



**FINANCIAL REPORTING COUNCIL**

**ACTUARIAL STAKEHOLDER GROUP SURVEY OF THE  
NEEDS OF PRINCIPAL USERS OF ACTUARIAL SERVICES**

**FINDINGS AND IMPLICATIONS FOR THE WORK OF THE FRC**

**JULY 2007**





**FINANCIAL REPORTING COUNCIL**

**ACTUARIAL STAKEHOLDER GROUP SURVEY OF THE  
NEEDS OF PRINCIPAL USERS OF ACTUARIAL SERVICES**

**FINDINGS AND IMPLICATIONS FOR THE WORK OF THE FRC**

**JULY 2007**

**The FRC and the Actuarial Stakeholder Group would welcome comments on this survey and on the implications for the work of the FRC and other bodies in relation to actuarial practice by 30 September 2007. In particular, views are invited from stakeholders on whether they share the views of survey participants and have additional or alternative points to add. Also whether the FRC should undertake any additional activities in this area.**

Anna Colban  
Financial Reporting Council  
Fifth Floor  
Aldwych House  
71-91 Aldwych  
London WC2B 4HN

e-mail to: [a.colban@frc.org.uk](mailto:a.colban@frc.org.uk)

## Contents

		<i>Page</i>
One	Introduction: what about the user?	1
<hr/>		
Two	Actuarial Stakeholder Group report on survey findings	3
<hr/>		
Three	FRC response to the Actuarial Stakeholder Group	14
<hr/>		
Four	Research Reports	
	i) Opinion Leader Research: survey of pension scheme trustees	17
	ii) iQ Research: survey of insurance company non-executive directors	35
<hr/>		
Annex A	Background to the FRC, the Actuarial Stakeholder Group and this survey	58
<hr/>		
Annex B	Membership of the Actuarial Stakeholder Group	60
<hr/>		
Annex C	Methodology for the survey of pension trustees	61
<hr/>		
Annex D	Methodology for the survey of insurance company non-executive directors	65
<hr/>		



## One - Introduction: what about the user?

### TRUSTEE VIEW

*"It's got to be much more open and professional, clearly communicated and assumptions explained."*

Following the Morris<sup>1</sup> Review of the Actuarial Profession, published in March 2005, the Government asked the Financial Reporting Council (FRC) to take on responsibility for independent oversight of the UK actuarial profession and the independent setting of actuarial technical standards. In accepting this role in April 2006, the FRC set itself the challenge of ensuring its work meets the need of the users of actuarial information and advice, as well as the expectations of the wider public.

During 2006, the FRC's Board for Actuarial Standards (BAS) and Professional Oversight Board (the Oversight Board) established an Actuarial Stakeholder Interest Working Group (Stakeholder Group), to advise them on the development of a conceptual framework for actuarial standards, and on the work of the Oversight Board. This Stakeholder Group (whose membership is set out in Annex B<sup>2</sup>) does not cover the whole range of stakeholders, some of whom are represented either as members of the FRC's Boards or as Board observers, such as the associated regulators. Rather, it seeks to draw in those whose views might not otherwise be heard, such as representatives of consumers, the public interest, journalists, pension trustees, IFAs (who advise consumers), demographers and so forth. Clearly there are many other stakeholders, in addition to regulators, particularly the profession itself, government, executive directors and management, auditors and others in the financial world. Thus this Group, and this piece of work, only represents one slice of the world affected by, or contributing to, the work of actuaries.

For the immediate purposes of the Stakeholder Group, the principal "users" of actuarial advice are those who take decisions based on actuarial reports (or those with a direct client relationship with the actuary); "consumers" – whom others describe as "end users" – are the policy holders, pension scheme members, shareholders, or beneficiaries of the outcome of such decisions (therefore those with a third party relationship); and the "public" is the wider community.

The Group's initial piece of work set out to obtain a snapshot of the current concerns of a segment of immediate users of actuarial output (pension trustees and non-executive directors, NEDs, of insurance companies) by commissioning two pieces of interview research with these groups. It should be noted that these were very small, qualitative, studies and not large scale, representative groups.

---

<sup>1</sup> Morris Review of the Actuarial Profession, March 2005

<sup>2</sup> See page 60

Nonetheless, they provide some valuable insight into the experience, and expectations, of these two important user groups. Further work will be necessary to gauge the views both of the end users/ consumers (policy holders, pension scheme members, shareholders) and also of the wider public. This report deals only with these two sample groups who take decisions based on information provided by actuaries.

The research findings set out in Chapter 4 give a fairly clear indication of some of the implications and considerations that might be drawn on to inform the future work of the FRC.

## Two - Actuarial Stakeholder Group report on survey findings

A number of themes emerged from the research, in particular in relation to the confidence and reliance placed by trustees and non-executive directors (NEDs) in their actuarial advisors, the level of understanding of trustees and NEDs of the advice they are given, the quality of communications between actuaries and their clients, and key areas of weakness in the performance of actuaries. These areas present challenges for the future regulatory landscape. In some areas the respective experiences of NEDs and trustees were quite different whilst in others remarkable similarities emerged from the research.

Trustees had concerns and needs in relation to important aspects of their use of actuarial information and advice. The trustees' observations painted a remarkably uniform picture of their experience of actuarial practice, as did those of the NEDs. The survey revealed, however, a striking contrast between the two groups of users in the level of confidence in their ability to understand the intricacies of actuarial information. Many trustees claimed they lacked confidence while the NEDs showed a high level of confidence. Interestingly, this might reflect on the actuaries' behaviour rather than on the individual trustees or NEDs, as some of the latter, who are also pension trustees, reported a noticeable difference in the quality of the two sets of actuarial advice, with the advice received as a NED perceived as much better quality.

### NED VIEW

*"On the Pension Fund side, it's completely different, much more difficult [...]. They come over as much more theoretical and find it very difficult to present to people who don't necessarily have a significant knowledge of the area."*

It should be noted that the research took place at a demanding time for pension trustees. The Pensions Act 2004 and The Pensions Regulator have added considerably to their responsibilities, at a time of high pension deficits, due to a number of factors including the stock market, low bond yields and the impact on liabilities of increased life expectancy. Not surprisingly, therefore, a number were concerned about their own responsibilities in the new regulatory environment whilst also having questions about past advice proffered by their actuaries.

The research findings are based on a small, qualitative survey of pension trustees and NEDs of insurance companies. Separate research agencies were commissioned to conduct a small number of in depth interviews with each of these groups (15 interviews per group). Due to the limited size of the sample the findings are not statistically significant or necessarily representative of the entire trustee and NED community; nevertheless, a stratified approach (based on entity size and type) was taken in the

selection of the interviewees, and care was taken to avoid duplication and existing links with the FRC, so that the survey provides a qualitative snapshot of the experiences of these two groups in dealing with actuaries.

The Stakeholder Group has considered the survey reports and has attempted to draw out some of the key areas of synergy and divergence between pension trustees and NEDs and to explore the implications for aspects of the future work of the FRC. It believes that the main findings may be summarised as follows:

### **Confidence and reliance**

Both trustees and NEDs place heavy reliance on the work of their actuaries, and have confidence in that work, although in different ways. NEDs' confidence was based on interaction with their actuaries, both at board and management level and reflected a more general confidence in the processes in place within their companies for ensuring the quality of actuarial advice. Trustees on the other hand tended to rely on trust of an individual actuary who was frequently the key professional advisor to the scheme. These differences derive primarily from the resources and expertise available to the typical insurance company and pension scheme respectively. Responses from pension trustees are understandable, but demonstrate that they place considerable reliance on the competence and integrity of the actuaries who advise them.

Trustees are highly reliant on their professional advisors and in particular on their actuaries. In reality, many pension schemes, particularly smaller ones, can only afford one professional advisor. The interviews identified a 'professional services relationship' between trustees and actuaries which is typified by high levels of satisfaction and trust, and low levels of switching between providers. The actuarial profession is seen by some as pretty impenetrable, with the concepts and workings underpinning the advice regarded as extremely complex. Most trustees appear to lack the confidence to scrutinise or challenge actuarial advice although they felt they had sufficient understanding to ask questions.

#### **TRUSTEE VIEW**

*"I probably don't [scrutinise the advice] very much. I just sort of assume that they have the knowledge to do the job. [...] assuming that they know what they're talking about [...]. In a way, I don't worry too much about how they got there."*

*"It's obviously an extremely skilled and technical profession, so I have this feeling that there's an awful lot going on behind the scenes, but I'm not particularly aware of what that is."*

Ensuring that trustees are equipped to scrutinise advice thoroughly and make more informed decisions is an important goal for the regulatory bodies concerned with pensions. The Pensions Regulator has undertaken a number of initiatives to enhance the knowledge and understanding of trustees and offers a range of tools to assist with this. Trustees reported that training was available from organisations such as the National Association of Pension Funds. Improving the capacity of trustees to challenge and scrutinise actuarial advice through training and education is clearly desirable. Actuarial standards could have a positive impact on the clarity of information and advice provided by actuaries to trustees, for example through the use of common formats and presentation of advice. *It would seem appropriate for the FRC to seek ways to improve the clarity of actuarial information and advice through actuarial standards and other means, as appropriate.*

Generally speaking trustees did not delve into the detail of the actuarial calculations. Rather, they assume (as with the medical or the legal profession) that the quality of information and the accuracy of the calculations are high. However, when it came to advice, rather than factual input, the profession is seen to be cautious and conservative. Trustees criticised the apparent reluctance of some actuaries to interpret the data and make recommendations, detracting from the quality of the advice given.

Reliance on the quality of actuarial input and the importance of trust in the relationship has a number of implications for regulation. The research also highlights the expectations trustees have of what the actuary should be providing. For most of the trustees interviewed advice, that is, interpretation and recommendations, was at least as crucial as raw data and information.

In contrast, many of the NEDs had extensive experience of insurance or other areas of financial services and judged themselves to have a moderate to high level understanding of actuarial principles. Most felt that they also had a grasp on the methodology behind the models. They were familiar with the content, methodology and format of the actuarial reports put to them, and had met the actuary several times. Most said they were unafraid to question actuarial assumptions and had sufficient confidence to be able to challenge effectively. They reported that they were not concerned about appearing to lack knowledge.

For the larger companies, most NED contact was with in-house actuaries, whereas for the smaller life companies, there was more often reliance on a third party actuarial consultancy. NEDs were so confident in the quality of actuarial advice they received that most asserted they would feel comfortable signing off on the information themselves. This probably reflects their faith in their companies' processes for the production of actuarial advice.

The NEDs clearly expected more than "number-crunching" from their actuaries. Commercial understanding, business acumen and sound judgment were considered to be hallmarks of a good insurance actuary. They also expected their actuaries to be accurate and unbiased in their advice.

## NED VIEW

*"[...] A good actuary for me has got to have some commercial judgment as well, it cannot just be they are really good at the actuarial techniques, they have got to understand the dynamics and actually the consequences of what they are recommending should happen."*

In summary, both trustees and NEDs expressed a need for their actuaries to provide more than raw data and information. Interpretation and recommendations based on the context in which the advice was being given were felt to be a crucial part of the actuary's role. It follows that where the expectations of users (for trustees, that interpretation and recommendation would form part of the advice; for NEDs that their business needs would be well understood), appear to be at variance with the actuary's own perception of their role, a greater congruity of the understanding of roles and of the respective responsibilities, between actuary and client would benefit both. *The FRC should therefore seek ways to improve clarity over the responsibilities of actuaries and their clients and their understanding of their respective roles.*

The Stakeholder Group felt that an important driver of actuarial advice should be the needs of the user in the context in which the advice was being given. *As a general principle, in designing standards, in considering the respective responsibilities of actuaries and their clients, and in reviewing actuarial training and behaviour, the FRC should take account of the context in which the advice is being given and the particular requirements of the user.*

NEDs reported having little awareness of any standards governing the production of actuarial advice or formal procedures used to assess actuarial performance, relying heavily on external audit or internal management. Most NEDs drew comfort from the belief that actuaries were assessed through the external audit and by the executive team, often making the assumption that the assessment of actuaries would be picked up by other parts of the organisation. On the whole, NEDs are not involved in appointing actuaries; this is typically carried out by the executive team.

## NED VIEW

*"In an organisation like this we would be relying on the Executive Committee, and below them, [...] and internal audit [...] to do that job."*

*"We have an audit procedure, external, which identifies difficulties or inconsistencies or points which may be relevant. I think the audit procedure is regarded as perhaps the most important factor [...]."*

External actuaries, who review the work of the internal actuaries and their processes, are frequently sourced from the same firm as the auditors, with the actuarial audit forming part of a bundled service from the audit firm. Thus, despite the importance of this form of external review, the choice of actuarial audit partner is based on the reputation and skills of the audit firm as a whole, rather than on the reputation of the actuarial department.

Some NEDs commented, in general terms, that actuaries could be somewhat blinkered and that they would benefit from drawing on external views, such as from economists. They saw actuaries as mathematicians, who were focused on the numbers and methodology. For the future, they felt more emphasis was needed on communication and commercial skills.

Similarly, it was clear from the research that trustees assumed a high level of quality assurance was taking place “elsewhere” and did not attempt to question or check on this. This is a useful reminder of the important role actuarial standards will play. The Stakeholder Group believes that confidence in the quality of the actuarial report and the knowledge that the report adheres to a set of standards, will free up the user to concentrate on the implications of the report and their subsequent decisions.

## **Understanding and communication**

Trustees and NEDs gave sharply different replies on these topics, although both groups recognised communication as a weakness in many actuaries. Trustees approached the subject very much as laymen, and saw the actuary as an expert from whom they took advice. They felt they needed more training and information to understand actuaries. On the other hand, NEDs felt it was their job to make sure that, collectively, they understood the decisions they were being asked to take. They reported feeling confident in their ability to grasp actuarial principles and concepts and to understand the thrust of the advice in sufficient detail. Again these differences can be expected largely from the different roles and backgrounds of trustees and NEDs.

Good communications between actuaries and trustees are regarded as vital and in need of improvement. At the very least, trustees expect their advisors to provide clear and thorough explanations. The ability of actuaries to communicate well was high on the priority list. Where trustees had been dissatisfied with their actuaries, it was in part due to a perceived inability to communicate effectively.

### **TRUSTEE VIEW**

*“It’s absolutely fundamental because it’s very complicated usually. There are some quite tricky issues you have to consider and therefore you’ve got to have an advisor who can explain things clearly and straightforwardly.”*

The language frequently used by actuaries was seen as difficult and technical and a key obstacle to clarity of information. Trustees reported a need for actuaries to explain things in plain language, and to summarise clearly the relevant facts, options and recommendations. Clearly, the central importance to users of good communication skills by actuaries suggests further improvements are needed in this area, both in relation to this aspect of actuaries' training and continuing professional development and in relation to the setting of actuarial standards.

The five key characteristics of good communications suggested by Opinion Leader Research – clarity, responsiveness, relevance, proactivity and interpretation - may well be a good starting point for the development of best practice in the area of actuary to trustee communication. They do, however, raise a number of other issues, such as who should define what is “relevant” for a trustee to know, or how to bridge the gap between trustee needs and actuaries' comfort levels in terms of making recommendations. The research suggested that trustees did not want to be overwhelmed by complicated material. At the same time, if information is kept back from them it can impede their understanding of the issues.

In considering the information needs of trustees, the Stakeholder Group highlighted the importance of actuaries clearly stating the assumptions underpinning their calculations, along with an explanation of sensitivities and the results of appropriate stress-testing. In addition, the Stakeholder Group felt that actuaries should make sure they “know their client”, know the information needs of their client, and tailor communications to suit each individual client.

It is not uncommon for there to be a main point of contact for the actuary when advising a pension scheme. This is often, but not always, the Chair of the Board of Trustees. In a number of instances it was clear from the responses of the interviewees that the Chair of trustees was indeed the main contact point for the actuary, and to some extent did act as a conduit between lay trustees and their actuarial advisor.

The law does not distinguish between the Chair and the other trustees. Similarly, the Pensions Regulator treats all trustees equally. However, given the key role played by this person, it will be important to ensure that, where the Chair does act as a main point of contact, they pass on accurate information and advice to the other trustees, and that the actuary is satisfied that every trustee has access to the information he provides, and that there is a process in place to enable effective dissemination of information. Especially where the Chair is an employer nominee, the actuary needs to guard against any “filtering” of his material. *In order to address this concern, the FRC should consider whether there needs to be a procedure in place for ensuring direct and equal access for all trustees to information and advice provided by the actuary.*

Despite the confidence expressed in their actuaries and the quality of advice they receive, a number of NEDs felt communication could be further improved. One interviewee, with a very long and distinguished career in finance found actuarial information very challenging, particularly in terms of the language used and the general thrust and underlying concepts of actuarial advice.

NEDs wanted advice to be accurate and unbiased, well presented and clearly explained. All of them placed great importance on the use of plain language, clarity of expression, and on the ability of the actuaries to explain their workings and concepts in terms accessible to non-actuaries. Most of the NEDs interviewed had noticed an improvement in the presentation of actuarial advice in recent years, and commented that actuaries appeared to be making greater efforts to communicate using non-technical language and to present more creatively, using graphics, traffic lights, heat maps and industry comparisons. The emphasis placed on communication by both NEDs and trustees, strongly suggests that communication issues must be addressed. *Communication should therefore be a priority to address through actuaries' training and continuing professional development and through actuarial standards.*

#### NED VIEW

*"I seriously believe that if someone can't express themselves in plain English and make somebody understand, the value of the work they have done is limited. Because they might be the best actuary in the world but if they can't get their message across, how is the person who is going to take the decision going to get there?"*

A number of respondents' comments suggest that the FRC should concentrate as much on its educational oversight and communication roles as on setting rigid standards. The Stakeholder Group believes that, in the training of actuaries, more input from communication specialists would enhance actuaries' understanding of what is meant by good communication and contribute to improvements in this area in more effective ways. It is sometimes suggested that the answer to the communication gap is to train trustees to understand actuaries (a challenging task given the constant turnover of trustees, especially with the growth in the numbers of member-nominated trustees). Other professionals do not expect their clients to be educated to understand technical terms. Rather, it is incumbent on the professional to present information clearly. *The FRC should focus attention on the training of actuaries to communicate effectively and to produce reports and advice that employ plain language, accessible to non-actuaries.*

TRUSTEE VIEW	NED VIEW
<p><i>"[...] I know that a lot of it is the jargon of the trade but I'm not impressed by it [...]. I like a summary in plain English of these are the facts, these are the options, this is my recommendation."</i></p>	<p><i>"I think there is a need for clear communication, what are the essentials, what are the key messages, and to express it with graphs and not, as we always get, pages and pages of tables. Seas of numbers don't tell me very much."</i></p>

Trustees and NEDs gave a clear message in relation to their communication needs and the ability of their actuaries to meet their expectations in this regard. Communication is evidently a vital indicator of the quality of advice. However, the research also identified other indicators, as outlined in the section on confidence and reliance. *Consideration should therefore be given to other aspects of the behavioural characteristics of actuaries, such as their attitude to risk, their willingness to offer advice, and the extent to which they look within or outside the profession for bench-marking. The reasons for these characteristics might also be identified, whether these lie in the selection, education, training, professional standards, culture or regulation of actuaries.*

A considerable amount of uncertainty remains about where the line should be drawn between the responsibility of the actuary to make best efforts to ensure NEDs understand actuarial advice and the responsibility of NEDs to make sure they have fully understood the advice upon which their decisions are based. Further research might therefore be needed in assessing what NEDs really need in order to fulfil their responsibility and discharge their duties effectively.

## Challenges

Trustees and NEDs identified a number of common challenges for actuaries, such as the need to deal with longevity and mortality assumptions. NEDs also mentioned investment assumptions. Trustees tended to be more focused on the needs of the consumers (or end-users) than NEDs who appeared to be focused on shareholder needs. These responses inevitably reflect the different roles played by NEDs and trustees. However, both groups stressed the need for actuaries to be competent in areas of core expertise such as mortality.

Life insurance NEDs painted a very consistent picture of the key risks to their business, namely longevity and investment returns. Investment risk was typically monitored more closely by the NEDs because of its potential to impact profits in the short-term. Longevity risk was seen as a more long term risk to the business as there is greater potential to mitigate the effects on profits of increased longevity by, for example, amending terms and conditions of a scheme or increasing employee contributions.

Actuaries are criticised for failing to react quickly enough to the body of evidence pointing to significant improvements in average life expectancy and to take account of these improvements in their advice, particularly to trustees. This failure has contributed to the large deficits faced by many pension schemes. The trustees interviewed confirmed that there has been some erosion of confidence in the actuarial profession related to past mortality predictions; specifically, actuaries were seen as having been slow to wake up to increased longevity despite the fact that it was common knowledge that people were living longer.

#### TRUSTEE VIEW

*“They were well behind on the mortality changes, I mean one of the biggest reasons for deficits in company schemes is that life expectancy improved, everybody knew it was improving.”*

*“As a profession, they were always behind what I call ‘medical advances’. [...], but as a profession they were well behind catching up in mortality.”*

Given the frequent press comment on changing life expectancy and improvements in medical science and public health, trustees and NEDs are likely to need reassurance that mortality tables are up to date, that actuaries have made adequate allowances for trends and future projections in the area of mortality, and have performed appropriate stress testing of assumptions. More reliable mortality projections are of crucial importance to the work of actuaries and to the confidence of pension trustees and the wider business community in the advice actuaries give. ***It follows that the FRC should consider how to address mortality through actuarial standards and other means.***

#### Regulation

Trustees and NEDs felt that any regulation should be proportionate. NEDs pointed out that the FSA took a proactive role and was driving change which was helpful. Principles-based regulation was welcomed, while over-prescriptive regulation was viewed with some scepticism. Despite coming from different regulatory positions, NEDs and trustees reached similar conclusions on the question of regulation of actuaries. It is worth noting that many of the NEDs were also pension trustees. ***The FRC should bear in mind the preference of users of actuarial advice for ‘light-touch’ regulation when setting standards and carrying out its other functions.***

***The Stakeholder Group felt that in addition, a way should be found to embed consideration of user interest, including end-users and the wider public interest, into the regulation of actuaries, including through coordination with the work of the FSA and The Pensions Regulator.***

TRUSTEE VIEW	NED VIEW
<p><i>“The danger of regulation is that unfortunately with regards to actuaries they may become even more tongue-tied in their ability to deliver service than they presently are.”</i></p> <p><i>“You could have some best practice guidelines in terms of openness with the trustees and explaining the assumptions carefully and that kind of thing.”</i></p> <p><i>“[...] I don’t think regulation or heavy handed regulation works. I think that there should be kind of, some general principles, [...]”</i></p>	<p><i>“We used to have a three year valuation and we got very little information from them really, about 4 and a half pages, that was all. But now it is much more in-depth, that is because of the FSA.”</i></p> <p><i>“Well, I think there has been a huge shift since the Equitable, and [...] the big shift in my view has been the risk assessment that has to be done inside the company is being driven by the FSA.”</i></p>

## Suggestions for further research

These include:

- (a) issues of communication and understanding,
- (b) most appropriate data and range of possible assumptions,
- (c) identification and quantification of risks and rewards,
- (d) risk tolerance decisions,
- (e) appreciation of the limits of actuarial information,
- (f) experience of discount rate decisions.

### *Discount Rates*

Despite the fairly frequent mention of longevity changes, trustees did not mention whether they had an understanding of how actuaries selected appropriate discount rates – even though most of the actuarial information they receive varies significantly depending on whether the discount rates chosen are best estimate, prudent rates for funding purposes, FRS 17<sup>3</sup> or annuity rates – and on what actual rate is selected under each of those headings. The Pensions Act 2004<sup>4</sup> requires trustees to select their own assumptions (on actuarial advice<sup>5</sup>) and so trustees should be vitally concerned on this point. Similarly, NEDs made no reference to discount rates, although investment assumptions were generally mentioned.

<sup>3</sup> UK accounting standard

<sup>4</sup> Regulations under s.222(4)

<sup>5</sup> s.230

It is possible that the interview design for both groups did not elicit discussion in this area and that probing by the interviewer did not explore this aspect of actuarial advice. Further research might therefore be needed to gain better insight into the level of understanding amongst users on this issue.

### *Policyholder interests*

It was interesting to note that NEDs made little reference to policyholders. Again, further research might be required to probe where the policyholder sits in the consideration of NEDs and whether they, or the actuaries, believe they have any responsibility to treat their policyholders, i.e. customers, fairly, in the interpretation or use of actuarial advice.

### *Other Users*

Research could also include other key users of actuarial information such as professional trustees, executive directors and management (both of sponsor companies and insurance companies).

### *End-users and Consumers*

The views and understanding of end-users, including policyholders and pension scheme members, should also be sought.

### Three - FRC response to the Actuarial Stakeholder Group

The Financial Reporting Council (FRC) and its Operating Bodies are very grateful to the members of its Actuarial Stakeholder Interests Working Group (the Stakeholder Group) for overseeing and interpreting this survey of the needs of the principal users of actuarial services. The main report on the survey has been produced by the Stakeholder Group itself.

Although this was a relatively small, qualitative survey, the FRC shares the Stakeholder Group's view that it provides useful insights into the needs and expectations of the principal users of actuarial work.

The FRC's existing work programme already goes some way to addressing the points made and the FRC will take these findings into account further as its work develops.

#### Implications for standard setting

The Board for Actuarial Standards (BAS) recently published a preliminary consultation on a conceptual framework for actuarial standards, in which it proposes that its immediate priority should be to set standards for actuarial information, including information provided by entities such as pension schemes and insurance companies.

The FRC notes the emphasis of both groups of interviewees on the quality of actuarial *advice*, including recommendations, which could go beyond this initial focus on standards for actuarial *information*. The BAS believes that a logical first step is to establish a common understanding about the content of actuarial *information*. This will in turn address many of the concerns expressed about communication by actuaries and the understanding of users, particularly trustees. The BAS is consulting on this approach and would welcome further views from the Stakeholder Group and others.

The FRC notes the Stakeholder Group's suggestions for further research, and will take these into account in framing its conceptual framework for actuarial standards.

The FRC shares users' concern about mortality assumptions. The FRC is working closely with the Actuarial Profession (the Profession)<sup>6</sup> and the statutory regulators to ensure that the Profession has clear, up-to-date technical guidance available to actuaries and their clients, as an aid to modelling, interpretation and understanding of mortality experience, including the scope for future improvements.

---

<sup>6</sup> The Faculty and Institute of Actuaries

## **Implications for the FRC's oversight of the Actuarial Profession**

The FRC has considered the implications of the survey and the Stakeholder Group's comments for the regulatory activities of the Profession and the work of the Professional Oversight Board (the Oversight Board) to oversee those activities.

In response to one of the Morris Review's recommendations, the Oversight Board is reviewing the effectiveness of monitoring and scrutiny of actuarial work, in conjunction with the Profession, the FSA and the Pensions Regulator. As part of this work, the FRC has invited actuarial firms to tell it about their quality assurance arrangements. As part of the consultation, the Oversight Board will also be seeking the views of users, including the Stakeholder Group.

The FRC notes the Stakeholder Group's interest in actuaries' behavioural characteristics. Actuaries are in many ways defined by their education and training, not least because of the difficulty of actuarial examinations and often lengthy qualification times. They are also defined as professionals by their wider public interest roles, particularly in pensions and insurance.

The Profession has recently reformed its education syllabus and training arrangements and introduced a compulsory continuing professional development scheme, and is reviewing some of its key examinations such as the communications examination, as well as reviewing its ethical standards to bring out key principles for actuaries. The Oversight Board's immediate priorities (which were set out in its report in December 2006 on the Profession's progress in implementing the recommendations made to it by the Morris Review) will therefore include:

- reviewing the Profession's progress and providing independent and objective comment on the outcomes of their reviews;
- making sure the Profession develops greater transparency and standardisation in its processes, as well as benchmarking against other professions; and
- assessing the impact of the reforms to education and training arrangements on pass rates and qualification times, and wider professional behaviour.

## **Implications for other bodies**

The FRC has shared these findings with the FSA and the Pensions Regulator which may also find this survey of use in their work with pension schemes and insurance companies. The FRC is committed to working closely with other bodies in order to promote quality and confidence in actuarial practice. The FRC has also shared these findings with the Profession.



## **Four - Research Reports**



# **Opinion Leader Research survey of pension scheme trustees**

**Commissioned by Financial Reporting Council**

-

## **1. Executive summary**

This study shows that trustees have an increasingly demanding role and that informed decision making is required now more than ever. Trustees are therefore highly reliant on their professional advisors and in particular, on their actuaries.

The findings of the interviews reflect those of the Morris Review which found that a 'professional services relationship' exists between trustees and actuaries. This relationship is typified by high levels of satisfaction and trust, and low levels of switching between providers.

However, the picture is not universally positive:

- There are some complaints about actuaries not going outside limited service agreements or providing the extra responsiveness that trustees require;
- There is also evidence of some erosion of confidence in the actuarial profession overall related to past mortality predictions. Specifically, actuaries are seen as having been slow to catch up with increased longevity;
- In addition, criticisms are voiced in some quarters about the perceived reluctance of actuaries to interpret the data and make recommendations.

Overall, most trustees have only a basic understanding of the world of actuaries; it is seen as a profession shrouded in mystery and the concepts and workings are regarded as being extremely complex.

In this context, good communications between actuaries and trustees are regarded as vital and an area in need of improvement in many cases.

The majority of non-professional trustees do not feel not sufficiently confident or informed to challenge actuarial advice, although in most cases they are able to ask questions to ensure they understand it.

Empowering trustees to scrutinise advice more thoroughly and make more informed decisions should therefore be a primary focus of future actuarial standards.

## **2. Confidence and reliance**

### **Role and responsibilities of trustees**

The interviews commenced with a brief discussion on the role of the trustee. Pension trustees regard their role as being primarily to protect the benefits of scheme members by helping to ensure the stability and success of the pension fund. All trustees treat being a trustee as a serious responsibility and appear very committed to working to protect their scheme in a period when many schemes face financial problems.

*“Basically, I think, look after the interest of the members, make sure that the fund is able to, as far as possible, pay out their pensions and also any [...] dependents if they happen to die. Just basically meet our obligations as far as the pension fund is concerned.”*

[Member nominated, medium scheme, <2 years experience]

*“So it’s like being the guardian of a child. You have to put a lot into it and you have to do the right thing for them, because it’s not just the decision you make today that is going to affect tomorrow. It’s going to affect lots of people years down the line.”*

[Member nominated, large scheme, >2years experience]

There is general agreement that the trustee’s role has become increasingly complex and demanding. The factors which have resulted in these increased demands include:

- Numerous legislative and regulatory changes for trustees to keep on top of;
- increasing administrative burdens;
- More financial pressures related to investment performance and revised mortality predictions;
- Resultant increased responsibility for pension trustees, particularly those representing defined benefits schemes.

*“These days it [the role of a trustee] just has a greater degree of responsibility because of the legal framework in which we operate.”*

[Employer nominated, large scheme, >5 years experience]

*“Really just looking after the interests of the pension fund and doing my best to do so. I feel woefully uninformed sometimes, it seems a real minefield especially since all the new legislations have been coming in.’*

[Member nominated, small scheme, 2-5 years experience]

*“Over time, and particularly over the last few years, the role of the trustees has become much more involved with the financial situation of the pension scheme. [This is] largely because of the emergence of the pension scheme deficits. So we have been much more involved in investment decisions, about investment strategy, asset allocation and poring over the valuation of the scheme, looking at assets and liabilities in more detail and in turn, negotiating with the sponsoring employer over contributions.”*

[Chair, small scheme, >5 years experience]

Those interviewed felt it was important to have some people with more understanding of pensions/ actuarial advice represented on the board of trustees. Several of those we spoke to had financial backgrounds (e.g. accountants, finance directors etc.).

*“We are very fortunate that we have a very powerful trustee board because of the business we are involved in [a chartered accountancy] [...]. The chairman of the company is an employer-nominated trustee [...] two of our trustees have audit specialisation in pension’s schemes [...] and we have a trustee who is actually a qualified actuary.”*

[Employer nominated, medium scheme, 2-5 years experience]

## **Ensuring informed decision-making**

Making informed decisions has never been more important according to the trustees we spoke to. In this context, trustees are heavily relying on their expert advisors (including actuaries, legal and investment advisors) to help them keep on top of their role, and to ensure they make the correct decisions. Trustees are expecting their advisors to provide clear and thorough explanations. However, trustees also recognise that they have responsibility to decipher advice, ask questions and ensure they understand.

Training is seen as critical, particularly for new trustees and those without financial backgrounds. Of particular relevance is training on:

- The role and requirements of a trustee;
- Basics of pension administration and governance;
- Legal, actuarial and investment issues.

However, experienced trustees also value ongoing training to help them keep up-to-date with various changes that will have a bearing on their role. Training is currently provided by a range of organisations including by the employer, by the external advisers (actuaries, lawyers etc.) and by the TUC and the National Association of Pension Funds. Face-to-face training is particularly valued, but online resources are also seen as useful.

The majority of trustees we spoke to have experienced some type of training. Many have used the Trustee toolkit online and have found it a valuable first stage. They have also attended free seminars, training courses run by their scheme advisors and a number have taken 2-3 day courses such as the National Association of Pension Funds course. Some respondents hold the Pensions Management Institute (PMI) trustees' qualification.

*“I’ve been working my way through the training material on the pension regulators website which is very good, that sort of then made me think you know, the induction course and training that was provided to myself was less than adequate.”*

[Employer nominated, small scheme, <2 years experience]

Training on the actuarial role is seen by pension trustees to be particularly important. The actuarial profession is seen by many as a ‘black art’. While trustees claim to have a basic understanding of how

actuaries work, most (even those with financial backgrounds) lack the detailed knowledge to make them feel confident in closely scrutinising advice given by actuaries – it’s a case of ‘you don’t know what you don’t know’.

*“I probably don’t [understand how actuaries work] very well. I just sort of assume that they have the knowledge to do the job. Bit like lawyers or doctors I suppose.”*

[Member nominated, large scheme, <2 years experience]

*“I think the issue I feel most strongly about is that there is a sort of assumption that you are just going to pick it up by osmosis. I think as well as a pension trustee being trained on the whole essence of what a pension scheme is and all the various responsibilities they will have, they do need to have quite a lot of information about the way actuaries work and the terms that actuaries use etc. I think this should be mandatory for any pension trustee.”*

[Employer nominated, small scheme, <2 years experience]

*“I think as a profession they ought to be very clear that pension trustees are pretty ignorant about things actuarial and they ought to make a big effort to sort of train up trustees in the actuarial side of the pension scheme just so that their pension trustees have a greater understanding. This is over and above the normal training of pension trustees for pensions, I think it’s worthwhile, I mean, all pension trustees should have a minimum amount of knowledge but the actuaries should be prepared to really get some of them absolutely on the ball in terms of the actuarial stuff.”*

[Employer nominated, small scheme, <2 years experience]

### **3. Understanding and communication**

#### **Trustees’ views on the relationship and service provided**

The relationship that trustees have with actuaries is broadly similar to the relationships they have with other professional services providers such as accountants, lawyers, fund managers etc. Relationships are typically long term and trustees value actuaries’ long term understanding of their fund and business. The relationship with the individual actuary providing the service is key to overall satisfaction.

*“From the inception of the pension scheme, I mean if you look at it from a business point of view, one of the things that you don’t rush to change are your bankers, your accountants, your lawyers and having become a trustee, I would say you don’t rush to change your actuaries [...]. You would hope they have an understanding of your pension scheme to such a depth where in fact a lot of things which may involve a lot of time and effort have been accommodated because of their involvement with the pension scheme over a great many years.”*

[Employer nominated, medium scheme, 2-5 years experience]

*“Ever since I can remember, we have always demanded an individual (actuary). That particular individual who knew us and who we felt understood our scheme and who could explain in words that we can understand. On one occasion that particular actuary wasn’t there so he sent along a colleague and we found it was ‘gobbledy-gook’. We didn’t understand a word, it was very difficult.”*  
[Employer nominated, medium scheme, 2-5 years experience]

In the main, trustees are satisfied with their actuaries and trust the advice given. However, we have also identified some specific cases of significant dissatisfaction based on particular communications/relationship problems (e.g. trusted actuary moving on and being replaced with a less responsive individual, a perceived general reduction in service over time or being de-prioritised).

In many cases the provision of actuarial advice is often tightly defined by the contractual agreement that the trustee board has with the actuarial firm providing the service. This means there is sometimes reluctance on the part of the actuary to provide service over and above what has been prescribed in this agreement. The minimum level of service appears to be tri-annual valuations, attendance at quarterly meetings and the provision of preceding reporting valuation paperwork.

*“We meet quarterly, and they come along to the meetings. They produce us a lot of paperwork, a lot of documents, and they come along and explain it to us and answer any questions we have.”*  
[Member nominated, medium scheme, <2 years experience]

*“Our role as Trustee is obviously the managing of the scheme on a day-to-day basis and essentially that is done on a quarterly basis when you look at quarterly investment returns, the quarterly valuation the actuary does, any other issues that come up and I just cannot conceive of issues coming up that you would not need the advice of the actuary on hand.”*  
[Member nominated, medium scheme, <2 years experience]

Some, but not all, actuaries also proactively notify trustees of relevant information and changes pertaining to the pension scheme and/or trustee role. This element is highly valued where it occurs and would be welcomed by all trustees.

*“They’re very good at keeping us up to date with all the information, you know, with pensions legislation changing every five minutes and such like, they provided us with briefing notes describing the impact of particular legislation on a very regular basis, I thought it was very good.”*  
[Employer nominated, small scheme, <2 years experience]

*“These are the kind of newsletter things that they send out about recent developments in mortality and it’s got all the big issues.”*  
[Member nominated, medium scheme, <2 years experience]

Trustees are critical where they feel they receive only standardised outputs or need to pay for extras, including questions and clarifications.

*“It did take a long time to produce and it does seem to me to be very much a sort of template or pro-forma type document. You just fill in the blank; the actuary just fills in the blanks. Now I appreciate there may be a lot of very clever work that goes behind that to actually fill in the blanks, but nonetheless I suspect it’s not rocket science.”*

[Member nominated, medium scheme, <2 years experience]

*“Nowadays it seems that as soon as you enter into the conversation someone presses the clock and you pay according to that. So one of the things that we have to do is make sure that the questions we ask and the way we conduct our business is done in as business-like way as possible to minimise the cost.”*

[Employer nominated, medium scheme, 2-5 years experience]

In addition, the costs and value for money of the actuarial service is a general concern, even amongst those with higher levels of satisfaction. So much so, that for trustees of some smaller schemes, it is no longer seen as affordable to use a large firm of actuaries. The actuarial profession is perceived to have become generally more commercial and profit oriented in recent years, following similar trends in the major law and accountancy firms. There is a feeling that personal service may be declining as a result.

*“We recently tendered our actuarial services partly because they were getting a bit expensive and particularly running two schemes where it’s an expensive business anyway [...] I think the finance was aware that there were some disparities - one scheme’s actuarial planned spending seems to be a bit higher than the others and so we thought well now is a good opportunity and that’s a good process to go through. And so having gone through that process you are sort of looking very keenly at the sort of actuarial services and what other companies could offer as well.”*

[Member nominated, medium scheme, <2 years experience]

*“One of the things I would say is that when you’re getting involved with a discussion with an actuary it’s not a cheap exercise and you know when you’re faced with what we are, our scheme actuary is the senior partner, it’s costing us £430 an hour. Now for a company of our size that is a hell of a lot of money.”*

[Employer nominated, medium scheme, 2-5 years experience]

*“I think it’s fair to say at the moment if you look at the board of trustees with the relationship of our particular actuaries at the moment they’re unhappy. They’re unhappy because they feel that the level of service has become less personal, it is more about affordability [...] we’ve certainly got a comment from our senior actuary yesterday basically saying from his point of view we’re not what they call a ‘high income earning proposition’ for them.”*

[Employer nominated, medium scheme, 2-5 years experience]

## Communications between actuaries and trustees

The main ways actuaries are currently communicating with trustees are via presenting and answering questions at the regular quarterly meetings and by sending preceding documents which outline the material to be presented. Trustees may also receive newsletters, fact sheets and email updates on current relevant issues, but in many organisations these would only be sent to the main contact, such as the Chair or the administrator.

The ability of actuaries to communicate well is highly prioritised by trustees.

*“It’s absolutely fundamental because it’s very complicated usually. There are some quite tricky issues you have to consider and therefore you’ve got to have an adviser who can explain things clearly and straightforwardly.”*

[Employer nominated, medium scheme, 2-5 years experience]

Where trustees have been dissatisfied with their actuaries, it has often been primarily due to a perceived inability to communicate effectively.

There is some suggestion from our interviews that actuaries may be communicating more frequently and proactively with major clients compared to smaller funds.

*“We find them pretty good generally, in terms of communications excellent because they are of a size where we are an important customer and they are always available and they’ve made sure that there is always another person, you know the scheme actuary will have a number two who we can talk to regularly and is honest with you. We deal with one or the other and then there will probably be a third one who we have met as well in addition to the investment person so communication is very good indeed and just what we want really, you want to be able to speak to somebody and know you’re going to get him, possibly that is the problem with one of the big boys, if you’re not big enough you may not always speak to the person you want to speak to.”*

[Chair, large scheme, >5 years experience]

Overall, we have identified 5 key principles of good communications from actuaries:

**Clarity:** Ability to communicate complex technical information in simple language (this applies to both verbal and written communications)

**Responsiveness:** Availability to provide clarifications and answer questions

**Relevance:** Telling trustees only what they need to know and tailoring communications to their needs

**Proactivity:** Alerting trustees to changes that will impact them

**Interpretation:** Outlining implications and making recommendations

However, not all individual trustees have the same communications needs. Normally, there is one trustee (such as the chair or the trustee with the most relevant experience) who is the main contact point for the actuary. This individual will be the liaison point with actuaries outside agreed meetings and

act as the channel for all other communication. These trustees have the most detailed communications needs as the conduit of actuarial information to the wider board.

In particular, the trustee who is the day-to-day contact with the actuary values quick response from the actuary to their requests for additional information or clarification. Some even set up pre-meetings to ensure that information presented to the full trustee board is appropriate, clear and comprehensive.

*“But in this particular case, because it was essentially a difficult subject to get across to everybody in the big meeting quickly, I and one of the other trustees had two pre-sessions [with the actuary] for them to just talk it through.”*

[Chair, large scheme, <2 years experience]

For others, the top priorities overall are:

Clear written information, ideally with executive summary and graphical representations of data  
Plain English explanations in meetings and the opportunity to ask questions

The main issue with respect to improving clarity of information is the language used. The language is acknowledged by most respondents to be difficult and technical but there appears to be considerable variation between actuarial firms in their ability to present information in an understandable and digestible form. For example, simple techniques such as including summaries are not always used.

*“We’ve had actuaries who have been excellent, who are able to explain and graphically present the impact of mortality on investment returns, to really help us understand.”*

[Employer nominated, medium scheme, 2-5 years experience]

*“I wish people would go on easy writing courses rather than look as if they are out to impress. I know that a lot of it is the jargon of the trade but I’m not impressed by it [...]. I like a summary in plain English of these are the facts, these are the options, this is my recommendation.”*

[Member nominated, small scheme, 2-5 years experience]

*“All specialist professions, I mean they have their own terms, I think again they just have to take care not to use terms that you don’t understand or if they do use a term then explain.”*

[Employer nominated, small scheme, <2 years experience]

*“Rate of increase in earnings I can just about get to grips with, membership movement, that’s fine, number of deferred pensioners that’s fine, and then you get on to, I haven’t got a clue what a reversionary pension is.”*

[Member nominated, medium scheme, <2 years experience]

Interpretation and providing recommendations also emerges as an important communications theme. A number of trustees commented that actuaries tend to ‘hedge their bets’ and are reluctant to interpret data and make clear recommendations. Caution is seen to be a general characteristic of the profession.

*“They don’t like making recommendations. They will give you the figures, they will tell you what the assumptions are but if you say ‘what do you think, do you think that it is appropriate for us to be doing that’, they will say, ‘well, the figures say this, it is your decision’ [...] they won’t get off the fence.”*

[Chair, medium scheme, <2 years experience]

## Quality and Understanding of advice

Most trustees feel they have a broad understanding of what actuaries do. As a result, they feel able to question actuaries about their assumptions and ask questions to ensure they fully understand the advice.

*“I think it’s the responsibility of the trustee to say ‘look, I don’t actually understand this’ and I have no problem doing that and getting the actuary to go over stuff, but that may not apply to everybody.”*

[Employer nominated, small scheme, <2 years experience]

However, even experienced or financially trained trustees admit that they lack detailed understanding of how actuarial assumptions are derived.

*“I probably don’t [scrutinise the advice] very much. I just sort of assume that they have the knowledge to do the job. Bit like lawyers, I suppose, or doctors. We tend to deal with fairly reputable firms. Our lawyers are pretty good, and the actuaries seem pretty good, so [...] assuming that they know what they’re talking about [...]. In a way, I don’t worry too much about how they got there.”*

[Member nominated, large scheme, >2 years experience]

Quality of advice is therefore to an extent assumed, based on:

- The reputation of the profession;
- The quality and longevity of the specific relationship.

Trust is therefore a key feature of how trustees respond to actuarial advice. This is particularly the case for less experienced and member trustees.

*“I think the rigorousness of the profession, you know, you’re expecting qualified actuaries with actuarial experience and a lot of different qualifications and a background in the subject. I mean, essentially you are putting your faith in the actuarial profession and saying that it’s delivering what it says in the same way as other professions.”*

[Member nominated, medium scheme, <2 years experience]

*“I’m getting there. I mean I’ve got a limited understanding of Maths. I’ve got a Maths A Level. I can understand projections and percentages, I don’t know how on earth they end up with them but I understand formulas. I don’t have to understand how that particular formula works but I understand that they have formulas that they apply to come up with average life expectancy and if this goes up by 0.5 % it effects that by 10% or whatever, so an understanding of concept if not the actual.”*

[Member nominated, small scheme, 2-5 years experience]

*“It’s obviously an extremely skilled and technical profession, so I have this feeling that there’s an awful lot going on behind the scenes, but I’m not particularly aware of what that is.”*

[Member nominated, medium scheme, <2 years experience]

Trustees feel they have a good sense of the risk element in the advice and information that is provided by actuaries. The profession as a whole is seen to be cautious and conservative by nature but this is generally viewed as a positive thing and seen to be in line with the strategy of most pension funds. The pension board will be very clear about communicating their risk tolerance with actuaries and expect the actuary to tailor their advice to fit this.

*“I think they are quite well in tune because actuaries are by themselves conservative and cautious, so I think it fits quite neatly with our concerns.”*

[Chairman, medium scheme, >2 years experience]

## **4. Challenges**

### **Perceptions of advice**

As mentioned above, the quality of actuarial advice is generally assumed to be high. However, there has been an erosion of confidence in actuarial advice in some quarters as a result of actuaries being seen to be too slow to respond to mortality changes. This is seen to have directly contributed to the financial difficulties that some schemes are now facing.

*“Well I mean I think we’ve had to accept that – unless the actuaries have generally got it wrong – but you know life expectancy has gone up. And everyone’s been a bit late to wake up to that.”*

[Member nominated, medium scheme, <2 years experience]

*“If you have an appointed actuary as we do, as trustees, we would have thought they could have given us more advance warning that this was going to happen because the annuity rates, because of mortality tables and because I think the actuarial profession has not exactly covered itself with glory over the last few years.”*

[Employer nominated, medium scheme, 2-5 years experience]

*"They were well behind on the mortality changes, I mean one of the biggest reasons for deficits in company schemes is that life expectancy improved, everybody knew it was improving."*

[Chair, large scheme, >5 years experience]

*"I have gained the impression that actuaries, in some respects, have almost given up attempting to predict life expectancy."*

[Employer nominated, medium scheme, 2-5 years experience]

*"I mean, there's certainly a feeling that if they had kept us more up to date and maybe updated their tables a bit earlier, then we wouldn't have been in such a mess as we are at the moment with such a big deficit. You know, we might have been able to cope with it if it had hit us gradually in small stages rather than in one go. I mean, I think most people involved with pension funds are probably saying the same thing I guess."*

[Member nominated, medium scheme, <2 years experience]

A related point is that actuaries are seen by some to be still too focused on the past and present as a predictor of the future, which leaves pension schemes open to the same problems recurring in future.

*"They look at what's happened in the last 6 months. Or they look at the situation now. They look at the mortality tables now and the annuity rates now and they then say 'this is what you should do. But actually, surely they should look ahead and say 'this is the trend line'. That must produce a different answer."*

[Employer nominated, medium scheme, 2-5 years experience]

There is a view that actuaries need to consider additional sources to the Government's mortality tables for calculating future life expectancy.

*"As a profession, they were always behind what I call 'medical advances'. They might have been under pressure from companies not to go too far, I don't know but as a profession they were well behind catching up in mortality."*

[Employer nominated, small scheme, <2 years experience]

In addition, the reluctance of some actuaries to make recommendations is criticised by some trustees, as has been mentioned earlier. This reluctance is seen to detract from the quality of the advice given.

*"There is also an absence of clear recommendations and trustees are left with the options. And despite the impression of a high level of accuracy, there seems to be a general vagueness when one asks a direct question as to what would be appropriate in a particular circumstance."*

[Chair, medium scheme, <2 years experience]

As a result, there is a view that the professional can't continue relying on innate trust any longer and that it needs to facilitate a more transparent relationship with more informed trustees.

*“It’s a severely misunderstood profession and I think it’s their (the actuaries’) own fault. They’ve sort of turned it into a black hole, sort of mystic egg kind of thing. Their view was that if nobody understood it then they were the only people who could do it. Well that’s got to change. You can’t carry on like that in the 21st century. It’s got to be much more open and professional, clearly communicated and assumptions explained.”*

[Employer nominated, medium scheme, 2-5 years experience]

## **Current accountability and scrutiny**

In terms of basic accountability, actuarial advice is always recorded. This includes minutes of meetings and having all formal communications in written report form.

However, it is only the most experienced trustees who claim that they are able to interrogate as well as ask for points of clarification. Because of the specialist nature of actuarial advice, most will either assume the basic assumptions are sound or leave any scrutiny to their trustee colleagues with most directly relevant experience and skills.

*“I would probably be a bit cautious about it because I’m not confident yet with the information. But some of the other trustees, one is an actuary in his own right. Not for that company. One or two others are very financially aware or they are in the finance business, and I don’t think would have any hesitation whatsoever in challenging that.”*

[Member nominated, large scheme, >2years experience]

*“Two of our trustees are experts in the area of pensions, so, yes, they sometimes raise things as well. I think the rest of us who are sort of less experts probably don’t tend to see things like that. I mean, obviously, we ask questions if there’s something that doesn’t sound right, or [...] but that’s generally more asking for clarification and explanation.”*

[Member nominated, medium scheme, <2 years experience]

*“It is tricky to challenge actuaries because it’s such a specialist field, you know, it really is, usually the advice that they give sounds pretty sensible when you listen to it, actuaries by nature are very conservative people, they don’t make outrageous suggestions, so by and large if they suggest something you say ‘oh that looks okay, we’ll definitely have to consider that’.”*

[Employer nominated, small scheme, <2 years experience]

The main area where there might potentially be challenges to actuarial assumptions is on life expectancy assumptions, which has been discussed in earlier sections. As there is frequently press comment on changing life expectancy and health issues, this is an area where trustees are likely to want reassurance that assumptions are up to date. Seeking a second opinion on actuarial advice is currently rare. Rather, if trustees are significantly dissatisfied with the quality of advice over an extended period, they may look to changing their provider. Without the experience of changing actuaries, it is seen as difficult to compare providers as many only have had experience of one actuarial firm. Customer satisfaction mechanisms offered by actuaries to their clients are also not known to many trustees.

*"I would have thought very unlikely [to get a second opinion]. I would have thought you had to be comfortable with the people who you were getting advice from and provided your trustees were up to it you would get a feel for whether it was going right or wrong."*

[Chair, large scheme, >5 years experience]

## 5. Regulation

### Views on future scrutiny and regulation

Trustees would like formal mechanisms to be in place so they can feed back directly to the actuarial provider on the service provided. However, the key to effective feedback is seen to be getting past tick box exercises to allow a free and open exchange between the trustee and their actuary.

*"If you want to build up a successful practice, you need to do that. Call it sort of client satisfaction awareness or whatever."*

[Member nominated, medium scheme, <2 years experience]

*"It's got to be creative, and it mustn't be ticking boxes. That's pointless, a complete waste of time. It's the quality of advice that's important."*

[Employer nominated, medium scheme, 2-5 years experience]

A number of respondents felt that the move should be made towards more formal evaluation procedures. Service agreements would be a step forward as would more formal contracts. In this way there would be a clearer set of standards and expectations for the relationship between actuary and trustee. Some trustees believed they went too long without reviews as it was an easy option in some cases to stick with an existing firm. Trustees who had gone through a review process and reappointed their existing actuary commented that their performance had improved considerably, possibly relating to the fact that the process had clarified the needs of the trustees.

Trustees also expect there to be some regulatory 'safety net' to protect them and provide recourse should there be issues with the quality of advice. However, they do not want anything that is too onerous or burdensome for an industry that they see as already over-regulated.

*"The danger of regulation in these areas is that unfortunately with regards to actuaries they may become even more tongue-tied in their ability to deliver service than they are presently."*

[Chair, small scheme, >5 years experience]

*"I think, as you probably can guess is that there is too much [...]. I don't think regulation or heavy handed regulation works. I think that there should be kind of, some general principles, such as a named individual should not be advising the scheme and the company. Those sorts of principle based regulation rather than a kind of rule book."*

[Chair, medium scheme, <2 years experience]

Having an ombudsman's role and complaints procedure in place was spontaneously suggested. The notion of best practice standards was also generally welcomed.

*"I think there should be a well developed complaints procedure. So when there is a complaint then they should have a proper investigative power to go and look at that and see what went wrong, and then make a judgement. And if they feel that the member has behaved badly then they should be dealt with as the Law Society does or the Institute of Chartered Accountants does."*

[Employer nominated, medium scheme, 2-5 years experience]

*"I think you should have an industry body saying 'yes this is best practice or this is where the market is going' and disciplining actuaries if they are fraudulent."*

[Chair, medium scheme, <2 years experience]

*"You could have some best practice guidelines in terms of openness with the trustees and explaining the assumptions carefully and that kind of thing."*

[Employer nominated, medium, 2-5 years experience]

In addition, there were spontaneous suggestions of having published quality assessments of actuaries.

*"Could the regulator publish some assessment of each of the actuaries? We're regulated as an awarding body by the qualifications and curriculum authority, so they could compare us with our competitors and say on certain aspects [...] and so before you choose who you're going to go with, you can consult the information."*

[Member nominated, large scheme, >2years experience]

*"I don't want to see anyone to sort of be overregulated. I think from almost any client's perspective, you want to know that your actuary is adequately or properly qualified. So you know there is some certification or accreditation. So you know that your actuary has a certain standard of – minimum standard – of knowledge and expertise. And then in a rather more negative way, you also want to know that you can hold him responsible for his mistakes and that he has got adequate insurance if he does make a mistake, his negligence."*

[Member nominated, medium scheme, <2 years experience]

Some oversight or control of fees charged was also suggested, particularly by those involved in smaller schemes.

*"I suppose in the fees that they charge. We've already had a few complaints from our members about the amounts of money in the balance sheet that's spent on the advisor's fees. Yes, that would be the main one. Because, you know, you feel you need all these expert advisors [listed] as actuaries, and people, they say, 'Oh well, it costs this much', and you think. But, you don't know if that's reasonable or if you can get it cheaper somewhere else or as good advice as cheap."*

[Member nominated, medium scheme, <2 years experience]

However, regardless of future regulation and best practice standards, trustees felt the onus would continue to fall on them to question the advice and act in the scheme members' best interests.

*"I think the trustees if they are going to be trustees have got to have the wit and intelligence to understand and challenge what they are being told and I don't think that it's right for trustees to sort of dump all the problems on the actuaries and blame them when it goes wrong. So I don't have an expectation or hope that any further interference in their lives really will help."*

[Chair, large scheme, <2 years experience]

It was commented by some trustees that the FRC should concentrate more on its educational and communication role than on setting rigid frameworks for standards. It was felt to be helpful, for example, to have a website where questions could be answered and independent profiles of firms would be available.

*"Education and communication covers it really when you think about it. They might consider having their own little website which concentrates a bit more on the actuarial side."*

[Employer nominated, small scheme, <2 years experience]

## **Development of user led standards**

From the trustee's point of view, **communications** need to be a strong focus of future actuarial standards. At its most simple, this means providing **clear written information**:

- Plain English;
- Standardised terminology and glossaries;
- Executive summary and graphical aids;
- Written information always provided in advance.

Trustees are also calling for actuaries to **assist them in comprehending** the information provided. This can be achieved by:

- Providing full and clear explanations, pitched at the right level;
- Being available to answer questions as required;
- Potentially also being more involved in providing trustee training.

They are also looking for **advice rather than just information**. This means providing:

- Interpretation and recommendation as well as data;
- Relevant updates on issues/changes that will affect them.

The other key need identified is for actuaries to be generally **service-oriented** in their approach to trustees:

- Responsive to trustees' needs;
- Providing a 'value for money' service.

These needs are clearly not all the province of BAS future regulatory standards. Some also pertain to the **professional standards** for the industry, while others are more about **service standards** that need to be demonstrated by individual actuarial firms. And in addition to the development of standards, there is a strong theme about providing more **education** for trustees so they can better scrutinise actuarial advice and grapple with its uncertainties and inherent risks.

However, there does appear to be significant scope for the regulator to develop **best practice standards** for the actuarial industry. These standards should be centred on enabling trustees to make informed decisions. This spans all of the communication points made earlier, but could also include standards for the actual content of advice. For example, the standards could prescribe the requirement that actuaries stress test conclusions as standard. This would enable trustees to see the various assumptions that can be made and resultant different outcomes.





**iQ Research Ltd**  
**survey of insurance company non-executive directors**

**Commissioned by Financial Reporting Council**

## 1. Executive Summary

To place the findings in context, the first stage is to understand the context behind the feedback given. The responses will be influenced by the nature of interactions the NEDs have with actuaries and actuarial advice, and also their own level of knowledge and understanding.

Although the research found NEDs of insurance companies have many common traits, they are not a homogeneous group. For example, all of those interviewed had a high degree of financial literacy, often combined with a long history of involvement with insurance or banking. Whilst many had a mathematical background, and this was especially so in the smaller companies, the larger companies had specifically brought on board NEDs with consumer, retail or marketing backgrounds. Capturing the NEDs' self-reported understanding of actuarial principles and risk provides a richness to the analysis and enables distinctions to be drawn between those with different levels of understanding.

Furthermore there are differences in the ways companies operate at the Board level and the various sub-committees below that. The research explored with NEDs the point at which they would touch actuaries and actuarial advice in the course of their duties, and when they have dealings with these actuaries and whether the actuaries are internal or external.

Once that baseline had been determined, the discussion could be refined to explore NEDs' expectations and assessment of actuaries, and to examine the level of NED involvement in the appointment of actuaries.

## 2. Confidence and Reliance

### NED Interaction with Actuaries and Actuarial Advice

Most NED contact with actuaries takes place in board or sub-committee meetings:

*"I am a member of the main Board, I am also a member of the audit committee and I chair the with-profits committee. In all of those in various stages [we] will have contact with actuarial input."*

NED (Life)

*"Our actuary sits in the Board meeting for the insurance services group so throughout the Board meeting he is there to deal with any questions or concerns we have throughout the meeting, so not just for the bit where he is presenting a paper to the Chairman but also when we are looking at the financials, the budget, the strategy, so we can be certain that he is happy with assumptions we are*

*making about costs, and the ability of the organisation to generate new business income in life and savings. So it is quite robust, he is there and available to us at all Board meetings.”*

NED (Composite)

Within this context, most NED communication with actuaries relates to balance sheet analysis, solvency and company reporting (preparation of financial statements, annual returns and so on). To a slightly lesser degree, NEDs also have contact with actuaries on matters such as new business development, mergers and acquisitions activity, reinsurance and taxation. This pattern was common across all NEDs, both small and large, life and non-life.

The NEDs interviewed for this project reported that the vast amount of actuarial information they receive is an update of a previous report. Board papers outlining financial reporting matters follow a very set pattern at regular intervals throughout the year and therefore this means that the NEDs are very familiar with the content, methodology and format, and have met the actuary responsible for this work on several occasions.

*“We normally do things on a continuum basis so whether it’s year-on-year or when this was last reviewed, in other words, or five-year trends or 20-year trends etc, so you’ll get, if there’s a margin of error [unclear], whatever it might be, you will see whether it’s getting worse or it’s getting better.”*

NED (Composite)

NEDs have most contact with internal actuaries, but external actuaries also play a role. Interviewees from the larger companies (both life and non-life) typically stated that the majority of their contact was with in-house actuaries. They would primarily see the most senior actuaries in the company.

The research found that the smaller life companies often do not have the resources to employ a dedicated actuary and have outsourced the function to a third party actuarial consultancy. In the past, this was predominately the large well known houses such as Watson Wyatt or Mercers, but increasing costs has meant that the service received from these larger firms has diminished over time. Today there is a marked trend towards placing business with smaller actuarial firms which specialise in dealing with the particular needs of the smaller life company.

*“We started off when I came here, it was [xx] and then they got too pricey for us so we went to a smaller actuary in Liverpool. Then we changed to [xx] and two years ago they said we weren’t big enough for them to deal with, for the amount of work they were putting in, the fees would be far higher than what we could afford and they recommended that we looked for another actuary and they recommended [xx] to us. So we approached [xx] and that is how we chose them. We were quite impressed when they came for an interview.”* NED (Life)

*“We were looking for someone who would explain everything, the actuarial function and all the analysis and things like that, and we were very impressed with the way they [xx] put it over to us, and also cost.”* NED (Life)

However, the larger companies also work at times with external providers, primarily to cross-check and validate models and / or assumptions, as illustrated in the following quotation:

*“So I would say there are, from time to time, requests that either the internal actuary department cannot address so we go for actuarial advice outside on particular issues where we want an external view to calibrate what we are doing inside.”* NED (Life)

*“We bring in when necessary to review particular issues and problems. In some areas overseas, for example, where we don’t have internal actuaries, we bring in external actuaries to review reserves”.* NED (Life)

In addition, external actuaries also play a key role in audit and are usually sourced from the same firm as the auditors. The role of the external actuaries in this context is to review the internal actuaries and their processes.

*“At the year end situation and as I understand it, has to be done by an independent actuary now, where I think I am right in saying the external auditors used to provide that second actuarial review. It used to be from the accountants.”* NED (Property and Casualty)

*“The information at the half year and the year end is different; they are signing off and external auditors are also looking at the information, so there is a greater amount of work being performed by the actuaries.”* NED (Property and Casualty)

The actuarial audit forms part of a bundled service from the audit company. The NEDs we spoke to reported that, for reputational reasons, the audit company they use is one of the Big Four, and the relationship has been in place for many years. This means that the choice of actuarial audit partner is not based on the reputation or skills of the actuarial department. No interviewee reported holding a beauty parade to choose the audit firm, and no interviewee reported a specific review of the actuarial audit capability of their audit company.

*“It has been satisfactory in the sense that the internal actuarial team is a strong one and the one we have [...] is also good. If that hadn’t been the case then we would have said we need to look more widely, there are obviously conveniences to be had from trying to package it where it provided that work satisfactorily.”* NED (Life)

*“At the year end I am further comforted by the fact that the auditors actually utilised their own in-house actuaries to verify the work of the actuaries that we employ. There are two aspects to the actuarial involvement at the year-end, there will be the presentation that the actuaries do to explain how they arrived at their figures. We will then hold a meeting with the auditors, the non-execs will meet with the auditors to go through how they have arrived at their opinion, and they will generally have their actuaries present to go through any areas where they feel should be highlighted.”* NED (Property and Casualty)

## NED Expectations of Actuaries and Actuarial Advice

NEDs require actuaries to be accessible. In terms of the advice itself, the primary demands of NEDs is that the advice is accurate and unbiased and that it is presented and explained clearly.

*“We were looking for someone who would explain everything, the actuarial function and all the analysis.” NED (Life)*

*“For me, a good actuary has got to be able to talk to non actuaries, if they can do that then I have got some chance of assessing whether I think they are any good. If they can’t do that, I have got no method of working out whether they are any good. I think a good actuary, very similar point to one I made right at the start, has to be able to see that it is not much use always giving you bad news that has been exaggerated. Safer for him because he will never be wrong, and nobody minds if you are wrong on the wrong side. A good actuary for me has got to have some commercial judgement as well, it cannot just be they are really good at the actuarial techniques, they have got to understand the dynamics and actually the consequences of what they are recommending should happen.”*

NED (Property and Casualty)

Indeed, as it will be demonstrated throughout this report, NEDs place great importance on clarity of expression. In addition, NEDs expect their actuaries to be accurate and unbiased in their advice.

*“Clarity of explanation, consistency of message because if things, if they have to come back and tell you they have got something wrong, which they sometimes do, you think “Shouldn’t have been like that, shouldn’t have got it wrong”. And like you would judge anybody else, whether you can understand and follow what they are doing, whether the advice they are giving is consistent and clear, obviously there are times when people have to change their view, but if they chop and change, that sort of thing.” NED (Life)*

Another NED requirement of actuaries is that they are easily accessible to them. For those with internal actuaries, there are no problems with accessibility with contact possible on both a formal basis, such as through board meetings or workshops, and an informal basis in the office. As members of the Board, NEDs are important people to the organisation and therefore have the ability to access senior people if they wish.

*“There’s informal contact with the actuarial people within the society [...]. There are our workshops, which we hold on particular subject areas and so on, and obviously we have the formal board papers and the debates which go on within the board associated with those papers.” NED (Life)*

*“Yes, this is the report that we receive prior to the meeting and you see we have a note about who it has been prepared by. If, for example, when we receive it we have questions, because everything is not just confined to the meeting room. We can pick up the phone, we can e-mail [xx], so I can say “I don’t understand this bit, can we run through it” or “I am going to raise this in the Board room”,*

*so he can come along prepared to answer this question, and this sort of thing. And that happens regularly.”* NED (Property and Casualty)

NEDs have little input into the actuarial information required. NEDs do not, typically, play a direct role in deciding what actuarial advice is needed. The majority of papers containing actuarial advice are on a rolling 3 or 6 month cycle and therefore no action is needed to get this type of information. For ad hoc topics, it is generally the remit of the different sub-committees of the board to decide what information is required and for those committees to be satisfied with the workings of that information.

*“We have to be satisfied that, for example, the Audit Committee, the Risk and Regulatory Committee, in their workings, have satisfied themselves, and they of course do.”*  
NED (Composite)

### **NED Assessment of Actuaries and Actuarial Advice**

NEDs are generally satisfied with the actuaries with whom they have had dealings and believe the presentation of actuarial advice is improving. The NEDs interviewed all expressed satisfaction, with no issues being reported.

*“We are very lucky in the sense that we have [...] some qualified actuaries who are totally capable of communicating in a way that anybody would understand.”* NED (Life)

*“On the whole, pretty positive.”* NED (Property and Casualty)

However, smaller companies who were more likely to use external actuaries also reported that it takes time for the relationship to develop.

*“Over the past 5 five years we have found they have taken a more personal interest in the business. Before it was just: they came along and that was it. But now you can ring up if you have any problems, they are much more approachable.”* NED (Life)

Strikingly, most respondents stated that they had witnessed a noticeable improvement in the presentation of actuarial advice in recent years, with actuaries making greater efforts to communicate information using non-technical language and to present concepts more creatively, using graphics, traffic lights, heat maps, industry comparisons and so on.

*“I think from what I hear, this company has changed a lot in the last, probably five years, in that the actuaries now make a point of not only speaking to us in layman’s language, but also putting their presentations into either graphical form or chart form.”* NED (Composite)

*“When I first joined as a non-executive we had a total of I think two or three qualified actuaries on the staff and I remember observing at the time that for a financial services organisation I found that an extraordinarily low figure as all our work ultimately depended on the receipt of properly documented actuarial advice and so on. This gave me concern, especially as I wasn’t able to rate particularly highly the individuals that I was relating to. But I mean, this changed quite dramatically and quite clearly over the years. I mean, both the number and the competence and the contribution arising from actuarial people has increased.” NED (Life)*

Only two interviewees stated that they had not witnessed any improvements in recent years. In one instance, this was not negative feedback and was more related to the fact that the interviewee felt that the communication of actuarial advice was of a high level already.

*“[...] and that may be a commentary on the people we have had, because of course we now have two layers, of which I approve, it was one of the elements that I was saying to Derek Morris, that when you are talking to accounts, internal accountants for example, you have always got an external validation and that is absolute in the case of the actuaries. So having the two-tier structure is beneficial. In practice I don’t think that changed the tonality of the advice that we get from the auditors, but I think we were actually getting, because of the individuals, pretty dispassionate advice in the first place.” NED (Life)*

In the second instance, the main criticism of the interviewee was that there was little true interaction between NEDs and actuaries.

*“I wouldn’t say that the actuaries interact with the non-executive directors. I don’t interact with them. I sit and listen to them when they come to the Board meeting, I read their papers beforehand, and at the end of it I feel I’ve understood it, I’ve walked away. Whether I could then sit down and explain to you the paper I’ve just read would be another matter. I do think I understand them at the end of it, but I certainly don’t have contact with them outside of the Board meetings. I mean, I’ve never had lunch with an actuary. I’ve never had any social contact with an actuary. I’ve never met them after the meeting to have anything explained to me. I’ve never had a teaching by an actuary, so no.” NED (Life)*

NEDs who also have responsibilities as pension fund trustees for either their company fund or an external fund, such as a local school or charity, see a growing divergence in the quality of the two sets of actuarial advice they see, with the advice received as a NED perceived as being of much better quality.

*“On the Pension Fund side, it’s completely different, much more difficult.... I mean, it may just be the people we’re dealing with, but they’re much more theoretical. They come over as much more theoretical and find it very difficult to present to people who don’t necessarily have a significant knowledge of the area, so our employee trustees, it’s actually very difficult for them, horrendous, so*

*that side of it's much more difficult. And it does come over as a black box and they seem to be very theoretical rather than commercial, because we do need to be commercial. So different [...] different perspectives".* NED (Property and Casualty)

*"Now what people are complaining about – [...] just it's very cumbersome and it takes too long and they haven't got the time to work through it all and it's not user-friendly, and so that puts off a lot of people from using it but actually having something like that I think is absolutely essential really, and getting it better would be very helpful for smaller, people who are involved either in small businesses with [unclear] small pensions or charities or any of these other things. Because they tend to be the ones that are very under-resourced."* NED (Composite)

NEDs were not always clear on what the key drivers have been for these improvements. They believe that while the Penrose<sup>1</sup> and Morris<sup>2</sup> reports have played a role, this was of minor influence, and improvements were already underway long before these reports were published.

*"Was this [Penrose and Morris] influential in change? I think the change was already going through."* NED (Life)

NEDs attribute the positive changes to changing business practices, many of which have been driven by the FSA's requirements on risk monitoring.

*"We used to have a three year valuation and we got very little information from them really, about 4 and a half pages, that was all. But now it is much more in-depth, that is because of the FSA."* NED (Life)

A key driver for change is a change in the leadership team. Two of the companies interviewed had experienced a change in the Senior Executive team – one from outside the industry and one from a larger company. Both had brought new working practices and had sufficient influence in the company to re-vamp communications.

---

<sup>1</sup> An independent inquiry led by Lord Penrose, started in 2001 and completed in December 2003, whose terms of reference were "to enquire into the circumstances leading to the current situation of the Equitable Life Assurance Society, taking account of relevant life market background; to identify any lessons to be learnt for the conduct, administration and regulation of life assurance business; and to give a report thereon to Treasury Ministers".

<sup>2</sup> In response to Lord Penrose's Report, a wide ranging inquiry into the actuarial profession was conducted by Derek Morris. The terms of reference for this review were to "consider what professional and/or other regulatory framework would best promote recognised, high-quality and continuously developing actuarial standards, openness in the application of actuarial skills, transparency in the professional conduct of actuaries, accountability for actions and an open and competitive market for actuarial advice in the UK".

*“One of the things that I think you have to take into account is that this is a Board, current members, we have just actually recruited a new one and there is another coming and a fairly new Chairman, but a lot of the current members have been on the Board for quite a while, so have a considerable familiarity with all the topics and that makes a big difference. A new member coming in, quite rightly, will ask a lot of questions, as I did, just to get himself familiar with all the issues.”*  
NED (Life)

*“Sometimes I think the actuaries don’t truly understand, they do this dump thing, and I think it is a question of having someone, we have a new Chief Executive who has sworn to get the papers to be improved.”* NED (Life)

Whilst the smaller companies are slightly behind the curve, the pressure they are under, especially from the FSA, is driving forward the change.

*“Well, I think there has been a huge shift since the Equitable, and the biggest single shift has really been driven by the FSA, all the reporting you have to do, and so although reporting standards have changed, and governance standards have changed with the Financial Reporting Council, the big shift in my view has been the risk assessment that has to be done inside the company is being driven by the FSA.”* NED (Life)

Other factors such as Sarbanes-Oxley<sup>6</sup> and the International Financial Reporting Standard (IFRS) have also had an impact on those operating internationally:

*“I think the major change has been caused by Sarbox [...] we’ve had to significantly change systems and processes as a result of that.”* NED (Property and Casualty)

*“Some of the accountancy issues, the IFRS issues over the last 18 months have been mind-boggling to get to grips with that, and it is that sort of process. I think this is a very naïve and amateur remark, but it is one you often hear, that for a while actuaries were protecting their profession through the language and the concepts they used and if you didn’t understand it, that was your fault. I think that has changed.”* NED (Life)

---

<sup>3</sup> The Sarbanes-Oxley Act was passed in the US in 2002, having been drawn up following a number of high profile accounting scandals, such as Enron, that seriously dented investor confidence. The Act brought significant legislative changes to financial practice and corporate governance regulation with the stated objective to “protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws.” The Act applies to US public companies and their global subsidiaries and from June 2005 it also applied to any foreign company whose shares are traded on the US stock exchange and those who are contemplating such a listing.

## **NED Involvement in Choosing Actuarial Providers**

NEDs have little involvement in the decision-making process for appointing actuaries. On the whole, NEDs are not involved in the appointment of actuaries. Indeed, this process is typically carried out by the executives, though sign-off may be required by the board. NEDs appear comfortable with this process and are comfortable that the appropriate checks and balances are in place:

*“The executives tend to do the appointing, but I think it all comes to the Board. I’m fairly certain it came to the Board for sign off before they were appointed.”* NED (Life)

However, in certain cases, the Board felt it had more than a “rubber stamping” role in the appointment of consulting actuaries.

*“We didn’t go as far as to formally have a beauty parade, but we asked people to recommend. I think there are only a handful of people who provide this service so there is not a great deal of choice. But we chose this firm, so it was a sort of beauty parade.”* NED (Property and Casualty)

## **Understanding and Communication**

### **NED Understanding of Actuarial Principles**

Many NEDs have a long history of working in insurance and therefore consider that they have a moderate to high-level understanding of actuarial principles. Indeed, many of those interviewed had had experience working for financial service companies and as trustees before taking their non-executive roles. Of the fifteen interviewed, just two did not have a strong financial background - one was a journalist and the other had come from retailing. The rest had either had a long history in the financial services industry, or had been accountants, auditors or finance directors. The smaller the company, the more “financially savvy” the Board. This is not by accident. It is only the larger companies who could “afford” to have specialist Board members, for example focused on consumer or marketing issues. The smaller companies need people with mathematical ability to be able to add value to their roles.

*“We have quite a professional Board with two chartered accountants, and a solicitor and the Chief Executive. There are only five on the Board but they are professionals.”* NED (Life)

*“We are also reasonably fortunate in that we have got a Board which is financially literate. I don’t come from an insurance background but I have spent my life around financial matters and these are all second nature things. And we have a couple of people on the Board who do have, one has been a lifetime working actuary, another had actuarial professional training but finished up in another career, so we have got a financially sophisticated Board which obviously helps.”* NED (Life)

*“Whilst we don’t have anyone with an actuarial qualification as a non-exec, we do have people with reasonable experience, as pension fund trustees. And I think that’s not by accident [...]. Life companies and insurance companies have people that have got those skills, because that’s the core business.”* NED (Life)

However, the more lay NEDs are very keen to develop a high level of understanding and will not take information they do not understand at face value.

*“I was a journalist, and therefore on quite a number of occasions throughout my time on the Board I have rung up and said I don’t understand this, and have had to arrange things and have things explained to me in more detail.”* NED (Life)

*“I have quite a considerable background in pensions matters, both from a policy point of view in government and as a parliamentarian and have been very involved in a lot of the discussions. And I have a great interest in pension issues and I was in the Treasury so I have the macro interest, if you like. When you get down to some of the detailed actuarial discussions which we particularly had in the large ‘90s in relation to with profit valuations and with profit results, there was a big learning curve to try and get on top of the language and to understand where they came from.”* NED (Life)

Furthermore, it is normally the case that other board members are qualified, though not necessarily practising, actuaries. This is considered to be an important comfort factor by the NEDs.

*“And we will be relying on the fact that the Chief Executive is an actuary, one of the other Directors is an actuary, and that there are actuaries in key positions all over the place down the chain.”* NED (Composite)

While some respondents admitted that there is a small risk in the fact they do not understand all actuarial principles fully, they also do not expect to be able to understand the information as well as an actuary would.

*“But in a lot of these papers, and some of which really are very technical, I can still only get 90% of the way through them. I don’t get the whole 100%. I don’t always grasp the detail. I mean I’m not a trained actuary, and they are very technical papers. But I have taken legal advice on this, and I am told by lawyers that I don’t have to go as far as everybody else because I don’t have the same financial background. I wouldn’t be expected to understand and challenge these papers to the same extent as someone who is chairman of the Audit Committee would. So I now accept that.”* NED (Life)

Given this, most NEDs draw comfort from the fact that there are other checks and balances on actuarial performance, for instance, the external audit process and the sub-committees.

*“We give the chief actuary a pretty tough time when he attends the risk committee meetings and the audit committee and he does very well in communicating clearly and in a concise fashion so that we understand the underlying issues, assumptions and impact of the numbers.” NED (Life)*

*“And remember, these papers are not just being thought out by an actuary and brought to the Board. They have gone through all the various committees and all the various levels and they are presented to the Board and they are challenged by the executives, and then they are challenged by the non-execs. So I am not going through a paper that hasn’t had a fair challenge before you get to the Board level.” NED (Life)*

In addition, most NEDs are provided with some form of training on actuarial principles. Most NEDs interviewed had a financial services background, sometimes at least ten years in insurance. As such, many of them have built up some familiarity of actuarial principles over time. Nonetheless, it is also common for them to be provided with some form of training to fill information gaps when they join the board of a company. However, the depth of training does vary according to the company in question.

*“We did get sort of training with a couple of hours with one person and a couple of hours with another, but it was mainly within the department and we did customer service within the bank.” NED (Life)*

While another, at the other extreme, stated:

*“When I started there I had a whole kind of induction, quite an intensive induction over a number of days, over a number of months, which was intended to do its best to get me up to speed as a non-financial and non-insurance or pensions industry Non-Executive Director.” NED (Life)*

Generally, NEDs feel confident enough in their knowledge to be able to challenge any assumptions. Given the fairly high level of understanding of actuarial principles by NEDs, it is no surprise to learn that most NEDs say they are unafraid to challenge any actuarial assumptions presented to them.

*“The point, one of the things we do as a Board and audit committee and with-profits committee, is try and test where in the range of plausible permissible outcomes they are pitching their advice. And if they were at an extreme then one would question further.” NED (Life)*

This is even the case where directors are less sure of their technical knowledge. In a positive move they are unafraid to reveal this lack of knowledge and to push for further explanations:

*“I think some of the more technical people on the Board will say ‘I don’t understand what you are saying?’ so I think the good thing about the Board I am on is there is, people won’t sit and be quiet because they are embarrassed that they don’t understand. They will actually say ‘I am sorry, I don’t understand what we are discussing’, so I think that is a positive.” NED (Lloyd’s)*

NEDs are fully aware of the legal implications of the roles they have taken on and are pushing to improve their levels of knowledge and understanding to ensure they do not expose themselves

*“I was quite financial literate but still had a bit of a job getting on top of it, which is why I had teachers to make sure I was at least half up to speed with what he was talking about.”* NED (Life)

NEDs have confidence in their own business pragmatism to be able to challenge effectively and are unafraid of appearing ignorant.

*Let’s take an example of longevity calculations. Once I had understood the language I was asking all sorts of questions about how the longevity was calculated. Having been through that process, we both understand what we are talking about. I am doing it for a pension fund at the moment, and really challenging the material that they are using to calculate the longevity because more and more pension funds, as you know, are looking properly at their own experience with their own employees, deferred pensioners and pensioners. And it is those sorts of questions one is now asking, to understand how they have reached the calculation they have. The language isn’t a problem, it is just the normal sort of thing you would do in challenging somebody on a Board who has an expertise and you are a layman.* NED (Life)

## **NED Understanding of Risk**

NEDs often sit on the Risk Committee and have a detailed understanding of the issues faced by their companies. The audit committee and risk committee are seen as the structures for ensuring that appropriate and detailed challenging of data is possible and that sufficient levels of detail are explored. This is perceived to be a key check and balance in the process and gives other non-executive directors confidence in the quality and reliability of actuarial advice presented at board meetings.

*“It is usual for the Chief Actuary to attend these meetings when non-execs submit them to rigorous questioning of assumptions and models being used.”* NED (Life)

*“This is the sort of detail that will be evidenced at the committee meetings and I take comfort that I am joined by another non-executive who is an actuary.”* NED (Life)

*“No, but where we do that, of course is in the risk assessments and in all the risk work that Compliance Committee does. But that is different, that is entirely different, that is judgement as to where the biggest risks to the company lie and an awful lot of it is non- actuarial stuff.”* NED (Life)

NEDs are most confident using information they receive on a regular basis, but are more uncertain when it comes to information on new business lines. For ongoing information that is presented to the Board before each meeting, NEDs look for highlighted changes to the picture, usually by a traffic light system in the reports. However, when the actuarial information is required for a non-standard decision, i.e. regarding new product development, the chief actuary will make a formal presentation to the Board.

*“It would only be entirely new products which are likely to provide a substantial business stream really are likely to come through the audit committee and the board to sign off. And on those cases we would see the background to the product and actuarial calculations. This would then be presented to the board by the Chief Actuary.”* NED (Property and Casualty)

## **NED Comments on Pre-Meeting Materials**

To ensure that the right level of detail was gathered, the NEDs interviewed for this research were asked to think of a very specific occasion where actuarial advice was presented, for example their last solvency review, or their last profitability assessment. With this in mind, interviewees were asked a series of detailed process and content questions covering the meeting itself and also about the pre-meeting materials, if any. In particular, the research probed how the actuarial papers were presented, how the methodology behind the numbers was explained, and whether the NEDs felt in a position to challenge and / or question the advice provided. The following sections present the results of this part of the research.

NEDs normally receive actuarial papers in advance of meetings. Boards of small and large, life and non-life companies followed a very consistent process. All of those interviewed reported that Board members are sent actuarial papers in advance of any meetings; normally the papers are made available around a week beforehand. These papers tend to be produced on a regular basis and provide updates on business performance. Given that the reports are produced on an ongoing basis, NEDs tend to be familiar with their content and format and it is therefore easy for them to recognise if there are any changes.

From time to time actuaries produce ad-hoc reports. The content of these papers obviously varies significantly, but interviewees referred to ad-hoc reports on subjects such as shifting investment strategy and new product stream proposals.

*“There are both regular papers and ad hoc papers. The regular papers are what you would expect to get. As well as the core papers, sometimes they are annual, so I have seen these ones on several occasions, and sometimes we get ad hoc papers, and in particular over the last two or three years.”*  
NED (Life)

Actuarial papers tend to be short in format and are increasingly visual. There was strong agreement amongst the NEDs interviewed that the actuarial papers had improved in format in recent years. Whereas before the reports tended to be long, text-heavy and full of data tables, now they are shorter and to the point with the authors making much greater use of charts and graphics.

*“Yes, they [the reports] tend to be shorter and one of the things that the actuaries used to do is to equate volume with transparency. And so one of the things that has [been] done is to educate them that what we are looking for is brief insight, insight as opposed to volume, so they are now shorter and more insightful.”* NED (Life)

In some cases, it appears that there is a more detailed report underlying the short paper presented in the meeting and this report can be referred to if further detail or clarification is required.

*“We very often will get the slide presentation that is much more graphic in a way and visual, and then there will be bullet points with that, but also we’re a very narrative company as well so we get then a book, a three-volume novel, which goes through it all, so you’ve got both ways of getting your head around it, plus tables and tables of numbers.”* NED (Life)

Finally, if there is anything that the NEDs struggle to understand, then they have the option of calling or meeting with the actuary to get further clarification.

*“If there’s anything in the Board papers that you don’t understand, whether it’s actuarial or financial or whatever, or you don’t feel comfortable with, you just pick up the phone and say, I didn’t quite understand this. But you can see that is not written in what you’d call technical language.”*  
NED (Composite)

### **NED Comments on Meetings**

NEDs consider that actuarial presentations are well-produced and are delivered in plain English. Actuaries normally present a summary or slide pack of their paper before the board and this is followed by a question and answer session. In some companies this handout works as a standalone document, but in others verbal clarification is needed.

As with the actual papers, the NEDs overwhelmingly stated that the actuaries were able to present their findings in plain, simple English. This is something that NEDs place great value on.

*“I seriously believe that if someone can’t express themselves in plain English and make somebody understand, the value of the work they have done is limited. Because they might be the best actuary in the world but if they can’t get their message across, how is the person who is going to take the decision going to get there?”* NED (Life)

*“He has a brilliant mind and communicates with utter precision. I am not an actuary but I trust his numbers and if I didn’t, it would be my responsibility to express this concern to the Board and possibly recommend he be replaced. However, his communication is wholly appropriate.”*  
NED (Life)

Most NEDs feel they have an understanding of the methodology behind models. Given the reported clarity of actuarial presentations, it is no surprise to learn that most NEDs feel that they also have a good understanding of the unavoidable risks faced by the company.

*“Yes. That is the advantage of having a financially sophisticated audience, from other things you have done you know which variables are going to produce the big swings so yes, I think you probably do.”* NED (Life)

However, other respondents made clear that it was the most pressing risks, as opposed to all risks, with which they were most familiar. With one respondent stating that while the actuarial papers would look at the 50 most important risks, at board level most discussion would centre around the top ten risks that would stand to damage the company the most.

In addition to understanding the risks themselves, most NEDs feel that they also have a grasp on the methodology behind the models used. For example, one interviewee recounted that the board members were taken through the models each year, so that they would have some understanding of how they worked. Furthermore, all but one of the respondents stated that the industry has moved and is continuing to move away from the ‘black box’ approach that existed some years ago:

*“When I was a Pension Fund Trustee ten years ago, in a FTSE 100 company, then the black box syndrome was definitely there [...]. I’d say in a situation like I’m in here today, because you’ve got all the processes and checks and balances and systems as well. Whilst I don’t know what the actuary does in detail, I have enough confidence in the systems and the checks that are carried out.”*  
NED (Composite)

One respondent did not share this view and complained of being presented with a ‘dump’ of information with no interpretation.

*“I think there is a bit of a problem with that, sometimes I think the actuaries don’t truly understand, they do this dump thing, [...] I think there is a need for clear communication, what are the essentials, what are the key messages, and to express it with graphs and not, as we always get, pages and pages of tables. Seas of numbers don’t tell me very much.”* NED (Life)

NEDs who also touch the actuarial profession through their current roles as trustees believe that whilst the black box syndrome does exist to some degree in the pensions world, commercial and regulatory pressures have driven the corporate world towards transparency and openness

*“I think when I first joined the Board, the actuaries tried to portray mystery and smoke and mirrors about it, and didn’t actually want to explain [...] how they came up with the Board calculation. The non-execs sort of accepted it because the executives were recommending it, but that’s not the case now. It has to be clear because we are putting our names to it. So we are much more careful about that now.”* NED (Life)

The majority of NEDs had confidence in the numbers presented to them and considered that the data is amply stress tested and checked, even if they are not always clear about how this is done.

*“Yes. Because we do the valuation under Peak Two<sup>4</sup> there isn’t a requirement to do stress testing, but we do stress test and what we find is that because the allowances that we have made in doing the realistic test, that actually we find with the stress testing that we do we don’t have to increase the working capital. Generally we find it works out at zero.”* NED (Property and Casualty)

Furthermore, NEDs also stated that where numbers do change from previous meetings, this is flagged up and the reasons behind the change are explained to the group.

*“Yes. Clearly highlighted. Certainly for those that are warning red then it is clearly highlighted. I was just thinking if last month was green and next month was amber would we immediately pick that up, and yes we would, because it would be signposted up or down.”* NED (Property and Casualty)

*“They explain it very well, they explain the reasons for it and what they need to do, as the client what we need to do to put it right, and they make recommendations.”* NED (Life)

NEDs are comfortable debating and discussing any questions they may have on the actuarial advice presented. After the presentation of the actuarial papers, there is typically some debate and discussion amongst the board members. Some respondents stated that it was typically the NEDs that had more questions and that this was largely because the Executives had already been through the content outside of the board meetings.

*“Obviously the non-execs do more of the questioning because supposedly the Chief Exec and all the rest have all been through it.”* NED (Life)

While all the NEDs feel they have a good understanding of the subject matter and are unafraid to challenge what is presented, some respondents made the point that they may not always understand the finer technical points and that it is normally other board members with an actuarial background, that will debate the most complex subject areas.

*“I would think that, in terms of real, real hard challenge, they [people with more of the actuarial/ financial background] would be the ones who go furthest because they have a deeper understanding.”*  
NED (Life)

That said, it appears that it is unusual for the discussions to get so technical, with some respondents relating that their chairman requests that members stick to the key points of the discussion and reserve highly detailed discussions for outside of the board meeting.

---

<sup>4</sup> Realistic balance sheet valuation of large with profits life insurance funds.

Probably the key indication of NEDs' confidence in the actuarial advice is that they all overwhelmingly stated that they would be happy to sign off on the information themselves. This, more than anything else, displays their faith in their companies' processes for the production of actuarial advice.

## Challenges

There is the feeling among some NEDs that actuaries can be somewhat blinkered. While NEDs are largely satisfied with the actuarial interactions that they have, some of those interviewed for this research expressed the view that actuaries could be somewhat blinkered in their opinions and that they should be more ready to draw on external views from sources such as economists and others.

*"I think that the actuarial type roles need to be more open to essentially sometimes non-actuaries. There needs to be some relationship between economists, accountants and ordinary business people sometimes, and actuaries, and the Institute (Faculty and Institute of Actuaries) almost needs to have non-actuaries in a role which really exposes the Institute to the thinking of others. Other professional bodies have struggled with it, but they've found ways of exposing themselves to people from outside their particular profession."* NED (Life)

On the life side, actuaries in the larger life companies are well connected to the investment departments and are able to draw on this expertise to inform their assumptions. Smaller companies will often outsource investments to a third party, and therefore do not have such ready access.

*"Everything, yes, we meet with the actuaries twice a year and we have a valuation every year at the end of December."* NED (Life)

*"Certainly the actuarial department work very closely with [...] on quite a number of issues to share their knowledge and make sure that one is not acting in a way that is different from the other side."* NED (Life)

A number of NEDs interviewed believed that going forward there would be a need for a different sort of person to perform the roles currently undertaken by the actuary of today and that the differences between the "old school" actuary and the new breed would become more and more distinct. NEDs believe actuaries were historically drawn from a very narrow pool of pure mathematicians, who were focused on the numbers and methodology. Going forward, much more emphasis is needed on communication and commercial skills, which will drive the need for applied mathematicians, or those with a numerate background e.g. engineers, economists and so on.

*"Well, I think it can probably do two things. One is revisit again the syllabus. They have built elements about presentation into it, but I think it is slightly lip service at the moment and needs to get a lot more substantial. And then I think at the qualifications stage, if it could be made more virtuous to change from firm to firm or with a range of assignments. If you are a trainee accountant then you are doing audit work and you see lots and lots of firms and you see a great spread and part*

*of the value is that breadth of experience. Whereas if you are always working in the same insurance company you won't see anybody else, you might do a formal comparison but you won't know them inside out. So it seems to me that the industry is in a good position to force the pace by saying if you want to get qualified or you want fellowship, then as a pre-condition you must be able to evidence that you have seen a range of firms rather than just been kind of blinkered within a single firm."*

NED (Life)

Life NEDs painted a very clear and consistent picture of the two biggest risks to their business; longevity (including morbidity and mortality) and investment returns.

Of the two, investment risk was monitored more closely by all those interviewed as this was seen to have the potential to have a big impact and to hit the bottom line very quickly. Life offices are still reeling from the last equity market crash and, for many, solvency margins are only just beginning to look healthier.

*"The input into the investment strategy is vital which of course radically affects the performance of the company. So it is very central to the core business."* NED (Life)

*"Investments, we take a very cautious approach to investment, 50% are in equities and the rest are in fixed assets. It used to be 40%."* NED (Life)

*"I mean equity risk, fundamentally, is probably the biggest risk this company is facing."*

NED (Composite)

Longevity risk is seen as a much more long term risk to the business, providing the potential to react to new information by changing prices, altering terms and conditions, and so on.

Furthermore, the FSA keeps a tight reign on the range of assumptions made and any outlier is quickly spotted and the company is asked to explain its rationale. This ensures that the life companies maintain a reasonably consistent set of assumptions across the industry.

*"I think you are right that investment is more immediate than longevity but they are both fundamentally important and I think the instruments that we have got for dealing with investment risk are a lot more developed and sophisticated than the instruments that we have got for dealing with mortality and morbidity risk, either in terms of having instruments, derivatives or whatever, that would allow us to trade in them. But also we are not allowed to be cautionary as far as mortality. We can take a spread of assumptions that they recommend, but you can't say that recent history has told us it is only going to get worse, therefore we are going to go a step more conservative. There is no facility for doing that and saying we want to be more conservative. They are all backward looking assumptions".* NED (Life)

## Regulation

NEDs have little awareness of the formal standards used to assess actuarial performance. None of the NEDs interviewed had any awareness of how actuarial performance is formally assessed internally and none reported being asked for formal feedback:

*“I have no idea. They seem good. They seem very good actually. The ones that we’ve got, they do explain their papers quite clearly.”* NED (Life)

For those with internal actuaries, informal feedback on poor performance is often through the CEO or Executive team, and is usually centred around communication issues, rather than technical issues.

*I think actuaries have taken on board the need to speak in English basically, rather than in statistical terms all the time. There is a tendency for the more technically minded to go off into speak, but at the Board that I am a member of there is a reluctance by the non-executives to not understand. So if we do go down those routes, people will actually say “I don’t understand what you are saying, can you explain it from a different angle?”* NED (Property and Casualty)

Companies dealing with external actuaries are able to influence the lead partner, and if they are unhappy with the relationship they will be assigned a new person.

In general, many of the respondents placed most store on the ability of the actuaries to explain their workings and concepts clearly.

*“You would hope the Executive, who are insurance experts, would know. As a non-expert I guess it is to do with clarity of information, comparable performance, it depends which area of the profession you are looking at, but if you can get comfortable with comparisons, I guess that is it really. You are relying on the professionals, the executives, to help you there.”* NED (Property and Casualty)

Yet the main sentiment which was expressed was that the assessment of actuaries would normally be picked up by other parts of the organisation.

*“In an organisation like this we would be relying on the Executive Committee, and below them, the [...] people that report to each other and internal audit and the whole structure, we would be relying on them to do that job. We do have actuaries in senior management, and they wouldn’t be in senior management if we didn’t think they should be there. And we would be relying on them to evaluate the actuaries down the line.”* NED (Composite)

Moreover, many respondents pointed out that their actuaries were also assessed through the external audit process.

*“We have an audit procedure, external, which identifies difficulties or inconsistencies or points which may be relevant. I think the audit procedure is regarded as perhaps the most important factor and as I’ve already indicated not much has arisen in that.”* NED (Life)

*“I get my comfort level from the fact that we have outside actuaries checking the actuaries.”*  
NED (Life)

In terms of the professional standards expected of actuaries, none of the respondents were aware of what these would be.

*“The kind of people I would see from elsewhere are, by and large, the best ones, so if they’re coming in from an external consultancy or another business they’re going to put their stars in front of you and the best communicators, so I think you get some kind of sense of benchmarking.”* NED (Life)

Peer review, both within the company and in the profession as a whole, is considered by NEDs to be an effective barometer of actuarial performances.

*“I suppose fundamentally it is an actuary whose skills and experience and judgement are respected and there are a lot of peers around who can give you that judgement [...]. One of the things I have discovered, and I don’t know if this is true or not, but certainly I have been told quite often and it seems to me to be right, is that you are talking about quite a narrow group of people and they all know each other, so when you talk to head hunters about who is good in the market, you get a view from them and you get a view from your own actuaries.”* NED (Life)

Finally, few of the NEDs interviewed possessed strong awareness of the role of the FRC and as such there were few responses related to this.

*“They weren’t on my radar until I received the letter about the research. But then as I am not an actuary, I guess that was understandable.”* NED (Composite).

*“Does the fact that the actuaries are sort of underpinned by the FRC and the Faculty and Institute of Actuaries, does that have any bearing on my comfort level? I haven’t given it a moment’s thought [...]. I get my comfort level from the fact that we have outside actuaries checking the actuaries, and the fact that they have senior positions in [xx]. I suppose also we are a public company, and if the figures are wrong and we were taking the wrong decisions or whatever, there are checks within and without the company.”* NED (Life)

Indeed, the respondent who had the most knowledge had previously worked for the FSA.

*“But then I sat in the Board of the FSA, so I was deeply involved, not directly with actuaries, although some of the people who were running part of the FSA had actuarial backgrounds, not functioning as actuaries, therefore encountered, if you like, the actuarial profession and actuarial subject matter.”* NED (Life).

## Conclusions

NED interaction with actuaries is typically limited to board and sub-committee meetings, where they often come into contact with their company's in-house actuary. However, if required, NEDs also have access to actuaries outside of these meetings. This is typically on an informal basis and happens when the NED needs further explanation on points raised in board meetings.

While few of the NEDs interviewed had any awareness of the formal standards used to assess actuaries, most stated that they were happy with the provision of actuarial advice in their company. In particular, many of the NEDs pointed out how the presentation and communication of actuarial advice had improved in recent years. For example, greater use of graphics is made to convey findings, rather than just a number of tables. These improvements were broadly attributed to general changes in the corporate approach to actuarial advice, as well as regulatory impetuses such as FSA risk assessments, Sarbanes-Oxley, IFRS and the Penrose and Morris reports.

In terms of the meetings with the actuaries themselves, the interviewees generally recounted that they were provided with the actuarial papers about a week in advance of the meeting. The actuary would then present their work in the meeting. In line with the earlier comments regarding communication, the majority of NEDs stated that the quality of the papers was high, that they were well written and presented and that the ideas were clearly expressed. This clarity of communication is valued greatly by NEDs, for the feeling prevails that if an actuary cannot convey their work in clear terms, then the value of their work is greatly diminished, and it is harder to get buy-in from the people to whom you are presenting.

None of the NEDs interviewed claimed to have an equivalent knowledge of actuarial principles as an actuary themselves, but many felt that they had a good understanding of basic actuarial principles. Typically, this understanding was due to previous experience of working, if not in insurance, then in financial services. Furthermore, on joining boards of companies, NEDs commented that they were often provided with some level of training to fill knowledge gaps; while in some companies, NEDs were regularly taken through the actuarial models so that they could gain some insight into the approach of their actuaries.

Given the relative confidence of NEDs in their actuarial understanding, it is no surprise to learn that they have no reservations about challenging the information presented by actuaries or asking for further details on the actuarial work. That said, some NEDs freely admitted that they did not have the knowledge to really get to grips with the more technical questions. However, this was not a cause for concern for many of the NEDs, who were confident in other checks and balances that were placed on the actuarial advice. For example, other board members are likely to have actuarial backgrounds and are therefore able to probe on more technical matters. In addition, internal actuaries are subject to review from external actuaries as part of the audit process.

As a consequence of this, all of the NEDs interviewed stated that they would be prepared to sign off on any actuarial papers, thus demonstrating their confidence in the actuarial processes of their companies.

With commercial and FSA pressures driving the NED and company behaviours, the FRC can play a critical role in helping companies, especially the smaller companies to understand best practice. However, there was no appetite for prescriptive legislation to govern actuarial interactions.

The changing role of the actuary will require a different skill set to the traditional focus on mathematical prowess. Whilst excellent numeracy will remain the bedrock, actuaries will need to draw on a wider range of disciplines to create a more rounded and commercially focused way of thinking. The best in the profession were seen to be making these changes, and the FRC could help by providing more guidance and career models.

NEDs felt that the FRC would do well to explore professions which had made this transition, such as the accountancy profession, to see what lessons could be learned. There was a sense that professional training and continuing professional development (CPD) should be much wider and encourage more inputs from economists, fund managers and so on.

Without a doubt, good communication is a vital element in the actuarial toolkit. NEDs felt that whilst good progress was being made, this would vary by size of company and there could be an important role for the FRC in helping actuaries to improve their communication skills. This was especially so for the trainees, and the current syllabus was felt to pay “lip service” to this issue.

Ultimately the FRC and the Actuarial Profession may wish to consider how to encourage those with non-traditional backgrounds to enter the actuarial profession. NEDs felt that the broadening remit and need for better communication skills meant that the profession may need to source its new talent from a broader graduate pool.

## **Annex A – Background to the FRC, the Actuarial Stakeholder Group and this survey**

### **The FRC's role in the regulation of actuaries**

Following the Morris Review of the Actuarial Profession, which reported in March 2005, the Government asked the FRC to take on responsibility for independent oversight of the Actuarial Profession - the Faculty of Actuaries in Scotland and the Institute of Actuaries - and the independent setting of actuarial technical standards.

The FRC assumed this responsibility in April 2006 and agreed a Memorandum of Understanding with the Actuarial Profession in May 2006. Its work is to be delivered through three of its Boards:

- **The Board for Actuarial Standards (the BAS)** –to set actuarial technical standards;
- **The Professional Oversight Board (the Oversight Board)** - to oversee the way in which the Actuarial Profession regulates its members acting in their professional capacity;
- **The Accountancy and Actuarial Discipline Board (AADB)** – currently the Accountancy Investigation and Discipline Board, which will implement an investigation and discipline scheme in relation to matters involving members of the Actuarial Profession that raise or appear to raise important issues affecting the public interest.

Through the new regime, the FRC and its Boards seek to promote high quality actuarial practice and the integrity, competence and transparency of the actuarial profession – to the benefit of all those who rely on, or who are affected by, actuarial advice.

In its plan for 2007/08, published in April 2007 following consultation with its stakeholders, the FRC set out its planned activities in relation to the regulation of actuaries, which include publication of this survey.

### *The FRC's Actuarial Stakeholder Group*

The quality of a product or service can in principle be measured by reference to whether the provider is meeting the needs and expectations of the users of its services. The Morris Review identified a number of concerns about the relationship between actuaries and their main users, including:

- a significant communication and understanding gap for many users;
- deficiencies in the way risk is treated in actuarial advice so that users often fail to understand the uncertainty relating to the actuarial information they receive;
- a relatively low level of switching between actuarial advisers, despite an apparently reasonable choice of actuaries;
- a lack of effective challenge and scrutiny of actuaries by users, in effect relying on the Actuarial Profession and regulators to safeguard their interests.

The FRC has therefore established the Actuarial Stakeholder Group to provide input to the work of the BAS and the Oversight Board, from users of actuarial services. The Stakeholder Group includes direct and indirect users of actuarial services, and industry and consumer representatives. Further details may be found in Annex B and on the FRC website at [www.frc.org.uk](http://www.frc.org.uk).

#### *Survey of principal users of actuarial services*

One of the first tasks of the Stakeholder Group has been to oversee a survey of pension fund trustees and the non-executive directors (NEDs) of insurance companies, representing the principal users of actuarial services. Insurance companies and pension funds and those who manage and control them are accountable to their stakeholders, including shareholders, policyholders, and pension scheme members, and are respectively regulated in the public interest by two bodies exercising statutory functions – the Financial Services Authority (FSA) and the Pensions Regulator.

Pension fund trustees and NEDs therefore play an essential part in the demand for and assessment of quality in actuarial practice; their decisions are relied on by end-users of actuarial services, principally pension scheme members and insurance policy holders.

The FRC is keen to understand the experience of trustees and NEDs in instructing actuaries and using actuarial information, as well as their expectations and understanding of the work of actuaries, and of the standards and regulation that apply to actuaries and their work. It therefore asked the Stakeholder Group to oversee and interpret this research.

The survey was undertaken by Opinion Leader Research and iQ Research. Further details about the survey are included in their reports which appear in Chapter 4.

## Annex B - Membership of the Actuarial Stakeholder Group

Gordon Beaumont	Chairman, Alfred McAlpine Pension Trustees Ltd
Rosemary Beaver	Head of International Compliance, Lloyd's (and Chair of the Insurance Institute International Committee)
Jocelyn Blackwell	CEO, Higham Dunnett Shaw
Steve Balmont	Director, Law Debenture
Roger Carroll	PR Consultant, Bell-Pottinger
Norma Cohen	Financial Times
Hilary Daniels	POB member. Formerly Chief Executive, West Norfolk Primary Care Trust and Interim Chief Executive, Norfolk PCT
Christopher Daws	BAS Member. Consultant to, formerly Financial and Deputy Secretary, Church Commissioners; Trustee, NCH; Trustee – Director NCH Superannuation Fund
Fiona Draper	Independent Pensions Consultant/Trustee
Dianne Hayter (Chair)	BAS Member. Board member, National Consumer Council
Melanie Johnson	ABI Consumer Impact
Trevor Larman	Independent Trustee, Golden Charter
Julian Lowe	BAS member. General Insurance (GI) Actuarial Director Aviva plc
Anne Maher	POB member. Formerly Chief Executive of the Pensions Board for Ireland. Board member, Irish Accounting and Auditing Supervisory Authority and of Allied Irish Banks plc
David Metz	Financial Services Consumer Panel
Peter Murray	Trustee, Retired pensions manager: Railway Pensions Scheme
Patricia Peter	Head of Corporate Governance and Employment, Policy Unit, IOD
Penny Shepherd MBE	Chief Executive, UK Social Investment Forum
Jay Sheth	Senior Policy Advisor, CBI
Anna Sofat	IFA, AJS Wealth Management Ltd
Doug Taylor	Which?
Roger Turner	Executive Officer, Occupational Pensioners Alliance

## Annex C - Methodology for the survey of pension trustees

A total of 14 depth interviews were conducted with pension trustees. Interviews were conducted face-to-face by senior Opinion Leader executives and typically lasted 60 minutes. Where permission was given by respondents, interviews were digitally recorded and then transcribed to allow detailed analysis.

The interviews followed a semi-structured discussion guide that ensured respondents were asked the same questions but it also allowed interviewers to pick up on particular themes and gain additional insights where relevant.

The sample was structured to represent the following key variables:

- Size of scheme – up to 100 members, 100-300 members, more than 300 members;
- Type of trustee – member nominated, employer nominated, chairman;
- Length of time as a trustee – up to 2 years, 2-5 years and more than 5 years.

In agreement with the FRC, the emphasis of the interviews was on relatively new trustees, trustees from smaller pension schemes, and trustees who are not chairmen (both member and employer nominated). The following sample frame shows the quotas that we were working to:

Criteria	Target	Achieved
Employer nominated trustee	5	5
Member nominated trustee	5	5
Trustee chairman	5	4
Small scheme (<100 members)	4	3
Medium scheme (100-300 members)	6	6
Large scheme (>300 members)	5	5
Least experience (<2 years)	6	7
Mid range experience (2-5 years)	6	4
Longest experience (>5 years)	3	3
<b>TOTAL</b>	<b>15</b>	<b>14</b>

The initial sample list was compiled from the UK Pension Fund Online database. Introduction letters were sent from both the FRC and Opinion Leader to the Chairman or main contact listed on the database, outlining the aim of the research and inviting them to take part or nominate a fellow trustee to take part. Follow-up phone calls were then made by our recruitment team to the named contact to determine the most appropriate trustee to take part, i.e. a trustee with more/less experience or a member or employer nominated trustee. Contact was then made with the individual trustee and an appointment booked at a time and place convenient to them.

## **Research with Pension Trustees Discussion Guide**

### **Introduction by Opinion Leader**

- Aims of consultation
- How results will be used
- Not a test
- Confidentiality
- Permission to tape

### **Introduction by Trustee**

- Current post – employer or member nominated trustee?
- Total experience as a trustee
- How define role of trustee and how has this changed over time?
- Knowledge and understanding of aspects of role (drawing from self-assessment form for the Pensions Regulator)
- Whether training has been received and whether this is required
  - Who provided their training and what was it on?
  - How useful was it?
- Use of actuarial advice – which firm etc.?
- Overall satisfaction with actuarial advice – considering relationship/communications, content of advice and accountability
- Key strengths and weaknesses/areas for improvement

### **Relationship/Communications**

- Run through live case study/studies that trustee has prepared in advance to outline how relationship works and advice is given. Then probe as required.
- How often in contact?
- Who initiates contact – is it proactive or reactive?
- Do you feel actuaries keep you up-to-date?

- What information is provided to you and in what formats?
  - What is the proportion of advice given orally versus written?
- How easy is it to understand – including views on language and presentation of information and any specific areas of uncertainty?
- What drives provision of actuarial information – is it supply driven (based on habit, established actuarial products) or demand-driven (actuaries responding to your specific requirements)?
- How well/poorly do you rate actuaries on communicating with trustees?
- How could actuaries make dialogue easier?
- To what extent is it the actuary's vs. the trustee's responsibility to ensure trustees fully understand actuarial advice and decisions are taken with proper understanding?
- Do trustees communicate actuarial advice on to end users? Do you feel an obligation to ensure end users understand actuarial advice?

### **Actuarial Advice Provided**

- How well do you feel you understand how actuaries work and how they reach decisions?
- What are their long-term and short-term considerations?
- How do they deal with uncertainty?
- How do they estimate life expectancy – and how satisfied are you with this?
- Do they also provide investment advice - and are they qualified to do so?
- Do they understand the business/consider business needs as well as actuarial needs – and should they do so?
- Do they clearly explain risk involved in the advice they give to you?
- How risk averse are they in their risk assessments? How does this fit with your own attitude to risk?

### **Scrutiny/Accountability**

- Do you actively have dialogue with and challenge actuaries about their assumptions?
  - What areas would you typically challenge your actuaries on e.g. data integrity, quality?
  - If not, why not and what would need to happen to enable you to do so?
- Is advice given recorded?
- How do you evaluate the quality of advice? How well equipped do you feel to do this?
- Are there formal processes in place and if so, how do these work?
- Do you check actuarial advice with a third party (internally or externally)?
- Do you ever compare different providers of actuarial advice?
- What customer satisfaction feedback is collected by the actuaries?
- Do you feel there are any potential conflicts of interest that exist with your actuaries – for example towards your employer and other members?
  - If yes, how do you deal with this?

- What are your expectations around the regulation of actuaries?
  - Do you feel regulation should provide a complete safety net for trustees in terms of their accountability?

### **Future Standards for Actuarial Services**

- Sum up overall level of confidence and trust in actuaries, and areas of uncertainty
- Sum up your key needs with respect to actuarial advice (and understanding of needs of policyholders)
- If/how are these needs changing?
- What needs to be done to better satisfy these needs?
- What are the key elements that the BAS needs to take into account in developing the conceptual framework for new actuarial standards?
- Thank and close – ask for their preferred charity for donation

## **Annex D - Methodology for the Survey of insurance company non-executive directors**

FRC asked iQ Research Ltd to conduct research amongst non-executive directors (NEDs) of insurance companies in order to increase its understanding of:

- a. The needs of the NEDs of insurance companies, specifically in relation to:
  - How they decide what actuarial information they require before making decisions, and how they use it in the decision making process (particularly in the area of risk);
  - Their understanding of actuarial advice and their views on the language in which it is written and the way in which advice is presented. How they distinguish between or test the quality of actuarial advice;
  - The degree of trust in the relationship with their actuarial advisors;
  - The extent to which NEDs feel able to critically challenge the actuarial information and advice they receive and to which they feel able to bring effective challenge.
- b. Their understanding of the standards that an actuary is expected to maintain in relation to technical competence, ethical considerations and continuing professional development, what takes place to make sure this happens and what happens if it doesn't. To what extent reliance and trust are placed on the existence of these standards to ensure the quality of the information received.
- c. Whether they feel equipped to distinguish between various actuarial providers or service propositions.

A total of 15 depth interviews were conducted with NEDs. Interviews were conducted face-to-face by iQ Research executives and typically lasted 60 minutes. Where permission was given by respondents, interviews were digitally recorded and then transcribed to allow detailed analysis.

The interviews followed a semi-structured discussion guide that ensured respondents were asked the same questions but it also allowed interviewers to pick up on particular themes and gain additional insights where relevant.

In agreement with the FRC, the emphasis during the selection process was on NEDs who did not have a background in financial services or who had less financial expertise and experience than other executive and non-executive members on their respective Boards.

The sample was structured to represent the following key variables:

- Size of insurance company
- Type of insurance company – composite, life insurance, property and casualty insurance
- Degree of experience and expertise of NEDs in financial services

Care was also taken not to select NEDs who were also actuaries and only to select NEDs who sat on more than one board in the insurance sector once and to avoid existing links with the FRC.

The initial sample list was compiled from the board profiles of UK insurance companies. Personalised introduction letters were sent from the Chairman of the Board for Actuarial Standards to the NED selected explaining the purpose of the research and inviting them to take part or nominate a fellow NED to take part. Follow-up phone calls were then made by an iQ Director to the Board Administrator with a view to scheduling an interview. If the NED was willing to participate, an appointment was booked at a time and place convenient to them.

Ultimately, 15 interviews were recruited with NEDs of 15 different insurance companies which included 3 composites, 7 life companies and 5 property and casualty companies.

Whilst every effort was made to recruit NEDs who had limited expertise in financial services the majority did have a financial services background. Just two of the fifteen had come from outside the financial services sector.

Directors of iQ who have significant experience of the financial services industry conducted 15 face-to-face interviews lasting approximately one hour. The research was qualitative and included almost wholly open-ended lines of questioning. The interviews were conducted along the lines of a discussion rather than using a structured questionnaire. However, a detailed discussion guide was agreed with the FRC and ensured that all topics and issues were addressed with each NED. This meant that the NEDs were able to provide detailed, complex and contextual responses of a richness which is unachievable through a more structured research approach. This qualitative approach did not lend itself to a comprehensive question and answer approach on all areas of FRC's interest. For example, respondents did not mention discount rates and there was little voluntary comment on policyholders.

Of the 15 NEDs interviewed, 12 were also trustees of pension schemes. They had therefore had contact with actuaries in the context of their role as pension scheme trustees and had a good baseline of knowledge to compare and contrast the relative performances of internal and external actuaries.

## **Research with NEDs**

### **Discussion Guide**

#### **Warm Up**

We would like to talk to you about the quality of actuarial advice you receive in your role as a NED. To start, could you tell me at what points in your decision making would you have contact with actuaries and actuarial advice?

## Prompt for:

- With profit valuations
  - Solvency
  - Company reporting and preparation of financial statements
  - Calculation of long-term business provisions
  - Balance sheet, profit and loss
  - Deferred taxation
  - Profitability analysis
  - New business development
  - M&A activities
  - Mergers & acquisitions
  - Any other?
- 
- How do you decide when you need actuarial advice?
  - How do you decide what advice is required and who will be responsible for delivering it?
  - Could you tell me which actuaries you have dealings with in your role as a NED? [Prompt: with profits actuary, independent actuaries etc.]

## General View of Actuaries & Characteristics

- Generally speaking, how would you describe the actuaries you have had dealings with?
- Probe for actuaries' attitude to risk, language used, ability to tailor communications to non-expert audiences, any changes in "house views" from the independents
- Have you seen a change over time? [Probe for the last few years since Morris and Penrose]
- Probe for any differences between in-house and independent actuaries
- How is the quality of your actuaries assessed?
- What performance benchmarks do you use?
- What is your understanding of the standards an actuary is supposed to maintain? [Probe for technical competence, ethical considerations, ongoing CPD]
- Who is responsible for doing this assessment/review? How often are they reviewed?
- Are you aware of the role of the Financial Reporting Council? Does their remit provide you with comfort that the actuarial professional is adequately governed?
- What role, if any, do you play in appointing the actuaries you use? Who is responsible for this?
- What do you look for? How easy is it to distinguish between various actuaries or actuarial providers?
- How would you describe the interactions that you have had with these actuaries?
- Have you seen a change over time? [Probe for the last few years since Morris and Penrose]
- Generally what are your views on the quality of advice you receive?
- How much do you trust the advice you are given? On what basis do you make this judgement? Are there areas where you are more likely to instinctively trust the advice you are given, and areas where you are more likely to challenge?

## NED Level of Understanding

- How well would you say you are aware of the basics of actuarial advice? What is your level of comfort and competence? And the rest of your Board?
- How comfortable are you to challenge the advice you are given? And the rest of the Board?
- How did you build your knowledge? Have you ever had training on actuarial principles to be able to better understand the advice you receive? Who delivered this? Is this something you think would be useful going forward? Who do you think should be responsible for setting the programme?
- **PROBE A SPECIFIC SITUATION – Now thinking about the last time you used actuarial advice and information [discuss a pre-defined specific situation i.e. reporting the long term business provisions, or the with profit report] what was the process that you and the Board went through?**

## Pre- Meeting

- What pre-meeting materials did you receive? What types of information did you receive?
- What is your opinion on the materials you received?
- How easy were they to understand? Are they stand-alone documents?
- Do you have a process in place to enable you to ask questions and receive more detailed background information?

## Meetings

- How many meetings was this issue discussed at? What format did the discussion take e.g. formal presentation followed by Q&A?
- How long was the presentation? What are your overall views on the way the information was presented to you?
- How well are risks explained to you? What language is used – would you describe it as plain English?
- Did you see evidence of stress testing and scenario planning? How was this explained to you and how was the final outcome presented?
- Are you sure what the unavoidable risks are?
- How do you feel about the methodology underlying the numbers you were shown? Is it a “black box” or do you feel you have a good understanding of the models etc?
- Do you know what level of uncertainty is attached to the assumptions and numbers used? How is this explained to you? What language do they use? Would you describe it as plain English?
- Did you have a good explanation as to why the numbers and assumptions had changed since the last report? Did you understand the reasons why the numbers had changed and what were the key drivers?

- Is the material easily understood as a stand alone document or does it require someone to talk it through?
- Did you feel satisfied that you fully understood every piece of information that was presented? Did you feel comfortable to ask questions or ask for points of clarity? Why? How technical would these be?
- How would you describe the discussion you had? How long did it last? What were the main sources of discussion?
- How much time did you spend debating the assumptions?
- Who were the main people talking and asking questions? Do any of the Board members play specific roles in these meetings – for example do those with actuarial or technical backgrounds make the challenges?
- How do you capture the oral debate? Was the discussion recorded as part of the minutes of the meeting?
- If you were the sole person responsible for signing off the numbers, would you feel comfortable to do so based on the process you went through? Why? What else would need to happen to put you in this position?

### Follow Up

- What was the nature of any follow up?
- **Was this process typical of the way you work? Could you describe situations where things have been better? And where things have been worse?**

### Wrap Up

- Ideally, what changes would you like to see happen to improve the way you receive and deal with actuarial advice in your role as a NED? [Probe specifically how do you think transparency and clarity can be improved, especially around risk]
- What are the things that the actuarial professional should be doing and what are the things that you, as a NED, should be doing? What can be done to make this happen?
- What role is there for professional bodies such as the Faculty & Institute of Actuaries and the FRC?
- Is there anything we have not covered that you would like to say about the actuarial profession, or the way actuarial advice is delivered?
- Is there anything you would like me to feed back to the FRC on your behalf?



© The Financial Reporting Council Limited

ISBN: 978-1-84140-955-9

SAP Code: UP/FRC-BI7009



**FINANCIAL REPORTING COUNCIL**

**5TH FLOOR**

**ALDWYCH HOUSE**

**71-91 ALDWYCH**

**LONDON WC2B 4HN**

**TEL: +44 (0)20 7492 2300**

**FAX: +44 (0)20 7492 2301**

**WEBSITE: [www.frc.org.uk](http://www.frc.org.uk)**