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By e-mail:
actuarialmonitoringreview@frc.org.uk

Dear Sirs

Monitoring and Scrutiny of Actuarial Work

Following your Discussion Paper on the above subject, issued in May 2008, we are pleased to enclose our response. The attached comments and answers to the consultation questions represent the views of the actuarial practices within our UK firm, having consulted with audit colleagues.

If you have any questions regarding our response, please contact Gordon Sharp, whose details are at the top of this letter.

Yours faithfully

Alastair McLeish
Partner

Tim Roff
Partner

General 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? [2.3]

Yes.

In life insurance, there is much wider use of independent peer review, wider use of independent directors and membership of With Profit Committees, the use of s166 skilled person reports, and the FSA requirement to have liabilities in regulatory returns subject to audit.

In pensions, the role of the Pensions Regulator is a very important one, which gives significant independent scrutiny of scheme funding advice where previously there was none. Further, the Pensions Act 2004 funding regime has encouraged many employers to take actuarial advice independent of that received by their trustees, which has also led to enhanced scrutiny and challenge.

Q2. Do you agree with our conclusion that, at the present time, there is only limited monitoring of compliance with professional standards? [2.26]

Yes, in that the paper correctly summarises the present role of the Actuarial Profession with regard to formal compliance monitoring. However it does not fully recognise the scope and value of the internal peer review systems and other monitoring carried out by many actuarial firms and insurance companies, as well as that carried out by the FSA.

We would caution against a heavy-handed approach to the strengthening of such compliance monitoring by the profession, as there is no evidence of significant non-compliance. We would of course expect to see a cost-benefit analysis of any strengthened requirements.

Life Insurance Questions

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)? [3.33]

Yes we agree that an appropriate way forward would be through Strategy 1, as generally the current processes work well. This would align with the desire for continual improvement and development.

Q3(ii) If not, why not?

n/a

Q3(iii) If so, do you support any of the options identified for additional regulatory support under Strategy 1? [3.34]

- **The development of relevant (audit/scrutiny) skills through education and continuing professional development (CPD) (Option 1A)**
 - Audit firms already provide extensive audit training to all audit staff, which is subject to review by the Audit Inspection Unit. However, the emphasis should not be on audit firms alone, as doing this for actuaries only in audit firms would be unbalanced, without putting in place similar requirements for actuaries working in non-audit firms who are engaged for review work.
- **The development of quality assurance standards (for example through independently verified kitemarks) and of guidance on effective internal quality control procedures for firms of actuaries (Option 1B). This could be supplemented by increased transparency of professional review processes through publication of further research and statistics (Option 1C)**
 - We would not want the actuarial profession to be a special case but if this were to apply to all audit and review arrangements then, for the audit firms, we would suggest that any proposals and their cost effectiveness be developed in conjunction with the Auditing Practices Board.
 - Directors of insurance companies are already required to sign off on their systems and controls. But beyond that, Sarbanes-Oxley type requirements do not apply to UK entities, so why should there be special focus on actuaries?
 - We wonder if there is anything to be gained by collecting and publishing further research and statistics on review processes – the effort required both of

firms, and of the profession (or POB) in doing so would be considerable, for questionable gain.

- **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 consider the current arrangements to be fit for purpose.

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?

No.

General Insurance questions

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)? [4.23]

Yes we agree that an appropriate way forward would be through Strategy 1. This would align with the desire for continual improvement and development.

Q4(ii) If not, why not?

n/a

Q4(iii) If so, do you support any of the options identified for additional regulatory support under Strategy 1? [4.24]

See our responses to Question 3(iii) which apply equally here.

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?

Given the lack of statutory roles for actuaries in general insurance (outside of Lloyds), we would suggest that there is scope for specific initiatives to enhance the profile of actuaries in this area, which would include monitoring and scrutiny recommendations.

Pensions questions

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? [5.46]

Yes, the profession should build on the GN48 scope and application, as indeed it said it would over time, when GN48 was introduced.

However, the paper recognises correctly that the introduction of some options could lead to disproportionate costs (and not just for smaller schemes). We would urge POB to consider carefully a cost-benefit analysis for each option which it considers proceeding with.

Responding to the comments in paragraph 5.29, the level of scrutiny now undertaken by the Pensions Regulator (who has also focused on the conflicts faced by pension scheme trustees) gives significant independent review of scheme actuaries' work.

We would point out an error in paragraph 5.20 – under GN48, a reviewer is not required to hold a practising certificate, but rather the reviewer must be satisfied that he or she has the experience necessary to provide advice of the nature covered by the review. (GN48 para 2.8)

Q5(ii) If not, why not?

n/a

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? [5.47]

- **The development of relevant review and audit skills for actuaries through education and CPD (Option 1A)**
 - We agree that this would be an appropriate area for which the profession could provide CPD material. However, we doubt if it would be appropriate to include it in the educational syllabus, partly because such activities would tend to be carried out by more experienced actuaries, some time after qualification – and so CPD would be the more effective route.
- **The development of quality assurance standards or guidance on effective internal quality control procedures for actuaries and their firms. (Option 1B). This could be supplemented by increased transparency of professional review processes through publication of further research and statistics (Option 1C)**
 - Encouragement of quality assurance standards is of course to be welcomed. However we agree with the stated disadvantages of Option 1B, if this was to be

taken beyond simply encouragement, and so we would object to any formal guidance.

- We wonder if there is anything to be gained by collecting and publishing further research and statistics on review processes – the effort required both of firms, and of the profession (or POB) in doing so would be considerable, for questionable gain.
- **The development of more effective arrangements for reporting concerns about actuarial issues or actuarial work (Option 1D)**
 - We find it difficult to comment on this, in the absence of any evidence that the existing arrangements are not working satisfactorily, and in the absence of any specific proposals which would need to give protection to whistleblowers.
- **Extending the application of GN48 *Compliance review* to corporate restructuring work and assignments for the sponsoring employer (Option 2A)**
 - We agree that there is scope to extend the application of GN48, as mentioned under Q5(i) above. However, it will be difficult to do more than to require a general quality assurance review for corporate work, given that this is not a reserved role, and that there are no specific standards for such work.
- **Requiring external peer review which is independent of the actuary and his or her firm – possibly limited to schemes with 20 members or more (Option 2B)**
 - This would be a major departure from present practice for all but the smallest firms (and whilst we acknowledge the sentiment behind a possible limitation by size of scheme, we see no logical reason for such a limitation). However, auditing requirements for public interest entities (for pension schemes, this means schemes with more than 20,000 members or more than £1bn in assets) mandate greater levels of internal review of audit work. This concept could be exported to pensions actuarial advice.
 - Further, and more importantly, we would regard internal, pre-issue, peer review as being much more valuable than external post-issue review, which could easily turn into a relatively worthless box-ticking exercise.
- **Administrative monitoring of compliance with quality assurance requirements. (Option 2C)**
 - See our comment under the second bullet point above. We do not see any advantage arising from such additional efforts, which would simply add to bureaucracy and costs.

- **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)**
 - Pressure has been growing for some time for stricter independence requirements. We would agree that it is becoming increasingly untenable for the same individual actuary to provide full and unbiased advice to both the trustees and sponsoring employer of a pension scheme (regardless of scheme size).
 - In an ideal world, that prohibition would apply to firms as well as to individual actuaries. We would suggest that POB ascertains the views of these users of actuarial services, of the investment community, and of regulators, to assist in decisions on this.
- **The introduction of additional requirements for individual actuaries holding practising certificates which relate to the practice environment in their firm (Option 2E)**
 - We are not clear as to what is envisaged here. If the suggestion relates to quality standards, then our more general comments on quality standards in the second option in this question are relevant.
- **Requiring practising certificates for external as well as regulated actuarial advice (Option 2F)**
 - We do not support this option – there are considerable difficulties of definition, and a significant ‘grey area’ where advice can be given by non-actuaries. The imposition of a practising certificate requirement for actuaries could in fact encourage the role of non-actuaries in this area.
- **Allowing firms as well as individuals to obtain a practising certificate (Option 2G)**
 - Although there is some merit in this proposal, the legislative and consequent changes necessary to implement it would be considerable, and so we would not consider it to be worthwhile to pursue.

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

Firstly, the difficult issue of “which firms” needs to be addressed. Is the proposal to regulate any and all organisations which employ actuaries, or only those organisations which employ actuaries who carry out statutory actuarial functions, or something in-between?

We do think there is merit in investigating the regulation of firms which employ actuaries who carry out statutory roles, given the importance (as noted) of 'house' policies, internal quality procedures, and relationships between actuaries and other employees of the firm who also provide services to the same clients.

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 very strongly agree with the assessment in paragraphs 5.40 and 5.41 that Strategy 3 would be disproportionate. The costs of such a system would be, firm-for-firm, very significant, and further we would doubt that a sufficient number of suitable staff could be found for such an inspection unit.

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?

As a general comment, the emphasis should be on promoting quality, rather than on introducing yet more bureaucratic requirements (such as further box-ticking requirements for CPD).

But perhaps the most effective form of scrutiny is the public domain, if there could be a greater emphasis on whistleblowing and discipline.

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?

Again, we would see the right emphasis as being on promoting quality. Specific regulation is really only appropriate for statutory roles.



Final Question

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

No comments.