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Dear Christina

Professional Oversight Board ("POB") - Discussion Paper: Monitoring and Scrutiny of Actuarial Work May 2008

INTRODUCTION

1. Ernst & Young LLP welcomes the opportunity to comment on POB's Discussion Paper entitled "*Monitoring and Scrutiny of Actuarial Work*" ("the Discussion Paper").
2. We recognise that the Financial Reporting Council ("FRC") has a very important role to play in improving corporate governance and the quality of financial reporting, auditing and actuarial work, all of which contribute to the maintenance and improvement of confidence in the capital markets. Given the ever increasing importance of actuarial information to the capital markets, the POB's work in this area is an integral part of the FRC's role and we fully support its work.
3. Unless the context dictates otherwise in this letter, defined terms shall have the same meaning given to them in the Discussion Paper. For the avoidance of doubt, references in this letter to the FRC include its Operating Bodies where relevant.

Our interest

4. As the POB will be aware, Ernst & Young is one of the largest global professional services organisations. We provide a wide range of audit, accounting, tax, corporate finance and other business advisory services. All of our UK activities are supervised by the Institute of Chartered Accountants in England & Wales, with further supervision over certain parts of our business by the Financial Reporting Council, the Financial Services Authority ("FSA") and other regulators.
5. Our interests in this Discussion Paper are threefold:



INVESTOR IN PEOPLE

- ▶ There are over 160 members of the actuarial profession (including both actuaries and trainees) working in our firm.
 - ▶ As a firm we have extensive dealings with actuaries, both in relation to pension matters and other liabilities in our work as auditors and in a whole range of advisory services. Increasingly, actuarial matters are more and more critical to our opinions.
 - ▶ As a large business contributing to a pension fund for its people, Ernst & Young LLP is itself a user of actuarial information.
6. The Discussion Paper provides a good summary and overall analysis of the issues. Subject to our response to the specific questions below, we are supportive of most of the points made.

RESPONSE TO SPECIFIC QUESTIONS

The POB has asked for comments and answers to the following questions:

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

Yes.

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

No. Although there is only limited formal monitoring of compliance with professional standards by regulators and other independent bodies, other monitoring of compliance with professional standards takes place through the forms of scrutiny listed in paragraph 2.2 of the Discussion Paper namely: professional quality assurance, direct clients, audit, regulation and other independent scrutiny.

Section 3: Life Insurance

Q3(i) In life insurance [Section 3], do you agree that the effectiveness of monitoring and scrutiny arrangements could be enhanced in the most proportionate manner through adopting Strategy 1 (additional regulatory support for existing regulatory and market practices)?

Yes provided that it is broad enough in scope.

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.

Whilst we accept that such monitoring and scrutiny is not within the power or remit of POB or the Profession, we believe that they both have a role to play in influencing other relevant regulators to develop better practices in this area.

We believe that Strategy 2 is too narrow in scope because actuarial quality is affected by a number of other factors which Strategy 2 would not address, particularly in relation to decision making and independent challenge of actuarial work.

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.

Q3(ii) If not, why not?

Not applicable.

Q3(iii) If so, do you support any of the options identified for additional regulatory support under Strategy 1?

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

We support this option in principle although in the case of life insurance we believe that this may be better covered by FSA guidance and controls.

As highlighted in paragraph 2.36 of the Discussion Paper, audit trail elements are already present in the modelling course. We agree that audit skills can be further included in the actuarial exams in the "Work Based Skills" module.

Scrutiny skills would generally apply to more experienced actuaries who are more likely to review actuarial work. In our view this skill is best gained through experience and we agree that CPD would also be helpful.

In addition to skills of audit and scrutiny, we believe there would be merit in training about the need for, and possible forms, of internal controls and processes around actuarial information and the quality of the decisions made using it.

- ▶ **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 (Option 1B).**

We support this option in principle although we would like to see a broader application of quality assurance standards. Quality assurance is not just relevant to actuaries. It is also relevant to insurers, life companies, pension funds and anyone else who makes decisions using actuarial information. Accordingly, to be as useful as possible, any guidance on internal quality control procedures about actuarial information ought to take into account all individuals and entities, not just actuaries.

Ernst & Young is a large organisation with internal quality control processes and procedures ("internal controls") based on various requirements set down by organisations like the Institute of Chartered Accountants in England and Wales (ICAEW) and their principles-based practice assurance standards or the IAASB and the International Standard on Quality Control 1 for audit and assurance. Our internal controls are inspected by the Audit Inspection Unit, in respect of our public interest entity audits, and by the ICAEW's Quality Assurance Department in respect of the rest of our business. We envisage that any quality assurance standards for actuarial work would be similar to our existing internal controls because the core activity of evaluating and reporting on financial data is similar as between actuaries, auditors and accountants.

This could be supplemented by increased transparency of professional review processes through publication of further research and statistics (Option 1C).

We support this option in principle particularly if transparency will lead to the sharing of examples of good practice where it is observed. We would need to understand more about the detail of these proposals before commenting further.

- ▶ **The development of more effective arrangements for reporting concerns about actuarial issues or actuarial work including, but not limited to, the AFH, WPA and the reviewing actuary (Option 1D)**

We support this option in principle. We believe that this could be tackled through the Profession's ethics and to a large extent as a matter to be covered by firms of actuaries themselves as part of their organisations' governance.

We would need to understand more about the detail of these proposals before commenting further.

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?

We refer you to the additional suggestions we make in response to Q3(iii) above.

We also 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 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.

Section 4: General insurance

Q4(i) In general insurance [Section 4], do you agree that the effectiveness of monitoring and scrutiny arrangements could be enhanced in the most proportionate manner through adopting Strategy 1 (additional regulatory support for existing regulatory and market practices)?

Yes, subject to our answers to the questions below.

Q4(ii) If not, why not?

Not applicable.

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

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

We repeat our response to Q3(iii) above.

- ▶ 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 (Option 1B).

We repeat our response to Q3(iii) above.

This could be supplemented by increased transparency of professional review processes through publication of further research and statistics (Option 1C)

We repeat our response to Q3(iii) above.

- ▶ The development of more effective arrangements for reporting concerns about actuarial issues or actuarial work (Option 1D)

We repeat our response to Q3(iii) above.

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?

We repeat our response to Q3(iv) above.

Section 5: Pensions

Q5(i) In pensions [Section 5], 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?

Yes, subject to our answers to the questions below.

Q5(ii) If not, why not?

Not applicable.

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

- ▶ **The development of relevant review and audit skills for actuaries through education and CPD (Option 1A)**

We repeat our response to Q3(iii) above.

- ▶ **The development of quality assurance standards or guidance on effective internal quality control procedures for actuaries and their firms. (Option 1B).**

We repeat our response to Q3(iii) above.

This could be supplemented by increased transparency of professional review processes through publication of further research and statistics (Option 1C)

We repeat our response to Q3(iii) above.

- ▶ **The development of more effective arrangements for reporting concerns about actuarial issues or actuarial work (Option 1D)**

We repeat our response to Q3(iii) above.

- ▶ **Extending the application of GN48 compliance review to corporate restructuring work and assignments for the sponsoring employer (Option 2A)**

This is a difficult question which requires the balancing of many interests. Corporate restructuring and assignments for the sponsoring employer are areas of work which are not, by their nature, reserved to actuaries. We believe therefore that the Profession should consider very carefully whether to extend the application of GN48. It could potentially place actuaries at a competitive disadvantage to other professions (including actuaries outside the Profession and those who may be members of overseas institutes).

Increasing work invariably means increasing costs for the client. This might encourage clients to use other professions to carry out the work where the fees are lower, or potentially encourage members of the Profession to let their membership lapse.

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

As a firm we do not provide actuarial services to pension schemes themselves. Other respondents, who are directly affected, are better placed than us to comment.

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

We support this option in principle. However, as we say above we believe that quality assurance as a concept is not just relevant to actuaries. It is relevant also to insurers, life companies, pension funds and anyone else who makes decisions using actuarial information. Whilst we appreciate this issue is not strictly a matter for POB, the FRC and the Profession could seek to raise this with the relevant stakeholders, including other regulators.

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

Provided that any requirements are proportionate to the risk arising from the conflicts to which the requirements relate, we believe that there is merit in exploring the imposition of stricter independence requirements in this area. We would expect the Profession to publish any specific proposals for full consultation first.

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

We support this option in principle. However, in order to provide more meaningful comments, we would need to understand more about the detail of any such proposals.

- ▶ **Requiring practising certificates for external as well as regulated actuarial advice (Option 2F)**

We support this option in principle. However, as we have identified above, such external advice may cover areas of work which are not, by their nature, reserved to actuaries. We believe therefore that the Profession should only require practising certificates for external work which is regulated actuarial advice or which can only be carried out by qualified actuaries.

- ▶ **Allowing firms as well as individuals to obtain a practising certificate (Option 2G)**

We support this option.

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

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?

We believe that the steps being taken by the FRC in relation to pensions are a proportionate response, bearing in mind the FRC's focus on being a market-led regulator. We believe those priorities need to be developed, properly implemented and be 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 steps; regulatory or otherwise.

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?

We repeat our response to Q5(v) above.

Section 6: Summary of findings and options

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?

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.

As we have said in response to previous consultations, we have concerns about imposing standards or other regulatory requirements on actuaries in respect of activities which are not reserved to actuaries. The BAS, POB and the Profession 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).

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

Whereas costs arising out of implementing Strategy 1 are unlikely to be significant for our organisation, more significant costs would arise by implementing Strategies 2 and 3.

Strategy 1 has the potential to improve actuarial quality over time by encouraging good practice and providing support, guidance and training to actuaries. Strategy 2 will not necessarily improve actuarial quality. However it includes initiatives where the results will be objectively verifiable by users of actuarial information and other stakeholders. Strategy 3 would provide greater independent assurance that actuarial quality is being maintained or enhanced over time. We, like POB, query the need to pursue Strategy 3 for the same reasons set out in the Discussion Paper. However, POB will be aware that Ernst & Young supports the concept of independent oversight for its audit practice (whether by professional regulators or by sufficiently independent peer review) because of its positive impact on audit quality.

CONCLUSION

We are grateful to POB for publishing this Discussion Paper and for the analysis it has put forward. We hope that you have found our comments helpful. We look forward to reading the responses, which we hope will be posted on the FRC's website shortly, and in due course POB's analysis of the results. If you would find it useful, relevant members of our firm are available to discuss further any of the points we have raised.

For the avoidance of doubt, none of the comments set out in this letter are intended to be confidential.

Yours sincerely




Robin Heath
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