Memorandum

To: All Fellows, Affiliates, Associates, and Correspondents of the Canadian Institute of Actuaries, and other interested parties

From: Josephine Marks, Chair
Actuarial Standards Board

Marco Fillion, Chair
Designated Group

Date: October 11, 2019

Subject: **Final Standards – Revisions within the Practice-Specific Standards for Insurance (Section 2500 and Part 1000)**

Document 219112

Introduction

Changes to Section 2500 of the practice-specific standards for insurance, Dynamic Capital Adequacy Testing (DCAT) (now renamed Financial Condition Testing) and Part 1000 were approved for distribution by the Actuarial Standards Board (ASB) on September 10, 2019. Due process was followed in the development of this standard.

Part 1000 is revised to address references to DCAT that are changed to Financial Condition Testing (FCT).

Background

The Office of the Superintendent of Financial Institutions (OSFI) and the Autorité des marchés financiers (AMF), issued guidelines on Own Risk and Solvency Assessment (ORSA) in 2013 and 2015, respectively.

A survey conducted by the Canadian Institute of Actuaries (CIA), through the Committee on Risk Management and Capital Requirements (CRMCR) and assisted by the Joint Risk Management Section of the Casualty Actuarial Society, the CIA, and the Society of Actuaries, indicated that a majority of respondents believed that DCAT and Own Risk and Solvency Assessment (ORSA) processes should be integrated. The survey also indicated that the development of updates to the standards of practice and educational notes was a high priority for many respondents.

In 2017 the ASB formed a designated group (DG) on the harmonization of DCAT and ORSA to propose revisions to Section 2500 Dynamic Capital Adequacy Testing of the Standards of Practice (SOP) that will:

- Provide a more robust approach to satisfy the requirements of the federal and provincial insurance company acts to report on the expected future financial condition of an insurance entity; and
- Allow for a better alignment with ORSA regulatory requirements as they relate to work needed to report on the expected future financial condition of an insurance entity.

A notice of intent (NOI) to provide the background and general information on these proposed changes was distributed by the ASB on November 24, 2017, with a comment deadline of March 20, 2018.

An exposure draft (ED) was published January 21, 2019, with a comment deadline of April 30, 2019.

Feedback from stakeholders

The DG solicited input from various stakeholder groups in the development of the ED. These included CIA membership, various CIA committees, industry associations, and regulators through the distribution of the NOI and the ED.

The DG appreciates the feedback received and has taken it into account in the revision of the standard. Many comments related to minor wording or reference clarifications were received and considered. The following section of this memorandum outlines the major issues raised by stakeholders and considered by the DG.

Summary of major issues raised by stakeholders, and proposed responses

The following paragraphs summarize the key issues raised by stakeholders and the rationale for the responses to the issues within the final standard.

Gone concern and going concern scenarios

Gone concern and going concern scenarios received the most comments from stakeholders:

- There was broad support for the three levels of testing (base scenario, going concern scenarios and gone concern scenarios).
- However, the definitions for going and gone concern raised several concerns. The most recurring were:
    - Use of different words to describe the tests already defined in prior paragraphs;
    - Some concern with the use of the words “gone concern” and the message it may convey;

- Confusion of the term “run-off of remaining obligations” in the definition of gone concern;
- Reference to “viable entity” (although consistent with regulatory language) in the definition of going concern scenario is too vague for purposes of this SOP;
- The meaningfulness of “plausible” in the context of a going concern scenario; and
- Some expressed confusion as to how going and gone concern scenarios would be set.

Gone concern scenarios are renamed solvency scenarios in the standard, and the definitions of going concern and solvency scenarios have been entirely changed and no longer refer to the tests, which are already described in a prior paragraph.

The concept of “plausible” scenario is now used only when describing solvency scenarios. Going concern and base scenarios are, by definition, plausible.

The Committee on Risk Management and Capital Requirements will be publishing an educational note providing guidance on the setting of going concern and solvency scenarios, and several other topics related to FCT.

Routine vs non-routine management actions

Generally, stakeholders requested more clarity in distinction between ripple effects, routine and non-routine management actions. There were also comments that the examples of routine and non-routine actions were presented in a way that appeared restrictive; for instance, what is a routine action for one insurer may not be for another.

Routine actions are now part of ripple effects, and references to “non-routine” actions are eliminated and are now effectively corrective management actions. Otherwise, consistent with the ED, when corrective management actions are used, scenarios must be presented with and without such actions. In addition, meeting satisfactory financial condition due to corrective management actions may result in the Appointed Actuary needing to further disclose that the satisfactory opinion is subject to certain conditions.

The standard provides examples of management actions and clarifies that a management action can be a ripple effect, a corrective management action, or a combination of both, depending on the scenario analyzed and circumstances of the insurer.

Qualified opinion

Most of the comments related to wording and clarity, including whether:

- “reliance” on ORSA was the appropriate reference
- the opinion should refer to internal target ratios or internal target levels
- use of the words “qualified opinion” is often perceived negatively

- reference to “under all going/gone concern scenarios…” implies that all possible scenarios need to be considered or tested

The standard includes changes to the opinion that, in the DG’s view, have addressed all comments related to clarity or proper use of certain words. In addition, instead of referring to “qualified opinion”, the standard uses the words “subject to”, which better convey that, in those situations, the financial condition is still satisfactory but subject to corrective actions under certain conditions.

A few stakeholders questioned some fundamentals of the opinion such as:

- The merit of linking DCAT and ORSA
- The need for a qualified opinion

The opinion had broad support from stakeholders. The DG had several discussions on the above questions throughout its mandate and strongly believes that linkage to the ORSA and the ability for the Appointed Actuary to state, under certain circumstances, the conditions under which the FCT is satisfactory, are key aspects of being able to fulfill the objective of its mandate.

Current members of the DG

The group responsible for the development of the revisions to the SOP consists of: Hélène Baril (life), Pierre Bernard (P&C), Wally Bridel (reinsurance), Marco Fillion (Chair), Kevin Gray (life), Pierre Lepage (P&C), Elise Maguire (mortgage insurance), Valerio Valenti (life), Diane Gosselin (OSFI observer), Sylvain St-Georges (AMF observer), and Azmina Jiwani (ASB liaison). Members of the DG may all be contacted at their membership directory addresses.

Effective date

This final SOP Section 2500 is effective January 1, 2020.

JM, MF