

## **Annex B – Our recommendations on professional quality assurance arrangements**

The following recommendations were confirmed by the Oversight Board in May 2009.

Under the Memorandum of Understanding between the FRC and the Actuarial Profession, the Profession is committed to responding to our recommendations, either by implementing them within a reasonable period, or by giving reasons in writing for not doing so, on the basis that these reasons will be published.

### **The Oversight Board’s review of monitoring and scrutiny of actuarial work**

Our review was undertaken in response to three parallel recommendations by the Morris Review – in life insurance, general insurance and pensions - that the FRC should satisfy itself that there is adequate independent scrutiny of actuarial work and monitoring of compliance with actuarial standards, through regulation, audit or external peer review.

As confirmed in our feedback statement (<http://www.frc.org.uk/pob/actuaries/reviewmonitoring.cfm>) published in January 2009, we found that there was enhanced independent scrutiny of actuarial work, primarily through regulation and audit, as well as additional responsibilities for governing bodies, but limited external monitoring of compliance with actuarial standards.

### **Support for existing regulatory and market review mechanisms (Strategy 1)**

We concluded that, given the extent of independent scrutiny already being undertaken, the primary strategy for the Profession in all areas should be to provide additional support for existing regulatory and market review mechanisms (Strategy 1), for example through:

Option 1A - develop relevant (audit/scrutiny) skills through education and continuing professional development (CPD);

Option 1B – develop non-binding quality assurance standards and guidance on effective quality control procedures within actuarial firms;

Option 1C – periodically publish research and statistics on professional review processes; and

Option 1D – develop consolidated whistle-blowing guidance.

In our feedback statement, we noted that many of these activities are the subject of existing initiatives by the Profession or outstanding recommendations by the Morris Review or the Oversight Board, which we would pick up as part of our ongoing monitoring of the Profession’s regulation of its members.

We are not therefore making any new recommendations in this area. However, we will pursue these separately with the Profession’s heads of division, and some of these initiatives – for example the development of non-binding guidance on professional quality assurance arrangements in firms - may be relevant to the recommendations below.

## Professional quality assurance requirements for actuaries (Strategy 2)

In pensions, we concluded that the Profession needed to supplement Strategy 1 with additional professional quality assurance requirements. We sought views on a number of options in our discussion paper:

- Option 2A – extend the application of GN48 Compliance review to corporate restructuring work and assignments for the sponsoring employer;
- Option 2B – require external peer review which is independent of the actuary and the actuary’s firm – possibly limited to schemes with 20 members or more;
- Option 2C – administrative monitoring of compliance with quality assurance requirements;
- Option 2D – introduce stricter independence requirements for actuaries undertaking relevant actuarial work, requiring separate advisers for scheme and sponsor for those schemes with say 20 members or more – possibly as an alternative to Option 2B;
- Option 2E – introduce additional requirements for individual actuaries holding practising certificates which relate to the practice environment in their firm;
- Option 2F – require practising certificates for external as well as regulated actuarial advice; and
- Option 2G – allow firms as well as individuals to obtain a practising certificate.

We are now setting out our high level recommendations in this area, by reference to the Profession’s current and proposed projects and reviews.

***1. As part of its development of an actuarial standard on conflicts of interest in pensions, the Profession should consider prohibiting actuaries from providing advice to separate parties, such as both trustees and sponsors, on the same or a closely related issue, unless there is a robust independent review of their work.***

We consulted on these proposals under Options 2B and 2D, which were also presented as alternatives. As explained in our feedback statement, there was a general view that actuaries should not normally be permitted to advise trustees and sponsoring employers; views were mixed on whether this could be acceptable with different actuaries from the same firm.

Our view is that there is no effective substitute for separation of advisory roles, even though external review may be used in mitigating the impact of conflicts.

It is for the Government and statutory regulators to determine whether dual roles should be made unlawful. However, it is important for the Profession to establish effective professional safeguards to ensure that the quality and reliability of actuaries’ work for trustees is not undermined by actual or perceived conflicts of interest.

**2. As part of its review of the operation of GN48 (compliance review in pensions), the Profession should consider:**

***a) extending the scope of the review obligation, to cover other areas where the BAS plans to issue specific technical actuarial standards which are not already subject to supervisory review by a regulatory body or through regulatory requirements for audit or other review mechanisms;***

We consulted on a version of this proposal as Option 2A in our discussion paper.

There was general support for an extension of the scope of compliance review requirements in pensions, although it was pointed out that this would not be possible in the absence of standards against which work could be reviewed.

We did not seek views on whether compliance review should be extended to other areas, such as insurance, as we had concluded that there was already sufficient scope for reliance on monitoring and scrutiny through regulation and audit, although the actuarial firms we spoke to all said that they do something further in any event.

However, we expect the Profession to bear this reliance in mind when developing its specific standards for the work of actuaries performing senior reporting, governance and review roles in insurance, and in audit support work (GN42 covers life insurance). The Profession should also consider the need for compliance review in the reserved role of actuaries advising pre-paid funeral plans.

***b) whether the depth of the review will be sufficient to provide reasonable assurance that the work complies with the principles established by the BAS's new technical actuarial standards.***

The existing requirements in GN48 take a fairly narrow approach to review, by focusing on compliance of written advice with existing standards, which are themselves fairly prescriptive and rules-based.

The BAS's new standards will be principles-based and will place considerable emphasis on meeting user needs. Consequently, when the Profession replaces GN48 with a new standard to require reviews of compliance with BAS standards, a more thorough review of an actuary's work will be required.

We consulted under Option 2C on whether the Profession should undertake administrative monitoring to confirm compliance with professional quality assurance requirements such as GN48, in the same way as it monitors compliance with its CPD requirements.

Changes to GN48 might also incorporate a strengthening of the independence requirements for the review in support of Recommendation 1 above.

**3. As part of its review of the arrangements for issuing practising certificates, the Profession should consider:**

***a) the scope of the obligation to hold a practising certificate and in particular whether, and if so in what circumstances, it should cover:***

***(i) any consulting actuary who provides professional actuarial services to an external client, who places reliance on professional quality assurance arrangements which are outside the client's direct responsibility or control;***

***(ii) the reserved role for actuaries advising trust-based pre-paid funeral plans which rely on the exclusion in Article 60 of the FSMA Regulated Activities Order.***

We consulted on (i) under Option 2F in our discussion paper. The rationale for regulating consulting actuaries is the greater reliance which is inevitably placed by external clients on consulting actuaries to have their own professional quality assurance requirements, compared with employers of in-house actuaries (who are responsible for their own systems and controls) and users of work which is not presented in a professional actuarial capacity.

It would be for the Profession to determine suitable definitions of ‘professional actuarial services’ and ‘external client’ for this purpose. The professional bodies for accountants and lawyers have developed a number of approaches to defining ‘accountancy services’ and ‘legal services’, through a combination of illustrative examples (not confined to reserved roles) and more general holding out tests. The definitions are imprecise, but do not appear to have caused significant problems in practice. In its feedback statement on promoting actuarial quality (<http://www.frc.org.uk/publications/pub1865.html>), the FRC proposed a similar definition of professional actuarial services using a holding out test.

Similarly, we envisage that the definition of ‘external client’ would reflect the substance of the relationship between the actuary and the client, and in particular whether there is reliance on the actuary to have independent professional quality assurance arrangements which are outside the direct responsibility or control of the client or the client’s group. Thus, a secondee or contractor would normally be regarded as working for an employer rather than an external client.

In (ii), we consider that the absence of a practising certificate requirement for the reserved role of undertaking an actuarial valuation of trust-based funeral plans is anomalous given the reliance which is placed on the actuary’s work in order to justify an exclusion from FSA regulation. We understand that the Funeral Planning Authority reviews the actuarial reports obtained by its members, but membership is not mandatory and there is no statutory obligation or requirement for the actuary’s work to be reviewed by the auditor.

***3b) the conditions which should apply to the issue of practising certificates, including reliance on the professional quality assurance requirements operated by actuarial firms, and the extent to which reliance may be placed on these and on senior actuaries in firms to support and confirm compliance of individual actuaries with their professional responsibilities.***

We consulted under this proposal in Option 2E in our discussion paper, and the majority of those responding agreed with this approach. We noted that many if not all firms which provide actuarial services to external clients have established professional quality assurance arrangements which are intended to support and confirm compliance of individual actuaries with their professional responsibilities.

We believe that the Profession should consider ways of promoting these arrangements in order to support confidence in the work of consulting actuaries and to enhance and confirm the compliance of its members with their individual responsibilities. However, there is a need for guidance, particularly for smaller firms.

It would be for the Profession to determine the appropriate conditions. However, based on the FRC's Actuarial Quality Framework (<http://www.frc.org.uk/pob/actuaries/drivers.cfm>), the Profession should consider the following matters:

- a senior actuary to provide professional leadership within the actuary's firm;
- arrangements for handling conflicts of interest, and confidential information;
- controls on competence and quality control, such as checks on individual actuaries' work;
- management of customer relationships, including terms of reference, complaints handling and compensation for shortcomings; and
- arrangements to support communications with regulators and whistle-blowing.

Consideration of these matters should also pick up the points we made in our progress report in January 2008 ([http://www.frc.org.uk/pob/actuaries/ap\\_progress.cfm](http://www.frc.org.uk/pob/actuaries/ap_progress.cfm)) about the role of senior actuaries, and whether, and if so when, actuaries would need professional indemnity insurance.

***4. As part of its wider review of regulatory priorities, and its regulatory activities generally, the Profession should consider the working environment for actuaries as a driver of actuarial quality and a means of supporting and confirming its members' compliance with their individual responsibilities.***

As highlighted in the FRC's Actuarial Quality Framework and discussed above, we consider that the working environment for actuaries is a key driver of actuarial quality.

We have expressed the view, in the context of the Actuaries' Code, that the Profession needs to consider the purpose of its professional requirements, and the nature of the general and specific threats which it is seeking to address through its regulation, as well as the scope and implications of actuaries' links with their employers (or other significant parties) for each aspect of their professional conduct.

Individual actuaries already rely on their employers to support them in complying with their professional responsibilities. For example, although the draft Actuaries' Code requires individuals to respect confidentiality, they in turn need to make judgments about the integrity of their employer's electronic and paper filing systems, and about the integrity of their colleagues. There are similar dependences in relation to the Code's requirements on the manner in which professional actuarial and related services are promoted; agreeing terms of reference; ensuring that actuarial work is undertaken with competence, skill and care; identifying and dealing with conflicts of interest; reporting concerns in the public interest; and ensuring that communications are clear and not misleading. These dependencies are particularly important for external users of actuarial work, who have no direct control over the way these matters are managed.

We also consulted on whether firms should be permitted to hold a practising certificate on behalf of their actuaries under Option 2G. We consider that this might be an effective and proportionate way of introducing a general practising certificate for consulting actuaries, which would meet our aim of ensuring that external users can rely on actuaries to have proper quality assurance arrangements for their work, without the need for extensive monitoring by the Profession.

In the feedback we received, there was significant interest in this idea. However, it is for the Profession to determine whether it should require all consulting actuaries in a firm to hold a practising certificate (as with lawyers), or allow them to rely on senior actuaries to hold a certificate (as with accountants), or to establish some form of voluntary registration arrangement under which firms themselves can provide the relevant confirmation. We note that the Profession currently promotes nearly 70 actuarial firms on its 'find an actuary' web pages, in reliance on a general disclaimer rather than seeking confirmation from the firms concerned that they will support individual members in complying with their professional requirements.

### **Impact assessment**

The aim of our proposals is to enable users to rely on proper quality controls over professional actuarial work. The proposals do not directly affect actuaries who provide internal actuarial services solely for the use of their employer (unless they perform a reserved role), or actuaries whose work is not presented as having been undertaken in a professional actuarial capacity, since users do not place the same degree of reliance on these actuaries to have professional quality controls. This should enable the Profession to tailor its requirements in a more targeted and proportionate way.

Our preliminary assessment is that the funds which depend on some form of substantive actuarial assessment in the UK may be as much as £3 trillion. Consequently, the benefits to users, even for a very modest improvement of confidence in the reliability of actuarial work, are potentially very large indeed. We consider that the substantive costs of our proposals on compliance review and practising certificates would be negligible since firms we spoke to said they aim to have proper quality assurance controls already. To the extent that some smaller firms do not have such controls, the proposals would reduce the costs of professional shortcomings.

The costs of independence restrictions, and the administrative costs of our other proposals, would depend on the way in which the Profession chooses to respond to our recommendations. We expect the Profession to ensure its proposals are proportionate to the size and the scale of the entities involved.

### **Active external monitoring (Strategy 3)**

As explained in our feedback statement, we have concluded that we should not recommend the establishment of an external inspection unit, either by the Profession or by another body, unless other proposals prove inadequate.

### **Next steps**

The Profession has agreed to consider our recommendations carefully and expects to have developed initial proposals and a clear timetable for its work by the end of 2009. We intend to make a further report in 2010 once we have reviewed the Profession's proposals and their implementation.