

## **MONITORING AND SCRUTINY OF ACTUARIAL WORK**

Barnett Waddingham LLP is a UK based firm of actuaries and consultants. We provide a range of actuarial and consulting services to trustees and sponsoring employers of occupational pension schemes, life assurance companies and friendly societies. We have therefore considered the consultation paper on monitoring and scrutiny of actuarial work with a great deal of interest.

The following represents the views of many, but not necessarily all, of the actuaries working at Barnett Waddingham LLP.

### **General comments**

In principle, we accept that in order to meet the recommendations of the Morris Review, a greater degree of monitoring and scrutiny should be applied to actuarial work in future than has been the case in the past. It may be more convenient for actuaries to opt for the status quo (Strategy 0) but we accept that, realistically, this is not an option if the profession is to restore its somewhat (unfairly) tarnished image and generally to meet its obligations towards the public at large who trust and rely on our judgement.

That said, many of the concerns surrounding monitoring and scrutiny in the life insurance industry have stemmed from the Equitable Life case and related matters. One could argue that subsequent legislative changes have since remedied those concerns.

In recent times, the key public concerns about pensions have stemmed from:

- dramatic changes in pension schemes' funding levels arising from market fluctuations (not a matter of actuarial making) and
- a perceived unfairness in the priority order in winding up (a function of regulation rather than of actuarial making)

One area where pension actuaries may be open to 'fairer' public criticism is the failure to properly advise clients of the risks associated with heavily investing pension fund assets in equities.

Any new monitoring and scrutiny requirements will inevitably result in increased cost and delay for firms' clients. Notwithstanding the additional assurance of actuarial quality that results, more clients will be forced to give up on good pension schemes as being too expensive and too regulated. This would not be in the public interest. Moreover, some actuaries might choose to leave the profession (in particular those in investment and general insurance) as a result of the additional regulatory burden. This could further damage the Profession's reputation.

We would urge therefore that whatever is eventually decided should be balanced and proportionate. It should recognise that the clients of actuaries are already burdened with their share of the cost of new regulations (of which there have recently been many) and that actuaries seem to spend much of their time in the unproductive activity of ensuring that their clients do not fall foul of those regulations.

We would also urge that no additional burden be placed on pension scheme trustees. It is already hard enough to recruit new trustees without having them subject to additional regulation and further training.

## **SECTIONS 3 + 4**

We have no specific comments.

## **SECTION 5 – PENSIONS**

*Q5 (i) 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? [5.46]*

Yes.

However, the nature of the enhancement is where the problems will arise. For example, we do not believe that enforced type 1 reviews would always be possible for smaller firms or sole-practitioners. If, therefore, type 1 reviews are required for only larger firms then they will cry “foul” because of the application of different standards. Thus, no enforcement of type 1 reviews would be possible – or, at least, not without a lot of care.

*Q5 (ii) If not, why not?*

*Q5 (iii) Do you support any of the options identified for additional regulatory support under Strategy 1 and for additional professional requirements under Strategy 2? [5.47]*

We have the following comments:

Option 1A : We believe that this approach will be necessary and that the profession must find a way of fitting it into the syllabus. We do not anticipate that the additional training would require significant additional CPD input from additional activities.

Option 1B: Under this option better defined rules will be required so that each actuary and each firm knows exactly what the standard is, and how it should be met.

The FRC might consider helping the profession to build and run internal training courses for firms. These would correspond with its own courses for individual actuaries. This combination would ensure that all actuaries follow the same appropriate courses of training. We believe it is neither necessary nor desirable for firms to show a kite-mark that their own in-house courses are “appropriate”.

Option 1C: We offer no comments.

Option 1D: We do not consider this alternative to be necessary. The introduction of such arrangements implies that they have been missing in the past and that had there been such systems in place then problems would not have arisen. The “problems” - such as they are, would still have arisen with a different complaints system in place. A different complaints system will not eradicate problems but it would tend to encourage complaints that might not otherwise be made, thus creating a lot of wasted effort (we doubt many more (if any) actuaries would be disciplined that have not already been so under the present system).

Option 2A: We do not believe the involvement of actuaries in corporate restructuring work or other corporate advice has resulted in many complaints or claims, if any at all.

This is an area where turn-around times have to be quick and where the actuary may, typically, not have time for work to be reviewed. In any event, the work would have to be anonymised to protect sensitive information and often to such a degree as to make the reviewer’s work almost impossible.

Advice in this area can be very specialised and frequently emanates from the legal profession. A lawyer may already know the work of particular actuaries in different areas to be sound, thereby providing a level of scrutiny indirectly. Review in these circumstances would be even more difficult. Moreover, commercial pressures already ensure that standards are maintained; that back-up is available; and that relevant training is given.

Option 2B: External review would not be possible for all areas of activity but might be possible for others. For example, external type 2 review might be possible for actuarial valuation reports subject to GN9.

Internal type 1 review works well for Barnett Waddingham as a whole especially for reports that are subject to GN9. Such reviews are usually carried out by an actuary in the same office (but not one involved with that particular client). Less frequently, but also not uncommonly, an actuary from a different office will carry out the review. This may be the case at holiday time or due to sickness.

One of the problems with external review is cost. It is apparent, and unlike internal review, it cannot be cross-subsidised, for example, with training time.

Another problem with this option is how to provide a level playing field that is not unfair towards smaller firms. At present, we believe some smaller firms and sole-practitioner actuaries come to “an understanding” with other firms (possibly of a similar size) which permits cost to be contained to a degree. This only works in reciprocal arrangements and care needs to be taken to acknowledge the need to seek a wide range of reviewers. However, such a wide range of reviewers is not essential when the work is as formal and well-defined as a GN9 report.

Limiting the external review to schemes of more than 20 beneficiaries is an interesting concept, which may be difficult to police in practice. Moreover, our smaller clients may feel they are getting a less valuable service if their advice is not subject to such review.

Option 2C : We offer no comments

Option 2D: 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.

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.

The ideal would therefore be for the employer to be advised by an actuary from a different firm.

Option 2E: This seems to us to be the combination of regulation of individuals and regulation of the firm. This is burdensome and expensive. Existing controls, training and internal peer review should be sufficient.

What would the external examiner do? Check that such systems exist? Check that they are adequate? This would require the external examiner to have knowledge of what constitutes "adequate".

The first is a wasteful cost and the second would be a significant additional cost.

There is a danger that all systems will be reduced to taking the same form in order to satisfy an external examiner. That would be a pity as it is the idiosyncrasies of such arrangements that make firms different places and interesting places to work.

If such an arrangement were to be introduced then the profession should require a substantial reduction in the burden of review that is currently imposed.

Option 2F: We offer no comments

Option 2G: This option appears to be tackling the wrong problem. In practice, under Option 2G, large firms would be able to further maintain client relationships by replacing outgoing Scheme Actuaries (eg on leaving the company) with another suitably qualified member of staff, retaining statutory appointments. This will be unfair on smaller firms with few or only one certified staff actuaries.

Moreover, the commercial issue of retaining a client has no place in deciding the policy for the monitoring of actuarial work. The commercial issue of maintaining client relationships will still exist whether or not Option 2G is employed.

*Q5 (vi) What would your view be on the regulation of firms that employ actuaries as against regulating actuaries only as individuals? [5.42/5.43]*

We are against the regulation of firms and are in favour of the present system of regulating individuals.

To regulate firms implies the following:

- There will have to be two systems of regulation rather than just one: one for the profession to regulate the firm and a second for the firm to ensure that it regulates its own actuaries.
- Employers who employ only a few actuaries will be unfairly burdened.
- How will subcontracted actuaries be regulated (where they are subcontracted to a single entity).

In our opinion this could lead to existing “actuarial” firms splitting off their actuarial work into a regulated subsidiary. This would not be ideal, particularly as actuaries can usefully interact with any aspects of a business.

Open discussion of actuarial matters might be curtailed as the interests of the actuary’s employer might have to be taken into account.

*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? [5.40]*

We believe the conclusions in 5.41 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.

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

Greater emphasis should be placed by the profession on the actuary’s responsibility to act independently – even if this sometimes conflicts with his client’s interests. The profession needs to breed a new generation of actuaries with the professional courage required to maintain high standards.

Training in this area is difficult but it should be introduced early and emphasised in professionalism courses on qualifying (as, we believe, is the case at the moment).

As so far as monitoring is concerned, this should start with particular and well-defined pieces of regulated work. We would suggest that reports to which GN9 relate and certificates given under GN16 would be examples of where formal monitoring would be appropriate.

The monitoring should be by internal type 1 review according to a structure established by the profession with the approval of the FRC. Type 2 review would be acceptable only by external reviewers from another firm.

Monitoring should be subject to 'self-certification' via the senior actuary who would report to the profession and be responsible for ensuring that appropriate compliance procedures have been established (and themselves reviewed and checked from time to time) and followed.

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).

We also believe that new procedures for monitoring and scrutiny could be introduced gradually and amended according to actuaries' experiences in applying the requirements.

A level playing field would result and individual actuaries can retain responsibility for their own activities. This would allow new and transparent monitoring to be introduced at reasonable cost.

### **Conclusion**

Any new approach to the monitoring and scrutiny of actuarial work should be balanced and proportionate. Clients are already burdened with their share of the cost of the new regulations (of which there have recently been many) and we would urge that no additional burden is placed on pension scheme trustees.

We hope that you find these comments useful. Please let us know if you would like us to expand any of our comments.

**Barnett Waddingham**  
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