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## Draft Educational Note

# Review of the Work of an Actuary

Document 203024

This document was replaced by document 203066

**This document was archived April 11, 2023**

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# ***DRAFT EDUCATIONAL NOTE***

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*Educational notes do not constitute standards of practice. They are intended to assist actuaries in applying standards of practice in specific matters. Responsibility for the manner of application of standards in specific circumstances remains that of the practitioner*

## **REVIEW OF THE WORK OF AN ACTUARY**

**COMMITTEE ON THE APPLICATION OF RULES AND STANDARDS**

**ARCHIVED**

**MARCH 2003**

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*Document 203024*

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## MEMORANDUM

**TO:** All Fellows, Associates and Correspondents of the Canadian Institute of Actuaries  
**FROM:** John Brierley  
Chairperson, Committee on the Application of Rules and Standards  
**DATE:** March 31, 2003  
**SUBJECT:** Draft Educational Note on the Review of Work of an Actuary

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The Committee on the Application of Rules and Standards (CARS) has been asked to implement a standard of practice for peer review. This will be accomplished by a change to Section 1640 of the Standards of Practice. This educational note will be a supplement to that standard.

The educational note applies to all reviews in general and more specifically to reviews of an insurer's appointed actuary. Neither the standard of practice nor the educational note apply to reviews conducted as part of a quality control process within an actuary's firm.

The educational note is similar to the Exposure Draft of the Standard of Practice for Peer Review that was published in June 2001. That draft was modified in 2002 but not published, other than as a paper on the CIA website (under the CARS page in the Members Only section). In order to fit in with the changes to Section 1640, the concept of having a sample engagement letter for a review of an insurer's appointed actuary was added.

Comments should be directed to John Brierley at his *Yearbook* address or by e-mail to <john.brierley@rbc.com> with a comment deadline of **April 30, 2003**.

JB

## INTRODUCTION

In this Educational Note,

section references are to those in the *Standards of Practice* (SOP),

terms set over dotted underlining have the meaning in Section 1110, and

“first actuary”, “review engagement”, “repeat engagement” and “reviewer” have the meaning in Subsection 1640.01.<sup>1</sup>

The purpose of this Educational Note is to provide information for a review engagement to which Section 1640 applies

- (a) specifically for work of an insurer’s appointed actuary in which the appointed actuary<sup>2</sup> or the insurer selects and agrees terms of engagement with the reviewer; and
- (b) generally for a review performed for any work.

This Educational Note does not apply to a repeat engagement.

## BACKGROUND AND OBJECTIVES

In general, the review process has the following objectives:

- To improve continually the quality of work that actuaries provide to their clients;
- To strengthen the position of the profession and individual actuaries, and to build upon procedures and good practices already in place;
- To maintain and strengthen confidence in actuaries among the public and the users of their work;
- To have a significant education component for both the first actuary and the reviewer as situations are discussed and differences of opinion are resolved; and
- To reduce the risk of having to deal with errors that might jeopardize the reputation of actuaries and their relationships with their clients.

The review process is intended to be a collegial rather than an adversarial process. All parties involved, including the first actuary and the reviewer, would cooperate in the process and take an active interest in it.

The Office of the Superintendent of Financial Institutions (OSFI) has issued Guideline E-15<sup>3</sup> for an objective review, from time to time, of work of each insurer’s appointed actuary.

The first actuary is encouraged to seek a review prior to the release of the work to the users.

It is also acceptable for the first actuary to seek a review subsequent to the release of the work to the users, provided the review is performed within a reasonable period (such as three months) following the release of the work to the users.

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<sup>1</sup> This draft assumes that the 20 December 2002 draft revision to Section 1640 has been adopted.

<sup>2</sup> The appointed actuary is therefore the first actuary referred to in Section 1640.

<sup>3</sup> OSFI Guideline E-15 is currently issued in draft form.

## OFFERING AND ACCEPTING THE ENGAGEMENT

Before offering the engagement, the first actuary would select a reviewer who is competent and objective.

In practice, the reviewer would likely be hired by the first actuary's firm. However, it is anticipated that the first actuary would either recommend the reviewer to be hired or have significant input into the hiring process.

A competent reviewer is someone who meets the same test of competence as the first actuary for the work subject to review.

This implies that if only an FCIA may take responsibility for the work, then it would be appropriate to select an FCIA to conduct the review of that work.

In addition, this implies that the reviewer has sufficient experience regarding the type of work to be reviewed.

An appropriate reviewer is also someone who is objective in regard to the work being reviewed.

The reviewer would be capable of performing an objective review without undue influence by the first actuary.

To have a variety of reviewers perform the reviews over time is encouraged. This may enhance the objectivity of the reviews and allow the first actuary to obtain different perspectives from each of the different reviewers. It is also likely that the educational goals of the review process will be enhanced when the first actuary uses a variety of reviewers and reviewers perform reviews for a variety of first actuaries. For practical reasons, it may be appropriate to have the review performed by the same reviewer for a period of time. However, the first actuary is encouraged not to use the same reviewer continually over an extended period of time.<sup>4</sup>

The first actuary or the first actuary's firm may wish to execute a contract with the reviewer.<sup>5</sup> The relationship between the first actuary and the reviewer is one of client and consultant.

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<sup>4</sup> For reviews of insurance companies where reviews are performed over a three-year cycle, it would be reasonable to use the same reviewer for one or two cycles. It would likely be inappropriate to use the same reviewer for more than two cycles.

<sup>5</sup> This contract could include the fee structure and services to be rendered. Such a contract may also specify that the reviewer will follow the guidelines identified in this note, that confidentiality will be ensured (except in cases where the reviewer is required to disclose the information pursuant to this standard, the Bylaws or Rules of Professional Conduct of the Institute, or law) and that the first actuary will hold the reviewer harmless in the event that the reviewer is sued in connection with the work.

In the first actuary's opinion, the reviewer would be seen to be competent and objective by the primary user of the work.

In some cases, the first actuary may wish to consult with his or her client or employer or a user of the work regarding the selection of an appropriate reviewer, the level of competence or the objectivity of the proposed reviewer, or confidentiality concerns or other reasons.

If a regulator or supervisor expects that a review be performed, it seems prudent to consult the regulator or supervisor in the selection of the reviewer and the drafting of the engagement letter. For example, OSFI Guideline E-15 lists criteria that OSFI would expect to be used in determining the objectivity of the reviewer.

Regulators or supervisors may consider that, in order to be seen as being objective, a reviewer need not necessarily be independent. For example, OSFI Guideline E-15 outlines requirements for objectivity, which are less onerous than the requirements for independence outlined in OSFI Guideline E-14.

As noted in Subsection 1640.13, the reviewer would be qualified to perform the review if the reviewer could accept an engagement to perform the work of the first actuary.

Before accepting the engagement, the reviewer would need to be satisfied of its appropriateness and his or her qualifications to perform it by considering the rules and Section 1400.

#### **THE ENGAGEMENT LETTER**

An engagement letter would be in accordance with Section 1410.

For a review of the work of an insurer's appointed actuary, the Sample Engagement Letter below could be taken as a starting point for a draft of the engagement letter. It would be convenient if the differences between this sample letter and the draft were marked, so that a reader of the draft readily recognizes them.

The starting point for drafting the engagement letter for a second or later review engagement may be the engagement letter for the primary review engagement.

#### **RULE 13**

Section 1640 deals with the unlikely but unpleasant possibility that Rule 13 may oblige the reviewer to bring to the Institute's attention an apparent material noncompliance with accepted actuarial practice by the first actuary. Rule 13 requires the reviewer to bring apparent material noncompliance with accepted actuarial practice to the attention of the Committee on the Application of Rules and Standards.<sup>6</sup>

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<sup>6</sup> This draft assumes that the proposed revision to Rule 13 has been adopted.

## **USE OF THE RESULT OF THE INSURER'S CONTROL PROCEDURES**

The control procedures of the insurer or its appointed actuary may include review of the work of the appointed actuary or his or her staff. Section 1640 does not apply to that review. It is usually by a person who is a colleague of the appointed actuary (and it is therefore sometimes called "internal peer review") but may be by an outside person, especially when the appointed actuary is an employee of a small insurer or a consulting actuary in a small firm. That person is usually but not necessarily an actuary. It may avoid duplication and, therefore, promote efficiency for the reviewer to use and to take responsibility for all or part of the result of the insurer's control procedures in accordance with Section 1610, and in particular Subsection 1610.07. The reviewer is analogous to an auditor of financial statements, and the reviewer's use of such is analogous to the auditor's use of internal audit. In applying Subsection 1610.07, the reviewer may find useful guidance in Section 5050, titled "*using the work of internal audit*" in the *CICA Handbook*.

However, the review would still need to be conducted in sufficient depth in order for the interests of all users of the review to be satisfied. In particular, the objectives of a regulator or supervisor would need to be considered.

## **CONDUCT OF THE REVIEW**

The first actuary and the reviewer would cooperate fully with each other during the conduct of a review.

The first actuary would use his or her best efforts to provide the reviewer with access to any documents and to provide any additional explanations that may be relevant to the review.

The reviewer would maintain the confidentiality of any information garnered in the process of performing the review, except in cases where the reviewer is required, pursuant to the Standards of Practice, the Bylaws or Rules of Professional Conduct of the Institute, or law to disclose the information.

In order to fulfill the objectives of the compliance process, the Institute may request feedback from the first actuary and reviewers. This information may then be provided to the first actuary with the Institute making its best efforts to avoid the disclosure of confidential information.

The Institute will encourage this information to be provided but will not require this information to be provided. If the reviewer believes that providing information for feedback to the Institute would identify the source of the information, then withholding this information would be appropriate. In this circumstance, the reviewer would be encouraged to obtain permission from the first actuary to provide the information to the Institute.

The reviewer would investigate to a sufficient depth in order to sign a written opinion.

Except in the simplest cases, adequate review requires something more than simply reading the work and being satisfied with the answers to questions that arise on that reading. However, in the typical case, the review is less onerous than the performance of the underlying work itself. The reviewer would not normally be expected to attempt to reproduce calculations or to devote much time to researching insurance contracts, pension plan documents and other agreements. It will shorten and simplify the review if the first actuary provides well-organized documentation, well-reasoned conclusions and applies thorough controls to all processes, especially software and manual procedures. Ultimately, the reviewer would determine the depth of the review. The reviewer would exercise professional judgment in determining the extent of the review necessary.

The review process need not duplicate all of the efforts of other review processes. For example, an internal review process may be adequate despite not being seen to be objective. In this case, the required external review process would likely be significantly less than a review where no internal review process exists. In these situations, the cost of an external review would be intended to be as small an additional expense to the client or employer as possible. However, the reviewer would take into account the considerations provided above dealing with “Use of the Result of the Insurer’s Control Procedures”.

For complex work, such as the appointed actuary’s report on the valuation of liabilities for an insurance company, a comprehensive annual review of all aspects of such a report may not be appropriate. For this type of report, the review may concentrate on different sections of the report in detail, supplemented by a less detailed review of the whole report. It is intended that the appointed actuary and the reviewer agree as to the appropriateness of how this is structured year by year in order to provide value to the appointed actuary and to control the cost of the review.

For example, for a review of the work of an appointed actuary as expected to be performed by OSFI, all aspects of the work would be reviewed over a maximum cycle period of three years. This could be accomplished by a review of one-third of the insurer’s business each year or by a full review every three years. Work not reviewed would have a review of material change only.

Upon completion of the review, the reviewer would confer with the first actuary, in order to discuss the review and resolve any differences that may exist between them. The reviewer would then deliver the written report to the first actuary and to any other appropriate parties concerned with the review.



**APPENDIX: SAMPLE ENGAGEMENT LETTER FROM THE REVIEWER TO THE APPOINTED ACTUARY**

*Note: It is contemplated that the appointed actuary and the reviewer would, if appropriate, consult OSFI about the engagement as suggested above.*

*Material in square brackets could be adapted to the particular situation.*

Dear Appointed Actuary:

I understand that you are the appointed actuary of [insurer] (“Company”). In our recent discussion, you proposed an engagement for my firm (“we”, “us”, “our”) in which we review your work as contemplated in the [date] CIA Educational Note, *Review of Work of an Actuary* (“Educational Note”) and Section 1640 of the *Standards of Practice* (“SOP”) (“the engagement”). The purpose of this letter is to propose the terms of the engagement. I am sending the letter to you in duplicate. If you are in agreement with it, then please sign both copies in the space provided below for your signature, retain one copy for your file, and return one copy to me.

I am the [partner] in our firm who will take responsibility for the engagement and sign the report on it.

[I am a policyholder of the Company and] I expect that the Company will pay the fee that we shall bill to you for the performance of the review. Apart from that, I have no direct or indirect interest in the Company [or its affiliated companies] and I have [since date] not been associated with or had an engagement from the Company. The same is true for each of my colleagues. I, therefore, believe that I am objective for the purpose of the review.

You will arrange for payment of our reasonable fee that we bill to you. *Insert if desired an estimate and/or the basis for determining the amount of the reviewer’s fee.*

You will provide us with the “reasonable assurance” described in Subsection 1410.01 of the SOP. In particular, you will make the arrangements, which enable us

to use the work of the Company’s auditor in accordance with the CIA/CICA *Joint Policy Statement* in Section 163 of the SOP and the Company’s internal control staff in accordance with Section 1610 and in particular Subsection 1610.07 of the SOP, and

to complete our report by our agreed deadline, which is [date].

We shall keep confidential any information which we receive from you in connection with this engagement and which is not in the public domain; provided, however, that we may

have open discussion about the engagement with the Company’s auditor and with [the applicable regulator or supervisor], and

fulfill our responsibilities under the CIA’s Rule 13 in its *Rules of Professional Conduct* (“Rule 13”) and under its Bylaws.

We shall do our work in accordance with accepted actuarial practice.

Your work to be reviewed is with respect to your valuation of the Company's policy liabilities at 31 December [year] and your report on dynamic capital adequacy testing at that date. We shall concentrate our review on the following classes of business:

[specify.]

We shall perform a review for the other classes of business only for material changes; namely,

[specify.]

In performing the review, we will consider:

- The procedures for supervision of any work not performed by you;
- The appropriateness of the assumptions and methods in the work;
- The accuracy of the reporting of assumptions and methods;
- The completeness of the required components of the work;
- The reasonableness of the results contained within the work;
- The procedures used to verify the integrity of the data underlying the work;
- The procedures used to ensure the accuracy of the calculations related to the work;
- The materiality of the work being reviewed; and
- The quality and reader-friendliness of the wording of the work;

but not:

[specify.]

We shall determine the intensity of the review needed to support our opinion. We do not contemplate, however, an intense review of the Company's policy forms, the experience studies on which you base your selection of assumptions, or the calculations performed by your computer systems.

We shall make our report to you. You may give a copy of the report, in confidence, to any of your colleagues, to the Company's board of directors, to the Company's auditor, and to [the applicable regulator or supervisor]. You will inform us in writing by [1 April year+1] if you have not given a copy of it to [the applicable regulator or supervisor]. You will make no further distribution of our report unless you have our prior written consent. We shall make no other distribution of our report unless we have your previous written consent.

*In the case of a pre-release review (i.e., where the review is completed before the release of the appointed actuary's report):*

Our report will identify the draft of your AAR [and of your DCAT report] on which our report is based. Before finalizing our report, we shall show it to you in draft and will be available to discuss the draft with you. We shall report and we shall discuss informally with you our suggestions, if any, for improvement to your work even though it is in accordance with accepted actuarial practice. If you change any of the reviewed work as a result of such discussions, then our final report will deal only with your work after such change. If a change in methods or assumptions requires disclosure in the appointed actuary's report and it is made as a result of the review, this change will be disclosed in our report.

*In the case of a post-release review (i.e., where the review is completed after the release of the appointed actuary's report):*

Before finalizing our report, we shall show it to you in draft and will be available to discuss the draft with you. If, as a result of such discussion, you decide to change any of the reviewed work, then we shall so report. We shall report and we shall discuss informally with you, our suggestions if any for improvement to your work even though it is in accordance with accepted actuarial practice, and which you may wish to consider in your subsequent work.

Our report will be in accordance with Section 1800 of the SOP. In particular, it will describe the extent of our review and our use of the work of other persons. It will include an opinion either

that your work is in accordance with accepted actuarial practice, or

that your work is in accordance with accepted actuarial practice except in respect of identified matters.

If we identify any such matters, then we shall report our rationale for so opining and the result of the discussion for each of them. If that discussion does not resolve our difference, then we shall consider our responsibilities under Rule 13.

*Insert a "hold harmless" provision if desired.<sup>7</sup>*

Yours sincerely,

*Signature of reviewer*

[date]

I agree to the engagement described above

*Signature of appointed actuary*

[date]

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<sup>7</sup> Such limitations and disclaimers could, for example, make it clear that the review being undertaken is limited in its scope, and that reliance may only be placed on the work itself. More specifically, the report may also state that the reviewer has not reproduced any calculations contained within the work, that the reviewer does not warrant or guarantee the accuracy of the results, and that the reviewer does not necessarily agree with the assumptions or methods chosen or the conclusions drawn by the appointed actuary in the work. The reviewer may also wish to ensure that his or her contract with the appointed actuary includes a clause in which the insurer will hold the reviewer harmless in the event that the reviewer is sued in connection with the work. The reviewer may also wish to obtain appropriate insurance coverage.