



BOARD FOR ACTUARIAL STANDARDS

**THE FUTURE OF ACTUARIAL STANDARDS IN
EUROPE**

RESPONSE TO CEIOPS CONSULTATION PAPER
LEVEL 2 IMPLEMENTING MEASURES ON SOLVENCY 2:
SYSTEMS OF GOVERNANCE
CEIOPS-CP-33-09

JUNE 2009

1 INTRODUCTION

- 1.1 The Board for Actuarial Standards (BAS) welcomes the opportunity to comment on consultation paper 33 from the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS); Draft CEIOPS Advice for Level 2 Implementing Measures on Solvency II: System of Governance (CP33).
- 1.2 We congratulate CEIOPS on producing this consultation paper, which adds more clarity to the thinking behind the Level 2 rules and, in our view, avoids over prescription.
- 1.3 Governance is of crucial importance in insurance firms. Risk management is at the heart of insurance, and it is the governing bodies and senior management who are responsible for it. Good systems of governance are vital in ensuring that the decision makers have the appropriate information on which to base their decisions, and that they fully understand the implications of the models on which they rely. Good governance helps to bridge the communications gap between the technical specialists who produce the information and those who use it.
- 1.4 The proposals in the paper will assist all insurance firms in ensuring their governance systems are appropriate, and so will contribute to improving management within the insurance market across the EU.

THE BOARD FOR ACTUARIAL STANDARDS

- 1.5 The BAS, which was established in 2006, is responsible for setting technical actuarial standards in the UK. It was established by the Financial Reporting Council (FRC) at the request of the UK Government. The FRC is responsible for promoting high standards of corporate reporting and governance in the UK. The BAS is, therefore, independent of the UK's professional actuarial bodies, which do not set technical actuarial standards. It is the world's first fully independent setter of actuarial standards.
- 1.6 The BAS is one of the six operating bodies of the FRC. The FRC Board appoints the members of the BAS and oversees its effective operation; but the BAS itself is responsible for issuing technical actuarial standards. The FRC brings together regulatory functions in relation to corporate governance, corporate reporting, auditing, actuarial practice and the professionalism of accountants and actuaries. It operates on the basis that there are strong connections between these issues and that the breadth of its functions enhances its effectiveness. In setting technical actuarial standards, the BAS has regard to the FRC's Regulatory Strategy, which sets out the broad outcomes which the FRC is seeking to promote - including the actuarial standards which contribute to the provision of clear and complete actuarial information. The FRC's annual plan sets out the actions which the FRC takes to contribute to the achievement of these outcomes - including outcomes in respect of the usefulness of actuarial standards.
- 1.7 The BAS's primary objective is that users of actuarial information should be able to place a high degree of reliance on the information's relevance, transparency of assumptions, completeness and comprehensibility, including the communication of any uncertainty inherent in the information.

- 1.8 The BAS has a Board of up to fifteen members, drawn from a wide range of users of actuarial information as well as practitioners. Currently, half the members are actuaries. There are also several observers, who attend Board meetings, representing regulators, the actuarial profession, and other interested parties. The composition of the BAS Board ensures that the primary focus of the BAS on the users of actuarial information is maintained.
- 1.9 The BAS is funded through levies on the pensions and insurance industries (45% each) and a contribution from the Actuarial Profession (10%).
- 1.10 In carrying out its work, the BAS is committed to:
- working on the basis that well informed users are central to the effectiveness of the regulatory framework;
 - targeting the use of its powers, taking a proactive, risk-based and proportionate approach, and making effective use of impact assessments;
 - emphasising principles and clarity in its standard-setting; and
 - being consultative – involving preparers, users of corporate and actuarial reports, the wider public and other regulatory organisations in its decision-making and allowing adequate time for consultation, without compromising confidentiality or its independence.
- 1.11 The BAS is part of the wider framework of actuarial standards and regulation operated by the FRC. The FRC's Professional Oversight Board (POB) oversees the role of the Actuarial Profession in regulating the activities of actuaries in the UK, including their compliance with technical actuarial standards and appropriate ethical and conduct standards. The FRC's Accountancy and Actuarial Disciplinary Board (AADB) provides independent arrangements for investigating and, where appropriate, taking disciplinary action in public interest cases involving members of the actuarial professional bodies.

OUR RESPONSE

- 1.12 We have limited our response to matters concerning the actuarial function (in paragraphs 3.249 to 3.309 and Annex B of CP33) and some aspects of the risk management function (paragraphs 3.178 to 3.192).
- 1.13 In section 2 we discuss the standards to be applied by the actuarial function in exercising its tasks. Of the three options presented in paragraph 3.253 we, like CEIOPS, prefer option 3 (European-wide standards to be developed by a separate body), but believe that the list of options presented by CEIOPS is not complete. The key points of our response are:
- The standards that are developed should have the objective of assisting the users of actuarial information in the decisions they make; they should be written so that anyone, whether an actuary or not, can comply with them; and there should be standards for ethical and conduct matters as well as for technical matters.
 - The endorsement should be of the standard setting body, not of individual standards; and there should be a clear separation between the functions of the standard setting body and those of the prudential regulators.

- The standard setting body should be independent of the entities (such as insurance undertakings) and practitioners (and their professional bodies) that have to comply with the standards; it should be international and multi-jurisdictional, and if established as a regional European body should be seen as a step towards the establishment of a global body; and it should set standards that apply across the range of actuarial work (including at a minimum both insurance and occupational pensions).
- In order to ensure its independence, the body should include users of actuarial information as well as other stakeholders; it should be securely and sustainably funded; and it should be publicly accountable.
- The body should be established on a permanent basis with a professional staff; and it should develop its standards through a fully consultative process.

1.14 In section 3 we discuss some of the other proposals in CP33.

CONTACT

1.15 We will be happy to discuss any points arising from our response. All queries should be addressed to

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2 DEVELOPMENT OF ACTUARIAL STANDARDS

INTRODUCTION

2.1 Paragraph 3.253 of CP33 presents three options for the development of technical standards for the actuarial function:

Option 1: The function should use technical standards developed by CEIOPS on Level 3.

Option 2: The function should rely on technical standards that are widely accepted in the industry and the profession.

Option 3: The function should rely on European technical standards to be developed and endorsed by a body of representatives of different stakeholders, including CEIOPS.

2.2 We share CEIOPS's view that a high level of convergence is not likely to be achieved if standards are issued by national actuarial associations or other national standard setting bodies. In addition, standards set by national actuarial associations are likely to be developed by practitioners in order to assist other practitioners. As we discuss below, we believe that it is important that standards do not have as their primary purpose the assistance of practitioners and that they are developed with input from a broad range of stakeholders.

2.3 Convergence is more likely to be achieved through either option 1 or option 3. Of the two, we prefer option 3 because we believe that standards should be developed with input from a broad range of stakeholders.

2.4 However, the list of options presented by CEIOPS is not complete. The discussion in paragraphs 3.256 to 3.259 appears to envisage that the body developing standards should be a Europe-wide body, set up specifically to develop actuarial standards for Solvency II. Based on its experience in the areas of accounting and auditing, the FRC (of which the BAS is a part) believes that there are a number of advantages to an independent world wide body, setting standards across the whole range of actuarial work, including pensions as well as insurance.

2.5 If actuarial standards for Solvency II are set by a separate standard setting body, the following issues will need to be considered:

- the objective and nature of the standards developed by the standard setting body;
- the interaction between the body and the prudential regulators, including the nature of any endorsement;
- the nature of the body, including its scope;
- its governance and funding; and
- how it should operate.

2.6 We discuss these issues in turn.

OBJECTIVE AND NATURE OF STANDARDS

- 2.7 The BAS has a clearly stated Reliability Objective, which all its standards are intended to support: that the users for whom a piece of actuarial information was created should be able to place a high degree of reliance on the information's relevance, transparency of assumptions, completeness and comprehensibility, including the communication of any uncertainty inherent in the information. We have found that having a clear objective such as this provides an invaluable focus when developing standards.
- 2.8 Paragraph 3.250 of CP33 explains CEIOPS's understanding that the Directive prescribes the establishment of an actuarial function as a measure of quality assurance in order to ensure that decisions in undertakings can be taken based on expert technical actuarial advice. We believe that this understanding is a clear statement of the purpose of the actuarial function, and indicates that the objective of actuarial standards should be to ensure that the information and advice provided by the actuarial function gives the best possible support to those who make decisions based on it.
- 2.9 We believe that the objective of actuarial standards should be to serve the public interest by assisting those who use and rely on actuarial information. Standards may accomplish other things as well, such as providing assistance to practitioners, but we believe that those potential benefits should be incidental to the primary objective.
- 2.10 We therefore recommend that the actuarial standard setting body should have a clear objective for its standards that makes it explicit that they are intended to assist the users of actuarial information in the decisions they make.
- 2.11 The scope and applicability of the standards should also be considered.
- 2.12 The tasks specified for the actuarial function cover a wide range, including contributing to the effective implementation of the risk management system. Moreover, the actuarial function does not have to be performed by actuaries. We therefore recommend that the standards should be written in such a way that any person working in either the actuarial or risk management functions (or indeed any other area) can comply with them. As a matter of policy, we have taken this approach in our own standards, which describe the outcomes to be achieved without specifying who should achieve them. We are able to do this because the BAS is an independent body, rather than a body of practitioners setting standards only for its own members.
- 2.13 CEIOPS appears to envisage that the actuarial standards would cover technical matters only, omitting coverage of ethical and conduct issues. However, if convergence is desirable for technical matters it is also desirable for matters such as integrity, objectivity and whistle-blowing.

- 2.14 Earlier this year the FRC published its *Actuarial Quality Framework*, which identifies the following drivers of actuarial quality:
- Methods: Reliability and usefulness of actuarial methods
 - Communication: Communication of actuarial information and advice
 - Actuaries: Technical skills of actuaries and Ethics and professionalism of actuaries
 - Environment: Working environment for actuaries and Other factors outside the control of actuaries.
- 2.15 Actuarial quality is thus supported by both technical and ethical aspects of actuarial work, and we believe that both aspects should be addressed by actuarial standards.
- 2.16 In the UK there is a split between technical matters on the one hand and ethical and conduct matters on the other, with the BAS responsible for technical standards and the Actuarial Profession responsible for ethical and conduct standards (and other aspects of professional regulation) subject to independent oversight. Although in many cases the boundary is clear, we have found that in some areas it is difficult to disentangle the two types of issue. On balance, therefore, we think that the standards covering technical matters should also cover relevant ethical and conduct matters, rather than having separate standards for the two.
- 2.17 We therefore recommend that Europe-wide technical actuarial standards should also address ethical and conduct matters.

INTERACTION BETWEEN STANDARD SETTING BODY AND PRUDENTIAL REGULATORS

- 2.18 If actuarial standards for Solvency II are to be set by a body other than CEIOPS, consideration needs to be given to the interaction between that body and the prudential regulators.
- 2.19 Paragraph 3.253 of CP33 implies that the standards should be endorsed by a body of representatives of different stakeholders, including CEIOPS. Paragraph 3.258 implies that the endorsement process could be implemented via Level 3 guidance. It is not clear whether it is the endorsement by CEIOPS that is of primary importance, or the endorsement by the stakeholders. In either case, there are two possibilities: it could be the standard setting body that is endorsed, or the individual standards.
- 2.20 The endorsement of individual standards would compromise the independence of the standard setting body, as the ultimate arbiter of the standards would be the endorser rather than the body itself. There is a risk that only those standards that suited the immediate agenda of the endorser would be chosen, regardless of their broader merit or of any interactions between them. The drawbacks of this approach can be seen in the accounting sphere, with the piecemeal adoption of IFRS standards.
- 2.21 We recommend that the standard setting body itself should be endorsed, rather than individual standards; this would require the body to be truly independent, be drawn from a broad range of stakeholders, and have effective governance mechanisms in place.

- 2.22 There are (at least) two ways in which the standards could interact with the requirements of prudential regulators.
- 2.23 The first option would be for the standards to fill in the gaps of the prudential regulators' requirements. This could only be effective if the standard setting body shared the regulators' objectives. As we discuss above, we believe that the standard setting body's objective should be to assist those who make the decisions.
- 2.24 A second option would be for the standard setting body to consider how the actuarial function should best perform its tasks in order to provide high quality support to the decision makers.
- 2.25 Under this option, the standards could, for example, set out how calculations should be performed. The regulators could then determine the solvency requirements taking the calculation methods into account – they could, for example, perhaps on a counter-cyclical basis, adjust the levels of capital required if the actuarial standards mandated a best estimate calculation of technical provisions.
- 2.26 We recommend the second approach, which would allow a clear split between the functions and purposes of the various parties: prudential regulators ensuring solvency, and the actuarial standard setting body ensuring the use of sound techniques. We believe that the degree of prudence required to ensure solvency should be a matter for prudential regulators, not for actuarial standard setters, which should concentrate on ensuring that the information on which the relevant decisions are based is of high quality.

STANDARD SETTING BODY

- 2.27 We believe that it is important that the standard setting body should be independent of both the entities (such as insurance undertakings or occupational pension schemes) that the standards affect, and the practitioners (and their professional associations) who comply with them. This will enable it to set standards that serve the common good, free from undue influence.
- 2.28 CEIOPS favours a single body setting standards across Europe, in order to promote convergence of actuarial practice. Convergence of actuarial standards is an issue that is growing in importance as multinationals operate over increasing geographical ranges and in increasing numbers of jurisdictions.
- 2.29 We agree with CEIOPS that convergence is unlikely to be achieved if standards are set by a number of different bodies which may treat the following matters (among others) differently:
- the purpose of standards – for example, whether the aim is to provide assistance to practitioners or to the users of actuarial information;
 - the degree of prescription of methods and assumptions;
 - the extent to which ethical and conduct matters are to be included; and
 - the weight to be given to proportionality and materiality when developing and complying with standards.
- 2.30 However, these arguments are as valid when applied globally as they are when applied across Europe. In particular, there is a risk that the

establishment of a body setting standards only for the EU would do little to promote convergence with standards in other major economic areas such as America. In our view, the establishment of any regional body should therefore be a stepping stone to the eventual establishment of a global body, rather than an end in itself.

- 2.31 CEIOPS appears to envisage that the body would develop actuarial standards covering only those matters relevant to Solvency II.
- 2.32 Different areas of actuarial work have much in common, and we think that where there are commonalities the same standards should apply. Our generic standards on *Data, Modelling and Reporting Actuarial Information* will apply to much of the actuarial work performed in both pensions and insurance, as well as in other areas, and will therefore be effective mechanisms for ensuring consistent quality of actuarial work across different fields.
- 2.33 We believe that any actuarial standard setting body should set standards across the range of actuarial work, including at a minimum both insurance and occupational pensions (both of which are within the remit of CEIOPS).

GOVERNANCE AND FUNDING

- 2.34 The governance arrangements for an international actuarial standard setter will be vital in ensuring its independence and the quality of its standards.
- 2.35 We believe that if, as we recommend above, the objective of the proposed standard setting body is to serve the needs of users, there must be strong user representation on the body. Users include directors and managers of insurance undertakings, trustees or other governors of pension funds, pension fund sponsors, insurance company policyholders and pension fund members. Other stakeholders, including regulators as well as practitioners, should also be represented. It is our experience that a broad range of interests on a standard setting body helps to ensure that no single interest dominates, and that the overall purpose of the body's standards is not compromised.
- 2.36 For an international body, issues that need to be considered include:
- The size of the body;
 - Geographic spread of membership;
 - Split between voting membership and observer status;
 - The skills and expertise of the individual members; and
 - Whether members should be appointed as individuals or as representatives of particular constituencies.
- 2.37 The funding arrangements are also a significant determinant of independence. The funding mechanism should be secure and sustainable, and free from any taint of vested interests (such as voluntary contributions from large commercial or professional organisations).
- 2.38 Consideration also needs to be given to how the status and governance of the body might affect the status of its standards. It is, for example, often difficult for governmental or other official bodies to delegate authority to private organisations. If an international actuarial standard setting body is established as a private body, there needs to be a mechanism by which it is

publicly accountable so that official bodies can mandate the use of its standards.

- 2.39 An alternative is for the body to be established as an official institution. Possible European precedents include the European Central Bank and Eurostat, as well as some of the institutions being considered as part of the de Larosière recommendations. Such a body would have accountability built into its constitution, and regulators would therefore be able to accord mandatory status to its standards.
- 2.40 There are useful lessons to be learned from the experience of the establishment and operation of the International Accounting Standards Board (IASB) and its parent, the International Accounting Standards Committee Foundation (IASCF), which would help to avoid many of the problems the IASCF has faced.

OPERATIONS

- 2.41 An international actuarial standard setting body could operate through volunteers or secondments from stakeholder organisations, or it could have a permanent staff. Our experience indicates that a permanent staff is much more effective for several reasons, including:
- there are fewer conflicts of interest;
 - volunteers often have other calls on their time, and it is difficult to develop standards in a timely manner using only volunteers;
 - permanent staff are better able to build effective working relationships with each other and with stakeholders.
- 2.42 We believe that the body should be established on a permanent basis with professional supporting staff. Its work will not be complete once the first tranche of standards has been developed. Changes, enhancement and maintenance will be required as regulation, industry practice, and economic and financial circumstances change, and as actuarial techniques develop and mature.
- 2.43 The process for developing standards needs to be considered. We recommend that the process should be fully consultative, like that used by the BAS. This has the potential disadvantage that standards may take longer to produce, but helps to ensure that, when they are produced, fewer unexpected problems are encountered. The BAS has a clear policy that its development process is not consensual: it consults with stakeholders, and listens to views, but the final decisions about standards are the BAS's alone. This type of process is, in our view, appropriate for an independent body.
- 2.44 A major difficulty is likely to be that of developing standards in time for the implementation of Solvency II in October 2012. In order for compliance to be practicable, standards must be promulgated some months in advance of their effective date. It would be desirable for the core standards to be complete by, say, the end of 2011. On the other hand, it will inevitably take some time to set up a suitable standard setting body – from our experience at the BAS, we doubt whether it could be done in less than 3 months once its final form had been determined (which would itself take some time). The time available in which standards could actually be developed is thus less than two years.

- 2.45 The BAS had some considerable difficulty at the beginning of its life in establishing a conceptual framework for how it would develop standards. A new international body would, we hope, be able to learn from our experience and build on the work we have done, but would face challenges that we have escaped. Current international practice varies widely, and an international body would have to work out how to reconcile the many different approaches that are used.
- 2.46 Ideally the new body would be established in time to produce a full set of standards for the implementation of Solvency II. This will be a challenge, so we recommend that, if the timetable slips, CEIOPS should consider making interim arrangements. For instance, it might like to consider the interim endorsement of existing standards. In our view, such endorsement should be given only to standards having the objective of ensuring that actuarial information gives the best possible support to those who make decisions on it, rather than having the objective of assisting practitioners.

3 ACTUARIAL FUNCTION

KEY POINTS

- 3.1 Paragraph 3.262 of CP33 presents two options for interpreting the list of mandatory tasks for the actuarial function. We agree with CEIOPS in preferring option 2, that the general scope of the tasks should be prescribed on level 2 to some extent.
- 3.2 Paragraph 3.283 presents two options for the reporting requirement of the actuarial function. Again, we agree with CEIOPS in preferring option 2, that annual reporting should be required but that the level of detail should not be prescribed on level 2. However, we believe that, although the details should be left to the undertakings, there should be an actuarial standard that describes principles that should be complied with in reporting the information.
- 3.3 There is potential overlap between the scopes of risk and actuarial functions and the tasks that they perform. We recommend that actuarial (or other standards) that would apply if work were performed within the actuarial function should also apply if the work were instead performed within the risk management function (and vice versa).

ESTABLISHMENT OF AN ACTUARIAL FUNCTION

- 3.4 Paragraph 3.250 of CP33 explains CEIOPS's understanding that the Directive prescribes the establishment of an actuarial function as a measure of quality assurance in order to ensure that decisions in undertakings can be taken based on expert technical actuarial advice. We believe that this understanding is a clear statement of the purpose of the actuarial function, and that actuarial standards should serve this purpose.

SCOPE OF THE TASKS OF THE ACTUARIAL FUNCTION

- 3.5 Paragraph 3.262 presents two options for the interpretation of the list of mandatory tasks of the actuarial function in Article 47(1):

Option 1: It should be left to undertakings to decide on the scope of these tasks individually.

Option 2: The general scope of the tasks should be prescribed on Level 2 to some extent.

- 3.6 CEIOPS favours the Option 2 approach (paragraph 3.265). It believes that there should be minimum tasks that are performed by the actuarial function, but that the undertaking should be free to organise its internal operations as it sees fit.
- 3.7 We agree with CEIOPS's preference. We believe that it is desirable that the quality assurance provided by the actuarial function (see above) should be available to undertakings across at least a minimum range of tasks.
- 3.8 CEIOPS recognises that the tasks allocated to the actuarial function may be more extensive than this minimum level, and we would expect this to be the case in practice.

REPORTING OF THE ACTUARIAL FUNCTION

3.9 Paragraph 3.283 presents two options for the reporting of the actuarial function:

Option 1: Require annual reporting with definition on Level 2 of its structure and content

Option 2: Require annual reporting but leave the decision on the details up to the undertakings as stated in paragraph 3.10.

3.10 CEIOPS favours option 2, on the grounds that it would be excessive to define the structure and content of the report in level 2 (paragraph 3.287). We agree that option 1 is excessive, and that the details of the structure and content should be left to the undertakings.

3.11 Paragraph 3.309 sets out the proposed purpose of the annual report. We believe that there are some general criteria that should be met by the annual reports, regardless of their structure. Both their content and structure should reflect the needs of the body whose decisions they are intended to assist. They should be clearly written so that users will understand them. We believe that such criteria should be provided through an actuarial standard.

APPLICATION OF ACTUARIAL STANDARDS OUTSIDE THE ACTUARIAL FUNCTION

3.12 The risk management function is responsible for the risk management system and the internal model. The framework recognises that this may require the input of the actuarial function, and that actuarial methods may be required.

3.13 There is no generally accepted definition of what is, or is not, an actuarial method. We have some concern regarding convergence given that actuarial standards will be developed that will apply to work if it is performed within the actuarial function, but may not be applied if the same work was performed within the risk function.

3.14 We therefore recommend that the same standards should apply when work is performed within the risk function as when it is performed within the actuarial function. This will be possible, if, as we recommend above (see paragraph 2.12), standards are written in such a way that anybody, regardless of whether they are an actuary or working in the actuarial function, can comply with them. Such standards can, we believe, only be developed by a body that is independent of practitioners. A standard setting body consisting only of actuarial practitioners would lack the necessary authority and independence if its standards are to be followed by others.