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The following material is based on a speech given by Teck Go, Director of Actuarial Services to the Canadian Institute of Actuaries (the "CIA") annual meeting held on November 19 and 20 1992 in Quebec City.

Mr. Go opened by stating that, in general, the actuarial profession has a good record of compliance with professional standards and pension law. He went on to describe some examples of non-compliance with professional standards that are cause for concern. The synopsis below focuses on non-compliance issues.

Until August 1991, all actuarial reports were required to be reviewed in the first instance by pension officers. Any suspected problems were referred to actuarial staff for further review. Since August 1991 all funding reports have been reviewed by actuarial staff. As a result of this procedural change, more non-compliance cases have been identified.

NON-COMPLIANCE ISSUES

The most serious non-compliance problems are:

- the omission of significant benefits from the valuation; and
- inappropriate actuarial assumptions.

The most widespread non-compliance problems are:

- failure to comply with professional requirements of certification; and
- failure to meet disclosure requirements.

Omission of Significant Benefits

Staff have found several cases of this type over the past few years. Generally they arise in a funding report or in a determination of the commuted values of benefits in a wind-up report. Since this problem is not easy to detect, the fact that a number of cases have come to light suggests that the problem could be more widespread than previously believed.

This problem can take two forms:

1) the report lists only the benefits used in the valuation

The problem is discovered when comparisons are made with the plan text.

2) the report lists all the benefits under the plan; however, a review indicates that the commuted values of benefits cannot be reproduced.

When PCO staff make enquiries, the actuary discloses that not all benefits were included in the valuation.

Use of Inappropriate Actuarial Assumptions

Aggressive economic assumptions are not necessarily a major problem, but we have seen cases with high enough interest rates to be cause for concern. Among the more extreme, there was a case of a going concern valuation for a flat benefit plan using an interest rate of over 10 per cent for the first five years, a slightly lower rate for the next 10 years or more, and an ultimate rate of 7 per cent. As well there are more than a few plans that use a 9.5 per cent valuation interest rate without a drop-off period. This is one area where most regulators believe better professional standards are required.

Unreasonable demographic assumptions are often a greater concern than aggressive economic assumptions. This is especially true for flat benefit plans with generous early retirement provisions.

Some time ago a valuation model was developed for various types of flat benefit plans by PCO staff. It demonstrated that a change in the interest rate of 1 per cent typically changes the liability of a flat benefit plan by a factor of a few per cent. However, changes to early retirement assumptions may change the liabilities by a factor of many times.

The implications are evident particularly in relation to flat benefit plans with very generous early retirement provisions, such as an unreduced pension with a bridging benefit after 30 years of service. Many such plans are valued using the assumption that all members will retire at age 64 or 65. Most valuations provide no gain and loss analysis at all. Of those that do include a gain and loss analysis, many show significant experience losses on retirement. Yet in spite of consistent losses, the demographic assumptions are not changed.

One case shows going concern liabilities of approximately $50 million but the plan has had experience losses over a two year period of over $10 million.

There is also widespread non-compliance with professional requirements of certification and disclosure. This problem occurs frequently.

Professional Requirements of Certification

For years the PCO has received reports that are not properly certified. Originally they were considered to be minor, unintentional oversights on the part of the actuary, and usually no action was taken unless there were other problems related to the report. Now it seems the problem is more serious than previously thought.

There have been instances where we have approached the actuary with concerns after reviewing a report that was not properly certified. A new report would then arrive with proper certification. Frequently, that new report would contain other major changes not related to any of the concerns that had been raised originally. As well, the financial results changed significantly from the original document.

On such occasions, it is difficult to construe the original lack of certification to be unintentional.

Disclosure

The professional (CIA) requirement on disclosure is quite clear. It says:

7.01 Report Contents

The report on the valuation of a pension plan prepared by an actuary should contain information which will be sufficient to permit another actuary to make an objective appraisal of the valuation.

In our experience, the amount of disclosure in reports varies. It is not unusual to receive a mere three page partial wind-up report involving hundreds of members and millions of dollars in assets.

Information frequently missing from funding reports include:

- detailed description of the actuarial cost method used (especially if non-standard elements are included);
- detailed description of the asset valuation method used;
- disclosure of the membership data (such as quinquennial age/service distributions); and
- description of the benefits being valued.

Other Issues: Gain and Loss Analysis

Another significant problem is the failure of many reports to include a gain and loss analysis. When they are included, the manner in which these analyses are performed is questionable. Even though it is not necessary to apply the same rigorous standard of analyses for all pension plans, professional standards require that a proper gain and loss analysis be performed.

As a pension regulator we take the position that a proper gain and loss analysis is a necessary and reasonable standard of analysis, especially for the larger plans.

Other Issues: Solvency Valuations

There are extensive problems related to solvency valuations. We recently sampled about fifteen solvency valuations to assess their acceptability. In our opinion, only two or three met professional requirements. The most common problem is the failure to describe the benefits being valued.

A serious and common problem relates to flat benefit plans (large and small) where members with long service can receive unreduced benefits (together with a bridging benefit) at age 60 or 62. In some cases, the plan would show a small deficit or surplus on a going concern valuation basis using questionable early retirement assumptions. In many of these cases the actuary certified that there was no solvency deficiency and, did not provide any valuation details. The same problem exists for some career average plans.

Solvency valuation is a relatively new requirement and some actuaries may not be totally familiar with the valuation techniques. Even so, under certain circumstances, professional judgement should tell you that it is insufficient simply to make a statement that there is no solvency deficiency. For the benefit of readers of the actuarial report and in order that it be meaningful, a detailed description should be included if a solvency valuation was performed.

Other Issues: Wind-up Reports

Unlike the reviews of triennial valuations, which are handled exclusively by the Actuarial Services Branch, wind-up reports are reviewed by the Pension Plans Branch and are referred to us when problems are detected.

The most common problem encountered in wind-up reports is the abuse of the term *CIA minimum transfer values*, and the most serious problem again, is the fact that benefits are not detailed or valued.

It is not unusual in wind-up reports for the statement by the actuary to say that the commuted values are calculated in accordance with the minimum transfer value Recommendations. Yet an examination reveals that the assumptions used are not consistent with the Recommendations.

The problems related to proper certification and disclosure for triennial valuations are even more serious in wind-up reports. In some instances, actuaries have submitted reports without professional certification or any conformation statement as

required by the Recommendations.

The professional requirement on disclosure is frequently not met. For example, in written response to a Pension Officer regarding benefits being valued, the actuary stated "there is no need to describe the benefits being valued in the actuarial report because they can be found in the plan text".

Furthermore, wind-up reports often fail to provide enough detail to assess and estimate the reasonableness of the commuted values.

In closing, it should not be construed from this discussion that these examples reflect the majority of the reports filed with the PCO. Certainly most actuaries comply fully with professional standards and meet statutory requirements. Unfortunately, however, the problems identified are more extensive than most members of the profession might expect.

Perhaps the problem has been aggravated by the fact that when problems have been detected the PCO traditionally has approached actuaries first. There are two disadvantages to continuing this practice. Because of the follow-up, some actuaries have lacked the incentive to file properly the first time. The other disadvantage is that time is wasted which in turn slows processing.

Actuarial Reports Submitted to the CIA for Review

Recently the CIA approached pension regulators about referring non-compliance cases to the Institute for review.
In future, the PCO may submit a report - which in its view is not in compliance with professional standards - to the CIA directly, without first discussing the issues in the report with the plan actuary. Reports may also be referred to the CIA for guidance where there is uncertainty as to whether professional standards have been met.

As measures are taken to improve professional standards and to foster closer co-operation between pension regulators and the professional body, it is hoped that these non-compliance problems can be eliminated entirely.