

The Director
Board for Actuarial Standards
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31 January 2008

Dear Sir

Consultation Paper on the Conceptual Framework

We are pleased to respond on behalf of Deloitte & Touche LLP with comments on your consultation paper entitled "Towards a Conceptual Framework". The main part of this letter is limited to matters of principle, with more detailed comments in the appendix.

The place of standards

We welcome the paper and the process of consultation you have adopted. We believe that actuarial standards will be an important contributor to maintaining and improving the quality of work produced by actuaries, including (just as importantly) the way the work is presented, and the quality of discussion around risks and sensitivities of results. Standards that help actuaries to deliver more relevant, complete and comprehensible information to users, can only serve to enhance the standing of the profession and the value that we add.

Establishing a coherent overall framework

We are conscious that there are many moving pieces at the moment, with you, the profession, and the FRC/POB all doing important work. We think it is difficult to set standards when fundamental questions in other areas are not settled, but the FRC's strategic goal does not appear to align well with your proposed approach to standard setting (we return to this later). We further note that actuaries need to abide by professional/ethical standards as well as technical ones, but the demarcation for setting

these and monitoring compliance is not yet fully clear. Similarly, the extent of an actuary's duty to uphold the wider public interest as opposed to meeting his client's requirements, remains a topic for debate – the outcome of which must surely inform the standards you set. We think that in particular actuaries need to establish a clear understanding as to the extent of their accountability (and liability) to third parties in relation to their work.

We encourage BAS, FRC and the profession to work together closely to develop a coherent overall framework. Currently, we perceive a danger that their various initiatives will not align. By starting with the more clearly defined regulatory roles/requirements typical of Category A, and focusing your early work in that area, we believe it will be easier to achieve an aligned position.

We think it is also vital that the requirements ultimately placed on an actuary (whether ethical, technical, or required by legislation), are unambiguous, easily accessible and consistent. A lot of care will be needed to ensure that standards fit well with regulation, and the communication of any requirements will need to be carefully co-ordinated with the pronouncements of the other bodies we have mentioned.

Scope and categories of work

The consultation paper helpfully brings out the difficult issues around the scope of application of your standards. We agree that the Categories A-E suggested in the consultation paper could be helpful, but we are not convinced that the current proposals fit with the FRC's strategic goal as stated in section 2.8, i.e. that "users of actuarial information can place a high degree of reliance on the information's relevance, transparency of assumptions, completeness and comprehensibility". Users may not fully appreciate the distinctions – and may in any case have different priorities, expecting the application of standards for work not in Category A (say M&A reports), and being content to have a lower degree of comfort in other circumstances. The question of whether/how to restrict the geographical scope of the standards adds a further dimension; we comment on this further in the appendix.

The consultation paper also makes a number of references to the fact that work that is not within scope would be judged against "the standards of...competence and professional judgement reasonably expected of an actuary"; however, it is not clear how this benchmark would be established.

We therefore suggest that a helpful model might be to have a single generic standard setting out the core principles which should apply to all actuarial work in all five categories. This might cover the basic considerations that an actuary should take into account when approaching actuarial calculations (as set out in paragraph 8.3) as well as the communication of results. This standard would be issued by BAS with reinforcement via the Profession if appropriate.

Having thus established the fundamental principles applying to all work performed by actuaries, the BAS can then issue additional generic and topic specific standards, as discussed in the consultation paper. We would suggest that you limit those to Category A work at first. Presently we do not know what the standards will be like: how extensive, how detailed, how prescriptive – so it is difficult to come to a firm view on how they should apply to the other categories of work that actuaries do. It ought to be easier to set standards for Category A, and you could then build from this base, and get a much more informed debate for the more difficult categories that follow. Whatever route you choose, we encourage you to produce a list of the areas of work you would expect to be included in Category A.

Clarity of Application

Paragraph 5.17 of your paper raises an important and difficult point, that of actuaries working as part of a team. We can envisage circumstances where an actuary has authority for only part of a report, for example an M&A report including the funding of the pension scheme. How would the standards then apply, given that the wider report probably is not subject to other standards?

We note too that within a business, a manager could commission a report, and indeed have regulatory responsibilities around it. 5.17 as currently worded could have unfortunate consequences where that person happens to be an actuary – for example, a Finance Director overseeing the company accounts or a CEO who has asked for an M&A report. The framework must avoid situations where the determination of whether a piece of work is or is not subject to standards, depends on who commissioned it.

By its nature Category A work will normally have clear ownership, which may be another reason to progress that as a priority, giving more time to work through the more difficult areas.

Training and Education

Communication of the standards will need to be supported by training and education strategies. In particular, we presume that the education syllabus and CPD requirements will have to be extended to cover the standards. Is there clear ownership of these responsibilities?

Explaining the Risks

We disagree with some of the proposals around determining values. We would encourage you to put more emphasis on explaining the risks in any situation, showing sensitivities and giving users some indication of the degree of uncertainty underlying any analysis.

For example, we disagree with the proposal set out in paragraph 8.48(d) for actuarial quantification of liabilities to include an assessment of the probability that the assets held by the entity at the valuation date will be sufficient to meet those liabilities. A user may not wish to pay for the considerable amount of work it may take to arrive at such an estimate. We agree that it will often be useful additional information, but that should not make it a requirement. Secondly, we should not underestimate the difficulties involved in assessing this probability. In many circumstances (for example catastrophe insurance, or very long tail insurance), it may be unwise to attempt it. Even if the situation is simple, we are not convinced that it is the actuary's role to make such an assessment. To take your example in 6.20 D, if a client has an exact liability of 100 in ten years' time, and it is currently backed by 50 of equities, is it for us to assess the likelihood of success? What is it that would make us specially qualified to do so? It would be better for the actuary to discuss the risks involved, or to provide sensitivity analysis.

We hope that our comments will assist you in developing appropriate standards. Please contact one of the following if you would like to discuss any of the points we have raised: David Murray (Life Insurance, 020 7303 3372), Orlando Harvey Wood (Pensions (020 7007 2982), or Alex Marcuson (General Insurance, 020 7303 3378).

Yours faithfully

For Deloitte & Touche LLP

Appendix: Detailed Points

General comments

Overall we welcome the introduction of actuarial standards and, contrary to the concern you express in paragraph 3.21 that the requirement to comply with standards might put actuaries at a competitive disadvantage, we believe that existence of standards might actually enhance the reputation and standing of the work performed by actuaries and thus act as a positive competitive differentiator. Related to this is a point that the consultation paper does not address namely, the increased scrutiny to which actuaries, in common with other professions, are subject (e.g. Equitable Life and Independent Insurance). In view of this scrutiny and the associated risks of litigation, a robust framework of standards is likely to be of benefit to both actuaries and their clients.

We note that in paragraph 2.1 the BAS intends to focus on actuarial standards, rather than on actuarial reports or actuarial work, but we feel this may be a difficult distinction to make in practice, since it is our work and reports which form the basis of the decisions made by our clients. Indeed this seems to be recognised in section 3 where the categorisation refers to actuarial work.

We also have concerns over the proposed geographical scope. If we are acting for a global client, perhaps signing off a Group's embedded value, they might not accept that we would work to different standards of professionalism. This leads to the subject of proportionality – we think this needs to be addressed. A less rigorous review may be appropriate in some circumstances and still meet the user's requirements; provided this is mutually agreed (and there is no shortfall in meeting regulatory requirements), there might not need to be any additional overlay. We are concerned that this may lead into the kind of grey areas that we have generally argued against, so needs considerable thought – but it may be that this kind of distinction is at least as valid as those currently proposed.

Responses to specific questions raised in the consultation paper

Do respondents agree with the proposals:

a) to introduce some generic standards, to provide coherence and consistency across areas of work, in addition to the topic-specific standards as is the case now?

Other than as set out in the accompanying letter, at this stage we are unable to assess whether or not it would be useful to have some generic standards. Given the differences in approach to valuation and planning as set out in section 6 of the paper, it may be that any generic standards would be relatively brief. It is important that any standards do not reinvent existing regulation.

b) that standards be principle-based, rather than rule-based, identifying any advantages or disadvantages arising from this approach?

A principles based approach would be consistent with the prevailing attitude in financial regulation, and should prove to be more flexible in the longer term. It does though rely more heavily on interpretation, and the distinction is not always clear cut, as exemplified in 4.11 of the paper, where the suggested forms of standards for assumption setting could equally be regarded as rules. In general we favour a principles based approach, with the principles behind the rules being clearly stated in the standards.

c) that standards address outputs and responsibilities, as now, with output-based standards focusing on the users of actuarial services and their needs as decision makers?

We agree with this approach, but are not sure that the current proposals will achieve this goal. We recommend that you continue to consult widely with users of actuarial reports to understand their wishes and requirements.

Are there any practical issues or problems that should be addressed in relation to the enforceability of standards, as set out in Section 5, in order to ensure the efficient functioning of the enforceability proposals?

In 5.13 it is emphasised that an actuary will be required to give “proper reasons” to justify a decision not to follow a standard, when the “comply or explain” option applies. We feel it would be helpful if the BAS could give some guidance on what constitutes a “proper reason”. In category B work, it seems likely that it would be the entity commissioning the work which would decide whether or not the work should conform with any applicable actuarial standards, since the alternative is to engage a non actuary who would not normally be subject to the standards. (We recognise though that the entity could still request that the standards be applied even in that case.) Would it therefore be a proper reason that the entity commissioning the work did not require the standards be followed? As an example, this might be because the entity disagreed with a limit placed on a particular assumption in the standards.

If an actuary decides to “opt out” of complying in a particular case, how would the notification process work? He would presumably disclose this in his report, but would this be sufficiently meaningful to the user that it would be likely to lead to the escalation of unprofessional work? Is it intended that users should raise concerns with you direct, or that actuaries should be able to discuss matters in advance with you – and will you be resourced to do so?

Comments on sections 6 and 7 of the Consultation Paper:

The distinction between valuation and planning in section 6 is a useful one and is well made. The one area in which we do take issue in this section is 8b) of the example and the following paragraphs, which portray “the opposing view of the world”. This might be characterised as the financial economists’ view of the world. This view does not require the same investment expectations to be used in D, E and F in the example. It simply says that the market consistent value of the liability is as calculated in A, and that this should not take credit in advance for any expected investment performance (unless the benefits are dependent in some way on that performance, which is not the case in the example used). To the extent that a non matching investment strategy is pursued then profits and losses can be expected to emerge over time. The market consistent value of the liability is a more useful starting point for assessing what might be paid for transferring the liability than are the other measures derived in the example, but that is because a different question is being asked. The purpose of a market consistent valuation is not to introduce a degree of conservatism as is suggested on page 31; that could be provided in the example by selecting a percentile other than the median. The key point in 6.24 is that planning involves risk, and that the central estimate (or median) calculated in the example is on its own not helpful. Some idea of the spread of outcomes is necessary, and for that reason we do have sympathy with the aim of 8.48(d) in particular for planning.

We like the discussion on risk and uncertainty in section 7 of your paper. We would though question the statement in 7.32 that the probability of sponsor insolvency is not a factor that should be taken into account in a valuation. For certain applications, such a probability, albeit subjective, should definitely be allowed for. In an analogous insurance context, the probability of reinsurance default (and the default of other counterparties) is often required by regulation to be taken into account, in the same way that the market for corporate debt prices the risk of default.

Do respondents agree with the proposals in section 8 for:

a) the general principles set out in section 8.2?

We agree with these principles, to the extent that they are appropriate and relevant to the work covered by the standards.

b) the quantification principles set out in paragraph 8.3-8.30?

The concepts and principles set out in these paragraphs seem reasonable to us.

c) the generic reporting standard set out in paragraphs 8.31-8.55?

As stated in 2 (a) we are unable to assess at this stage whether a generic reporting standard is necessary. The example provided here is that of a generic standard relating to the reporting of actuarial work falling within the scope of the BAS standards. Given the comments in 2.1 to 2.3 of the consultation paper, we would be interested to know if the BAS has in mind writing generic standards for areas other than reporting.

As a general comment, in the absence of any commercial and time constraints on the scope actuarial work and reporting, we agree that actuarial reports would benefit significantly from the inclusion of much of the material in these paragraphs. In an insurance context, it is likely that the directors would receive a series of reports throughout the year which would contain much of the information in these paragraphs. However, there are specific reports such as those required to cover the calculation of reserves for insurance companies, where there is no regulatory requirement to include for example the detailed discussion of risks which seems to be envisaged in 8.42-8.47. Such discussion would more naturally be included in reports on capital adequacy and risk management, in particular reports on Individual Capital Assessment which are typically prepared by actuaries (and would presumably fall within category B). Our specific comments on these paragraphs are as follows:

8.37 and 8.41: Any decision regarding requirements to report undiscounted cashflows will need to take into account the circumstances of the particular industries. While in general insurance this is common practice, such a blanket requirement may prove unhelpful in the area of pensions and life insurance.

8.42-8.47: Setting out the key risks faced by an entity can involve a substantial amount of work, whose more natural home is in reports on risk management and capital requirements, rather than in standard regulatory valuation reports. Nevertheless, we do believe it is helpful to require actuaries to consider and communicate the uncertainties associated with the quantitative work they have carried out.

8.48 (b)&(c): We agree that some form of reconciliation to the previous valuation - an analysis of change - and some measure of the sensitivity of the valuation to various assumptions and to any uncertainties in the method itself will usually be very helpful. However, the scope of this analysis, where not specified in regulation, should be agreed between the entity and the actuary. Care will be needed by BAS in specifying this requirement so as not to introduce an unduly onerous requirement, inappropriate to the intended audience of the work being performed.

8.52-8.55 These paragraphs contain some very useful advice for report writers when probabilities need to be communicated.

Any practical problems in assessing the probabilities which the proposal calls for?

As noted in our main response, attempting to estimate such probabilities may sometimes be inappropriate. Even if it is appropriate, there are several practical problems: the uncertain distributions for many risks, how to combine the various risks in a sound way, the limitations of empirical frequency measures derived from past experience on which such probability estimates are typically based, and the fact that some things are genuinely unknown.

Any limitations on the usefulness of the information if one or more of the probabilities has to be omitted from the assessment?

It would be better not to quote a probability than to produce a “forced” one.

Standards and Guidance

Under the accountancy model the Accounting Standards Board issues the standards and the ICAEW issues, where appropriate, technical releases on how the standards should be interpreted. We think it important that the Profession should take an active role in supporting the members in the application of the standards.

Urgent issues

What will the process be if an urgent technical issue arises but there isn't time to go through the full consultation process? Again using the accountancy profession as a comparison, the FRC includes the Urgent Issues Task Force whose role is to get guidance out quickly to deal with immediate needs and then issues/updates standards in due course.