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Dear Christina

Monitoring and scrutiny of actuarial work

PwC is pleased to respond to the Professional Oversight Board's discussion paper on how the work of actuaries should be monitored for compliance with professional standards. We agree that monitoring and scrutiny need to be enhanced to protect the public interest and we support the Board and the Financial Reporting Council in moving this forward through wide-ranging discussion.

We encourage the Board to set aside short-term considerations and construct a monitoring and scrutiny system that is sufficiently robust to protect the public interest in future without the need for further change. With this in mind, it is important to look ahead, rather than looking backwards and concluding, perhaps wrongly, that because the existing system has not failed it is fit for the future. We should not wait until we are actually in a position to demonstrate any shortcomings before making changes. The recent turmoil in the financial markets serves to demonstrate just how quickly large and unexpected changes can occur.

Independent oversight of self-regulation

PwC has considerable experience of the success, and otherwise, of monitoring and scrutiny in other areas of professional advice. This has shaped our high-level view of how a monitoring and scrutiny framework should function for actuaries. We set out our suggestions below.

We suggest this should apply initially to all regulated positions (with some exclusions on grounds of proportionality, including advice provided by Syndicate Actuaries and some minor roles of Appointed Function Holders). Once it is in place and some experience has built up, consideration should be given to extending it to other areas of actuarial advice.

This framework can be summarised as independent oversight of self-regulation and it corresponds most closely to "Strategy 3", as defined in the discussion paper. We consider below how this could encompass the various practice areas and the appendix sets out our responses to the specific questions the Board is asking.

Enhanced peer review will not suffice

A key decision for the Board is whether to focus on strengthening peer review procedures and independence requirements or to introduce a system of external monitoring and scrutiny (of individual actuaries or firms) by the Profession or independently.

Whilst to our knowledge peer review has not demonstrably failed in the context of UK actuarial advice, it is instructive to consider how effective it is thought to be in other areas of professional advice and globally. In our experience, external peer review is regarded with increasing suspicion around the world. In the US in particular there is a widely held view that peer review has failed to protect the interests of recipients of professional advice in the auditing space and has become somewhat discredited. Some criticise it as being simply a route for reapportioning blame when things go wrong and having limited success at preventing problems in the first place.

Therefore, our view is that a monitoring and scrutiny framework that is reliant on external peer review will not suffice, even if the existing peer review requirements are tightened (for example to require review by an actuary independent of the advice-providing actuary's firm, and with clear standards of performance for the peer reviewer – such as ISQC1, the international standard for quality control for firms providing assurance, or international standards of auditing). Nor do we think users of actuarial advice will perceive peer review to provide the reassurance they seek. Some may question whether even external peer review can be effective, given that a relatively small number of firms provide the bulk of actuarial advice in the UK. Others may wonder whether actuarial peer reviewers would question adequately matters that have become established actuarial practice.

Active monitoring is preferable

Instead, we support the idea of independent monitoring and scrutiny by an "inspection unit". A similar process has been operating in the audit area and is widely regarded as having been very successful. That is not to say there is not a role for peer review; on the contrary, it is likely to remain a key component of most if not all firms' internal quality control and assurance procedures. An independent sample monitoring process limits the potential problems that have been identified with external peer reviews, not least protecting client confidentiality.

The primary goal of the inspection unit would be to ensure compliance with BAS Technical Actuarial Standards. It would achieve this in large measure through scrutinising firms' procedures rather than individual actuaries' work (although some random sampling may be an important part of monitoring firms' procedures). Some firms are already subject to standards such as ISQC1 (for example our firm's own pensions actuarial appointments and other actuarial engagements) which the Board may consider provide sufficient comfort. Those that are not subject to such recognised standards may have their own, but the onus would be on them to demonstrate their adequacy and consistency with recognised standards. This would help to produce more consistent standards across all firms.

To be effective, the inspection unit must not become pre-occupied solely with process matters and would need to be capable of making judgement-based decisions. This would require experienced staff at a senior level. We believe this could be achieved by secondments of practising actuaries or possibly the participation of retiring senior actuaries.

As well as clarity in the BAS Standards, there must also be clear ethical standards from the Profession, against which compliance can be assessed.

Application to practice areas

We believe the high level framework of monitoring and scrutiny should be common across all practice areas, although at a more detailed level there may be reasons for different implementation in different areas of work.

We think a high level framework based on active monitoring can be extended to cover the areas of life and general insurance with relative ease. In these areas, significant elements of regulated advice are subject to audit (on top of any peer review conducted within the firms).

For pensions, there are additional difficulties. Little work is subject to audit and, as the paper notes (and we agree), the existing professional peer review requirements (a) do not apply in a number of areas and (b) where they do apply (to Scheme Actuary advice) are not sufficiently strong.

Actuarial liabilities should appear in pension scheme accounts

Oversight from an inspection unit is the best way to address (a) and will to some extent address (b). However, we also suggest the FRC pursues the possibility that pension scheme accounts should be required to include actuarial liabilities, making much of the Scheme Actuary's advice subject to independent audit. With effective auditing practice standards, we think this would provide significant comfort to users of Scheme Actuary advice, without the need to introduce external peer review requirements. As Morris pointed out, audit and peer review are to some extent alternatives.

In summary, we propose a framework that provides for truly independent oversight of self-regulation. Flexibility is afforded firms to formulate their own internal procedures but these are subject to effective scrutiny by an independent inspection unit. We believe this is the best way to protect users of actuarial advice going forwards. We would welcome the opportunity to discuss this further with the Board.

Yours sincerely



Peter Tompkins
Partner

Appendix

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

For insurance, the increased scrutiny arising from the audit of regulatory returns has improved standards significantly. This is particularly so for life insurance, with a set of detailed regulations against which to audit; much less so for general insurance.

For pensions work: yes to a limited extent; but not enough. In some cases the introduction of GN48 will have enhanced scrutiny but most firms have always had adequate scrutiny procedures and will not have felt it necessary to change them following Morris or to comply with GN48 – other than for record-keeping purposes.

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

Yes (other than through audit of financial reporting).

Q3. *In life insurance, 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 in most areas: audit provides effective scrutiny of the financial reporting responsibilities of the Actuarial Function Holder and it may well be disproportionate to extend review requirements to the other responsibilities of this position. However, we believe that the work of the With Profits Actuary is subjected to significantly less monitoring and scrutiny, and review along the lines expressed above should be considered.

Q4. *In general insurance, 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, with the proviso that our recommendations set out in the body of this letter are carried out.

Q5(i) *In pensions, 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]*

No, we do not support enhancing the scope and application of GN48. Our suggestion – active monitoring – will enable firms to control their own internal procedures and provide users of actuarial advice with the comfort of oversight by an expert and independent body.

We also suggest that a more robust alternative to peer review would be to make Scheme Actuary advice subject to independent audit, by ensuring pension scheme accounts include actuarial liabilities.

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

See above. We do not consider peer review to be an effective form of scrutiny going forwards.

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]*

2G and 2E are possibilities.

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]*

We have no strong view on this. It would not be strictly necessary in order to implement our proposed framework; but equally it would not be problematic. A practising certificate for a firm (scheduling a list of approved actuaries) would be a very practical route. This works in a similar way with FSA investment advisers.

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 prefer a strategy along the lines of Strategy 3 in all circumstances.

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

The regime adopted by the FRC should be clear and sufficiently broad in its initial sampling of work to give confidence that high quality behaviours ensure.