

## **Draft paper from ASSC to ProfC for Sofia meeting on the AAE's approach to addressing the recent amendments to ISAP1**

### **IAA standards**

1. The IAA first adopted ISAP1 on 18 November 2012. Definitions were moved to a separate Glossary on 13 October 2013, and conformance changes were adopted on 23 April 2017. Separately, ISAP1A was adopted on 21 November 2016.
2. IAA has adopted a revised ISAP1 with effect from 1 December 2018 which includes text drawn from ISAP1A, and some other drafting amendments. ISAP1 notes that conformance with the prior version can be denoted by referring to ISAP1 (2017). The main changes are summarised in Appendix 1.
3. IAA Standards are developed by the Actuarial Standards Committee (ASC) and go through due process, including consultation with IAA Member Associations, before being submitted to IAA Council for approval. Three members of the ASC are members of European Associations, including the Chair of the AAE ASSC, who is Co Vice Chairperson of the ASC.

### **AAE reaction to IAA standards**

4. The AAE decided at the General Assembly on 3 October 2014 to adopt ESAP1. Only minimal changes were made to ISAP1 i.e. ESAP for ISAP everywhere. The main difference between ESAP1 and ISAP1 is the fact that definitions are included in each ESAP whereas ISAPs have a separate Glossary. Appendix 2 gives extracts from meetings of the ProfC (then the SFPC) and the General Assembly around that time, and the promulgation letter to Member Associations on 8 October 2014.
5. The implications of the IAA proposed ISAP1A for ESAPs were outlined in the report of the SPT to the SFPC in September 2016, and various options were outlined. In particular, it was noted that ISAP1A used a different definition for model to that in ESAP2. It was understood that the IAA intended to merge ISAP1A into ISAP1 in the medium term and it was agreed that the implications of this would need to be considered at that time. Extracts from the papers for the SFPC meeting in 2016 are included in Appendix 2. As expected, IAA adopted ISAP1A in November 2016.
6. AAE has not made any changes to reflect conformance changes to ISAP1 adopted 23 April 2017.
7. In anticipation that the IAA would adopt the revised ISAP1 in December 2018, it was agreed at the ProfC meeting in Utrecht in September 2018 that the ASSC will prepare a paper/recommendation on the approach to be adopted to the revised ISAP1 taking into account the IAA Council decisions on this issue. The discussion at that meeting

identified a number of different points of view, which are included in the discussion below.

### **Memorandum of Understanding with IAA**

8. The IAA and AAE signed a formal Memorandum of Understanding (MoU) in October 2017. This *“establishes a framework for this cooperation [between IAA and AAE] that will seek to optimize strengths, leverage relationships, share work product where helpful and appropriate and minimize duplication.”*
9. The MoU lists areas of common interest, including “promoting the development of relevant practice standards for actuaries”.
10. As noted in the extracts from the SFPC meetings, the AAE has taken the view that European standards should be produced only where the subject matter was European rather than global e.g. Solvency II to “minimize duplication”. It can also be seen that, despite this principle, the view was taken (before the formal MoU came into effect) that there should be an ESAP1 which would act as the foundation for all ESAPs in the same way that ISAP1 would for ISAPs.

### **Possible approaches to ISAP1 and issues to consider**

11. The ASSC believes that there are three approaches which could be adopted by the AAE, on the presumption that ProfC is happy that the changes which have been made to ISAP1 are appropriate for the AAE. The implications of these approaches are discussed below.
  - A. Make all changes which have been made to ISAP1 i.e. update ESAP1 to be ISAP1 as it now is, but with ESAP instead of ISAP everywhere.
    - a. Can AAE incorporate into ESAP1 the changes to ISAP1 without due process i.e. by agreement within ProfC?
    - b. If there is a policy decision to keep ESAP1 in line with ISAP1, this will require constant monitoring of ISAP1 and updating ESAP 1 when changes are made, following due process. But will there be many/any future substantive changes to ISAP1, given that actuarial principles are expected to stand the test of time?
  - B. Don't change ESAP1
    - a. It would still be consistent with ISAP (2017) and FMAs who have adopted ESAP1 or are consistent with it can still denote conformance with ISAP1 (2017)
    - b. This is a practical short-term solution, but may become untenable. Why would AAE not wish to incorporate Model Governance standards into ISAP1, given that it endorsed ISAP1A when it was adopted by IAA?

### C. Scrap ESAP1

- a. AAE FMAs (all of whom are FMAs of the IAA) will need to consider compliance with ISAP1; those already compliant with ESAP1/ISAP1 (2017) will need to consider if they want to move to ISAP1 (2018).
  - b. If AAE wants to have its own self-contained set of standards which can be applied to European issues, it is inappropriate to scrap ESAP1.
  - c. Can we rely on influence of European association representative in IAA ASC/Council to represent AAE interests in relation to future, so that we can support future changes to ISAP1 and not revert to a European standard?
  - d. If it were thought pragmatic to scrap ESAP1, other ESAPs would need to be amended to reflect ISAP1 rather than ESAP1, which would be tedious but not contentious. It might be necessary to review these ESAPs, if and when further changes are made to ISAP1 in future, to ensure that the reference to ISAP1 is still appropriate.
12. As noted in the 2016 discussion, there is a difference between the definitions of “model” in ESAP2 and in the IAA Glossary which will need to be resolved in dealing with the revised ISAP1.

**Recommended approach (to be added)**

## **Appendix 1 – substantive differences between ISAP1 (2017) and ISAP1 (2018)**

**Preface:** Inclusion of text regarding nomenclature of different versions of ISAPs.

**1.3 Compliance:** Clarification that departures from ISAP are not permitted where the word “must” is used except where there is a conflict with law or code of professional conduct.

**1.4 Applicability:** Clarification of the situation where an actuary is working as part of a team.

**1.6 Language:** uses “failure to comply with” rather than “departure from” the ISAP. (b) calls out the reasons why failure to comply with an ISAP might arise i.e. a conflict with law or code of professional conduct, and makes it clear that where compliance with the ISAP (where the word “should” is used) would produce inappropriate or misleading results, the actuary “should depart from the guidance and disclose that fact and provide the reason”. (d) defines “any” as in e.g. “any reports”.

**2.3 Reliance on Others:** List of examples has been removed, as has “projections”.

2.3.3 Clarification that reliances should be disclosed in any reports.

**2.4 Materiality:** Clarification that the actuary should disclose in any report if errors or omissions are material.

### **2.5 Data Quality:**

2.5.1 - New text: “Data are reliable if they are substantially accurate. If sufficient and reliable data are not available, then the actuary should follow the guidance in paragraph 2.5.5. below.”

2.5.4 – New text “Data Modification – The actuary should disclose any modification of data before its use (such as interpolation, extrapolation, adjustment, or discarding of outliers) in any report.”

### **2.7 Assumptions and Methodology set by the Actuary:**

2.7.1. Text moved from 2.7.2 “The actuary should consider to what extent it is appropriate to use assumptions or methodology if they have a known significant bias to underestimation or overestimation of the result.”

**2.9 Assumptions and Methodology Mandated by Law:** new text “and whether such assumption or methodology may limit the relevance of the work for other purposes” replacing “that the report should not be used for other purposes where the assumptions and methodology used are not appropriate (unless appropriately adjusted).”

**2.10 Model Governance** – new section based on ISAP1A.

### **3.2 Report**

3.2.2. Disclosures – more detail provided

## **Appendix 2 – extracts from SFPC and GA meetings**

### **From SFPC April 2013**

In relation to GCASP1 (Quality of actuarial work), Chris explained that the SPT has agreed that ISAP1 should be adopted as GCASP1, subject to due process: an Exposure Draft will be submitted to the Committee at the September meeting in Dublin. Chris emphasised that ISAP1/GCASP1 is a model standard, and that only associations can impose standards. Several members expressed concern that a separate GCASP1 was unnecessary, and introduced the potential for conflict if ISAP1 were to be amended. Chris pointed out that GCASP1 is necessary since GCASP2 builds on it: however, GCASP1 could be tied exactly to ISAP1, with any additional aspects covered in a further GCASP. It was agreed that the SPT should continue to develop an ED for GCASP1, but also explore how to avoid two different standards if ISAP1 changes in the future.

### **From SFPC October 2013**

Chris presented the proposed ED of GCASP1, and explained that it was virtually identical to ISAP1 except for references to Groupe Consultatif instead of IAA in the preface. It was noted that an amendment to ISAP1, to introduce a separate glossary of definitions, has already been proposed by IAA: it is not, however, intended to amend the GCASP1 ED to reflect this. Chris explained that the SPT preferred that Groupe model standards should be self-contained, with definitions included as part of the standards. It will be up to local associations how they deal with this since they have already adopted ISAP1. However, the question remains as to whether a material change in ISAP1 should require full due process for a new ED of GCASP1: it was agreed that this could be dealt with by agreements among associations on a fast-track basis rather than waiting for the next General Assembly.

Gábor Hanák drew attention to some minor points of detail which had been overlooked (reference to individual or full members; reference to Groupe instead of IAA). Subject to amending these points, it was agreed to approve this exposure draft for consultation with member associations and other stakeholders. The period of consultation will begin on 1 November 2013 and end on 28 February 2014.

### **From GA 2013**

David also presented the proposed Exposure Draft of GCASP1, and explained that it was virtually identical to the IAA's ISAP1 except for references to Groupe Consultatif instead of IAA in the preface. He noted that an amendment to ISAP1, to introduce a separate glossary of definitions, has already been proposed by IAA: it will be necessary to amend the GCASP1 ED to reflect this. David explained that the SPT preferred that Groupe model standards should be self-contained, with definitions included as part of the standards. Subject to a few minor amendments

suggested by SFPC, this exposure draft will be circulated for consultation with member associations and other stakeholders between 1 November 2013 and 28 February 2014. It will be up to local associations how they deal with this since they have already adopted ISAP1. However, the question remains as to whether a *material* change in ISAP1 should require full due process for a new ED of GCASP1: SFPC agreed that this could be dealt with on a fast-track basis.

#### **From SFPC April 2014**

The Committee noted the feedback provided in response to the comments received on ESAP1 – General Actuarial Practice.

Chris presented the final draft of ESAP1 and highlighted the following points:

- ESAP1 is essentially the same as the IAA's ISAP1, as agreed at the Committee's Dublin meeting;
- a specific change in the Preface to cover the duality with ISAP1 – member associations can adopt either ESAP1 or ISAP1

It was noted that, for an association to endorse an ESAP, the blanks in the model standard would need to be completed to make the endorsed document formal.

There was some discussion on whether the definitions section should be moved to an Appendix, but it was finally agreed that the version of ESAP1 proposed by the SPT should be recommended to the General Assembly for adoption as a model standard of the AAE. (Chris pointed out that, in adopting/adapting ESAP1, member associations would be free to re-arrange the layout). It was agreed that this recommendation should be considered at the meeting of the General Assembly on 3 October in Helsinki and not by electronic vote before then. Chris was asked that the SPT give some thought to preparing a draft of the transmission letter with which the model standard will be issued to member associations (signed by the Chairman of the AAE) after the Helsinki meeting, assuming that the standard is adopted.

In addition, the SPT were asked

- to review the due process for adoption (and for revision) of model standards, particularly in the light of the need to keep ESAP1 aligned as far as possible with ISAP1, and to consider a formal arrangement with the IAA to ensure that AAE receives adequate notice of any changes; a mechanism for this might be that approved ISAPs (including revised ISAPs) would have a given future date from which they would apply
- to consider including in the due process document recommended procedures for adopting non-binding guidelines or educational notes (the AAE equivalent of the IAA's IANs). Chris agreed to prepare a paper on this for the Helsinki meeting of the Committee.

#### **FSPC October 2014**

It was noted that note that ESAP 1 is on the agenda for approval at the General Assembly meeting on 3 October. The Committee confirmed its support for ESAP 1. Chris reminded the

Committee that ESAP 1 is a model standard and, if approved by the General Assembly, it will be promulgated to member associations, to adopt, adapt, or confirm that an equivalent standard is already in place.

#### **GA October 2014**

Chris reported that ESAP 1 had completed the full due process, and its approval by the General Assembly was recommended by the Standards, Freedoms and Professionalism Committee (SFPC). He reminded those present that ESAP 1 is a model standard and, if approved by the General Assembly, it would be promulgated to member associations, to adopt, adapt, or confirm that an equivalent standard is already in place. Only then would the standard apply to individual actuaries. There was unanimous approval for ESAP 1.

#### **From promulgation letter to FMAs 8 October 2014**

I am pleased to enclose a copy of ESAP1 – General Actuarial Practice. This is the first model standard adopted by the Actuarial Association of Europe (AAE), which represents an important step forward in the development of the actuarial profession in Europe. Having completed due process as an exposure draft it was approved by the Standards, Freedoms and Professionalism Committee (SFPC) at its meeting in Vilnius on 24 April 2014 and was then submitted to a vote of the General Assembly of the AAE on 3 October 2014 in Helsinki, when it was adopted unanimously.

ESAP1 is a model standard intended to be suitable for adoption or adaptation by Full Member Associations of the AAE, and other actuarial standard-setting organizations who wish to adopt it. It is the AAE's intent that, by publishing model standards, it will encourage the creation and convergence of national actuarial standards.

The AAE encourages relevant actuarial standard-setting bodies in Europe to consider taking one of the following courses of action:

- ☐ adopting ESAP1 as a standard with modification only as directed by ESAP1 or
- ☐ adopting ESAP1 with modification where items covered in ESAP1 are not currently contained in existing actuarial standards, or where such portions of existing standards are to be withdrawn, or where local environment warrants such modification - however maintaining substantial consistency;
- ☐ endorsing ESAP1 as a standard as an alternative to existing standards;
- ☐ modifying existing standards to achieve substantial consistency with ESAP1;
- ☐ confirming that ISAP1, a model standard issued by the International Actuarial Association (IAA), has already been adopted; or
- ☐ confirming that existing standards are already substantially consistent with ESAP1.

ESAP1 is essentially the same as ISAP1 as issued by the IAA. Where a member association of the AAE adopts or endorses either ISAP1 or ESAP1, this can be assumed to imply adoption or endorsement of the other.

Member associations which have declared that their own standards are substantially consistent with ISAP1 will, without further action, be reasonably be considered to have done so also in respect of ESAP1 (and vice versa). Whilst ESAP1 and ISAP1 are model standards, individual actuaries may elect, or be required by a relevant actuarial regulator, to use ESAP1 or ISAP1, or one or more standards which are equivalent to ESAP1 or ISAP1. In such situations, compliance with ISAP1 should be treated by the individual or actuarial regulator as 'deemed compliance' with ESAP1 (and vice versa).

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## **Previous Discussion on ISAP1A**

### **SPT report to SFPC Sept 2016**

#### AAE's approach to dealing with ISAP1A Governance of Models

The IAA had made progress on the development of ISAP1A Governance of Models and it was sent out to stakeholders for a final review consultation on 18 August with a 31 day comment deadline (18 September 2016). The expectation is that this ISAP will be adopted by the IAA Council on 21 November 2016.

ISAP1A will basically have a similar foundation role as of ISAP1 for the IAA's model standard structure. The reason of not amending ISAP1 was merely not wanting to interfere with the ongoing adoption process by IAA FMAs of ISAP1. Nevertheless there is a view in the IAA that ISAP1 and ISAP1A will be merged in due time. The AAE will have to decide how to deal with this situation. There are a number of options available to consider:

Option 1. Simply endorse ISAP1A by the AAE as an appropriate model standard to be considered by AAE FMAs.

Option 2. Adopt the clone of ISAP1A as ESAP1A making the necessary changes only (due to different name, the different geography of the Definitions section)

Note that this Option 1 and Option 2 would create a slight inconsistency between the definitions of "model". Model is defined in ESAP2. It was not possible to have this definition accepted by the IAA for the purpose of ISAP1A. The definition in the current draft ISAP1A sent out for the final review consultation is similar but not the same. There seems to be no serious differences between the two definitions though. For a comparison between the two definitions, see [below]

Unlike the IAA model standards for which one single Glossary is maintained for all ISAPs adopted, each ESAP is envisaged to include a Definition section. ESAP2 has this section so does the draft ESAP3 and the potential ESAP1A could also have it.

Option 3. Same as Option 2 but using the ESAP2 definition of model.

Option 4. Develop an ESAP that is using ISAP1A as the basis but is different in some aspects (other than the definition of model).

Option 5. Do nothing.

## Definitions of “model” [updated to reflect IAA Glossary adopted 1 December 2018]

### ESAP2 definition of model:

*A simplified representation of some aspect of the world. A model is defined by a specification which describes the matters that should be represented and the inputs and the relationships between them, implemented through a set of mathematical formulae and algorithms, and realised by using an implementation to produce a set of outputs from inputs in the form of data and assumptions, usually involving judgement of the actuary.*

### IAA definition of model:

*A simplified representation of relationships among organizations or events using statistical, financial, economic, or mathematical concepts. A model has a specification, uses assumptions, data, and methodologies to produce results that are intended to provide useful information on that system.*

## SFPC meeting September 2016

Gábor referred to the problem which would arise over an inconsistency in the definition of “model” between ISAP1A and ESAP2 when the former is adopted by IAA. The SPT report outlined several options as to how AAE might deal with this issue. In discussion of these options, Malcolm Campbell pointed out that AAE would either have to accept the IAA definition or have its own definition used across all ESAPs. Thomas Béhar and Kristoffer Bork suggested that further steps should be taken to exert greater European influence within the IAA, in particular its Actuarial Standards Committee, and indicated that the strategy review will promote closer links and avoid duplication/conflict. It was agreed to endorse ISAP1A and then review the position when it is absorbed into ISAP1.