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Summary: This panel discussion covers emerging issues in Canadian financial reporting for life insurance companies.

Topics covered include:

- *New Consolidated Standards of Practice: the CIA standards of practice, which have evolved over time, have been written into a consistent new version. They will come into practice in 1996.*
- *Future Financial Condition Opinion: a controversial proposal is to require the appointed actuary to give a public opinion on the future solvency of a life insurance company.*
- *Disclosure: more public disclosure of financial information is being required by the regulator. The form and level of detail are being debated within the industry.*

Mr. Robert M. Smithen: Morris Chambers will be speaking to us first about the new consolidated standards of practice in Canada. Jeff Guy will talk about the financial condition opinion. I'll be speaking about disclosure of actuarial issues.

Mr. Morris W. Chambers: The first thing I should point out, notwithstanding what was printed in the program, is that the new consolidated standards of practice will not take effect in 1996. In fact, there's some possibility that they won't even take effect in 1997.

The Canadian version of the CIA is a relatively democratic institution; therefore, the adoption of standards of practice requires a measure of consensus across the Institute's membership. That consensus has been slow to develop with respect to the consolidated standards of practice. This should not come as a surprise to us, given the ambitious scope of the project.

The work of consolidating the standards has been under way for several years under the able leadership of Ken Clark. I'll use Ken's own words to explain why the CIA is engaged in this exercise. In a recent speech on the subject, Ken said that, "First, standards should unify our profession by articulating what we have in common. Standards should be integral to our profession." You all know Ken and really believe that he said that.

Standards should explain and depict our profession to the public. They should answer the question, What do you get when you ask an actuary? Standards should provide a core from which we extend our expertise to new fields of practice. In short, actuaries will neither respect nor conform to the spirit of standards unless those standards unify, unless they are integral to our nature and being, unless they explain us, and unless they establish a foundation.

Actuaries in Canada, like actuaries in the U.S., practice in different fields including life insurance, property/casualty insurance, and pensions. Standards of practice have evolved over the years in each of these areas. Uniting them has involved distilling what they have in common in the form of general standards and leaving what was different in the practice-specific standards. At the same time, as Ken said in the same speech, standards should not create an indefensible variation in practice among practice areas. Second, standards should stimulate actuaries in one practice area to learn from actuaries in another practice area.

I won't dwell any longer on the subject of the general consolidation of our standards—at least for the moment. That has proven to be a most stimulating and controversial exercise in itself. You'll be well aware of that if you attended the November 1995 CIA meeting in Ottawa or if you're a subscriber to the CIA general mail list on the Internet.

Before consolidation, the standards of practice applicable to life insurance financial reporting were voluminous and diverse. They begged for consolidation. This has been the task of the Committee on Life Insurance Financial Reporting, generally known as CLIFR. To put things in perspective, I will give a brief summary of history of these standards.

Before 1978, the liability evaluation bases for life insurance statutory reporting were strictly prescribed—much as they still are in the U.S. Life insurance companies could follow the net-level-premium method or a modified preliminary term method known as the Canadian method.

Even with the modified method, there could be substantial issue strain. Dissatisfaction with that circumstance gave rise to the 1978 Canadian method. That new method was more than just a new modified method in the genre of full preliminary term or the commissioner's reserve valuation method. It represented a departure from the past in one fundamental respect: it left to the actuary the selection of valuation assumptions—assumptions that were in keeping with the circumstances of the company and the policies in force.

Those words were taken from the recommendations that were adopted by the CIA in 1978. They were intended to provide guidance to actuaries in the performance of their duties under the then-new insurance legislation. Yes, the appropriate valuation basis according to law was to be the actuary's responsibility. That might well be the most important development in the evolution of the actuarial profession in Canada.

The 1978 Canadian method wasn't perfect. While it did permit the actuary to choose the assumptions and it required explicit treatment of all relevant experience factors, it still limited artificially the extent of the deferral of acquisition expenses. In addition, it was never clear how changes in assumptions were to affect the valuation premium. Indeed, the 1978 Canadian method was seen by many actuaries as only the first step in the direction of full emancipation. Most importantly, it was not considered by our accounting brethren as consistent with GAAP.

The 1978 legislative changes were developed in an environment in which interest rates had yet to make their climb into the stratosphere, in which there were no term-to-100 policies, no nonsmoker/smoker policies, and no AIDS risk. As these developments emerged, the 1978 recommendations were perceived to provide inadequate guidance to actuaries on dealing with those issues. Moreover, the recommendations called on the actuary to provide reasonable provisions for adverse deviations without any guidance on or reference to what was reasonable.

In response to concerns expressed by the supervisory authorities and others, new standards of practice known as valuation technique papers (VTP) were adopted, one by one, to supplement the recommendations. The recommendations that had been comprehensive in scope and general in nature became hedged with a number of largely prescriptive and proscriptive standards. Those standards were designed to curb specific abuses or to avoid perceived abuses that some were afraid the new regime permitted actuaries to commit. These new standards were intended to expand upon and interpret the recommendations in some specific applications and to constrain the range of practice. At the same time, they inevitably raised questions about the interpretation of the recommendations in all other areas. A sharp contrast had arisen between those applications where practice was strictly prescribed, and those where the more general guidance of the recommendations left room for professional judgment.

As you may know, federal legislation in Canada requires that the amount of the actuarial liabilities used in any public financial report of an insurance company must be the same as the amount that is used in the government's statement. Because of the restrictions placed on that valuation by the insurance law, particularly with respect to limitations on the deferral of acquisition expense, the insurance company financial reports were not considered by auditors to be prepared in accordance with GAAP. In fact, the handbook of the Canadian Institute of Chartered Accountants (CICA) had specifically exempted the insurance industry from GAAP.

In the early 1980s, there developed increasing pressure for conformity with GAAP, so the CICA and the CIA worked together to develop a valuation method that could comply. The two institutes jointly agreed on the policy premium method as the appropriate regime. That was followed by lengthy discussions with the federal regulators to convince them that the time for removing the insurance industry exclusion from GAAP had come, and that the new method had sufficient safeguards to avoid the wholesale insufficiency of actuarial liabilities.

As most of you are aware, the CIA had expressed concern about adopting the policy premium method. It insisted that there be some other considerations given—for instance, some means of assuring that the provisions for adverse deviation that were used were appropriate, and that there be other provisions to ensure there was adequate capital to support the whole operation.

The new federal insurance legislation, which was implemented on June 1, 1991, requires insurer financial statements to be prepared in accordance with GAAP and with accepted actuarial practice. This time, the law does not mention the valuation method.

In the early stages of the general consolidation of standards, CLIFR strove to draft new valuation technique papers, in an attempt to fill a gap between the limited areas covered in the existing valuation technique papers and the generality of the recommendations. Among other things, the committee struggled with how the policy premium method was to apply to participating insurance, given that the policy premium method was defined in the context of nonparticipating individual insurance, its application to accident and sickness insurance, and universal life insurance. CLIFR turned out one draft paper after another, much to the annoyance of practitioners.

By the autumn of 1994, the Committee on Consolidation of Standards Practice, at the urging of counsel, was ready to move to the exposure draft or final stage, with respect to the consolidation. CLIFR, however, was not ready. It had yet to tackle the process of consolidating the life practice-specific standards.

In June 1995, the exposure draft of the consolidated standards was issued. Rather than attempt to consolidate the life practice-specific standards, the existing standards—consisting of the recommendations for life insurance company financial reporting, the *Provision for Adverse Deviation* (*PAD*) paper, and the VTPs that had been adopted—were brought together in the section of the consolidated standards reserved for life practice-specific standards in as reasonable a fashion as the committee and consolidation could muster.

All of you have been exposed to these developments, so I'll discuss what is now in the standards. The consolidation begins with the recital of the general principles, before turning to a discussion of valuation methods and valuation assumptions. The general principles begin with a declaration of the objective of the valuation, which is to measure that amount of assets that, in the opinion of the actuary, is sufficient, without being excessive, to provide for the insurer's commitments over the term of the policy liabilities.

The scope of the insurer's commitments must extend beyond what is strictly guaranteed; otherwise, no liability need be recognized for policyholder dividends, among other things. This is referred to as providing for policyholder's reasonable expectations—a principle that is also reflected in the guidance notes published by the Institute of Actuaries in the U.K. with, we believe, the same intent. At the same time, the expression "policyholder's reasonable expectations" probably has been the most controversial expression in the whole exercise.

The classification of policy liabilities points out that the policy liabilities may appear under different names in the financial statements. The same type of liability may be shown on one line or another. It is the actuary's responsibility to ensure that the user understands how the liabilities have been classified. Policy liabilities are different from most other financial statement items. They are determined prospectively through a process of valuation, rather than at historical cost. Contrary to the general rule of historical cost, the valuation process brings to the present period the events of future financial periods. It is important that one projects into the future no further than necessary to provide for the insurer's commitments. To that end, the appropriate terms of the various liabilities are considered.

To speak about valuation methods is somewhat misleading, because there is essentially only one method described. It is referred to as the *general method*. It involves the projection of all future cash flows over the term of the liability with all experience factors treated explicitly. In some circumstances, the relation between the value arrived at by the actuary and the supposed future cash flows is so tenuous as to make it impossible to say that the actual method employed is an approximation to the general method.

The policy premium method is hardly mentioned. The same is true of the cash flow valuation method, which is the term that has been used to describe the valuation of annuity liabilities under VTP-9.

I'll now summarize the general method of valuation which can be described as consisting of four steps:

1. The actuary begins by projecting both asset and liability cash flows using the actuary's expected or best-estimate assumptions. The asset cash flows will depend upon the portfolio assets and future prevailing interest rates. In this expected experience scenario, the actuary assumes that future prevailing interest rates will be the same as the current rates.

2. The actuary applies appropriate margins for adverse deviation to the expected cash flow assumptions, consistent with the degree of uncertainty associated with the expected assumptions.

3. Rather than provide for interest-rate risk by assuming a scenario of prevailing interest rates that decline over time, as required in VTP-3, the actuary tests the assets required under a variety of scenarios of future prevailing interest rates. In this context, probably the standards will prescribe a number of scenarios that will need to be run through the system—including the VTP-3 scenario. But it will remain the actuary's responsibility to test for more adverse, but no less likely, scenarios.

4. The final step in the valuation is to recognize explicitly in the projection the freedom of the insured to pass through the cost of adverse experience to the policyholders in the form of premium hikes, dividend cuts, or other adjustments. In so doing, the actuary should take into account likely delays in taking action, together with marketing and other constraints. The difference

between the final result and that of the expected experience scenario represents the amount of the provision for adverse deviations.

The general method cannot be applied to situations in which the insured does not have the assets required to support the liabilities to be valued. In such cases, the actuary is expected to make do with the assets available and to "top up" the liability in some reasonable manner.

The sections on selecting the cash flow assumptions cover the general principles involved in setting the expected assumptions and margins for adverse deviations. A major difficulty faced by the committee in attempting to generalize the standards is that up until now, minimum and maximum margins have been prescribed in the so-called *PAD* paper and in some other papers, but only for some assumptions. Moreover, the minima and maxima are varied from one assumption to another in a manner that was related not to the degree of uncertainty associated with the particular assumption, but rather to the value of the liabilities that resulted from applying margins of that magnitude. Because these results had been tested specifically for certain lines and certain products as the standards evolved, the committee thought that they could not be relied upon as a universal guide.

CLIFR recognizes that while each risk factor must be considered, the size of the overall provisions for adverse deviations is also of concern. On the other hand, the committee is also concerned with putting in place a system that can readily be extended to new situations. For that reason, the committee is recommending that a standard range of high and low margins be adopted with certain qualifications. The membership is far from convinced that this is a good idea, and discussion is expected to continue through the months ahead. This, and other issues raised by the draft consolidation, will make for what is expected to be a lively and informative debate as the CIA works to prepare itself for the next round. What is the next round? That is the harmonization of GAAP among all financial institutions in Canada.

Mr. Geoffrey (Jeff) I. Guy: I'm not sure how much I could say about the appointed actuary's opinion in Canada, although the issue about whether this should be amended is certainly an area that has caused a fair amount of controversy in Canadian actuarial circles.

I'll start by looking at the current opinion. In most companies it tends to follow a fairly basic form. The appointed actuary in a Canadian company will state the value of the liabilities, that the value of those liabilities is fairly reflected, and that the change in the value of those liabilities is fairly reflected. In other words, the reader of the statement can believe that the balance sheet, the statement of net income, and the numbers at the bottom of the page—whether they be net income or whether they be surplus—are fairly represented. I'm not sure when that opinion came into force.

The question is, should the opinion be changed? The reason it gets asked is because a large part of the appointed actuary's job in Canada is to actually look at the future through a series of scenario tests—something I call dynamic solvency testing. Why would the question even be asked? There are many reasons why this has come up as an issue. The first one is the motto of the Canadians to their actuaries: *nobis cura futuri*, which I'm going to translate very loosely to mean "We care about the future." So why would an appointed actuary in an insurance company—where he or she spends a tremendous amount of professional time looking at the future financial condition of the company—not make some statement about that in the opinion?

Going back in history, the CIA made a commitment to the Office of the Superintendent of Financial Institutions (OSFI). It's not quite clear at this point exactly what form that commitment took, who made it, or how strong it was. The commitment was that the CIA would change the actuarial opinion to make a statement that the actuary has looked at the future financial condition of the company and that future financial condition is satisfactory.

The other reason that you might consider a change to the opinion is simply because of dynamic capital adequacy testing or dynamic solvency testing, in which the actuary looks at the insurance company's business under a variety of scenarios. There is a projection of the future and the company's income statements and balance sheets, and there is testing of scenarios that can range from simple changes in mortality, to changes in interest rates, to exotic things. I used to work for a company that had real estate in California, and we actually modeled the impact of an earthquake; it was significant.

As that's done, adverse situations might occur because of an exotic event or because of the company's growth rate and its ability to generate enough capital from its existing businesses to support that growth rate. The company's future financial condition might deteriorate in some manner, and the actuary's responsibility is to work with management to find solutions. Clearly those solutions aren't the sort of things you've got on a spreadsheet—those are business solutions—so these can be quite complex discussions. It's part of the conceptual framework of capital adequacy testing. Finally, the actuary has to give an annual report to the board.

So with all of that—a great deal of formality around that and much discipline applied to it—it appears to be an absolutely perfect preparation to give a future financial condition opinion. I'm sure this was what was in the minds of the CIA executives when they made the commitment to the Actuarial Standards Board (ASB) some years ago.

Insurance companies have a variety of stakeholders. The policyholders and the investors, if it's a stock company, clearly have immediate financial interest in the company and have a right to know. If the actuary has a concern about the future financial condition of the company, it's appropriate that it be made known to the investors and the policyholders.

What happens if an actuary has done this testing and determines that a company is in trouble? What if there is a problem with future financial conditions? Let us suppose the actuary is producing an opinion that states that he or she has concerns about the future financial condition of the company. The first question to ask is, Would the publication of that opinion result in a "run on the bank?" The actuary may believe that the event identified may not be a serious threat to the company. The actuary may believe that management has a plan in place that is going to address that particular role. But as soon as that information gets out into the public arena, there is a concern with the future financial condition of the company. Will it be understood by the various publics, and will it result in a run on the bank?

If an actuary has identified this type of problem, how is the actuary serving in the role of the regulator? Regulators in Canada have the power to do something about the situation. They don't have to wait until management hopefully finds a solution to the problem. They can be more proactive and work with other companies in the industry to try to, perhaps, buy blocks of business or maybe the whole company. Behind-the-scenes action can be more effective than publishing a statement that there may be a problem.

I work on a committee that Rob chairs. We looked at various options on how to address this particular issue. I'm going to go through them and tell you what we concluded. The first option is not to change anything. The second option is to give a future financial condition opinion. Many members of the CIA felt that assuming the future financial condition of a company to be satisfactory was not appropriate because the actuary placed the future financial conditions and opinions or analysis in the public arena.

The third option is to say that the dynamic solvency testing has been done and adverse situations are being addressed. The committee believed that one of the options was to recognize that the appointed actuary had, in fact, done this work and had been through this dialogue with management and the board. I want to stress here that if there had been any adverse situations, this comment would be made about every single company. It would be made about the company that had no problems. It would be made about a company in which there had been an adverse situation. As long as that adverse situation was being addressed, the actuary could make a statement saying that he or she had done the work. I'm not saying all these are perfect; these are just options that the committee looked at.

In my opinion, it's very difficult to say the status quo is fine. The world is changing rapidly, and with it, the role of the appointed actuary also has changed substantially over the past few years. I'm convinced it's going to change substantially in the future. The demands made on companies by their various stakeholders are substantial. I do not believe that this kind of statement that we make these days, while it's very important, is sufficient by itself. I believe that the world is changing, and that to continue with the status quo is to lodge ourselves in the past and not recognize the change in realities.

In giving the future financial condition opinion, the issue is that we really are usurping the due process for a company in trouble. This is an incredible responsibility. Maybe there would be one appointed actuary who had exactly the right opinion with no grey areas around it. It was black and white and it worked perfectly. But generally my view is that the world isn't like that. The regulator has a key role. If a future financial condition opinion starts to look vague, there's much that needs to be done. I think it needs to be done by the regulator behind the scenes. I think that for the actuary to go public and to make a public statement would cause more problems.

If we make the statement that any adverse situations are being addressed, I think it will beg the question, What adverse conditions? I think that at the company's annual meetings, people will have a tendency to ask: "What adverse conditions did the actuary find, and what action is management taking about them?" If the actuary stands up and says, "There were none," they will say, "Why did you make this statement anyway?" It has a tendency to produce a fairly vague opinion that I don't think would be accepted in the outside world.

What the committee recommended—and this is up for discussion because it's in the early stage—is to modify the opinion to say that the actuary has analyzed the future financial condition. Because it is such an important part of the actuary's role, it was thought to be appropriate to make that statement and also to strengthen the current wording to say a little more than those vague words about the values are fairly presented. I'll read some possible text soon.

It does not state that the future financial condition is satisfactory or unsatisfactory, for the reason I mentioned. One of the types of presentations that we could use, we've said, is first using accepted actuarial practice of all the valued-policy liabilities. Second, analyze the future financial condition of the company. That's a change from today because there are two components, as opposed to one component. It says, "The valuation is appropriate, and the consolidated financial statements fairly present the results." In other words, you completed the balance sheet and the income statement not just today. Then it says, "In addition, the value of consolidated actuarial and other policy liabilities together with total capital and surplus makes a good and sufficient provision for all obligations under the terms of the policies in force." It is designed to give more comfort to at least the current generation of policyholders. When the material goes to the CIA meeting in Quebec City, that's what will be included for debate by the membership.

There are some other things that need to happen at the same time. As an appointed actuary, I think that the world is quite complicated these days. However well we craft a single opinion, I don't think that we'll be able to cover all the issues. I think it's absolutely critical—and I have no reason to believe this is not happening in most companies—that the actuary, management, the auditor, and the directors work together. OSFI should be involved too, regardless of whether a troubling situation exists. This is very important because there are always scenarios out there that can threaten companies. These scenarios might not make a company insolvent in the normal sense, but they can threaten the financial stability of a company. For example, decreased earnings with potential rating downgrades could be a significant threat to many companies. It's very important that people work together so adverse situations are addressed in a timely manner.

If a company is facing difficult situations, they should be presented to the stakeholders of the company as part of the management discussion and analysis (MD&A) or as part of the notes of the financial statement. That gives the company a certain amount of latitude in how it presents it, but it's incumbent on the actuary and the management of the company to identify the problem and to describe the action that is being taken. They can do that in a way that is designed not to frighten or scare the current policyholders or to cause a run on the bank. But I would not feel at all comfortable, as the appointed actuary, if I had significant problems in my company. My opinion may not require me to disclose them because they might be in the future. However, I would want to disclose that the company was taking action that was designed to address some potential future event that would be described.

I also think it's important that the public understand the role of the appointed actuary. If you look in the present Canadian statements, some of the descriptions are quite detailed—they describe how the actuary values the assets and liabilities and what that entails. They describe this very important future financial condition work. Others are very brief and only acknowledge the existence of an actuary. I think it's important that the role of the actuary is well described in the report and put in the context of the role of the auditor. In our current report to the government (you may feel bothered by this) the auditor's role goes on for about six times as long as the actuary's role. I think the role of the actuary is just as important. It's important, I think, to ensure that's known by the public. That needs to happen as well as changing the opinion. I think just changing the opinion is not going to achieve the desired end result.

I think it's critical that the actuarial role be clearly articulated. That can be done partly through changing the opinion, but also through required disclosure and required statements in the annual reports. It's critical that we reinforce the role of the actuary as part of a financial team, which involves all those components that I mentioned earlier. It's also important that we continue to recognize that management is responsible for the financial health of the company. Hopefully, the actuary is a part of that management team, because the actuary has a tremendous contribution to make. I don't think we want to be in a situation in which any member of that management team—be it the actuary, the chief accountant, the chief marketing officer, or the chief investment officer—has the ability to put a statement out in the public arena that can cause incredible distress about a situation that's occurring within the company.

Mr. Smithen: I'm chairperson of the CIA Committee on the Role of the Appointed Actuary, which was established less than a year ago. Two topics that we have examined are the future financial condition and disclosure. We have looked at both issues. We did not endorse a black or white opinion on the future financial condition of a company. We thought that it was more appropriate for the appointed actuary to disclose what's happening as it happens, rather than a cliff type of approach (everything is great until one day suddenly everything's terrible). In real life it doesn't work that way. Everything starts off great and it gradually deteriorates. We thought some early warning of that deterioration is important and, hopefully, will lead to resolution.

Before 1994, there was little or no disclosure of actuarial issues anywhere. If you look at the financial statements of major life insurance companies in Canada in 1994–95, you will see some disclosure. You're starting to see some breakdown of liability. You're starting to see some information about earnings. Some companies do MD&As. I know Jeff's company does an MD&A, so it's starting to happen gradually on its own. There has been other pressure for change and for increased disclosure of actuarial issues. The Canadian Institute of Chartered Accountants (CICA) has two standards on measurement and uncertainty and on financial instruments. Both get into issues about financial disclosure of areas that affect the actuarial practice in life insurance companies.

About a year ago, OSFI produced a speech by Doug Palmer and a White Paper from the Department of Finance that said there must be increased disclosure by life insurance companies. This all followed the Confederation Life fallout. There was a great deal of pressure to increase disclosure. What has been done? The CICA and the CIA created independent task forces that didn't have anything to do with each other. When we figured out what was going on, we decided it was a smart idea to set up a meeting. A subgroup of my committee and the CICA committee met and worked out what we thought were appropriate principles for disclosure of actuarial matters.

In January 1996, a draft CIA guidance note incorporated the CICA standard or guideline at the same time. We asked for comments by the end of April, and we received approximately ten. In Quebec City, we'll have a good dialogue about this to see if there are any other changes recommended by membership, and we'll expose some of the comments. Final standards ought to be out late this year or in 1997. There may not be any specific actuarial standards. There may just be CICA standards. We'll see whether we need any actuarial standards in this area, but you should know actuarial input has been strong here.

We expect disclosure to be an evolutionary—not a revolutionary—process. We're not going from nothing to everything all at once. The initial target audience is an educated reader of the financial statements. We expect five to eight pages of disclosure, including both charts and text. We'll try to make it user-friendly, but ultimately it will lead to a detailed analysis of earnings and a breakdown of the reserves in much more detail than we're talking about initially.

First, we want actuarial liabilities—policy liabilities—shown by major line of business and geographic area. In fact, that has started. If you'll look at the financial statements this year, a number of companies did that. If you're a company that has a large number of term-to-100 business, or doing a great deal of business in Pacific Asia, we expect you to show that, so that it's not just one number in the financial statements, it's one number broken down into its subcomponents.

We expect you to show the asset supporting liabilities in the capital and surplus of the company separately, by asset class. If you have participating liabilities, nonparticipating liabilities, and capital, you would show your asset breakdown by asset class supporting each one of those categories. Nobody has been doing that; that would be new. Some companies started to do that in this year's statements.

We expect actuaries and accountants to talk about the key assumptions underlying the liability calculation, and how each assumption is derived. That does not mean that we expect you to say what your mortality table is or what lapse rate you're using, but to tell the reader the assumptions that really matter in your financial statements. Are you most dependent on meeting your lapse assumption or your morbidity assumption? And where do you get your data? Is it industry experience? Is it your own experience? How good are those data? Have the data been variable or volatile?

We expect to see the financial risks to which the company is exposed, and how they're being dealt with. We expected the actuary to do this in a nonthreatening way to the company, but to get it out there. For example, if you're a term-to-100 company and that's all you do, you are obviously exposed to long-term lapse risk. You should say that. You should say what you're doing to control that exposure, and talk about the kinds of financial consequences if the exposure is realized.

I've asked for the amount of the margin, the *PAD*, and the actuarial liabilities to be disclosed in aggregate, but not by each assumption. We expect a breakdown of the change in actuarial liabilities. You start with the liabilities at the end of last year's statement and build up as to how you got this year's: you added new business, you had some business lapse, you had a change in assumptions, you did a merger, whatever. You should be able to do a breakdown of the source of the change.

Specifically, we mentioned exposure to risks, but everybody will have to talk about their exposure to reinvestment risk. We're not exactly sure how to do this yet. But there will be some standards saying how to do that, so a change of 1% in interest rates would have an effect of *x*. We expect companies to disclose the allowance in their liabilities for future asset credit losses. A number of companies already do this. You should be able to show how much you're providing for credit losses through your assets, and how much you're providing through your liabilities, so the reader can see the sum of the two.

We expect disclosure on the extent to which liabilities have been reduced by reinsurance and on whether there is any concentration of reinsurance. If you've got treaties with two companies and it's a significant part of your liabilities, it's important to the reader to have some confidence that those reinsurance liabilities will be paid. We expect the actuary to disclose something about those reinsurance treaties. We haven't asked for disclosure of the companies, but somehow the actuary is going to have to get the reader comfortable with the extent of the reinsurance, if it's significant.

There is a requirement that already exists: by 1997 there should be disclosure of the fair value of assets, liabilities, and capital and surplus of the company. This was the one item that was controversial between the accountants and actuaries. The actuarial committee and the accounting committee didn't agree on this. The actuarial committee believed that fair value exposure of the liabilities was unnecessary under Canadian financial reporting. Furthermore, the committee believed that Canadian financial reporting already has a close tie-in between the assets and liabilities, and to come up with a market value of liabilities would be a great deal of work without gain. That is in the current standards of the CICA, and we will all have to do it, if they aren't changed.

The actuaries wanted disclosure that there's a relationship between the assets and liabilities. They wanted to disclose what that relationship is, how the assets are used in terms of driving the liabilities, and the fair value or the market value of surplus.

Those were all CICA standards. The CIA added that we talk about capital and include disclosure of minimum continuing capital and surplus requirements (MCCSR), which OSFI had mandated by 1997, and that there be a discussion of liquidity, some disclosure on liquidity, and that companies talk about the liquidity of their assets and the liquidity needs of the liabilities.

We've left the disclosure to be fairly free-form. We haven't mandated how it should be disclosed. Those who have to do it should start looking at what's being done now. We see this as gradually evolving over a few years.

What has been controversial? I had ten comments only, so I don't know if anything is controversial. Some of the comments were: we don't need any of this; it's all bad news; disclosure is bad; nobody is ever going to understand this; all it's going to do is get people concerned; we're trying to do too much too fast. Our committee believed that we were sort of going halfway to what we wanted. There is still controversy about disclosing MCCSR. If there are any Americans in the room, that's the Canadian counterpart to risk-based capital (RBC), which will be misused and abused. There's a great deal of disclosure of RBC ratios in the U.S. I don't think it meant too much, so I can't imagine it's going to be a problem in Canada, but there still is some controversy about that.

The most controversial area is the disclosure of PADs. A number of people thought that disclosing PADs without talking about the underlying assumptions is misleading, and we're certainly going to have to discuss that in our committee again before we finalize that. There's some strongly held views on both sides of that issue. On the issue I just mentioned—the fair value of liabilities—there is controversy as to whether that's appropriate disclosure or necessary disclosure under Canadian financial reporting, and, in fact, there will be a great deal of work without gain. Those were the issues that were most frequently mentioned.

From the Floor: A number of years ago I was the valuation actuary for a small stock company that was ultimately sold and disappeared, and I've moved on since then. During the few years that I was the valuation actuary and filing technique papers, one of the challenges was to come up with the PADs rather than the expected valuation, and ultimately at the end of the day or the end of the year to provide an opinion that the reserves were adequate, appropriate, but not excessive. The pressures always were to get sufficient reserves out there. In dealing with the consolidated standards of practice, Rob, you touched on the disclosure of the amount. My question is, What guidance is there for what is considered excessive versus not excessive?

Mr. Chambers: The accountants have adopted an expression, and I'm afraid I'm not going to quote it precisely, but unfortunately it's no more specific. The operative expression is appropriate to the circumstances of the company, and by appropriate they mean enough but not too much. Now the question is, enough for what? Prior to 1978, let's say "enough" was to provide in all circumstances that the reserves would be sufficient, or that's what we thought. Of course, it wasn't really true. Then with the advent of GAAP, it was enough to preserve the integrity of the reserves in circumstances that you can expect to occur, but not so much that you've covered circumstances that might rarely occur.

You will recall in the PAD paper that it talks about providing for misestimation of the mean and deterioration of the mean, but not for fluctuations in the mean. Well, I think that was just so much rhetoric, because if you've provided for these other items, you can't help but absorb fluctuations in the mean. Whether you intended to or not, you're going to do it. The idea was that under GAAP, it would be appropriate to the circumstances of the company, in respect to income measurement as opposed to solvency measurement, which was presumably the prior regime. I don't think that adequate guidance, particularly for the actuary in the small company, has yet been provided.

Mr. Smithen: I think your question is a good one. I know that it perplexes all of us. There are a variety of practices out there. There were a couple of surveys this year that indicated that even among the big companies, the practice is all over the map. That's one of the major reasons we want disclosure on this issue. Unless there's a prescribed standard, which I don't favor, nothing is going to cause the margins to get into at least some reasonable boundary until everybody knows what they are. When they do know what they are, hopefully they'll get there.

Mr. Chambers: I don't think disclosure is going to resolve that issue. I'm not against disclosure. All I'm saying is that if one actuary views the amount of provision for adverse deviation, or the margin for adverse deviation, as being at a particular level for his or her company, and another actuary sees a different measure for the circumstance that he or she is in, how do you determine whether they've been done on a comparable basis? How do you dictate what the comparable basis is to which those two individual actuaries have to accede? I think there will always be arguments about what the circumstances of the company are. There will be different views from what the circumstances are and different views of actuaries as to what is appropriate in those circumstances. When we were talking about adopting GAAP for life insurance financial reporting, one of the arguments for all of this—for the policy premium method (PPM) and for GAAP—was ultimately to provide for comparability of financial reporting. My personal view is that it is not an achievable goal—it never will be and never has been. As long as you're doing subjective work, and that's what the appointed actuary does, you will never have totally comparable reporting for life insurance companies.

From the Floor: I don't envy the role of any appointed actuary these days. I prefaced my remarks by saying that they are trying to get reserves that are adequate where they might be too low, given a particular circumstance of an actuary who had reserves that were too high. I don't know how anyone ever gets the right answer.