

Minutes of a meeting of the Actuarial Council held on Tuesday 12 May 2015 in the Dearing Room at 8th Floor, 125 London Wall, London EC2Y 5AS

Present:

Olivia Dickson Chair of Council
Keith Barton
Rosemary Beaver (from minute 2b)
Angela Darlington
Ashok Gupta
David Hindley
Howard Jacobs (by conference call)
Paul Johnson (from minute 3)
Joanne Livingstone

Observers:

Des Hudson Institute and Faculty of Actuaries (IFoA)

In attendance:

Siân Barr Project Director, Actuarial Oversight (Agenda Items 1, 2a & 2b only)
Dawn Bardwell Director, Professional Oversight (Agenda Items 1, 2a, 2b & private session only)
Francesca Carter Council Secretary
Ufuk Cengiz Economist (Agenda Item 2a only)
Faye Dyce Project Director, Actuarial Policy Team
Robert Inglis Project Director, Actuarial Policy Team
John Instance Interim Director, Actuarial Policy Team
Melanie McLaren Executive Director, Codes & Standards
Natasha Regan Project Director, Actuarial Policy Team

Introductions and apologies for absence

Apologies were noted from Martin Bradley and Martin Miles (Council Members).

1. Executive report

1.1 John Instance (JI) introduced a report that provided an overview of FRC activities relevant to the remit of the Actuarial Council not covered elsewhere on the agenda. The Council considered and noted the report; particular emphasis was given to the following matters:

FRC Board meeting

1.2 The Council noted that the FRC Board is due to meet on 20 May and will consider actuarial regulation, receiving an update on progress following Project Capri.

Staff matters

- 1.3 Melanie McLaren (MM) reported that the FRC had made an appointment for the role of Director of Actuarial Policy and that an announcement would be made shortly.

Council working groups

- 1.4 JI reported that two technical working groups have been established to support the review of the Pensions and Insurance Technical Actuarial Standards (TASs). JI confirmed that the FRC consider the membership of the groups to be suitably diverse and representative. It was noted that Council Members would also be invited to sit on these technical working groups. JI undertook to circulate the membership lists to the Council.

AS TM1 accumulation rate review

- 1.5 The Council noted that the FRC would shortly undertake its ASTM1 annual accumulation rate review survey. It was confirmed that respondents would be asked to provide rationale for the assumptions used.
- 1.6 It was suggested that the survey include a question on the extent to which providers are making use of the flexibilities offered by the revised Disclosure regulations. FD undertook to consider this.

JFAR thematic reviews

- 1.7 JI reported that the JFAR had considered a paper on *Freedom and Choice in Pensions* at its March meeting and had identified three areas for consideration as part of a thematic review on DB to DC transfers.
- 1.8 The Council discussed the draft project plan for a thematic review on DB to DC transfers. It supported the scope and the objectives as set out. The following observations and comments were made:
- It was suggested that there is a need to manage expectations as to what the 'outputs' of the thematic review will be.
 - One member highlighted that a number of the decisions on which the thematic review will be seeking information are taken by Trustees on the advice of their actuaries. Therefore, the member suggested that in asking actuaries to provide a rationale for the decisions that have been taken will not provide a full picture.
 - It was commented that the thematic review will be a valuable evidence gathering exercise. It was also commented that if it proves difficult to engage with actuarial firms on the thematic review that this would also be a useful learning point.
 - It was noted that whilst the FRC has no powers to request information from firms, other regulators represented on the JFAR may have greater powers.
- 1.9 It was noted that the JFAR had also identified that consideration should be given to including additional principles in the Pensions TAS to restrict the range of judgement that might be exercised by actuaries. However, the JFAR had concluded it would be sensible to defer consideration of this matter to a later date when the changes introduced on 6 April 2015 have had time to embed and a greater evidence base is available.

2. Horizon Scanning

2a. FRC Matters

2a.1 The Chair welcomed Ufuk Cengiz (UC) to the meeting.

2a.2 UC introduced a framework for Horizon Scanning that had been developed in response to:
a) a steer from the FRC Board who had suggested there is a need for the FRC to think further in to the future and more widely about issues that are affected by or may affect the work of the FRC; and b) a request from the Council for clarity as to its risk identification role. UC reported that the framework has been designed to encourage the identification and consideration of trends, risks and opportunities that would not normally be considered and will be discussed by all of the FRC's Councils, Committees and advisory groups. The Council noted that it is the intention that the framework will be used by the Board to inform FRC strategy and risk management.

2a.3 The Council commended the framework and suggested mapping the risk hotspots that had been identified through the JFAR's risk work to the framework. Through discussion the following suggestions and observations were made:

- It was suggested that the FRC may wish to add the following risks and opportunities to the framework:
 - Media influence; in particular the risk that the media may slant or narrow the focus of a message resulting in the amplification of an undesired message.
 - Technological innovations.
 - Health and medical innovations, such as the discovery of a cure for cancer.
- It was also suggested that it might be useful to attach the FRC's objectives and responsibilities to the framework for reference.

2a.4 UC thanked the Council for their input. NR undertook to map the risk hotspots identified by *JFAR: A risk perspective* to the framework for consideration at the next Council meeting.

2b. Procyclicality and Structural Trends in Investment Allocation by Insurance Companies and Pension Funds

2b.1 Ashok Gupta (AG) introduced a Bank of England (BoE) discussion paper, developed by the BoE and the procyclicality working group to the Council. AG reported that the discussion paper is the result of a rigorous, two-year analytical study which focused on procyclicality and structural trends in investment allocation by insurance companies and pension funds and also considered long term investment risk.

2b.2 AG summarized the findings of the study. The following key points were noted:

- Over the past 25 years there has been a structural shift in asset allocation with UK pensions funds and insurance companies reducing their holdings of UK equities, largely in favour of fixed income instruments. It is suggested that the shift is a result of "de-risking" and is in to a response to a variety of regulatory, valuation and accounting changes.
- There is clear evidence of procyclical investment behaviour by insurance companies both internationally and in the UK.
- Evidence of procyclical investment behaviour by UK pensions funds is mixed, this could be a result of the introduction, in the UK and internationally, of elements of regulatory

flexibility in periods of stress to avoid incentivising procyclical behaviour and to limit the impact of periods of market volatility or stress on pension fund sponsors.

- Procyclical behaviour is a toxic risk and if it continues could have important consequences for the economy as a whole.
- There is evidence to suggest that within UK pension funds there are elements of current industry practice which result in a tendency for pension funds to herd, this may be the result of the mis-measurement of liquidity requirements and use of volatility as a measure of risk.

2b.3 The Council discussed the findings in detail and the following observations and comments were made:

- It was noted that there is a need to consider short-term solvency of pension schemes.
- It was commented that there is a need for the public to understand that risk exists and there are costs associated with risk management.
- It was suggested there is a need to flag the potential unintended risks that may arise as a result of the implementation of Solvency II and a need to identify the potential mitigants to those risks.
- It was suggested that potential solutions that could be considered to reduce procyclicality include:
 - The introduction of cyclical capital buffers, which could be achieved under current legislation.
 - A review of how risk is categorized.
 - A review of the PRA's approach to matching adjustments.

2b.4 The Council noted that the FRC's is not responsible for the direct oversight of actuarial work and cannot hold individuals to account beyond requiring compliance with the TASs through the IFoA and public interest responsibilities. Therefore, the FRC is restricted in the action it can take to respond to the issues raised in the paper. It was suggested that the findings could be explored as part of the JFAR's thematic review on 'group think' on which the IFoA is taking the lead.

2c. HMT/DWP consultation: Creating a secondary annuity market

2c.1 Faye Dyce (FD) introduced a paper that reported on the HMT / DWP proposal to establish a secondary annuity market from April 2016. FD reported that the newly appointed Minister of Pensions has publicly supported the proposals on a secondary annuity market.

2c.2 The Council considered the proposal and the key considerations that had been identified. Through discussion it was suggested that for some, such as those with small annuities or those who are in ill-health, selling their annuity income might be a good decision if the provision of underwriting and advice could be provided in a cost effective manner. The Council also noted the consumer protection proposals and expressed concern as to the value a benchmark price from the provider would add.

2c.3 The Council identified that there will be significant reliance on actuarial work in the following areas:

- pricing existing annuity income for intermediary purchasers or ultimate third party investors;
- providing benchmark prices for annuity providers;

- if providers are permitted to buy back in-force annuity contracts, determining the price and providing advice on capital implications; and
- underwriting.

2c.4 The Council suggested that it would be helpful for the FRC to identify and discuss with the new Pensions Minister, the high level risks to the public interest associated with the proposals and the level of reliance on actuarial work that will be required. It was suggested that the FRC may wish to draw on its experience of setting a benchmark annuity basis in AS TM1.

3. Technical actuarial standards framework consultation

3.1 Robert Inglis (RI) introduced a paper that set out an analysis of the responses to the consultation on *A new framework for FRC Technical Actuarial Standards*, a draft update statement on the consultation and a draft paper for the FRC Board.

3.2 RI summarised the feedback from the consultation. It was noted that:

- Some respondents are concerned about the extension of scope, particularly to areas of work that are neither reserved to, nor mainly performed by actuaries, and the additional compliance costs associated with TAS 100.
- Some respondents suggested that the extension of scope might be acceptable if actuaries are, with the agreement or on instruction of their users, permitted not to comply with some or all of the principles and provisions in TAS 100 for work which is not reserved to actuaries, as is currently permitted within the current TAS framework under paragraph 24(c)(iii) of the Scope & Authority.
- Several practitioners consider that the definition of actuarial work needs to be amended or supported with guidance.
- Several practitioners suggested there should be more consistency with the definitions of actuarial work used by the IFoA and the IAA in their standards.
- There was considerable opposition to the proposed timetable for implementing TAS 100. Most respondents consider that TAS 100 should not come into force until the revised Specific TASs are effective to avoid two regimes being in place at the same time which could be costly and confusing.

3.3 The Council considered the concern expressed by respondents regarding the proposal to extend the scope of TAS 100 to all actuarial work. The Council also considered the related proposal that a concession, such as that permitted in paragraph 24(c)(iii) be built in to TAS 100 and queried how frequently the concession is used. It was noted that the FRC is in the process of gathering evidence from practitioners on the extent to which the concession is used and that research to date suggests the concession is used:

- infrequently;
- predominantly by general insurance actuaries;
- for short, 'ad-hoc' pieces of work where compliance with the TASs would mean that the work could not be completed in the time available;
- in instances where the user is working alongside the actuary as part of a multi-disciplinary team and is aware of the risks associated with non-compliance.

3.4 In considering whether to permit a concession similar to that permitted within the existing framework the Council highlighted a need to ensure that any risks to the public interest that could arise would be minimal and that the FRC is comfortable that those risks could be

appropriately managed. Following a detailed discussion the Council suggested that the FRC should continue to develop two options:

- that actuaries be permitted, on the instruction of their user, not to comply with part or all of the TAS 100 for work that is not in the scope of the Specific TASs. It was noted that this approach should not be permitted for work that is deemed to be of significant risk to the public.
- develop the wording of the proportionality and materiality provisions as set out in TAS 100 to ensure they are appropriate should no opt-out be permitted.

3.5 The Council discussed the recommendation of the Executive that TAS 100 be deferred to coincide with the implementation of the revised Specific TASs, noting the concerns that had been expressed in the consultation. Through discussion the following observations and suggestions were made:

- It was noted that the new Specific TASs are due to be issued in July 2016. The scope of the Specific TASs may be increased to reflect the work undertaken by the JFAR in respect of emerging risks.
- It was noted that if the decision is taken to defer the implementation of TAS 100 to coincide with the issue of the Specific TASs the delay would be for a period of 6-9 months. Whilst the Council considered that this delay would be acceptable the Council highlighted the importance of not allowing the further delay.
- It was noted that the FRC has the option to issue remodeled Specific TASs within a shorter timeframe and issue TAS 100 in accordance with the original timetable. However, the Council suggested this would not be appropriate given that the further amendment to the Specific TASs would be required in the near future and could result in unnecessary regulatory annoyance and burden.
- The Council noted that delayed publication of TAS 100 would allow the FRC more time to analyse responses to the consultation, talk to respondents and test alternative approaches, including the proposal discussed at 3.3.
- The Council discussed whether deferring the implementation of TAS 100 would lead to increased risk to the public interest risks. In response RI confirmed that there are no areas of actuarial work outside of the traditional areas of insurance and pensions, identified by JFAR as being of high risk to the public interest, that are not captured within the scope of the existing framework and require urgent attention. RI also confirmed that, should any public interest risks be identified in the interim period, the FRC is in a position to act reasonably quickly.
- The Council also discussed whether deferral would result in reputational damage for the FRC. It was concluded that reputational damage would be greater if the FRC issued standards that are not of sufficient quality and need to be amended in the near future.

3.6 Whilst some members of the Council expressed the view that the FRC should continue with the original timetable and issue TAS 100 later in 2015, the majority of Members agreed with the Executive proposal to defer implementation to coincide with publication of the Specific TASs. The Council considered that the option to present the new TASs in one package is preferable as it will allow for smoother transition (from one regime to another single regime) with reduced transition costs and the FRC would have more time to consider how best to deal with issues raised by respondents to the consultation, including review of the definition of actuarial work.

3.7 On the basis of discussion the Council approved the draft paper to the FRC Board recommending deferral of the implementation of TAS 100 to coincide with the

implementation of the specific TASs. However, the Council requested that text be inserted to the Board paper to confirm that there are no known areas of actuarial work, of high risk to the public interest, that fall outside of the scope of the existing TAS framework and require urgent attention.

4. JFAR: A Risk Perspective discussion paper – Feedback statement

4.1 NR introduced a paper that set out a summary of the responses that had been received to the discussion paper, both in the form of written responses and oral feedback gathered through outreach sessions and a draft feedback statement. The Council noted that whilst there is general support for the aims of the JFAR in identifying risks and coordinating regulatory responses to avoid overlaps and gaps; there is a concern that members of JFAR may regulate too much where education and raising awareness of risks would add more value. NR reported that since the paper had been drafted the FRC had met with the Association of Consulting Actuaries who had identified an additional hotspot in relation to the consistency of communications to consumers regarding pensions to individuals taking advice on a DB to DC transfer.

4.2 The Council was invited to comment on the content, structure and tone and tenor of the feedback statement. Through discussion the following observations and suggestions were made:

- Mixed views were expressed as to the level of detailed feedback that should be provided. Whilst some members suggested that providing too much information can distract the reader from identifying what is important, others highlighted the importance of reporting on all the feedback that has been received in order to acknowledge the breadth of engagement that has taken place. It was noted that it is normal FRC policy to publish non-confidential responses to consultations on the FRC website.
- In noting that many respondents are keen to understand how JFAR will use the risk analysis the Council advised that the 'next steps' should be set out in the feedback statement. The Council suggested that it should be made clear that the JFAR does not intend to regulate against all of the risks that have been identified and that a prioritisation exercise has been undertaken to identify which risks require consideration first.
- in describing the 'next steps' reference should also be made to the commitment made by the IFoA to more routinely scan the horizon and report to the FRC any risks to actuarial work that it identifies.
- Further work to distinguish which of the hotspots are actual 'risks' that can be mitigated and which are 'uncertainties'. It was suggested that this clarification should be referenced in the introduction.
- Greater emphasis should be placed on the outreach programme that was undertaken and the breadth of evidence that resulted from the outreach programme. It was also suggested that the discussion paper be used as a tool to inform further engagement.
- It was noted that whilst the FRC has responsibility for drafting the feedback statement, it would be issued as a JFAR document.

4.3 NR thanked the Council for its input and undertook to consider the suggestions made in finalising the feedback statement.

5. IFoA Observer Report

5.1 Des Hudson (DH) introduced a report that provided an update on the activities of the IFoA since the last meeting of the Council.

5.2 It was noted that:

- Since drafting the report the IFoA's Regulation Board had approved the Quality Assurance Scheme for organisations and that it is expected that the applications for the scheme would open in October.
- The IFoA is in the process of revising the APS Z1: Funeral Plans documents in light of responses to its consultation.
- The IFoA is going to develop and publish its own risk outlook. The risk outlook will be constructed through consultation with the JFAR, other regulators and the profession and will be used as a basis for setting the IFoA's regulatory objectives and planning.

6. Minutes of the previous meeting and rolling actions

6.1 The minutes of the Council meeting held on 10 March 2015 were approved as an accurate record of the meeting.

6.2 The Council noted the rolling action log.

7. Forward agenda

7.1 The Council noted the forward agenda.

8. AOB and private session

8.1 There was no other business.

8.2 The Council members met in private session to discuss actuarial regulation.