



Office of the Superintendent of
Financial Institutions Canada

Bureau du surintendant des
institutions financières Canada

Office of the Superintendent of Financial Institutions

Internal Audit Report on Regulation Sector: Actuarial Division

June 2014



OSFI
BSIF

Canada 

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1. Background

Introduction

Internal Audit conducts assurance work to determine whether the risk management, control and governance processes at the Office of the Superintendent of Financial Institutions Canada (OSFI), as designed and represented by management, are adequate and functioning in a manner to ensure risks are appropriately identified and managed, and to ensure compliance with such requirements as policies, plans, procedures and applicable laws and regulations.

The audit of the Actuarial Division (AD) was recommended by the OSFI Audit Committee and approved by the Superintendent for inclusion in the OSFI 2013-2014 Internal Audit Plan.

This report presents the results of that audit based on audit work completed at the end of March 2014.

This report was presented to the OSFI Audit Committee on June 19, 2014 and approved by the Superintendent on June 24, 2014. The Deputy Superintendent, Regulation Sector and Actuarial Division's Senior Management have reviewed this report and provided their comments.

Context

The Actuarial Division (AD) is part of OSFI's Regulation Sector and its mandate is to ensure that appropriate actuarial and insurance industry knowledge, advice and standards are applied in the regulatory and supervisory systems governing federally regulated financial institutions (FRFIs) so that policyholders are safeguarded from undue loss, and public confidence in the financial services system is enhanced.

AD provides support to the Relationship Managers' (RMs) supervisory teams responsible for the supervision of insurance conglomerates and non-conglomerates, in identifying, assessing, and reporting on actuarial risk related matters at financial institutions.

AD contributes to OSFI's rule making process by periodically assessing that OSFI's rules and guidelines involving actuarial related matters at the financial institutions are timely, clear and relevant.

1. Background, Continued

Why this audit is important

AD contributes to OSFI's mandate by providing the Supervision Sector with technical and specialized insurance industry and actuarial expertise in risk assessing insurance companies applying OSFI's *Supervisory Framework*, related guides and templates.

The objective of the Framework is to assess the safety and soundness of an institution on a consolidated basis, to allow OSFI to intervene in a timely and effective manner where it considers a FRFI's risk management and control practices to be, or likely to become, imprudent or unsafe.

It is expected that AD and the RMs' supervisory teams work together, leveraging off their respective expertise, when reviewing and assessing an insurer's business activities and actuarial risk management function net risk rating.

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2. About the Audit

Audit Objective The objective of the audit was to provide reasonable assurance that the supervisory process and procedures followed by the Actuarial Division (AD) support the Supervision Sector - Relationship Managers' (RMs) supervisory teams in identifying, assessing and reporting on actuarial risk related matters at financial institutions.

The audit assessed whether:

- AD's planning activities clearly demonstrate their risk-based thinking and approach, and allocation of resources.
- The logic and flow of AD's supervisory work and documentation support their actuarial risk related assessments, conclusions (i.e. supervisory ratings) and supervisory actions taken.
- Quality Control (QC) reviews are effective at detecting work quality issues and ensuring that OSFI's Supervisory Methodology and related Guides are appropriately and consistently applied.

Audit Scope The audit covered AD's activities for supporting Supervision's Life and Property & Casualty teams in risk assessing their institutions during the fiscal year 2013/14.

Recognizing that the supervisory process is a cumulative knowledge process and is continuously evolving, IA reviewed documentation relating to events after the audit period chosen for evidence of improvements, as appropriate.

Follow-up of previous Internal Audit recommendations on the Actuarial Division was part of this audit.

Audit Approach The audit evaluation criteria (described in *Appendix I – Audit Evaluation Criteria*) used for assessing AD are based on the internationally recognized Enterprise Risk Management – Integrated Framework recommended by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

The approach to conducting the audit included discussions with key personnel, process walkthroughs with AD's teams, a review of AD's operational manual of procedures, and examination of selected supervisory documents.

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3. Conclusion

Statement of Conformance

The audit was conducted in conformance with the professional internal audit standards of the Institute of Internal Auditors (IIA) and the Government of Canada, as supported by the results of the Quality Assurance and Improvement Program. The evidence was gathered and the procedures used are in compliance with Treasury Board (TB) policies, directives, and both the IIA and TB standards on internal audit.

Conclusion

Overall, IA is reasonably assured that the supervisory process and procedures followed by the Actuarial Division appropriately support the RMs' supervisory teams in identifying, assessing and reporting on actuarial risk related matters at financial institutions.

Application of OSFI's *Supervisory Framework* is complex and requires the application of significant expert judgement and the use of a disciplined and structured approach. AD, together with the RMs' supervisory teams, utilize expert judgement in conducting their assessments. As a result, it is important that there be clear and documented rationale to support actuarial risk related assessments, conclusions reached, and supervisory actions taken.

In recognition of the need to strengthen and formalize its supervisory process and procedures, and enhance its contribution to Supervision's overall supervisory process, AD introduced significant changes since the prior audit. At that time, it was a challenge for AD to appropriately and consistently apply the supervisory methodology to allow for integration of its work efforts into Supervision's overall supervisory process.

The changes introduced are appropriate and have several positive aspects, notably:

- Enhancements to the planning process that allow for better balancing of its resources and the planned actuarial work.
- Process changes that allow AD to better effect its mandate (i.e., as a specialist support group) and facilitate implementation of the supervisory process within AD.
- Development of technical guidance and tools, in co-participation with OSFI's Practices group, that allow for conclusions to be reached in a structured and systematic manner and for better integration of work efforts into the overall supervisory process.
- A more proactive and participative approach, in the overall supervisory process, that promotes an effective use of AD's specialized knowledge and technical skills.
- Enhanced practices that ensure the quality control reviews are conducted at each step in the supervisory process and achieve their intended purpose.

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3. Conclusion, Continued

Conclusion IA encourages and supports AD's management in their continuous improvement efforts. As new guidance and tools are being refined and implemented, it is important that ongoing training, coaching, and oversight be provided to ensure that AD's supervisory process continues to meet the expectations as set out by OSFI's *Supervisory Methodology* and applicable Guides.

We wish to recognize the good rapport and exchange of views with all involved in the audit. The ability of focusing on what matters would not have been possible without the support received throughout the audit.

Chief Audit Executive, IA

Date

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4. Management Response

Overview This report has been reviewed by the Senior Director, Actuarial Division, Senior Director, Insurance Risk Management and Strategy and the Deputy Superintendent, Regulation, who acknowledge its observations.

The observations will support the Actuarial Division with the continuing work to maintain or develop (as appropriate) controls over its processes (e.g. reviews, approvals, monitoring etc.).

Responses / Comments AD is appreciative of the positive feedback received from Internal Audit throughout the review. We will continue to monitor and revise processes as appropriate.

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Appendix I: Audit Evaluation Criteria

Actuarial Division (AD) Audit Evaluation Criteria		
Key Inherent Risks	COSO Element	Audit Evaluation Criteria
1. External Environment	<p><i>Process and Control Activities:</i></p> <p>Application of OSFI's supervisory methodology</p>	<p>1.1 AD's supervisory process is risk-based and effectively contributes to the Supervision's risk assessment and intervention process by:</p> <ul style="list-style-type: none"> a. monitoring and analyzing industry-wide emerging insurer and actuarial risk related matters in a timely manner; b. assessing its potential implications to the insurers supervised by OSFI; c. identifying and drilling down into the insurer specific risks and assessing the quality of its risk management control function (s) as appropriate; d. following-up on actuarial risks/issues previously identified and/or reported to the FRFIs to ensure they are addressed; and e. communicating the results of their work to Supervision, at the right level of detail and in a timely manner.
2. Business Processes	<p><i>Process and Control Activities:</i></p> <p>Application of AD's procedures and OSFI's Supervisory Framework and Guides</p> <p><i>Governance:</i></p> <p>Management Oversight</p>	<p>2.1 The analysis and assessments contained in AD's planning documentation, clearly demonstrate their risk-based thinking and approach, and rationale for allocation of resources.</p> <p>2.2 The logic and flow of AD's key supervisory documentation clearly support their actuarial risk related assessments, conclusions and ratings, and supervisory actions taken.</p> <p>2.3 The structure and format of the information provided to Supervision, facilitates its incorporation into the RM's supervisory work.</p> <p>2.4 Quality control reviews are conducted by the appropriate level of management and there is evidence in the file that:</p> <ul style="list-style-type: none"> a) OSFI's methodology is appropriately and consistently applied, and that the work is reviewed in accordance with the G-19 guide requirements; b) The reviewer is effective at detecting work quality issues and focus on substance, not just administrative matters; c) Variations in staff understanding and in the application of OSFI's methodology, if any, are identified for additional staff development and training; and d) Expectations regarding AD's work documentation format and contents are clearly communicated to all staff members. e) There is an escalation process to resolve actuarial work related disagreements between AD and the RMs' teams. <p>2.5 AD's formal practices and procedures are reviewed periodically to ensure continued relevance, reflecting changes in the environment and supervisory processes.</p>