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# Joint Forum on Actuarial Regulation: A risk perspective

Analysis of responses to the October 2014  
discussion paper

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# Foreword

Actuarial work is central to many financial decisions in insurance and pensions and is an important element in other areas requiring the evaluation of risk and financial returns. High quality actuarial work promotes well-informed decision-making and mitigates risks to users and the public; poor quality actuarial work can result in decisions being made which are detrimental to the public interest.

The Joint Forum on Actuarial Regulation (JFAR) co-ordinates the identification of and response to public interest risks to which actuarial work is of key relevance.

A discussion paper *Joint Forum on Actuarial Regulation: A risk perspective (the Risk Perspective)*<sup>1</sup> was published in October 2014. The *Risk Perspective* is a first step in the process of identifying the UK public interest risks to which actuarial work is of key relevance. It outlined a broad range of areas where there is a potential risk to the UK public interest and in which actuarial work plays a part in the risk or its management.

We received feedback from a wide range of stakeholders including actuaries, other professionals and users of actuarial work. JFAR will use this feedback, which is summarised in this document, to guide its future work. JFAR will initially focus on a more detailed assessment of the role and quality of actuarial work in areas where actuarial work is in the public interest, is central and where feedback indicates that the risks to the quality of actuarial work are developing:

- DB to DC transfers following the introduction of pension freedoms;
- General insurance provisions in the light of market conditions; and
- Group think (particularly around methodologies and assumptions) and its potential impact. This review will consider how regulators contribute to and might address the risk of group think.

JFAR will also maintain the risk perspective using a range of inputs including from further public feedback.

We would like to thank all respondents and participants in our outreach events for the rich feedback that they provided.



Stephen Haddrill, Chair of the Joint Forum on Actuarial Regulation

Melanie McLaren, Financial Reporting Council  
Des Hudson, Institute and Faculty of Actuaries  
Andrew Ruddle, Financial Conduct Authority  
Chinu Patel, the Pensions Regulator  
Giles Fairhead, Prudential Regulation Authority

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<sup>1</sup> [https://frc.org.uk/Our-Work/Publications/Actuarial-Policy-Team/Discussion-Paper-JFAR-a-risk-perspective-\(October-File.pdf\)](https://frc.org.uk/Our-Work/Publications/Actuarial-Policy-Team/Discussion-Paper-JFAR-a-risk-perspective-(October-File.pdf))

# 1 Introduction

## JFAR: A risk perspective

- 1.1 The Financial Reporting Council (FRC) is the UK's independent regulator responsible for promoting high quality corporate governance and reporting to foster investment. It issues and maintains Technical Actuarial Standards (TASs) for actuarial work in the UK. It oversees the regulatory activity of the Institute and Faculty of Actuaries (IFoA).
- 1.2 JFAR was established in 2013 by the FRC, the IFoA, the Financial Conduct Authority, the Pensions Regulator and the Prudential Regulation Authority to co-ordinate, within the context of the regulators' own objectives, the identification of and response to the UK public interest risks to which actuarial work is relevant.
- 1.3 In October 2014 the FRC published a discussion paper *Joint Forum on Actuarial Regulation: A risk perspective* (the *Risk Perspective*). The *Risk Perspective* is a first step in the process of identifying the UK public interest risks to which actuarial work is relevant. It outlines a broad range of areas where there is a potential risk to the UK public interest and in which actuarial work plays a part in the risk or its management.
- 1.4 JFAR considered that the *Risk Perspective* would in itself help to raise awareness of these risks and potential mitigations. JFAR will use the feedback both as individual regulators and in a coordinated way to improve its analysis and guide its future work.

## Responses to the discussion paper

- 1.5 We received 16 written responses to the *Risk Perspective* of which two were confidential. The non-confidential respondents are listed in Appendix A. Their responses can be found on the FRC's website<sup>2</sup>.
- 1.6 In order to promote discussion of the risks and obtain face-to-face feedback, we ran a substantial outreach programme including bilateral meetings with stakeholders and themed round-table discussions with practitioners and users of actuarial work. We ran a series of workshops around the UK featuring group discussions of particular risks. A summary of our outreach programme, which involved over 300 practitioners, users of actuarial work and others, is listed in Appendix B. Respondents were supportive of the aims of the *Risk Perspective* including our intention to understand the risks better and to develop co-ordinated responses. Several were keen to understand how it would be maintained and what the next steps would be. The general feedback to the *Risk Perspective* is discussed in section 2.
- 1.7 There was a large volume of feedback on the individual risks JFAR identified and some other risks were suggested. Many participants highlighted the risks relating to the fast changing pensions environment as a priority current hotspot that could potentially benefit from JFAR's coordinated approach. JFAR will do this, focusing on an aspect where actuarial work is central: transfers from DB to DC schemes. The risk-specific feedback is discussed in section 3.

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<sup>2</sup> <https://www.frc.org.uk/Our-Work/Publications/Actuarial-Policy-Team/Discussion-Paper-JFAR-a-risk-perspective-October/Responses.aspx>

## Next steps

### *JFAR reviews*

- 1.8 The responses to the discussion paper have informed JFAR's view of the risks to be considered first. Members of JFAR will carry out reviews to help determine whether the risks are being appropriately mitigated or managed and to determine if additional responses are needed. These reviews will consider matters such as:
- the extent of risks to the public interest;
  - the role of the actuary; and
  - what actuarial work is involved and its quality.
- 1.9 We have identified three JFAR reviews to be undertaken in 2015/16. These are in areas of high public interest where actuarial content is central and where the risks are amenable to coordinated response by JFAR. The three reviews are:
- **DB to DC transfers** – this review will consider the public interest risks in relation to DB to DC transfers arising as a result of the pension freedoms legislation where actuarial work is of key relevance.
  - **general insurance provisions** – this review links the high-level risks “general insurance reserving” and “financial reporting” identified in the Risk Perspective. There is a risk that inadequate claims provisions combined with inadequate premium rates caused by a very competitive market reduces the financial soundness of a general insurer; and
  - **group think** – this risk generated a large response including a challenge that regulators and regulation can cause group think. JFAR will explore further the potential impacts and how awareness can be raised.

### *JFAR risk processes*

- 1.10 JFAR has considered how to maintain and develop its risk perspective and expects to do so by adopting the process described below.
- 1.11 JFAR will meet quarterly to review the findings from JFAR reviews. It will consider and agree recommendations for any desirable coordinated actions. Members will bring to the table matters identified through each member's risk outlook and/or horizon scanning processes. This will give an opportunity to raise, discuss and agree any necessary coordinated action, including further JFAR reviews.
- 1.12 A key new input to JFAR will be the results of an annual risk scanning process being developed by the IFoA to inform its strategy and plans. It will report publically on this annually and will formally share its insights with JFAR.
- 1.13 Using all these inputs JFAR will in a year's time and annually thereafter report publicly on its activities and its risk perspective. Every other year this will include consulting on whether there have been substantive changes to that perspective.
- 1.14 More details about the development of the JFAR reviews and risk processes are set out in Section 4.

## 2 General feedback on the Risk Perspective

### Introduction

2.1 In this section we summarise the general feedback we received on the *Risk Perspective*. In summary, respondents generally:

- supported the aims of more co-ordinated regulation;
- considered that the exercise was valuable or even essential for organisations such as JFAR members;
- emphasised that regulation is not always the most effective response to a risk (for example education and/or guidance can be more effective) and highlighted the risks of over-regulation;
- recommended that JFAR focus on a small number of priority risks; and
- highlighted the need to consider interactions between risks.

### General comments

2.2 Respondents generally considered the broad view of the public interest and the analysis in the *Risk Perspective* to be sensible, balanced and relevant. However, at one outreach meeting concerns were expressed that JFAR is seeking out risks that may not exist. We have borne this in mind when developing the JFAR risk processes by being guided as to where public interest risks are valid, actuarial work is central to the risk or its mitigation, and in developing a process which is transparent and based on ongoing feedback.

2.3 Some respondents expressed concern that JFAR's response to these risks would be more regulation. JFAR does not intend to propose additional regulation to mitigate all the risks that have been identified. We do not start with the mind-set that regulation should be the first response to a given risk. If we decide to take action our responses will be proportionate and will be selected from a wide toolkit including education, outreach, guidance and, if necessary, regulation developed transparently including through consultation.

2.4 Several respondents wanted to understand how the *Risk Perspective* would be maintained and what the next steps would be. Some respondents made suggestions about how the *Risk Perspective* could be further developed including identifying risk drivers, prioritising risks and setting up an early warning system for emerging risks. JFAR will use the feedback to assist qualitative prioritisation based on what it was told about the centrality of actuarial work and the probability of and impact of risks crystallising. Horizon scanning by all JFAR members, including the output from a new risk outlook process to be developed by the IFoA, will be shared. This is covered further in Section 4.

2.5 Several respondents considered that risks from regulation itself should be included as a risk and particularly highlighted that regulators contribute to the risk of group think which may adversely impact the quality of actuarial work. JFAR will explore this further.

## 2.6 Other comments made included:

- the *Risk Perspective* should consider the risks in the context of all the parties that might be involved rather than focusing on actuaries and actuarial work. JFAR members consider their approach to risks taking account of their broader roles and responsibilities;
- it would be useful to have more recognition of work carried out by actuaries in wider fields, such as healthcare, where there may be different considerations to traditional areas of actuarial work. JFAR has not prioritised such work for review at this stage and may consider if further once its initial reviews have been completed;
- there appear to be differences between the regulation of actuaries and other professionals that the FRC regulates (eg accountants and auditors). The FRC is reviewing its role in the oversight of actuaries; and;
- there should be a consistent and coherent definition of “actuarial work” in FRC and IFoA standards and publications. The FRC and IFoA are reviewing this.



### 3 Risk-specific feedback on the Risk Perspective

#### Introduction

3.1 In this section we summarise the risks identified in the *Risk Perspective* and the feedback we received relating to specific hotspots.

#### Identified risks and hotspots

3.2 In the *Risk Perspective* we identified 12 high-level risks provisionally selected by JFAR for co-ordinated analysis. Within the high-level risks we identified 40 related hotspots or possible manifestations of the high-level risks.

3.3 We asked for feedback on whether we are looking at the right risks and if any are particularly important. We asked how important is actuarial work to these risks and their mitigation and how JFAR members might support practitioners or users of actuarial work in responding to these risks.

3.4 These risks and hotspots are listed below with the feedback we received on each. The high-level risks and the 40 related hotspots resonated with respondents who also suggested additional hotspots for each high-level risk. Respondents noted however that actuarial work was less central to some hotspots than others and that JFAR should take this into account in taking forward its work. This means, for example, that JFAR does not expect to carry out coordinated reviews and actions in respect of product distribution.

#### Modelling

<b><i>Risk of inappropriate model design, implementation, use, or poor communication of actuarial modelling work resulting in poor decisions being made and detriment to the public interest</i></b>	
<b>Hotspots in Risk Perspective</b>	<b>Additional hotspots highlighted by respondents</b>
Insufficient use of stress-testing and scenario analysis	External models
Internal capital models	“Fitness for purpose” of adapted models
Long-term assumptions	“Inertia risk” - models can be hard to change
General Insurance personal lines pricing	Data quality
	Users acting on imperfect understanding

3.5 A risk driver for some of the hotspots was seen as the use of overly complex models. A number of respondents expressed concerns that some Solvency II internal models are overly complex.

3.6 Respondents suggested that scenario testing is especially useful where there is high uncertainty (eg climate change; economic or political instability), provided it could be carried out cost effectively.

3.7 It was highlighted that modelling is of fundamental importance in actuarial work. However, there was a risk that models were seen as belonging exclusively to actuaries whereas others (eg the Board, underwriters, finance, claims departments) need to understand what the models represent and their strengths and weaknesses. If users of the results of these models lack the necessary understanding this may lead to too much reliance and/or pressure on the actuary.

- 3.8 A key mitigant to the risk was identified as clarity of communication. It was suggested that education rather than standards would lead to better practice. Independently, a survey of users of actuarial information carried out for the FRC suggested that clarity of communication might sometimes be improved.

### Group think

<b><i>Risk of actuarial 'group think' / herd-like behaviours resulting in poor conduct or systemic business failures</i></b>	
<b>Hotspots in Risk Perspective</b> Herding around assumptions and modelling 'Group think' in investments Life expectancy Failure to speak up Smaller financial institutions Lack of diversity of actuaries	<b>Additional hotspots highlighted by respondents</b> Regulation leading to the use of common or similar approaches or assumptions Publicly available material such as the CMI mortality tables and models; or use of working party research leading to systemic risk Optimism about increases in interest rates and bond yields

- 3.9 Herding around long-term investment and mortality assumptions in particular was seen as a current hotspot. Corporate and firm culture was also highlighted as a potential source encouraging group think.
- 3.10 On the other hand, it was suggested that concerns over the risk of group think should be balanced with the benefits that collaborative research or consensus bring. The risk could be mitigated by involving other professionals or academics and by promulgating material which promotes creative thinking.
- 3.11 Many suggested that regulators need to consider whether regulation, including standards and enforcement practices, is proportionate or is tending to encourage group think with systemic implications.
- 3.12 One respondent suggested that regulators need to be alert to collective errors caused by a tendency to follow generally accepted actuarial practice. Going out on a limb by deviating from generally accepted actuarial practice carries more risk to individual actuaries and actuarial firms than following it. In such circumstances, relying on ethical standards alone may be an inadequate mitigant.

### Understanding of risk and return

<b><i>Inadequate understanding of risk and return by actuaries and users of actuarial work may result in poor decisions</i></b>	
<b>Hotspots in Risk Perspective</b> Communications on savings business Retirement income changes Understanding of alternative assets	<b>Additional hotspots highlighted</b> Communication of risk and return The correlation of assets and liabilities Users of actuarial work not having the right skills

- 3.13 Understanding asset risks is topical. Respondents advised substantial risk analysis is being done currently on new asset classes being considered for investment in the search for yield. In some companies this work sits predominantly with actuaries and the work may not be fully understood by others.

- 3.14 The current low interest rate environment is encouraging this search for yield. Therefore, the risk from investors, trustees and some advisors having a limited understanding of alternative assets is heightened which makes it a very live current hotspot.
- 3.15 Communication was identified as a priority with more complex assets being developed and used by pension schemes and insurance companies.
- 3.16 One respondent suggested that financial education should form a larger part of the national curriculum and that there may be a role for ‘rules of thumb’ to help individuals’ understanding of risks.
- 3.17 Additionally, respondents confirmed that the rapid changes in the pensions market caused by the pension freedoms legislation were a current risk with many individuals not being equipped to understand the risks of some options.

### Product design and distribution

<b><i>Risk that companies using actuarial information do not design products that respond to consumers' real needs or do not promote transparency on financial products and services</i></b>	
<b>Hotspots in Risk Perspective</b> Annuity and retirement income products General Insurance personal lines products and pricing Health and care products Product distribution mechanisms	<b>Additional hotspots highlighted</b> Pressure from stakeholders Tendency to consider how the world looks today rather than how it will be Increasing speed of pricing Lack of data to understand new features

- 3.18 Stakeholders confirmed that annuity and retirement income product development was a potential risk. There is considerable uncertainty about how the market will evolve following the pension freedoms changes. Individuals may have difficulty in understanding new products, some of which may be complex.
- 3.19 It was suggested that actuaries often play only a small part in product design, with others making key decisions. Accordingly JFAR is unlikely to carry out a co-ordinated review in this area.
- 3.20 One respondent recommended that JFAR should look at just a small sample of products, with pension products having the biggest impact on the public, and that this risk may be fast moving.

### Financial reporting

<b><i>Risk that reporting of actuarial information in the annual report and accounts is not fair, balanced and understandable to investors</i></b>	
<b>Hotspots in Risk Perspective</b> Estimating insurance liabilities Auditing Life insurance accounting	<b>Additional hotspots highlighted</b> Reporting of pension liabilities for public sector and not-for-profit entities Valuation of assets Time pressures for reporting

- 3.21 Respondents confirmed that estimating and auditing insurance liabilities were hotspots. High-quality actuarial work is an important mitigant of this risk but the level of

coordination and cooperation between actuaries, accountants and auditors may be equally as important.

3.22 Possible mitigants suggested included better internal controls and reviews of work, and auditors getting a better understanding of actuarial matters.

3.23 One respondent suggested there may be merit in reviewing the scope of audits.

### General insurance provisions

<b><i>Risk that inadequate claims provisions combined with inadequate premium rates reduces the robustness of a general insurer</i></b>	
<b>Hotspots in Risk Perspective</b>	<b>Additional hotspots highlighted</b>
Influence of actuaries	Data (eg sparse or not captured correctly)
Settlement of general insurance claims via PPOs	Group think risk (eg use of research results)
Provisioning methodologies	

3.24 It was highlighted that this risk links into other risks. It is fundamental to ensuring an insurer's premium rates are adequate, including allowance for events that may not be in the data.

3.25 The implementation of Solvency II and its transition into business as usual was considered a current hotspot.

3.26 Feedback also noted that periodic payment orders (PPOs) relate to other classes of insurance as well as motor.

3.27 Taking these points together and given the centrality of actuarial work, JFAR has concluded that one of its first reviews should be in this area.

### Liability management of defined benefit pension schemes

<b><i>Risk that liability and risk management actions of pension schemes results in some scheme members being disadvantaged or taking on excessive risk</i></b>	
<b>Hotspots in Risk Perspective</b>	<b>Additional hotspots highlighted</b>
Transfers out of DB schemes	Use of deterministic assumptions – the money weighted return could be substantially less than the average return especially for contracting schemes.
Investment assumptions for closed schemes	
Special purpose vehicles (SPVs)	

3.28 Transfers from DB to DC schemes were confirmed as a hotspot particularly in view of the recent pension freedoms which are likely to mean that trustees will need actuarial advice on their response. Actuarial work can help clients' understanding and help them in addressing the risks.

3.29 It was suggested that pressure may be placed on actuaries to provide advice that suits their clients' motives and that there could be a conflict with the public interest.

3.30 One respondent suggested there may be areas where regulation is required. JFAR should engage on these risks with practitioners as a good understanding is key.

- 3.31 It was noted however that actuaries do not normally have control over the communications which are given to members and that the onus for clear communications must remain with trustees and employers.
- 3.32 Taking these points together and given the role of actuarial work, JFAR has concluded that one of its first reviews should be of DB to DC transfers.

### Changes in the external environment

<b><i>Risk that changes in the external environment (for example from political or legislative changes, or economic or demographic shifts) are not adequately responded to</i></b>	
<b>Hotspots in Risk Perspective</b>	<b>Additional hotspots highlighted</b>
Limits to growth	Medical advances and lifestyle changes
Climate change	External factors such as wars and civil unrest
Technological shifts and cyber risks	Political risks (changes can make a business plan unviable)
Not communicating the world has changed	Changes in living standards due to increased globalisation
Retrospective changes or changes in practice	

- 3.33 The responses indicated that all of the hotspots were considered important, in particular environmental and technological risks.
- 3.34 Respondents suggested that the risks relating to climate change are much broader than those described in the paper. These risks are exacerbated by the interconnectedness of our social, economic and financial systems. This risk also forms an element of many of the other risks in the paper.
- 3.35 Additional potential hotspots identified included (sometimes unpredictable) political changes, medical advances, external factors such as civil unrest and war and the impact of globalisation.
- 3.36 It was suggested that actuaries have been slow to recognise such changes in their methodology and assumptions eg mortality improvements and changes to the financial environment.
- 3.37 In one outreach session it was recognised that to quantify effects (eg of limits to growth) is very difficult and too big a problem for an individual actuary. It was therefore suggested that the IFoA and/or JFAR should address these risks by encouraging sharing of information and collaboration with other professionals and academics.
- 3.38 Other suggestions were that stress and scenario testing could be useful here both for specific risks (eg stranded assets and carbon exposure), and for a resilience agenda, including recovery and resolution planning.
- 3.39 JFAR expects to return to these suggestions once it has completed its initial co-ordinated reviews.

## Economic outlook – impact on insurers

<b><i>Risks to insurers arising from a relatively low interest rate environment persisting for an extended period</i></b>	
<b>Hotspots in Risk Perspective</b> Annuity pricing and valuation Uncertainty in future interest rate movements Long-term business models of life insurers	<b>Additional hotspots highlighted</b> Framing risk – poor press coverage of annuities may result in consumers taking higher risks and not protecting themselves in respect of longevity risk.

- 3.40 Participants at one outreach session highlighted the fundamental role of investment to life insurers and one agreed that business models were under challenge.
- 3.41 We have also had comments about other risks in this paper being exacerbated by low interest rates (eg comments relating to understanding of asset risks and the search for yield).

## Economic outlook – impact on pension schemes

<b><i>Risk that the uncertain economic outlook could challenge affordability for pension scheme sponsors or a market move could threaten the pensions system as a whole</i></b>	
<b>Hotspots in Risk Perspective</b> Ability of scheme sponsors to meet their long-term obligations Advice to pension trustees Stress testing of economic assumptions	<b>Additional hotspots highlighted</b> Risk of underfunding of public sector pension schemes (including LGPS) Inappropriate choice of investments in a low yield environment

- 3.42 The risks highlighted in the *Risk Perspective* are focused on actuarial advice given to trustees. It was suggested by one respondent that there has been, and will continue to be, a reduction in the role of actuaries as the trusted adviser to trustees, mainly due to the associated cost.
- 3.43 Some respondents highlighted wider issues when an actuary provides advice to an employer or third party.
- 3.44 One respondent cited anecdotal evidence of actuaries advising employers on contingent assets which have value to the pension scheme whilst the employer remains solvent, but which would have little value if that employer were to become insolvent.

## Competitive pressures on insurers

<b><i>Risk that the UK insurance sector's competitive commercial environment, pressures on premium rates and low investment returns may drive firms to seek out too much risk</i></b>	
<b>Hotspots in Risk Perspective</b> Balance sheet structuring Management actions may not work	<b>Additional hotspots highlighted</b> Management pressure on assumptions Competitive pressure on pricing Data –past data is never exactly right for future products

- 3.45 One discussion group concluded that neither of the hotspots we identified in the *Risk Perspective* are high priority as these management actions may be after a company's core business plan is in difficulty.

- 3.46 It was commented that maybe we have too much risk aversion including a fear of insurers failing.
- 3.47 It was noted that the role of the actuary may be limited to advising on pricing with others responsible for the decisions. However some felt that the actuary should speak up if decisions are inappropriate including having whistleblowing routes and routes through robust corporate governance.

### Rapid change in the pensions market

<b><i>Risk that the rapid change in the market due to legislative developments and new initiatives leads to inappropriately designed products</i></b>	
<b>Hotspots in Risk Perspective</b>	<b>Additional hotspots highlighted</b>
Legislative developments	People do not generally invest enough in saving for retirement Other implications (eg tax; political) Commutation factors and transfer values

- 3.48 One respondent suggested the risk is generalised as “significant or rapid change owing to legislative developments and new initiatives that lead to inappropriate or unforeseen outcomes”.
- 3.49 At our outreach sessions, discussions on rapid changes in the pensions market tended to gravitate to discussions of the newly introduced pension freedoms. The risks highlighted link to other risks in the *Risk Perspective*: product design and DB to DC transfers. There is also the risk that guarantees on insured pension products may be lost on early termination by members wanting early access to their pension assets.
- 3.50 A number of respondents suggested this risk as a risk that JFAR should prioritise. One of JFAR’s first reviews will consider actuarial work in DB to DC transfers.
- 3.51 There was a perceived risk of actuaries becoming scapegoats retrospectively for any problems that arise, either through the work they do or through staying too silent as a profession.
- 3.52 Some respondents suggested that engagement between the IFoA, regulators and government policy makers could be strengthened. JFAR coordination should assist this.
- 3.53 It was suggested that regulators need to engage quickly with the risks which include:
- poor product design or mis-selling; and
  - lack of understanding by individuals of the information received and/or the risks resulting in poor decisions being made.

### Other risks

- 3.54 The following additional risks were identified by respondents:
- the Financial Ombudsman’s yardstick for measuring compensation paid in respect of mortgage endowments is shown to be too low so compensation costs turn out to be much higher than expected; and
  - inadequate use of evidence and research and over-reliance on judgement when compared with other professions leading to a reduction in confidence in the quality of actuarial work.

## 4 Next steps

### Introduction

- 4.1 When we published the *Risk Perspective* we acknowledged it was the first step in the process of identifying and responding to the UK public interest risks to which actuarial work is relevant. The publication was designed to stimulate discussion and engagement with stakeholders to improve our analysis and guide our future work. In this section, we set out how JFAR intends to make use of the *Risk Perspective* and the feedback which we have received; in particular:
- the ongoing maintenance of the JFAR risk processes;
  - the areas we have selected for further consideration through JFAR reviews; and
  - how this work will influence our development of revised specific TASs.
- 4.2 In identifying risks described in the *Risk Perspective* we emphasised that we were not necessarily saying there is current evidence of these risks materialising or of poor quality or insufficient actuarial work.
- 4.3 The *Risk Perspective* did not prioritise particular areas for co-ordinated analysis. The feedback has guided initial prioritisation for reviews and indeed areas where reviews are unlikely to be helpful.
- 4.4 JFAR does not intend to propose additional regulation to mitigate all the risks that have been identified. We do not start with the mind-set that regulation should be the first response to a given risk. If we decide to take action our responses will be proportionate and will be selected from a wide toolkit including education, outreach, guidance and, if necessary, regulation developed through outreach and consultation.

### JFAR Risk Processes

- 4.5 JFAR has considered how to maintain and develop its risk perspective and expects to do so by adopting the process described below.
- 4.6 JFAR will meet quarterly to review the findings from JFAR reviews. It will consider and agree recommendations for any desirable coordinated actions. Members will bring to the table matters identified through each member's risk outlook and/or horizon scanning processes. This will give an opportunity to raise, discuss and agree any necessary coordinated action, including further JFAR reviews.
- 4.7 A key new input to JFAR will be the results of an annual risk scanning process being developed by the IFoA to inform its strategy and plans. It will report publically on this annually and will formally share its insights with JFAR.
- 4.8 Using all these inputs JFAR will in a year's time and annually thereafter report publicly on its activities and its risk perspective. Every other year this will include consulting on whether there have been substantive changes to that perspective.

### IFoA Risk Outlook

- 4.9 A key development since issuing the risk perspective document is that, as part of its own regulatory strategy, the IFoA will develop a risk outlook to:
- raise awareness of risks as they emerge;



- maintain a clear view at any time of IFoA members' perceptions of emerging risks; and
  - identify mitigating actions.
- 4.10 This initiative will draw together JFAR's work in producing the *Risk Perspective* and existing horizon scanning throughout the IFoA. The IFoA will use its risk outlook to establish a risk framework for its regulatory work, with potential wider application throughout the IFoA. The risk outlook will cover not only risks to the UK public interest where actuarial work is relevant but will include a broad spectrum of risks that impact upon the IFoA's members both in the UK and overseas.
- 4.11 The IFoA will monitor the continuing relevance and accuracy of its risk outlook and where necessary make any interim amendments. It will formally review the risk outlook on an annual basis.
- 4.12 The IFoA will share its risk outlook with JFAR and other stakeholders, as well as make public the results in due course. JFAR members welcome this development which should be a key input to its risk considerations.

#### *Areas for JFAR review*

- 4.13 Members of JFAR will carry out reviews to help determine appropriate responses to some key areas of risk we have identified. These reviews will consider matters such as:
- the extent of risks to the public interest;
  - the role of the actuary;
  - what actuarial work is involved; and
  - the controls in place and how effectively they are working.
- 4.14 We take a broad view of the public interest. We consider that there is a risk to the public interest if its crystallisation would impact significantly on a substantial group of individuals, on the financial system or on the community as a whole. In addressing the impact of actuarial work on the public interest, we consider both how actuarial work may contribute to risks to the public interest if done without sufficient care or appreciation of the full context and how it can be used to mitigate those risks.
- 4.15 In its analysis and consideration of coordinated response JFAR will be mindful of the differences between:
- 'risks' where quantitative actuarial work can be relevant to their mitigation; and
  - 'uncertainties' where there is ambiguity and/or lack of knowledge and a wider risk management toolkit (eg scenario testing to develop contingency plans) may be more appropriate.
- 4.16 Based on the work carried out in developing the *Risk Perspective* and on the feedback we received, we have identified three JFAR reviews to be undertaken in 2015/16. These are in areas of high public interest where actuarial content is central and where the risks are likely to lend themselves to coordinated response by JFAR. The three initial reviews are:
- **DB to DC transfers as a result of pension freedoms** - "Rapid change in the pensions market" was identified as a risk in the *Risk Perspective*. In the feedback we received the pension freedoms (effective from 6 April 2015) were identified as key

changes which may give rise to risks. Whilst noting the potential for increased actuarial work in the DC field and in product design as a result of these changes, the review will focus on public interest risks in relation to DB to DC transfers (arising as a result of the pension freedoms) where actuarial work is relevant. This review will be led by the FRC.

- **General insurance provisions** – this review links the high-level risks “general insurance reserving” and “financial reporting” identified in the Risk Perspective. There is a risk that inadequate claims provisions combined with inadequate premium rates caused by a very competitive market reduces the robustness of a general insurer. This review will be led by the FRC.
- **Group think** – this risk generated a large response including a challenge that regulation can cause group think and that it is difficult to act outside of the pack without feeling out on a limb. This review, which is exploratory in nature, will be led by the IFoA.

4.17 The objectives of each review are as follows:

JFAR review	Objectives
<p><b>DB to DC transfers –</b></p> <p>Risks stemming from potential increases in DB to DC transfers as a result of the pension freedoms</p>	<ol style="list-style-type: none"> <li>1. Gather evidence on the actuarial work being undertaken in three areas of risk- the promotion of DB to DC transfer, the value(s) placed on individual’s DB benefits and the implications for DB schemes of an increased level of transfers.</li> <li>2. Gather evidence on DB to DC transfer activity and evidence on whether, and how, scheme sponsors are encouraging members to transfer from DB schemes; and</li> <li>3. For the actuarial work being undertaken, investigate whether the mitigants in place are sufficient or whether additional mitigants are required.</li> </ol>
<p><b>General insurance provisions –</b></p> <p>Risk that inadequate claims provisions combined with inadequate premium rates reduces the robustness of a general insurer</p>	<ol style="list-style-type: none"> <li>1. Increase our understanding of the scale of the public interest risk and of the quality of actuarial work being undertaken;</li> <li>2. Test the effectiveness of audit as a control on the quality of actuarial work supporting the determination of claims provisions in the financial statements of general insurers; and</li> <li>3. Test the effectiveness of the TASs as a control on the quality of actuarial work in determining claims provisions in both the financial statements and regulatory returns of general insurers.</li> </ol>

<p><b>Group think –</b></p> <p>Risk of actuarial 'group think' / herd-like behaviours resulting in poor conduct or systemic business failures</p>	<ol style="list-style-type: none"> <li>1. Identify the origins of the main influencers of group think. Group think will develop from a series of influencers that will cause many of those subject to those influencers to behave in the same way.</li> <li>2. Assess the scale of the impact using case studies to illustrate how systemic risk developed within individual markets following Group Think.</li> <li>3. Investigate the mitigants through discussion with practitioners</li> </ol>
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4.18 As well as undertaking the JFAR reviews in the three specific areas detailed above, members of JFAR will use the *Risk Perspective* and the feedback on it in identifying what action they take, if any, to respond to risks relating to actuarial work.

4.19 Using all these inputs, JFAR will in a year's time and annually thereafter report publicly on its activities and view of risk. Every other year this will include consulting on whether there have been substantive changes to the risk perspective.

**FRC's Technical Actuarial Standards**

4.20 The FRC is planning to consult on revisions to its Specific TASs towards the end of 2015. The output from the *Risk Perspective* and the feedback to it will help determine what work will be in the scope of these standards and what principles they will contain.

## **Appendix A: List of respondents to the October 2014 discussion paper**

Andrew Hitchcox  
Anthony Pepper  
Association of Consulting Actuaries  
CIPFA  
Debbie Harrison  
Government Actuary's Department  
Mercer

Pension Protection Fund  
PricewaterhouseCoopers  
P-Solve  
Society of Pension Professionals  
Tony Hewitt  
Towers Watson  
Trevor Llanwarne

## **Appendix B: List of outreach events for the October 2014 discussion paper**

IFoA – Staple Inn

IFoA – Edinburgh

Yorkshire Actuarial Society

Norwich Actuarial Society

Birmingham Actuarial Society

FRC Event – Risk and Public Interest – A focus on insurance

FRC Event – Risk and Public Interest – A focus on pensions

FRC Event – JFAR Breakfast consultation

Norwich Actuarial Society

Bristol Actuarial Society

Risk and Investment conference, Newport

Forum for Public Actuaries





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