

Ms Christine Trickett
Professional Oversight Board
5th Floor
Aldwych House
London
WC2B 4HN

30 September 2008

Dear Ms Trickett

We welcome the opportunity to respond to the Discussion Paper by the Professional Oversight Board on the Monitoring and Scrutiny of Actuarial Work following the discussion Chris Norden and I had with Paul Kennedy and Jon Thorne on 5 September.

We agree wholeheartedly with the objective of the POB of improving the quality of actuarial work throughout the profession and are keen to see any reasonable measures incorporated in the training of actuaries both before and after qualification that would enhance this. Ultimately, this should improve the trust and confidence of recipients of the advice whether they are clients, members of pension schemes, employers, policyholders, regulators and other third parties in all actuarial advice. However, we have a number of serious concerns about the proposals which are contained in the Appendix to this letter but an executive summary of these concerns is as follows

1. There should be a level playing field in terms of the application of the strategy for improving quality across the entire range of actuarial work whether this is the area of pension schemes, life insurers, general insurers or other areas. The means adopted for improving quality should not depend on who the recipient might be and, if necessary, efforts should be made elsewhere, e.g. by the Pensions Regulator for improving further the knowledge and understanding of trustees.
2. The focus of efforts should be to improve the quality of all actuarial advice before delivery and at the point it is considered by clients rather than to concentrate on the monitoring and scrutiny of actuarial work after the event when decisions may already have been taken that, with the benefit of hindsight, might then be considered to be less than perfect by the standard at that later point in time.
3. 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.
4. We believe that many firms are already committed to good quality actuarial work but inevitably, some changes will be needed to comply with whatever proposals are eventually agreed by the POB. The Discussion Paper appears to ignore that these changes will have a cost impact ultimately on the recipients of the advice and will not fall solely on the advisor.
5. We question how easy it will be to establish an independent team of monitors and scrutineers that will be key to the implementation of the POB proposals and whether the individuals will have the requisite skills.

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We would be pleased to discuss our observations on the POB proposals as you wish.

Yours sincerely

A handwritten signature in black ink, appearing to read 'G. Farren', with a long horizontal flourish extending to the right.

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Appendix – Detailed Comments

Introduction

The POB is considering implementing different strategies for monitoring and scrutiny of actuarial work for pensions actuaries and for actuaries working in the areas of life and general insurance. We do not believe that the case for adopting different strategies has been considered in sufficient depth although, as noted in para 5.5 of the paper, reference is made to a suggestion in the Morris Review that the Pensions Regulator might wish to adopt different approaches for large and small pension schemes. The method by which insurance companies and pension schemes are advised differs fundamentally in that:

1. insurance companies are, in the main, advised by actuaries working for those companies, whereas
2. scheme actuaries advise pension schemes and others employed in independent external firms or, in the case of the very smallest schemes, actuaries working for insurance companies.

The use of independent external firms brings with it many advantages not least the opportunity for scheme actuaries and other actuaries to share knowledge and experiences across a wide range of clients and to develop appropriate standards that supplement the professional standards of BAS and the Actuarial Profession. These actuaries are then able to apply that knowledge for the benefit of individual clients supported by a scrutiny process, whether for the purposes of GN48 or the firm's own higher standards, which involve other suitably qualified actuaries with wider client experience.

It is arguable that the recipients of actuarial advice within insurance companies may have some more knowledge and understanding of actuarial issues and advice than their counterparts in the area of pension schemes, i.e. trustees, not least because they, themselves, are actuaries. However, with this knowledge comes a lack of independence and up to date experience of other similar client situations. We do not believe that this is sufficient justification for the adoption of a different approach to the scrutiny of actuarial work according to the types of work. Accordingly the same strategy should be applied across the entire range of advice provided by actuaries.

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

We agree that there has been an increase in the independent scrutiny of actuarial work since the Morris Review reported in March 2005. The reasons for this have been threefold:

1. GN 48 was introduced by the Actuarial Profession as Recommended Practice from 31.12.04 to 31.12.06 and thereafter as a Practice Standard,
2. The Pensions Regulator has played a role directly or indirectly in the scrutiny of actuarial advice, and
3. There has been an increased tendency for trustees and employer sponsors of occupational pension schemes to receive independent actuarial advice. As a result, employers are better able to review critically and, if appropriate, to challenge the actuarial advice provided to trustees particularly to trustees in the context of pension scheme valuations.

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

There is virtually no **independent** monitoring of compliance with professional standards across the entire actuarial profession except following a complaint under the Disciplinary Schemes of the Actuarial Profession or where the firm has a DPB license (but only in respect of compliance with the DPB Handbook) and this position has not changed for many years. However, in our own firm we have a policy of ensuring two levels of review of all actuarial work in terms of:

“Hot file” review for the purpose of our own quality standard and supplementing GN48 undertaken at the time the work is carried out and ideally before the client can act on the advice, and

“Cold file” review undertaken once each year by an independent team of actuaries on a sample basis across the entire firm and designed to ensure that the work of all scheme actuaries and other actuaries at a certain level of seniority is subject to review.

This regime of review has been in operation for several years and predates the introduction of GN48. The hot file approach was introduced in the 1990s and modified to accommodate GN48 and the cold file reviews were introduced around 2002/2003. It is important to emphasise that the hot file review applies to **all** actuarial work and, if necessary, takes place immediately after the advice is given, e.g. in the case of meetings or telephone conversations where only the advising actuary might be present. The cold file review applies on a sample basis but is carried out with access to all the client files and correspondence so that the reviewer has the benefit of sight of the advice sought by the client and the advice provided. This applies whether or not it falls within the scope of the various Practice Standards. Accordingly, the review is much wider than the narrow review of Scheme Actuary advice. Moreover, it is carried out by an independent team of senior actuaries from other office locations and with experience of carrying out such reviews.

This approach maintains client confidentiality and protects the intellectual property of the firm and is one that we would commend to other similar firms. It is not suitable for smaller firms because of the inability to carry out independent reviews and indeed some smaller firms might be unable to carry out hot file reviews. In this situation, there may be a need for an independent quality assurance unit (similar to the QAD unit of the ICAEW that carries out reviews of the regulated activities of DPB licensed firms to carry out such reviews for those smaller firms).

Q3 and Q4

We do not wish to comment on these detailed questions as our firm no longer advises life and general insurance clients other than to reiterate our views about the need for a level playing field across all areas of actuarial advice.

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

In principle, we agree with this objective and that the scope of GN48 should be extended to all actuarial advice. This would correspond to our firm’s “hot file” review approach.

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

- In principle, we would support the development of relevant review and audit skills for actuaries through education and CPD subject to these being timely, proportionate, and supplemental to our own quality assurance procedures and part of a life-long learning process for actuaries. This development could be part of the requirement for continued CPD in the same way as attendance at professionalism event every 10 years is necessary.

- In principle we would support the development of quality assurance standards on effective internal quality control procedures for actuaries. These standards having been sponsored by BAS stakeholders could play a useful role in defining clients' expectations and could, in due course, form part of the terms and conditions agreed with clients.
- We do not believe that there is a need for more effective arrangements for reporting concerns about actuarial issues or actuarial work. The existing reporting arrangements within the PCS are well known to and binding on all actuaries and we see no reason for their extension.
- We would support the extension of GN48 Compliance reviews to corporate restructuring work and assignments for the sponsoring employer. Indeed, we see no reason why these should be excluded or why GN48 Compliance reviews should not apply to all actuarial work, i.e. work that only an actuary can provide.
- We are unable to support the concept of external peer review, which is independent of the actuary and his firm (irrespective of the size of that firm) unless these reviews were to be carried by an organisation that is not a competitor and is only engaged (like QAD of the ICAEW) in carrying out such reviews. This is because of the risk that the client confidentiality could be compromised as well as the intellectual property of the advisor. There could also be threats of the recruitment of employees of the advising firm. We also believe that the present approach we have adopted works well, has not been shown to be defective and may be found in other larger firms. We also disagree that the increased cost of such reviews were they to be carried out should fall on the advising firm rather than the client e.g. by way of increased fees.

Some firms may be too small to be able to carry out these reviews and these would need to be carried out by "friendly" firms or an independent quality assurance firm. The adoption of this approach in Ireland may be a consequence of the size of actuarial firms (with one exception).

- If the confidence of clients and users of actuarial advice is to be maintained, we doubt that voluntary compliance is likely to be effective. It is possible that a more effective approach might be the agreement in the advisor's terms and conditions of certain quality standards allowing audit of the quality of the advice by the client but at the client's expense.
- We have adopted our own arrangements for ensuring that trustees and sponsoring employers are separately advised within the firm and that these arrangements are agreed by the respective clients. Clients who require separate advisors in separate firms are free to choose to make such appointments and a minority do so. These types of arrangements were considered in the Morris Review and not at that stage found wanting and we see no reason at this juncture some three years after the Morris review for requiring independent actuarial advisors in different firms. Accordingly, we would not support any stricter arrangements beyond a need for the Scheme Actuary to agree with his trustee client and to document in writing what arrangements are in place for ensuring that the trustees and the sponsoring employer receive independent advice.
- At this stage, we would not support the introduction of additional requirements for individual actuaries holding practising certificates, which relate to the practice environment of their firm. We believe that the scope for savings after taking into account the effective cost of agreeing the practice review with the Profession would not be material. Although some firms might still be managed as small partnerships, we believe that in the larger firms there is likely to be one or more persons responsible for all aspects of the firm's practice including quality issues.
- We see no benefits in requiring practising certificates for external as well as regulated advice
- 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

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- 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.

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

We believe that the current regime of regulating scheme actuaries and not their employing firms works well and no case has been made for the regulation of firms providing actuarial advice. As a result, we believe that the current regime should continue for the time being.

The regime could be reviewed as part of a two stage strategy and if found to be wanting could be replaced by a regulatory regime of firms and not individual scheme actuaries. However, this would require major changes within the Actuarial Profession and should, we believe, not be considered

Q5(v) in what circumstances should the Profession consider adopting Strategy 3 for pensions? What additional options should the Profession consider?

We are very supportive of the reasons given in para 5.41 of the Discussion Paper for not introducing Strategy 3 at this time and for the later review of this view when the intermediate options for improving the monitoring and scrutiny of actuarial advice have taken effect and their benefit assessed relative to the objectives.

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.

Some consideration could be given to extending the role of the Scheme Actuary and hence his personal responsibility for the work undertaken. However, this would require some major legislative changes and might not be popular within the Profession

Q6 What strategy should the profession consider for other areas in which the activities of actuaries are not specifically recognised through regulation?

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.

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

We have not carried out any estimates of the costs given the multiplicity and broad outline of the suggestions in the Discussion Paper. We are nervous that, like other compliance initiatives e.g. in the area of financial services compliance, there will be substantial costs that will ultimately fall on clients if the profitability and viability of consulting firms is to be maintained. Stakeholders are unlikely to appreciate the magnitude of these costs until they materialise whilst the perceived benefits will be minimal and could be obtained by other more direct means, such as by a contract between the client and the advisor.

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.