SOLVENCY STANDARDS DEVELOPMENTS (CANADA)

MR. TREVOR C. HOWES: Our topic is the current and anticipated future course of development of solvency standards in Canada.

If you have attended many sessions on this topic either at previous symposia, or at meetings of the Canadian Institute of Actuaries, my panelists and I will no doubt be familiar to you, as we have spoken on numerous previous occasions. Nevertheless, in the interest of those of you unfamiliar with this topic, or perhaps short on either eyesight or memory, let me provide a formal introduction.

I am Trevor Howes, and in addition to being a consultant with Tillinghast, in Toronto, I am the chairman of the CIA Committee on Solvency Standards for Financial Institutions, having succeeded David Johnston in that position as of June 1989. My two panelists are also members of the committee: Allan Brender, who is both a professor at the University of Waterloo and a consultant with William Mercer Ltd. in Toronto, and Bob Howard, who works at Mutual Life of Canada.

My panelists will be speaking shortly on the two specific pending developments, but before they do, let me set the stage a little and also highlight a few recent developments outside our committee which are relevant to the topic of solvency.

Following the presentation of my panelists, I shall conclude with some remarks on fundamental issues which in my opinion need to be addressed by the profession in the near future, and then invite you to offer your opinions, comments or questions, in response.

The solvency standards committee was formed with the mandate to study the actuarial aspects of testing the solvency of financial institutions, and to recommend standards for the guidance of actuaries in this area. Although we concluded that our ultimate goal relates to the direct assessment of a company's solvency as of a specific date, as may be required for reporting to the public and the regulatory authorities, we also concluded that this could only be achieved over the longer term. Accordingly, our committee's current statement of direction, as approved by Council in June 1988, refers to two shorter-term objectives in addition to this longer-term direction.

The first short-term objective is the development and implementation of Dynamic Solvency Testing -- that is, the process of projecting a company's future trends in actual surplus, as compared to that required by the relevant regulatory authority, under a number of scenarios.

The second short-term objective in our statement of direction relates to the need for some solvency standards to be in place prior to the implementation of GAAP, in order to comply with the specific condition to that effect established by the CIA for the acceptance of the policy premium method (PPM) of valuation.

Our intention is to require that any reduction in unappropriated surplus at the time of change to PPM be appropriated as a transitional solvency provision (or TSP). This provision would be held for a temporary period until the CIA and Office of the Superintendent of Financial Institutions (OSFI) can agree on a better approach. Adjustments would not normally be made to the amount of the TSP unless there were significant changes in the circumstances of the company.

A lot of our emphasis to date has been on the first objective, dynamic solvency testing. This has been reflected by the many sessions we've sponsored on this topic, including the teaching session using a model company's test results which we sponsored at last year's symposium. Throughout this time, we've presented the concept as being valuable on its own merits, without relying on any specific mandate for this additional work, in the form of current or pending regulatory requirements.

As you are likely aware, however, within the past year the CIA has proposed to the Federal Minister of Finance that the role of the valuation actuary be broadened and strengthened, and has suggested a number of specific changes to the Insurance Acts to incorporate these concepts.

The written submission in May 1989 was followed by a meeting with the Minister of State for Finance, Gilles Loiselle, in August at which the benefits of both the broadened role, and the proposed combined GAAP and solvency reporting, were emphasized, and all indications are that the federal government is receptive to our ideas.

One specific recommendation within the CIA's proposal was that the actuary be required to report to the board of directors at least annually on the current and expected future financial condition of the company. Such a report would examine the impact of various possible future changes in the operating environment. It is clear this fits perfectly with the thrust of dynamic solvency testing as we have been describing it.

Following up on this proposal, the Committee on the Role of the Valuation Actuary has started work preparing a draft of formal standards that would implement these concepts, and I expect material will be distributed by that committee for discussion purposes within the next few months.