

BAS Consultation Nov 07

Though my comments are informed by my experience at the FSA, none of them should be taken as representing FSA views. I have not attempted to order my comments in order of importance.

Categorisation of actuarial work: reviewing actuary

The work of the reviewing actuary in life assurance is not, or may not be, just monitoring the work of the actuarial function. IPRU(INS) 9.35(1A) requires the insurer to ensure that the auditor obtains ... advice from a suitably qualified actuary ... independent of the insurer. The scope of that advice is not limited, as BAS suggest, to audit of the actuarial work. For instance the reviewing actuary should presumably¹ seek to ensure that the audit team properly understand the scope and implications of the actuarial work for the rest of their audit and, in particular, what parts of the data used by the actuary are most material. IPRU(INS) does not specify the scope of that advice which leaves a lacuna that BAS standards might fill.

While the nature of the standards applying to the reviewing actuary role might be very different to those applying to other roles and it may be that this is not an immediate priority, that does not justify never applying standards to that role. Indeed IPRU(INS) requires (albeit indirectly) the auditor to commission the reviewing actuary so the role falls squarely within category A.

Categorisation of actuarial work: S166 reports

The consultation does not make clear the categorisation of a report that the FSA requires a firm to commission under S166 of the FSMA. The requirement to produce a report does not arise from regulation but from an ad hoc decision of the FSA. FSA needs to rely on a S166 report at least as much as on the routine reports required by its rules. Therefore a S166 report should be treated as if it fell within category A or B, as appropriate.

Category C & D work

BAS proposes that work within these categories should not be subject to its standards, though it may be prepared to make exceptions in particular circumstances. This is a significant shift from the current position whereby GN12 applies to any general insurance actuarial report (subject to the “*should normally*” override).

The reasons given include that the entity commissioning the work determines for itself that the work is necessary and is free to choose the terms of reference. This might be adequate justification where those commissioning the work fully understand the implications and third parties are not expected to rely on the advice. But this is not invariably the case. For

¹ As I was not involved in the policy discussions leading up to the establishment of the reviewing actuary role, this is pure inference.

instance, small general insurers may be relatively unsophisticated and not fully understand what standards are appropriate: indeed they may be largely dependent on their actuarial advisers for guidance on this. While most large insurers have a good understanding of actuarial matters and can normally be expected to look after themselves, there have been times when some have lacked understanding and, of course, it may be that those who commission the actuary lack the necessary understanding.

While it is true that inadequate work may give rise to charges of misconduct, in the absence of agreed standards it is more difficult to pursue such charges.

Where the actuary knows or should know that the work is or is likely to be relied on by third parties there is even more need for standards.

The wide variety of work within categories C & D may make it difficult to create standards that are generally applicable, and any standards may have exceptions. That is no reason for not seeking to create standards, though BAS may be correct to consider that categories A & B should have priority.

In my view, if BAS standards are applied to categories C & D, it should not be sufficient for the actuary to state that the work is non-compliant. She should also explain.

Comply or explain

This would seem a sensible and proportionate approach as justification is needed. I assume that it would be necessary for the explanation to be one that the majority of the actuary's peers would accept as reasonable in the circumstances. In practice the effect may be similar to that of "should normally" in GN12.

Principle based

I endorse this approach, though the challenge of writing clear, unambiguous principles should not be underestimated. However on balance a better result is likely to be achieved than by a rule based approach, leading to a box-ticking mentality and a search for loopholes enabling the spirit of the rules to be broken while the letter is adhered to. Guidance, explaining the application of the principles in clearly defined situations, would be helpful.

Working in a non-actuarial team

BAS standards should also apply in circumstances where the actuary is responsible for an identifiable sub-component of the work. Otherwise the principle enunciated is broadly correct. It needs to be carefully phrased to prevent avoidance (by, for instance, placing a non-actuary in nominal charge of the team). There may also be cases where the work of an actuary is not actuarial in nature (hard to define as most work by actuaries is regarded as actuarial), so that BAS standards should not apply; but the comply or explain approach may be sufficient to deal with this.

Geographic scope

This does not seem quite right. For instance BAS standards should cover reports on overseas branches of an UK life insurer for included in an FSA return. Likewise it should not cover reports to the home State of an US general insurer on its UK branch. It should apply to independent experts' reports on Part VII transfers, including those covering business carried on in other EEA member states, but would not apply to any similar reports covering UK business prepared under similar legislation in another member state.

Probability of sufficiency

This would be inappropriate for a Lloyd's syndicate – it ignores the way business at Lloyd's is carried on and the existence of members' funds at Lloyd's that are not controlled by the syndicate's managers. It would be also be a significant extension of scope for any investigation into insurance liabilities, and would not readily fit into either the solvency 2 framework or FSA's current ICAS process.

If certain risks are omitted, then the assessment of probability is likely to be misleading.

Example in 6.20

This example is instructive. I am one of those who consider that the calculation of the central estimate in case D (that assuming equity out-performance) is one that should not be done, at least in isolation. For planning purposes the possibility that the desired performance may not be met should be considered and plans should be made to cope with this contingency.

The reaction to the stock market falls earlier this decade suggests that, for a significant proportion of pension schemes, such plans were not considered in sufficient depth by scheme sponsors and trustees and that they had assumed equity outperformance would continue indefinitely without significant fluctuations.

Para 8.55

I consider it worrying that the reporting standard will be deemed to be met if all the specified material is included irrespective of its quality. The quality of the underlying work may be covered by other parts of the standard but the report should be reasonably clear to its intended audience.

There are things that can and should be done to make reports more comprehensible; for example: separating the main conclusions and broad reasoning from detailed workings, omitting irrelevant detail, using non actuaries to review drafts and testing them to see what they understand, "plain Englishing" to ensure that the report is readable and that there is no unnecessary jargon.

Minor points

6.5(4/5) These paragraphs are too inaccurate to serve as a broad overview.

7.32 The second sentence may be too sweeping as it stands. In a different context, this type of calculation is likely to be required when valuing reinsurance recoveries under Solvency 2 (see, for example, the draft QIS4 specification).

8.18 It is surprising that the risks associated with inflation and legal change are considered less important than catastrophe risks for general insurance. Also asbestosis, perhaps the biggest single cause of loss to hit the industry, was not a catastrophe as defined in the paper.

8.36(c) If there is no material difference then it would normally be appropriate to say so rather than leave the reader of the report to guess.

8.37 It is not clear what is required in the case of a valuation prepared on a deterministic basis, supplemented by a valuation of options.

8.39/40 The words in 8.39 carry a real implication of sufficiency, and would lead many readers to assume that they could sleep easily in their beds and not worry about stock market falls or fluctuations. What is meant is “£15m of assets today would suffice to meet the liabilities if the assumed rate of return on the scheme’s investments is achieved.” Similarly in 8.40 the investment return assumption is not just taken into account, it is used in the calculation.

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