



FINAL

**CONSOLIDATED STANDARDS OF PRACTICE –
GENERAL STANDARDS**

**COMMITTEE ON CONSOLIDATED
STANDARDS OF PRACTICE**

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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 consensus of the actuarial profession on how work should be done. [*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*]
- .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*]
- .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 by the entity to monitor the financial condition of that entity. [*actuaire désigné*]
- .07 Appropriate engagement is one which 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*]
- .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 policy 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*]
- .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 oeuvre 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 policyholders, 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”. [*capitaliser*]
- .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*]
- .28 Insurer includes a fraternal benefit society and the Canadian branch of a foreign insurer, but does not include a public personal injury compensation plan or a government monopoly. [*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*]
- .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 balance sheet are the liabilities at the balance sheet date on account of the insurer's policies, including commitments, which are in force at that date or which were in force before that date. [*passif des polices*]
- .36 Practice committee means the committee or committees, either standing or ad hoc, to which the Practice Standards Council has assigned responsibility for the practice area which particular new standards affect. [*commission de pratique*]
- .37 Premium liabilities are the portion of policy liabilities which are not claim liabilities. [*passif des primes*]
- .38 Prescribed means prescribed by these standards. [*hypothèse prescrite*]
- .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. The compulsory coverage, monopoly powers, and assured continuity of these plans require the selection of methods and assumptions which differ from those which are appropriate for a comparable benefits plan provided by the private sector or by an insurer. The Canada Pension Plan, the Quebec Pension Plan, and the pension provided by the Federal Old Age Security Act are excluded as their primary purpose is the provision of retirement income. [*régime public d'assurance pour préjudices corporels*]
- .41 Recommendation means an italicized recommendation in these standards. Similarly for "recommend". [*recommandation*]
- .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*]
- .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 Institute's 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 payment for that period in respect of unfunded accrued liability. [*cotisation d'exercice*]
- .48 Standard reporting language is standard language for an external user report. [*libellé du rapport type*]
- .49 Subsequent event is an event which occurs after a calculation date but before the corresponding report date. [*événement subséquent*]
- .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*]

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1120 INTERPRETATION

Recommendations

- .01 These standards are binding on Fellows and Associates of the Canadian Institute of Actuaries.
- .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 for termination of membership in the 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.
- .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 policy 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 which 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 Section 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. 1610
- .18 The standards provide guidance **only** on accepted actuarial practice. 1310
- .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 “policy liabilities” rather than to “reserves” because, in financial reporting, “reserve” means 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 Institute's Guiding Principle No. 1,*
 - the rules,*
 - common sense, and*
 - constraints on time and resources. [Effective date December 1, 2002]*

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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.*”

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

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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.*”

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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 Institute’s 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 (“A member shall act honestly and in a manner to uphold the reputation of the actuarial profession and to fulfil the profession’s responsibility to the public.”); 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 standards in a particular case may also consult in confidence with the chairperson or vice-chairperson of the appropriate practice committee, of the Practice Standards Council, or of the Committee on Rules of Professional Conduct. Rule 13 does not apply to such consultation.

- .08 An actuary who has a question about the spirit and intent of the standards in a particular case may also consult another actuary. It is expected that the other actuary will, as a professional courtesy, offer reasonable assistance. Rule 13 applies to such consultation.

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 sections 1450, 1520, and 1730.06. 1450
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- .12 The actuary would conform to the “integrity, skill, and care” requirement of rule 2 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 standards describe the theoretical ideal. In practice, however, the actuary’s work is constrained by available time and resources. The actuary would therefore strive for an interpretation and application of the standards which strikes a reasonable balance between the theory and the constraints. The actuary has two powerful tools in so doing: materiality and approximation. 1340
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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 date December 1, 2002]*
- .02 The rules and the standards are the only explicit articulation of accepted actuarial practice. 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 Institute's 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, 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.

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1220 EDUCATIONAL NOTES

- .01 *The actuary should be familiar with relevant educational notes and other designated educational material.* [Effective date December 1, 2002]
- .02 Educational notes and other designated educational material describe but do not recommend practice in illustrative situations.
- .03 A practice which the 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 date 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 formal guidance, analogous to the rules and standards, which the actuarial profession in that country gives to its members. An example is the *Manual of Actuarial Practice* of the Faculty of Actuaries and the Institute of Actuaries 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 Institute members is formal. The Institute has reciprocal agreements with its counterpart professional organizations in certain other countries under which the Institute deems the formal guidance which the counterpart gives to its members to be applicable to Fellow(s) and Associate(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 and Associates 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, 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 which apply to the work of the appointed actuary of an insurer:

They include standards for valuation of the insurer's policy liabilities. There are no comparable standards if the insurer has no appointed actuary. An actuary may value that insurer's policy liabilities in accordance with the standards applicable to an appointed actuary to the extent permitted by legislation and would so report.

They also include standards for reporting an adverse condition which 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, but 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 student enrolled pursuant to Section 5 of the Institute’s Bylaws.
- .02 The Institute 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 and useful, report the result of applying accepted actuarial practice. [Effective date December 1, 2002]*
- .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.
- Regulation may preclude the use of present values in valuing an insurer's policy liabilities.
- .03 If the law merely requires a practice, or limits practice to a range, which 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 which 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 section 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,
- to 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
- to 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.

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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 and useful, report the result of applying accepted actuarial practice. [Effective date December 1, 2002]*

.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. Here are examples of such an engagement:

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.

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The client or employer or the terms of a benefits plan stipulates a method or an assumption which is not in accordance with accepted actuarial practice.

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.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.

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.05 The practicality and usefulness of reporting a result in accordance with accepted actuarial practice are the same as for Section 1310, conflict with law.

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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 Standards Council, or of the Committee on Rules of Professional Conduct. [Effective date December 1, 2002]*

.02 An unusual or unforeseen situation is rare and would arise because it is neither practical nor useful to anticipate every situation when drafting the standards. Disclosure of such a situation gives the Institute 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 if 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 which the Institute may not see.

- .03 Accepted actuarial practice evolves. The standards are not intended to inhibit research and discussion which 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 Rule 13 does not apply to the disclosure.¹
- .05 Usually, the actuary would report without reservation when deviating from a particular recommendation or other guidance in the standards in accordance with this Section 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 date 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 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. Usually, however, the user does not specify a standard of materiality, so the judgment falls to the actuary. That judgment may be difficult for one or more of these reasons:

1130.02
1510.01

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.

1820.12

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. Similarly for advice on a policyholder dividend scale.

¹ It seems to the committee that a recipient of disclosure pursuant to paragraph 1330.01 should be exempted from the procedures set out in Annotation 13–1 to Rule 13, and we have so recommended to the Practice Standards Council.

.04 The standard of materiality also depends on the work and the entity which 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 determining 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's liabilities).

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 if 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 differ immaterially from the result of a simpler practice requiring less time and expense. For example, the practice-specific recommendations for valuation of policy 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 which are reported separately. For example, if simple practices requiring less time and expense than those in the recommendations materially overstate the premium liabilities of a property and casualty insurer 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 policy 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 unconservative. Usually, the criterion of materiality is the same in both cases.

Reporting standards

- .10 The result of applying a recommendation may provide information which 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 if there is any professional reason not to accept the engagement. The predecessor actuary should cooperate with the actuary who seeks to determine if there is any professional reason not to accept the engagement.* 1560
- .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, or*
- discontinue the engagement, or,*
- provided that the engagement continues to be an appropriate engagement, report the impediment and its implications. [Effective date 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, 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 which does not impair the actuary's ability to conform to the rules and in particular rules 1, 2, 3, 6, and 7. An engagement which leads to deviation from any rule is not appropriate. An engagement which 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. 1120
1320

.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.

1730.04

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 which 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 which 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.

1520.12

- .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
- which involves a conflict of interest which falls outside of the permitted scope of rule 6.

1440

Subsequent information

- .12 While performing the engagement, the actuary may become aware of information which, 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.
- Promised resources are not forthcoming and a substitute for them is not practical.
- .13 Renegotiation which 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.

1410.04

1420 FINANCIAL INTEREST OF THE ACTUARY

- .01 *The financial interest of the actuary should not influence the result of the actuary's work.* [Effective date December 1, 2002]
- .02 The actuary's compensation for work may be fixed or may involve an incentive which is related to the result of the work. Examples of incentives are contingent fees and performance-related bonuses. Fixed compensation or an incentive which is related to efficient or timely performance of the work is not considered as compensation which would influence the result of the actuary's work. This section 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 which 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 date 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 to 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. 3400
- .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. 1410.05
1820.09
1820.18
- .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. 1410.05
1820.12

1440 GENERAL KNOWLEDGE

- .01 *The actuary should have adequate knowledge of the conditions in the practice area in which he or she is working.* [Effective date December 1, 2002]
- .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 date 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.

1130.03
1130.12

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.* 1340.02
- .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 date 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. 1710.05
- .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 suitable 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.

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:

The calculation of the liabilities in a benefits plan using an explicit expense assumption may be approximated by calculating the liabilities without an explicit expense assumption and using a lower liability discount rate assumption than otherwise appropriate.

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 which results 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.

1410

1520 SUBSEQUENT EVENTS

- .01 *The actuary should correct any data defect or calculation error which a subsequent event reveals.*
- .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* 1520.04
- provides information about the entity as it was at the calculation date, or* 1520.07
- retroactively makes the entity a different entity at the calculation date, or* 1520.10
- makes the entity a different entity 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.* 1520.13
1520.16
- .03 *The actuary should not take the subsequent event into account if it makes the entity a different entity after the calculation date and a purpose of the work is to report on the entity as it was at the calculation date, but the actuary should report that event. [Effective date December 1, 2002]* 1520.13
1520.16

Classification

- .04 *A subsequent event is relevant to the recommendation if it reveals an error, provides information about the entity, or is a decision which changes the entity.*
- .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 which 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 which has been proclaimed, or the like. A virtually definitive decision is one which is virtually certain to become definitive, but which lacks one or more formalities like ratification, due diligence, regulatory approval, third reading, royal assent, or proclamation. However, a decision which still involves discretion at an executive or administrative level is not virtually definitive.*

Event provides information about entity as it was

.07 Examples of a subsequent event that provides information about an entity as it was at the calculation date are

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

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

adoption of a pension plan amendment that takes effect prior to the calculation date.

.08 In such a case, the effect of the subsequent event on the work is the same as if it had occurred on or before the calculation date.

.09 The actuary would not report the event as being a subsequent event. That is, the actuary would report it only if its importance as an event, whether subsequent or not, warrants reporting.

Event retroactively makes entity different

.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,

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

to lay off employees who are members of a pension plan,

to report to an insurer a claim incurred after the calculation date,

to amend the benefits of a pension plan, or

to transfer a portion of an insurer's policies to another insurer.

.11 In such a case, the effect of the subsequent event on the work is the same as if it had occurred on or before the calculation date.

.12 The actuary would not report the event as being a subsequent event. That is, the actuary would report it only if its importance as an event, whether subsequent or not, warrants reporting.

Event makes entity different after

.13 If the subsequent event makes the entity a different entity 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 a different entity 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 a different entity 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. Examples of such events are:

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 a different entity only after the calculation date as 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 which makes the entity a different entity 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 condition, 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 which makes the entity a different entity 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 condition, 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 which makes the entity a different entity after the calculation date.

- .17 The following table may assist in determining when a subsequent event does or does not take place and what action to take:

When does actuary first become aware of event?	When did event occur?	How does event change entity?	What is the purpose of the <u>work</u> ?	Suggested action
Before <u>calculation date</u>	N/A	N/A	N/A	Treat as other information
After report date	N/A	N/A	N/A	Include in subsequent report and/or withdraw or amend report
	Before calculation date	N/A	N/A	Treat as if knowledge obtained before calculation date
After calculation and before report date (a subsequent event)	After calculation date	Entity became different as of or prior to calculation date	N/A	Take event into account as if it occurred prior to calculation date
		Entity becomes different after calculation date	Report on entity as it was at calculation date	Report event but do not take into account in calculations
			Report on entity as it will be after calculation date	Report event and take into account in calculations
		Unclear	N/A	Gather more information until classification is clear

1820.33

Reporting

- .18 Sometimes it is practical and useful to report an alternative and opposite calculation; i.e., an alternative calculation which does not so take the subsequent event into account when the main calculation does, or which takes the 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, the plan member has elected at some time between the calculation date and the report date to retire with an early retirement penalty. 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 those cases, the actuary makes the same calculations regardless of the purpose of the work but their reporting depends 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 defect in the obtainable data precludes a useful result, then the actuary should so report or make no report.* [Effective date 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.

1530.10
1530.11
1530.13

.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.

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.04 Examples of the usual practice are:

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.

1610

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.

1610

.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 verification, either personally or by using the work of other persons.

1610

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

what, if any, independent confirmation is available.

- .12 If the user is able to verify the data, then the actuary may avoid verification 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 verification 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 classifies them as one of the following:

1610

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 if practical a result, 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 which prevent and detect error should accompany a calculation.* [Effective date December 1, 2002]
- .02 A calculation which is data-intensive, which is complex, which 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 inadvertently changed, 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 date December 1, 2002]
- .02 As a result of defective data, defective computer software, a cumulation 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:
- How does the result compare to the corresponding result for a prior period or a similar case, or to a related but independently determined 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 date December 1, 2002]*
- .04 Documentation is an integral part of work which 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 seek further advice.

1840

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 date 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 which 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 Institute encourages the actuary's use of auditor's work in accordance with the *Joint Policy Statement* of the Institute 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.

1630

.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.

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 Institute and the Canadian Institute of Chartered Accountants. [Effective date December 1, 2002].*

1630

1630 CIA/CICA JOINT POLICY STATEMENT

The following Joint Policy Statement is also in the standards of practice of the accounting profession; i.e., in the *CICA Handbook*.

The Institute and the Canadian Institute of Chartered Accountants agreed that each would incorporate the Joint Policy Statement in its standards of practice. The Joint Policy Statement is accordingly in the *CICA Handbook* and in these standards. 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.

JOINT POLICY STATEMENT

CONCERNING AN AUDITOR'S USE OF THE WORK OF AN ACTUARY

AND AN ACTUARY'S USE OF THE WORK OF AN AUDITOR

IN CONNECTION WITH THE PREPARATION AND

AUDIT OF FINANCIAL STATEMENTS

This Joint Policy Statement of March 1991 has been approved by the Council of the Canadian Institute of Actuaries (CIA) and by the Auditing Standards Committee of The Canadian Institute of Chartered Accountants (CICA).

PURPOSE AND APPLICATION

- 1 The purpose of the Joint Policy Statement is to discuss:
 - (a) under what circumstances the actuary and auditor would use the work of the other in carrying out their respective responsibilities with respect to financial statements;
 - (b) how actuaries and auditors should interact in carrying out their respective responsibilities; and
 - (c) how their responsibilities may be disclosed to readers of financial statements.
- 2 This Statement applies when:
 - (a) an auditor is using the work of an actuary in connection with the auditor's examination of financial statements; or
 - (b) an actuary is using the work of an auditor in connection with the verification of data on which actuarial calculations are based.
- 3 The financial statements of a pension or welfare plan, and of the sponsor of such a plan, and the financial statements of an insurance company, are the best examples of when this Statement applies. The use of each other's work in these examples is usually appropriate and should always be considered.

DEFINITIONS

- 4 For the purposes of this Statement:
- (a) “actuary” means an actuary who has been appointed to determine and report on amounts to be used in financial statements;
 - (b) “auditor” means an auditor who has been appointed to perform an audit and report on financial statements or to perform specified procedures on data;
 - (c) “reporting professional” means the actuary or the auditor, as the case may be, who is using the work of the other;
 - (d) “specialist professional” means the actuary or the auditor, as the case may be, whose work is being used by the other;
 - (e) “management” refers to any person(s) having authority and responsibility for planning, directing and controlling the activities of an enterprise, including its board of directors or its trustees;
 - (f) “insurance company” includes an enterprise similar to an insurance company, for example, a fraternal benefit society;
 - (g) “data” includes particulars of (i) invested assets of a pension or welfare plan or insurance company, (ii) membership of a pension or welfare plan, (iii) policies of and claims against an insurance company and (iv) reinsurance of an insurance company.

ROLES AND RESPONSIBILITIES OF THE AUDITOR AND THE ACTUARY WHEN EXPRESSING OPINIONS IN RESPECT OF 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 this case, the actuary has a responsibility to express an opinion about the appropriateness of such amounts and would consider using the work of an auditor with respect to the accuracy and completeness of data used to determine the amounts. In such case, the actuary acts as the reporting professional and the auditor acts as the specialist 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 changes in financial position in accordance with generally accepted accounting principles or another appropriate disclosed basis of accounting. When the financial statements include amounts determined by an actuary, the auditor would consider using the work of the actuary as audit evidence as set out in Using the Work of a Specialist, Section 5360, of the CICA Handbook. In such case, the auditor acts as the reporting professional and the actuary acts as the specialist professional.

BASIS FOR USING THE SPECIALIST PROFESSIONAL'S WORK

- 7 The reporting professional may use the work of the specialist professional provided that the reporting professional takes reasonable care to determine that there is a basis for such use. This is done by communicating with the specialist professional to establish an understanding of the work to be carried out by each and by considering:
- (a) the specialist professional's qualifications, competence, integrity and objectivity;
 - (b) the specialist professional's appointment to do the work;
 - (c) whether the specialist professional has followed the standards of his or her profession in carrying out the work; and
 - (d) the appropriateness of the specialist professional's findings and opinion.

COMMUNICATION BETWEEN THE TWO PROFESSIONALS

- 8 Communication should be established between the auditor and the actuary during the planning stages of their respective engagements, and further communication should take place as necessary throughout the engagement.
- 9 Each professional has a duty of confidentiality in respect of the information acquired in the course of working with the plan or company. To promote fair financial reporting, the auditor and actuary should have the ability to meet when necessary and to discuss and to disclose to each other, in confidence, information believed by one professional to be relevant to the work of the other.
- 10 Before accepting an appointment, each professional should seek from management the right to communicate with the other professional and when necessary disclose any relevant information. The appointment should be refused if that right is not obtained.
- 11 The reporting professional should:
- (a) inform the specialist professional of the intended use of his or her work in accordance with this Statement;
 - (b) obtain confirmation that the specialist professional has been appointed by the shareholders, policyholders, or management to do the work that the reporting professional intends to use;
 - (c) obtain confirmation that the specialist professional will carry out the work required in accordance with the applicable professional standards; and

- (d) make the specialist professional aware of the reporting professional's needs. This would include a discussion of:
 - (i) materiality, to determine that the specialist professional will be using a materiality level that is appropriate in relation to the reporting professional's materiality level;
 - (ii) subsequent events, to determine that the specialist professional understands how they are to be treated and that he or she will consider the effect of matters which come to his or her attention up to the date of his or her report;
 - (iii) verification of data, so that adequate assurance will be obtained with respect to the accuracy and completeness of the required data;
 - (iv) the timing of the work to be carried out by the specialist professional and the date of his or her report; and
 - (v) any questions relating to the specialist professional's work.

12 The specialist professional should:

- (a) confirm the expectation that he or she can do the work that the reporting professional intends to use;
- (b) confirm that he or she has been appointed by the shareholders, policyholders, or management to do the work that the reporting professional intends to use;
- (c) confirm that this work will be carried out in accordance with the applicable professional standards;
- (d) confirm awareness that the reporting professional will be using the work;
- (e) discuss any problems expected in meeting the needs of the reporting professional on a timely basis;
- (f) prepare a report to the reporting professional; and
- (g) assist the reporting professional in determining whether there is a basis for using the specialist professional's work.

THE SPECIALIST PROFESSIONAL'S QUALIFICATIONS, COMPETENCE, INTEGRITY AND OBJECTIVITY

- 13 In the case of an auditor, *prima facie* evidence of professional qualification is membership in good standing in a provincial institute of chartered accountants. In the case of an actuary, *prima facie* evidence of professional qualification is fellowship in good standing in the Canadian Institute of Actuaries.
- 14 When the specialist professional is not well known to the reporting professional, the reporting professional may obtain assurance as to the specialist professional's reputation for competence and integrity by consulting with others who are familiar with the specialist professional's work.
- 15 Unlike an auditor, who is independent of the entity being audited, an actuary may be a member of the entity's staff. In fact, for life insurance companies, it is likely that the valuation actuary will be a member of management.
- 16 Evidence from a source independent of the entity being audited is considered to be more reliable than evidence from a source that is not independent. The reason is that the existence of a relationship between the specialist and the entity being audited may impair the specialist's ability to be objective. Using the Work of a Specialist, Section 5360, states that when the specialist is on the client's staff, the auditor may consider it necessary to test the reliability of audit evidence provided by the specialist by performing more extensive procedures, or engaging an independent specialist to check some or all of the assumptions, methods or findings of the client's specialist.
- 17 The decision as to whether to perform more extensive procedures or engage an independent specialist to check some or all of the work of the specialist is a matter of professional judgment. In making this judgment, when the specialist is an actuary, the auditor would consider factors relating to the entity and to the industry in which it operates that could have a bearing on the actuary's objectivity. Such factors could include:
 - (a) Adverse economic and competitive conditions.
 - (b) Significant concern by management about operating results.
 - (c) Evidence of undue management pressure on the actuary.

- 18 The auditor would also consider factors that, by enhancing an actuary's ability to be objective, may compensate for the lack of independence. For example:
- (a) Actuaries must adhere to CIA standards of professional conduct and professional practice, which include a rule of professional conduct on objectivity.
 - (b) Actuaries must provide an opinion and a detailed report on the appropriateness of the actuarial liabilities to regulatory authorities and often provide an opinion on the appropriateness of the actuarial liabilities to policyholders, shareholders and plan holders.
 - (c) In certain circumstances, the board of directors formally appoint the actuary and the actuary may also have access to the board.
 - (d) When there is formal appointment of the actuary by the board, legislation often requires that regulatory authorities are informed of the actuary's appointment and any change in appointment.

THE SPECIALIST PROFESSIONAL'S STANDARDS

- 19 When the specialist professional is the actuary, the relevant professional standards are set forth in the Recommendations of the CIA. The CICA accepts those standards for the purpose of this Statement.
- 20 When the specialist professional is the auditor, the relevant professional standards are set forth in the CICA Handbook. The CIA accepts those standards for the purpose of this Statement.
- 21 In deciding whether the specialist professional's work can be used, the reporting professional should base the decision not on how he or she thinks the work should be done but whether it has been done in accordance with the above-mentioned standards applicable to the specialist professional.

THE SPECIALIST PROFESSIONAL'S FINDINGS AND OPINION

- 22 The specialist professional's report to the reporting professional should:
- (a) identify its nature and purpose;
 - (b) identify the financial statements or data to which it relates;
 - (c) identify the specialist professional's relationship to the entity to which the financial statements or data pertain;
 - (d) confirm awareness that the reporting professional intends to use the work in accordance with this Statement;

- (e) set forth findings and opinions, including a representation that the work was performed in accordance with the relevant professional standards and this Statement; and
 - (f) represent, in the case of a report by the actuary, that the financial statement items determined by the actuary exist or occurred, are complete, and are properly valued or measured.
- 23 Normally, the reporting professional would use the report of the specialist professional in the course of his or her own work. When the reporting professional has a question about an aspect of the specialist professional's work, the question should be raised with the specialist professional who should provide a reasonable explanation about that aspect of his or her work. This does not, however, limit the right of the reporting professional to any information or explanation that may be required in the performance of his or her duties in accordance with his or her professional standards.

DISCLOSURE OF RESPECTIVE ROLES TO THE READERS OF FINANCIAL STATEMENTS

PENSION PLAN, WELFARE PLAN OR INSURANCE COMPANY

- 24 The significance of the amounts that the actuary determines for inclusion in the financial statements of a pension or welfare plan and an insurance company, and the unique relationship of the auditor and actuary in such cases, make it desirable that a report by each be included with the financial statements and that there be disclosure of their respective roles. That disclosure would be provided by management either as part of its report accompanying the financial statements or in a note to the financial statements.

OTHER THAN PENSION PLAN, WELFARE PLAN OR INSURANCE COMPANY

- 25 In some cases (the best example being the financial statements of the sponsor of a pension or welfare plan), the amounts the actuary determines may be sufficiently material to be identified in the financial statements or in the notes thereto. In such a case, disclosure of the role of the actuary is desirable. Such disclosure would be provided by management, preferably in a note to the financial statements.

1640 REVIEW OR REPEAT OF ANOTHER ACTUARY'S WORK

- .01 In this section 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 section 1640 apply to a review engagement which 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 consider Rule 13 (apparent material noncompliance with the rules or standards).*
- .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 date: September 1, 2003]*

Applicable rules

- .10 The rules affect a review engagement, in particular Rule 1, on upholding the reputation of the profession; Rule 9, on dealing with other actuaries; and Rule 13, on apparent material noncompliance by another member with the rules or standards.

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 section 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 which 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 appropriate practice committee, the chairperson or vice-chairperson of the Practice Standards Council, or the chairperson or vice-chairperson of the Committee on Application of Rules and Standards.
- .22 If the review is confidential, then the extent and duration of any exemption provided to the reviewer, as such, from the application of Rule 13 is limited to the circumstances described in its Annotation 13-1.

Review engagement which precludes discussion between the two actuaries

- .23 The reviewer would consider the appropriateness of a review engagement which 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 in, for example, any of the following cases:

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 which are within the range of accepted actuarial practice.
- .25 An engagement which 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 which 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 on which the model and data assumptions depend. [Effective date December 1, 2002]*

Model assumptions

- .05 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 zero rate. The actuary may compensate for an inappropriate implicit assumption on a matter which the model does not take into account by altering the explicit assumption on a matter which 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 assumes an investment return rate which is, for example, the best estimate assumption of investment return minus 30 basis points (.3%).

- .06 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.

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 assumptions, usually qualitative, about 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 on them. Such assumptions are numerous and it is not practical to identify all of them.

Needed assumptions

- .10 Here are examples of matters about which assumptions may be needed:

Economic

The discount rates to calculate present values.

The investment return rates earned on the investment of positive cash flow or which affects the price at which assets are sold in order to meet negative cash flow.

The investment return rates earned on assets which support liabilities.

The risk of asset depreciation (C-1 risk).

The 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.

Compensation base on which increases are to apply

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

Social

Family composition.

Marital status.

Age difference between spouses.

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 policyholders.

Increment

Rates of future new entrants.

Benefit continuance

Death, disability recovery, remarriage, termination of economic dependency, and re-employment rates.

Post-retirement pension adjustments.

Maintenance expense for a disabled person.

Claims development

Reporting patterns.

Settlement patterns.

Reopened claims.

Expense

Expenses of marketing, administration, claim adjustment, and investment management.

Taxation

Tax rates.

Definition of tax base.

Limitations on the funding of registered pension plans.

Other

Government benefit plan provisions and their integration with private sector plans.

1720 SELECTION OF ASSUMPTIONS

- .01 *The assumptions which the actuary selects or for which the actuary takes responsibility, other than alternative assumptions selected for the purpose of sensitivity testing, should in the aggregate be appropriate.* 1610
- .02 *The actuary should select each needed assumption except for those, if any, 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 and useful to do so, the actuary should report the result of an alternative assumption. [Effective date December 1, 2002]* 1530.12
1610.02
- .04 If each assumption is appropriate, then the assumptions in the aggregate are *ipso facto* appropriate. If the inappropriateness in a particular assumption is offset by the inappropriateness in another – for example if one is conservative and the other unconservative – then they are in the aggregate appropriate. Such practice may be expedient but introduces a risk of faulty offset.
- .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 to report the result of an alternative assumption near the other end of the accepted range, especially in an external user report. Similarly 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, and to identify and expose any flaws in the other side's case. It is therefore 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. On the other hand, the members of a pension plan who use the actuary's work would usually depend entirely on the actuary's report to put in perspective the result of a biased assumption for which the actuary did not take responsibility.

1730 APPROPRIATE ASSUMPTIONS

- .01 *The appropriate model or data assumption for a matter is 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.*
- .02 *The appropriate assumption for other matters is continuation of the status quo, unless there is none or unless it will change, and the actuary so reports.*

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 each selecting assumptions for a particular case is less important.
- .05 Sometimes, however, it is desirable that actuaries produce results within a relatively narrow range which 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. In the case of salaries, however, both the circumstances of the case and the economy affect experience.

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 which 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 decisions on plan changes. 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, policyholder 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
- of the case itself, rather than of similar cases,
 - of the recent past, rather than of the distant past,
 - which are homogeneous, rather than heterogeneous, and
 - which 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 like policy benefits having like
- 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: 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 which is more favourable than intercompany experience data in valuing an insurer's policy 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 which 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 policyholder, 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,

policyholder 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

a shareholder to retract a share.

- .21 A particular policyholder 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 policyholders 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 policyholder's right to renew term life insurance, the stipulated renewal premium to an unhealthy policyholder is less than the premium for a new policy whose purchase is subject to underwriting; the healthy policyholder may be able to purchase replacement insurance for less than that renewal premium.
- .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 policyholder 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 policyholder in ill health may be unable to afford to continue an insurance policy with a low premium),
 - the policyholder's or plan member's difficulty in making the required judgment (for example, everyone knows his or her age, but a person in ill health may be unable to gauge its effect on longevity), and
 - the sophistication of the policyholder, 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.
 - Voluntary termination rates may affect death rates through anti-selection.

Supporting assets

- .25 The investments which 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. For example:

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 that 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.

Indexing of benefits

- .26 Workers' compensation benefits are usually indexed to inflation or wage rates, as are certain pension benefits. In such cases, the needed assumption is of the "net" or "real" rate of investment return. While there may be no need for separate assumptions of investment return rates and of inflation or wage rates, it may, in some cases, be preferable to report them separately.
- .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. 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, that the fund of a registered pension plan continues to be untaxed 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

which is different from continuation of the status quo, and

on 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 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 section, “provision” means “provision for adverse deviations”.
- .02 *A calculation should not include a provision if the related work requires an unbiased calculation.* 1740.06
- .03 *Otherwise, if a provision promotes expectations for financial security, then the calculation should include a provision which* 1740.09
- 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.* 1740.11
- .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,* 1740.13
- 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, and* 1740.17
- in the case of a provision in respect of uncertainty of assumptions, result from selection of assumptions which are more conservative than best estimate assumptions.* 1740.20
1740.27
- .05 *Reporting the amount of the provision is usually accompanied by a discussion of the related uncertainty and risk. [Effective date December 1, 2002]* 1740.37

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. A provision is used when the entity benefiting from the enhanced financial security has a reasonable expectation that such enhanced security exists. 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: “neutral”, “even-handed”, or using “best estimate assumptions”, or “best estimates”.

Conflicting interests

.09 A provision in a calculation is a bias which may affect two conflicting interests in opposite ways. Hence the need to strike a balance.

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.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.

Provision in funding a pension plan lessens the likelihood that the contributor will be obliged later to increase contributions, but increases the likelihood of later surplus in the plan which 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 approximately reduce the provision, thereby avoiding the distortion which the provision causes. Healthy skepticism is appropriate in assessing their credibility.

.12 One example of other means is a retrospective rating, when a policyholder is insured at a premium calculated from best estimate assumptions but with an undertaking to reimburse the insurer for adverse deviations in experience.

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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; one may not get 5 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 aleatory assumptions.

.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 which are plausible in usual operations. The provision would only partially offset the effect of catastrophe or other major adverse deviations which are not plausible in usual operations.
- .18 It is difficult to quantify the distinction between adverse deviations which are, and which are not, plausible in usual operations. For each situation, the actuary would adopt a distinction which results in a provision which 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 which specifically addresses that possibility; for example, calculation of the minimum capital which 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 which, either individually or in the aggregate, are more conservative than best estimate assumptions. Testing may be needed to assure that a contemplated assumption is in fact more conservative than the corresponding best estimate assumption.
- .21 Examples of use of conservative assumptions are
- a best estimate assumption combined with a margin for adverse deviation and
 - scenario testing of a range of assumptions and selection of a scenario (or a point between two scenarios) which produces a result which 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, 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 policyholder dividends, premium rates, contributions, and benefits

- .23 Those adjustments can offset the effect of adverse deviations.
- .24 The insurer promises to declare policyholder dividends in accordance with experience, but does not promise a specified amount of dividends. An insurer's participating insurance policy liabilities include the present value of expected future policyholder dividends. If the insurer experiences adverse deviations and reduces dividends as a result, then the amount included in policy liabilities corresponding to the reduction in dividends becomes available for other

promised benefits and therefore is not needed in the provision. If the amount included for dividends is large, and if the insurer's management of its 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 which can substitute for contributions.

.26 Those adjustments are rarely fully credible. For example, an insurer's legal right to adjust policyholder 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 in two situations, as follows:

work which requires an unbiased calculation. In that situation, the provision of zero is always appropriate;

where the actuary considers a provision but concludes that a provision does not promote expectations for financial security or that there are other means which reduce or eliminate the need for the provision.

Examples

.28 Two important examples of provision for adverse deviations are in the valuation of

the policy 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.

.29 In valuing those liabilities, the actuary would strike a balance between security of benefits promised to policyholders or plan members and equity among conflicting interests.

Security of benefits promised

.30 A provision in liabilities reduces the likelihood that their amount will later prove to be inadequate. As well, if those liabilities (including the provision) are funded (i.e., fully supported by investments) and the provision accelerates the funding of those liabilities, 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 results which improves benefit security) since the actual ultimate value of the benefits has not changed and neither has the likelihood of them being paid.

Generations of policyholders, 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 policyholder dividends or benefit increases or contribution decreases. That is an inequitable result if one generation of policyholders, shareholders or plan members bears the cost of making the provision, and if a later generation makes a windfall from its reversion to equity or surplus, but, 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 policyholders, the provision and its later reversion may affect dividends on participating policies and premiums and benefits on adjustable non-participating policies. It is appropriate for the insurer to manage its dividends and adjustments so that an unneeded provision reverts to the policyholders 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.

Policyholders versus shareholders, and plan members versus the participating employer

- .36 A provision tends to favour policyholders 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 policyholders for payment of the promised benefits. The actuary would therefore strike a balance which promotes security of promised benefits but which 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.

Assumptions: margin for adverse deviations

.38 The standards in this subsection apply to the selection of a margin for adverse deviation 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.

.39 *The margin for adverse deviation in each assumption should reflect the uncertainty of that assumption and of any related data.* [Effective date December 1, 2002]

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.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 which 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 .1 x expected claim liabilities.

An addition to the liabilities without provision for adverse deviations, determined 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 the following:

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 which 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, or

an approximation with less precision is being used, or

the event assumed is farther in the future, or

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 opposite is 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 undiscounted.

.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.

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.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 insurer policy liabilities, the margin for the withdrawal rate assumption may be positive at some policy durations and negative at other policy durations.

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 have to have the same sign to ensure consistency: 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 date 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 nominally 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 .5% between the two dates.
- .03 For valuation of an insurer's policy 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 deviation, 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 and useful, 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 date 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 accompanying 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 a usual situation, or that it was done in accordance with accepted actuarial practice "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

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- .01 *In an external user report, the actuary should* 1820.06
- identify the client or employer,* 1820.12
- describe the work, its purpose, and its users,* 1820.16
- say whether or not the work is in accordance with accepted actuarial practice and, if not, disclose the deviation from that practice,* 1820.18
- if useful, disclose any unusual application of accepted actuarial practice,* 1820.20
- disclose any aspect of the work for which the actuary does not take responsibility,*
- disclose any assumption which is different from assumption of continuance of the status quo and, if practical and useful, 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 which is not taken into account in the work,* 1520
- disclose any reservation,* 1820.23
- express an opinion on the results of the work,* 1820.27
- identify himself or herself and sign the report, and* 1820.29
- date the report.* 1820.30
- .02 *Any description or disclosure may be in material referred to in the report and either accompanying the report or plausibly 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 which 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 Institute, pursuant to the Bylaws or the Rules of Professional Conduct. [Effective date 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 is 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 do not run together. 1830
- .07 Appropriate description and disclosure in a report strike a balance between too little and too much. Too little deprives the user of needed information. Too much 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. For example:

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. 1510
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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.

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. 1310
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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. 1330
- .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 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 any of the following:

Specified by law or by the actuary's client or employer. 1410

Excluded from the accepted range by an exposure draft or by approved, but not yet effective, new standards. 1210

Inconsistent with the corresponding assumption of a prior periodic report. 1750

Dependent on a special permissive feature in the law for its acceptability.

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. 1320

Disclosure of Assumptions

- .21 Disclosure of an assumption includes its description, and, if practical and useful, quantification 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, and, if useful, 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.

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The actuary was obliged to use insufficient or unreliable data.

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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.

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There is an unresolved conflict of interest. Rule 6 permits the actuary who has a conflict of interest to perform professional services if stated conditions are met. In reporting in 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 consultation with another actuary or legal advice.

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- .26 Barring explicit disclosure to the contrary in the report, the user is entitled to assume that

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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.

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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 assume 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 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 Institute.

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 work 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.

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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 affected the report, but, if additional information comes to hand, would consider if it invalidates the report. Additional information invalidates 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 a different entity at the calculation date, or
 - makes that entity a different entity 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 invalidates the report. It does not invalidate the report if it makes the entity which is the subject of the report a different entity 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 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.

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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 date 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.

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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.

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