



**PROFESSIONAL OVERSIGHT BOARD**

**MONITORING AND SCRUTINY OF ACTUARIAL WORK:  
SUMMARY OF CONSULTATION RESPONSES**

**JANUARY 2009**



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## INTRODUCTION

In 2005, the Morris Review of the Actuarial Profession made three parallel recommendations to the Financial Reporting Council (the FRC) – in life insurance, general insurance and pensions - that within 2-3 years it should satisfy itself that appropriate monitoring of actuaries' compliance with professional standards and independent scrutiny of actuarial advice is occurring through direct supervision by the regulator, audit or external peer review.

Between May and September 2008, the Professional Oversight Board (the Oversight Board), an operating body of the FRC, consulted on a discussion paper *Monitoring and scrutiny of actuarial work*, which set out the work we had undertaken in response to the Morris Review's recommendations:

- A regulatory analysis of actuarial work – in conjunction with the Faculty and Institute of Actuaries (the Profession), the FSA and the Pensions Regulator, and users of actuarial work – to identify and prioritise significant gaps and overlaps in monitoring and scrutiny;
- A survey of quality assurance arrangements adopted by actuarial firms (defined as firms offering actuarial services to external clients); and
- Development of various regulatory options which the Oversight Board might in due course consider recommending to the Profession (Annex A).

We sought views on our findings and on the resulting regulatory options which we introduced in terms of three strategies which the Profession might adopt:

- Strategy 1 (additional support for existing regulatory/market review processes)
- Strategy 2 (additional professional requirements on actuaries or their firms)
- Strategy 3 (active external monitoring).

The discussion paper accompanied an FRC paper, *Promoting actuarial quality*, which aimed to create a wider understanding of actuarial quality and how it might be improved.

Consultation on the monitoring and scrutiny paper ended on 30 September. Public responses are at [http://www.frc.org.uk/pob/actuaries/response\\_discussion\\_paper.cfm](http://www.frc.org.uk/pob/actuaries/response_discussion_paper.cfm).

As well as our formal consultation, we developed and discussed the paper and the public responses in conjunction with a number of stakeholders including other regulators and representative bodies. The paper was also discussed at the Birmingham Actuarial Society, and an Open Forum organised by the Profession in London.

We received 30 substantive written responses, broken down as follows:

- 4 non-actuarial bodies (including the FRC actuarial stakeholder group)
- 4 actuarial bodies (including two international)
- 4 insurers (one confidential)
- 4 accountancy firms (all offering actuarial services)
- 10 actuarial/consultancy/trustee firms (including two smaller firms)
- 1 law firm (confidential)
- 1 large pension scheme
- 2 academics (non-actuaries)

We found the responses to be well considered and helpful, and we wish to thank all the organisations, firms and individuals concerned.

Most respondents offered comments on specific questions in the discussion paper, and we have picked these up in the sections that follow. We sometimes include, with the summary of responses, one or more specific comments, by way of illustration.

The majority of respondents were actuaries or represented actuaries, who can provide useful feedback and insights, but from a practitioner viewpoint. We recognise that we cannot simply rely on counting responses for or against a particular proposition and must consider the arguments made and the public interest. Nevertheless we have found it useful - in the case of questions seeking a yes/no answer - to include the number of responses agreeing (or mainly disagreeing) or disagreeing (or mainly disagreeing) with the particular proposition.

Two respondents asked for their comments to be kept confidential. Their responses have been included in the summary of responses but without identifying them.

Some respondents made it clear that they were only qualified to comment on the sector in which they either worked or had detailed knowledge and, in life and general insurance in particular, this reduced the number of responses.

Although it makes for some repetition (particularly between life and general insurance), we have maintained the sectoral split used in the discussion paper.

Several respondents, including the Actuarial Profession and the FRC's Actuarial Stakeholder Interests Working Group (see Annex E), chose to make general comments in their formal responses, and others included general observations with their comments on specific questions.

As far as possible, we have sought to summarise general comments in the context of the question or the topic to which they relate, including:

- Our conclusions that there was enhanced independent scrutiny but limited monitoring of compliance with actuarial standards (sections 1 and 2);
- The strategy for the Profession to adopt in life insurance, general insurance, pensions and other areas (sections 3-6) – comments on specific options under these strategies have been summarised at Annex B (Strategy 1) and Annex C (Strategy 2).

Other comments which could not be accommodated in one of these sections have been picked up together with responses on the costs and benefits of these proposals (section 7). This includes some general comments from the Profession about the principles that should be adopted in assessing the effectiveness of monitoring and scrutiny and in taking these proposals forward.

Given the general support we received for our assessment and proposals, we intend to take some of the options forward. Proposed next steps are set out in section 8.

## 1. INDEPENDENT SCRUTINY

Q1. Do you agree with our conclusion that there is enhanced independent scrutiny of actuarial advice since the Morris Review reported in March 2005?

### Proposition

1.1 In the discussion paper, we said we had found enhanced independent scrutiny since the Morris Review reported in March 2005 across all mainstream areas of actuarial work through professional quality assurance, client challenge, audit, regulation (principally by the FSA and the Pensions Regulator) and other independent scrutiny by the courts, complaints arrangements, and consumer and trade bodies.

### Summary of responses

Agree	Mainly agree	Mainly disagree	Disagree
13	2	0	0

1.2 15 respondents commented on this question, and there was substantial agreement with our provisional assessment that there is enhanced independent scrutiny of actuarial work - through regulation and audit, in pensions as well as insurance.

### Life insurance

1.3 The proposition was strongly supported in life insurance, where we had referred to continuing and new developments in risk-based supervision by the FSA, supported by audit (with mandatory input from a 'reviewing actuary') of actuarial information, enhanced responsibilities for governing bodies, and with-profits governance arrangements:

*"In life insurance, there is much wider use of independent peer review, wider use of independent directors and membership of With Profit Committees, the use of s166 skilled person reports, and the FSA requirement to have liabilities in regulatory returns subject to audit." (KPMG)*

1.4 Some who agreed with the proposition still believed that improvements could be made:

*"We agree that actuarial advice, in particular in life insurance, has been subject to enhanced independent scrutiny in recent years, although there is still further room for improvement." (Deloitte)*

### General insurance

1.5 Although relatively few in number, those respondents who commented specifically on general insurance confirmed our view that independent scrutiny was enhanced through continuing and new developments in risk-based supervision by the FSA, supported by audit of actuarial information, enhanced responsibilities for governing bodies, and external scrutiny of syndicate returns by Lloyd's.

1.6 The consensus was that scrutiny is at about the right level for general insurers in all markets and especially at Lloyd's.

## Pensions

- 1.7 Those respondents who specifically mentioned pensions confirmed that scrutiny had been enhanced through a new risk-based approach by the Pensions Regulator, supported by audit of actuarial information in the published financial reports of sponsoring employers, enhanced responsibilities for scheme trustees, and the Profession's compliance review obligations for pension scheme actuaries:

*"In the pensions area, following the introduction of the new funding regime in 2005, clients are now much more questioning and the Pensions Regulator has more involvement than its predecessor Opra. Accordingly, the position with regard to the level of independent scrutiny is significantly different from that prevailing when Sir Derek Morris reported." (Watson Wyatt)*

*"In pensions, the role of the Pensions Regulator is a very important one, which gives significant independent scrutiny of scheme funding advice where previously there was none. Further, the Pensions Act 2004 funding regime has encouraged many employers to take actuarial advice independent of that received by their trustees, which has also led to enhanced scrutiny and challenge." (KPMG)*

*"We agree that there has been enhanced independent scrutiny of actuarial advice in the pensions arena since the publication of the Morris review. This has resulted from closer monitoring of the actuarial valuation process by the Pensions Regulator and increased analysis of actuarial assumptions by auditors in the preparation of accounting information." (Buck Consultants)*

## **Outcome**

- 1.8 Although half the respondents chose not to answer this question directly, those that did respond supported our view that there is an enhanced level of independent scrutiny of actuarial advice.
- 1.9 Given that no significant additional gaps in scrutiny arrangements have been identified in the responses to this consultation, there is no reason to alter the conclusion we proposed at the consultation stage that there is enhanced scrutiny in all major areas of actuarial activity.

## 2. MONITORING OF COMPLIANCE

Q2 Do you agree with our conclusion that at the present time there is only limited monitoring of compliance with professional standards?

### Proposition

- 2.1 In the discussion paper, we noted that much of the scrutiny that occurs is indirect, without a formal role for actuaries, and there is only limited actual monitoring of compliance with actuarial standards. Such compliance monitoring as there is occurs within actuarial firms primarily through internal 'compliance review' against actuarial standards (particularly in relation to the work of pension scheme actuaries for whom this is mandatory), by the 'reviewing actuary' who advises the auditors in relation to FSA returns for long-term insurers, and by the Society of Lloyd's in relation to syndicate actuary reports.
- 2.2 We found that formal compliance monitoring was limited in activities where there were no technical actuarial standards, in activities which are so extensively regulated or scrutinised already that additional monitoring of compliance with actuarial standards (if any) is not regarded as a priority, in activities which are not formally reserved to actuaries, and to activities which are regarded as non-core.

### Summary of responses

Agree	Mainly agree	Mainly disagree	Disagree
7	5	1	2

- 2.3 15 respondents commented on this question. Of these, 12 agreed (or mainly agreed) and 3 disagreed (or mainly disagreed). Those who gave qualified agreement picked up our point that in many areas there were no standards to monitor against. The three who disagreed pointed to the work that takes place in firms already to secure a quality product in line with generally accepted actuarial practice.

### Life insurance

- 2.4 Those respondents who dealt with life insurance agreed, and pointed to gaps that had been identified in formal compliance monitoring for the with-profits actuary and other non-reporting work:

*"We agree that formal monitoring of compliance with actuarial standards is limited. For example, in life insurance, the monitoring of compliance with actuarial standards is limited to the areas covered by the reviewing actuary, e.g. it excludes such things as pricing of products. However there is considerable informal monitoring and review especially within larger firms. In our firm, we try to ensure that advice to clients is reviewed before it is issued."* (Deloitte)

*"We agree that, at the present time, there is only limited monitoring of compliance with professional standards. While the UK Actuarial Profession may not monitor my compliance and that of my colleagues, a certain amount of compliance review is incorporated in our business processes around the statutory valuation and other actuarial work. In addition, of course, as the paper makes clear, aspects of the audit and regulatory review cover compliance with professional standards in some respects. More could*

*certainly be done to increase the extent of monitoring of compliance with professional standards. However, any enhancement could potentially be costly for firms and so would need to be justified by a robust cost/benefit analysis in order that firms saw it as worthwhile.” (Standard Life)*

### General insurance

- 2.5 Respondents referred to the distinction between the compliance monitoring which is undertaken at Lloyd’s and the position of general insurers:

*“The Lloyd’s actuary performs an essential role in reviewing and benchmarking the reserving by individual syndicates.” (FRC Actuarial Stakeholder Group)*

*“The paper correctly summarises the present role of the Actuarial Profession with regard to formal compliance monitoring. However it does not fully recognise the scope and value of the internal peer review systems and other monitoring carried out by many actuarial firms and insurance companies, as well as that carried out by the FSA.” (KPMG)*

### Pensions

- 2.6 Most of the responses we received were from those in the pensions field and this is the area of greatest coverage from existing standards in the form of Guidance Notes (GNs) adopted in May 2006 by the BAS. Although there is no equivalent to the reviewing actuary (found in life insurance) for the audit of regulatory returns in pensions, many respondents pointed to the effectiveness of existing peer review arrangements and the risk-based reviews performed by actuaries at the Pensions Regulator:

*“We would accept that there is only limited ‘external’ monitoring and scrutiny of a lot of actuarial work. However, although we can understand that this creates some adverse perception issues, we do not believe that in practice it necessarily leads to significant problems with the quality of actuarial work, which we consider can be adequately served by a rigorous education system and robust internal quality control procedures. In the area of pensions, which has already been subject to substantial recent increases in its regulatory and compliance burden, we cannot see that the extra costs arising from the introduction of new requirements for greater external scrutiny of actuarial advice could be justified by the resultant modest benefits to the users of that advice.” (Watson Wyatt)*

### Other factors

- 2.7 Several respondents pointed to the existence of internal review processes, designed in part to secure compliance with technical standards and counselled against heavy additional regulation in this area. Several also pointed to the shortcomings in existing technical actuarial standards and the need for these to be addressed before compliance with standards could be seen as effective:

*“The POB is certainly correct that there is little external review of pensions actuaries work, specifically against actuarial guidance. However, as we observe in our detailed comments (which are attached in an appendix to this letter), regulators and auditors have various opportunities to review work done. Although they will not explicitly monitor work against actuarial guidance, they will comment on its appropriateness and so, indirectly, a review takes place. This can also serve to identify where in-house views appear to distort the independence of the advice given. Consequently, we are not convinced of the value in imposing additional requirements.” (Mercer)*

*“At the present time there is very limited, if any, monitoring of compliance with Professional Standards. Many technical standards are not in a form designed to make independent external monitoring easy. Monitoring of Ethical Standards is by nature sparse and if done has to rely on post event judgement. Post event judgement will not always get buy-in and that is not helped by hind sight issues. Away from narrow regulatory compulsory reporting, there is little if any whistleblowing with behaviour shielded by commercial or client confidentiality.” (Foresight Trustees)*

## **Outcome**

- 2.8 Our survey of firms in 2007 revealed the extent of internal compliance review of actuarial work and the importance of quality control procedures in firms and we shall be framing any recommendations in the light of these arrangements, recognising however that their application is not universal or uniform.
- 2.9 We plan to take full account of the plans of the BAS to implement technical actuarial standards to replace most if not all of the existing Guidance Notes adopted in May 2006, including the outcome of its consultation on a new book of Technical Actuarial Standards (TASs).
- 2.10 The majority of those responding confirmed our view that formal monitoring of compliance with professional standards is limited in all areas but that internal quality review processes (within firms and insurers) provide elements of the assurance required.

### 3. LIFE INSURANCE

Q3(i) In life insurance, do you agree that the effectiveness of monitoring and scrutiny arrangements could be enhanced in the most proportionate manner through adopting Strategy 1 (additional support for existing regulatory and market review practices)?
Q3(ii) If not, why not?
Q3(iii) If so, do you support any of the options for additional support under Strategy 1?
Q3(iv) Do you have any further suggestions of how the Profession could promote effective and proportionate monitoring and scrutiny of actuarial work for life insurance?

#### Proposition

3.1 Based on our analysis of the monitoring and scrutiny arrangements for actuarial work in life insurance, our provisional assessment was that we should encourage the Profession to adopt Strategy 1: additional support for existing regulatory and market practices in terms either of education provision, quality assurance standards, published research or by way of enhanced whistle-blowing provision. Accordingly, we sought views on a number of options, listed in Annex B.

#### Summary of responses

	Agree	Mainly agree	Mainly disagree	Disagree
Q3(i)	5	1	0	0

3.2 Six respondents commented on Q3(i). All but one of them agreed with the approach suggested and none disagreed. Consequently, there were no substantive responses to Q3(ii):

*“Yes, we agree that an appropriate way forward would be through Strategy 1, as generally the current processes work well. This would align with the desire for continual improvement and development.”*  
(KPMG)

*“We agree that Strategy 1 would provide the most efficient mechanism for addressing current gaps in arrangements for monitoring and scrutiny of actuarial work performed under regulatory roles. We would also support additional measures from Strategy 2 such as encouraging peer review of all Actuarial Function Holder and With-Profit Actuary advice. We believe that any such review could be provided by another actuary from the same firm.”* (Deloitte)

*“We believe that looking at monitoring and scrutiny arrangements for actuaries alone is too narrow. Arguably, such arrangements should cover all individuals and entities associated with actuarial work, not just actuaries. For example, we believe that the capital markets would benefit if there was greater monitoring and scrutiny of boards of life companies to ensure that they obtain sufficient assurance in relation to the process to which actuaries contribute.”* (Ernst & Young)

3.3 In respect of the Strategy 1 options we listed in Q3(iii) (included at Annex B), there was little difference between the responses given for each sector. Several respondents cross-referred their

response for one sector to the response they had given for another. The responses are summarised together in Annex B, with reference to any sector-specific points made.

- 3.4 There were few other suggestions under Q3(iv). One respondent welcomed the initiative by the Association of British Insurers (ABI) on the use of external review of internal actuarial advice: <http://www.abi.org.uk/Newsreleases/viewNewsRelease.asp?nrid=17095> also commenting that there was little else that could be expected of the Profession.

### **Outcome**

- 3.5 There was broad support for the proposition that we should encourage the Profession to adopt Strategy 1 options in life insurance and we conclude that our assessment is broadly correct. Accordingly we intend to pursue Strategy 1 options as part of our ongoing oversight of the Profession, taking account of the points made on specific options which are summarised in Annex B.
- 3.6 However, when developing Strategy 2 options (additional professional requirements on actuaries or their firms) for the pensions sector we may consider whether any of our recommendations could usefully and proportionately be applied in any aspects of life insurance as well.

#### 4. GENERAL INSURANCE

Q4(i) In general insurance, do you agree that the effectiveness of monitoring and scrutiny arrangements could be enhanced in the most proportionate manner through adopting Strategy 1 (additional support for existing regulatory and market practices)?

Q4(ii) If not, why not?

Q4(iii) If so, do you support any of the options for additional support under Strategy 1?

Q4(iv) Do you have any further suggestions of how the Profession could promote effective and proportionate monitoring and scrutiny of actuarial work for general insurance?

#### Proposition

4.1 Based on our analysis of the monitoring and scrutiny arrangements for actuarial work in general insurance, our provisional assessment was that we should encourage the Profession to adopt Strategy 1: additional support for existing regulatory and market practices in terms either of education provision, quality assurance standards, published research or through enhanced whistle-blowing provision. Accordingly, we sought views on a number of options, which are listed in Annex B.

#### Summary of responses

	Agree	Mainly agree	Mainly disagree	Disagree
Q4(i)	4	1	0	0

4.2 Five respondents commented on Q4(i). All but one of them agreed with the proposition, and none disagreed. Consequently there were no substantive responses to Q4(ii).

4.3 The respondent offering a mixed response was supportive of Strategy 1 but also supported additional measures under Strategy 2 with enhanced peer review arrangements (for all insurance work), which could be provided by another actuary in the same firm:

*“Given the lack of statutory roles for actuaries in general insurance (outside of Lloyd’s), we would suggest that there is scope for specific initiatives to enhance the profile of actuaries in this area, which would include monitoring and scrutiny recommendations.” (KPMG)*

4.4 In respect of the options we listed in Q4(iii) (included at Annex B), there was little difference between the responses given for each sector and several respondents cross-referred their response for one sector to the response they had given for another. The responses are summarised together in Annex B, with reference to any sector-specific points made.

4.5 Apart from the one respondent who had suggested we also consider Strategy 2 options, there were no other suggestions under Q4(iv).

## **Outcome**

- 4.6 As with life insurance, we conclude that our assessment in general insurance is broadly correct, and we shall accordingly pursue Strategy 1 options as part of our ongoing oversight of the Profession, taking account of points made on specific options as set out in Annex B.
- 4.7 However, when developing Strategy 2 options in the pensions sector we may consider whether any of our recommendations could usefully and proportionately be applied in any aspects of general insurance as well.

## 5. PENSIONS

Q5(i) In pensions, do you agree that the Profession should build on existing strategies (under Strategy 1 and Strategy 2) to enhance the scope and application of GN48 and to develop additional tools for regulatory support in accordance with Strategy 2?

Q5(ii) If not, why not?

Q5(iii) If so, do you support any of the options identified for additional support under Strategy 1 and for additional professional requirements under Strategy 2?

Q5(iv) What would your view be on the regulation of firms that employ actuaries as against regulating actuaries only as individuals?

Q5(v) In what circumstances should the Profession consider adopting Strategy 3 (active monitoring by the Profession, or independently, say through an Actuarial Inspection Unit) for pensions? Which additional options should the Profession consider?

Q5(vi) Do you have any further suggestions of how the Profession could promote effective and proportionate monitoring and scrutiny of actuarial work for pensions?

### Proposition

- 5.1 Based on our analysis of the monitoring and scrutiny arrangements for actuarial work in pensions, our provisional assessment was that we should encourage the Profession to adopt Strategy 1 (additional support for existing regulatory and market review practices) and Strategy 2 (additional professional quality assurance requirements for actuaries or their firms). Accordingly, we sought views on a number of options under Strategy 1 (listed in Annex B), and Strategy 2 (listed in Annex C).
- 5.2 Several of the options we developed would involve a greater regulatory emphasis on the role of firms. Our survey and discussions with stakeholders had revealed the importance of the professional quality assurance arrangements operated by consultancy firms in pensions; and the influence of a 'house view' in setting assumptions and methodology, and more generally in the way scheme actuaries manage their relationship with trustees and employers. So we sought views on the regulation of firms more generally.
- 5.3 We also gave serious consideration to Strategy 3 (active external monitoring), which would involve a significant change in the regulation of the work of pensions actuaries. On balance, however, the provisional conclusion we reached was that more proportionate actions were available to enhance how the existing system works; and the impact of these should be considered before concluding that active monitoring is needed.

### Summary of responses

	Agree	Mainly agree	Mainly disagree	Disagree
Q5(i)	13	4	0	2
Q5(iv)	5	7	1	5
Q5(v)	3	1	3	13

## Strategy 1 (Additional regulatory support for existing regulatory and market practices)

- 5.4 In responding to question 5(i), most expressed the view that the existing arrangements provide a good foundation on which to build:

*“Yes, to the extent that it is considered that any gaps in current monitoring and scrutiny processes need to be filled, we agree that it would be best to do this by building on existing practice.” (Watson Wyatt)*

*“For work that is not reserved or regulated (and where there are no technical actuarial standards) we would prefer a more general protocol encompassing all the reviews – technical and compliance – that the work should be subject to. Ensuring and promoting quality as a principle needs to be embedded as a general principle for all work.” (Deloitte)*

- 5.5 In respect of the Strategy 1 options we listed in Q5(iii) (included at Annex B), there was little difference between the responses given for each sector and several respondents cross-referred their response for one sector to the response they had given for another. The responses are summarised together in Annex B, with reference to any sector-specific points made.

## Strategy 2 (Supplementing Strategy 1 with professional quality assurance requirements)

- 5.6 We received 19 responses to question 5(i), 13 of which agreed with the proposal that the Profession should build on existing strategies, developing additional tools for regulatory support in line with Strategy 2. Four others mainly agreed and only two disagreed.

*“If monitoring is currently inadequate then it would seem sensible for this to be addressed by building on existing practice. The options listed in the discussion document under Strategies 1 and 2 appear to cover the options available to monitor actuarial work. In general some strengthening of the current monitoring system may be useful, provided that it does not interfere with existing practices of those firms whose own standards already exceed any minimum requirements.” (Royal Mail Pension Plan)*

- 5.7 Those not in favour of our proposals either highlighted the shortcomings in the existing compliance review framework or believed that Strategy 3 options would be more effective:

*“We think there is a place for GN48 reviews for reserved roles where there are also defined technical standards that the client must meet. GN48 focuses on a particular type of final review (actuarial professional standards compliance) by someone external to the client team (as opposed to a technical review).“All efforts to monitor and scrutinise actuarial work should respect the confidentiality of the client relationship and the intellectual property of the advising actuary and more particularly that of his employer. As a result, independent external monitoring is preferred to monitoring by a potential competitor.” (Hewitt)*

- 5.8 Responses to Strategy 2 options listed in Q5(iii) are included at Annex C.

## Regulation of firms

- 5.9 Of the 18 respondents who commented in response to Q5(iv), the majority either agreed or mainly agreed with the suggestion that firms as well as individual actuaries might be subject to regulation by the Profession.

- 5.10 Many of those who expressed views felt that greater regulation of firms should be explored, but that it should not be mandatory and should not replace individual responsibility. This was consistent with responses to question 5(iii), specifically in relation to the option allowing firms as

well as individuals to obtain a practising certificate, for which there was strong support (see Annex C).

5.11 Some respondents were clear in their support for the regulation of firms:

*"We consider the regulation of firms that employ actuaries to be more appropriate and cost effective than the regulation of individual actuaries. We consider some of the monitoring of individual actuaries could be more effectively done by their firms."* (Jardine Lloyd Thompson)

5.12 Others saw merit in the regulation of firms but not to the exclusion of the regulation of actuaries as individuals:

*"We believe that individual actuaries need to continue to be accountable to the Profession for their conduct and quality of work. We also believe that firms who employ actuaries should be accountable to the Profession because it is firms who take the commercial benefit of the actuaries which they employ. Accordingly, we support the regulation of both firms and individuals. However, we would not support the regulation of firms instead of individuals."* (Ernst & Young)

5.13 Others were clear in their opposition:

*"We do not see any reason for moving from the current approach of regulating individuals"* (Punter Southall)

5.14 One respondent spoke of the regulation of specific types of work, for which the regulation of firms might represent the first step:

*"This is a good question on which we have an open mind. Detailed consideration needs to be given to the pros and cons of potential changes and these would best be analysed by cross-firm working parties. From our point of view, the key point is whether or not such a change would reduce or increase the compliance burden in terms of the cost that would need to be passed on to clients."*

*"In principle, we have a preference for regulating specific types of work or products rather than regulating specific individuals who might carry out that work or deliver that product. Regulating firms that employ actuaries would be a step towards this, although it would still leave a gap (applicable to non-reserved work) for firms that do not employ actuaries but carry out work that is actuarial in nature."*

*"The practical effect of making such a change would differ by firm. Actuaries are so pre-eminent in the running of some firms that the current regulation of individual actuaries is in practice tantamount to regulating the whole firm, whereas in other firms the influence of actuaries is much lower."* (Watson Wyatt)

5.15 At least one other saw merit in using the regulation of firms as the foundation for a more exhaustive inspection regime as outlined under Strategy 3:

*"In summary, we propose a framework that provides for truly independent oversight of self regulation. Flexibility is afforded firms to formulate their own internal procedures but these are subject to effective scrutiny by an independent inspection unit. We believe this is the best way to protect users of actuarial advice going forwards. We would welcome the opportunity to discuss this further with the Board."* (PwC)

### Strategy 3 (Active external monitoring)

5.16 In response to question 5(v), only three respondents fully supported this approach. One was content for his comments to be referred to (and allowed for in the running totals) but asked for his name to be excluded from the list of those making submissions and for the submission itself to be omitted from those we included on the website.

5.17 His view was that it is unlikely that effective monitoring and scrutiny will be achieved voluntarily or through self-certification. Instead he suggested a meaningful degree of independent and compulsory review together with powers to act in cases of non compliance.

5.18 When coming to this view he said that he had taken into account his experience in respect of the FSA, the Pensions Regulator and Solicitors Regulatory Authority regulation. His view is that professional firms carry out greater levels of compliance checks and take compliance more seriously if they are aware of there being a mandatory independent review. Only two others supported this view:

*"We support the idea of independent monitoring and scrutiny by an inspection unit. A similar process has been operating in the audit area and is widely regarded as having been very successful. That is not to say there is not a role for peer review; on the contrary, it is likely to remain a key component of most if not all firms' internal quality control and assurance procedures. An independent sample monitoring process limits the potential problems that have been identified with external peer reviews, not least protecting client confidentiality." (PwC)*

*"Whilst the Group recognised and valued all in-house efforts to improve and promote high quality work, this is no substitute for independent and external scrutiny in providing the necessary confidence. Such oversight might be provided in any number of ways (audit, inspection, desk returns, sampling, checks by the regulators, benchmarking and so forth) but needs to be in addition to internal processes." (FRC actuarial stakeholder group)*

5.19 Another respondent said that although it accepted that in a risk based environment it is healthy for some failures to occur, it did not believe that the Pensions Regulator is equipped to "audit" the work of scheme actuaries.

5.20 Most respondents disagreed with Strategy 3, pointing to the likely cost and intrusiveness of options under that Strategy:

*"[We] believe that in the current climate the disadvantages of Strategy 3 (active monitoring of Pensions work) outweigh the perceived advantages. We believe the current Peer Review regime has much to commend it; it should be allowed to evolve over time, and only if there is strong evidence that it doesn't work (e.g. High profile scheme failures which can be attributed to the role of the scheme actuary), should this option be re-addressed." (The Pensions Management Institute)*

*"We very strongly agree with the assessment in paragraphs 5.40 and 5.41 that Strategy 3 would be disproportionate. The costs of such a system would be, firm-for-firm, very significant, and further we would doubt that a sufficient number of suitable staff could be found for such an inspection unit." (KPMG)*

*"Strategy 3 will involve substantial increased costs and overlap with the work of the FSA without providing an immediately apparent benefit. It would also have a limited influence on those drivers of actuarial quality which would not be covered by independent oversight by POB." (Ernst & Young)*

*“We believe the conclusions in 5.41 [concerning strategy 3] are correct and for the reasons given are sound. If actuaries were diverted to a new (but unproductive) activity, then this would serve to put additional inflationary pressures on actuarial salaries for the actuaries who choose not to join the new inspection teams.” (Barnett Waddingham)*

#### Further suggestions

- 5.21 Few further comments were received on how the Profession could promote effective and proportionate monitoring and scrutiny of actuarial work in pensions.
- 5.22 One respondent thought that greater emphasis should be placed by the Profession on the actuary’s responsibility to act independently – even if this sometimes conflicts with his or her client’s interests. Actuaries needed professional courage to maintain high standards.

#### **Outcome**

- 5.23 There was broad support for the proposition that we should encourage the Profession to build on existing strategies under Strategy 1 and Strategy 2 and we conclude that our provisional assessment is broadly correct. Accordingly, we intend to pick up Strategy 1 options as part of our ongoing oversight of the Profession, while we will undertake a further consultation on draft recommendations arising from Strategy 2 options.
- 5.24 As suggested in the discussion paper, several of the options under Strategy 2 would involve greater regulatory reliance on firms, as a proportionate way to streamline quality assurance requirements on individuals. The arguments for and against permitting firms to hold practising certificates need further development, together with a detailed impact assessment, and we will consider grouping any recommendations in respect of these options.
- 5.25 Although we understand the arguments from those advocating an immediate move to Strategy 3, we also understand the practical and cost arguments put to us about an inspection regime which would ultimately be borne by users of actuarial services. We believe that more proportionate options under Strategies 1 and 2 should be explored before concluding that active external monitoring is needed.
- 5.26 Most of the additional suggestions were for matters which lie outside our remit -such as the inclusion of pensions liabilities of defined benefit schemes in their financial statements, thereby exposing them to audit - which we will refer to the bodies concerned.

## 6. OTHER AREAS

Q6. What strategy should the Profession consider for other areas in which the activities of actuaries are not specifically recognised through regulation? What are the advantages and disadvantages of the various options?

### Proposition

- 6.1 We did not develop any specific proposals for other areas of actuarial work, but we made clear in the introduction to the discussion paper that we did not confine the scope of our review to regulated actuarial roles; nor did we confine our interest to the three main areas identified by the Morris Review. We considered certain monitoring and scrutiny arrangements, particularly at firm level, without distinguishing between the types of actuarial service offered.
- 6.2 Accordingly, we sought views on the strategy and options which the Profession should consider in other areas.

### Summary of responses

- 6.3 More than one respondent expressed concern over the imposition of standards or other regulatory requirements on actuaries in respect of activities which are not reserved to them. The view of one accountancy firm was that we should consider very carefully whether to impose standards or other regulation to protect users while at the same time potentially placing actuaries at a competitive disadvantage to other professions (including actuaries outside the Profession and those who may be members of overseas institutes).

*“Leaving aside matters of ethics and professional conduct which should govern everything an actuary does, we believe that any strategy for areas of actuarial work, which are not recognised through regulation, including actuarial standards, should focus on providing support to actuaries. This would include the provision of information, training, guidance, thought leadership, sharing of good practice and advice. We believe that regulation in this respect should be an option of last resort if these other methods do not work.”* (Ernst & Young)

- 6.4 On the other hand, another respondent, commenting specifically on pensions rather than life insurance, felt that there should be a level playing field with whatever requirements were imposed on actuaries in pensions applying to other actuarial work as well.

- 6.5 Several respondents felt we should at least consider extending regulatory requirements more generally:

*“[The Profession] could consider strengthening its professional conduct standard so that the relatively high level of peer review that applies to pensions actuaries is applied more generally across the profession. Messages from, and examples set by, senior members of the profession would also provide a strong impetus, since these individuals often set expectations of behaviour in their firms.”* (Mercer)

*“For the purposes of consistency, we believe that the GN48 approach should be applied uniformly in respect of all actuarial advice although we accept that there will be many situations where these reviews might be difficult to carry out. However, in order to increase the confidence of the eventual recipient of the advice and those likely to be affected by the advice, these reviews are needed and we would accept that it is difficult to justify why some activities of actuaries should escape regulation.”* (Hewitt)

## Outcome

- 6.6 We are alert to the argument that actuaries should not be put at a disadvantage when competing with non-actuaries for work which is not reserved to actuaries. On the other hand, actuaries generally enjoy a significant advantage from their professional status and reputation, on which the public is entitled to rely and which we would expect the Profession and its members to wish to protect.
- 6.7 Most of the Strategy 1 options we have considered in the insurance and pensions sectors would appear to have equal if not greater importance in other areas where the degree of regulation may be weaker. Accordingly, in pursuing Strategy 1 options in the insurance and pensions sectors, we will generally expect the Profession to consider them in other areas as well.
- 6.8 We do not expect the Profession to pursue Strategy 2 options for specific areas outside pensions. However, in developing draft recommendations to the Profession, we will consider whether any of them could usefully and proportionately be applied in other areas.

## 7. COSTS AND BENEFITS

Q7 We would welcome your assessment of the costs and/or benefits for your organisation, or generally resulting from these proposals.

### Proposition

- 7.1 In the introduction to the discussion paper, we suggested that monitoring and scrutiny would be effective when they provide users of actuarial services with confidence that the work is being carried out to a high quality and in accordance with actuarial standards and that any breaches are promptly investigated.
- 7.2 The test of the effectiveness of any regulatory measure would then be whether it contributes to achieving the intended actuarial practice and professionalism outcomes – as discussed in the accompanying FRC discussion paper *Promoting actuarial quality* - at a cost which is proportionate to the likely benefits and is lower than any alternatives offering equivalent benefits.
- 7.3 We recognised that different regulatory strategies and options might be appropriate in different circumstances, and so we considered the position in each of the main industry sectors separately, in accordance with the FRC's regulatory principle of targeting our recommendations, and taking a risk-based and proportionate approach.
- 7.4 We sought views on the costs and benefits of the various options.

### Summary of responses

- 7.5 Comments on cost were made most often for option 1B (development of quality assurance standards or guidance on effective internal quality control procedures for actuaries and their firms) and for options under strategies 2 and 3.

### Methodology

- 7.6 The Profession was anxious that we establish clear and agreed principles for this important area of regulation. It said it was important that any principles can be applied across all practice areas of actuarial work and that the principles be capable of clear and simple communication to the external user of actuarial work.
- 7.7 The Profession recognised that we will have our own views on appropriate principles but hoped that we might take account of;
- the objectives of scrutiny and monitoring,
  - the nature of the work and of the client/end user,
  - whether the work is reserved to actuaries or not,
  - the cost of the scrutiny relative to the benefits for the client, and
  - the types of scrutiny available.
- 7.8 It also suggested that the monitoring and scrutiny of actuarial work has two principal objectives:
- to improve the quality of individual work before its final delivery to the client;
  - to avoid the undisclosed use of assumptions or methods not generally accepted by peers i.e. the avoidance of atypical house views;
- and that these two drivers are fundamentally different and as a result that they can best be scrutinised in two different fashions.

- 7.9 The FRC's actuarial stakeholder group thought that, in looking at the monitoring and scrutiny of actuarial work in terms of the public interest, it would be helpful to start with clear objectives of what such scrutiny seeks to achieve.

*"The group's view is that, given the difficulty faced by consumers/users of actuarial advice either in choosing or in assessing actuarial service (bearing in mind both the expertise of lay trustees, and the internal pressures on actuaries within insurance companies), it is vital that such scrutiny offers comfort and reassurance to such clients/users about the quality of work and the judgments provided by their actuarial advisors." (FRC actuarial stakeholder group)*

### Proportionality and consistency

- 7.10 One respondent said that work that is to be subject to professional scrutiny (as opposed to firm-based scrutiny, which is more to do with each firm's risk management procedures and internal culture) must be subject to professional standards that have been drafted with scrutiny in mind. The respondent also said that it is exceptionally difficult to define what work is within scope of professional scrutiny and the nature (and limitations) of that scrutiny.
- 7.11 Another respondent, whilst recognising that recipients of actuarial advice within insurance companies have more knowledge and understanding of actuarial issues and advice than their counterparts in the area of pension schemes i.e. trustees, considered that with this knowledge comes a lack of independence and up-to-date experience of other similar client situations. Consequently, it questioned the adoption of a different approach to the scrutiny of actuarial work according to the types of work. It concluded that the same strategy should be applied across the entire range of advice provided by actuaries.
- 7.12 As part of the Groupe Consultatif's mutual recognition agreement, it actively encourages individual members who are working a significant amount of time in another territory to join the local association. It explained that it had put effort into ensuring a consistent code of conduct in all of its member associations, and we can expect actuaries from its member associations to live up to similar ethical standards; the Institute and Faculty of Actuaries will however not have the power to oversee actuaries that are not members of their own associations.
- 7.13 The Institute of Actuaries of Australia suggested that the overall direction taken in the UK by the Profession, the regulators and legislators differs from that taken in Australia in recent years:
- "The full range of actuarial work undertaken today (including, for example, non-modelling based advice and advice in developing market areas such as ERM) suggests that different levels of quality assurance requirements can be appropriate. This is important from at least two perspectives:*
- *In the absence of such a focus, excessive regulatory requirements may be imposed with significant attending economic costs without sufficient evidence of harm to be avoided or public interest to be promoted; and*
  - *In non-statutory areas of actuarial work at least, actuaries will be competing with other professions and an excessive or unjustifiable regulation overlay may ultimately undermine the intended result (driving clients to non-regulated advisors)."*
- (Institute of Actuaries of Australia)*
- 7.14 Under Strategy 3 (active external monitoring), one respondent thought we could base our costings on the existing regime operated by the Profession for its Designated Professional Body role with exempt investment business:

*“It is possible that some broad idea of the costs could be obtained by considering the costs of DPB compliance and incurred by the Institute with QAD and applying a multiplier appropriate to the increased universe and the magnitude of the task. Clearly this would be substantial running into £ms most of which would be staff costs and we question how easy it would be to recruit the necessary number of good quality compliance reviewers who would not be current practitioners but who would need to keep themselves up to date with developments in their field.” (Hewitt)*

### Focus on cost to clients

7.15 There was a mixed response (see Option 2G in Annex C) to our suggestion that permitting firms to hold a practising certificate would be cost-neutral or might even reduce costs for larger firms, although some based their thinking on the regime being mandatory. Those commenting on the costs and benefits of proposals for life and general insurance were eager to point out that the existing regulatory framework is well developed and to the absence of gaps in the existing arrangements:

*“We would caution against a heavy-handed approach to the strengthening of compliance monitoring by the profession, as there is no evidence of significant non-compliance. We would of course expect to see a cost-benefit analysis of any strengthened requirements.” (KPMG)*

*“Many of the extra costs incurred as a result of these [pensions] suggestions would be passed on to pension schemes (in some cases the employers). In either case, they will be perceived as an additional reason to move away from “expensive” final salary type arrangements to ‘cheaper’ money purchase type plans which the profession feels will not generally provide adequate provision for retirement. It doesn’t seem appropriate that the profession should take action that might be seen to hasten this.” (Legal and General Assurance Society)*

*“We understand the purpose and intent of the [pensions] proposals but please note our concern that it could further add to the cost of running poor beleaguered defined benefit plans. There appears to be a lack of evidence that supports a need to have a comprehensive and independent review of the monitoring and scrutiny of pension’s actuarial work. One aspect appears to be the lack of understanding in the Trustees of the small to medium sized pension plans. This may be true but any significant change will affect these pension plans in particular. To conclude, we would only welcome changes that would demonstrably be a benefit to these defined benefits plans.” (Buck Consultants)*

*“We are concerned that requiring the appointment of separate firms could lead to increased costs for scheme sponsors. We do accept that the appointment of separate firms could be appropriate in some circumstances however we consider that any additional regulatory support introduced in this area should be principles-based rather than prescriptive.” (Punter Southall)*

*“Our concern surrounds the cost implication for our customers. Despite the proposed threshold of 20 members, most of our schemes would be included even though, by most measures, they would be regarded as small schemes. The cost of external peer review would inevitably be significant compared with their current administration and actuarial costs. We have estimated that our charges would need to be increased by at least 20%, and possibly by up to 50% depending on the circumstances.” (AXA Sun Life)*

*“We are supportive of the POB identifying areas in which it believes the quality of actuarial advice and information can be improved and generally support any recommendations which might limit the risks faced by pension scheme members, through higher quality advice. There is inevitably a balance to be struck between increased regulations/compliance, designed to improve the quality of actuarial advice, and the*

*increased costs charged by service providers to meet those standards. We believe that there is suitable monitoring and scrutiny of the actuarial services we employ and would not welcome any extra costs that would result from the imposition of additional requirements in this area.” (Royal Mail Pension Plan)*

- 7.16 The Association of Consulting Actuaries (ACA), which represents close to 1700 members working in around 80 firms welcomed the document but on the basis (as they saw it) of a broadly "no change" position advocated in the area of pensions:

*“Were that not the case and, say, compulsory external independent review of work were to be imposed then we would have grave concerns.”(ACA)*

## **Outcome**

- 7.17 Most responses we received concentrated on the additional costs that might result from the options we outlined, particularly in respect of options 1B, 2B and Strategy 3. In respect of Strategy 3, one respondent believed that some comparisons could be made with the cost incurred by the Quality Assurance Department of the ICAEW.
- 7.18 We intend to develop and consult further on draft recommendations arising from most, if not all, Strategy 2 options and to perform a more detailed impact assessment as part of that consultation, drawing on the helpful responses in this area.
- 7.19 We will consult the Profession, the regulators and other stakeholders in performing our assessment of each of our proposed recommendations.

## 8. NEXT STEPS

- 8.1 Given the broad support we have found for our approach and the provisional assessment on the adequacy of monitoring and scrutiny in actuarial work, as well as the proposed strategies for the Profession in each industry sector, we will develop further the options set out in the discussion paper in the light of the many helpful responses.
- 8.2 We will continue to pursue options under Strategy 1 (support for existing regulatory and market mechanisms) through our ongoing oversight of the Profession's regulation of its members, on which we plan to report in early 2009.
- 8.3 In pensions, we will pursue options under Strategy 2 (professional quality assurance requirements) by working with the Profession, the principal regulators and others to develop draft recommendations to the Profession. We will assess their regulatory impact, in conjunction with stakeholders, and seek views through a further public consultation. We expect to publish a consultation paper in the first half of 2009, with a view to finalising our recommendations to the Profession by the end of 2009.
- 8.4 In line with our assessment of the different sectors, our Strategy 2 recommendations will be directed at actuarial work in pensions. However, as suggested by a number of respondents, we will consider whether any of these recommendations should also be applied more generally so as to apply in other areas of actuarial work, including certain aspects of life and general insurance. We will also use this further consultation paper to explore the possibility of a greater regulatory emphasis on the role of firms.
- 8.5 We will not pursue Strategy 3 options (active external monitoring) at this stage. Instead we will monitor the operation of Strategy 1 and Strategy 2 options that are adopted by the Profession, in the context of other regulatory and market review mechanisms, to see if they are effective in enhancing proportionately the monitoring and scrutiny of actuarial work.

ANNEX A

**Summary of regulatory monitoring and scrutiny strategies for the Profession**

<b>Strategy 1: Regulatory support</b>	<b>Strategy 2: Professional requirements</b>	<b>Strategy 3: Active monitoring</b>
<p>Additional regulatory support for existing regulatory and market practices</p>	<p>Supplement Strategy 1, by imposing professional quality assurance requirements on individual actuaries or their firms, and taking account of the practice environment in which actuaries work</p>	<p>Supplement or substitute Strategy 2, with monitoring and scrutiny of firms and individual actuaries, by the Profession or independently</p>
<p>Option 1A – develop relevant review and audit skills through education and CPD</p> <p>Option 1B – develop or encourage quality assurance standards or guidance on effective internal quality control procedures for actuaries and their firms</p> <p>Option 1C – increase transparency of professional review processes through publication of further research and statistics</p> <p>Option 1D –Develop more effective arrangements for reporting concerns about actuarial issues or actuarial work</p>	<p>Option 2A – impose quality assurance requirements for relevant actuarial work</p> <p>Option 2B – require external peer review which is independent of the actuary and the actuary’s firm</p> <p>Option 2C – administrative monitoring of compliance with quality assurance requirements</p> <p>Option 2D – introduce stricter independence requirements for actuaries undertaking relevant work</p> <p>Option 2E – introduce additional requirements for individual actuaries holding practising certificates which relate to the practice environment in their firm</p> <p>Option 2F – require practising certificates for external as well as regulated actuarial advice</p> <p>Option 2G – allow firms as well as individuals to obtain a practising certificate</p>	<p>Option 3A – regulatory inspection by the Profession of actuaries’ work using firm-based sampling</p> <p>Option 3B – independent regulatory inspection of actuaries’ work using firm-based sampling</p>

Note: Some of these options were expressed more specifically in respect of each industry sector.

## FEEDBACK ON STRATEGY 1 OPTIONS

As explained in sections 3-5, we asked respondents if they supported any of the following options for providing additional support to existing regulatory and market review processes, in life insurance, general insurance and pensions:

- 1A The development of relevant (audit/scrutiny) skills through education and continuing professional development (CPD).
- 1B The development of quality assurance standards (for example through independently verified kite-marks) and of guidance on effective internal quality control procedures for firms of actuaries.
- 1C Increased transparency of professional review processes through publication of further research and statistics.
- 1D The development of more effective arrangements for reporting concerns about actuarial issues or actuarial work including, but not limited to, the actuarial function holder (AFH), the with-profits actuary (WPA) and the reviewing actuary.

<b>Strategy 1</b>				
	Agree	Mainly agree	Mainly disagree	Disagree
<b><u>Life</u></b>				
1A	2	3	0	0
1B	3	1	0	1
1C	1	1	0	2
1D	1	1	0	1
<b><u>General</u></b>				
1A	1	3	0	0
1B	2	1	0	1
1C	1	0	0	2
1D	1	1	0	1
<b><u>Pensions</u></b>				
1A	8	7	1	0
1B	9	2	1	2
1C	7	0	1	2
1D	5	1	0	7

**Option 1A - The development of relevant (audit/scrutiny) skills through education and continuing professional development (CPD)**

- 1 There was broad support for this option. Most respondents agreed there was a need for actuaries to develop relevant audit/scrutiny skills, but like us were anxious that this should not increase qualification times.
- 2 Some respondents felt the Profession should focus on CPD based on the argument that audit/scrutiny skills are mainly required by more experienced actuaries:  
*“The Profession could, and perhaps should, include more review and audit techniques in its education process, but I would not be in favour of this if it leads to longer qualification times. Perhaps consideration can be given to this as CPD material for newly qualified actuaries.” (Professor Philip J Boland)*  
*“Option 1A is clearly a good idea, although we suggest that more emphasis be put on covering the material through CPD rather than through the actuarial exams - actuaries will get more out of this type of development once they have gained some meaningful work experience (beyond that required for attaining Associateship or Fellowship)” (Standard Life)*
- 3 One response suggested including audit and scrutiny training as part of work-based skills or professionalism training for students; others suggested including internal controls and processes more generally, and (in insurance) understanding the FSA’s guidance and controls.

**Option 1B - The development of quality assurance standards (for example through independently verified kite-marks) and of guidance on effective internal quality control procedures for firms of actuaries.**

- 4 Most respondents welcomed the idea of quality assurance standards, although some larger firms felt these would be more useful for smaller firms.
- 5 Several respondents felt that such standards could be of broader application, not confined to actuaries:  
*“We would support such developments provided they are developed as guidance. Advice, other than checking compliance with regulatory or professional requirements is not capable of a tick box review and needs to cover much more in terms of clarity, completeness and relevance. Kite-marking can be expensive to achieve and maintain as invariably it requires outside review in implementation and regular review. This is particularly true for small firms of one or two actuaries.” (Association of Consulting Actuaries)*
- 6 There was very little support for such standards being mandatory, and no real enthusiasm for ‘kite-marks’:  
*“We believe the FRC and Profession could take steps to encourage other regulators and stakeholders to focus on the skills of others involved in actuarial work including the users of actuarial information and the quality of decisions made by them as well as their abilities to review and challenge actuarial work.”*  
*“The Profession might also publicise examples of good practice in monitoring and scrutiny of actuarial work, perhaps in the form of a guidance note or technical release, to encourage the development of good practice throughout the industry.”*  
*“Subject to these points, we believe that the steps that the FRC is already taking to promote actuarial quality are a proportionate response bearing in mind the FRC’s focus on being a market-led regulator. We believe those steps need to be properly implemented and given time to bed down. A review of their effectiveness in the medium term should then take place before the FRC considers whether to take further regulatory or other steps.” (Ernst & Young)*

**Option 1C - increased transparency of professional review processes through publication of further research and statistics**

- 7 Many respondents in life and general insurance were unclear what additional research or statistics we had in mind, although there was support for such materials in pensions:

*“We do not believe that this would provide any real benefit, indeed it would probably distract attention and effort from the real goal of improving quality of work.” (Deloitte)*

*“We wonder if there is anything to be gained by collecting and publishing further research and statistics on review processes – the effort required, both of firms and of the profession (or POB) in doing so would be considerable, for questionable gain.” (KPMG)*

**Option 1D - The development of more effective arrangements for reporting concerns about actuarial issues or actuarial work including, but not limited to, the Actuarial Function Holder, With-Profits Actuary and the Reviewing Actuary**

- 8 Again many respondents were unclear what more effective whistle-blowing arrangements we had in mind and most were resistant to change:

*“The whistle-blowing requirements imposed on actuaries and, indeed, on all individuals involved in the administration of pension schemes are well understood, and often emphasised and reinforced by consultancies. We do not see the need for any further development in this area.” (Buck Consultants)*

- 9 At least one respondent saw enhanced whistle-blowing as a more cost-effective solution than alternative strategies:

*“I believe the current drivers of poor quality actuarial work and outcome are not pure computational work but ethical matters overridden or driven to the edge of acceptability by commercial market behaviour. Also many reports are seen ultimately by others (e.g. TPR). Also I believe a more open whistle-blowing regime would be a lower cost effective solution than an Actuarial Inspection Unit. Any expanded whistle-blowing regime does however have to be established with a culture of improvement rather than punishment and hence perhaps a better word than whistle-blowing can be found.*

*“I also support more education on ethical standards and removal of whistle-blowing restraints to the operation of the disciplinary scheme. This may need to involve some statutory protection. Those who object to such a regime may be brought more on board if it can be made clear commercial information would be held confidentially within the disciplinary regime.” (Foresight Trustees)*

**Outcome**

- 10 Several of the options under Strategy 1 are the subject of existing work or development initiatives which are being or have been picked up in our ongoing oversight of the Profession:

- The Profession tells us it has instructed principal examiners to consider more scrutiny and review questions in its later specialist examinations, to supplement the audit trails provided for in subject CA2 “Modelling”, and it is also considering what it could include by way of CPD.
- In respect of the Profession’s ethical and conduct standards, we have recommended that the Profession should do more to encourage its members to scrutinise and challenge actuarial work. There are already standards for specific scrutiny roles in life insurance - such as the Reviewing Actuary – the principles of which the Profession could usefully extend.

- Research is being undertaken on monitoring and scrutiny arrangements by the Profession and others, such as on life insurance and the operation of GN48 (*compliance review*) in pensions.
- We have followed up the Morris Review recommendation to the Profession to provide more comprehensive guidance on whistle-blowing by recommending the Profession consolidates its whistle-blowing guidance through common principles that are of general application for all actuaries and the Profession has confirmed its intention to address this in due course.

11 Taking account of the comments we have received, and given the broad support for Strategy 1, we do not propose to re-consult on these options. Instead, we will pick up these themes, and the consultation responses, in our ongoing monitoring and recommendations to the Profession. We will include these aspects in our planned report on the Profession's regulation of its members in early 2009.

## FEEDBACK ON STRATEGY 2 OPTIONS

As explained in section 5, we asked respondents whether they supported any of the following options for additional professional requirements in pensions:

- 2A Extending the application of GN48 *Compliance review* to corporate restructuring work and assignments for the sponsoring employer.
- 2B Requiring external peer review which is independent of the actuary and his or her firm – possibly limited to schemes with 20 members or more.
- 2C Administrative monitoring of compliance with quality assurance requirements.
- 2D The introduction of stricter independence requirements for actuaries undertaking relevant work, requiring separate advisors for scheme and sponsor for those schemes with 20 members or more.
- 2E The introduction of additional requirements for individual actuaries holding practising certificates which relate to the practice environment in their firm.
- 2F Require practising certificates for external as well as regulated actuarial advice.
- 2G Allowing firms as well as individuals to obtain a practising certificate.

Strategy 2	Agree	Mainly agree	Mainly disagree	Disagree
<b><u>Pensions</u></b>				
2A	10	3	6	2
2B	6	1	4	10
2C	5	1	4	4
2D	5	1	5	4
2E	8	0	2	5
2F	1	1	4	6
2G	6	5	1	2

### Option 2A - Extending the application of GN48 *Compliance review* to corporate restructuring work and assignments for the sponsoring employer

- 1 Most respondents favoured extending these provisions to areas such as business rearrangements and FRS 17 disclosures, and one (pensions) firm felt this should apply across all actuarial work. However, it was pointed out that it would be difficult to apply GN48 (the existing compliance review requirement) to areas in which no actuarial standards apply:

*“We are in favour of extending the application of GN48 *Compliance review* to corporate restructuring work and assignments for the sponsoring employer. However as noted in the paper there are limited actuarial standards covering such work at present and this work is often time critical, which might result in such reviews taking place after the advice has been issued.” (Punter Southall)*

**Option 2B - Requiring external peer review which is independent of the actuary and his or her firm – possibly limited to schemes with 20 members or more**

- 2 Apart from the Stakeholder Group and some smaller firms, most respondents strongly opposed this option. However, some of the arguments, and the indicative costings suggested, ignored the point that this would only apply on a sample basis (10% in Ireland):

*“It appears that a favoured solution is to increase the use of peer reviews. Whilst in a number of Anglo-Saxon countries there has been an increased use of peer reviews, this trend has not emerged in other European countries. A key issue is often the availability of actuarial resource, and thus the need to use actuaries efficiently. If more use is to be made of peer reviews we would recommend that thought is put into how this can be done with a minimum of duplication of effort.” (Groupe Consultatif Actuariel Européen)*

*“Given that this apparently works well in Ireland for regulated pension work, [we] would be happy to see the principle extended to the UK, apart from the smallest of schemes. The cost implications would have to be carefully considered before introducing such a change. Any additional regulatory costs can be particularly onerous on smaller schemes. In this context, we note that there is no clear definition across the board of what counts as a ‘small’ scheme; perhaps 50, or even 100, would be better than 20, or 12, as has been used elsewhere.” (Pensions Management Institute)*

*“In response to the general point about peer review, we would urge that this be thrown open to non-actuaries, who are often well-qualified to comment. For example, in the setting of assumptions for future mortality improvements, demographers and statisticians are at least as technically competent as actuaries in this area (and often more so).” (Richards Consulting)*

*“External peer review is less likely to be undertaken within a timeframe, where the advice to a client can be corrected before it is used by the client. The existence of the Regulator already acts in part as an external reviewer for scheme funding. In M&A work where advisers to both sides will usually be from separate firms, external peer review should form part of the process.” (Confidential respondent)*

- 3 One of the strongest objections to external peer review concerned the confidentiality of the commercial material that might be made available to a competitor firm. The arrangements in Ireland were understood to have been in response to its market structure, in which one firm has a large share of the market. Several expressed a preference for inspection (by the Profession or an independent actuarial inspection unit, or equivalent) over peer review by a competitor firm:

*“Any move to compulsory external review will also cause problems around confidentiality. Firms will be reluctant to involve external parties on matters of commercial sensitivity or involving competitive advantage. Direct writers may be able to engage consultants with some degree of independence, but how would consultants’ advice to firms be reviewed?” (Deloitte)*

*“The Committee wishes to express concern that there might be conflicts of interest arising as a result of the proposals for external peer review. This is a concern given the small size of the actuarial profession in Scotland. Any peer review mechanism would need to take account of potential conflicts.” (The Law Society of Scotland)*

**Option 2C - Administrative monitoring of compliance with quality assurance requirements**

- 4 Views were mixed. Many firms were dismissive, arguing this would do little to improve quality at the point of delivery:

*“We are not sure how this could be made to work effectively for people whose work is not governed by a clearly defined process.” (The Society of Pensions Consultants)*

*“We believe that, unless this is mandatory, it is unlikely to work in practice and we feel this could be costly for the Profession to maintain. We feel this would only be appropriate if it were a stepping stone to active monitoring under Strategy 3.” (Deloitte)*

5 Some saw merit in the proposals:

*“The profession could arrange periodic checks to be made of the processes in place. This might involve an outside agency but only if it were the procedures being checked, and not the actuarial work itself (as that would be too expensive).” (Barnett Waddingham)*

**Option 2D - The introduction of stricter independence requirements for actuaries undertaking relevant work, requiring separate advisors for scheme and sponsor for those schemes with 20 members or more**

6 Views were mixed. There was general support for clearer handling of conflicts:

*“We strongly support strict independence requirements for pension-scheme work. In particular, we regard it as untenable that the same advisor can advise both trustees and sponsoring employer. The two groups have directly competing aims – one wants to maximise the funds in the scheme, while the other wants to minimise the cost of the scheme. A good lawyer wouldn’t for a moment entertain advising both trustees and employer, and neither should an actuary.” (Richards Consulting)*

*“We agree that the Scheme Actuary should be barred from advising the employer. However, the Scheme Actuary is normally the best person to carry out any calculations as he has the access to the data and has the computer systems available to him that would be used, for example in valuing changes.*

*“Even this apparently innocuous situation will lead to conflict. If the Scheme Actuary is led to believe from the requests made that the employer is considering a particular option (for example, closing the scheme) then it would be difficult for the Scheme Actuary to ignore that possibility when advising the trustees. The Scheme Actuary’s primary responsibility must always be to the trustees.”(Barnett Waddingham)*

7 Most respondents felt it was unacceptable for the same individual to advise the sponsor and the scheme:

*“Pressure has been growing for some time for stricter independence requirements. We would agree that it is becoming increasingly untenable for the same individual actuary to provide full and unbiased advice to both the trustees and sponsoring employer of a pension scheme (regardless of scheme size).” (KPMG)*

8 There were mixed views on whether different actuaries from the same firm could provide advice to the trustees and the employer:

*“We believe it can be possible for the two actuaries to work for the same firm. This can create conflict and each must be aware of that possibility and take steps to avoid it arising. A properly documented procedure would be necessary, with physical and electronic barriers placed between the two individuals.” (Barnett Waddingham)*

*“In an ideal world, that prohibition would apply to firms as well as to individual actuaries. We would suggest that POB ascertains the views of these users of actuarial services, of the investment community, and of regulators, to assist in decisions on this.” (KPMG)*

9 Some felt there should be an exemption for small firms and argued for a higher threshold than our proposal of 20 scheme members:

*“This proposal has merit given current concerns regarding conflicts of interest. The market for actuarial services is also moving in this direction, in particular for larger schemes. However, we do not believe that a threshold of 20 members would be acceptable to scheme sponsors both on the grounds of cost and on the*

greater amount of time that need to be spent by company management if this was introduced. A much higher threshold would have more chance of being accepted.” (Buck Consultants)

10 Others saw no reason to change the existing arrangements:

“We would not support Option 2D (introduction of structural independence requirements) because we consider that any benefit to clients would generally not compensate for the additional costs. We are far from convinced that actuarial conflicts of interest are sufficient to require separate appointments.” (The Society of Pensions Consultants)

#### **Option 2E - The introduction of additional requirements for individual actuaries holding practising certificates which relate to the practice environment in their firm**

11 Again there was a mix of views. Many recognised that the Profession already takes account of the firm environment within which a practising certificate holder operates:

“So much work is now done by teams within firms and appointments held by firms, it must be sensible to start to move the regulation away from individuals towards firms. Without that, the capacity exists for much parcel passing between individuals or different professional roles. Equally it would be wrong to go the full way to just regulation of firms. Some individual responsibility and hence regulation must remain.” (Foresight Trustees)

12 Others were doubtful that the additional costs would be justified:

“This could adversely affect the competitiveness of smaller firms and sole practitioners. If carried out by the profession, it would place a greater workload on the relatively small administrative capabilities of the profession, adding to the costs. An extension of the role of the senior actuary in conjunction with a relaxation of the demands on individual actuaries may be an acceptable way to manage this proposal subject to careful consideration of the effect on small firms.” (Buck Consultants)

“We would have thought that the requirements on pensions practice certificate holders were onerous enough, without adding an additional layer of complexity.” (PMI)

13 More than one respondent linked Option 2E to Option 2G:

“A lighter touch of regulation in firms where there is a high standard of internal review (and for regulation under Option 2G) could be favourable but individual actuaries may not be in a position to influence their firms.” (Deloitte)

#### **Option 2F - Require practising certificates for external as well as regulated actuarial advice**

14 Most firms opposed this option, either on grounds of parity with non-actuaries or in terms of the practicality of application:

“We would rather not see the introduction of this option which could potentially put the actuarial profession at a disadvantage compared to other professionals who could potentially carry out the non-regulated advice.” (Punter Southall)

“We are opposed to this as an unnecessary restriction. In particular, it would slow the development of junior actuaries who are gaining experience to become scheme actuaries.” (Legal and General Assurance Society)

15 Several respondents felt that this option would need combining with Option 2G:

“We would not wish to see 2F without 2G.” (Watson Wyatt)

## Option 2G - Allowing firms as well as individuals to obtain a practising certificate

16 Option 2G was seen by us as a permissive measure and there was general support for, or at least interest in, allowing firms as well as individuals to obtain a practising certificate:

*"We believe that further consideration should be given to this proposal particularly to the transition phase while procedures were being set up to permit firms to comply with the requirements set by the Profession. Careful consideration would need to be given to interaction with the current scheme actuary role and whether this could, or should, be relaxed (subject to the necessary change in legislation). In practice, this would recognise the reality of the way in which many consulting firms carry out business." (Buck Consultants)*

17 Nevertheless, several firms, including one of the largest, were opposed:

*"We see little benefit in allowing firms as well as individuals to obtain practising certificates. The present system works well and the Discussion Paper does not identify:*

*(a) what benefits might be obtained; and*

*(b) the costs to each firm of the initial application and the subsequent renewal applications akin to the present review and renewal by the Actuarial Profession of the Scheme Actuary practising certificates.*

*However, the Discussion Paper does hint that the set up costs could be substantial, presumably with BAS and the Actuarial Profession and hence we do not support this suggestion." (Hewitt)*

## **Outcome**

18 Taking accounts of the comments received, we propose to develop and consult further on draft recommendations to the Profession, as outlined in sections 5 and 8, in respect of Strategy 2 options.

19 We have considered carefully the comments we have received (and summarised in section 7) on the likely costs and benefits of our proposals. We therefore plan to carry out an assessment of the regulatory impact of Strategy 2 options, in conjunction with stakeholders, and to seek views on these through a further public consultation.

20 We expect to publish a consultation paper in the first half of 2009, with a view to finalising our recommendations to the Profession by the end of 2009.

## List of non-confidential respondents

The Actuarial Profession  
Association of Consulting Actuaries  
Axa Sun Life  
Barnett Waddingham  
Professor Philip J. Boland  
Buck Consultants  
Deloitte  
Ernst & Young  
Foresight Trustees  
FRC actuarial stakeholder interests working group (Annex E)  
Groupe Consultatif Actuariel Européen  
Hewitt Associates  
Institute of Actuaries of Australia  
Jardine Lloyd Thompson  
KPMG  
Lane Clark & Peacock  
Law Society of Scotland  
Legal and General Assurance Society  
Dr Alan Mayer  
Mercer  
Pensions Management Institute  
PricewaterhouseCoopers  
Punter Southall  
Richards Consulting  
Royal Mail Pension Plan  
Society of Pensions Consultants  
Standard Life  
Watson Wyatt

**We also received two confidential responses.**

## Members of the FRC actuarial stakeholder group

Rosemary Beaver	Lloyd's of London
Steve Balmont	Law Debenture
Neil Carberry	Confederation of British Industry
Roger Carroll	Bell-Pottinger
Niki Cleal	Pensions Policy Institute
Norma Cohen	Financial Times
Lynn Collins	Marks & Spencer Pension Scheme
Hilary Daniels	Professional Oversight Board
Christopher Daws	NCH Superannuation Fund
Fiona Draper	BRE Pension Scheme
Helen Evans	Trade Union Congress
Dianne Hayter [chair]	Property Standards Board
Melanie Johnson	ABI Consumer Impact
Julian Lowe	Board for Actuarial Standards
Anne Maher	Allied Irish Bank
David Metz	Financial Services Consumer Panel
Peter Murray	Railway Pensions Scheme
Penny Shepherd MBE	UK Social Investment Forum
Malcolm Small	Institute of Directors
Margaret Snowdon	Lucida
Anna Sofat	AJS Wealth Management
Doug Taylor	Which?
Roger Turner	Occupational Pensioners Alliance

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