

GN41: The Role of the With-Profits Actuary

Classification

Paragraphs marked (M) and in bold type are Practice Standard. The remainder of the guidance, marked (G) and in normal type, is Recommended Practice.

MEMBERS ARE REMINDED THAT THEY MUST ALWAYS COMPLY WITH THE PROFESSIONAL CONDUCT STANDARDS (PCS) AND THAT GUIDANCE NOTES IMPOSE ADDITIONAL REQUIREMENTS UNDER SPECIFIC CIRCUMSTANCES

Purpose

The *FSA Handbook of Rules and Guidance* requires insurance companies and friendly societies with with-profits insurance liabilities to appoint a *with-profits actuary*. It also provides rules and guidance on the duties of the *with-profits actuary* and the firm. This note provides professional guidance to *with-profits actuaries*.

Definitions

Defined terms appear in italics when used in the standard.

Reference	Definition
firm	an insurance company or friendly society in respect of which the actuary is appointed <i>as with-profits actuary</i>
FSA	Financial Services Authority
governing body	The board of directors or committee of management of a <i>firm</i>
PCS	Professional Conduct Standards of the Faculty of Actuaries and Institute of Actuaries
with-profits actuary	a Fellow of the Faculty of Actuaries or of the Institute of Actuaries appointed by (or by the <i>FSA</i> for) a <i>firm</i> in accordance with SUP 4.3.1R or SUP 4.3.3R of the <i>FSA Handbook</i> to perform the role specified in SUP 4.3.1R(1)(b)

The following terms have the meanings given to them in the glossary section of the *FSA Handbook of Rules and Guidance*:

actuary

customers

friendly society

guidance

policy

policyholder

Principles and Practices of Financial Management (“PPFM”)

realistic basis life firm
rules
with-profits fund
with-profits business
with-profits insurance capital component
with-profits insurance contract
with-profits policyholder

In addition, the following abbreviations are used for sections of the *FSA Handbook of Rules and Guidance*:

COB	Conduct of Business sourcebook
PRU	Integrated Prudential sourcebook
SUP	Supervision manual

Legislation or Authority

The Financial Services and Markets Act 2000
 The *FSA Handbook of Rules and Guidance* (the “*FSA Handbook*”)
 The Financial Services and Markets Act 2000 (Communications by Actuaries) Regulations 2003 (the “*Regulations*”)

Application

With-profits actuaries of UK authorised insurance companies and friendly societies writing long-term insurance business except to the extent provided in paragraph 1.2 below.

Where the duties of the *with-profits actuary* are related to:

- (i) COB rules (in particular the parts relating to the *Principles and Practices of Financial Management*), the requirements below should be taken as being restricted to UK business, except to the extent that other business has a direct impact on the UK business, including where the *FSA* rules provide explicitly for other business to be covered;
- (ii) PRU, they apply to a *firm’s* overseas business as well as to its UK business, except where PRU provides otherwise.

Author

Life Board

Status

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1 General

- 1.1 (G) In this standard, requirements of legislation or of *FSA* rules and guidance are specifically referred to as such. Any other guidance is that provided additionally by the profession. The inclusion of summarized references to, or quotations from, particular provisions of the *FSA Handbook* is not a substitute for referring to the *FSA Handbook*.
- 1.2 (M) **A *with-profits* actuary need not apply any of this Guidance Note where and to the extent that policyholders are not eligible to participate in the surplus of a *with-profits fund* of the *firm* to which he or she is appointed.**
- 1.3 (G) GNs 37 and 39 are also applicable to *with-profits actuaries*. All or parts of one or more of GNs 44-47 may also be applicable to *with-profits actuaries* when carrying out their duties.
- 1.4 (M) **The *with-profits actuary* must hold a practising certificate, with that certificate covering *with-profits business*.**
- 1.5 (M) **SUP 4.3.1R allows a *firm* to appoint more than one *with-profits actuary*, each in respect of one or more classes of business. However, because there can be conflicts of interest between different classes of business, an actuary must, before accepting an appointment, have regard to paragraphs 1.6 to 1.7 below.**
- 1.6 (G) Where a *firm* has more than one *with-profits fund* it will normally be unacceptable for an actuary to accept appointment as *with-profits actuary* for some but not all of the *with-profits funds* unless:
- (a) the *Principles and Practices of Financial Management* of the funds adequately describe the way in which the exercise of discretion impacts on the interactions between the different funds;
 - (b) the extent to which such interactions from the exercise of discretion impact on *with-profits policyholders* is unlikely to be material; and
 - (c) the terms of reference of the appointment allow him or her to discuss freely with the other *with-profits actuaries* appointed by the *firm* the operation of all of its *with-profits funds*, and to have access to their written advice to the *firm*.
- 1.7 (M) **It would be inappropriate for an actuary to accept an appointment as *with-profits actuary* in respect of only some of the classes of business in any one *with-profits fund*.**

2 Regulatory requirements on the *with-profits actuary*

- 2.1 (M) **The duties of the *with-profits actuary* are set out in SUP 4, and in particular in SUP 4.3.16AR. He or she must:**

- “(1) advise the *firm’s* management, at the level of seniority that is reasonably appropriate, on key aspects of the discretion to be exercised affecting those classes of the *with-profits business* of the *firm* in respect of which he has been appointed;
- (2) where the *firm* is a *realistic basis life firm*, advise the *firm’s governing body* as to whether the assumptions used to calculate the with-profits insurance component under PRU 7.4 are consistent with the *firm’s PPFM* in respect of those classes of the *firm’s with-profits business*;
- (3) at least once a year, report to the *firm’s governing body* on key aspects (including those aspects of the *firm’s* application of its *Principles and Practices of Financial Management* on which the advice described in (1) has been given) of the discretion exercised in respect of the period covered by his report affecting those classes of *with-profits business* of the *firm*;
- (4) in respect of each financial year, make a written report addressed to the relevant classes of the *firm’s with-profits policyholders*, to accompany the *firm’s* annual report under COB 6.11.9R, as to whether, in his opinion and based on the information and explanations provided to him by the *firm*, and taking into account where relevant the *rules and guidance* in COB 6.12, the annual report and the discretion exercised by the *firm* in respect of the period covered by the report may be regarded as taking, or having taken, the interests of the relevant classes of the *firm’s with-profits policyholders* into account in a reasonable and proportionate manner;
- (5) request from the *firm* such information and explanations as he reasonably considers necessary to enable him properly to perform the duties in (1) to (4);
- (6) advise the *firm* as to the data and systems that he reasonably considers necessary to be kept and maintained to provide the duties in (5); and
- (7) in the case of a *friendly society* to which this section applies, perform the function of appropriate actuary under section 12 (Reinsurance) of the Friendly Societies Act 1992 or section 23A (Reinsurance) of the Friendly Societies Act 1974 as applicable, in respect of those classes of its *with-profits business* covered by his appointment.”

3 Relationship between the *with-profits actuary* and the *firm*.

- 3.1 (M) The *with-profits actuary* must ensure that he or she has sufficient information and resources to enable him or her to carry out his or her duties. In particular the *with-profits actuary* must seek to ensure that he or she has timely access to all legal advice received by the *firm* that is relevant to his or her duties. SUP 4.3.16AR(5) (see paragraph 2.1 above)

imposes upon the *with-profits* actuary the duty to request the *firm* to provide such information. SUP 4.3.16AR(6) (see paragraph 2.1 above) imposes on the *with-profits* actuary the duty to advise the *firm* as to the data and systems that he or she reasonably considers necessary to carry out his or her duties.

3.2 (G) SUP 4.3.16DG states the following:

“Firms should normally obtain advice from the actuary appointed to perform the with-profits actuary function in respect of the affected class or classes of with-profits business, whenever they are preparing to make key decisions based on the exercise of discretion affecting their with-profits business. Firms should also have risk management processes in place to ensure that all relevant matters are referred to the actuary for advice.”

The *with-profits* actuary should take reasonable steps to inform himself or herself of the risk management processes in place in accordance with SUP 4.3.16DG.

3.3 (M) The *with-profits* actuary must seek to ensure, through appropriate wording in his or her terms of reference, that he or she will receive, on a timely basis, copies of all papers issued to members of the governing body that are relevant to the management of the *with-profits* fund.

3.4 (M) SUP 4.3.17R requires the *firm* to allow the *with-profits* actuary to perform his or her duties, and in particular:

- “(1) keep him informed of the *firm*’s business and other plans (including, where relevant, those of any related *firm*, to the extent it is aware of these);**
- (2) provide him with sufficient resources (including his own time and access to the time of others);**
- (3) hold such data and establish such systems as he reasonably requires;**
- (4) request his advice about the likely effect of material changes in the *firm*’s business plans, practices or other circumstances on the fair treatment of the relevant classes of the *firm*’s *with-profits* policyholders; and**
- (5) pay due regard to his advice, whether provided in response to a request under (4) or on the *actuary*’s own initiative; this will include, if he requests it, allowing him to present his advice directly to the *firm*’s governing body (that is, the board of directors or, for a *friendly society*, the committee of management).”**

The *with-profits* actuary must indicate to the *firm*’s management at the appropriate level of seniority the range of information that he or she will

need under SUP 4.3.17R(1). He or she must also ask the *firm* to confirm that all the relevant information has actually been provided.

3.5 (M) The *with-profits* *actuary* must seek to ensure, through appropriate wording in his or her terms of reference, that he or she will have the opportunity to comment on any communications or reports issued from time to time by the *firm* that:

- (a) relate to the *firm's* exercise of discretion affecting its *with-profits* *business*, and
- (b) will be made available to some or all of the *firm's* actual or potential *with-profits* *policyholders*, or to their actual or potential advisers whether employed by the *firm* or independent of it.

The *with-profits* *actuary* must similarly seek to ensure that he or she will, as far as is reasonably possible, be made aware, in time to be able to comment on them before issue, of any such communications or reports which could significantly affect the readers' understanding of the *firm's* past or future exercise of discretion affecting its *with-profits* *business*.

4 Reporting and advising

4.1 (M) When giving advice under SUP 4.3.16AR(1) or preparing a report under SUP 4.3.16AR(3), the *with-profits* *actuary* must bear in mind the guidance in SUP 4.3.16BG. This guidance states the following:

“In advising or reporting on the exercise of discretion, an *actuary* performing the *with-profits* *actuary* *function* should cover the implications for the fair treatment of the relevant classes of the *firm's* *with-profits* *policyholders*. His opinion on any communication or report to them should also take into account their information needs and the extent to which the communication or report may be regarded as clear, fair and not misleading. Aspects of the business that should normally be included are:

- (1) bonus rates to be applied to *policies* at maturity or on the death of a *policyholder*, or when calculating the annual bonus;
- (2) investment policy in the light of product descriptions disclosed to *customers*;
- (3) surrender value methodology (including market value adjusters);
- (4) new business plans and premium rates;
- (5) allocation of expenses to *with-profits* *business*;
- (6) investment fees to be charged to *with-profits* *business*;
- (7) changes to the *Principles and Practices of Financial Management*;
and

(8) communications with *policyholders* or potential *policyholders* on the issues in (1) to (7).”

The *with-profits* actuary must include in his or her advice or report reference to all those matters set out in the *firm’s Principles and Practices of Financial Management* that he or she considers relevant to that advice or report. In advising on any changes to the *Principles and Practices of Financial Management* he or she must take account of COB 6.12.13R and COB 6.12.15R, which limit the circumstances in which a *firm* may make changes.

- 4.2 (G) When formally advising the *firm’s* management in writing under SUP 4.3.16AR(1) on key aspects of the discretion to be exercised affecting the *with-profits* business of the *firm*, the *with-profits* actuary should normally include at least his or her:
- (a) interpretation of what would constitute fair treatment of *with-profits policyholders* having regard in particular to the *firm’s Principles and Practices of Financial Management*, past actions, *policy* literature, other publicly available information such as own-charge illustrations, and any legal advice given to the *firm* constraining or potentially constraining the *governing body’s* discretion;
 - (b) opinion on the extent to which past or proposed exercise of discretion, including:
 - if asset share techniques are used, the way in which asset shares are calculated and the way in which the levels of payouts relate to them; and
 - discretion affecting *with-profits* business exercised in connection with the provisions of any applicable Schemes of Transfer,is in line with that interpretation;
 - (c) opinion on the extent to which it is appropriate to distinguish between groups of *with-profits* insurance contracts having regard inter alia to the nature of the *policies* including the premium rates on which they were effected, their duration, their relevant pooled experience, and communications with the relevant *policyholders*; and
 - (d) opinion on how any recommendations made maintain fairness between different categories of *policy* or *policyholder* and between *policyholders* and the *firm*.
- 4.3 (M) When commenting on any communication addressed to *with-profits policyholders*, the *with-profits* actuary must bear in mind the guidance in SUP 4.3.16BG (see paragraph 4.1 above) to take into account both the *firm’s Principles and Practices of Financial Management* and the *with-profits policyholders’* information needs and the extent to which the communication or report may be regarded as clear, fair and not misleading. The *with-profits* actuary must also draw the attention of the

management of the *firm*, at the appropriate level of seniority, to any circumstances in which he or she believes that a further communication should be issued by the *firm*.

- 4.4 (M) The *with-profits actuary* must give advice to a *firm* on the future exercise of discretion affecting its *with-profits business*:
- (a) whenever the *firm* requests it,
 - (b) whenever he or she considers that in any respect a proposed exercise of discretion would be inconsistent with the *firm's Principles and Practices of Financial Management*,
 - (c) whenever he or she considers that the *firm's Principles and Practices of Financial Management* have become inappropriate, and
 - (d) whenever the *firm's* ability to meet its regulatory capital requirements raises particular issues relating to the exercise of discretion affecting those classes of the *with-profits business* of the *firm* in respect of which he or she has been appointed.
- 4.5 (M) Where, in the opinion of the *with-profits actuary*, there is uncertainty regarding the extent to which the *governing body* can exercise discretion when allocating surplus, he or she must state in his or her report or advice the nature of the uncertainty, the assumptions he or she has made with regard to the uncertainty and the consequences were the uncertainty to be resolved differently. If appropriate, the *with-profits actuary* must recommend that the *firm*, if it has not already done so, take legal advice with regards to the uncertainty. If the *firm* has taken legal advice, the *with-profits actuary* must state in his or her report or advice the extent to which he or she has relied on that legal advice and whether in his or her opinion there is any conflict between that legal advice and his or her interpretation of the fair treatment of the *firm's with-profits policyholders* having regard in particular to the *firm's Principles and Practices of Financial Management*.
- 4.6 (M) If the *firm* is a *realistic basis life firm*, SUP 4.3.16AR(2) (see paragraph 2.1 above) requires the *with-profits actuary* to advise the *firm's governing body* as to whether he or she is satisfied that in the calculation of the *with-profits insurance capital component* the assumptions made are consistent with the *firm's* application of its *Principles and Practices of Financial Management*. The advice must cover the assumptions made in the calculation of the realistic valuation of the liabilities and the other elements of the calculation of the *with-profits insurance capital component*, including the assumptions made concerning future bonuses, future investment policy and all other future management actions. It must include the *with-profits actuary's* opinion on whether he or she is satisfied that all the assumptions are consistent with his or her interpretation of what would constitute fair treatment of the *firm's with-profits policyholders*. When assessing what would constitute fair treatment the *with-profits actuary* must have regard in particular to the *firm's Principles and Practices of Financial Management* and, as required by SUP

4.3.16AR(2), to the *firm's* application of them. When assessing the implications of the *firm's* application of them the *with-profits* *actuary* must assess the extent to which the *firm's* past actions are relevant to what would constitute fair treatment in the future and in different economic and other circumstances.

4.7 (G) The advice referred to in paragraph 4.6 above is not intended for publication, and the advice should be proportionate to the nature and complexity of the *with-profits* *business*.

4.8 (M) If the *with-profits* *actuary* is not satisfied with the assumptions described in paragraph 4.6 above, he or she must consider whether this is a matter which requires communication to the *FSA* under the *Regulations* (see paragraph 1.3 above).

4.9 (G) SUP 4.3.16CG states:

“The reports in SUP 4.3.16AR(3) and SUP 4.3.16AR(4) should be proportionate to the nature of the *with-profits* *business*. For smaller *firms* with fewer products, the extent of reporting would be proportionately less.”

A significant factor in determining the detail and length of the report is likely to be the nature and complexity of the *with-profits* *business*.

4.10 (G) A report to the governing body under SUP 4.3.16AR(3) (see paragraph 2.1 above) covers the key aspects of the way in which the firm has exercised discretion affecting its *with-profits* *business* in respect of the period covered by the report. This report is not intended for publication. The amount of information required, and the discussion appropriate, will depend upon the extent to which, if at all, each aspect is relevant or has been covered in other reports or advice formally presented to the *governing body* in the previous eleven months.

4.11 (M) When preparing a report under SUP 4.3.16AR(3) (see paragraph 2.1 above), the *with-profits* *actuary* must make clear his or her views on:

- (a) **the extent to which the actions of the *firm* in the period have been fair to the different groups of *with-profits* *policyholders* and between *with-profits* *policyholders* (as a class) and any shareholders; and**
- (b) **the extent to which communications or reports issued to *with-profits* *policyholders* or potential *with-profits* *policyholders* have met their information needs, have been clear, fair and not misleading, and have been consistent with the *firm's* *Principles and Practices of Financial Management*;**

and must refer to those aspects of the business that are mentioned in SUP 4.3.16BG (see paragraph 4.1 above) that are relevant, and to any other significant relevant factors.

- 4.12 (G) The *with-profits actuary* should normally present the report under SUP 4.3.16AR(3) in person to the *governing body*, so that he or she may identify and address any areas of misunderstanding or concern that may arise. The *with-profits actuary* has the right under SUP 4.3.17R(5) (see paragraph 3.4 above) to make such a presentation, if he or she requests to do so.
- 4.13 (G) When preparing a report under SUP 4.3.16AR(4) (see paragraph 2.1 above), the *with-profits actuary* should normally consider whether it is necessary or desirable to repeat or elaborate on material that has been covered by the *firm's* own report (under COB 6.11.9R) to which his or her report is annexed. It is likely to be confusing for *policyholders* to receive two lengthy reports. Provided the *with-profits actuary* is satisfied that the *firm's* report adequately explains how the discretion exercised by the *firm* may be regarded as taking, or having taken, the interests of the relevant classes of the *firm's with-profits policyholders* into account in a fair and reasonable manner, it may be sufficient to accompany it with a brief statement of his or her own opinion, in words similar to those of the relevant rule. If he or she is not so satisfied, a fuller report will be required. The content and presentation of this should, as far as possible, be such as to enable *with-profits policyholders* and their advisers to understand any concerns of the *with-profits actuary*. Any such concerns should already have been raised with the firm at the earliest opportunity.
- 4.14 (G) The *with-profits actuary* should bear in mind that *policyholders* and third parties including advisors, potential *policyholders* and financial analysts may all use the report to the *firm's with-profits policyholders*. Any of these may make enquiries and representations to the *with-profits actuary* or to the *firm* in connection with the report. The *with-profits actuary* should seek to agree with the *firm* suitable arrangements for responding to such enquiries and representations.
- 4.15 (M) **The *with-profits actuary* must make clear in all of his or her responses the capacity in which he or she is responding.**