

Memorandum

To: All Fellows, Affiliates, Associates and Correspondents of the Canadian Institute of Actuaries and Other Interested Parties

From: A. David Pelletier, Chair
Actuarial Standards Board

Date: February 4, 2011

Subject: **Final Standards of Practice – Part 5000 Practice-Specific Standards for Public Personal Injury Compensation Plans**

Document 211012

INTRODUCTION

The attached final Standards of Practice for Part 5000 were approved by the Actuarial Standards Board (ASB) on February 1, 2011.

EFFECTIVE DATE

The final Standards of Practice are effective for calculation dates after March 15, 2011 in respect of financial reporting periods beginning after 2010, with one exception. The exception relates to parts of paragraphs 5410.02 and 5410.08, which are applicable to calculations dated as of December 31, 2014, or later, to enable practitioners to prepare for their implementation. The final Standards of Practice replace the existing Part 5000.

EARLY IMPLEMENTATION

The recommended changes do not introduce any conflicts with existing Standards of Practice. Hence, early implementation of the final Standards of Practice is permitted.

DUE PROCESS

The ASB's Policy on Due Process for the Adoption of Standards of Practice was followed in the development of the final Standards of Practice.

BACKGROUND

Practice-Specific Standards of Practice for Public Personal Injury Compensation Plans (PPICPs) were first adopted in 1994 to provide additional guidance to members practicing in this area. No significant changes have been made to these Standards of Practice since inception. The Actuarial Standards Board (ASB) believes that it is in the public interest and the interest of the profession to revise the Practice-Specific Standards for PPICPs (Part 5000) to reflect evolving practices and new developments.

A [notice of intent](#) on this subject was published on June 19, 2009, with a comment period ending on September 30, 2009. An [exposure draft](#) was published on May 17, 2010, with a comment period ending on August 15, 2010. A number of comments were received on the exposure draft, and, subsequently, a number of changes were made in the preparation of the final Standards of Practice. The Designated Group is of the view that the final Standards of Practice have substantially benefited from the comments received and is grateful for the time and effort that commentators took to communicate their views.

SUMMARY OF CHANGES SINCE EXPOSURE DRAFT

The comments received on the exposure draft highlighted a number of important issues. A red-lined version of the final Standards of Practice showing the changes made since the exposure draft can be obtained from Josée Gonthier, at josee.gonthier@actuaries.ca. These changes include both editing revisions and more substantial clarifications and changes. A summary of the more significant changes made since the exposure draft is as follows:

Deferral of the effective date for the inclusion of an amount for potential occupational disease claims in the benefits liabilities from December 31, 2012, to December 31, 2014 (paragraphs 5410.02 and 5410.08).

Revision of the conditions required for excluding the benefits liabilities in respect of self-insured employers, to be subject only to the circumstances of the work and not to the risk retained by the plan (paragraph 5410.05).

Expansion of circumstances and addition of examples where more than one assumption for the expected rate of investment income may be used (paragraphs 5430.06 and 5430.07).

Clarification of the actuary's responsibilities and addition of examples where the terms of an appropriate engagement conflict with accepted actuarial practice (paragraph 5700.06).

Modification of the preclusion in the exposure draft from assuming any additional returns, net of investment expenses, from an active investment management strategy compared to a passive investment management strategy, to allow such additional returns to be assumed where the actuary has reason to believe, based on relevant supporting data, that such additional returns will be consistently and reliably earned over the long term and provides a description of the rationale for such assumption (paragraph 5430.04).

Revision of the third required sensitivity test to refer specifically to high-quality bonds, instead of to a rate that would be promulgated by the ASB from time to time (paragraph 5460.02).

Various clarifications and improvements in wording.

OTHER ISSUES

In addition to the wording in the final Standards of Practice, a couple of other issues should be highlighted.

One issue relates to what should be included in the Standard of Practice as opposed to in educational notes or other guidance material. A number of areas have been identified that were considered preferably to be handled initially by means other than directly in the Standards of Practice. A list of topics has been compiled for which the ASB considered it would be desirable to develop non-binding guidance, although it is anticipated that as practice evolves some may ultimately find their way into the Standards of Practice. This list has been forwarded to the CIA, together with a recommendation for the undertaking of significant research in the area of occupational disease.

Anticipated changes to financial reporting standards are expected to result in a further revision of the actuarial Standards of Practice for Public Personal Injury Compensation Plans. Some Canadian PPICPs may decide to prepare financial statements in accordance with International Financial Reporting Standards (in particular IFRS 4) upon the implementation of IFRS as Generally Accepted Accounting Principles (GAAP) in Canada for publicly accountable entities on January 1, 2011. Conversion to IFRS is expected to have a minimal immediate effect on the calculation of benefits liabilities for those PPICPs that do convert. Nevertheless, the Actuarial Standards Board recognizes that it is more than likely that Part 5000 – Practice-Specific Standards for PPICPs – will have to be revised further once the revision of IFRS 4 (frequently referred to as IFRS 4 Phase II) is completed. Timing is unclear, but the revised IFRS 4 is expected to apply as of 2013 at the earliest. In the meantime, the attached Standards of Practice apply to all PPICPs, whether or not the PPICP has elected to report in accordance with IFRS 4.

SUMMARY OF COMMENTS RECEIVED ON THE EXPOSURE DRAFT

A total of 10 submissions on the exposure draft were received from a variety of stakeholders. In particular, comments were received from:

- five members or groups of members of the CIA,
- the CIA's Committee on Workers' Compensation,
- three provincial or territorial organizations providing PPICP coverage, and
- one external professional body.

A summary of the comments and the Designated Group responses are presented below, grouped by major issue.

Occupational Disease

Several concerns were raised over the inclusion in the benefits liabilities of a provision for potential occupational disease claims with a long latency period, where such claims are expected to arise after the calculation date as a result of exposures incurred in the workplace before the calculation date. These concerns included:

- research, better data, enhanced guidance and time are needed before reasonable estimates of these liabilities can be prepared,
- the estimated liabilities would be unreliable numbers,
- the relevant occupational diseases should be better defined and would vary by jurisdiction,
- the relevant legislation or PPICP policy may require a valuation approach for occupational disease claims that is different than that prescribed by the Standards of Practice,
- relevant data may be unavailable or may not be credible, especially in the case of smaller PPICPs, and
- it may be more appropriate to exclude the estimate in respect of potential occupational disease claims from the balance sheet, or to include such number as a reserve instead of part of the benefits liabilities.

One submission agreed that inclusion of such a provision for potential occupational disease claims may be ideal, but it concluded that the determination of the amount would be very challenging at this time and highly unreliable. Another submission recommended that the effective date in paragraph 5410.02 be updated from December 31, 2012, to December 31, 2011.

In conjunction with the concerns raised, there were requests to revise this provision for potential occupational disease claims. The suggested changes included: delete the provision; permit the calculation but not require compliance with such provision; require the calculation but allow exclusion of the amount from the benefits liabilities; phase in the provision by starting with specific identified occupational diseases, or postpone implementation.

The Designated Group continues to believe that it is appropriate for the actuary to calculate a provision in the benefits liabilities for potential occupational disease claims with a long latency period. Nevertheless, it acknowledges that a substantial amount of research and guidance may be needed to assist actuaries with the valuation of such potential claims. The estimated liabilities for potential occupational disease claims may be approximate and variable numbers, at least initially, but the Designated Group believes that the development of this estimate would constitute better practice than effectively assuming a liability of \$0 as is current practice for many actuaries. The Designated Group also believes that the inclusion of a component for potential occupational disease claims would better reflect the principle of equity among generations and other groups.

Taking into account the comments made, the Designated Group's responses include the following:

retain the requirement to include an allowance for potential occupational disease claims in the benefits liabilities, but delay the effective date from December 31, 2012, to December 31, 2014, to allow more time for research, additional guidance and implementation,

clarify that the actuary may deviate from this standard if required under the terms of an appropriate engagement, but that the actuary would disclose any such deviation from accepted actuarial practice in the report, as prescribed in subsection 1320 of the General Standards of Practice, and

recommend that the CIA conduct appropriate research on occupational disease, and prepare an educational note to provide additional guidance with respect to the many practical issues raised regarding the valuation of occupational disease claims.

The Standards of Practice would require that the actuary include a provision for potential occupational disease claims in the benefits liabilities shown in his or her report. Nevertheless, it is recognized that the approach to reporting such amounts in the financial statements and the approach to funding potential occupational disease claims falls under the jurisdiction of the PPICP and is approved by its auditors. Consequently, that approach may be different from that prescribed in the Standards of Practice.

Present Value of Future Assessments

Some of the comments questioned why the exposure draft required inclusion of the present value of certain future earmarked assessments or scheduled reductions in the actuary's report. In their opinion, the calculation is simple, often undertaken by others and potentially misleading. Further, it was considered that all aspects of the plan's funding are the responsibility of the PPICP, and not the actuary. It was suggested that an educational note on funding or rate setting, and not the Standard of Practice itself, should address this issue. Comments on this item also extended to the next item (funding focus versus liability valuation).

The Designated Group elected to retain this required calculation and reporting in the final Standard of Practice. Although the calculation may be straightforward, with appropriate communication the results provide useful information for evaluation of the funded position and future funding requirements. It should be noted that paragraphs 5500.02 and 5500.03 clarify that the disclosure of such results is subject to the terms of the engagement. Hence, if the terms of the engagement so specify, the actuary would not disclose this calculation.

Funding Focus versus Liability Valuation

In several jurisdictions, the actuary's role currently is limited to the calculation of the benefits liabilities. In view of this role, some submissions advised that there should be a very clear distinction between the calculation of the benefits liabilities and all funding issues, and that the Standards of Practice should address the calculation of the benefits liabilities only. Any issues which relate to other aspects of funding should be removed from the Standards of Practice. Although the actuary may be asked to advise on funding arrangements, the process is and should be kept separate from the valuation exercise. Other submissions, however, held an opposite view and would have preferred further emphasis on the central role of funding even in the determination of benefits liabilities.

The Designated Group decided to retain the funding references in the Standards of Practice, for a number of reasons, including:

- these references will provide useful guidance to those actuaries who do have a broader mandate that includes some aspects of funding,

- possibly the references to funding issues will encourage an expanded role for some actuaries, and

- if the terms of the engagement restrict the actuary's role to the valuation of the benefits liabilities only, the actuary may disregard the funding references in the Standards of Practice that are not applicable.

At some point in the future, the ASB may adopt Standards of Practice to cover funding issues or rate setting for a PPICP, in which case it is possible that some of the funding references could be transferred to those new standards.

Accounting Policy versus Actuarial Standards

Some comments expressed the concern that certain elements of the exposure draft may conflict with the PPICP's accounting policies, and that certain decisions should be left to the accounting profession.

As noted under "Occupational Disease" above, the Designated Group is clarifying that the actuary may deviate from this Standard of Practice if required under the terms of an appropriate engagement, but that the actuary would disclose any such deviation from accepted actuarial practice in the report. Hence, if the PPICP's accounting policy that is referenced under the terms of an appropriate engagement conflicts with the Standards of Practice, the actuary may follow the accounting policy.

Self-Insured Employers

Some submissions noted that there appeared to be potential contradiction between sections 5100 and 5200 with respect to self-insured employers. As well, it was suggested that the actuary should not be expected to evaluate the risk retained by the PPICP in respect of the self-insured employers, as was required in paragraph 5410.05 of the exposure draft, and that such requirement should be deleted.

The Designated Group agreed with the comments. Hence, the wording in sections 5100 and 5200 was revised to eliminate any potential conflict, and the requirement for the actuary to evaluate the risk retained by the PPICP was clarified in paragraph 5410.05 to depend on the circumstances of the work.

Assumption for Expected Rate of Investment Return

Paragraph 5430.04 of the exposure draft prohibits the actuary from assuming a premium for an active investment management strategy. A couple of submissions requested that the wording in this paragraph be revised to be consistent with the provisions included in the final Pension Standard of Practice that was published by the ASB on June 14, 2010. The revised pension wording allows for assumed additional returns from active management in limited circumstances.

One submission questioned the intent of paragraph 5430.06, where more than one interest rate assumption may be permitted.

Another submission noted that the best estimate assumption for the expected rate of investment income should be based solely on a risk-free rate of return.

To ensure consistency, the Designated Group has adopted a policy identical to that adopted in the Pension Standards of Practice. That policy allows in limited circumstances an assumption of an additional return due to an active management policy. In addition, paragraphs 5430.06 and 5430.07 identify circumstances where more than one interest rate assumption may be used. No other changes have been made in respect of the best estimate assumption for the expected rate of investment income.

Sensitivity Testing

A number of submissions requested that the third required sensitivity test included in paragraph 5460.02 of the exposure draft, with respect to the fixed income discount rate promulgated by the ASB, be deleted. It was noted that the results of this test would be of little or no value, and could be misleading.

The Designated Group elected to retain the prescribed discount rate scenario, since the results would provide a measure of the potential risk assumed by the plan and would enhance consistency with other practice areas. The rate will not be promulgated by the ASB, however, but will be determined by the actuary based on a hypothetical portfolio of high-quality bonds of relevant durations. This reference to high-quality bonds, instead of to a promulgated discount rate, will result in a more current discount rate for the sensitivity testing and will be more responsive to the timing needs of practitioners.

Other

One submission requested that the references to “terms of engagement” be deleted, and replaced with a reference to the circumstances of the work. The Designated Group decided to retain the references to “terms of the engagement” as this wording is also used in the General Standards of Practice and in other practice-specific Standards of Practice. It should be noted that, as in the case of the General and other practice-specific Standards of Practice, such engagements can be either formal or informal.

Another submission noted that when setting the margin for adverse deviation, the actuary could take into account the funding policy and other funding-related issues for the plan, and that additional guidance should be provided in this area. The Designated Group agrees that an educational note on setting best estimate assumptions and the margin for adverse deviations, and the considerations that would affect the actuary’s work in this respect, would be useful.

A number of other changes to the wording were suggested. The Designated Group considered all of the suggestions, and adopted those which improved the Standards of Practice.