

Paul Kennedy  
Professional Oversight Board  
FRC  
Aldwych House

June 2008

Dear Paul

***Monitoring and scrutiny of actuarial work:*** May 2008 Discussion Paper

At its meeting on 19 June, the FRC's Stakeholder Interest Working Group had the opportunity to comment on the above discussion paper. As a result of this, the Group asked me to bring the following points to the attention of the Professional Oversight Board. You will note that the comments are not in the form of responses your specific questions (which are really rather more directed at the profession<sup>1</sup>) but encompass the whole document rather than particular fragments of it.

- 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.
- Thus the objectives of monitoring and scrutiny might be defined as providing for lay trustees the necessary confidence in the advice they receive, and for insurers that the internal culture fosters work of a good quality. Monitoring and scrutiny represents more than internal quality control. The overall framework of independent review, sampling and regulation needs to have sufficient transparency to give confidence to end users.

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<sup>1</sup> The discussion paper is relevant to consumers and consumer bodies as it may affect the security of the amount of the benefits they can expect to receive from insurance policies, pension funds or other investments which are managed using actuarial information and advice. Perhaps the POB might consider an "implications" summary or highlighting the parts of relevance to consumers in their consultations, rather as the FSA does.

- The Group noted that the conclusions reached on the gaps and overlaps in monitoring and scrutiny of actuarial work, and the solutions identified to make the necessary corrections, were not entirely clear from the discussion paper. The members also commented that, in the tables at the start of each sector-specific section, the various forms of monitoring and scrutiny are given equal weight when they in fact vary in their impact and effectiveness. For example, the Lloyd's actuary performs an essential role in reviewing and benchmarking the reserving by individual syndicates, whereas the role of the International Insurance Department of the National Association of Insurance Commissioners in the US is of marginal significance to Lloyd's and the actuaries employed there. One option might therefore be to rank the differing interventions within a hierarchy of accountabilities at the level of Regulator, Profession and Firm.
- Perhaps because of the extensive range of alternatives, it was not easy to see the implications of a specific emerging option. Of particular significance are the costs and benefits associated with any proposed change - information that will be needed before a decision can be made on any of the options.
- Although the paper distinguishes<sup>2</sup> between (internal) quality assurance and (external) peer review, this distinction is a more fundamental one than is perhaps suggested. The final proposals need to recognise the shortcomings of internal review (which is about quality assurance) and concentrate on scrutiny and external monitoring.
- It was noted in this context that the special characteristics of the emerging buy-out market should not be forgotten.
- Since audit has limitations, regulators can play a significant role in the monitoring and scrutiny of actuarial work. Morris was looking for solutions by way of external peer review, audit or regulation. A matrix of monitoring and scrutiny processes, including monitoring at the firm level, could prove the most effective solution.
- Quality assurance procedures<sup>3</sup> say nothing about the product but rather provide a means of assessing the adequacy of the underlying procedures. By way of example, Lloyd's uses external benchmarking among over 60 syndicates which allows the Lloyd's actuary to measure quality; this is an alternative which lies between quality assurance and individual external peer review.
- Efforts to improve quality assurance are naturally welcome. However, where such efforts identify any weakness, this tends to lead to improved processes, or more appropriate training, rather than to rectification of past work. By contrast, scrutiny involves testing the "product" or outcome (rather than the processes) and – for example by benchmarking and the identification of outliers – can facilitate the re-working of reports and rectification of errors.

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<sup>2</sup> in Options 2A and 2B and in 5.16 to 5.23 for pensions

<sup>3</sup> such as ISO 9001

- With pensions, Morris envisaged independent external review. This is important as the ultimate consumer is unable to distinguish between a product that is of good quality and one that is not. From the user's point of view, the choice is usually made between firms and not between individual actuaries. Thus robust regulation of firms may be preferable to, for example, a retired fellow being invited to peer review the work of another actuary. Whilst accepting that mandatory external peer review would be costly, especially to smaller pension funds, sample reviews might suffice or benchmarking by the Regulator. However, the Group did also note that as pension funds now appoint a separate actuary from the employer, an in-built peer review may anyway occur.
- 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 regulators, benchmarking and so forth) but needs to be in addition to internal processes.
- This also enables a check on "house-think" which, by its nature, cannot be subject to internal testing.
- The Group noted that the discussion paper pulls back from a clear steer on either peer review or post-hoc review, and fails to make clear that this remains on the agenda. The Group would prefer to see the issue of peer review as an integral part of the discussion on scrutiny, and would urge that it is dealt with as part of this exercise, whilst acknowledging that the routine monitoring and benchmarking work undertaken at Lloyd's and by the Pensions Regulator might reduce the need for external peer review in some circumstances.

I trust these comments are of assistance to the Board members as they take forward their discussion of this vital area of regulation.

Yours sincerely

A handwritten signature in black ink that reads "Dianne". The signature is written in a cursive, flowing style.

Dianne Hayter  
Chair  
FRC Stakeholders Interest Working Group