with the auditor in accordance with the *CIA/CICA Joint Policy Statement*.

## **2450 REPORT ON MATTERS REQUIRING RECTIFICATION**

- .01 *The appointed actuary should identify and monitor matters that may threaten the insurer's financial condition. The appointed actuary should investigate and then report any such matter which requires rectification to the senior management and, in the case of a Canadian insurer, send a copy of the report to the directors. The report may include recommendations for rectification and should specify a deadline for rectification that the actuary may later extend if appropriate. If there is no suitable rectification by that deadline or its extension, then the appointed actuary should report the matter to the insurer's regulator. [Effective January 1, 2003]*
- .02 The sensitivity of financial condition to adverse conditions and events varies among insurers. For example, an increase in withdrawal rates among policies may be devastating in one life insurer and may be beneficial in another. Financial condition and hence, the magnitude of the conditions and events that may threaten it, also varies among insurers.
- .03 The frequency and intensity of the monitoring depend on the threatening conditions and events and on the circumstances of the insurer. A quarterly review would usually be a minimum.
- .04 There would be no such report to senior management of an adverse condition that does not threaten the insurer's financial condition. Informal notification and consultation would usually precede, and may obviate, that report to senior management.
- .05 That report would describe the threatening condition or event and the methods and assumptions in the actuary's investigation of it. It is desirable that the report includes recommendations for its rectification.
- .06 The deadline would allow time, that is reasonable in the circumstances to arrange rectification.
- .07 The report to the regulator would describe the actuary's investigation, the report to senior management, and senior management's response to that report. The actuary would advise the directors of the report to the regulator.

## **2460 REPORT TO THE DIRECTORS**

- .01 *The appointed actuary for a Canadian insurer should report at least yearly to the directors, or to their audit committee if the directors so delegate,*  
*on the insurer's financial position and financial condition, and*  
*if required by law,*  
*if the insurer has one or more participating accounts,*  
*on the method of allocation of income and expenses to each such participating account,*  
*on the management of the participating account(s), the dividend policy and dividend scales for the participating policy owners, and*  
*if the insurer has adjustable policies in force, on the criteria established or amended by the directors 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.*
- .02 *The appointed actuary for a foreign insurer should report at least yearly to its chief agent for Canada on its financial position and financial condition.* [Effective December 1, 2011]

### **Allocation of income**

- .03 The report on allocation of income and expenses among accounts would consider the fairness and equity of such allocation to participating policy owners.

### **Management of the participating account(s)**

- .03.1 The report on the management of the participating account(s) would consider the fairness to participating policy owners of the policy established by the directors respecting the management of the participating account(s).

### **Dividend policy and dividend scale**

- .04 The report on the dividend policy would consider the fairness of the policy to the participating policy owners. The report on the dividend scale would consider the conformity of the dividend scale to the dividend policy and its fairness to the participating policy owners.

### **Adjustments of adjustable policies**

- .05 The report on adjustable policies would consider the fairness of the criteria for changes to adjustable policies established or amended by the directors, the fairness to adjustable policy owners of the adjustments made and their conformity to those criteria.

## **Fairness Opinions**

- .06 Where the applicable law requires that the appointed actuary opine on the fairness of the policies, criteria or methods established by the insurer with respect to any of
- management of the participating accounts,
  - dividend policy,
  - dividends declared,
  - policy established respecting the criteria for making adjustments to adjustable policies and the adjustments made under this policy,
  - allocation of investment income to the participating accounts, and
  - allocation of expenses to the participating accounts,
- the wording of an unqualified opinion would be as follows,

### **Management of participating accounts opinion**

I have reviewed the policy established by the Board of Directors with respect to the management of the participating accounts of [the Company], [including amendments made during the most recent 12 months]. I conducted my review in accordance with accepted actuarial practice in Canada and pursuant to the guidance of the Superintendent of Financial Institutions.

In my opinion, the policy is fair to the participating policyholders.

Mary F. Roe  
Fellow, Canadian Institute of Actuaries  
[Place of issue of opinion]  
[Date of opinion]

**Dividend policy opinion**

I have reviewed the policy established by the Board of Directors for determining the dividends [and bonuses or other benefits] of [the Company], [including amendments made during the most recent 12 months]. I conducted my review in accordance with accepted actuarial practice in Canada and pursuant to the guidance of the Superintendent of Financial Institutions.

In my opinion, the policy is fair to the participating policyholders.

Mary F. Roe  
Fellow, Canadian Institute of Actuaries  
[Place of issue of opinion]  
[Date of opinion]

**Dividend declaration opinion**

I have reviewed the proposed dividends [and bonuses or other benefits], determined by the Board of Directors of [the company] with respect to policy years [ending between XX and YY], and have considered whether they have been determined in accordance with the policy established by the Board. I conducted my review in accordance with accepted actuarial practice in Canada and pursuant to the guidance of the Superintendent of Financial Institutions.

In my opinion, the proposed dividends [and bonuses or other benefits] are in accordance with the policy established by the Board and are fair to the participating policyholders.

Mary F. Roe  
Fellow, Canadian Institute of Actuaries  
[Place of issue of opinion]  
[Date of opinion]

**Adjustable policy changes opinion**

I have reviewed the criteria established by the Board of Directors of [the company] with respect to any changes to be made to the premium or charge for insurance, amount of insurance or surrender value in respect of its adjustable policies [including amendments made during the most recent 12 months] and the changes made pursuant to those criteria. I conducted my review in accordance with accepted actuarial practice in Canada and pursuant to the guidance of the Superintendent of Financial Institutions.

In my opinion, the criteria are fair to the adjustable policyholders, and the changes made to the adjustable policies during the most recent 12 months are in accordance with those criteria and are fair to the adjustable policyholders.

Mary F. Roe  
Fellow, Canadian Institute of Actuaries  
[Place of issue of opinion]  
[Date of opinion]

**Allocation of investment income to participating account(s) opinion**

I have reviewed the method established by the Board of Directors for determining the portion of the investment income or losses of [the company] for the financial year ending [XX], including capital gains and losses, that is allocable to the participating account [each participating account] maintained by the company. I conducted my review in accordance with accepted actuarial practice in Canada and pursuant to the guidance of the Superintendent of Financial Institutions.

In my opinion, the method is fair and equitable to the participating policyholders.

Mary F. Roe  
Fellow, Canadian Institute of Actuaries  
[Place of issue of opinion]  
[Date of opinion]

### **Allocation of expenses to participating account(s) opinion**

I have reviewed the method established by the Board of Directors for determining the portion of the expenses, including taxes, of [the company] for the financial year ending [XX] that is allocable to the participating account [each participating account] maintained by the company. I conducted my review in accordance with accepted actuarial practice in Canada and pursuant to the guidance of the Superintendent of Financial Institutions.

In my opinion, the method is fair and equitable to the participating policyholders.

Mary F. Roe

Fellow, Canadian Institute of Actuaries

[Place of issue of opinion]

[Date of opinion]

- .07 If the appointed actuary is unable to issue an unqualified opinion, the wording of the opinion would be adjusted to reflect the necessary qualification.

### **2470 COMMUNICATION WITH THE AUDITOR**

- .01 Communication with the insurer's auditor would be desirable when the actuary makes a report to the insurer's senior management on a matter requiring rectification or makes an unfavourable report on the insurer's financial condition.

### **2480 CERTIFICATION OF CAPITAL FILINGS AS REQUIRED BY THE REGULATOR**

- .01 This subsection 2480 applies to the appointed actuary of a life insurer when giving an opinion on the appropriateness of capital requirement calculations pursuant to law or on the appropriateness of internal models used to determine required capital for segregated fund guarantees pursuant to requirements of the regulator.
- .02 *Such certifications should contain an opinion signed by the appointed actuary.*

#### **Appropriateness of capital requirement calculations**

- .03 *The appointed actuary should prepare a report to support the opinion on the appropriateness of capital requirement calculations that outlines the areas where the calculation required discretion or significant technical calculations, and the methodologies and judgments that were applied. The report should be completed before the provision of a signed opinion pursuant to subsection 2480. [Effective February 8, 2013]*
- .04 The opinion would be provided annually in support of the fiscal year-end regulatory capital filing on form(s) as directed by the regulator.

.05 In providing such an opinion, the actuary would not be opining on whether the underlying factors or specified methods to be followed are appropriate but rather on the appropriateness of any interpretation and discretionary technical calculations and methods with respect to such guidelines.

.06 .Here is the standard opinion language [insert appropriate wording where indicated by square brackets].

“I have reviewed the calculation of the Minimum Continuing Capital and Surplus Requirement ratios of [company name] as at [date]. In my opinion, the calculations of the components of the required and available capital have been determined in accordance with the regulatory guidelines, and the components of the calculations requiring discretion were determined using methodologies and judgement appropriate to the circumstances of the company.”

[Note: For Test of Adequacy of Assets in Canada form filings “Minimum Continuing Capital and Surplus Requirement ratios” and “required and available capital” are replaced by “test of adequacy ratio” and “required and available margin”.]

[Note: For filings for provincially-regulated companies, the ratio definition, and definitions of required and available resources, should be amended to reflect the appropriate definitions in the provincial requirements.]

**Appropriateness of internal models used to determine required capital for segregated fund guarantees**

.07 *The appointed actuary should prepare a report to support the opinion on the appropriateness of internal models used to determine required capital for segregated fund guarantees that outlines how the models comply with the related requirements of the regulator. The report should be completed before the provision of a signed opinion pursuant to subsection 2480. [Effective February 8, 2013]*

.08 The opinion would be provided annually in support of the fiscal year-end regulatory capital filing on form(s) as directed by the regulator. The opinion would also be provided to the regulator upon a new application to the regulator for permission to use such a model for required capital purposes and upon request of the regulator when making a modification to an existing model approved by the regulator.

.09 In providing such an opinion, the actuary would not be opining on whether the underlying factors or specified methods to be followed are appropriate, but rather on the compliance with the requirements of the regulator.



.10 Here is the standard opinion language [insert appropriate wording where indicated by square brackets].

“I have reviewed the internal model of [company name] for determining required capital for segregated fund guarantee risks as at [date] in the context of the requirements of [the regulator]. In my opinion, the [proposed] model is compliant in all material respects with the requirements of [the regulator] for an approved model used to determine required capital for segregated fund guarantee risks.”

## 2500 DYNAMIC CAPITAL ADEQUACY TESTING

### 2510 SCOPE

- .01 This section 2500 applies to the appointed actuary of an insurer when preparing a report on the insurer's financial condition pursuant to law.

### 2520 INVESTIGATION

- .01 *The appointed actuary should make an investigation at least once during each financial year of the insurer's recent and current financial position, and financial condition, as revealed by dynamic capital adequacy testing for selected scenarios.*
- .02 *The appointed actuary should make a report of each investigation in writing to the insurer's board of directors (or to their audit committee if they so delegate) or its chief agent for Canada. The report should identify possible actions for dealing with any threats to satisfactory financial condition that the investigation reveals.*
- .03 *The appointed actuary should also make an interim investigation if there is a material adverse change in the insurer's circumstances.*
- .04 *The appointed actuary should ensure that the investigation is current. The investigation should take into consideration recent events and recent financial operating results of the insurer. [Effective December 31, 2011]*
- .05 The actuary's investigations would be done with a frequency sufficient to support timely corrective actions by management and the board of directors or chief agent for Canada.

#### **Recent and current financial position**

- .06 The investigation would review operations of recent years (normally at least three years) and the financial position at the end of each of those years.

#### **Dynamic capital adequacy testing**

- .07 Dynamic capital adequacy testing examines the effect of selected plausible adverse scenarios on the insurer's forecasted capital adequacy. It would be one of the actuary's primary tools for investigation of an insurer's financial condition.
- .08 The purpose of dynamic capital adequacy testing is to identify plausible threats to satisfactory financial condition, actions that would lessen the likelihood of those threats, and actions that would mitigate a threat if it materialized.

- .09 Dynamic capital adequacy testing is defensive, i.e., it addresses threats to financial condition rather than the exploitation of opportunity.

### **Satisfactory financial condition**

- .10 The insurer's financial condition would be satisfactory if throughout the forecast period, under the base scenario and all plausible adverse scenarios, the statement value of the insurer's assets is greater than the statement value of its liabilities, and under the base scenario, the insurer meets the supervisory target capital requirement.

### **Data, methods and assumptions**

- .11 The actuary would start the forecast period using the data as of the most recent available fiscal year-end balance sheet date.
- .12 The methods and assumptions would reflect up-to-date studies and analysis available to the actuary.
- .13 The policy liabilities would be revalued at the end of the first financial year of the forecast period if a change in method or assumptions that is expected to be made by the insurer would result in a material change to the financial position of the insurer.
- .14 The actuary would consider recent events and recent operating results of the insurer up to the date of the report.
- .15 If an adverse event occurs between the date of the report and the date of its presentation to the insurer's board of directors (or its chief agent for Canada), then the actuary would, at a minimum in the presentation to the insurer's board of directors (or its chief agent for Canada), address the event and its potential implications on the results of the investigation. If appropriate, the actuary would redo the investigation.

### **Forecast period**

- .16 The forecast period would begin at the most recent available fiscal year-end balance sheet date. The forecast period for a scenario would be sufficiently long to capture the effect of its adversity and the ability of management to react. The forecast period for a typical life insurer would not be less than five fiscal years. The forecast period for a typical property and casualty insurer would not be less than three fiscal years.

### **Scenarios**

- .17 The scenarios would consist of a base scenario and several plausible adverse scenarios. Each scenario takes into account not only in-force policies but also the policies assumed to be sold or acquired during the forecast period, and both insurance and non-insurance operations (for example, the operations of an insurer's trust company subsidiary).

### **Base scenario**

- .18 The base scenario would be a realistic set of assumptions used to forecast the insurer's financial position over the forecast period. Normally, the base scenario would be consistent with the insurer's business plan. The actuary would accept the business plan's assumptions for use in the base scenario unless these assumptions are so inconsistent or unrealistic that the resulting report would be misleading. The actuary would report any material inconsistency between the base scenario and the business plan.

### **Plausible adverse scenarios**

- .19 A plausible adverse scenario would be a scenario of adverse, but plausible, assumptions about matters to which the insurer's financial condition is sensitive. Plausible adverse scenarios vary among insurers and may vary over time for a particular insurer.
- .20 The actuary would consider material, plausible risks or events to the insurer. Reverse stress testing can help assess whether certain risk factors need to be tested, on the grounds that certain risk factors could never deteriorate to the point where it would be a threat to the insurer's financial condition. The actuary can thereby determine whether a material, plausible risk or event exists for the insurer over the forecast period.

### **Risk categories**

- .21 For life insurers, the actuary would consider threats to capital adequacy under plausible adverse scenarios that include, but are not limited to, the risk categories
- mortality,
  - morbidity,
  - persistence and lapse,
  - cash flow mismatch (C-3 risk),
  - deterioration of asset values (C-1 risk),
  - new business,
  - expenses,
  - reinsurance,
  - government and political issues,
  - counterparty,
  - off-balance-sheet items, and
  - related companies.

- .22 For property and casualty insurers, the actuary would consider threats to capital adequacy under plausible adverse scenarios that include, but are not limited to, the risk categories
- claim frequency and severity,
  - policy liabilities,
  - inflation,
  - premium,
  - reinsurance,
  - investment,
  - government and political issues,
  - off-balance-sheet items, and
  - related companies.

### **Integrated scenarios**

- .23 In many cases, plausible adverse scenarios would be associated with a low probability of occurrence. In such cases, it would usually not be necessary for the actuary to construct integrated scenarios by combining two or more low-probability adverse scenarios.
- .24 In some cases, however, the probability associated with a plausible adverse scenario may be close to the probability associated with the base scenario. For example, a significant asset on the balance sheet may be showing early signs of distress. In such cases, an integrated scenario would be constructed by combining each more probable adverse scenario with a low-probability adverse scenario. The low-probability adverse scenario selected would be the one that has the greatest effect on the insurer's financial condition and is plausible when combined with the more probable adverse scenario.
- .25 An integrated scenario would be included in the minimum of three plausible adverse scenarios required by paragraph 2520.33 if the integrated scenario was found to be one of the three most adverse scenarios.

### **Ripple effects**

- .26 In assuring consistency within each scenario, the actuary would consider ripple effects. Although most of the other assumptions used in the base scenario may remain appropriate under the plausible adverse scenario, some may require adjustment to reflect the interdependence of assumptions in the plausible adverse scenario.

- .27 Ripple effects would include both policy owner action and the insurer's expected response to adversity. Selection of the assumptions for the insurer's response would, where appropriate, take into account
- effectiveness of the insurer's management information systems and adjustment mechanisms,
  - insurer's historical record of promptness and willingness, when faced with adversity, to make difficult decisions, and
  - external environment assumed in the scenario.
- .28 The actuary would report the expected response, so that users may consider its practicality and adequacy. The actuary may also report the results assuming that the insurer does not respond to the adversity.
- .29 Ripple effects also include regulatory action, especially under any plausible adverse scenario where the insurer fails to meet the supervisory target capital requirement. The actuary would consider action that could be taken by the Canadian regulator(s) as well as action taken by regulators in foreign jurisdictions. Such regulatory action and associated management response would consider the local assessment of solvency regardless of the insurer's worldwide solvency position as measured by Canadian regulatory standards.

### **Corrective management actions**

- .30 For each of the plausible adverse scenarios that would result in a threat to satisfactory financial condition, the actuary would identify possible corrective management actions that would lessen the likelihood of that threat, or that would mitigate that threat, if it materialized. These actions could include but are not limited to
- repricing the insurance products,
  - suspending dividend payments, capital reductions and transfers to the parent or home office, where applicable,
  - raising additional capital or adopting an approved plan to raise additional capital if and when needed within a reasonable timeframe, or, in the case of a branch, requesting transfer of adequate funds from the parent company,
  - strengthening risk management practices,
  - mitigating the risk causing the capital shortfall, and
  - an increased level of monitoring and reporting with respect to the insurer's capital position.
- .31 Consideration would also be given to the effectiveness of planned management actions in a volatile or stressed environment.

### **Scope of the investigation and report**

- .32 The report would contain the key assumptions of the base scenario and the plausible adverse scenarios posing the greatest risk to the satisfactory financial condition of the insurer.
- .33 The report would disclose each of the risk categories considered in undertaking the dynamic capital adequacy testing analysis, including those identified in these Standards of Practice. It is expected that the actuary would scenario test and report at least once during each financial year on the base scenario, and a minimum of three plausible adverse scenarios posing the greatest risk for the insurer. Fewer than three plausible adverse scenarios may be reported only in the rare event that it is not possible to develop such scenarios.
- .34 The report would also contain the plausible adverse scenarios examined that cause the insurer to fall below the supervisory target capital requirement. The report would make it clear that under these scenarios the regulators may impose restrictions on the operations of the insurer, including its ability to write new business.
- .35 If the investigation identifies any plausible threat to satisfactory financial condition, then the actuary would identify possible corrective management action that would lessen the likelihood of that threat, or that would mitigate that threat, if it materialized. For each such adverse scenario reported upon, the actuary would report the results both with and without the effect of corrective management action. The actuary would report the corrective management action so that users may consider its practicality and adequacy.
- .36 The report would present the financial position of the insurer at each fiscal year-end throughout the forecast period.

### **Revaluation of the policy liabilities**

- .37 Ideally, for the base and each plausible adverse scenario, the insurance contract liabilities and, if applicable, other policy liabilities or reinsurance recoverables, would be revalued throughout the forecast period. But their revaluation only at the end of the forecast period may be a suitable compromise, unless the actuary believes, given the financial position at the end of the forecast period, that the financial condition would not be satisfactory at some point during the forecast period if revaluation were performed at that point.

### **Interim investigation**

- .38 In rare cases, a material adverse change in the insurer's circumstances since the last investigation may be so far-reaching that to delay reporting to the time of the next scheduled investigation would be imprudent. For example, failure to meet the supervisory target capital requirement, or adoption of a radically different business plan, may make an immediate report urgent. In such a case, the actuary would undertake and report on an interim investigation.

## **2530 REPORTING**

- .01 *In the case of a Canadian insurer, the appointed actuary should report to the board of directors or to their audit committee if they so delegate. In the case of a Canadian branch of a foreign insurer, the appointed actuary should report to the chief agent for Canada and may also report to the responsible senior executive in the parent head office. [Effective December 31, 2011]*
- .02 In order to give the insurer's senior management an opportunity to react to the results of the investigation, the actuary would discuss the report with the insurer's senior management in advance of its submission to the board of directors or chief agent for Canada.
- .03 The report would be in writing, but an additional oral report that permits questions and discussions is desirable. An interpretative report would be more useful than a statistical report.
- .04 The timing of the report would depend on the urgency of the matters being reported and on the desirability of integrating dynamic capital adequacy testing into the insurer's financial planning cycle. The report would be submitted within 12 months following each fiscal year-end.

## **2540 OPINION BY THE ACTUARY**

- .01 *The report should contain an opinion signed by the appointed actuary. [Effective December 31, 2011]*
- .02 In this opinion, "future financial condition" has the same meaning as "financial condition." The actuary may use the words "future financial condition" in order to comply with legislation or regulation in some jurisdictions.



.03 The wording of the opinion follows: [insert appropriate wording where indicated by square brackets]

“I have completed my investigation of the [future] financial condition of [insurer name] as at [date] in accordance with accepted actuarial practice in Canada.

I have analyzed the forecasted financial positions of the insurer during the [number] year forecast period under a series of scenarios. A description of these scenarios and their impact on the insurer is included within this report.

The most significant assumptions are described within this report. The investigation incorporates assumptions relating to business growth, investments, [mortality, morbidity, claims frequency, capital injections, other policy-related experience] and other internal and external conditions during the forecast period.

My report includes the identification of key risk exposures [and corrective management actions that could be taken to mitigate the effect of plausible adverse scenarios].

In my opinion, the [future] financial condition of the insurer [is satisfactory or is not satisfactory for the following reason(s)...]”

[Montréal, Québec]  
[Report date]

[Mary F. Roe]  
Fellow, Canadian Institute of Actuaries

**2600 RATEMAKING: PROPERTY AND CASUALTY INSURANCE**

**2610 SCOPE**

- .01 This section 2600 applies to the derivation of indicated rates for an insurance contract of property and casualty insurance written by an insurer, a reciprocal insurance exchange or an underwriting syndicate.
- .02 This section 2600 does not apply to the derivation of indicated rates for public personal injury compensation plans covered by the Practice-Specific Standards for Public Personal Injury Compensation Plans.
- .03 This section 2600 applies to the derivation of indicated rates for any entity, such as a residual market mechanism or an advisory organization, which derives indicated rates for an insurance contract to be written by an insurer, regardless of whether or not that entity is itself an insurer.
- .04 This section 2600 applies to the derivation of indicated rates, but not to the recommendation or selection of rates to be charged. The recommended or selected rates may reflect considerations beyond those set forth in this section 2600.
- .05 This section 2600 also applies to the derivation of indicated rates for insurance risks accepted by a property and casualty quasi-insurer, similar to insurance risks accepted under an insurance contract. In this section 2600, “property and casualty quasi-insurer” means an entity that assumes insurance risks that a property and casualty insurer may assume, without having the legal form of an insurer. Examples of property and casualty quasi-insurers include
- federal or provincial crown corporations or agencies acting in a capacity similar to a property and casualty insurer,
  - providers of extended warranties, and
  - self-funding mechanisms, such as those created by members of a professional association, or entities that retain some or all of their property and casualty insurance risk.

**2620 METHOD**

- .01 *The best estimate present value of cash flows relating to the revenue at the indicated rate should equal the best estimate present value of cash flows relating to the corresponding claim costs and expense costs, plus the present value of a provision for profit, over a specified period of time.*

- .02 *The actuary should select appropriate methods, techniques and assumptions recognizing that such elements depend on the circumstances of the case and that a variety of actuarial methods may be appropriate to derive an indicated rate. [Effective January 1, 2012]*

**Data**

- .03 The actuary would consider the availability and relevance of subject experience and related experience.

**Credibility**

- .04 The actuary would consider the blending of information from subject experience with information from one or more sets of related experience to improve the predictive value of estimates.

**Changes in circumstances**

- .05 The actuary would consider that the subject experience, related experience and future cash flows may be affected by changes in circumstances that may affect expected claim costs, expense costs, and provision for profit.

- .06 Relevant circumstances subject to change may include items that are largely under the control of the entity providing insurance, such as

- underwriting practice,
- distribution system,
- claims handling and case estimate setting practice,
- reinsurance arrangements,
- data processing and accounting systems,
- distribution or type of business written,
- provisions of the insurance contract(s), when not legislated,
- premium rates, and
- rating variables,

as well as items that are largely not under the control of the entity providing insurance, such as

- legislated coverage or benefits, and
- the economic, social and legal environments.

**Development**

- .07 The actuary would consider that subject experience and related experience may be subject to development over time.

### **Trend**

- .08 The actuary would consider that subject experience and related experience may be subject to trend over time.

### **Unusual events**

- .09 The actuary would consider that subject experience and related experience may or may not have been subject to catastrophes, large losses or other unusual events.

### **Provision for Expense Costs**

- .10 The actuary would determine the provision for expense costs that is appropriate for the period during which the rates are expected to be in effect.

- .11 In selecting a provision for expense costs, the actuary would consider
- the various categories of expense costs that are incurred including, as may be applicable, residual market assessments, statutory assessments, policyholder dividends, and reinsurance costs,
  - that expense costs may not be directly proportional to premium, and
  - that one-time expense costs may need to be amortized.

- .12 The provision for expense costs, or other assumptions that are pertinent to its derivation, may be specified to the actuary under the terms of an appropriate engagement.

### **Provision for Profit**

- .13 An indicated rate would include a provision for profit.
- .14 The provision for profit, or other assumptions that are pertinent to its derivation, may be specified to the actuary under the terms of an appropriate engagement.

### **Time Value of Money**

- .15 The investment return rate for calculating the present value of cash flows would reflect the expected investment income to be earned on assets that might be acquired with the net cash flows resulting from the revenue at the indicated rate.

- .16 Among various possible sets of such assets the actuary would consider
- default-free assets of appropriate duration,
  - fixed income assets of appropriate duration, and
  - assets which are expected to be acquired.

- .17 The actuary would consider the fact that the provision for profit is not independent of the selected investment return rate and its associated uncertainty.

### **2630 REPORTING**

- .01 *If an external user report is required and the actuary can report without reservation, the actuary's report should include the standard reporting language consisting of the following scope paragraph,*

I have derived the indicated rate(s) in accordance with accepted actuarial practice in Canada, on behalf of [entity commissioning the work], for the following insurance category(ies): [name of insurance category(ies)], to be effective Month XX, 20XX for new business and Month XX, 20XX for renewal business.

- .02 *If an external user report is required and the actuary cannot report without reservation, the actuary should modify the standard reporting language accordingly. [Effective January 1, 2012]*

- .03 An additional opinion paragraph may be included to conform to the requirements of an external user.

<b>2700 POLICYHOLDER DIVIDEND DETERMINATION</b>
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**2710 SCOPE**

- .00 Part 1000 applies to work within the scope of this section 2700.
- .01 Section 2700 applies to advice provided on policyholder dividend determination on individual life, annuity and health policies.

**2720 REPORT ON POLICYHOLDER DIVIDENDS**

- .01 *There should be a written report which documents the advice on policyholder dividend determination, and which describes the framework of facts, assumptions and procedures upon which the advice was based.*
- .02 *The report should include:*
  - a description of the process used to determine dividends;*
  - the manner in which policy and experience characteristics are reflected in that process; and*
  - the methodology used to calculate dividends, including specific factors used to reflect policy and experience characteristics.*
- .03 *The report should state whether or not the contribution principle has been followed, and, if it has not been followed, the report should describe any deviations and their rationale.*  
[Effective January 1, 2014]

**3000 – PENSION PLANS**

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## 3100 SCOPE

.00 Part 1000 applies to work within the scope of this part 3000.

.01 The standards in part 3000 apply as follows:

- Section 3200 applies to advice that an actuary provides regarding the funded status or funding of a pension plan, except where such advice is with respect to:
  - The wind-up, in full or in part, of a pension plan; or
  - The financial reporting of a pension plan's costs and obligations in the employer's or the pension plan's financial statements;
- Section 3300 applies to advice that an actuary provides on the funded status or funding with respect to the wind-up, in full or in part, of a pension plan;
- Section 3400 applies to advice that an actuary provides with respect to financial reporting of a pension plan's costs and obligations in the employer's or the pension plan's financial statements; and
- Section 3500 applies to advice that an actuary provides regarding the computation of commuted values in the circumstances described in subsection 3510.

The wind-up of a pension plan involves the settlement of plan benefits and distribution of all plan assets. The cessation of benefit accruals or termination of a plan, not involving the settlement of plan benefits and distribution of plan assets, would not constitute a plan wind-up.

.02 The standards in sections 3200 through 3400 apply to advice with respect to a pension plan, including any arrangement that provides retirement income to its members, whether funded or not, whether registered or not, and whether in the private or public sector, except for:

- A defined contribution pension plan (noting that the standards do apply, however, to any pension plan that is a hybrid of a defined contribution pension plan and a defined benefit pension plan);
- A pension plan whose benefits are all guaranteed by a life insurer; and
- Social security programs such as the Canada Pension Plan, Québec Pension Plan, and the pension provided by the federal Old Age Security Act.

**3200 ADVICE ON THE FUNDED STATUS OR FUNDING OF A PENSION PLAN**

.01 This section 3200 applies to advice that an actuary provides regarding the funded status or funding of a pension plan, except where such advice is with respect to:

- The wind-up, in full or in part, of a pension plan; or
- The financial reporting of a pension plan's costs and obligations in the employer's or the pension plan's financial statements.

**3210 GENERAL**

.01 *The actuary's advice on the funded status or funding of a pension plan should take account of the circumstances of the work.*

.02 *The actuary should select an actuarial cost method that is consistent with the circumstances of the work.*

.03 *The actuary should select an asset valuation method that is consistent with the circumstances of the work.*

.04 *The actuary's advice on the funded status of a pension plan should take account of the pension plan's benefits at the calculation date, except that the actuary's advice may anticipate a pending amendment to the pension plan that increases the value of its benefits.*

.05 *The actuary's advice on the funded status or funding of a pension plan should take account of expenses if they are expected to be paid from the pension plan's assets.*

.06 *The actuary's advice on the funded status or funding of a pension plan may, consistent with the circumstances of the work, take into account the value and the terms of a letter of credit of which the pension plan is the beneficiary.*

.07 *If the actuary is providing advice on funding:*

- *The actuary should determine the next calculation date, and*
- *The actuary's advice on funding should cover at least the period between the calculation date and the next calculation date. [Effective December 31, 2010]*

### **Circumstances of the work**

- .08 For the purposes of section 3200, the circumstances of the work would include:
- Whether the actuary's advice relates to the funded status or the funding of the pension plan, or a combination thereof;
  - The terms of the appropriate engagement under which the work is being performed; and
  - The application of the law to the work.
- .09 In the case of a pension plan registered under the Income Tax Act (Canada), the actuary would be familiar with guidance with respect to the funding of pension plans that has been published by an applicable regulatory authority.
- .10 Advice on funding would include:
- A valuation to establish the amount of a letter of credit to secure the payment of pension plan benefits;
  - Advice regarding an amount of assets to be earmarked, but not segregated, to a trust fund, to cover pension benefit commitments; and
  - Advice on the funding implications of a plan amendment.
- .11 The terms of an appropriate engagement may specify applicable objectives of funding, which may include a formal or informal funding policy. For example, the terms of an appropriate engagement for a pension plan registered under the Income Tax Act (Canada):
- May be limited to preparation of an external user report on the basis of applicable law including the minimum contributions required by law;
  - May require the preparation of an external user report recommending contributions reflecting objectives of funding specified by the plan sponsor or plan administrator, as applicable, in addition to the requirements of law; and
  - Where contributions are fixed, may require the preparation of an external user report reflecting objectives of funding specified by the plan administrator or other appropriate authority, as applicable in addition to the requirements of law.
- .12 The terms of an appropriate engagement may specify the use of a particular actuarial cost method and/or a particular asset valuation method, consistent with these standards.
- .13 Objectives of funding specified by the terms of an appropriate engagement may include considerations such as the security of benefits and related provisions for adverse deviations, the orderly and rational allocation of contributions among time periods, and/or inter-generational equity.

.14 Depending on the circumstances of the work, the actuary's advice on funding may describe a range of contributions.

### **Actuarial cost methods**

.15 Actuarial cost methods include:

- Cost allocation methods, which allocate the actuarial present value of projected benefits among time periods, including attained age actuarial cost methods, entry age actuarial cost methods, aggregate actuarial cost methods, and individual level premium actuarial cost methods;
- Benefit allocation methods, which allocate a portion of the actuarial present value of projected benefits to a time period as a function of the change in accrued or projected benefits during the period, including the accrued benefit actuarial cost method, the unit credit actuarial cost method and the projected unit credit actuarial cost method; and
- Forecast actuarial cost methods, which allocate a portion of the actuarial present value of projected benefits to the forecast period based on:

- The actuarial present value, at the calculation date, of projected benefits at the end of the forecast period including, if appropriate, benefits for those who are expected to become members between the calculation date and the end of the forecast period;

minus

- The actuarial present value of projected benefits at the calculation date;

plus

- The actuarial present value, at the calculation date, of benefits expected to be paid during the forecast period.

.16 When using a forecast actuarial cost method, the beginning and ending actuarial present value of projected benefits may be calculated from the perspective of either a hypothetical wind-up valuation or a going concern valuation.

### **Asset valuation methods**

.17 The use of an asset valuation method that produces an asset value different from market value may be appropriate depending on the circumstances of the work. For example, the use of a smoothed asset value may be appropriate to moderate the volatility of contribution rates for purposes of advice on funding.

- .18 The value of assets may be, subject to specific requirements for different types of valuation, any of:
- Their market value;
  - Their market value adjusted to moderate volatility in investment returns;
  - The present value of their cash flows after the calculation date; and
  - Their value assuming a constant rate of return to maturity in the case of illiquid assets with fixed redemption values.

#### **Deferred recognition of pending amendment**

- .19 If, at the calculation date, an amendment to the pension plan is definitive or virtually definitive:
- If the effective date of the amendment is during the period for which the report gives advice on funding, then the advice on funding up to the effective date may disregard the amendment, unless otherwise required by law, but the advice on funding after the effective date would take the amendment into account; or
  - If the effective date of the amendment is after the period for which the report gives advice on funding, then the advice on funding may disregard the amendment unless otherwise required by law.

- .20 The effective date of the amendment is the date at which the amended benefits take effect, as opposed to the date at which the amendment becomes either definitive or virtually definitive.

#### **Next calculation date**

- .21 The next calculation date is the latest date for which the actuary considers the advice on funding to be applicable. The actuary would take into consideration the law and the terms of an appropriate engagement in determining the next calculation date.

### **3220 TYPES OF VALUATIONS**

- .01 *When giving advice on the funded status or funding of a pension plan, the actuary should undertake one or more types of valuations that are consistent with the circumstances of the work. [Effective December 31, 2010]*

#### **Types of valuations**

- .02 There are different types of valuations that an actuary may undertake when giving advice on the funded status or funding of a continuing pension plan, the most common of which are:
- A going concern valuation;
  - A hypothetical wind-up valuation; and
  - A solvency valuation.

### 3230 GOING CONCERN VALUATION

.01 *For a going concern valuation the actuary should:*

- *Assume that the plan continues indefinitely;*
- *Notwithstanding subsection 1740, select either best estimate assumptions or best estimate assumptions modified to incorporate margins for adverse deviations, as described in paragraph 1740.40, to the extent, if any, required by law or by the terms of an appropriate engagement; and*
- *Consider all benefits of which the actuary is aware, including contingent benefits, payable under the pension plan and should include provision for all such benefits expected to be paid while the plan is ongoing unless:*
  - *The law requires the valuation to exclude such benefits; or*
  - *The law permits the exclusion of such benefits and the terms of an appropriate engagement stipulate that the actuary exclude such benefits. [Effective December 31, 2010]*

#### **Assumptions**

.02 For pension plans that are funded, in selecting the best estimate assumption for the discount rate, the actuary may either:

- Take into account the expected investment return on the assets of the pension plan at the calculation date and the expected investment policy after that date; or
- Reflect the yields on fixed income investments, considering the expected future benefit payments of the pension plan and the circumstances of the work.

.03 In establishing the discount rate assumption, the actuary would assume that there will be no additional returns achieved, net of investment expenses, from an active investment management strategy compared to a passive investment management strategy except to the extent that the actuary has reason to believe, based on relevant supporting data, that such additional returns will be consistently and reliably earned over the long term.

.04 If the plan is a “designated plan” as that term is defined in the Income Tax Regulations (Canada) and the purpose of the going concern valuation is to determine the maximum funding permitted by law, then the actuary would use assumptions stipulated by law for that purpose.

#### **Contingent benefits**

.05 An example of a contingent benefit relevant to a going concern valuation is a provision granting the employer or plan administrator the right to waive early retirement reductions to members retiring from active employment. In making provision for such a contingent benefit, the actuary would consider past experience, current circumstances and future expectations relating to the employer’s or plan administrator’s granting of such benefits.

### **Benefits stipulated by law**

- .06 If the plan is a “designated plan”, as that term is defined in the Income Tax Regulations (Canada), and the purpose of the going concern valuation is to determine the maximum funding permitted by law, then the actuary would reflect the benefits stipulated by law for that purpose.

### **3240 HYPOTHETICAL WIND-UP VALUATION**

- .01 *A hypothetical wind-up valuation determines the funded status of a pension plan on the assumption that the plan is wound up at the calculation date. The standards for a full wind-up valuation in section 3300 apply to a hypothetical wind-up valuation except for the external user report requirements therein and as superseded by the following recommendations.*

- .02 *For a hypothetical wind-up valuation, the actuary should determine benefit entitlements on the assumption that the pension plan has neither a surplus nor a deficit.*

- .03 *In determining the benefit entitlements, the actuary should postulate a scenario upon which the hypothetical wind-up valuation is based, taking account of the circumstances of the work.*

- .04 *The actuary should take account of contingent benefits that would be payable under the postulated scenario for the hypothetical wind-up.*

- .05 *For a hypothetical wind-up valuation, the actuary may assume that the wind-up date, the calculation date and the settlement date are coincident.*

- .05.1 *For a hypothetical wind-up valuation, the actuary may assume that benefits would be settled by the purchase of annuities regardless of any limitation of capacity in the market for group annuity contracts.*

- .06 *For a hypothetical wind-up valuation, the value of assets should be the market value of assets.*

- .07 *For a hypothetical wind-up valuation, the actuary should select an explicit assumption for expenses expected to be payable from the pension plan’s assets to wind up the pension plan.*  
[Effective September 18, 2013]

### **Membership data**

- .08 The precision of the membership data is less critical for a hypothetical wind-up valuation than for an actual wind-up valuation.

- .09 Since an actual wind-up is not occurring, pertinent membership data may not be available. The actuary would make appropriate assumptions regarding such missing membership data. For example, it may be appropriate to retroject current earnings based on aggregate historical pay increases in order to estimate final average earnings.

### **Postulation of scenarios**

.10 There are often multiple scenarios regarding the circumstances that may result in the wind-up of a pension plan. For a hypothetical wind-up valuation, the actuary may postulate any reasonable, internally consistent, scenario regarding the circumstances resulting in the wind-up of a pension plan, consistent with the circumstances of the work. For the postulated scenario, the actuary would reflect the treatment of any contingent benefits, including:

- Those that are contingent upon the wind-up scenario, such as a plant closure benefit; or
- Those that are required by law, such as a provision for earlier commencement of deferred pension entitlements in the event of plan wind-up; and
- Those that are contingent upon a factor other than the wind-up scenario.

.11 Examples of contingent benefits that are dependent upon factors other than the wind-up scenario or as required by law are:

- A provision granting the employer or plan administrator the discretion to waive early retirement reductions; and
- A provision providing enhanced benefits if funds are sufficient.

### **Subsequent events**

.12 The actuary may reflect subsequent events in the valuation provided that doing so either increases the actuarial present value of the projected benefits at the calculation date or reduces the value of the pension plan's assets at the calculation date.

### **Wind-up expenses**

.13 Since the actuary would assume that the pension plan has neither a surplus nor a deficit, wind-up expenses related to the resolution of surplus or deficit issues need not be considered.

.14 In developing the assumption for expenses expected to be payable from the pension plan's assets to wind up the pension plan, the actuary would also make an assumption as to the solvency of the employer. The assumption with respect to the payment of expenses and the assumption with respect to the solvency of the employer would be consistent.

### **Settlement Methods**

.15 A hypothetical wind-up valuation requires the actuary to select assumptions about the methods of settlement.

.16 The actuary may assume a settlement method permitted by law or any relevant regulatory policy or guideline.

.17 The actuary may assume settlement by means of a replicating investment portfolio if permitted by law or any regulatory policy or guideline, or where it is anticipated that annuities could not be purchased due to group annuity capacity limitations. The assumed replicating portfolio would provide for an appropriate level of security for the pension benefits covered.



.18 The actuary may incorporate assumptions as to the exercise of regulatory discretion, a change in law, or a plan amendment which would be required to enable a practical settlement of benefits. When making such assumptions, the actuary would consider any relevant regulatory policy, guidance, or precedent.

.19 For example, for a plan where pensions are indexed with the Consumer Price Index and where it is impractical to purchase annuities indexed with the Consumer Price Index, the actuary may assume that annuities would be purchased with indexing at a fixed percentage rate of comparable value to indexing in accordance with the plan provisions.

### **3250 SOLVENCY VALUATION**

.01 *A solvency valuation typically is a form of a hypothetical wind-up valuation required by law and the actuary should apply the standards for a hypothetical wind-up valuation unless:*

- *Otherwise required by law; or*
- *Otherwise permitted by law and stipulated by the terms of an appropriate engagement. [Effective December 31, 2010]*

.02 Examples of exceptions permitted by law for the preparation of a solvency valuation under the law of certain jurisdictions include:

- Use of a value of assets other than market value;
- Use of one or more assumptions that are not best estimate assumptions; or
- Exclusion of certain benefits from the valuation.

### **3255 OTHER VALUATIONS**

.01 *For a valuation that is not a going concern valuation, a hypothetical wind-up valuation, or a solvency valuation, the actuary should select actuarial methods and actuarial assumptions that are consistent with the terms of an appropriate engagement. [Effective December 30, 2012]*

.02 To the extent that a valuation is not a going concern valuation, hypothetical wind-up valuation, or solvency valuation, but has characteristics similar to one or more of these types of valuations, the actuary would consider any relevant standards for these types of valuations in undertaking the work.

.03 For example, a valuation for determining the required amount of a letter of credit for a supplemental plan is typically similar to a hypothetical wind-up valuation, but with the actuarial methods and actuarial assumptions stipulated by the terms of the engagement. In such circumstances, the actuary would consider the relevant standards for hypothetical wind-up valuations in undertaking the work.

### **3260 REPORTING: EXTERNAL USER REPORT**

.01 *An external user report on work pursuant to section 3200 should:*

- *Include the calculation date, the report date, and the next calculation date;*
- *Describe the sources of membership data, plan provisions, and the pension plan's assets, and the dates at which they were compiled;*
- *Describe the membership data and any limitations thereof;*
- *Describe the tests applied to determine the sufficiency and reliability of the membership data and plan asset data for purposes of the work;*
- *Describe the assets, including their market value and a summary of the assets by major category;*
- *Describe the pension plan's provisions, including the identification of any pending definitive or virtually definitive amendment;*
- *Disclose subsequent events of which the actuary is aware, whether or not the events are taken into account in the work, or, if there are no subsequent events of which the actuary is aware, include a statement to that effect;*
- *State the type of each valuation undertaken under the terms of the appropriate engagement; and*
- *Describe any significant terms of the appropriate engagement that are material to the actuary's advice.*

.02 *For each going concern valuation undertaken by the actuary, the external user report should:*

- *Describe the actuarial cost method;*
- *Describe the method used to value the pension plan's assets;*
- *Describe the assumptions used to determine the actuarial present value of projected benefits, including the extent of any margin for adverse deviations included with respect to each such assumption, and provide the rationale for each assumption that is material to the actuary's advice;*
- *Describe the rationale for any assumed additional returns, net of investment management expenses, from an active investment management strategy as compared to a passive investment management strategy, included in the discount rate assumption;*
- *Report the funded status at the calculation date and the service cost or the rule for calculating the service cost between the calculation date and the next calculation date;*
- *Disclose any pending but definitive or virtually definitive amendment of which the actuary is aware, and whether or not such amendment has been included in determining the funded status and the service cost;*

- Describe any contingent benefits provided under the pension plan and the extent to which such contingent benefits are included or excluded in determining the funded status and the service cost;
  - Describe any benefits that are not contingent benefits and that have been excluded in determining the funded status and the service cost; and
  - If there is no provision for adverse deviations, include a statement to that effect.
- .03 If an external user report includes one or more going concern valuations then the external user report should, for at least one such valuation included in the report, describe and quantify the gains and losses between the prior calculation date and the calculation date.
- .04 If an external user report includes one or more going concern valuations, other than a valuation for the purpose of determining the maximum funding permitted by law for a “designated plan”, as that term is defined in the Income Tax Regulations (Canada), then the external user report should, for at least one such valuation included in the report, report the effect of using a discount rate 1.0% lower than that used for the valuation on:
- The actuarial present value, at the calculation date, of projected benefits allocated to periods up to the calculation date; and
  - The service cost or the rule for calculating the service cost between the calculation date and the next calculation date.
- .05 For each hypothetical wind-up valuation and solvency valuation undertaken by the actuary, the external user report should:
- Describe the methods used to determine the reported liabilities;
  - Describe the assumptions used to determine the reported liabilities and provide the rationale for each assumption that is material to the actuary’s advice;
  - Describe the basis for inclusion and the amount considered in respect of a letter of credit of which the pension plan is the beneficiary;
  - Report the funded status at the calculation date;
  - Include a description of the postulated scenario; and
  - Include a description of the extent to which contingent benefits provided under the pension plan are included or excluded in determining the funded status.
- .06 If an external user report includes one or more hypothetical wind-up valuations or solvency valuations then, for any one such hypothetical wind-up valuation or solvency valuation, the external user report should:
- Report the incremental cost between the calculation date and the next calculation date, in respect of the defined benefit portion of the plan;
  - If the external user report does not include a going concern valuation, report the incremental cost between the calculation date and the next calculation date in respect of the defined contribution portion of the plan;
  - Describe the methods used to determine the incremental cost;

- Describe the assumptions used to determine the incremental cost and provide the rationale for each assumption that is material to the actuary's advice;
- Report the effect on the hypothetical wind-up or solvency liabilities, at the calculation date, of using a discount rate 1.0% lower than that used for the valuation; and
- If the external user report does not include a going concern valuation, describe and quantify the gains and losses between the prior calculation date and the calculation date;

unless

- The pension plan is a “designated plan” which has, as members, only persons “connected” with the employer as those terms are defined in the Income Tax Regulations (Canada); or
- The hypothetical wind-up valuation or solvency valuation is based on an extrapolation of results disclosed in a previous external user report.

.06.1 For each valuation that is not a going concern valuation, a hypothetical wind-up valuation, or a solvency valuation, the external user report should:

- Describe the methods used to determine the reported liabilities and/or service cost, as applicable;
- Describe the methods used to value the plan's assets, if any;
- Describe the assumptions used and provide the rationale for each assumption that is material to the actuary's advice; and
- Include a description of the extent to which contingent benefits provided under the pension plan are included or excluded.

.07 An external user report that provides advice on funding should:

- Describe the determination of contributions or a range of contributions between the calculation date and the next calculation date;
- If contributions are fixed by the terms of the plan or other governing documents, then either:
  - Report that the contributions are adequate to fund the pension plan in accordance with the law; or
  - Report that the contributions are not adequate to fund the pension plan in accordance with the law; and
    - Describe the contributions required to fund the pension plan adequately in accordance with the law;
    - Describe one or more possible ways in which benefits may be reduced such that the contributions would be adequate to fund the pension plan in accordance with the law; or

- Describe a combination of increases in contributions and reductions in benefits that would result in the funding being adequate to conform to the law.

.08 An external user report should provide the following four statements of opinion, all in the same section of the report and in the following order:

- A statement regarding membership data, which should usually be, “In my opinion, the membership data on which the valuation is based are sufficient and reliable for the purpose of the valuation.”;
- A statement as to assumptions, which should usually be, “In my opinion, the assumptions are appropriate for the purpose(s) of the valuation(s).”;
- A statement as to methods, which should usually be, “In my opinion, the methods employed in the valuation are appropriate for the purpose(s) of the valuation(s).”; and
- A statement as to conformity, which should be, “This report has been prepared, and my opinions given, in accordance with accepted actuarial practice in Canada.”

.09 An external user report should be sufficiently detailed to enable another actuary to assess the reasonableness of the valuation. [Effective December 30, 2012]

### **Membership data**

.10 Any assumptions and methods used in respect of insufficient or unreliable membership data would be described.

.11 The actuary may describe limitations on the tests conducted in the review of the data which has been determined to be sufficient and reliable for purposes of the valuation(s). For example, the actuary may describe that the data tests will not capture all possible deficiencies in the data and reliance is also placed on the certification of the plan administrator as to the quality of the data.

### **Types of valuations**

.12 The external user report may provide information with respect to multiple valuations, but would, as a minimum:

- If the pension plan is a registered pension plan and is not a “designated plan”, as that term is defined in the Income Tax Regulations (Canada), provide information with respect to:
  - A going concern valuation, if required by law or by the terms of an appropriate engagement;
  - A hypothetical wind-up valuation under the scenario regarding the circumstances resulting in the wind-up that, subject to paragraph 3260.19, maximizes the wind-up liabilities, unless the pension plan and the law do not define the benefits payable upon wind-up; and
  - Any other hypothetical wind-up or solvency valuation required by law;

- If the pension plan is a “designated plan” as that term is defined in the Income Tax Regulations (Canada), provide information with respect to:
    - A going concern valuation, if required by law or by the terms of an appropriate engagement;
    - A hypothetical wind-up valuation under the scenario regarding the circumstances resulting in the wind-up that, subject to paragraph 3260.19, maximizes the wind-up liabilities, unless the pension plan and the law do not define the benefits payable upon wind-up or the plan has, as members, only persons “connected” with the employer as that term is defined in the Income Tax Regulations (Canada); and
    - Any other hypothetical wind-up or solvency valuation required by law;
- and
- If the pension plan is not a registered pension plan, include information with respect to the types of valuations required by the circumstances of the work.

### **Significant terms of appropriate engagement**

.13 Significant terms of the appropriate engagement may include matters like:

- The use of a specified actuarial cost method;
- The use of a specified asset valuation method;
- The exclusion of benefits for purposes of a valuation, as permitted by law;
- The extent of margins for adverse deviations, if any, to be included in selecting assumptions;
- A policy to fund only the minimum contributions required by law; and
- Specified methodology for the determination of contribution requirements in excess of the requirements of law.

### **Service cost**

.13.1 For a plan that is a hybrid of a defined contribution pension plan and a defined benefit pension plan, the service cost for a going concern valuation would include the service cost in respect of both the defined contribution portion of the plan and the defined benefit portion of the plan.

### **Reporting gains and losses**

.14 The reported gains and losses for a going concern valuation would include the gain or loss due to a change in the actuarial cost method or a change in the method for valuing the assets and each significant change in assumptions and plan provisions determined at the calculation date. If an amendment to the pension plan prompts the actuary to change the assumptions, the actuary may report the combined effect of the amendment and the resultant change in assumptions.

### **Discount rate sensitivity**

- .15 When following the recommendations to illustrate the effect of a change in discount rate on a valuation, the actuary would maintain all other assumptions and methods as used in the underlying valuation.

### **Incremental cost**

- .15.1 The incremental cost for a hypothetical wind-up valuation or a solvency valuation represents the present value, at the calculation date, of the expected aggregate change in the hypothetical wind-up liability or solvency liability between the calculation date and the next calculation date, increased for expected benefit payments between the calculation date and the next calculation date.

### **Methods**

- .16 For each valuation included in the external user report for which there was a prior valuation, the description of the actuarial cost method would include a description of any change to the actuarial cost method used in the prior valuation and the rationale for such change.
- .17 For each valuation included in the external user report for which there was a prior valuation, the description of the method to value the assets would include a description of any differences in change to the asset valuation method used in the prior valuation and the rationale for such change.

### **Assumptions**

- .18 For each valuation included in the external user report for which there was a prior valuation, the description of assumptions would include a description of each change to the assumptions from the assumptions used in the prior valuation.
- .18.1 When describing the assumptions for methods of settlement for a hypothetical wind-up or solvency valuation, the actuary would describe any related limitations. For example:
- If the settlement method assumes that annuities would be purchased but it might not be possible to purchase annuities on actual wind-up of the plan due to capacity limitations; or
  - If the settlement method assumes the exercise of regulatory discretion, a change in law, or a plan amendment for which there is no specific authority.

### **Scenario that maximizes wind-up liabilities**

- .19 In reporting the funded status of the pension plan under the scenario regarding the circumstances resulting in the wind-up that maximizes the wind-up liabilities, the actuary would include benefits that are contingent upon the scenario regarding the circumstances resulting in the wind-up or required by law. However, the actuary may disregard:
- Benefits that are contingent upon a factor other than the scenario regarding the circumstances resulting in the wind-up or as required by law; and
  - Possible plan member earnings after the calculation date.

### **Other types of valuations**

- .19.1 Valuations that are not going concern valuations, hypothetical wind-up valuations, or solvency valuations are usually similar in nature to one of these three types of common valuations. In preparing the external user report for such a valuation, the actuary would consider the relevant reporting requirements for a type of valuation similar to the valuation undertaken and would include additional disclosures as appropriate.

### **Statements of opinion**

- .20 Where different statements of opinion apply in respect of different purposes of the valuation, the above requirements may be modified but would be followed to the extent practicable.
- .21 While a separate statement regarding assumptions would generally be included in respect of each purpose of the valuation, the statements regarding assumptions may be combined where the statements do not differ among some or all of the valuation's purposes. The report would indicate clearly which statement regarding assumptions applies to each of the valuation's purposes.
- .22 While a separate statement regarding methods would generally be included in respect of each purpose of the valuation, the statements regarding methods may be combined where the statements do not differ among some or all of the valuation's purposes. The report would indicate clearly which statement regarding methods applies to each of the valuation's purposes.



## 3300 FULL OR PARTIAL WIND-UP VALUATION

.01 This section 3300 applies to advice that an actuary provides on the funded status or funding with respect to the wind-up, in full or in part, of a pension plan.

### 3310 GENERAL

.01 *The actuary's advice with respect to a pension plan that is being wound-up, in full or in part, should take account of the circumstances of the work.*

.02 *The actuary should take account of subsequent events up to the cut-off date.*

.03 *The pension plan's assets should be valued at liquidation value. [Effective December 31, 2010]*

#### Scope

.04 This section is not intended to prescribe the manner in which:

- The pension plan's assets would be allocated between jurisdictions in the case of wind-up of a pension plan covering members in several jurisdictions;
- Benefit entitlements would be determined;
- Contributions to a pension benefits guarantee fund would be determined;
- Funding obligations would be determined; or
- The pension plan's assets would be allocated between the employer and the members or between members themselves.

.05 Rather, those issues would be determined in accordance with the law or the plan provisions, or an entity empowered thereunder to make that determination. It may be appropriate, however, to use the results of the valuation to address one or more of those issues, or to disclose their resolution in the report.

#### Circumstances of the work

.06 For the purposes of section 3300, the circumstances of the work would include:

- Whether the actuary's advice relates to the funded status or the funding of the pension plan, or a combination thereof;
- The terms of the appropriate engagement under which the work is being performed; and
- The application of the law to the work.

#### Cut-off date

.07 The cut-off date would be the date up to which subsequent events would be recognized in the valuation.

## Partial wind-up

.08 A partial wind-up occurs when a subset of the members terminates membership in circumstances that require wind-up with respect to those members. Such wind-up does not apply to the continuing members, although it may be necessary, for legal or other reasons, also to value the benefits of the continuing members.

.09 The law regarding partial wind-ups varies by jurisdiction. As a result, the application of law can cause a partial wind-up to range from an insignificant change in the pension plan to something similar to a full wind-up.

.10 The standards for a partial wind-up are the same as the standards for a full wind-up. Their application may be easier, however, when the partial wind-up applies to relatively few members. For example:

- The standard of materiality for determination of benefit entitlements may be less rigorous for continuing members than for those to whom the partial wind-up applies; or
- The standard of materiality for reporting wind-up expenses may be less rigorous.

## 3320 ASSUMPTIONS

.01 *The actuary should select assumptions that:*

- *Notwithstanding subsection 1740, are either best estimate assumptions or are best estimate assumptions modified to incorporate margins for adverse deviations, as described in paragraph 1740.40, to the extent, if any, required by law or by the terms of an appropriate engagement;*
- *Are selected as at the cut-off date; and*
- *Reflect the expected method of benefit settlement.*

.02 *Unless it is expected that expenses will not be paid from the pension plan's assets, the actuary should select an explicit assumption regarding the expenses of wind-up and either offset the resulting expense provision against the pension plan's assets or add the resulting expense provision to the pension plan's liabilities. [Effective December 31, 2010]*

## 3330 REPORTING: EXTERNAL USER REPORT

.01 *If a previous external user report was prepared with respect to the wind-up, the actuary should describe and quantify the gains and losses between the prior calculation date and the calculation date.*

.02 *An external user report should:*

- *Include the wind-up date, the calculation date, the cut-off date, and the report date;*
- *Describe the events precipitating the wind-up, of which the actuary is aware, that affect the terms of the wind-up, the benefit entitlements, or the valuation results;*

- Describe the sources of membership data, plan provisions, and the pension plan's assets, and the dates at which they were compiled;
- Describe the membership data, including any assumptions made about missing membership data;
- Describe the tests applied to determine the sufficiency and reliability of the membership data and plan asset data for purposes of the work;
- Subject to any applicable privacy legislation:
  - Include the detailed individual membership data; or
  - Include an offer to provide detailed individual membership data on request to the employer, the plan administrator, or the regulator;
- Describe the liquidation value of the assets and a summary of the assets by major category;
- Describe the pension plan's provisions, including an identification of
  - Any benefits that have been insured;
  - Any amendments made since any previous external user report with respect to the plan which affect benefit entitlements; and
  - Any subsequent events or post-wind-up contingencies, of which the actuary is aware, which affect benefit entitlements;
- Describe the methods used to determine the reported liabilities;
- Describe the assumptions used to determine the liabilities and provide the rationale for each assumption that is material to the actuary's advice;
- Report the explicit assumption regarding the expenses of wind-up or justify the expectation that expenses will not be paid from the pension plan's assets;
- Report the funded status at the calculation date;
- Disclose subsequent events of which the actuary is aware, whether or not the events are taken into account in the work and, if there are no subsequent events of which the actuary is aware, include a statement to that effect;
- State that the funded status at settlement may differ from that contained in the report unless the report includes the funded status at the time of final settlement;
- State whether an updated report will be required in the future;

- If the actuary relies upon direction concerning unclear or contentious issues,
  - Describe each such issue;
  - Describe the direction relied upon or, where appropriate, a summary thereof; and
  - Identify the person providing such direction and the basis of authority of such person;
- Describe any post-wind-up contingencies that may affect the distribution of the pension plan's assets;
- Describe whether a recalculation of the value of benefit entitlements is required at settlement;
- Where a member has a choice that the member has not yet made between receiving a commuted value and a deferred or immediate pension, describe the assumptions made regarding such choice;
- If applicable, describe the method to allocate the pension plan's assets among classes of members and the method to distribute surplus;
- Describe the actuary's role in calculating commuted values, the standards for their calculation, and an opinion on whether their calculation is in accordance with accepted actuarial practice in Canada; and
- Describe the sensitivity of the valuation results to the pension plan's investment policy and to market conditions between the report date and the settlement date.

.03 An external user report should provide the following four statements of opinion, all in the same section of the report and in the following order:

- A statement regarding membership data, which should usually be, "In my opinion, the membership data on which the valuation is based are sufficient and reliable for the purpose of the valuation.";
- A statement regarding assumptions, which should usually be, "In my opinion, the assumptions are appropriate for the purpose(s) of the valuation(s).";
- A statement regarding methods, which should usually be, "In my opinion, the methods employed in the valuation are appropriate for the purpose(s) of the valuation(s)."; and
- A statement regarding conformity, which should be, "This report has been prepared, and my opinions given, in accordance with accepted actuarial practice in Canada."

.04 The external user report should be sufficiently detailed to enable another actuary to assess the reasonableness of the valuation. [Effective December 30, 2012]

## Dates

.05 The wind-up date of the pension plan would be determined by the regulator, the plan administrator or the plan sponsor based on the plan provisions and the law.

.06 The calculation date of the funded status would usually be the wind-up date.

.07 For a particular member:

- The date of calculation of benefit entitlement would depend on the circumstances of the wind-up, the terms of the pension plan, and the law, and may be the date of termination of employment, the date of termination of membership, the wind-up date, or another date; and
- The settlement date would be the date of settlement of the member's benefit entitlement.

## Nature of wind-ups

.08 The purpose of a wind-up valuation may be to determine, or to provide, the basis for determining:

- The funded status of the pension plan;
- The total value of the benefit entitlements of all members prior to taking account of the funded status of the pension plan;
- Any required additional funding;
- The amounts and methods of settlement of benefit entitlements, including any adjustment required due to a wind-up deficit; or
- The amount and method of distribution of a wind-up surplus.

.09 A wind-up may be complex and may take a long time. Delays may require a series of reports by the actuary. Since the funded status of the pension plan at the final settlement date may affect whether benefit entitlements can be settled in full, the reflection of subsequent events in each report would be critical.

.10 For example, between the wind-up date and the settlement date:

- The wind-up liabilities may fluctuate if there are fluctuations in interest rates and annuity prices;
- The pension plan's assets may fluctuate depending upon the manner in which they are invested; and
- The surplus may fluctuate if the pension plan's assets and liabilities are not matched.

.11 The actuary would usually report the value of the benefit entitlements of all members and the funded status of the pension plan. That report would be filed with the regulator for approval. After that approval, the plan administrator would settle the benefit entitlements.

- .12 The actuary may prepare, or may be required to prepare, a final report after settlement of all benefit entitlements. Such report, if any, would document the distribution of the pension plan's assets by describing those entitlements and their settlement.

### **Membership data**

- .13 The membership data are the responsibility of the plan administrator. The actuary would, however, report on the sufficiency and reliability of the membership data, specifically including the commuted values used in the valuation whether or not the plan administrator was the calculator thereof.
- .14 The finality of wind-up would call for the actuary to obtain precise membership data. The actuary may, if the circumstances dictate, include contingency reserves in the wind-up valuation with respect to missing members if the actuary believes that additional members still have benefit entitlements under the pension plan but their membership information is missing.
- .15 The reported membership data would include details of the amounts and terms of payment of each member's benefits.

### **Assumptions**

- .16 The selected assumptions would:
- In respect of benefit entitlements that are assumed to be settled by purchase of annuities, reflect single premium annuity rates;
  - In respect of benefit entitlements that are assumed to be settled by lump sum transfer, reflect the standards in section 3500 respecting commuted values; and
  - In respect of benefit entitlements that are assumed to be settled in some other manner, reflect the manner in which such benefits would be settled.
- .17 If future benefits depend on continued employment (e.g., the pension plan is terminating but employment is not), the actuary would consider reflecting contingencies such as future salary increases and termination of employment.
- .18 If the pension plan provides special early retirement allowances that may be reduced if the members have employment income following their actual or assumed early retirement dates, then the wind-up valuation would require assumptions regarding the likelihood and the amounts of the members' future employment income. To extrapolate the pension plan's historical experience as a going concern would not necessarily be appropriate in selecting those assumptions.

.19 Wind-up expenses usually include, but are not limited to:

- Fees related to the actuarial wind-up report;
- Fees imposed by a regulator;
- Legal fees;
- Administration expenses; and
- Custodial and investment management expenses.

.20 The actuary would either net wind-up expenses against the pension plan's assets or add the assumed wind-up expenses to the pension plan's liabilities in calculating the ratio of assets to liabilities as a measure of financial security of the benefit entitlements, unless the expectation is that expenses will not be paid from the pension plan's assets. However, an exception may be made for future custodial and investment management expenses, which may be netted against future investment return in the treatment of subsequent events.

#### **Use of another person's work**

.21 Some aspects of the wind-up may be unclear to the actuary or contentious. Examples are:

- Interpretation of the law;
- The determination of the wind-up date;
- The members, former members or recently terminated members to be included in the wind-up;
- Whether or not to assume salary increases in determining benefit entitlements;
- Eligibility for plant closure benefits and permanent lay-off benefits;
- Eligibility for benefits payable only with the consent of the employer or plan administrator;
- The liquidation value of the pension plan's assets;
- The method to allocate the pension plan's assets among members;
- The allocation of surplus between the employer and the members; and
- Whether or not wind-up expenses are to be paid from the pension plan's assets.

.22 To decide those aspects, the actuary may rely upon direction from another person with the necessary knowledge, such as legal counsel or the employer, or the necessary authority, such as a regulator or the plan administrator. The actuary would consider any issues of confidentiality or privilege that may arise.

### Post-wind-up contingencies

.23 Post-wind-up contingencies may affect benefit entitlements. Examples are:

- Member election of optional forms of benefits;
- Member election of retirement date;
- Salary increases; and
- Change in marital status.

### Subsequent events

.24 In contrast with a going concern valuation, in a wind-up valuation all subsequent events, ideally, would be reflected. This ensures that the funded status is presented as fairly as possible as of the report date. However, it would be impossible to recognize subsequent events right up to the report date. Accordingly, the actuary would select a cut-off date that is close to the report date.

.25 The actuary would ascertain that no subsequent events have occurred between the cut-off date and the report date that would change the funded status significantly, otherwise the actuary would select a later cut-off date. For clarity, a subsequent event may be material yet not be so significant as to require selection of a later cut-off date.

.26 It may be appropriate to have more than one cut-off date. For example, the actuary may select one cut-off date for the active membership data and another cut-off date for the inactive membership data.

.27 Common subsequent events are:

- Contributions;
- Expenses paid from the pension plan's assets;
- Actual investment return on the pension plan's assets;
- Change in annuity purchase rates;
- Change in assumptions for the calculation of commuted values;
- Corrections to the membership data;
- Deaths of members; and
- Crystallization of post-wind-up contingencies.

.28 One method for taking account of subsequent events is to determine the value of benefits as of the cut-off date and then discount such value back to the calculation date at an interest rate equal to the rate of investment return, net of investment expenses, earned on the pension plan's assets between the calculation date and the cut-off date. The pension plan's assets would be determined at the calculation date, but adjusted for the subsequent events (such as contributions and non-investment expenses) that affect the pension plan's assets.



- .29 There may be situations where, due to legal or practical considerations, subsequent events are not recognized, at least in a preliminary report and the cut-off date for such a report would be the calculation date. In such reports, the effect of subsequent events may be disclosed and quantified in an approximate manner. Where the effect of subsequent events is provided in a later report, it may be practical, in that report, to use a calculation date corresponding to the cut-off date.

**Statements of opinion**

- .30 Where different statements of opinion apply in respect of different purposes of the valuation, the above requirements may be modified, but would be followed to the extent practicable.

## 3400 FINANCIAL REPORTING OF PENSION COSTS

.01 This section 3400 applies to advice that an actuary provides with respect to financial reporting of a pension plan's costs and obligations in the employer's or the pension plan's financial statements.

### 3410 GENERAL

.01 *For financial reporting purposes, the actuary should use methods and assumptions for the value of assets and pension benefit obligations that are appropriate to the basis of financial reporting in the employer's or pension plan's financial statements, as applicable, and that are consistent with the terms of an appropriate engagement. [Effective December 30, 2012]*

.02 The actuary would reflect the financial reporting standards specified by the terms of the appropriate engagement. Where financial reporting standards require methods and assumptions to be established by the preparers of the financial statements, the actuary would use the methods and assumptions specified by the preparers of the financial statements.

#### Assumptions

.03 The assumptions that the actuary uses would be best estimate assumptions, unless otherwise specified in the relevant financial reporting standards or as otherwise selected by the preparers of the financial statements.

.04 If the preparers of the financial statements select the assumptions and those are not in accordance with accepted actuarial practice, Rule 6, Control of Work Product, may apply. That is so whether or not the actuary expresses an opinion on the assumptions.

#### Benefit commitments

.05 The actuary would include in the valuation of pension benefit obligations the effect of a commitment to provide benefits beyond the terms of the plan to the extent stipulated by the preparers of the financial statements.

### 3420 REPORTING: EXTERNAL USER REPORT

.01 *An external user report should:*

- *Include the calculation date and the report date;*
- *Describe the sources of membership data, plan provisions, and the pension plan's assets, and the dates at which they were compiled;*
- *Describe the membership data;*
- *Describe the tests applied to determine the sufficiency and reliability of the membership data and plan asset data for purposes of the work;*
- *Describe the market value of assets and a summary of the assets by major category;*
- *Describe the pension plan's provisions;*

- Describe any commitment to provide benefits beyond the terms of the plan reflected in the valuation of pension obligations;
- Describe the method used to value the pension plan's assets;
- Describe the actuarial cost method;
- Describe the assumptions used to determine the actuarial present value of projected benefits;
- Report the funded status at the calculation date and the applicable service cost;
- Disclose any pending but definitive or virtually definitive amendment of which the actuary is aware, and whether or not such amendment has been included in determining the funded status and the service cost;
- Disclose subsequent events of which the actuary is aware, whether or not the events are taken into account in the work, and, if there are no subsequent events of which the actuary is aware, include a statement to that effect;
- Describe any contingent benefits provided under the pension plan and the extent to which such contingent benefits are included or excluded in determining the funded status and the service cost;
- Describe any benefits that are not contingent benefits and that have been excluded in determining the funded status and the service cost;
- Describe the method and period selected in connection with any amortizations;
- If the valuation is an extrapolation of an earlier valuation, then describe the method and any assumptions for, and the period of, the extrapolation; and
- State whether or not the valuation conforms with the actuary's understanding of the financial reporting standards specified by the terms of an appropriate engagement.

.02 With respect to the assumptions, the actuary should report:

- That the preparers of the financial statements have selected the assumptions and the actuary expresses no opinion on them;
- That the preparers of the financial statements have selected the assumptions and they are, or are not, in accordance with accepted actuarial practice in Canada; or
- That the actuary has selected the assumptions and they are in accordance with accepted actuarial practice in Canada.

.03 An external user report should be sufficiently detailed to enable another actuary to assess the reasonableness of the valuation. [Effective December 30, 2012]

**Membership data**

.04 Any assumptions and methods used in respect of insufficient or unreliable membership data would be described.

.05 **Reference to report on funding**

The descriptions required in the external user report may be incorporated by reference to an external user report on funding.

## 3500 PENSION COMMUTED VALUES

### 3510 SCOPE

- .01 The standards in this section 3500 apply to an actuary's advice on the computation of commuted values, including commuted values to be paid from a pension plan that is registered under an Act when the method of settlement is a lump sum payment in lieu of an immediate or deferred pension resulting from death or individual termination of plan membership except for the specific circumstances that are described below in paragraph 3510.03. In particular, the standards in this section 3500 apply:
- In a jurisdiction whether or not there is legislation in that jurisdiction that specifically provides for portability of pension benefit credits;
  - Regardless of limits imposed by the Income Tax Act (Canada) on amounts that may be transferred to other tax-sheltered retirement plans; and
  - Under a reciprocal pension agreement between plan sponsors where the result of the reciprocal agreement is either to establish a pension amount determined on a defined contribution basis or to establish an account balance under a defined contribution provision of a plan, whether the account balance is to be converted immediately or subsequently into a pension.
- .02 The standards in this section 3500 also apply to the determination of a lump sum payment from the pension plan in lieu of an immediate or deferred pension to which a plan member's former spouse is entitled after a division of the member's pension on marital breakdown.
- .03 The standards in this section 3500 do not apply:
- Under a reciprocal pension agreement between plan sponsors where the result of the reciprocal agreement is to provide defined pension benefits for the plan member;
  - To the determination of commuted values of pensions and deferred pensions payable from pension arrangements that are not registered under an Act;
  - To the conversion of defined pension benefits to a defined contribution arrangement where there is no termination of active employment;
  - To the determination of commuted values of pensions that have commenced payment and where commutation is at the discretion of the member, except as explicitly required under paragraphs 3510.02 or 3560.01; or
  - When calculating the capitalized value of pension benefits for actuarial evidence purposes, pursuant to part 4000, where such value does not relate to a commuted value payable from a registered pension plan.

## **Act**

.04 For the purposes of this section 3500, “Act” means a pension benefits standards act of a province or the federal government of Canada or the Income Tax Act (Canada).

## **Retirement Compensation Arrangements**

.05 Since Retirement Compensation Arrangements (RCAs) are not required to be registered under the Income Tax Act (Canada), this section 3500 applies to commuted values payable from an RCA only if the RCA is registered under a pension benefits standards act of a province or the federal government of Canada.

## **3520 METHOD**

.01 *The commuted value should be independent of the funded status of the pension plan at the valuation date.*

.02 *The actuary should establish the period for which the commuted value applies before recomputation is required, taking into account the requirements of applicable legislation and the plan rules. Commuted values paid after the end of such period should be recomputed on the basis of a new valuation date.*

.03 *The commuted value should be adjusted for a reasonable rate of interest, taking into account the requirements of applicable legislation, between the valuation date and the first of the month in which the payment is made.*

.04 *The commuted value should reflect the plan member’s full benefit entitlement as a deferred or immediate pensioner, as may be applicable, determined under the terms of the pension plan. In the case of a deferred pensioner, the commuted value should include the value of the death benefit that would have applied before commencement of the deferred pension.*

.05 *The actuary should not calculate a commuted value using methods or assumptions that produce a commuted value smaller than the value computed in accordance with this section 3500. [Effective April 1, 2009]*

## **Valuation date**

.06 The valuation date means the date as of which a value is being computed. Generally, this would be the date upon which the plan member becomes entitled to an immediate or deferred pension resulting from death or individual termination of plan membership, or as of such other date as may be determined either by legislation, by the plan rules, or by a plan administrator who is empowered to do so, on which the right to receive a commuted value becomes effective.

.07 In the event that recomputation is required in accordance with these standards, the actuary would establish a new valuation date. The actuary would make calculations at the new valuation date in accordance with the standards in effect on the new valuation date.

## **Conditions attached to payment**

.08 Applicable legislation or the plan provisions may attach conditions to the payment of a portion of the commuted value when the plan is less than fully funded on a plan termination basis.

### **Benefit entitlement**

.09 Where, at the valuation date, a plan member has the right as a deferred or immediate pensioner, as may be applicable, to optional forms of pension or optional commencement dates, and where such right is contingent on an action that is within the member's control and where it is reasonable to assume that the member will act so as to maximize the value of the benefit, the option that has the greatest value would be used in the determination of the commuted value. For example, where a member has terminated employment and, upon application, is eligible for a particular benefit that has a value, it is reasonable to assume that, upon acquiring expert advice, the member will apply for the benefit.

.10 However, where such right is contingent upon an action that is within the member's control and where it is not reasonable to assume that the member will act so as to maximize the value of the benefit, an appropriate allowance would be made for the likelihood and timing of such action. For example, where a member is continuing in employment and is entitled to an unreduced pension that commences upon termination of employment, it may not be reasonable to assume that the member will immediately terminate employment in order to maximize the value of the benefit. In determining the likelihood and timing of such action, the actuary may use group data, and the actuary would be prepared to justify the allowance that has been made.

.11 The commuted value determined by the actuary using these assumptions made in accordance with the preceding paragraphs 3520.09 and 3520.10 may prove to have recognized certain potential entitlements that are never realized, or may prove to have disregarded certain entitlements that ultimately provide value.

### **Alternative methods and assumptions**

.12 The actuary may calculate a commuted value on methods and assumptions that differ from those prescribed in these standards only if:

- The resulting value is larger; and
- Such value is required by the plan terms or applicable legislation, or by a plan administrator who is empowered to specify the basis on which commuted values are to be determined.

## **3530 DEMOGRAPHIC ASSUMPTIONS**

.01 *Except for situations specifically noted below, the actuary should assume:*

- *Separate mortality rates for male and female members; and*
- *Mortality rates in accordance with a mortality table promulgated from time to time by the Actuarial Standards Board for the purpose of these calculations.*

.02 *No adjustment should be made to reflect the health or smoker status of the member.*

.03 *The current age of the plan member should be used when valuing an immediate pension.*

.04 *If the plan provides a contingent benefit only to the person who is the plan member's spouse at the date of termination of membership, the actual age of the spouse, if any, should be used in the computation. If this information cannot be obtained, an appropriate proportion married and age difference between the plan member and spouse should be assumed.*

.05 *Where the plan provides a contingent benefit to a plan member's spouse and a change in the member's marital status after the valuation date is relevant to the determination of the commuted value, the actuary should make an appropriate assumption concerning the likelihood of there being an eligible spouse, and the age of that spouse, at the time of death.*

.06 *When valuing deferred pensions, including deferred pensions for a plan member who may also be entitled to an immediate pension, the normal retirement age should be used, except in the situation where the terminated plan member has the right to elect an earlier commencement date and the consequent early retirement pension exceeds the amount that is of actuarial equivalent value to the pension payable at normal retirement age. The retirement age should be determined in a manner consistent with paragraph 3520.09. [Effective February 1, 2014]*

.07 The demographic assumptions would be the same for all types of immediate and deferred pensions.

### **Mortality**

.08 The actuary would calculate commuted values that do not vary according to the sex of the plan member where the actuary is required to do so by applicable legislation or by the provisions of the plan or by the plan administrator if the administrator is so empowered by the provisions of the plan. In this case, the actuary would adopt a blended mortality approach by either developing a mortality table based on a combination of male and female mortality rates, or computing the commuted value as a weighted average of the commuted value based on male mortality rates and that based on female mortality rates. The relative proportions of males versus females would be appropriate for the particular plan.

.09 If the requirement that commuted values do not vary according to the sex of the plan member is legislated and applies only to benefits earned after a particular date or only to a subgroup of plan members, the actuary may extend the use of a blended mortality approach to commuted values of benefits earned prior to such date or to commuted values of benefits of all members.

## **3540 ECONOMIC ASSUMPTIONS**

.01 *The actuary should select economic assumptions that vary depending on whether the pension is fully indexed, partially indexed or non-indexed.*

<sup>1</sup> The UP-94 Table and Projection Scale AA were published in the Transactions of the Society of Actuaries, Volume XLVII (1995).



.02 *If the valuation date is on or before January 31, 2011, the actuary should select economic assumptions that depend on the reported rates for the applicable CANSIM series for the second calendar month preceding the month in which the valuation date falls. If the valuation date is on or after February 1, 2011, the actuary should select economic assumptions that depend on the reported rates for the applicable CANSIM series for the calendar month immediately preceding the month in which the valuation date falls.*

.03 *The actuary should calculate two interest rates, one applicable to the first 10 years after the valuation date and the second applicable to all years thereafter.*

.04 *The commuted value of a fully or partially indexed pension should be at least equal to the commuted value applicable to a non-indexed pension in the same amount and having similar characteristics.*

.05 *The actuary should determine from the CANSIM series the following three factors.*

CANSIM Series	Description	Factor
V122542	Seven-year Government of Canada benchmark bond yield, annualized (final Wednesday of month)	$i_7$
V122544	Long-term Government of Canada benchmark bond yield, annualized (final Wednesday of month)	$i_L$
V122553	Long-term real-return Government of Canada bond yield, annualized (final Wednesday of month)	$r_L$

*Note that the factors determined above are not the reported CANSIM series, but the annualized value of the reported figure.*

.06 *The actuary should also determine a fourth factor, calculated as:*

$$r_7 = r_L * (i_7 / i_L)$$

.07 *The actuary should determine the interest rates from the following:*

	Non-Indexed	Indexed
First 10 Years	$i_{1-10} = i_7 + 0.90\%$	$r_{1-10} = r_7 + 0.90\%$
After 10 Years	$i_{10+} = i_L + 0.5 * (i_L - i_7) + 0.90\%$	$r_{10+} = r_L + 0.5 * (r_L - r_7) + 0.90\%$

.08 *The actuary should calculate the commuted value of a non-indexed pension using a two-tier interest rate of:*

*$i_{1-10}$  for the first 10 years and  $i_{10+}$  thereafter.*

.09 *The actuary should calculate the commuted value of a pension that is fully indexed to increases in the Consumer Price Index using a two-tier interest rate of:*

*$r_{1-10}$  for the first 10 years and  $r_{10+}$  thereafter.*

- .10 *For pensions that are partially indexed to increases in the Consumer Price Index, the actuary should determine the implied rates of increase in the Consumer Price Index in the first 10 years and thereafter that make the above assumptions for non-indexed and fully indexed pensions internally consistent. The actuary should then determine the rates of pension escalation that are produced by applying to those implied rates of increase in the Consumer Price Index the partial indexing formula of the plan. The actuary should determine the adjusted interest rates applicable to partially indexed pensions by appropriately reducing on a geometric basis the non-indexed rates of interest to reflect the rates of pension escalation.*
- .11 *Where increases in pensions are related to increases in the average wage index, the actuary should assume that the average wage index will increase at rates that are one percentage point higher than the implied rates of increase in the Consumer Price Index.*
- .12 *A pension that is indexed according to an excess interest approach involves increases that are linked to the excess of formula A over formula B, where A is some proportion of the rate of return on the pension fund or on a particular class of assets, and B is a base rate or some proportion of the rate of return on another asset class. In determining the interest rates under formula A and formula B, the actuary should use the interest rate applicable to a non-indexed pension as a proxy for the rate of return on the pension fund or on any particular asset class for which the rate of return is expected to be equal to or greater than the non-indexed interest rates determined in accordance with paragraph 3540.07.*
- .13 *Prior to calculating the commuted value, the actuary should round the rates of interest determined in accordance with this subsection 3540 to the nearest multiple of 0.10%. The actuary should round only the interest rates to be used in the calculation of the commuted value. The actuary should not round any rates of interest, increase or escalation used in calculations prior to the final step of the determination. [Effective April 1, 2009]*

### **Pension index frequency**

- .14 For an indexed pension, the actuary would apply the indexed interest rates as determined above without adjustment only if the frequency of indexing is equal to the payment frequency. Reasonable approximations may be used to calculate an adjustment that takes into account the specific circumstances of the situation regarding payment frequency, indexing frequency, and time and amount of the first increase.

### **Pension indexed on an excess interest formula**

- .15 If the pension is indexed on an excess interest formula and the particular asset class is one for which the rate of return is expected to be less than the non-indexed interest rates determined in accordance with paragraph 3540.07, the actuary would appropriately reduce the rate of interest to reflect the actuary's expectation of the difference between the non-indexed interest rates determined in accordance with paragraph 3540.07 and the rate of return on the particular asset class. In determining the expected rate of return on a particular asset class for this purpose, the actuary would be guided by the current economic environment as well as long-term historical experience.

### Other modifications

- .16 Where benefit adjustments are based on one of the above approaches but are either modified by applying a maximum or minimum annual increase, with or without carry forward of excesses or deficiencies to later years, or modified by prohibiting a decrease in a year where the application of the formula would otherwise cause a decrease in pension, the actuary would adjust the interest rates otherwise applicable, based on the likelihood of the modification causing a material change in the pension payable in any year. In determining such likelihood, the actuary would be guided by the current economic environment as well as long-term historical experience. The actuary would be prepared to justify any such adjustment or lack of adjustment to the interest rates.
- .17 Where increases in benefits are not determined by reference to increases in the Consumer Price Index, the actuary would ensure that the commuted value is not inconsistent with the values of non-indexed pensions and fully indexed pensions.

### Alternative calculation method

- .18 For pensions that are either fully or partially indexed, rather than using the implicit approach described above, the commuted value may be determined explicitly by indexing each expected payment based on the indexing rate that makes the assumptions for non-indexed and fully indexed pensions, prior to rounding under paragraph 3540.13, internally consistent.

## 3550 DISCLOSURE

- .01 *When communicating the amount of the commuted value of a member's pension, the actuary should provide:*
- *A description of the benefit entitlements involved;*
  - *A description of the actuarial assumptions used in determining the commuted value and the rate of interest to be credited between the valuation date and the date of payment;*
  - *A statement of the period for which the commuted value applies before recomputation is required;*
  - *When the payment of a portion of the commuted value is subject to a condition based on the funded status of the plan, the additional contribution required for the payment of the full commuted value to be made or the recommended schedule for payment of the balance of the commuted value, if applicable; and*
  - *A statement as to whether the commuted value has been computed in accordance with these standards.*
- .02 *Where the commuted value has not been determined in accordance with these standards, the actuary should clearly state that the calculation is not in compliance with these standards and disclose all areas of noncompliance and the reasons for the noncompliance.*
- .03 *When communicating to the plan administrator an actuarial basis to be used in determining commuted values, the actuary should provide a statement that the actuarial basis is in accordance with these standards.*

### **Disclosure of plan values which differ from these standards**

.04 *In a situation where the use of commuted values (called plan values in this subsection 3550) that are different from those computed in accordance with this section 3500, is required by the plan terms or applicable legislation, or by a plan administrator who is empowered to specify the basis on which commuted values are to be determined, the following disclosure requirements are applicable:*

- *If the plan values are lower, the actuary should disclose that the commuted values so calculated are in accordance with the plan or the applicable legislation but not in accordance with the standards; or*
- *If the plan values are higher, the actuary should disclose that the commuted values so calculated are in accordance with the plan or the applicable legislation and the standards.*

.05 *Where the actuary is required to calculate commuted values that do not vary according to the sex of the plan member, and where that requirement applies only to benefits earned after a particular date or only to a subgroup of plan members, the actuary should describe the extent to which the actuary's blended mortality approach has been extended to benefits earned before the particular date or to benefits of all members.*

.06 *Where the actuary uses assumptions or methods described in these standards to calculate a commuted value in a situation where these standards does not apply, the actuary should not state or imply that the commuted value has been computed in accordance with these standards. [Effective April 1, 2009]*

### **3560 REDUCED LIFE EXPECTANCY**

.01 *The standards in this subsection 3560 applies to an actuary's advice on the computation of commuted values, from a registered pension plan, where the right to receive the lump sum is based on subsection 51.1 of the regulations to the Ontario Pension Benefits Act. These standards may also be applicable in other directly comparable situations.*

.02 *These standards do not apply where the right to receive a lump sum is not conditional upon medical certification, under legislation or plan provisions, even if the former member is known to be terminally ill.*

.03 *All standards set out in preceding subsections of section 3500 apply, except as superseded by the following recommendations.*

.04 *The commuted value should be calculated as of the date of the medical certificate specifying that the former member has life expectancy less than two years, even if other conditions for payment of the benefit (such as spousal consent) are not met until a later date.*

.05 *The commuted value should be adjusted for interest and benefits paid to the date of payment.*

.06 *The computation should not be adjusted to reflect the actual death or change in health of the former member after the valuation date. However, if a former pension plan member becomes eligible for immediate commencement of a pension after the date of the medical certificate and prior to payment of the benefit, this eligibility should be reflected in the calculation.*

- .07 *If the former member is entitled to a commuted value transfer based on plan provisions or legislation that is not conditional on reduced life expectancy, the amount payable should be the greater of the amount calculated in accordance with this subsection 3560 and the amount computed in accordance with subsections 3520 through 3540 without regard to shortened life expectancy. [Effective April 1, 2009]*

### **Benefit Entitlement**

- .08 The commuted value would reflect the plan member's full benefit entitlement as a deferred or immediate pensioner, as may be applicable, determined under the terms of the pension plan.

There are three possible cases:

- (a) a former member with deferred pension entitlement, not eligible for immediate commencement of pension.

In this case, the commuted value would reflect the present value of the death benefits that would be payable in respect of the former member. For this purpose, the value of the death benefit would be calculated as of the valuation date, assuming the former member died as of the valuation date.

- (b) a former member with deferred pension entitlement, eligible for immediate commencement of pension.

In this case, the lump sum value would be the greater of the amount determined as in (a) above and a value determined as if the member had retired at the date of valuation and elected the most favourable combination of the highest surviving spouse pension permitted by the plan (if there is an eligible spouse) and the longest guaranteed period available under the plan. This value would be determined as for pensioners in (c) below.

- (c) a former member in receipt of pension.

In this case, the commuted value would reflect the present value of pension payments for a period certain of four months from the valuation date, any additional guaranteed payments and any survivor benefits potentially payable.

### **Disclosure**

- .09 When communicating the amount of the commuted value of a member's pension, the actuary would also provide a description of the survival period assumption.

**4000—ACTUARIAL EVIDENCE**

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<b>4100 SCOPE</b>
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- .00 Part 1000 applies to work within the scope of this part 4000.
- .01 The standards in part 4000 apply to actuarial evidence work.
- .02 With respect to actuarial evidence work:
- An expert is an actuary who is qualified by knowledge, skill, experience, training, or education to render an opinion or otherwise testify concerning the matter at hand; and
  - An expert opinion is a conclusion drawn from actuarial knowledge and experience or from the application of one or more actuarial methods to a body of data.
- .03 An expert opinion may be provided in a written report, oral or written testimony, or both.
- .04 The provision of an expert opinion which is actuarial evidence work and which involves a practice area such as insurance or pensions is work in both that practice area and the actuarial evidence practice area. The actuary would refer to the standards applicable to that practice area, in addition to the standards in part 4000.

**Examples**

- .05 Examples of actuarial evidence work are:
- Determination of the capitalized value of pecuniary losses arising as a result of an event such as personal injury, death, or wrongful dismissal from employment;
  - Determination of capitalized values of pensions in marriage breakdown proceedings;
  - Expert opinions given in litigation arising from work completed in respect of a pension plan or an insurance business;
  - Work as an expert advisor to a mediating official, such as a judge;
  - Determination of effective rates of interest in cases of alleged charging of criminal interest rates; and
  - Provision of an expert opinion with respect to another actuary's work that is being challenged or in cases of alleged professional negligence.



.06 Work in a practice area, such as insurance or pensions, may be performed in an adversarial environment but not involve an anticipated expert opinion for a dispute resolution proceeding. Such work would not normally be considered to be actuarial evidence work. Examples of such work, where the standards in part 4000 are not applicable, are:

- Pension plan valuations or costings related to union negotiations, or actuarial assistance with the merger of pension plans or the valuation of a pension plan in connection with the sale of a business; and
- Actuarial assistance with the valuation of an insurer, the merger of insurers, or the acquisition of an insurer.

### **Fact evidence**

.07 The standards in part 4000 do not apply to the work of an actuary who is providing only fact evidence, and not an expert opinion. For example, an actuary testifying in his or her own defense in a proceeding related to professional negligence would normally be providing fact evidence, and not an expert opinion. As another example, an actuary may be providing evidence in a dispute resolution proceeding regarding his or her involvement in work performed in a practice area such as insurance or pensions. If the circumstances were not adversarial and there was no anticipation of a dispute resolution proceeding at the time the work was performed, the actuary's evidence in the dispute resolution proceeding would normally be fact evidence and not an expert opinion. The standards in part 4000 would apply, however, if the actuary's role includes providing an expert opinion in a dispute resolution proceeding, where such opinion is expected or required to be independent.

### **Litigation advice**

.08 The terms of an appropriate engagement may require that the actuary provide only litigation advice, other than an expert opinion that is expected or required to be independent, such as assisting counsel or a client in identifying and analyzing legal or actuarial issues, advising in connection with relevant case law, and preparing for cross-examination of opposing witnesses. In such cases, provided that the actuary makes it clear that the work product does not represent an expert opinion that is actuarial evidence work, the standards in part 4000 would not apply.

.09 The terms of an appropriate engagement may require that the actuary provide both litigation advice that is not actuarial evidence work and also an expert opinion. If work related to the expert opinion meets the definition of actuarial evidence work, then the standards in part 4000 would apply to that aspect of the engagement.

**Additional guidance**

- .10 The actuary may be uncertain as to whether all or part of the engagement meets the conditions to be classified as actuarial evidence work. In such case, the actuary would seek clarification from the chair or vice-chair of the Committee on Actuarial Evidence of the Canadian Institute of Actuaries and the standards in part 4000 would apply for that portion of the engagement that is actuarial evidence work.

**4200 GENERAL**

**4210 CIRCUMSTANCES OF THE WORK**

- .01 *When performing actuarial evidence work, the actuary should take into account the circumstances of the work. [Effective December 31, 2013]*
- .02 The circumstances of the work would include:
- Relevant legislative or regulatory provisions;
  - Rules of civil procedure and rules of court in the relevant jurisdictions;
  - Other rules that may be applicable to the dispute resolution proceeding;
  - Established legal principles relevant to the work; and
  - Terms of an appropriate engagement under which the work is being performed.
- .03 Relevant legislative or regulatory provisions may include:
- Provisions relating to allowable pecuniary damages under automobile insurance legislation or regulations;
  - Provisions related to division of assets under a marital property act or regulations; and
  - Provisions relating to pensions, benefits, insurance, or workers' compensation.
- .04 Rules of civil procedure and rules of court, as well as other rules that may be applicable to the dispute resolution proceeding, may include:
- Mandated assumptions;
  - Required content and format of reports;
  - Role of experts; and
  - Duties and obligations of experts.
- .05 Established legal principles relevant to the work may address:
- Issues relevant to the actuary's engagement; and
  - Role and obligations of experts.
- .06 The terms of an appropriate engagement would define the role of the actuary and the purpose, context, and scope of the work. An engagement for actuarial evidence work would not be appropriate if it would impair the ability of the actuary to perform independent and objective work.

.07 Significant terms of an appropriate engagement may stipulate one or more of:

- Assumptions to be used in the actuary's work;
- Methods to be used in the actuary's work; and
- Various scenarios to be considered by the actuary.

.08 An engagement may be appropriate if its terms require that the actuary assist his or her client or counsel with challenging the application or a particular interpretation of existing law, regulation, court practice, or established legal principles relevant to the work. Nothing in part 4000 is intended to prevent the actuary from assisting with a challenge of the application or a particular interpretation of existing law, regulation, court practice, or established legal principles relevant to the work, even if the result of such challenge of the application or a particular interpretation would otherwise, in the opinion of the actuary, be inconsistent with accepted actuarial practice. If an engagement would impair the actuary's ability to conform to the rules, such engagement would not be appropriate.

#### **4220 FINANCIAL INTEREST OF THE ACTUARY**

.01 *The amount of the actuary's compensation should not be related to the outcome of the matter (e.g., dispute resolution proceeding) in connection with which the work is done. [Effective December 31, 2013]*

.02 For example, contingency fees that depend on the outcome of the dispute resolution proceeding would not be appropriate.

#### **4230 ROLE AS EXPERT**

.01 *The actuary's actuarial evidence work should be independent and objective.*

.02 *The actuary's role as an expert should be to assist the court or other entity in the dispute resolution proceeding in its search for truth and justice, and the actuary should not be an advocate for one side of the matter in dispute.*

.03 *Where the terms of the engagement require that the actuary provide both litigation advice that is not actuarial evidence work and also an expert opinion that is actuarial evidence work, the litigation advice role should not influence the independence and objectivity of such expert opinion. [Effective December 31, 2013]*

.04 Where the actuary is providing both litigation advice that is not actuarial evidence work and an expert opinion that is actuarial evidence work, the actuary would have a clear understanding of the differences between the two roles included in the engagement. The actuary would clearly identify in any work product which component of the engagement is involved, and would ensure that the litigation advice role does not impair his or her ability to perform the actuarial evidence work.

## 4240 TESTIMONY

- .01 *The actuary's testimony should be independent, objective, and responsive.*
- .02 *Where the terms of the engagement require that the actuary provide both litigation advice that is not actuarial evidence work and also an expert opinion that is actuarial evidence work, the actuary should be aware that full disclosure of all work and work products with respect to both roles within the engagement may be required in any testimony.*
- .03 *In the course of providing testimony in the dispute resolution proceeding, the actuary should:*
- *Present a balanced view of the factors surrounding the actuarial aspects of the questions put to him or her;*
  - *Answer all the questions that are asked on the basis of his or her own best assessment of all the relevant factors;*
  - *Apply best efforts to ensure that the evidence is clear and complete, that the information the actuary is providing will not be misunderstood or misinterpreted, and that the audience will be able to utilize it correctly; and*
  - *Indicate when a particular issue or question falls outside his or her expertise.*
- .04 *The actuary should respond truthfully and fully to questions posed in the course of providing testimony, but the actuary need not volunteer information which is beyond the scope of the question posed. [Effective December 31, 2013]*
- .05 *Testimony is the actuary's communication presented in the capacity of an expert witness in any dispute resolution proceeding where the actuary is examined or cross-examined. Such testimony may be oral or written, direct or responsive, formal or informal.*
- .06 *When responding to a direct question relating to any error or shortcoming the actuary perceives in the report of another actuary or expert witness, the actuary would respond truthfully and fully, notwithstanding paragraph 4710.08.*

## 4250 CAPITALIZED VALUES

- .01 *The actuary should calculate the capitalized value of future amounts payable in respect of an individual utilizing the actuarial present value method. [Effective December 31, 2013]*
- .02 *Actuarial evidence work frequently deals with the determination of the capitalized value of amounts for purposes of a dispute resolution proceeding. These amounts are often payable in respect of an individual and sometimes in respect of a group of individuals. Such calculations must often be performed within a framework established by law, regulation, and/or legal precedent.*
- .03 *Payment of the capitalized value is an alternative to payment of defined amounts to which an individual is entitled. Often the courts and others have recourse to require payment of a capitalized value when payment of the defined amounts comprising that value is not practical or not desired.*
- .04 *Calculation of the capitalized value is within the domain of actuarial practice.*

- .05 The actuary would not calculate the capitalized value of future amounts that are subject to any contingent event as the present value of an annuity certain. For example, when utilizing the actuarial present value method in respect of a life annuity, the capitalized value of each life annuity payment is weighted by the probability of survival to the date of that payment. Under this method, the present value of possible overcompensation in an individual circumstance is balanced by the present value of possible undercompensation.

**4300 ACTUARIAL EVIDENCE CALCULATIONS, OTHER THAN CAPITALIZED VALUE OF PENSION PLAN BENEFITS FOR A MARRIAGE BREAKDOWN AND CRIMINAL RATE OF INTEREST**

**4310 SCOPE**

- .01 The standards in section 4300 apply to an actuary's advice when performing actuarial evidence calculations, other than for the capitalized value of pension plan benefits for a marriage breakdown and for a criminal rate of interest.

**4320 ASSUMPTIONS AND METHODS**

- .01 *The assumptions and methods selected by the actuary should be appropriate in the aggregate, taking into account the purpose of the work and the parts of the standards that are applicable to the actuary's work.*
- .02 *The assumptions selected by the actuary should be best estimate assumptions, unless it is appropriate to incorporate margins for adverse deviations in accordance with the circumstances of the work.*
- .03 *The actuary should ensure that any assumptions stipulated by the terms of the engagement are plausible.*
- .04 *The assumptions and methods used by the actuary should take account of the circumstances of the work, including applicable law, regulation, court practice, and established legal principles relevant to the work.*
- .05 *The assumptions and methods selected by the actuary should not be influenced by the party to the dispute resolution proceeding that has retained the actuary. [Effective December 31, 2013]*
- .06 Examples of the circumstances of the work where it would be appropriate to incorporate a margin for adverse deviations in an assumption include, but are not limited to:
- The assumption or the requirement for a margin for adverse deviations is mandated by law, regulation, court practice, or established legal principles relevant to the work; and
  - The actuary's work relates to a practice area such as insurance or pensions, and the standards for that practice area require or permit the inclusion of a margin for adverse deviations for such work.
- .07 Notwithstanding paragraph 4320.03, the terms of an appropriate engagement may stipulate assumptions that are not considered plausible by the actuary or methods that are not considered appropriate by the actuary. In such case, if the actuary performs the work in accordance with the terms of the engagement, the actuary would report the deviation from accepted actuarial practice in Canada.

- .08 The terms of the engagement may require that the actuary complete calculations for related items, such as one calculation for the capitalized value of a pecuniary loss and another calculation for the income tax gross-up. The underlying assumptions would be consistent for the calculation of these related items. In this example, the actuary would utilize the same underlying assumptions, such as the same real rate of interest, the same rate of price inflation, and the same mortality assumption, for both the calculation of the capitalized value of the loss and the calculation of the income tax gross-up.
- .09 Where there are insufficient data to support a particular assumption regarding a contingency incorporated in the actuary's work, the actuary may present a range of results.

### **4330 CONTINGENCIES**

- .01 *The actuary should consider incorporating any contingency where, in the actuary's opinion, there are adequate legal, theoretical, or empirical grounds to justify this. The actuary should disclose the omission from the work of any contingencies he or she considers material.*
- .02 *If the actuary gives advice on the effect of a specific contingency, that advice should be based on an assessment of that contingency, both alone and in combination with other factors, using appropriate actuarial methods. [Effective December 31, 2013]*
- .03 Where the actuary has prepared results under more than one scenario, the actuary's report would show the results of the actuarial calculations separately for each scenario and identify which contingencies have been incorporated in each scenario. For example, the results of the actuarial calculations under one scenario may include precise recognition of only net investment return and mortality. The results taking into account any other provision for contingencies would be prepared under another scenario and would be reported separately.
- .04 Recognition of a contingency may create a positive or negative effect on a calculation.

### **4340 APPLICATION OF LAW**

- .01 In a situation where law, regulation, court practice, or established legal principles relevant to the work mandates that a method or assumption be adopted in an actuarial evidence calculation, a broad interpretation of accepted actuarial practice in Canada is appropriate, so that in most such situations the law, regulation, court practice, or established legal principles relevant to the work would be considered to be within the range of accepted actuarial practice in Canada.
- .02 If the actuary is unsure as to whether such a mandated assumption or method is within accepted actuarial practice in Canada, he or she would consult with the chair or vice-chair of the Committee on Actuarial Evidence of the Canadian Institute of Actuaries.
- .03 Where an assumption is mandated by law, regulation, court practice, or established legal principles relevant to the work, such assumption may be outside of the range of assumptions that the actuary considers to be reasonable. Subsection 1720 provides additional guidance for these situations.



**4400 CAPITALIZED VALUE OF AMOUNTS OTHER THAN PENSION PLAN  
BENEFITS FOR A MARRIAGE BREAKDOWN**

**4410 SCOPE**

- .01 The standards in section 4400 apply to an actuary's advice when calculating the capitalized value of amounts other than pension plan benefits for a marriage breakdown. A capitalized value relates to amounts payable at various times, each amount subject to various contingencies related to the individual or to the individual's dependants. Examples of situations where capitalized values may be calculated are:

<b><u>Event</u></b>	<b><u>Capitalized Value of:</u></b>
Disability	individual's loss of earnings, loss of household services, and/or cost of extraordinary expenses attributable to the disability.
Death	dependant's loss of financial support and/or loss of household services.
Wrongful dismissal	individual's loss of earnings, pension benefits, and/or employer-sponsored benefits other than pensions.
Marriage breakdown	individual's support obligations.

**4420 ASSUMPTIONS AND METHODS**

**Past loss**

- .01 In some cases, the capitalized value is the present value of amounts payable both before and after the date at which the capitalized value is established. For example, in an accident caused by negligence, litigation of the damages may result in the capitalized value becoming payable several years after the accident. Then the damages consist of those in respect of both the period before and the period after the date at which the capitalized value is established, called "past losses" and "future losses", respectively.

**Income tax**

- .02 Subject to the terms of the engagement, the actuary may include an appropriate allowance in the capitalized value calculation for the expected effect of income tax, taking account of applicable law, regulation, court practice, and established legal principles relevant to the work. The actuary's report would deal with income tax in an internally consistent way, and the report would fully disclose the assumptions and methods utilized.

**Investment expenses**

- .03 Subject to the terms of the engagement, the actuary may include an appropriate allowance in the capitalized value calculation for any expenses expected with respect to the future investment, management, or administration of any settlement amount, taking account of applicable law, regulation, court practice, and established legal principles relevant to the work. The actuary's report would deal with such investment expenses in an internally consistent way, and the report would fully disclose the assumptions and methods utilized.

**4500 CAPITALIZED VALUE OF PENSION PLAN BENEFITS  
FOR A MARRIAGE BREAKDOWN**

**4510 SCOPE**

- .01 The standards in this section 4500 apply to an actuary's advice when the capitalized value of a pension plan's benefits is needed for calculating the value of family property at the breakdown of the marriage of a plan member.
- .02 For the purposes of this section 4500, "plan" means "pension plan" and is broadly defined, including not only a plan that is registered under the federal Income Tax Act but also an unregistered plan, such as a retirement compensation arrangement and an unfunded pension plan.
- .03 The standards in this section 4500 do not apply when the purpose of the calculation is to calculate an amount, in respect of a pension benefit, to be paid:
- By the plan to the plan member or beneficiary as a result of the plan member's death or termination of membership; or
  - By a party other than the plan in connection with litigation other than in respect of a marriage breakdown.
- .04 The standards in this section 4500 may provide useful guidance for similar calculations for other deferred compensation arrangements, such as a partnership retirement buy-out agreement, a sick leave buy-out plan, and a retirement lump sum allowance, but they do not provide useful guidance for current compensation arrangements such as group life and disability insurance.
- .05 The standards in this section 4500 do not apply when applicable legislation mandates a different basis for the calculation of the value of a pension for family property purposes at the breakdown of the marriage of a plan member.

**4520 METHOD**

- .01 *The benefits to be valued are the plan's benefits in respect of the member (including survivor benefits vested in the member's spouse) at the calculation date or calculation dates.*
- .02 *The value of the member's benefits is the capitalized value of the benefits to be valued, but assuming that the member has no spouse. The value of the survivor benefits vested in the member's spouse is the excess, if any, of the capitalized value of the benefits to be valued over the value of the member's benefits. [Effective January 1, 2004]*

### **Principle**

- .03 The capitalized value would conform to the intent of applicable family law. The capitalized value may, thus, differ from the corresponding transfer value from a registered pension plan. Transfer values typically include only unconditional rights, whereas property under family law typically includes both vested and contingent rights. Thus, such contingent rights as early retirement rights, bridging benefits, and ad hoc inflation adjustments are property to be considered in a calculation for marriage breakdown purposes.
- .04 The standards in this section will often produce more than one result, by taking account of alternative possibilities for:
- Pension commencement age;
  - Future increases in accrued benefits before and after retirement;
  - Allocation of value earned before marriage;
  - Inclusion or exclusion of non-vested benefits; or
  - Special circumstances, such as buy-back or transfer of benefits.
- .05 If the actuary has reason to believe that the plan's financial position is so weak that payment of the capitalized benefits is doubtful, then the actuary would so report, making clear that allowance for this factor could significantly reduce the present values calculated, given that such present values have been calculated assuming that the plan would meet its obligations. In making that assessment, the actuary would take into account any benefits payable under provincial pension guarantee legislation. The actuary would take into account further the extent to which plan benefits are provided through a retirement compensation arrangement and/or an unfunded pension plan.
- .06 The terms of the actuary's engagement may determine some or all of:
- The relevant law or jurisdiction;
  - The calculation date or calculation dates;
  - Retirement age, but only if established as a matter of fact pursuant to an agreement of the parties or a determination by the court; and
  - Inclusion or exclusion of the effect of income taxes.

### **Benefits to be valued**

- .07 The benefits to be valued would include all of the plan's contractual benefits, including pre- and post-retirement death benefits, and any contractual inflation protection and non-contractual inflation protection.
- .08 The benefits to be valued would exclude spousal survivorship benefits, except to the extent that these may have vested upon retirement prior to the calculation date.

- .09 The form of plan benefits that would be valued would be the most favourable of any optional form available to the member with no spouse. For example, a 15-year guaranteed pension option would have a greater value than a five-year guaranteed pension option for a member with impaired mortality. However, if the applicable law disregards a particular optional form of plan benefit, then the actuary may omit that option in calculating the capitalized value.
- .10 The benefits may include or exclude any non-vested benefits. Non-vested benefits may be included in the values, or may be illustrated separately, and would be valued without discount for the possibility of future forfeiture. Separately from the illustrated values, the report may contain comments including suggestions for recognizing the contingent nature of non-vested benefits. The references in this paragraph to inclusion of values of non-vested benefits apply in jurisdictions where the inclusion of such values depends on the plan provisions applicable to a deferred vested member. In other jurisdictions, the inclusion of such values depends on the extent to which continued employment is assumed.
- .11 The capitalized values would include ancillary benefits that are provided by the plan as of the calculation date and are expected to become available to the member after the calculation date if the plan member continues as an active member of the plan, but are not available to the member as of the calculation date, such as unreduced early retirement benefits.
- .12 The actuary would disclose whether or not the benefits valued include benefits that will be provided by the plan after the calculation date and that are expected to become available to the member after the calculation date if the plan member continues as an active member of the plan, but are not available to the member as of the calculation date, for example:
- A future increase in benefits as a result of a collective bargaining agreement; or
  - A future increase in benefits as a result of an adopted plan amendment.
- .13 The benefits referred to in paragraph 4520.11 are those payable by the plan as a going concern, and not those payable on plan wind-up, if different, unless the plan has been fully wound up or partially wound up with respect to the plan member.
- .14 Where various legal interpretations for a specific question appear possible, the actuary would obtain clarification of such unclear matters from the instructing lawyer or from another authoritative source. If that is not possible, the actuary would advise that various interpretations exist, and would report the effects of these interpretations or report values that, in the actuary's opinion, are most consistent with accepted actuarial practice.

### **Calculation date**

- .15 The calculation date may be single or multiple, depending on the circumstances and applicable law. The possibilities include:
- The date of separation;
  - The date of marriage or commencement of cohabitation;
  - The date of trial; and
  - The report date.
- .16 If the use of an alternative calculation date, close to the calculation date, would significantly affect the capitalized value, then the actuary would so report. Examples are:
- The date at which the member becomes eligible for early retirement with unreduced benefits; and
  - The date at which the plan is amended to enhance its benefits.

### **Applicable standards**

- .17 The applicable standards are those in effect at the calculation date. If there are two or more calculation dates, however, and if the standards applicable to one differ from the standards applicable to another, then the actuary would use the same standards for all calculation dates. The choice of standards would be governed by the latest of the calculation dates, except that the choice would be governed by the base calculation when the actuary selects an alternative calculation date, close to the calculation date, in accordance with the previous paragraph.

### **Future service**

- .18 If the member's employment terminated before the calculation date and was not reinstated at the report date, then the actuary would include nothing in the capitalized value on account of assumed service after the calculation date, even if reinstatement is possible after the report date. The actuary may, however, report a useful alternative calculation that assumes reinstatement.
- .19 If the member's employment terminated between the calculation date and the report date and was not reinstated at the report date, then the actuary may, with disclosure, exclude from the capitalized value any non-vested benefits forfeited by the termination of employment.

### **Effect on capitalized value of minimum benefits**

- .20 In calculating the capitalized value, the actuary would take account of any minimum benefit related to member contributions, for example:
- The so-called "50% minimum employer contribution rule"; and
  - A minimum benefit equal to the member's contributions accumulated with interest.
- .21 The minimum benefit would not necessarily be limited only to the value determined on a termination of employment assumption. The capitalized value would incorporate the relevant minimum benefit rule according to the event.

### **Effect on capitalized value of salary increases after the calculation date**

- .22 If the pension is an earnings-related benefit, then the possibilities are:
- The capitalized value takes account of all the member's salary increases—general increases, promotional increases, and seniority increases—after the calculation date;
  - The capitalized value takes account of the member's salary increases that result from general (as opposed to promotional and seniority) salary increases after the calculation date. A rationale for this possibility is that the member's spouse has no entitlement to the effect of promotions or seniority increases that the member earns after the calculation date;
  - The capitalized value does not take account of the member's salary increases after the calculation date. A rationale for this possibility is that the member's spouse has no entitlement to the effect of salary increases, which depend on the member's continued employment after the calculation date.
- .23 The assumed salary increases after the calculation date would be consistent with the prescribed economic assumptions, except that salary increases revealed by subsequent events would be substituted for the corresponding assumed increases.

### **Effect on capitalized value of non-contractual indexing of pensions and other benefit adjustments**

- .24 In calculating the capitalized value, the actuary would assume continuance of the plan's established practice or current policy, if any, for non-contractual indexing for inflation of pensions after pension commencement age and of vested deferred pensions before pension commencement age, unless there is explicit reason not so to assume. The actuary would report:
- The established practice or current policy; and
  - The indexation assumption.
- .25 If that assumption is doubtful, then the actuary would also report the numerical effect on the capitalized value of helpful alternative assumptions.
- .26 In the case of a final or best average earnings plan, there would be no allowance made for indexing of vested deferred pensions before pension commencement age in the period for which salary increases are projected after the calculation date.

### **Effect on capitalized value of income tax**

- .27 Income tax may be taken into account in the calculation. If it is to be taken into account, then the actuary would do so by calculating the average income tax rate based upon the member's anticipated retirement income computed in "current" dollars, including accrued and projected future pension income, Canada Pension Plan, Old Age Security, and other anticipated income, and continuance of the tax environment at the report date or the calculation date; i.e., assuming continuation of the existing tax rates, brackets, surtaxes, and clawbacks, applied to the projected income on retirement expressed in "current" dollars. The actuary would disclose which date was used and if the tax environment is as at the report date, would disclose the use of any tax provisions that have not yet been enacted.
- .28 The actuary may report useful alternative calculations that take income tax into account.

### **4530 ASSUMPTIONS**

- .01 *The actuary should select all assumptions, except those depending upon interpretation of applicable law. [Effective January 1, 2004]*

#### **Mortality rates**

- .02 *The actuary should assume mortality rates in accordance with a mortality table promulgated from time to time by the Actuarial Standards Board for the purpose of these calculations, modified, if appropriate, to reflect the member's or the member's spouse's impaired health, if medically determinable. [Effective January 1, 2012]*
- .03 Tobacco use (or lack of tobacco use) would not, in itself, be sufficient reason to modify the mortality rates identified above.
- .04 Use of unisex mortality rates would not be appropriate except that it may be appropriate in situations where the plan member has terminated employment and has elected, or has the option to elect, a transfer value that was or would be calculated under a unisex basis.

#### **Retirement age**

- .05 If the retirement age is a matter of fact (i.e., one agreed by the parties or determined by the court), then the actuary would report the selection of the assumed retirement age as such.
- .06 The retirement of the member before the report date does not necessarily preclude assumption of a different retirement age.
- .07 Unless paragraph 4530.05 applies, the actuary would usually assume and report the results for a range of useful retirement ages, based on data at the calculation date, which would include:
- The earliest age at which the member is entitled to a pension whose amount is not reduced on account of early retirement, assuming that the member's service ceases at the calculation date;
  - The earliest age at which the member is entitled to a pension whose amount is not reduced on account of early retirement, assuming that the member continues in service either to that age or to an earlier age after the calculation date;



- If there is an upper limit to the number of years of credited service, the earliest age at which the member has attained, or will attain, that upper limit and becomes entitled to a pension whose amount is not reduced on account of early retirement; and
- The normal retirement age.

### Economic assumptions

- .08 The actuary should select economic assumptions that depend on the reported rates for the applicable CANSIM series for the calendar month immediately preceding the month in which the calculation date falls.
- .09 The actuary should determine from the CANSIM series the following four factors:

<i>CANSIM Series</i>	<i>Description</i>	<i>Factor</i>
VI22487	average long (>10 yrs) Government of Canada bond yields (final Wednesday of month)	$G_L$
VI22544	long-term Government of Canada benchmark bond yield, annualized (final Wednesday of month)	$b_L$
VI22553	long-term Government of Canada real return bond yield, annualized (final Wednesday of month)	$r_L$
$(1 + b_L)/(1 + r_L) - 1$	break-even inflation rate	BEIR

Note that the factors determined above do not reflect the reported CANSIM series, but the annualized value of the reported figure.

### Inflation and indexing

- .10 The actuary should calculate the projected benefit obligation for a pension that is fully indexed to increases in the Consumer Price Index using an assumed inflation rate of EI. For pensions that are partially indexed to increases in the Consumer Price Index, the actuary should derive inflation rates in a like manner by applying to the stipulated inflation rates the partial indexing formula of the plan.
- .11 The actuary should determine the assumed rate of inflation EI as:
- First 20 years  $EI_{0-20} = BEIR$
  - After 20 years  $EI_{20+} = 2.25\%$
- EI should be rounded to the nearest multiple of 0.01%.
- .12 Where increases in pensions are related to increases in the average wage index, the actuary should assume that the average wage index will increase at rates that are one percentage point higher than EI.

.13 *The capitalized value of a fully- or partially-indexed pension should be at least equal to the capitalized value applicable to a non-indexed pension in the same amount and having similar characteristics. [Effective January 1, 2012]*

.14 Where the plan so provides, the indexing in any of the above arrangements may be modified by:

- Applying a maximum or minimum annual increase, with or without carry forward of excesses or deficiencies to later years; or
- Prohibiting a decrease in a year where the application of the formula would otherwise cause a decrease.

The actuary would then adjust the expected inflation rate for a year to reflect the probability and extent of modification for that year.

.15 If the pension is indexed using an “excess investment return” approach, the expected indexation rate would be determined using the “floor rate” and the interest rates determined in accordance with paragraph 4530.18 to produce an expected indexation rate consistent with excess interest situations.

.16 For a pension in a plan that has a policy or a history of indexing on an ad hoc basis, the actuary would determine an indexation rate consistent with the indexing policy or history.

### **Interest rates**

.17 *The actuary should calculate two interest rates, one applicable to the first 20 years following the calculation date, and the second one applicable to all years thereafter.*

.18 *The actuary should determine the interest rates as:*

- *First 20 years*             $i_{0-20} = G_L + 0.50\%$
- *After 20 years*         $i_{20+} = 5.50\%$

*Prior to calculating the capitalized value, the actuary should round the rates of interest determined in accordance with this paragraph to the nearest multiple of 0.1%.*

.19 *The actuary should calculate the capitalized value of a pension using a two-tier interest rate of:*

- $i_{0-20}$  for the first 20 years; and
- $i_{20+}$  thereafter. [Effective January 1, 2012]

### **Assumptions selected by client**

.20 The actuary would obtain instructions from the client with respect to assumptions dependent upon the interpretation of applicable law.

.21 The actuary would report his or her reliance on an assumption selected by the client.

#### **4540 REPORTING: EXTERNAL USER REPORT**

.01 Here is model text if the actuary reports without reservation with regard to marriage breakdown:

I have determined the capitalized value of the pension benefits and prepared this report in accordance with accepted actuarial practice in Canada, for purposes of settlement of a division of pension benefits resulting from marriage breakdown under the [Family Law Act] of [province]. In my opinion, the capitalized values are appropriate for this purpose.

Respectfully submitted,

[actuary]

Fellow, Canadian Institute of Actuaries

## 4600 CALCULATION OF CRIMINAL RATE OF INTEREST

### 4610 SCOPE

- .01 The standards in section 4600 apply to an actuary's advice when determining whether the interest rate for a particular agreement or arrangement is a "criminal rate".
- .02 The Criminal Code of Canada defines "criminal rate" as meaning an effective annual rate of interest calculated in accordance with generally accepted actuarial practices and principles that exceeds 60 percent on the credit advanced under an agreement or arrangement.

### 4620 DATA

- .01 *The actuary should ascertain or make assumptions regarding the quantum and timing of all amounts actually or deemed to be advanced as well as all amounts actually or deemed to be repaid either as principal or as "interest" as defined in the Criminal Code.*
- .02 *The actuary should report all data used in the calculation, and their sources. [Effective December 31, 2013]*
- .03 If data are not clear from the initial terms of the engagement, the actuary would obtain clarification from his or her client (for example, whether or not a particular item falls within the statutory definition of "interest," or the timing of a particular payment that could be made on various alternate dates).

### 4630 METHOD

- .01 *The actuary should calculate and report the effective rate of interest compounded annually, "i", such that the following equality is established:*

$$\sum_{r=1}^m A_r \times (1+i)^{t_r} = \sum_{s=1}^n B_s \times (1+i)^{t_s}$$

where

- *m is the total number of payments advanced by the lender to the borrower;*
- *n is the total number of payments repaid by the borrower to the lender;*
- *A<sub>r</sub> is the amount of the r<sup>th</sup> payment advanced by the lender;*
- *B<sub>s</sub> is the amount of the s<sup>th</sup> payment repaid by the borrower, consisting of principal, "interest" as defined, or a combination of both;*

- $t_r$  is the period measured in years (including fractional parts of a year) between the time that the  $r^{\text{th}}$  payment is advanced by the lender to the borrower and the time on which the final repayment is made by the borrower to the lender; and
- $t_s$  is the period measured in years (including fractional parts of a year) between the time that the  $s^{\text{th}}$  payment is repaid by the borrower to the lender and the time on which the final payment is made by the borrower to the lender. [Effective December 31, 2013]

- .02 If the calculation produces only one result, then the actuary would report that result. If the calculation produces more than one result, then the actuary would report only those that are positive and real, or zero.
- .03 The formula in paragraph 4630.01 applies in most, but not all, situations.

<b>4700      REPORTING</b>
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**4710 EXTERNAL USER REPORT**

.01 For work pursuant to part 4000, any external user report that is prepared should:

- Identify the person for whom the report was prepared and, if that person is acting on behalf of a party to the dispute, that party to the dispute;
- State the effective date of the report and the effective date of any actuarial opinions and calculations in the report;
- Describe any terms of the appropriate engagement that are material to the actuary's work, including the role of the actuary, the scope and purpose of the work, any limitations or constraints on the work and any stipulated assumptions or methods;
- Where the actuary is aware of circumstances where the independence of his or her expert opinion may reasonably be questioned, disclose such circumstances;
- Disclose the results of the work;
- Describe the data, methods, and assumptions used for the work, including the terms and the amounts of the payments relevant to any calculations, for each of the scenarios presented in the report;
- Identify the assumptions and methods that are constrained by law, regulation, court practice, or established legal principles relevant to the work;
- Identify the differences between scenarios where the results of multiple scenarios are presented;
- Identify any margins for adverse deviations that are included, except where the assumption or method is mandated by law, regulation, court practice, or established legal principles relevant to the work, and the rationale for inclusion of any identified margins for adverse deviations;
- Describe every contingency that has been taken into account, and state that there may be other contingencies that could have a positive or negative effect that have not been taken into account;
- Disclose the extent of the actuary's reliance on others;
- List the sources of information on which the actuary has relied; and
- Include any other information required in accordance with the rules of civil procedure, the rules of law, or other rules that may be applicable for the relevant jurisdiction.

.02 *The actuary's external user report should be sufficiently detailed to enable another actuary to assess the reasonableness of the results.* [Effective December 31, 2013]

.03 The actuary would prepare any draft reports and other documentation, taking into account the potential disclosure of such documents that may be required as part of the dispute resolution proceedings.

.04 Where the actuary reports the results of a capitalized value calculation without reservation, the disclosure wording that may be used is:

I have determined the capitalized value of those aspects of the pecuniary damages described herein and prepared this report in accordance with accepted actuarial practice in Canada. It is my opinion that the assumptions and methods for which I have taken responsibility are appropriate in the circumstances of this case and for the purpose of this report.

Respectfully submitted,

[actuary]

Fellow, Canadian Institute of Actuaries

### **Reporting with reservation**

.05 Reporting with reservation or stating that the reporting requirements have not been followed would not excuse an actuary from these reporting standards.

.06 Notwithstanding paragraph 4340.01, the circumstances of the work may result in deviation from accepted actuarial practice in Canada. For example, the terms of the engagement may require that the actuary use an assumption that is outside of the range that the actuary considers plausible, or that the actuary use a method that the actuary considers is not appropriate, or that the actuary assist counsel with challenging a specific interpretation of the law. In such case, the actuary would disclose such deviation in the report.

### **New information**

.07 Notwithstanding paragraph 1515.01, where an event occurs, such as the availability of new information, after the actuary has completed his or her report, the actuary would consider the potential effect of such event on his or her work, and would advise his or her client on a timely basis, if appropriate and subject to the terms of the engagement.

### **Disclosure of other expert's report**

.08 The external user report need not disclose any error or shortcoming that the actuary identifies in the report of another actuary or other expert witness.

## **4720 INTERNAL USER REPORT**

- .01 *Unless an internal user report conforms to the recommendations for an external user report, an internal user report should state that it is not to be given to an external user. [Effective December 31, 2013]*
- .02 For the purpose of determining whether or not the work is in accordance with accepted actuarial practice, an internal user report continues to be an internal user report even if, in breach of the statement required by paragraph 4720.01, it is given to an external user or utilized in the dispute resolution proceeding.



**5000—PUBLIC PERSONAL INJURY COMPENSATION PLANS**

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<b>5100 SCOPE</b>
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- .00 Part 1000 applies to work within the scope of this part 5000.
- .01 The standards in this part apply to an actuary's work on the valuation of benefits liabilities of a public personal injury compensation plan, including its benefits liabilities in respect of a self-insured employer, and to any other items required under the terms of an appropriate engagement for a public personal injury compensation plan, for the purpose of its financial statements and for the purpose of providing input into its funding arrangements.
- .02 The standards in this part do not apply to an actuary's work for an employer on the valuation of benefits liabilities and other related items in respect of its employees who are covered by a self-insured element of a public personal injury compensation plan, where such work is covered by the Practice-Specific Standards for Post-Employment Benefit Plans. Nevertheless, the standards in this part may provide useful guidance for such work.

<b>5200    EXTENSION OF SCOPE</b>
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- .01 The standards in this part may also provide useful guidance for other work of an actuary for a public personal injury compensation plan, such as work on the development of assessment rates or premiums, the costing of benefits or policy changes, or work on experience-rating programs.
- .02 The standards in this part do not, however, provide useful guidance in the case of an entity merely because it is a monopoly, such as a monopoly of benefits that are optional or a government monopoly that is required to operate like a private sector entity.

**5300 GENERAL**

**5310 CIRCUMSTANCES OF THE WORK**

- .01 *The actuary's work on the valuation of the benefits liabilities or other items for the purpose of the financial statement of a public personal injury compensation plan or for the purpose of providing input into its funding arrangements should take into account the circumstances of the work. [Effective March 15, 2011]*
- .02 The circumstances of the work would include
- terms of the relevant statute,
  - relevant accounting standards and policies, and
  - terms of an appropriate engagement under which the work is being performed,
- and the circumstances of the work may include the funding policy of the public personal injury compensation plan.
- .03 The terms of an appropriate engagement would define the role of the actuary and the purpose of the work. The work of the actuary may be limited to the valuation of the benefits liabilities, or the work may also include the provision of advice on the funding of the public personal injury compensation plan, its financial position, its financial condition and any other actuarial item required under the terms of an appropriate engagement.
- .04 The terms of an appropriate engagement may specify applicable policies of the public personal injury compensation plan relevant to the work of the actuary. These policies may include a formal or informal funding policy, an accounting policy and an investment policy.
- .05 Significant terms of an appropriate engagement may stipulate one or more of
- use of a specified asset value or method of asset valuation, and
  - depending on the circumstances of the work, treatment of definitive amendments and other pending changes.
- .06 Objectives of funding specified by the terms of an appropriate engagement may include, but are not limited to, a specific funding target, the security of benefits, a principle of equity among various groups of employers or various groups of individuals or among generations, or a funding approach for occupational disease claims.

## **5320 DATA**

- .01 *Where sufficient, reliable and relevant data are not available for the valuation of a specific benefit, the actuary should make appropriate assumptions or introduce appropriate methods to compensate for any perceived deficiencies in the data. [Effective March 15, 2011]*
- .02 Sufficient, reliable and relevant data may not be available to the actuary in various circumstances, for example,
- the relevant statute may have been amended to provide a new or revised benefit,
  - an applicable policy of the public personal injury compensation plan may have been revised recently,
  - the public personal injury compensation plan's claim adjudication practices or administration practices may have changed recently,
  - a recent appeal decision may be expected to have a material effect on future benefit payments, or
  - economic conditions or health care practices in the relevant jurisdiction may have changed, which may be expected to have a material effect on benefits.
- .03 Where the data are not sufficient, not fully reliable or not sufficiently relevant to expected future experience for a specific benefit, the actuary may consider taking one or more of the following actions,
- introducing appropriate assumptions regarding missing, incomplete or unreliable data, and
  - adjusting data and historic claim settlement patterns for the purpose of the work, as appropriate, to remove any perceived distortions, such as the effect of historical inflation or one-time benefit changes.

**5400 BENEFITS LIABILITIES**

**5410 METHODS**

- .01 *The actuary should value the benefits liabilities assuming that the public personal injury compensation plan continues indefinitely as a going concern entity.*
- .02 *The value of the benefits liabilities is the value, by the actuarial present value method, of cash flows after the calculation date with respect to all claims incurred before that date and not fully discharged as of that date, whether reported or not, and for calculation dates on and after December 31, 2014, the value, by the actuarial present value method, of cash flows after the calculation date with respect to workplace exposures that have occurred prior to that date. The workplace exposures should include those which may potentially lead to occupational disease claims, in accordance with the policy of the plan.*
- .03 *The cash flows after the calculation date on account of all claims incurred before that date should include all expenses expected to be incurred after the calculation date which are related to those claims, including relevant administration expenses.*
- .04 *The actuary's work should take into account the benefits, relevant policies and administration practices of the public personal injury compensation plan as of the calculation date, and should take into account any definitive amendment to these items that is expected to have a material effect on benefits, unless the circumstances of the work require otherwise.*
- .05 *The benefits liabilities should include an amount in respect of benefits for employees of a self-insured employer, unless the exclusion of such benefits is in accordance with the circumstances of the work.*
- .06 *When estimating the benefits liabilities, the actuary should consider all claims, whether reported or not, until the claims are fully discharged or closed, with no or minimal chance of re-opening. [Effective March 15, 2011]*

**Occupational disease**

- .07 *The actuary would value the benefits liabilities in respect of occupational disease claims, and would include the benefits liabilities for all occupational disease claims reported prior to the calculation date.*

- .08 For calculation dates on or after December 31, 2014, the actuary would also include in the benefits liabilities an appropriate allowance for all occupational disease claims expected to arise after the calculation date as a result of exposures incurred in the workplace prior to the calculation date in respect of occupational diseases with a long latency period that are recognized as such by the public personal injury compensation plan, by legislation, by regulation, or by appeal, regardless of the public personal injury compensation plan's approach to funding potential occupational disease claims. For calculation dates preceding December 31, 2014, the actuary may include in the benefits liabilities an appropriate allowance for such potential occupational disease claims.

**Amendments and subsequent events**

- .09 The actuary's valuation of the benefits liabilities would normally reflect all definitive amendments of which the actuary is aware on the calculation date, including those amendments with an effective date after the calculation date. Where the circumstances of the work require otherwise, the actuary may exclude the effect of a known definitive amendment, but the actuary would disclose the effect of such amendment.

**5420 ASSUMPTIONS**

- .01 *The actuary should set assumptions that reflect the expectation that the public personal injury compensation plan will continue indefinitely as a going concern entity, but may make adjustment for short-term considerations, where appropriate.*
- .02 *The actuary should select either best estimate assumptions or best estimate assumptions modified to incorporate margins for adverse deviations to the extent, if any, required by law or by the circumstances of the work, and should provide the rationale for the decision made with respect to the inclusion or exclusion of margins.*
- .03 *Where a public personal injury compensation plan has an established practice of providing ad hoc increases to benefits, or a periodic update to rates or tables used in the administration of the plan, the actuary should recognize such established practice when valuing the benefits liabilities by assuming the continuation of such practice, unless a definitive policy decision to discontinue such established practice has been taken by the plan. [Effective March 15, 2011]*



## 5430 ECONOMIC ASSUMPTIONS

- .01 The needed economic assumptions include the expected rate of investment income, the expected investment expenses and, depending on the benefit being valued, one or more of
- expected rate of general inflation,
  - expected rate of health care cost inflation,
  - expected rate of wage inflation,
  - if different, expected earnings increase specific to wage loss benefits, and
  - expected rate of change of any other economic factor that may be applicable.
- .02 The economic assumptions that are needed would depend on the nature of the benefits that are being valued, and may vary by year.
- .03 The actuary would develop and disclose separate nominal assumptions, but may prefer to complete the calculations using rates that are net of inflation, net of expenses or net of some other factor. Such calculations may, however, be approximations.
- .04 When determining the best estimate assumption for the expected rate of investment income, the actuary would take into account the expected pattern of risk-free rates of return, the expected additional investment return on the assets of the public personal injury compensation plan at the calculation date (if any) and the expected investment policy after that date. The expected additional investment return would depend on one or more of
- additional returns over risk-free rates expected to be earned on non-risk-free fixed income assets of the type and quality owned on the reporting date and expected to be acquired pursuant to the investment policy of the plan,
  - additional returns over risk-free interest rates expected to be earned on other types of investments, including publicly traded common or preferred equities, private placements, real estate and private equity, and
  - projected composition of the investment portfolio in future years.

In establishing the assumption for the expected rate of investment income, the actuary would assume that there would be no additional returns achieved, net of investment expenses, from an active investment management strategy compared to a passive investment management strategy except to the extent that the actuary has reason to believe, based on relevant supporting data, that such additional returns will be consistently and reliably earned over the long term.

- .05 The expected investment expenses would depend on the investment policy of the plan and the types of investments held and projected to be held in future.
- .06 The actuary may adopt an assumption for the expected rate of investment income that varies depending on the part of the public personal injury compensation plan being valued, and the assets backing the liabilities in that part.
- .07 The assumed expected rate of investment income need not be a flat rate but may vary from period to period.

#### **5440 NON-ECONOMIC ASSUMPTIONS**

- .01 When setting non-economic assumptions, the actuary would reflect all material contingencies.
- .02 The actuary would recognize the effect of varying experience and settlement patterns that result from definitive or virtually definitive revisions to the plan's benefits or claims practices and would consider the relevance of historical claims experience.
- .03 When setting the assumptions for wage loss, disability, pension and other benefits, the actuary would take into account all applicable material contingencies, including the possibility of recoveries, relapses, mortality improvements, changing benefit levels and the intermittence of income replacement and rehabilitation benefits throughout the lifetime of claimants. Further, the actuary would consider the potential effect on future benefit payments of factors such as changing economic conditions, employment levels, the claimant's occupation and industry and seasonal variations.

#### **5450 MARGINS FOR ADVERSE DEVIATIONS**

- .01 *The actuary should not include a margin for adverse deviations when the circumstances of the work require a best estimate calculation or an unbiased calculation.*
- .02 *The actuary should include margins for adverse deviations when the circumstances of the work require such margins. A non-zero margin should be sufficient, without being excessive, and should have the effect of increasing the benefits liabilities or reducing the reported value of the offsetting assets, the computation of which falls within the scope of the work of the actuary. In addition, the provision resulting from the application of all margins for adverse deviations should be appropriate in the aggregate.*
- .03 *If the actuary is required by legislation, regulation, accounting standards, the accounting policy or the funding policy of the plan to use a margin for adverse deviations that is outside the range that the actuary considers appropriate, the actuary may use such imposed assumption, but the actuary should disclose that the margin is outside of the appropriate range and disclose the reason for using such margin. [Effective March 15, 2011]*

- .04 Examples of situations where the circumstances of the work might require an unbiased calculation include

legislation governing the plan may require an unbiased calculation,  
the relevant accounting standards or the accounting policy of the public personal injury compensation plan may require the use of best estimate assumptions, or

the plan's funding policy may recognize the monopoly nature of the plan and place a high priority on equity among generations, employers and other groups, and hence require the use of best estimate assumptions.

- .05 Examples of situations where the circumstances of the work might require the inclusion of a margin for adverse deviations include

where the relevant accounting standards or the accounting policy of the plan, or its funding policy, require inclusion of a margin for adverse deviations, or

where the level of uncertainty or volatility may be high, and not considered to be sufficiently mitigated by the underlying adaptability of the plan.

- .06 Where the actuary includes a margin for adverse deviations, the actuary would provide the rationale for inclusion of the margin and for the selection of the specific amount of the margin. The rationale may include considerations such as

funding policy or accounting policy of the public personal injury compensation plan,

relative importance placed on the balancing of competing interests compared to the achievement of full funding,

level of uncertainty inherent in the assumptions,

level of reliability or credibility of the data or historical information upon which the assumptions are based,

asset/liability mismatch risk,

propensity for ad hoc changes to be made to plan conditions, and

legislative or other restrictions on the ability to mitigate past losses.

## **5460 SENSITIVITY TESTING**

- .01 *The actuary should perform sensitivity testing of adverse scenarios, to illustrate and aid the understanding of the effect of adverse changes to assumptions.*
- .02 *The adverse scenarios that the actuary tests should include at least
  - a decrease of 100 basis points in the assumed rate of investment earnings in all future years,*
  - an increase of 100 basis points in the assumed general rate of inflation,*
  - a discount rate that is equal to the expected rate of return earned on a hypothetical fixed income portfolio, consisting of high-quality bonds of pertinent durations. [Effective March 15, 2011]**
- .03 *The actuary would consider testing other scenarios, depending on the plausible material risks to which the plan may be exposed.*
- .04 *The actuary may also perform sensitivity testing of favourable scenarios.*
- .05 *When selecting the assumptions and scenarios for sensitivity testing, the actuary would consider the circumstances of the work, and would select those assumptions that have a material impact on the benefits liabilities. The actuary may consider the use of testing of integrated sensitivity scenarios, for example, the effect of a deep and prolonged recession.*

**5500 OTHER RELATED ITEMS**

- .01 *The actuary should compute, separately from the benefits liabilities, the present value on the reporting date of any future assessments that have been specifically earmarked to amortize a current deficit and any future scheduled reductions to assessments that have been specifically identified to reduce a current surplus, in accordance with the circumstances of the work. [Effective March 15, 2011]*
- .02 Where the public personal injury compensation plan has specifically earmarked a defined portion of specified future assessments to amortize a current deficit, the actuary would determine the actuarial present value of such earmarked assessments, and disclose such amount separately from the benefits liabilities and assets of the plan, provided that such disclosure is in accordance with the terms of the engagement.
- .03 Where the public personal injury compensation plan has specifically identified reductions to future assessments to reduce a current surplus, the actuary would estimate the actuarial present value of such reductions to future assessments, and disclose such amount separately from the benefits liabilities and assets of the plan, provided that such disclosure is in accordance with the terms of the engagement.

**5600 GAIN AND LOSS ANALYSIS**

- .01 *The actuary should conduct a gain and loss analysis, including a comparison of actual and expected experience for the period between the prior calculation date and the current calculation date.*
- .02 *The actuary should also conduct a reconciliation of the surplus or deficit position of the plan, provided that such reconciliation is in accordance with the terms of the engagement. [Effective March 15, 2011]*
- .03 The actuary's analysis would include all material gains and losses. At a minimum, the actuary's gain and loss analysis would consider the impact of any significant changes to the assumptions or methods used, any significant changes to the benefits or policies of the plan, gains or losses due to investment returns on the plan's assets, legislative changes, and any other areas where the difference between actual and expected experience is significant.
- .04 The actuary would report a change in assumption if the current assumption differs nominally from the corresponding prior assumption, unless the change in the nominal amount results from the application of the same calculation method. For example, if certain rates used in the valuation are based on historical claims experience and calculated using the same averaging formula, the difference in assumed rates between the calculation date and the prior calculation date would not normally be considered as a change in assumptions. Nevertheless, the actuary may choose to disclose the effect of the updated rate assumption on the valuation results.

**5700 REPORTING**

- .01 For work pursuant to this part, the actuary should prepare a report that
- states the calculation date and the prior calculation date,*
  - identifies the legislation or other authority under which the work is completed,*
  - describes any significant terms of the appropriate engagement that are material to the actuary's work, including the purpose of the work,*
  - describes the sources of data, benefit provisions and policies used in the work, and any limitations thereon,*
  - summarizes the data used for the valuation, the data tests conducted to assess the accuracy and completeness of the data used in the work, and issues regarding insufficient or unreliable data,*
  - describes the plan's benefits, significant policies and relevant administration practices, including the identification of any amendments made since the prior calculation date, and the effect of such amendment on the benefits liabilities,*
  - describes any pending definitive or virtually definitive amendment, policy change or change to administration practice, confirms whether or not such amendment or change has been reflected in the benefits liabilities, and identifies the effect of such amendment or change on the benefits liabilities,*
  - identifies any significant changes to the relevant statute, strategic direction or management policy, or any significant appeal decision that changes management policy or practice, since the prior calculation date and the consequent effect on the benefits liabilities,*
  - summarizes the benefits liabilities,*
  - describes the method and the assumptions used to determine the benefits liabilities,*
  - provides the rationale for each assumption that is material to the actuary's work,*
  - states that there is no provision for adverse deviations, where that is the case,*

*describes the margins for adverse deviations included with respect to each assumption where that is the case, and discloses*

*any imposed margins that the actuary has used in accordance with paragraph 5450.03 that, in the opinion of the actuary, are outside of the appropriate range,*

*the rationale for each margin, and*

*the aggregate provision for adverse deviations included in the benefits liabilities,*

*describes changes to the assumptions or methods used since the prior calculation date, and the rationale for those changes,*

*describes the treatment of liabilities for self-insured employers,*

*discloses subsequent events of which the actuary is aware, whether or not the events are taken into account in the work, or, if there are no significant events of which the actuary is aware, include a statement to that effect,*

*describes and quantifies the gains and losses between the prior calculation date and the current calculation date, and provides an analysis and explanation of the significant gain and loss items, and*

*describes the treatment of the liabilities for occupational disease claims, and states either that the amount of the benefits liabilities includes an appropriate allowance for potential occupational disease claims that are expected to arise after the calculation date as a result of exposures in the workplace prior to the calculation date or, if such is the case for calculation dates preceding December 31, 2014, that the amount of the benefits liabilities excludes such an allowance.*

.02 *Depending on the terms of the engagement, the report should*

*describe the sources of information on the plan's assets,*

*describe the plan's assets, including their market value, the methods and assumptions used to value the assets and a summary of the assets by major category,*

*report the financial position at the calculation date, and*

*report the actuarial present value of any future assessments earmarked to amortize a current deficit or of any reductions in future assessments intended to reduce a current surplus.*



- .03 *If the report does not include the results of the sensitivity testing that was completed, the actuary should prepare a separate report for the management of the public personal injury compensation plan that does include such sensitivity testing results.*
- .04 *The report should provide the following five statements of opinion, all in the same section of the report and in the following order*
- a statement regarding data, which would usually be, “In my opinion, the data on which the valuation is based are sufficient and reliable for the purpose of the valuation.”,*
- a statement regarding assumptions, which would usually be, “In my opinion, the assumptions are appropriate for the purpose of the valuation.”,*
- a statement regarding methods, which would usually be, “In my opinion, the methods employed in the valuation are appropriate for the purpose of the valuation.”,*
- a statement regarding appropriateness, which would usually be “In my opinion the amount of the benefits liabilities makes appropriate provision for all personal injury compensation obligations and the financial statements fairly present the results of the valuation.”, and*
- a statement regarding conformation, which should be, “This report has been prepared, and my opinions given, in accordance with accepted actuarial practice in Canada.” [Effective March 15, 2011]*
- .05 The report would be sufficiently detailed to enable another actuary to examine the reasonableness of the valuation.
- .06 The circumstances of the work may result in a deviation from accepted actuarial practice in Canada. For example, the applicable legislation or the terms of the engagement may require that the actuary use a margin for adverse deviations that is outside the range that the actuary considers appropriate, or require that the actuary exclude the benefits liabilities in respect of certain occupational disease claims. In such case, the actuary would disclose such deviation in the report.

**6000 – POST-EMPLOYMENT BENEFIT PLANS**

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<b>6100 SCOPE</b>
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.01 The standards in part 6000 apply as follows:

- Section 6200 applies to advice that an actuary provides regarding the funding, funded status, financial position, or the financial condition with respect to a post-employment benefit plan, except where such advice relates to items covered by section 6300 or section 6400;
- Section 6300 applies to advice that an actuary provides regarding the funding, funded status, financial position, or the financial condition with respect to the wind-up, in full or in part, of a post-employment benefit plan; and
- Section 6400 applies to advice that an actuary provides regarding financial reporting of a post-employment benefit plan's costs and obligations in the employer's financial statements, or the post-employment benefit plan's financial statements, or the financial statements of a trust associated with the post-employment benefit plan, where the calculations and advice are provided in accordance with an applicable financial reporting standard.

For the purposes of determining whether section 6300 applies, the wind-up of a post-employment benefit plan would involve the termination of future benefits for some or all plan members, the termination of some or all plan benefits and the distribution of some or all of the plan's assets, if any. Examples of work with respect to wind-ups include the calculation of benefit plan costs or entitlements:

- When a benefit trust is being replaced with an insured arrangement;
- Where assets from a company's liquidation may be provided as cash in lieu of employee benefit plans upon insolvency or upon the wind-up of a post-employment benefit plan trust; and
- Where the plan sponsor offers cash in lieu of future benefits.

The cessation of benefit accruals or termination of a post-employment benefit plan, not involving the termination of plan benefits and distribution of plan or other assets, would not constitute a plan wind-up. For example, the closure of a post-employment benefit plan to future new members would not constitute a wind-up.

.02 The standards in sections 6200 through 6400 apply to an actuary's advice with respect to a post-employment benefit plan that provides benefits other than pension benefits to the plan's members and their covered spouses and dependants, whether funded or not, whether insured or not, and whether in the private or public sector. Such plans include any arrangement that provides:

- Long-term employee benefits (and compensated absences) including long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits, and profit sharing, bonuses, and other deferred compensation such as retiring allowances that are to be paid far enough into the future to be considered to be a post-employment benefit (long-term employee benefits would generally include benefits that commence or continue to be payable more than 12 months after the initial incident that caused the benefit to be paid; for example, long-term disability benefits);
- Short-term employee benefits (and compensated absences) that accumulate or vest, such as accumulated sick days or vacation days that can be saved in one period and drawn or paid out in another period;
- Benefits to which plan members become entitled when they are no longer actively at work, such as post-employment life insurance or post-employment health care; and/or
- Termination benefits payable to an employee as a result of termination of employment, if some or all of the benefits are payable on or after the date of termination of employment.

.03 The standards in sections 6200 through 6400 do not apply to an actuary's advice with respect to any arrangement that is:

- A plan within the scope of part 3000 Pension Plans or part 5000 Public Personal Injury Compensation Plans;
- A short-term employee benefit plan such as wages, salaries, and social security contributions, paid annual vacation/leave and paid sick leave, profit sharing and bonuses (if payable within 12 months of the end of the period to which they relate) and non-monetary benefits (such as medical care, housing, cars, and free or subsidized goods or services) for current employees that do not accumulate or vest;
- A post-employment benefit plan whose benefits are all guaranteed by a life insurer; or
- A social security program such as the Canada Pension Plan and Québec Pension Plan.

.04 The standards in sections 6200 through 6400 also apply to an actuary's advice to an employer with respect to the self-insured element of a public personal injury compensation plan that covers the employees of that employer; for example, self-insured workers' compensation plans.

.05 An actuary's advice with respect to a post-employment benefit plan may relate to items such as:

- Required or recommended funding of the plan;
- Projected cash flows of the plan with or without future new entrants;
- Determination of the actuarial present value of the projected or accrued benefits of the plan with or without future new entrants;
- Determination of amounts for financial reporting of a plan's cost; or
- Determination of the obligations for reporting in the employer's financial statements, or the plan's financial statements, or the financial statements of a trust associated with the plan.

**6200 ADVICE ON THE FUNDING, FUNDED STATUS, FINANCIAL CONDITION, OR FINANCIAL POSITION OF A POST-EMPLOYMENT BENEFIT PLAN**

.01 This section 6200 applies to advice that an actuary provides regarding the funding, funded status, financial position, or the financial condition with respect to a post-employment benefit plan, except where such advice is with respect to:

- The wind-up, in full or in part, of a post-employment benefit plan; or
- The financial reporting of a post-employment benefit plan's costs and obligations in the employer's financial statements, or the post-employment benefit plan's financial statements, or the financial statements of a trust associated with the post-employment benefit plan, where the calculations and advice are provided in accordance with an applicable financial reporting standard.

**6210 GENERAL**

.01 *The actuary's advice with respect to a post-employment benefit plan should take account of the circumstances of the work.*

.02 *The actuary should select an actuarial cost method that is consistent with the circumstances of the work.*

.03 *The actuary should select an asset valuation method, where applicable, that is consistent with the circumstances of the work.*

.04 *The actuary's advice with respect to a post-employment benefit plan should take account of the post-employment benefit plan's benefit provisions at the calculation date, except that the actuary may reflect a pending amendment to the post-employment benefit plan that increases the value of its benefits.*

.05 *The actuary's advice with respect to a post-employment benefit plan should take account of all relevant data, including historical claims experience.*

.06 *The actuary should select assumptions that are consistent with the circumstances of the work.*

.07 *The actuary should determine the next calculation date and the actuary's advice should cover at least the period between the calculation date and the next calculation date. [Effective June 30, 2013]*

### **Circumstances of the work**

.08 For the purposes of section 6200, the circumstances of the work would include:

- The terms of the appropriate engagement under which the work is being performed; and
- The application of the law to the work.

.09 The terms of an appropriate engagement would specify whether the actuary's advice relates to:

- The funded status or the funding of the post-employment benefit plan or a combination thereof;
- The calculation of the actuarial present value of future benefits payable from a post-employment benefit plan;
- The calculation of the expected future cash flows from a post-employment benefit plan; or
- Other financial information with respect to the post-employment benefit plan that is actuarial in nature.

.10 The terms of an appropriate engagement may specify the use of a particular actuarial cost method and/or a particular asset valuation method.

.11 The terms of an appropriate engagement may specify that the actuary's advice may be related to the entire plan, or to a portion of the plan, or to a selected group of members only.

### **Actuarial cost methods**

.12 Actuarial cost methods include, among others:

- Cost allocation methods, which allocate the actuarial present value of projected benefits among time periods, including attained age actuarial cost methods, entry age actuarial cost methods, aggregate actuarial cost methods, and individual level premium actuarial cost methods;
- Benefit allocation methods, which allocate a portion of the actuarial present value of projected benefits to a time period, including the accrued benefit actuarial cost method, the unit credit actuarial cost method, and the projected unit credit actuarial cost method; and
- Forecast actuarial cost methods, which allocate a portion of the actuarial present value of projected benefits to the forecast period based on:
  - The actuarial present value, at the calculation date, of projected benefits at the end of the forecast period, including, if appropriate, benefits for those who are expected to become members between the calculation date and the end of the forecast period;



minus

- The actuarial present value of projected benefits at the calculation date;

plus

- The actuarial present value, at the calculation date, of benefits expected to be paid during the forecast period.

### **Asset valuation methods**

.13 If the plan has assets, the use of an asset valuation method that produces an asset value different from market value may be appropriate depending on the circumstances of the work. For example, the use of a smoothed asset value may be appropriate to moderate the volatility of contribution rates for purposes of advice on funding.

.14 The value of assets may be, subject to specific requirements for different types of valuation, any of:

- Their market value;
- Their market value adjusted to moderate volatility in investment returns;
- The present value of their cash flows after the calculation date; and
- Their value assuming a constant rate of return to maturity in the case of illiquid assets with fixed redemption values.

### **Plan provisions**

.15 The actuary would determine the plan provisions with sufficient accuracy for the purposes of the valuation. Sources of information on plan provisions include:

- Current plan documents;
- Funding or underwriting arrangements;
- Collective bargaining agreements;
- Information regarding past practices;
- Cost-sharing arrangements between the plan sponsor(s) or plan administrator and plan members; and
- Communication between the plan sponsors or plan administrator and the plan members.

Prior plan provisions may be needed to analyze claims information from periods prior to the calculation date.

.16 The actuary would consider all benefits that are to be payable under the post-employment benefit plan and would include provision for all such benefits expected to be paid under the plan.

### **Anticipated amendment or deferred recognition of a pending amendment**

.17 The actuary's advice on a post-employment benefit plan may, subject to disclosure, reflect an expected amendment to the plan if the amendment is definitive or virtually definitive, and the amendment increases the plan's benefits. For example, the plan sponsor may have a regular pattern of increasing the dental fee guide schedules that the post-employment benefit plan uses for its benefit limit. The actuary's advice would normally reflect continued adoption of such increased limits.

.18 If, at the calculation date, an amendment to the post-employment benefit plan is definitive or virtually definitive, and:

- If the effective date of the amendment is during the period for which the report gives advice on funding, then the advice on funding up to the effective date may disregard the amendment, but the advice on funding after the effective date would take the amendment into account; or
- If the effective date of the amendment is after the period for which the report gives advice on funding, then the advice on funding may disregard the amendment.

.19 The effective date of the amendment is the date at which the amended benefits take effect, as opposed to the date when the amendment becomes either definitive or virtually definitive.

.20 If an actuary is aware of an expected amendment to the post-employment benefit plan, but does not reflect the amendment in the work, then the actuary would report the event in accordance with the requirements for the disclosure of subsequent events.

### **Data**

.21 In addition to the current plan membership and asset data, if relevant, the actuary would collect information on historical claims experience, such as nature of absence and benefit levels. Data may come from the plan sponsor or plan administrator or other sources, such as insurance carriers, brokers, or external third-party plan administrators.

.22 In identifying the data needed, the actuary would bear in mind the pertinent benefits (e.g., those applicable during retirement, disability, or following termination of employment). If applicable, the actuary may obtain claims data split by plan, by age, by location, by status (retiree, inactive, spouse, etc.) and by type of expense (drug, hospital, payment for loss of income, etc.).

.23 Where appropriate, in analyzing any relevant historical claims data, the data would be adjusted to reflect the trend in the cost of benefits between the reference period and the calculation date. Where appropriate, the actuary would also adjust past experience results to reflect non-recurring influences such as changes in the benefits offered, significant changes in the demographics of the group, changes in government programs, or unusual claims.

.24 Available data may have limited value or low credibility. Where the benefit cost for former members or current retirees is not fully credible or does not reasonably represent the likely benefit cost for similar future groups, the actuary may rely on the experience of other members or other sources of data that the actuary considers reasonable and relevant. Such other data would be adjusted appropriately for the expected differences between these groups and the group from which the data were drawn.

.25 The actuary may project data, including membership data and data with respect to claim costs from the effective date of the data to the calculation date, using appropriate extrapolation techniques. The actuary would not normally extrapolate membership data more than three years from the effective date of the membership data. The actuary may also use recent credible claims experience in the extrapolation.

### **Assumptions**

.26 In establishing the assumptions, the actuary would usually assume the continuation of the current provisions and practices of government programs, but anticipate the effect of legislative changes scheduled to be implemented at a future date. The actuary may also present alternative results reflecting different scenarios of the future. If the purpose of the valuation is such that the effect of anticipated future government changes is to be taken into account, the actuary would make appropriate assumptions in respect thereof.

.27 In determining claim costs assumptions, where necessary, the actuary would consider available claims experience with regards to items such as:

- Claimant age, member status, coverage category, and benefit type;
- Credibility; and
- Relevance to future periods and future benefit provisions.

.28 The assumption with respect to the future claims trend rate, where necessary, may be divided into short-term and longer-term components. The short-term component would often be based on the level experienced in the recent past by the plan and plan members. The longer-term component would be consistent with the assumption regarding future changes in benefit programs and general economic conditions such as nominal Gross Domestic Product growth. The actuary would determine the period of time required to transition from the short-term trends to the longer-term trends and when the short-term trends may need to be revised.

.29 In situations where there is not sufficient data with respect to claim costs—for example if the post-employment benefit plan has only a small number of members or does not yet have any members in payment status—the actuary may develop the applicable assumptions based on experience with other similar plans.

### **Discount rate**

.30 For post-employment benefit plans that are not funded, in selecting the best estimate assumption for the discount rate, the actuary would reflect the yields on fixed income investments, considering the expected future benefit payments of the plan and the circumstances of the work.

### **Expenses**

.31 The actuary's advice on a post-employment benefit plan would take account of expenses, including whether or not they are expected to be paid from the post-employment benefit plan's assets, if any.

.32 The actuary would consider, as part of the claims experience, the administration costs related to the adjudication of the claims including any related general administration expenses charged by the party adjudicating the claims and all applicable taxes. The actuary would also consider other expenses related to the post-employment benefit plan.

### **Next calculation date**

.33 The next calculation date is the latest date for which the actuary considers the advice with respect to a post-employment benefit plan to be applicable. The actuary would take into consideration the terms of an appropriate engagement in determining the next calculation date, but the next calculation date would not normally be more than three years after the current calculation date.

## **6220 ADVICE ON FUNDING OR FUNDED STATUS**

.01 *If the actuary is providing advice with respect to the funding and/or funded status of a post-employment benefit plan that is pre-funded in some manner, the actuary should, notwithstanding subsection 1740, select either best estimate assumptions or best estimate assumptions modified to incorporate margins for adverse deviations, as described in paragraph 1740.40, to the extent, if any, required by the terms of an appropriate engagement. [Effective June 30, 2013]*

.02 Advice on funding or funded status may include:

- Advice regarding the amount of assets to be earmarked, whether or not segregated, to cover post-employment benefit commitments;
- Advice regarding a systematic method of accumulating funds to provide the post-employment benefit commitments; or
- Advice on the funding implications of a plan amendment.

.03 The terms of an appropriate engagement may specify applicable objectives of funding, which may include a formal or informal funding policy.

.04 Objectives of funding specified by the terms of an appropriate engagement may include considerations such as the security of benefits and related provisions for adverse deviations, the allocation of contributions among time periods, and/or inter-generational equity.

.05 Depending on the circumstances of the work, the actuary's advice on funding may describe a range of contributions.

### **Discount rate**

.06 If the actuary's advice relates to the funding or funded status of a post-employment benefit plan, in selecting the best estimate assumption for the discount rate, the actuary may either:

- Take into account the expected investment return on the assets, if any, of the post-employment benefit plan at the calculation date and the expected investment policy after that date; or
- Reflect the yields on fixed income investments, considering the expected future benefit payments of the post-employment benefit plan and the circumstances of the work.

.07 In establishing the discount rate assumption, the actuary would assume that there will be no additional returns achieved, net of investment expenses, from an active investment management strategy compared to a passive investment management strategy except to the extent that the actuary has reason to believe, based on relevant supporting data, that such additional returns will be consistently and reliably earned over the long term.

## **6230 REPORTING: EXTERNAL USER REPORT**

.01 *An external user report on work pursuant to section 6200 should:*

- *Describe any significant terms of the appropriate engagement that are material to the actuary's advice;*
- *Include the calculation date, the report date, and the next calculation date, if applicable;*
- *Describe the sources of membership data, plan provisions, the post-employment benefit plan's assets, if any, and historical claims data, if any, and the dates at which they were compiled;*
- *Describe the membership data and any limitations thereof, and any assumptions made about missing or incomplete membership data;*
- *Describe the tests applied to determine the sufficiency and reliability of the membership data and plan asset data for purposes of the work;*
- *Describe the assets, if any, including their market value and a summary of the assets by major category;*
- *Describe the post-employment benefit plan's provisions, including the identification of any pending definitive or virtually definitive amendment of which the actuary is aware, and the manner in which any such amendments have been reflected in the actuary's advice;*

- Disclose subsequent events of which the actuary is aware, whether or not the events are taken into account in the work, or, if there are no subsequent events of which the actuary is aware, include a statement to that effect;
- State the type of valuation undertaken under the terms of the appropriate engagement;
- For any one valuation undertaken, describe and quantify the gains and losses between the prior calculation date and the calculation date;
- For any one valuation undertaken, report the effect on the key results of the valuation of using a discount rate 1.0% lower than that used for the valuation; and
- For any one valuation undertaken, where relevant, report the effect on the key results of the valuation of using an assumed future claims trend rate 1.0% higher than that used for the valuation.

.02 For each valuation undertaken by the actuary, the external user report should:

- Describe the actuarial cost method;
- Describe the method used to value the post-employment benefit plan's assets, if any;
- Describe the assumptions used, including the extent of any margins for adverse deviations included with respect to each such assumption, and provide the rationale for each assumption that is material to the actuary's advice;
- If there is no provision for adverse deviations, include a statement to that effect;
- Describe the claims administration expenses or other plan expenses that are included in the work; and
- Report the results of the valuation.

.03 An external user report that provides advice on funding should:

- Describe the rationale for any assumed additional returns, net of investment management expenses, from an active investment management strategy, included in the discount rate assumption;
- Describe the determination of contributions or a range of contributions between the calculation date and the next calculation date; and
- If contributions are fixed by the terms of the post-employment benefit plan or other governing documents (e.g., a collective agreement), then either:
  - Report that the contributions are adequate to fund the post-employment benefit plan in accordance with its terms; or
  - Report that the contributions are not adequate to fund the post-employment benefit plan in accordance with its terms; and

- Describe the contributions required to fund the post-employment benefit plan adequately in accordance with its terms;
- Describe one or more possible ways in which benefits may be reduced such that the contributions would be adequate to fund the post-employment benefit plan in accordance with its terms; or
- Describe a combination of increases in contributions and reductions in benefits that would result in the funding being in accordance with its terms.

.04 An external user report should provide the following four statements of opinion, all in the same section of the report and in the following order:

- A statement regarding membership data, which should usually be, “In my opinion, the membership data on which the valuation is based are sufficient and reliable for the purpose of the valuation.”;
- A statement as to assumptions, which should usually be, “In my opinion, the assumptions are appropriate for the purpose(s) of the valuation(s).”;
- A statement as to methods, which should usually be, “In my opinion, the methods employed in the valuation are appropriate for the purpose(s) of the valuation(s).”; and
- A statement as to conformity, which should be, “This report has been prepared, and my opinions given, in accordance with accepted actuarial practice in Canada.”

.05 An external user report should be sufficiently detailed to enable another actuary to examine the reasonableness of the valuation. [Effective June 30, 2013]

### **Significant terms of appropriate engagement**

.06 Significant terms of the appropriate engagement may include matters such as:

- The use of a specified actuarial cost method;
- The use of a specified asset valuation method, where applicable;
- The exclusion of benefits for purposes of a valuation;
- The extent of margins for adverse deviations, if any, to be included in selecting assumptions; and
- The funding policy, which may include pay-as-you-go funding.

### **Membership data**

.07 The actuary would describe any assumptions and methods used in respect of insufficient or unreliable membership or census/employee data.

.08 The actuary may describe limitations on the tests conducted in the review of the data which has been determined to be sufficient and reliable for purposes of the valuation(s). For example, the actuary may describe that the data tests will not capture all possible deficiencies in the data and reliance is also placed on the certification of the plan sponsor or plan administrator as to the quality of the data.

### **Methods**

.09 For each valuation included in the external user report for which there was a prior valuation, the description of the actuarial cost method would include a description of any change to the actuarial cost method used in the prior valuation and the rationale for such change.

.10 For each valuation included in the external user report for which there was a prior valuation, the description of the method to value the assets, if any, would include a description of any change to the asset valuation method used in the prior valuation and the rationale for such change.

### **Types of valuations**

.11 An external user report with respect to a post-employment benefit plan would normally include information on only one valuation, which is typically a going concern valuation. To the extent that the external user report provides information with respect to multiple valuations, the actuary would include information with respect to the types of valuations required by the circumstances of the work.

### **Assumptions**

.12 For each valuation included in the external user report for which there was a prior valuation, the description of assumptions would include a description of any changes to the assumptions used in the prior valuation.

.13 For each valuation included in the external user report, the description of the assumptions would, if appropriate for the circumstances of the work, describe:

- The development of the assumed claim costs;
- The claims experience information used to develop the assumed claim costs; and
- The extent to which the claims experience information has influenced the selection of the assumed future cost trend rates.



### **Relevant results of the valuation**

- .14 The results of the valuation will depend on the purpose(s) of the valuation and the circumstances of the work. The results of the valuation may include such information as:
- The present value of projected benefits;
  - The present value of projected benefits allocated to periods up to the calculation date;
  - The projected cash flows; and/or
  - The service cost for periods following the calculation date.

### **Reporting gains and losses**

- .15 The reported gains and losses for a valuation would include the gain or loss due to a change in the actuarial cost method or a change in the method for valuing the assets, if any, and each significant change in assumptions and plan provisions determined at the calculation date. If an amendment to the post-employment benefit plan prompts the actuary to change the assumptions, the actuary may report the combined effect of the amendment and the resultant change in assumptions.

### **Sensitivity analysis**

- .16 When following the recommendations to illustrate the effect of a change in discount rate, trend rate or other assumption on a valuation, the actuary would maintain all other assumptions and methods as used in the underlying valuation.

### **Reference to other reports**

- .17 The disclosures required in the external user report may be incorporated by reference to another actuarial valuation report prepared in accordance with accepted actuarial practice with the same calculation date.

### **Statements of opinion**

- .18 Where different statements of opinion apply in respect of different purposes of the valuation, the above requirements may be modified but would be followed to the extent practicable.
- .19 While a separate statement regarding assumptions would usually be included in respect of each purpose of the valuation, the statements regarding assumptions may be combined where the statements do not differ among some or all of the valuation's purposes. The report would indicate clearly which statement regarding assumptions applies to each of the valuation's purposes.
- .20 While a separate statement regarding methods would usually be included in respect of each purpose of the valuation, the statements regarding methods may be combined where the statements do not differ between some or all of the valuation's purposes. The report would indicate clearly which statement regarding methods applies to each of the valuation's purposes.

## 6300 FULL OR PARTIAL WIND-UP VALUATION

.01 This section 6300 applies to advice that an actuary provides with respect to the wind-up (termination of future benefits for some or all members, the termination of some or all plan benefits, and the distribution of some or all of the plan's assets, if any), in full or in part, of a post-employment benefit plan. Examples of work with respect to wind-ups include the calculation of benefit plan costs or entitlements:

- When a benefit trust is being replaced with an insured arrangement;
- Where assets from a company's liquidation may be provided as cash in lieu of employee benefit plans upon insolvency or upon the wind-up of a post-employment benefit plan trust; and
- Where the plan sponsor offers cash in lieu of future benefits.

.02 This section 6300 does not apply in situations where the post-employment benefit plan is no longer available for future members but accrued benefits are not being settled.

### 6310 GENERAL

.01 *The actuary's advice with respect to a post-employment benefit plan that is being wound up, in full or in part, should take account of the circumstances of the work, and assume the plan is being wound up at the calculation date.*

.02 *The actuary should take account of subsequent events up to the cut-off date.*

.03 *The post-employment benefit plan's assets, if any, should be valued at liquidation value.*

.04 *The actuary should take account of the post-employment benefit plan's benefit provisions at the calculation date, except that the actuary may reflect a pending amendment to the post-employment benefit plan.*

.05 *The actuary's advice with respect to a post-employment benefit plan should take account of all relevant data, including historical claims experience.*

.06 *The actuary should select assumptions that:*

- *Notwithstanding subsection 1740, are either best estimate assumptions or are best estimate assumptions modified to incorporate margins for adverse deviations, as described in paragraph 1740.40, to the extent, if any, required by the terms of an appropriate engagement;*
- *Are selected as at the cut-off date; and*
- *Reflect the expected method of benefit settlement.*

.07 *Unless it is expected that expenses will not be paid from the post-employment benefit plan's assets, the actuary should select an explicit assumption regarding the expenses of wind-up and either offset the resulting expense provision against the post-employment benefit plan's assets, if any, or add the resulting expense provision to the post-employment benefit plan's liabilities. Expenses may include administration costs (which may be incurred from a third-party administrator or an insurer), or other expenses. [Effective June 30, 2013]*

### **Scope**

.08 This section does not prescribe the manner in which:

- Benefit entitlements would be determined;
- Funding obligations would be determined; or
- The post-employment benefit plan's assets, if any, would be allocated between the employer(s) and the members or among members themselves.

.09 Rather, those issues would be determined in accordance with the law, the plan provisions or governance documents, or by an entity empowered thereunder to make that determination. It may be appropriate, however, to use the results of the valuation to address one or more of those issues, or to disclose their resolution in the report.

### **Circumstances of the work**

.10 For the purposes of section 6300, the circumstances of the work would include:

- Whether the actuary's advice relates to the funding, funded status, financial position, or the financial condition of the post-employment benefit plan, or a combination thereof;
- Whether the actuary's advice relates to the present value of expected future benefits under the post-employment benefit plan;
- The terms of the appropriate engagement under which the work is being performed; and
- The application of the law to the work.

### **Cut-off date**

.11 The cut-off date would be the date up to which subsequent events would be recognized in the valuation.

### **Partial wind-up**

.12 A partial wind-up occurs when a subset of the members terminates membership in circumstances that require wind-up with respect to those members. Such wind-up does not apply to the continuing members, although it may also be necessary, for other reasons, to value the benefits of the continuing members.

.13 The standards for a partial wind-up are the same as the standards for a full wind-up.

### Assumptions

- .14 The selection of the assumptions would normally be determined in accordance with the law (if applicable), the plan provisions or governance documents, or by an entity empowered thereunder to make that determination.
- .15 The actuary may need to consider various appropriate tax treatments for calculations prepared for wind-ups of post-employment benefit plans.

### Expenses

- .16 The actuary would consider as part of the claims experience the administration costs related to the adjudication of the claims, including any related general administration expenses charged by the party adjudicating the claims and all applicable taxes. The actuary may also consider other expenses related to the post-employment benefit plan.

### Plan provisions

- .17 The actuary would determine the plan provisions with sufficient accuracy for the purposes of the valuation. Sources of information on plan provisions include:
- Current plan documents;
  - Funding or underwriting arrangements;
  - Collective bargaining agreements;
  - Information regarding past practices;
  - Cost-sharing arrangements between the plan sponsor(s) or plan administrator and plan members; and
  - Communication between the plan sponsors or plan administrator and the plan members.

Prior plan provisions may be needed to analyze claims information from periods prior to the calculation date.

- .18 The actuary would consider all benefits that are to be payable under the post-employment benefit plan and would include provision for all such benefits expected to be paid under the plan.

### **6320 REPORTING: EXTERNAL USER REPORT**

- .01 *If a previous external user report was prepared with respect to the wind-up, the actuary should describe and quantify the gains and losses between the prior calculation date and the calculation date.*

*An external user report should:*

- *Include the wind-up date, the calculation date, the cut-off date, and the report date;*
- *Describe the events precipitating the wind-up, of which the actuary is aware, that affect the terms of the wind-up, the benefit entitlements, or the valuation results;*
- *Describe the sources of membership data, plan provisions, and the post-employment benefit plan's assets, if any, and historical claims data, if any, and the dates at which they were compiled;*
- *Describe the membership data and any limitations thereof, including any assumptions made about missing or incomplete membership data;*
- *Describe the tests applied to determine the sufficiency and reliability of the membership data and plan asset data for purposes of the work;*
- *Subject to any applicable privacy legislation:*
  - *Include the detailed individual membership data; or*
  - *Include an offer to provide detailed individual membership data on request to the plan sponsor or the plan administrator;*
- *Describe the liquidation value of the assets, if any, and a summary of the assets by major category;*
- *Describe the post-employment benefit plan's provisions, including an identification of:*
  - *Any amendments made since any previous external user report with respect to the plan which affect benefit entitlements; and*
  - *Any subsequent events or post-wind-up contingent events, of which the actuary is aware, which affect benefit entitlements;*
- *Describe the methods used to determine the reported liabilities or expected future benefit payments;*
- *Describe the assumptions used to determine the liabilities or expected future benefit payments and provide the rationale for each assumption that is material to the actuary's advice;*
- *Report the explicit assumption regarding the expenses of wind-up or justify the expectation that expenses will not be paid from the post-employment benefit plan's assets, if any;*

- *Report the funded status at the calculation date, and state whether an updated report will be required in the future;*
- *If applicable, report the settlement value for each plan member when settlement is to be made by cash payments to the member;*
- *Disclose subsequent events of which the actuary is aware, whether or not the events are taken into account in the work and, if there are no subsequent events of which the actuary is aware, include a statement to that effect;*
- *State that the funded status at settlement may differ from that contained in the report, unless the report includes the funded status at the time of final settlement;*
- *If the actuary relies upon direction concerning unclear or contentious issues:*
  - *Describe each such issue;*
  - *Describe the direction relied upon or, where appropriate, a summary thereof; and*
  - *Identify the person providing such direction and the basis of authority of such person;*
- *Describe any post-wind-up contingent events that may affect the distribution of the post-employment benefit plan's assets, if any;*
- *Describe whether a recalculation of the value of benefit entitlements is required at settlement;*
- *Where a member has a choice of settlement options that the member has not yet made, describe the assumptions made regarding such choice;*
- *If applicable, describe the method to allocate the post-employment benefit plan's assets among classes of members and the method to distribute surplus;*
- *Describe the actuary's role in calculating settlement values, including the assumptions and methods used for their calculation; and*
- *Describe the sensitivity of the valuation results to the post-employment benefit plan's investment policy and to market conditions between the report date and the settlement date.*

.03 An external user report should include the following four statements of opinion, all in the same section of the report and in the following order:

- A statement regarding membership data, which should usually be, “In my opinion, the membership data on which the valuation is based are sufficient and reliable for the purpose of the valuation.”;
- A statement regarding assumptions, which should usually be, “In my opinion, the assumptions are appropriate for the purpose(s) of the valuation(s).”;
- A statement regarding methods, which should usually be, “In my opinion, the methods employed in the valuation are appropriate for the purpose(s) of the valuation(s).”; and
- A statement regarding conformity, which should be, “This report has been prepared, and my opinions given, in accordance with accepted actuarial practice in Canada.”

.04 The external user report should be sufficiently detailed to enable another actuary to examine the reasonableness of the valuation. [Effective June 30, 2013]

### **Dates**

.05 The wind-up date of the post-employment benefit plan would be determined by the plan administrator or the plan sponsor or others with responsibility to wind up the plan, based on the plan provisions, the law, and the circumstances of the wind-up.

.06 The calculation date of the funded status would usually be the wind-up date.

.07 For a particular member, the date of calculation of benefit entitlement would depend on the circumstances of the wind-up and the terms of the post-employment benefit plan, and may be the date of termination of employment, the date of termination of membership, the wind-up date, or another date.

### **Nature of wind-ups**

.08 The purpose of a wind-up valuation may be to determine, or to provide the basis for determining:

- The funded status of the post-employment benefit plan;
- The total value of the benefit entitlements of all members prior to taking account of the funded status of the post-employment benefit plan;
- Any required additional funding;
- The amounts and methods of determining benefit entitlements, including any adjustment required due to a wind-up deficit;
- The amount and method of distribution of a wind-up surplus; or
- Payout for loss of benefit entitlements upon insolvency.

.09 A wind-up may be complex and may take a long time. Delays may require a series of reports by the actuary. Since the funded status or other available funds for the post-employment benefit plan at the final settlement date may affect whether benefit entitlements can be settled in full, the reflection of subsequent events in each report would be critical.

### **Membership data**

.10 The finality of wind-up would call for the actuary to obtain precise membership data. The membership data are the responsibility of the plan sponsor or plan administrator. However, if the actuary is working with incomplete, unreliable, or missing data the actuary would make assumptions regarding the data. The actuary may, if the circumstances dictate, include a provisional sum in the wind-up valuation with respect to missing members if the actuary believes that additional members might have benefit entitlements under the post-employment benefit plan but their membership information is missing.

### **Assumptions**

.11 The selected assumptions would:

- In respect of benefit entitlements that are assumed to be settled by purchase of insurance, reflect single premium rates; and
- In respect of benefit entitlements that are assumed to be settled in some other manner, reflect the manner in which such benefits would be settled.

.12 If future benefits depend on continued employment, the actuary would consider reflecting contingent events. For example, if a member is eligible for post-retirement benefits only if the member remains in employment until age 55, the actuary may make an assumption as to the probability of this event occurring and the member's benefit may be discounted for the probability of the event occurring.

.13 Wind-up expenses usually include, but are not limited to:

- Fees related to the preparation of the actuarial wind-up report;
- Legal fees;
- Insurer or adjudicator administration expenses; and
- Custodial and investment management expenses.

.14 The actuary would either net wind-up expenses against the post-employment benefit plan's assets, if any, or add the assumed wind-up expenses to the post-employment benefit plan's liabilities in calculating the ratio of assets to liabilities as a measure of financial security of the benefit entitlements, unless the expectation is that expenses will not be paid from the post-employment benefit plan's assets, if any. However, an exception may be made for future custodial and investment management expenses, which may be netted against future investment return in the treatment of subsequent events.



### **Subsequent events**

- .15 Ideally, in a wind-up valuation, all subsequent events would be reflected. This ensures that the funded status is presented as fairly as possible as of the report date. However, it would be impossible to recognize subsequent events right up to the report date. Accordingly, the actuary would select a cut-off date that is close to the report date.
- .16 The actuary would ascertain that no subsequent events have occurred between the cut-off date and the report date that would change the funded status significantly; otherwise the actuary would select a later cut-off date. For clarity, a subsequent event may be material yet not be so significant as to require selection of a later cut-off date.
- .17 It may be appropriate to have more than one cut-off date. For example, the actuary may select one cut-off date for the active membership data and another cut-off date for the inactive membership data.
- .18 Common subsequent events are:
- Contributions remitted to the plan;
  - Expenses paid from the post-employment benefit plan's assets, if any;
  - Actual investment return on the post-employment benefit plan's assets, if any;
  - Change in assumptions;
  - Corrections to the membership data; and
  - Deaths of members or other significant plan experience.

### **Use of another person's work**

- .19 Some aspects of the wind-up may be unclear to the actuary or contentious. Examples are:
- The determination of the wind-up date;
  - The members, former members, or recently terminated members to be included in the wind-up;
  - Whether or not to assume salary increases or health care cost trend rate in determining benefit entitlements;
  - Eligibility for benefits payable only with the consent of the plan sponsor or plan administrator;

- The liquidation value of the post-employment benefit plan's assets, if any;
- The method to allocate the post-employment benefit plan's assets, if any, among members; and
- Whether or not wind-up expenses are to be paid from the post-employment benefit plan's assets, if any, or included in the calculation of the liabilities or expected future benefits.

.20 To decide those aspects, the actuary may rely upon direction from another person with the necessary knowledge, such as legal counsel or the employer, or the necessary authority, such as the plan sponsor or plan administrator. The actuary would consider any issues of confidentiality or privilege that may arise.

### **Statements of opinion**

.21 Where different statements of opinion apply in respect of different purposes of the valuation, the above requirements may be modified, but would be followed to the extent practicable.

## 6400 FINANCIAL REPORTING OF POST-EMPLOYMENT COSTS

.01 This section 6400 applies to advice that an actuary provides regarding financial reporting of a post-employment benefit plan's costs and obligations in the employer's financial statements, or the post-employment benefit plan's financial statements, or the financial statements of the trust associated with the post-employment benefit plan, where the calculations and advice are provided in accordance with an applicable financial reporting standard.

### 6410 GENERAL

.01 *For financial reporting purposes, the actuary should use methods and assumptions for the value of assets, if any, and post-employment benefit obligations that are appropriate to the basis of financial reporting in the employer's or post-employment benefit plan's or trust's financial statements, as applicable, and that are consistent with the circumstances of the work. [Effective June 30, 2013]*

#### Circumstances of the work

.02 For the purposes of section 6400, the circumstances of the work would include:

- The terms of the appropriate engagement under which the work is being performed; and
- The application of the law to the work.

.03 The actuary would reflect the financial reporting standards specified by the terms of the appropriate engagement. Where financial reporting standards require methods and assumptions to be established by the preparers of the financial statements, the actuary would use the methods and assumptions specified by the preparers of the financial statements.

#### Plan provisions

.04 The actuary would determine the plan provisions with sufficient accuracy for the purposes of the valuation. Sources of information on plan provisions include:

- Current plan documents;
- Funding or underwriting arrangements;
- Collective bargaining agreements;
- Information regarding past practices;
- Cost-sharing arrangements between the plan sponsor(s) or plan administrator and plan members; and
- Communication between the plan sponsor or plan administrator and the plan members.

Prior plan provisions may be needed to analyze claims information from periods prior to the calculation date.

.05 The actuary would consider all benefits in accordance with the terms of the appropriate engagement that are to be payable under the post-employment benefit plan and would include provision for all such benefits expected to be paid under the plan.

**Anticipated amendment or deferred recognition of a pending amendment**

.06 The actuary's advice on a post-employment benefit plan may reflect an expected amendment to the plan if the amendment is definitive or virtually definitive, as appropriate based on the applicable financial reporting standard.

.07 The effective date of the amendment is the date at which the amended benefits take effect, as opposed to the date when the amendment becomes either definitive or virtually definitive.

.08 If an actuary is aware of an expected amendment to the post-employment benefit plan, but does not reflect the amendment in the work, then the actuary would report the event in accordance with the requirements for the disclosure of subsequent events.

**Data**

.09 In addition to the current plan membership and asset data, if any, the actuary would collect information on historical claims experience, such as nature of absence and benefit levels. Data may come from the plan sponsor or plan administrators or other sources, such as insurance carriers, brokers, or external third-party plan administrators.

.10 In identifying the data needed, the actuary would bear in mind the pertinent benefits (i.e., those applicable during retirement, disability, or following termination of employment). If applicable, the actuary may obtain claims data split by plan, by age, by location, by status (retiree, inactive, spouse, etc.) and by type of expense (drug, hospital, payment for loss of income, etc.).

.11 Where appropriate, in analyzing any relevant historical claims data, the data would be adjusted to reflect the trend in the cost of benefits between the reference period and the calculation date. Where appropriate, the actuary would also adjust past experience results to reflect non-recurring influences such as changes in the benefits offered, significant changes in the demographics of the group, changes in government programs, or unusual claims.

.12 Available data may have limited value or low credibility. Where the benefit cost for former members or current retirees is not fully credible or does not reasonably represent the likely benefit cost for similar future groups, the actuary may rely on the experience of active members or other sources of data that the actuary considers reasonable and relevant. Such other data would be adjusted appropriately for the expected differences between these groups and the group from which the data were drawn.

.13 The actuary may project data, including membership data and data with respect to claim costs from the effective date of the data to the calculation date, using appropriate extrapolation techniques. The actuary would not normally extrapolate membership data more than three years from the effective date of the membership data. The actuary may also use recent credible claims experience in the extrapolation.

### **Assumptions**

.14 The assumptions that the actuary uses would be best estimate assumptions, unless otherwise specified in the relevant financial reporting standards or as otherwise selected by the preparers of the financial statements.

.15 If the preparers of the financial statements select the assumptions and those are not in accordance with accepted actuarial practice in Canada, the actuary would consider the application of Rule 6 – Control of Work Product, regardless of whether the actuary expresses an opinion on the assumptions.

.16 In determining initial claim costs assumptions, the actuary would consider available claims experience with regards to items such as:

- Claimant age, member status, coverage category, and benefit type;
- Credibility; and
- Relevance to future periods and future benefit provisions.

.17 In situations where there are insufficient data with respect to claim costs—for example, if the post-employment benefit plan has only a small number of members or does not yet have any members in payment status—the actuary may develop the applicable assumptions based on experience with other similar plans.

.18 If the actuary is determining the assumption with respect to the future claims trend rate, where necessary, it may be divided into short-term and longer-term components. The short-term component would often be based on the level experienced in the recent past by the plan and plan members. The longer-term component would be consistent with the assumption regarding future changes in benefit programs and general economic conditions such as nominal Gross Domestic Product growth. The actuary would determine the period of time required to transition from the short-term trends to the longer-term trends.

### **Expenses**

.19 The actuary's advice on a post-employment benefit plan would take account of expenses, including whether or not they are expected to be paid from the post-employment benefit plan's assets, if any.

.20 The actuary would consider, as part of the claims experience, the administration costs related to the adjudication of the claims including any related general administration expenses charged by the party adjudicating the claims and all applicable taxes. The actuary may also consider other expenses related to the post-employment benefit plan.

## 6420 REPORTING: EXTERNAL USER REPORT

.01 An external user report should:

- Include the calculation date and the report date;
- Describe the sources of membership data, plan provisions, the post-employment benefit plan's assets, if any, and historical claims data, if any, and the dates at which they were compiled;
- Describe the membership data and any limitations thereof, and any assumptions made about missing or incomplete membership data;
- Describe the tests applied to determine the sufficiency and reliability of the membership data and plan asset data for purposes of the work;
- Describe the actuarial cost method;
- Describe the assets, if any, including their market value and a summary of the assets by major category and the method used to value the post-employment benefit plan's assets;
- Describe the assumptions used to determine the actuarial present value of projected benefits;
- Describe the post-employment benefit plan's provisions, including the identification of any definitive or virtually definitive pending amendment of which the actuary is aware, and whether or not such amendment has been reflected in determining the plan's obligations;
- Describe any commitment to provide benefits beyond the terms of the plan reflected in the valuation of post-employment benefit obligations;
- Disclose subsequent events of which the actuary is aware, whether or not the events are taken into account in the work, and, if there are no subsequent events of which the actuary is aware, include a statement to that effect;
- Include all other provisions as required for disclosure purposes as per the terms of the appropriate engagement, such as:
  - Reporting the funded status at the calculation date and the applicable service cost or expected cost of new claims;
  - Describing the method and period selected in connection with any amortizations; and
  - Stating whether or not the valuation and/or extrapolation conforms with the actuary's understanding of the financial reporting standards specified by the terms of an appropriate engagement.

.02 An external user report should provide the following four statements of opinion, all in the same section of the report and in the following order:

- A statement regarding membership data, which should usually be, “In my opinion, the membership data on which the valuation is based are sufficient and reliable for the purpose of the valuation.”;
- A statement regarding assumptions which indicates either:
  - That the preparers of the financial statements have selected the assumptions and the actuary expresses no opinion on them;
  - That the preparers of the financial statements have selected the assumptions and they are, or are not, in accordance with accepted actuarial practice in Canada; or
  - That the actuary has selected the assumptions and they are in accordance with accepted actuarial practice in Canada;
- A statement regarding calculations, which should usually be, “In my opinion, the calculations have been made in accordance with my understanding of the requirements of [name financial reporting standard]”; and
- A statement regarding conformity, which should be, “This report has been prepared, and my opinions given, in accordance with accepted actuarial practice in Canada.”

.03 An external user report should be sufficiently detailed to enable another actuary to examine the reasonableness of the valuation. [Effective June 30, 2013]

#### **Membership data**

.04 Any assumptions and methods used in respect of insufficient or unreliable membership data would be described.

#### **Reference to other external reports**

.05 The descriptions required in the external user report may be incorporated by reference to another actuarial valuation report prepared in accordance with accepted actuarial practice in Canada.