Guideline

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Introduction

This guideline provides guidance with respect to the responsibilities and duties of the Independent Actuary (IA) in the preparation of a report in support of an approval of an amalgamation agreement, an approval of the sale of all or substantially all the assets or an agreement to reinsure, on an assumption basis, policies; or a valuation report required by the Superintendent under subsections 365.1(1) or 629.1(1).

Application

The guidance provided in this guideline applies to federally regulated life insurance companies and fraternal benefit societies under the situations noted below.

Subsection 247(2) of the ICA requires that an amalgamation agreement submitted to the Superintendent for approval be accompanied by an IA's Report.

With respect to applications for approval of the sale of all or substantially all of the assets under subsection 254(2) or the reinsurance of policies on an assumption basis under subsections 254(2), 254(2.01) or 587.1 (2), the Superintendent considers that a report of an IA is necessary, as it provides vital information with respect to these transactions.

Under subsections 365.1(1) and 629.1(1), the Superintendent may appoint an actuary to value the matters to be valued by the actuary of the company or foreign company under subsection 365(1) and 629(1) respectively, namely, the actuarial and other policy liabilities of the company or foreign company and any other matter specified in any direction that may be made by the Superintendent.

The Role of the Independent Actuary

Although the consent of the policyholders may not be required for all transactions, the ICA requires, or permits the Superintendent to request, that an IA's Report be prepared. The purpose of requiring this report is to ensure that an independent party assesses the effects of the proposed transaction on policyholders' interests. The report to the

Superintendent should identify the effects on policyholders and opine on the fairness of the transaction to the policyholders.

Appointment of the Independent Actuary

The ICA does not prescribe which party to the proposed transaction engages the services of the IA; however, in practice, the company seeking the approval of the Minister or the Superintendent usually engages the IA. In any event, an independent opinion should be given without influence from either company. In general, the IA should be one who has not done any work over the past two years for the companies involved and who does not work for a company that provided services to these companies for that period of time. Before accepting the assignment to prepare a report, the IA should confirm to OSFI in writing that those criteria have been met. The IA may proceed with the assignment once OSFI has given permission to do so. Any work done as a professional external reviewer or as an IA is not considered to impair the IA's independence.

Although OSFI often receives requests for names of potential IAs, OSFI does not publish a list of these names. Companies should refer to a list of actuarial membership that identifies consulting actuaries.

If, for any reason, other than the abandonment of the transaction, the IA's appointment is revoked or the IA resigns prior to the report being submitted to OSFI, the IA must consider whether the circumstances are such that they should be made known to OSFI. An example of such a circumstance is where the IA found evidence that the transaction is not in the best interest of some or all of the parties. In addition, any actuary offered an appointment as an IA should ask whether the appointment has previously been accepted and subsequently vacated by another actuary. If such is the case, the new actuary should take all reasonable steps to establish the circumstances under which the previous IA's appointment was revoked or the previous IA resigned.

Considerations for the Independent Actuary

OSFI expects the IA to perform the following key tasks:

- review the effect of the transaction on all the policyholders, as it relates to:
    - their current and future rights, security, interests and benefits;

    - their reasonable benefit, cost and dividend expectations (e.g., effect on the dividends to participating policyholders, or on the cost of insurance of non-fully guaranteed policies);
    - continuing service to all policyholders;
- review the strategic and business plans and ensure that these plans will not adversely affect the companies' policyholders;
- review the tax consequences of the agreement, in so far as these could affect policyholders;
- recommend enhanced protection and/or remuneration of the policyholders to the companies, if so warranted;
- submit formal opinions on the basis of the review (described later).

Extent of the Independent Actuary's Involvement

The amount of investigative work that the IA will need to undertake will depend on the circumstances of the case. In carrying out the assignment, the IA should review all documents judged necessary for the purpose of reaching his or her opinion. As a minimum, some of the more critical documents to review would include:

- the Appointed Actuary's Report (or equivalent) for both companies;
- the Financial Condition Testing Reports for both companies;;
- financial statements for both companies;
- any significant correspondence with regulators for both companies;
- the Life Insurance Capital Adequacy Test (LICAT), the Life Insurance Margin Adequacy Test (LIMAT) or other capital ratio calculations (where applicable), before and after the effective date of the proposed transaction, for both companies;
- the rules governing any closed block of business;
- any supplemental documentation, as may be required in the circumstances, for both companies;
- in particular, a description of the policies being ceded as well as the rights attached to those policies;
- pro forma financial statements, business plan and three-year financial projections, including LICAT, LIMAT or other capital ratio calculations and projections (where applicable) for the company to which the policies are being ceded;

- the reinsurance, sale or amalgamation agreements;
- ancillary agreements, such as shareholder agreements, management agreements, outsourcing agreements, investment management agreements, service agreements, custodial agreements; and
- any other independent expert opinion that could help to assess the reasonableness of the purchase price, if necessary.

In addition to reviewing these documents, the IA should meet with senior officers of the companies, in particular the appointed actuary (or chief actuary where not so designated), the chief financial officer, and some or all of the following: CEO, president, COO, CFO, chair of the audit committee, general counsel, secretary, relevant vice-presidents, internal auditor, and external auditors.

The companies should provide the IA with a copy of their most recent actuarial and FCT reports, any significant correspondence with regulators, and any supplemental documentation on the assets and liabilities, as may be required. The IA must, however, form his or her own judgment on the quality of the information supplied, the appropriateness of the work of company actuaries, and therefore, the extent of any investigation or verification that needs to be done.

When a foreign entity reinsures the risks undertaken outside Canada by the company or society, the IA should be aware of the rules and supervision practices in effect in the country where the foreign entity is incorporated and where the policies subject to the reinsurance were issued. If the IA is unsure of the rules and practices, he or she should contact the foreign regulators to discuss the transaction in terms of current and future supervision practices, and any issues that could help the IA in coming to an opinion.

The IA should discuss with OSFI information or documentation that the actuary requires and that is either not available, or has not been made available by the companies.

Timing Differences

When the report and opinion of the IA are produced and submitted with a time lag after the date of the agreement under consideration or the after date of the calculation of the values supporting the agreement, the IA should consider any adjustment that may be made to maintain fairness and to protect the interests or positions of the

policyholders.

The Report

A copy of the IA report (or a summary) is usually provided to the members or the policyholders of the companies concerned. Although OSFI has permitted a summary of the report to be provided instead of the entire report, the full report must be available for inspection by policyholders, members or shareholders at the time the notices of the company's intention to amalgamate or cause itself to be reinsured, on an assumption basis, are published. It is the IA's responsibility to ensure that the contents of the summary are appropriate given the context in which it is being circulated, and that neither it nor any accompanying document gives a misleading impression of the findings in the full report. Any information supporting the actuary's conclusions that, for sound business reasons, the parties to the transaction wish to keep confidential may be submitted to OSFI in a technical memorandum.

The IA needs to consider and, as appropriate, report the effect of the transaction on all policyholders. OSFI is seeking assurance that the position and interests of all policyholders of the parties to the transaction are preserved, and that the security of their benefits will be maintained. The IA should consider the business plans of the companies involved, as the plans may adversely affect policyholders including those who become policyholders on or after the effective date of the agreement.

In summary, the contents of the IA's report will be influenced by the circumstances of each case. The following are some of the matters the report should address:

- the name of the company (companies) that has (have) appointed the IA;
- a statement of the IA's professional qualifications;
- whether the IA has a direct or indirect interest in any of the companies involved that could be perceived as influencing the actuary's independence;
- the purpose of the transaction;
- a summary of the terms of the agreements, in so far as they are relevant to the contents of the report;

- a list of documents and reports the IA has considered in relation to each of the companies involved in the "agreement" transaction, and a statement that the IA can rely on this information;
- the reasonableness of the purchase price and tax consequences of the agreement, in so far as these may affect policyholders;
- the appropriateness of the assets to be transferred to support the transferred liabilities;
- the effect of the agreement on the security of policyholders' contractual benefits;
- the effect of the transaction on the quality and extent of service that will be provided to the policyholders;
- the effect of the proposal on the nature and value of any rights of policyholders to participate in future profits;
- the likely effects of the agreement on matters such as investment management, new business strategy, administration, expense levels and valuation bases, in so far as they may affect the ability of the companies to meet the contractual obligations to the policyholders throughout the lifetime of the existing policies;
- in cases where participating policyholders are involved, the effect of the agreement or transaction on the proprietary rights of such policyholders and in particular, the significance of any loss or dilution of the rights of those persons to secure or prevent further constitutional changes which could affect their expectations as policyholders (for example, conversion to a closed fund, the loss of the right to vote, etc.). The actuary should state whether, and to what extent, members will receive compensation under the agreement for any diminution of their proprietary rights, and comment on its appropriateness;
- when commenting on the fairness of the proposal, any differences in treatment between policyholders with voting rights and those without;
- the overall assessment of the effect of the transaction on the reasonable expectations of policyholders and whether the actuary is satisfied that the transaction is equitable to all classes and existing generations of its policyholders. In the case of participating policyholders, the cost of maintaining the current dividend scale and/or dividend policy, premium scale, cost of insurance rates, or benefit level of existing policyholders,

should have been considered in the current proposal. Each class of policyholder should not receive fewer benefits, or pay more than they expected to pay at the time of the transaction, unless such changes are justified by unexpected and unfavourable conditions or experience in the coming years;

- in cases where the legal requirements of the jurisdiction of incorporation, or of the incorporating instrument, of the company, provide for voting and/or other proprietary rights that extend to non-participating policyholders, the effect of the transaction on the rights of these policyholders;
- in cases where closed blocks of business are part of the transaction, the effect of the transaction on the operating rules of these blocks and on the policyholders' benefits and expectations. The actuary should ensure that current and future rules for the closed blocks are not changed or if they are, that they are appropriately converted, with initial and future monitoring, certifications and approvals remaining in place to adequately protect the interests of the policyholders concerned;
- wherever the IA expresses an opinion in the report, an outline of the rationale for such an opinion;
- a summary table, submitted to OSFI, that discloses the major financial aspects of the transaction and the financial position, including pro formas of each company before and after the transaction; and
- any matters the IA has not taken into account or evaluated in the report that might be relevant to the policyholders' consideration of the amalgamation.

The Opinion

The opinion of the IA should cover all the items of the review. Although there is no specified wording for the opinion (other than the statement on objectivity, below), a satisfactory opinion would include the following components:

- with regard to the rights of policyholders, a statement that policyholders' rights will be unaffected or protected by the transaction or will be cancelled in exchange for appropriate consideration;
- in the event of the sale of all or substantially all the assets or the reinsurance of policies, on an assumption basis, with regard to the security of policyholders' benefits, a statement that, based on the current and

projected future financial conditions of the transacting companies, the security of benefits for policies being ceded between companies will remain satisfactory or be improved after implementation of the transaction, and that the security of benefits with respect to those policies in either company that are not being moved will be unaffected or improved by the transaction;

- in the event of an amalgamation of companies, with regard to the security of policyholders' benefits, a statement that, based on the current financial condition of the transacting companies and the pro forma projected condition of the amalgamated company, the security of benefits for all policies in the companies will remain satisfactory or be improved after implementation of the transaction;
- with regard to the interests of participating policyholders and policyholders with non-fully guaranteed policies and to the service that will be provided to them, a statement that the amount(s) to be allocated to the appropriate participating account(s) is (are) calculated on an appropriate basis consistent with methods used by the ceding company, and that the reasonable benefit and service expectations of participating policyholders and policyholders with non-fully guaranteed policies are not diminished by the transaction; and
- with regard to the interests of non-participating policyholders with fully guaranteed policies and to the service that will be provided to them, a statement that the transaction will preserve their benefit and service expectations.

Declaration of Objectivity

The following statement of objectivity should be included in each opinion:

- I declare that I have carried out my work objectively, in accordance with generally accepted actuarial practice and without regard for potential gain other than compensation for the work undertaken.

Signature

The IA Report required under subsections 247(2), 254(4.1) and 587.1(6) of the ICA must be signed by only the responsible IA. The signature should be followed by the IA's name and qualification written in full.

Review of the Report

A draft version of the report should be submitted to OSFI for review.

OSFI expects that the IA will discuss his or her work and the report with another actuary (within the firm or not).

When more than one actuary worked on the report of the IA, the report should disclose the name and the contribution of each actuary involved.

Conclusion

Should any issues arise with respect to preparation of a report, please consult with OSFI.

Other instruction guides set out the rules and procedures relating to amalgamations and to reinsurance. Copies are available on OSFI's Web site at www.osfi-bsif.gc.ca. Additional enquiries may be addressed to:

- Office of the Superintendent of Financial Institutions
- Legislation and Approvals Division
- Regulation Sector
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- Ottawa, Ontario, Canada
- K1A 0H2
- Telephone: (613) 990-3590, Fax: (613) 991-0325