



PROFESSIONAL OVERSIGHT BOARD

DISCUSSION PAPER

MONITORING AND SCRUTINY OF ACTUARIAL WORK

MAY 2008

Contents

	<i>Page</i>
Foreword by Sir John Bourn	1
<hr/>	
One Introduction	3
<hr/>	
Two Monitoring and scrutiny options	8
<hr/>	
Three Life insurance	20
<hr/>	
Four General insurance	30
<hr/>	
Five Pensions	38
<hr/>	
Six Summary of findings and options	52
<hr/>	
<hr/>	
Annex A Guidance notes maintained by the BAS and the Profession	58
<hr/>	
Annex B International peer review comparisons	59
<hr/>	
Annex C Survey of actuarial firms	60
<hr/>	
Annex D Acknowledgements	75
<hr/>	

Foreword

This is one of two discussion papers which have been published by the Financial Reporting Council (FRC) and its operating bodies seeking views on the drivers, threats, checks and balances relating to quality in actuarial work. The first paper, *Promoting actuarial quality*, has been issued by the FRC itself and considers the nature of actuarial practice, and seeks views on the drivers of actuarial quality and the threats to those drivers, in life insurance, general insurance and pensions.

The Professional Oversight Board has issued this accompanying paper on *Monitoring and scrutiny of actuarial work* in response to the Morris Review of the Actuarial Profession, which recommended that the FRC, working closely with the Financial Services Authority, the Pensions Regulator and the Profession, should satisfy itself that appropriate monitoring of actuaries' compliance with professional standards and independent scrutiny of actuarial advice is occurring through either direct supervision by the regulator, audit or external peer review.

The paper builds on the analysis in the FRC paper by providing relevant detail of the checks and balances available on actuarial quality. It then develops strategies and detailed options for discussion with the Profession and other stakeholders in order to enable us to make recommendations which will promote actuarial quality through appropriate monitoring and scrutiny of actuarial work.

We have supplemented the Morris Review's original analysis with our own survey of actuarial firms, and discussions with the Profession and statutory regulators and other stakeholders. We have found enhanced levels of scrutiny since the Morris Review reported in March 2005 through professional quality assurance, client challenge, audit, regulation (principally by the Financial Services Authority, and the Pensions Regulator) and other independent scrutiny by the courts, complaints arrangements, consumer and trade bodies.

Nevertheless, a number of gaps remain, specifically in the pensions field, and we have developed for discussion a range of options falling within four strategies which the Profession might adopt in each sector:

- *Strategy 0 (no proposed changes to existing arrangements)* - reliance on existing arrangements for monitoring compliance with actuarial standards and scrutiny of actuarial work;
- *Strategy 1 (regulatory support)* – additional support for existing external regulatory and market practices for monitoring and scrutiny;
- *Strategy 2 (professional requirements)* – supplementing this regulatory support with imposition of the Profession's own professional quality assurance requirements (such as peer review) on individual actuaries, recognising the practice environment in which they work;
- *Strategy 3 (active monitoring)* – supplementing these requirements with monitoring and scrutiny of firms and individual actuaries, by the Profession or independently.

Our provisional assessment is that the Profession should consider options under Strategy 1 (regulatory support) for life insurance and general insurance, and Strategy 2 (professional requirements) for pensions in the first instance although we are anxious to have the views of all concerned before reaching our final conclusions on what needs to be done.

We have given serious consideration to Strategy 3 (active monitoring) for pensions, which would involve a significant change in the regulation of the work of pensions actuaries. On balance, however, the provisional conclusion we have reached is that more proportionate actions are available to enhance how the existing system works, and the impact of these should be considered before concluding that active monitoring is needed.

Nonetheless, a number of stakeholders believe Strategy 3 to be the right solution for pensions, and we welcome views on whether, and if so how, this might be introduced and financed, and the extent to which compliance monitoring might be arranged at a firm rather than an individual level.

Sir John Bourn
Chairman
Professional Oversight Board
May 2008

Introduction

- 1.1 Following the Morris Review of the Actuarial Profession, published in March 2005, the Government asked the FRC to take on responsibility for independent oversight of the UK 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 UK Actuarial Profession in May 2006.
- 1.2 The FRC's work is delivered through three of its operating bodies:
- **The Board for Actuarial Standards (the BAS)** – which sets actuarial technical standards in the UK, and has adopted many of the existing Guidance Notes made by the Actuarial Profession;
 - **The Professional Oversight Board (the Oversight Board)** – which oversees the way in which the UK Actuarial Profession regulates its members acting in their professional capacity;
 - **The Accountancy and Actuarial Discipline Board (AADB)** – which operates an investigation and discipline scheme in relation to matters involving members of the UK Actuarial Profession that raise or appear to raise important issues affecting the public interest in the UK.

Further details of the work of these and other FRC bodies may be found on www.frc.org.uk.

- 1.3 The Oversight Board has issued this discussion paper to accompany a discussion paper by the FRC on *Promoting actuarial quality* <http://www.frc.org.uk/publications/pubs.cfm> which considers and seeks views on the drivers of quality in actuarial work and the threats to those drivers, across the life insurance, general insurance and pensions sectors. Further information about the importance of the work of actuaries in these sectors may be found in that paper.

The Morris Review's recommendations

- 1.4 A critical concern which the Morris Review derived from Lord Penrose's Inquiry into the Equitable Life, published in 2004, was the lack of scrutiny of actuarial work and in particular the role of the then 'appointed actuary' in life insurance. In its final report in March 2005 the Morris Review supported the Profession's introduction of a limited form of peer review for scheme actuaries' advice (in pensions), and strongly supported the FSA's new reviewing actuary role (to advise auditors of life insurers).

- 1.5 The Morris Review highlighted the need not only for independent scrutiny, but also more comprehensive monitoring of compliance with actuarial standards, if the quality of actuarial work is to be ensured. It made a number of recommendations in pursuit of this aim:
- the FSA should, in line with its risk-based approach, pro-actively monitor a sample of life insurers' with-profits reports and accompanying opinions as well as any issues that arise from them;
 - as a matter of urgency, the Profession should identify any gaps in the monitoring of compliance with actuarial standards or significant actuarial calculations within a life (or 'long-term') insurer that are unlikely to be scrutinised by the reviewing actuary, and might therefore benefit from peer review, and report to the Oversight Board on this matter;
 - in the meantime, life insurers should themselves consider whether peer review of the actuarial advice that they receive is appropriate;
 - the Association of British Insurers should, with input from the Profession, consider how education and training might be provided for non-executive directors of insurance companies to assist them to challenge actuarial advice;
 - the Pensions Regulator should, with input from the Profession and other industry bodies, ensure that trustees have access to good practice guidance on the effective management of their professional advisers, including their scheme actuary. Information and case study material should be provided to help trustees to challenge their actuarial advice and should provide them with guidance on potential conflicts of interest;
 - the Pensions Regulator should ensure that scheme actuaries' advice to pension schemes is subject to formal scrutiny by independent experts, through either risk-based supervision, audit or external peer review. The Pensions Regulator may wish to adopt different approaches for large schemes and smaller schemes; and
 - the FSA should consider consulting on introducing a requirement for actuarial advice as part of audit, in both the company market and the Lloyd's market for general insurance.
- 1.6 In each industry sector, the Morris Review recommended that the FRC, working closely with the relevant regulator and the Profession, should – within 2 to 3 years – satisfy itself that appropriate monitoring of actuaries' compliance with professional standards and independent scrutiny of actuarial advice is occurring through either direct supervision by the regulator, audit or external peer review.
- 1.7 The Morris Review further recommended that, in overseeing the regulatory activities of the Profession, the Oversight Board should take account of the extent of direct supervision and regulatory requirements by the statutory regulators to ensure that there is a minimum of material regulatory gaps or overlaps. If the FRC found that the Profession and the overall regulatory framework were providing insufficient monitoring of compliance with standards, it might wish to consider introducing an actuarial inspection unit or expanding the remit of the existing audit inspection unit to undertake direct monitoring of actuarial firms and actuaries.

1.8 In December 2006, the Oversight Board announced that it would undertake a review of the monitoring and scrutiny of actuarial work on behalf of the FRC, and this review was incorporated into the FRC's Plan and Budget for 2007/08.

Our approach to this review

1.9 The regulatory arrangements for the industry sectors in which actuaries operate vary considerably. Given our overall responsibilities and the wide-ranging nature of actuarial work, we have not confined the scope of our review to regulated actuarial roles nor have we confined our interest to the three main industry sectors identified by the Morris Review, although these have inevitably been the focus of the review. Our review has therefore considered some aspects of firm-wide monitoring and scrutiny arrangements as a whole, without distinguishing between the types of actuarial service offered.

1.10 The Oversight Board's role is to oversee the Profession's regulation of its members rather than to make recommendations to other regulators on how they perform their functions. However, the Morris Review made clear that, in framing recommendations to the Profession, we should take into account the nature and extent of scrutiny undertaken or required by other regulators. It also suggested that we should work closely with the Profession and the regulators in undertaking this review.

1.11 Our approach to this review has therefore been as follows:

- *Regulatory analysis and collaboration* - we have worked closely with the Profession, the FSA and the Pensions Regulator to identify and prioritise the various types of actuarial work, identify gaps and overlaps in monitoring and scrutiny, and coordinate our respective review work (including their responses to the Morris recommendations), having regard to the drivers and threats to actuarial quality identified in the FRC discussion paper *Promoting actuarial quality*;
- *Survey of actuarial firms* (Annex C) – we have undertaken a qualitative survey of the main entities which fall outside the remit of regulators and the Profession, namely actuarial consultancy firms, including actuarial teams working in accountancy firms and insurance companies which provide actuarial services to their clients;
- *Stakeholder input* – we have sought input from the main users of actuarial services and information, including the FRC's actuarial stakeholder interest working group (the actuarial stakeholder group), and considered precedents from overseas (see Annex B) and in other professions;
- *Development of options* – in the light of our findings we have developed a number of options for the Profession in order to ensure there is effective monitoring and scrutiny: these are considered further in section 2 and the sections that follow.

- 1.12 In our assessment, monitoring and scrutiny are effective when they provide consumers of actuarial services with confidence that the work is being carried out to a high quality and in accordance with actuarial standards and that any breaches are investigated promptly.
- 1.13 The test of effectiveness of an existing (or new or modified) regulatory measure will therefore be whether (based on our findings) it contributes to achieving the intended actuarial practice and professionalism outcomes, at a cost which is proportionate to the likely benefits and is lower than any alternatives offering equivalent benefits.
- 1.14 In developing options for the Profession based on our review assessment, we have considered the following broad regulatory strategies which it might pursue:
- *Strategy 0 (no proposed changes to existing arrangements)* - reliance on existing arrangements for monitoring compliance with actuarial standards and scrutiny of actuarial work;
 - *Strategy 1 (regulatory support)* – additional support for existing external regulatory and market practices for monitoring and scrutiny;
 - *Strategy 2 (professional requirements)* – supplementing this regulatory support with imposition of the Profession’s own professional quality assurance requirements (such as peer review) on individual actuaries, recognising the practice environment in which they work;
 - *Strategy 3 (active monitoring)* – supplementing these requirements with monitoring and scrutiny of firms and individual actuaries, by the Profession or independently.
- 1.15 Different regulatory strategies and options may be appropriate in different circumstances, and so we have considered the position in each of the main industry sectors separately, in accordance with the FRC’s regulatory principle of targeting our recommendations, and taking a risk-based and proportionate approach.

Reporting

- 1.16 This report considers and develops the main monitoring and scrutiny options (section 2) and then analyses the position in each of the main industry sectors which employ actuaries:
- life insurance (section 3);
 - general insurance (section 4); and
 - pensions (section 5).
- 1.17 The report then summarises these findings and possible options for the Profession (section 6), and asks some specific questions on which we invite views. Based on responses to this consultation, we intend to develop specific recommendations to the Profession and other relevant bodies.

The Oversight Board welcomes the views of those stakeholders and other parties interested in the effectiveness of monitoring and scrutiny of actuarial work

Although the discussion paper raises specific questions, commentators should not feel that they are constrained by those questions, or required to answer all of them. However, it will assist collation of views, if the questions are used to structure responses on this topic

Comments, to reach the Oversight Board by **30 September 2008**, should be addressed to:

Christina Trickett
Professional Oversight Board
5th Floor Aldwych House
71-91 Aldwych
London
WC2B 4HN

E-mail: actuarialmonitoringreview@frc.org.uk

All responses will be regarded as being on the public record unless confidentiality is expressly requested. If you are sending a confidential response by e-mail, please include the word 'confidential' in the subject line of your e-mail

Two – Monitoring and scrutiny options

Introduction

2.1 This section considers the main forms of monitoring and scrutiny of actuarial work operating in the UK, and then develops some of the main regulatory options available to the Profession in the light of existing regulatory and market practice.

Existing forms of monitoring and scrutiny

2.2 The Morris Review identified the following main forms of scrutiny of actuarial work, which we have considered in more detail below:

- *Professional quality assurance* – including private review by another actuary, either informally by a colleague or line manager, or more formally as external ‘peer review’ (which is the description used by the Morris Review);
- *Direct clients* - challenge by senior management and governing bodies of the client institutions with responsibility for taking decisions in relation to actuarial issues, including board and committee members and trustees;
- *Audit* - independent (and usually public) review of the actuarial information produced by or for the client institutions concerned, which may be undertaken by another body, such as a firm of registered auditors in the case of audit of the financial statements, often with its own actuarial advice;
- *Regulation* – regulatory supervision, monitoring and discipline by or on behalf of statutory regulators and professional bodies; and
- *Other independent scrutiny* – including through the courts (litigation, business transfers, insolvency), complaints arrangements, independent reviews, and public comment in the press, or by rating agencies, analysts, academics, consumer or trade bodies.

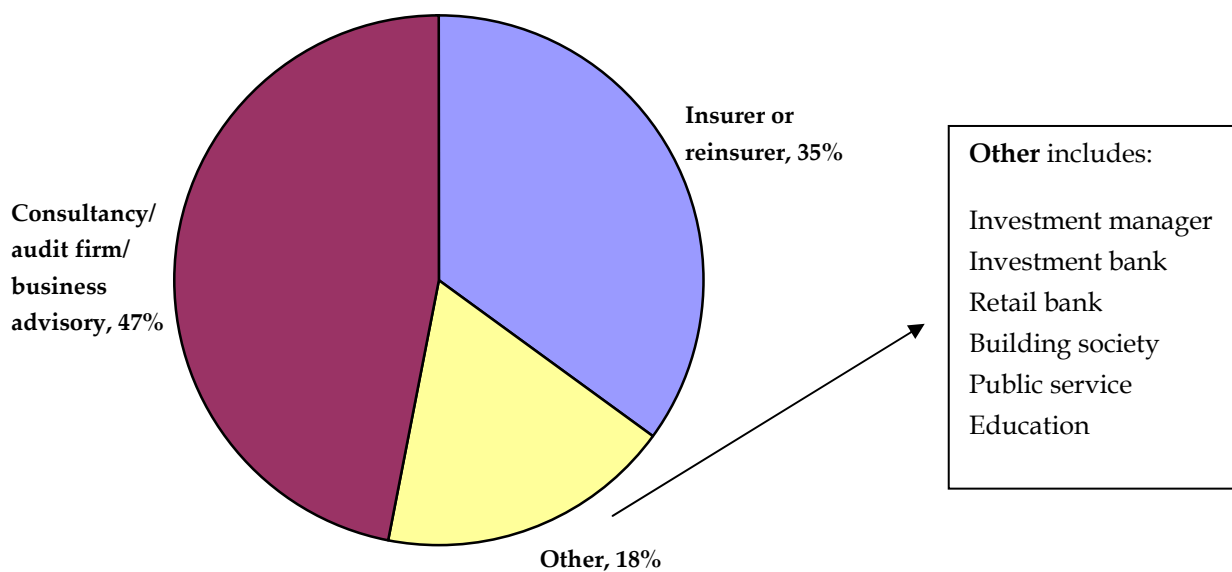
2.3 We have found, since the Morris Review reported, enhanced levels of scrutiny through all these methods, although gaps remain. Our findings vary significantly by sector, and are considered in more detail in sections 3 to 5 below. This section provides a broad introductory description.

2.4 We have supplemented this information through our own survey of actuarial firms, and discussions with the Profession and statutory regulators and other stakeholders.

Professional quality assurance

2.5 Although actuaries are regulated by the Profession in their professional capacity as individuals, most are employees, either of insurers or reinsurers, or of consultancy firms or large audit firms. The FRC's separate discussion paper *Promoting Actuarial Quality* sets out the importance of the working environment for actuaries, including the role of firms; this has led us to consider options in this review that might involve changes beyond those the Profession could make single-handed.

UK Fellows - employment



Source: The Actuarial Profession - from annual returns submitted by UK actuaries as at 31st January 2008

- 2.6 Quality assurance arrangements within regulated entities such as insurers are overseen by the statutory regulators, and are considered in more detail in respect of specific sectors in sections 3 to 5 below.
- 2.7 Consultancy firms are not regulated in respect of the provision of professional actuarial advice, unless this involves regulated advice about particular investments or other financial services. A legislative change would be needed for regulation at the firm level to be applied more generally.
- 2.8 We have supplemented our discussions with the regulators through our own survey of the quality assurance arrangements operated by the actuarial firms (see Annex C).

2.9 The main findings which are not specific to a particular industry sector are as follows:

Main professional quality assurance findings from our survey of firms: we have defined a firm as any organisation providing actuarial services to external clients

Importance - all firms say they regard quality assurance as important, and have established internal arrangements accordingly. Some firms had difficulty in identifying measures used to evaluate the overall quality of their work and to monitor any improvements. Few firms demonstrated established structures for updating their quality assurance procedures; many said they were on the point of reviewing them

Firm specific - a wide variety of quality assurance arrangements have been established, reflecting:

- size of the organisation involved
- actuarial services which the firm provides
- other activities which the firm undertakes and regulatory requirements applying to those activities
- professional indemnity insurance requirements

Monitoring - when it is monitored centrally, quality is generally assessed by reference to client satisfaction, absence of complaints/claims, and in the case of the largest firms on the basis of internal or external audit or practice review processes

Internal review – for most firms, external actuarial advice or any significant external communication is reviewed by another actuary within the firm or typically, in the case of a sole practitioner, by arrangement with another sole practitioner. This is normally performed before the advice is given, although drafts are sometimes shown to the client, pending review

Compliance with standards - internal review (formally documented, in most cases through checklists) typically includes compliance with actuarial standards as well as any internal quality standards, together with broader scrutiny of the communication made

Other controls – there are a variety of approaches to skills and training, conflicts management and whistle-blowing, often reflecting the size of organisation – larger firms are typically more prepared to manage potential conflicts of interest through the operation of information barriers (sometimes known as ‘chinese walls’) whereas smaller firms will typically limit the assignments they are prepared to take on. Most large firms retain a separate research team; many make use of a house range in setting assumptions

Training - few firms said they had given their staff specific training in how to undertake quality assurance roles. The mandatory CPD requirements for actuaries in practice are not seen as demanding either by practising actuaries or by reference to those in other jurisdictions. In-house technical meetings will generally be supplemented by material made available by the Profession, the trade bodies and the regulators

Best practice - there is no clear consensus, even among the very largest firms, of what is or might be regarded as best practice quality assurance for actuarial firms. There was no consistency in approach between firms in the choice of reviewer or in the checks over completeness of coverage

2.10 Further findings from our survey are set out in Annex C, and are also considered in the sector-specific sections and in respect of other types of activity such as audit.

Direct clients

- 2.11 The senior management and governing bodies of regulated entities must increasingly take responsibility for decisions on actuarial issues and for the actuarial information produced for their stakeholders, and this is also regarded as a matter of good governance. Inevitably they will take actuarial advice on relevant matters, and indeed in respect of certain matters they are required by regulation to take advice from actuaries or other quantitative risk professionals.
- 2.12 The Morris Review identified a significant ‘understanding gap’ between actuaries and non-actuaries, which could affect the ability of direct users to take effective decisions based on the actuarial advice they receive. In 2007, the actuarial stakeholder group oversaw a limited survey of the principal non-executive users of actuarial advice, namely insurance non-executive directors and pension scheme trustees.

Main findings from the actuarial stakeholder group survey of principal users

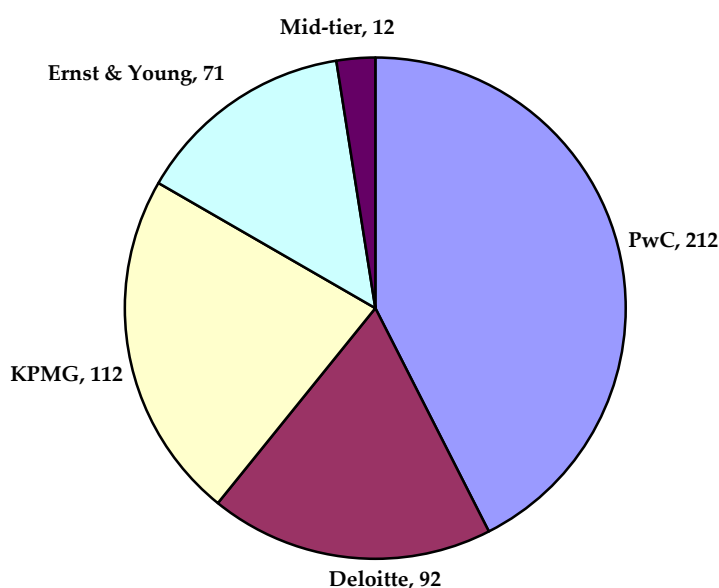
- Many non-executive directors (NEDs) of insurers said they had extensive experience of insurance or other financial services and were familiar with the content, methodology and format of actuarial reports - NEDs appeared more confident in their ability to challenge actuaries than pension trustees
- Although the general level of understanding of pension trustees has improved through such initiatives as the Pensions Regulator’s trustee toolkit, there is still a limit to the scope for bridging the gap in user understanding
- Most pension trustees and insurance NEDs felt that communications from actuaries had improved but that there was still room for improvement

- 2.13 The strength of challenge by senior management and governing bodies is an important source of scrutiny of actuarial work. It is unusual for direct clients themselves to monitor compliance by their advisers with professional standards, and they cannot be regarded as external or independent. However, they may well determine the form and quality of the external review arrangements which are undertaken.

Audit

- 2.14 An important independent source of review of actuarial information produced by an entity is external audit of its financial statements, both as part of corporate reporting and often for regulatory and other stakeholder reporting as well.
- 2.15 An audit is designed to provide reasonable assurance that the financial statements taken as a whole are free from material misstatement. The largest audit firms employ significant numbers of actuaries to support this work as well as to provide external consultancy services, and six audit firms were included in our survey of firms providing external actuarial advice (see Annexes C and D).

Audit firms - UK Fellows based in UK



Source: The Actuarial Profession - as reported in annual returns submitted by UK actuaries as at 31st January 2008

- 2.16 Feedback from audit firms included within our survey suggests that actuaries are well integrated with the rest of the audit team, but may not be prepared with the skills needed for audit work by their professional education and therefore need additional training from their firms.
- 2.17 Although the existing ethical code for actuaries makes it clear that criticism of one member's work by another is acceptable, provided that the criticism is properly reasoned and believed to be justified, some spoke to us of a possible cultural difficulty and, for employed actuaries, uncertainty over statutory protection, in challenging the work of another actuary.
- 2.18 Criticism of the work of another actuary was seen as particularly difficult where a range of possible assumptions could have been used and heavy reliance has been placed on the actuary's judgment.
- 2.19 Specific features of audit are considered separately in respect of each industry sector.

Regulation

- 2.20 The Financial Services Authority (FSA) regulates life and general insurers and other financial services firms, while occupational pension schemes are regulated by the Pensions Regulator. Regulatory requirements are specific to particular industry sectors. However, in general, regulation involves controls over who may undertake specific activities, the setting of rules and standards for the conduct of those activities, and monitoring and enforcement of compliance with those rules and standards.
- 2.21 Because of the scale and range of their responsibilities, the two main statutory regulators take an extensive risk-based approach to regulatory scrutiny based on the potential impact of the risks relating to each entity and issue. The rules and standards imposed by regulators may themselves provide for scrutiny and monitoring of actuarial work by or through third parties, such as auditors, other actuaries and governing bodies.

2.22 Actuaries who work in particular sectors may also be subject to an element of indirect review by other bodies, often in the form of self-regulation of their clients. Examples include the Society of Lloyd's in relation to the work of syndicate actuaries, and the auditing and accountancy bodies in relation to actuaries working for audit firms. Sector specific requirements are described in the sections which follow.

2.23 The Morris Review identified the following reasons for reserving particular roles to actuaries:

- ensures clients take advice from a qualified person;
- controls who may give advice on certain matters;
- gives the regulator a means of enforcing disclosure requirements and standards directly on individuals;
- makes role-holders accountable to the wider public interest, for example through whistle-blowing duties;
- creates a counterbalance to management; and
- engenders and maintains public confidence.

2.24 Although there are a number of roles which must still be undertaken by an actuary, these are increasingly advisory, so as to enable challenge of and by relevant decision-makers.

Regulation by the Profession

2.25 Regulation by the Profession is described more fully in the FRC paper *Promoting actuarial quality* but includes:

- actuarial qualifications - through examinations and training requirements in order to become an Associate or Fellow of the Faculty or Institute as appropriate;
- standard setting - since April 2006, the BAS has been responsible for setting technical standards, but the Profession remains responsible for ethical and conduct standards including any requirements relating to professional quality assurance (such as compliance review requirements in pensions). Annex A provides a list of standards in force at the present time although BAS standards in particular are expected to undergo substantial revision in the near future: <http://www.frc.org.uk/bas/publications/pub1599.html>;
- practising certificates – before undertaking a role which is reserved to actuaries by legislation or regulation, an actuary must hold a practising certificate issued by the Profession;
- monitoring - the Profession does not monitor the activities of its members except in relation to their compliance with Continuing Professional Development (CPD) requirements, and regulated financial services activities undertaken by firms which are regulated by the Institute of Actuaries as a Designated Professional Body under the Financial Services and Markets Act 2000 (FSMA) – some of this work is undertaken on its behalf under contract by the Quality Assurance Directorate (QAD) of the Institute of Chartered Accountants in England and Wales (ICAEW);
- compliance review in pensions – discussed in more detail in section 5; and
- investigation and discipline for misconduct.

2.26 Although the Profession undertakes investigation and discipline of misconduct, this is not preventative in nature and it neither provides best practice guidance on quality control nor routinely monitors actuaries' compliance with professional standards.

Other independent scrutiny

2.27 Historically courts, tribunals and other public commentators have been reluctant to question an actuary's judgment, partly because of the difficulty and cost of understanding the complexity of actuarial concepts. As the Morris Review noted, this is changing. However, the occasions on which actuarial issues are subject to judicial or other public comment are still rare, often relating to specific transactions or occasions when something has already gone wrong. Accordingly, apart perhaps from investment analysts and credit rating agencies, these other forms of independent scrutiny cannot be relied on to be preventative or provide routine compliance monitoring for most actuarial work.

Development of options

2.28 Although we are not developing the full implications of emerging options at this stage (and so have not carried out a Regulatory Impact Assessment), we have considered the possible cost implications and the need for proportionality in the framing of the options included.

2.29 In our review we have identified a number of emerging options for the Profession to address gaps and overlaps, and improve the effectiveness of monitoring and scrutiny of actuarial work, on which we are seeking comments.

2.30 In developing these options, we have considered the following broad regulatory strategies which the Profession might adopt:

- *Strategy 0 – (no proposed changes to existing arrangements)* – reliance on existing arrangements for monitoring compliance with actuarial standards and scrutiny of actuarial work;
- *Strategy 1 (regulatory support)* – additional support for existing external regulatory and market practices for monitoring and scrutiny;
- *Strategy 2 (professional requirements)* – supplementing this regulatory support with imposition of the Profession's own professional quality assurance requirements on individual actuaries, recognising the practice environment in which they work;
- *Strategy 3 (active monitoring)* – supplementing these requirements with monitoring and scrutiny of firms and individual actuaries, by the Profession or independently.

2.31 The advantages and disadvantages of these strategies and the underlying options, which are not intended to be mutually exclusive, are assessed in the context of each of the three main sectors considered in sections 3 to 5. The options are then summarised in section 6.

Strategy 0 – no proposed changes to existing arrangements

- 2.32 We might have concluded that no further regulatory action is required by the Profession because there was already adequate monitoring and scrutiny being undertaken through regulation or audit in the sector under consideration; or because the regulatory activities of the Profession already provided the required level of monitoring and scrutiny in the light of the existing regulatory framework. Naturally, there are no options associated with this strategy.
- 2.33 Given our survey findings and the lack of formal monitoring against actuarial standards in most areas, Strategy 0 is not seen as appropriate for any of the primary sectors of actuarial work.

Strategy 1 - regulatory support

- 2.34 Additional support for existing regulatory and market practices is the strategy which the Profession has largely adopted, as described in the forms of monitoring and scrutiny set out above. For regulated work, the Profession already requires actuaries who undertake a reserved role to hold a practising certificate, and has set specific technical standards (for which the BAS became responsible from April 2006) as well as ethical and conduct standards, which reflect regulatory and other market practice requirements.
- 2.35 This strategy relies on external regulators, auditors and other external mechanisms to achieve the required level of compliance monitoring and scrutiny of the quality of actuarial work. If the Profession pursues this strategy then, to the extent that we identify gaps which have not been filled by the Profession, these would have to be filled by further regulatory action.
- 2.36 Based on our review of current practice, and in particular our quality assurance survey, we believe the Profession could take a number of additional steps in order to improve the effectiveness of monitoring and scrutiny of actuarial work through existing regulatory and market processes:
- *Option 1A - Develop relevant review and audit skills through education and CPD*
The Profession could include more review and audit techniques in its education, building on the audit trail elements in its modelling course, probably at the later specialist stages, or as a module, as well as in work-based training. This could add to qualification times if incorporated as an educational requirement, but we believe the Profession could integrate such requirements without a significant increase in costs, since review processes are an effective way to test broader skills. There is also scope for development of relevant CPD.
 - *Option 1B - Develop or encourage quality assurance standards or guidance on effective internal quality control procedures for actuaries and their firms*
The main aim of this option would be to inform firms about best practice in quality assurance, rather than to impose additional obligations on actuaries or their firms. This might in particular help smaller firms to design and maintain effective arrangements at lower cost. Standards might be generic, along the lines of the International Standard on Quality Control

(ISQC1¹) *Quality control for firms that perform audits and reviews of financial statements, and other assurance and related services engagements*, or practice-specific. Guidance might also be made available to users of actuarial services, in conjunction with relevant industry and regulatory bodies.

- *Option 1C - Increase transparency of professional review processes through publication of further research and statistics*

In conjunction with industry and regulatory bodies, as well as commercial and consumer organisations and academics, the Profession could increase transparency, demonstrate continuing efficacy and help share examples of good practice, by undertaking and publishing regular research and statistics on the monitoring and scrutiny of actuarial work. This option would serve to improve collective intelligence, possibly by way of a think-tank, would be forward-looking in its assessment of risk, and might be most effectively pursued on a practice-specific basis.

- *Option 1D –Develop more effective arrangements for reporting concerns about actuarial issues or actuarial work*

Courage and back-bone are essential characteristics for actuaries placed in difficult situations and we cover this in greater depth in our companion paper *Promoting actuarial quality under Ethics and professionalism of actuaries*. The Profession updated its guidance on whistle-blowing to the FSA in February 2006, and its guidance to scheme actuaries in GN29: *Occupational pension schemes – advisers to the trustees or a participating employer* in April 2007. In addition, the Pensions Regulator has updated its Code of Practice, Code 01 Reporting breaches of the law. The aim of this option – which is an outstanding recommendation from the Morris Review - is that the Profession consolidates its whistle-blowing guidance through common principles that are of general application for all actuaries, recognising the importance of statutory protection for those that feel obliged to whistle-blow.

Strategy 2 – professional requirements

2.37 The Profession could supplement regulatory support by imposing its own professional quality assurance requirements - as it has already started to do in pensions (see section 5) - and recognising the practice environment in which actuaries work as part of its wider regulatory processes such as the issuing of practising certificates.

2.38 The options for the Profession if it adopts this strategy are as follows:

- *Option 2A: impose quality assurance requirements for relevant actuarial work*

This involves review by another suitably qualified actuary of an actuary's specified work output against actuarial standards and can either take place prior to release of the advice

¹ <http://www.frc.org.uk/apb/publications/pub1387.html>

(‘hot’ review) or some time after (‘cold’ review). Apart from a sole practitioner, the review could and probably would be undertaken by a colleague within the same firm. An example of this in pensions is GN48 *Compliance review* – see section 5.

- *Option 2B: require external peer review which is independent of the actuary and the actuary’s firm*

This involves review of a sample of the actuary’s work by an independent actuary some time after the advice has been given (an external ‘cold’ review). A full list of the actuary’s relevant assignments would be needed either from the actuary or from the relevant regulator. The independent actuary could be chosen by the actuary, or by the Profession or the relevant regulator. The Society of Actuaries in Ireland and the Irish Pension Board have introduced such a requirement for regulated pensions work – see section 5.

- *Option 2C: administrative monitoring of compliance with quality assurance requirements*

Compliance with the requirements in Options 2A and 2B could be monitored administratively by the Profession on a sample basis. The Profession would need a full list of the actuary’s relevant assignments, as in Option 2B.

- *Option 2D: introduce stricter independence requirements for actuaries undertaking relevant work*

This option would have to be justified in its own right, but might permit a relaxation of other review requirements, such as option 2B, since the actuary’s work would in effect be reviewing the work of others or would itself be reviewed by independent third parties.

- *Option 2E: introduce additional requirements for individual actuaries holding practising certificates which relate to the practice environment in their firm*

Such requirements could include making the firm’s quality assurance arrangements subject to a standard form of independent practice review by the Profession, similar to that already offered to firms of some other professional bodies by practice monitoring teams. Another requirement might be for a senior actuary to take responsibility for aspects of the firm’s practice, in the same way as the head of a barristers’ chambers. The Profession might then be able to relax the requirements it imposes on individual actuaries within the firm; in some respects, this would merely be a formalisation of the existing criteria against which applications for practising certificates are already assessed. Care would be needed to ensure that small firms and sole practitioners are not disproportionately affected.

- *Option 2F – require practising certificates for external as well as regulated actuarial advice*

This would draw a distinction between internal actuarial work undertaken by an employee, which can be controlled by the actuary’s employer; and external work which is the responsibility of the consultancy firm providing the advice. In the case of external advice, the client is reliant on the actuary and the actuary’s firm to ensure that the work is of high quality

and complies with applicable actuarial standards. There would need to be a suitable definition of actuarial advice.

- *Option 2G – allow firms as well as individuals to obtain a practising certificate*

This option relaxes the restriction requiring an activity to be undertaken by an individual, and reflects the commercial reality of the relationship between many actuaries and their clients. The Profession could then regulate actuarial firms in the same way as firms of accountants and some other professions are regulated. To the extent that the Profession requires practising certificates for actuarial advice which is not already regulated (see Option 2F), this would be a matter for the Profession alone. Firms could only undertake regulated actuarial roles if the Government or regulator as appropriate agreed to relax the relevant statutory or regulatory restriction. However, we would envisage that the Profession's practising certificate requirements for individuals could be reduced for those individuals employed by such a firm.

Strategy 3 – active monitoring

2.39 The Profession does not actively monitor the activity of its members and its approach to compliance is reactive, relying upon complaints. It will investigate (and, where necessary, discipline) its members when it receives information indicating possible misconduct.

2.40 Active monitoring or scrutiny by the Profession or independently is in some respects an alternative as well as a substitute for the imposition of professional review requirements on actuaries. To be effective it needs to involve full recognition of the role and responsibilities of firms for the quality of their professional work. The approach would be similar to that undertaken in respect of audit and other assurance work performed by accountancy firms.

- *Option 3A – regulatory inspection by the Profession of actuaries' work using firm-based sampling*

This is similar to the inspection work undertaken by the monitoring teams for the professional accountancy bodies as recognised supervisory bodies for audit, although there is no statutory basis at present for a regime of this kind for actuaries. Random or stratified sampling could be used to select from reported assignments for individual actuaries (see Options 2B and 2C), but firm-based sampling would probably be the most proportionate and effective way for the Profession to dove-tail with firms' own quality assurance arrangements.

- *Option 3B – independent regulatory inspection of actuaries' work using firm-based sampling*

This is similar to the inspection work of the FRC's Audit Inspection Unit (AIU) for public interest audits. Random or stratified sampling could be used to select from reported assignments for individual actuaries (see Options 2B and 2C), but, as with Option 3A, firm-based sampling would probably be the most proportionate and effective way to dove-tail with firms' own quality assurance arrangements.

Summary of regulatory monitoring and scrutiny strategies for the Profession		
Strategy 1: Regulatory support	Strategy 2: Professional requirements	Strategy 3: Active monitoring
Additional regulatory support for existing regulatory and market practices	Supplement Strategy 1, by imposing professional quality assurance requirements on individual actuaries or their firms, and taking account of the practice environment in which actuaries work	Supplement or substitute Strategy 2, with monitoring and scrutiny of firms and individual actuaries, by the Profession or independently
<p>Option 1A – develop relevant review and audit skills through education and CPD</p> <p>Option 1B – develop or encourage quality assurance standards or guidance on effective internal quality control procedures for actuaries and their firms</p> <p>Option 1C – increase transparency of professional review processes through publication of further research and statistics</p> <p>Option 1D –Develop more effective arrangements for reporting concerns about actuarial issues or actuarial work</p>	<p>Option 2A – impose quality assurance requirements for relevant actuarial work</p> <p>Option 2B – require external peer review which is independent of the actuary and the actuary’s firm</p> <p>Option 2C – administrative monitoring of compliance with quality assurance requirements</p> <p>Option 2D – introduce stricter independence requirements for actuaries undertaking relevant work</p> <p>Option 2E – introduce additional requirements for individual actuaries holding practising certificates which relate to the practice environment in their firm</p> <p>Option 2F – require practising certificates for external as well as regulated actuarial advice</p> <p>Option 2G – allow firms as well as individuals to obtain a practising certificate</p>	<p>Option 3A – regulatory inspection by the Profession of actuaries’ work using firm-based sampling</p> <p>Option 3B – independent regulatory inspection of actuaries’ work using firm-based sampling</p>

Three - Life Insurance

Introduction

3.1 Set out below is a high level summary of the various roles actuaries fill within life insurance, the nature of the activity, applicable standards and, in outline, the monitoring and scrutiny activity already taking place. Fuller details of the work of actuaries in life insurance may be found in the FRC's discussion paper *Promoting actuarial quality*.

Life insurance - summary of monitoring and scrutiny of actuarial work			
Actuarial role	Nature of activity supported	Applicable standards²	Monitoring and scrutiny activity
<p>Actuarial function holder (AFH) – for companies and directive societies</p> <p>The AFH need not advise on other activities, but in practice will need to review the work done because of the possible impact on the AFH's regulatory duties</p>	<p>Regulatory reporting and financial management (AFH must advise):</p> <ul style="list-style-type: none"> • long-term liabilities and/or with-profits insurance component • ability to meet policyholder liabilities <p>Other financial management and customer transactions:</p> <ul style="list-style-type: none"> • risk management and stress testing • financial condition and planning • asset-liability matching and investment strategy • individual capital assessment • pricing • reinsurance protection 	<p>Standards primarily set by the FSA</p> <p><i>SUP 4.3.13</i></p> <p>IPRU-INS IPRU-FSOC</p> <p>GN39,GN40, GN44,GN45</p> <p>No technical standards for pricing actuary</p>	<p>The governing body is responsible for taking decisions, on the basis of advice from the AFH. Actuaries subject to internal quality assurance; some external review</p> <p>External audit of regulatory returns. Auditor must take advice from a qualified actuary (known as the 'reviewing actuary'). GN42 requires the reviewing actuary to review compliance with actuarial standards</p> <p>Risk-based supervision by the FSA, typically using its own actuarial expertise, including thematic review</p> <p>Consumer complaints referred under the 'wider implications' process may act as an early warning to the FSA</p>
<p>Appropriate actuary (for non-directive friendly societies)</p>	<p>For transfer of engagements involving a friendly society, the AFH or appropriate actuary must report</p>	<p>Friendly Society Acts 1992 s88 Friendly Society Act 1974 s23</p>	<p>Reviewed by the FSA and independent actuary, and subject to review and challenge in court or other proceedings</p>

² Reference Annex A for current actuarial guidance notes (GNs)

Life insurance - summary of monitoring and scrutiny of actuarial work			
Actuarial role	Nature of activity supported	Applicable standards²	Monitoring and scrutiny activity
Reporting actuary	Corporate reporting under the Companies Acts: <ul style="list-style-type: none"> • Long-term liabilities • Realistic reporting and embedded values (EVs) 	FRS 27, GN7 Insurance SORP, IFRS4 Sch9A para 46(2) Companies Act 85; EEV principles. Inconsistency between UK GAAP & realistic basis	Internal review and decisions are similar to those for the AFH, who usually oversees this work as well External audit - Practice Note (PN20): <i>The audit of insurers in the United Kingdom</i> , for companies or PN24: <i>The audit of friendly societies in the United Kingdom</i> Generally reviewed by auditor's in-house actuary EV more often reviewed by specialist external consultancy
With-profits actuary (WPA)	Reporting and exercise of discretion relating to with-profits business. Principles and Practices of Financial Management (PPFM) <ul style="list-style-type: none"> • With-profits report • Policyholder communications • Exercise of discretion in relation to activities above 	Standards set primarily by the FSA e.g. SUP 4.3.16 COBS 20	Governing body is responsible for taking decisions, on the basis of advice from the WPA. Actuaries are subject to internal quality assurance, some external review. The FSA requires additional with-profits governance arrangements such as review by a with-profits committee, NEDs or an independent expert Risk-based supervision by the FSA, using its own actuarial expertise Consumer complaints referred under the 'wider implications' process may act as an early warning to the FSA
Appropriate actuary (for non-directive friendly societies)	For (re)insurance involving incorporated friendly society, WPA or appropriate actuary must report		
Expert advisory (Independent actuary for friendly societies)	Skilled person reports (business transfer, insolvency, regulatory support) Transfer of engagements Advice on compensation for misselling, and impaired lives (damages/Ogden tables) Life interests and reversions Pre-paid funeral plans	Parts 7, 11 and 24 of FSMA GN23 (for takeovers) GN24 GN10 GN38	Reviewed by the FSA. Subject to review and challenge in court or other proceedings

3.2 As explained in sections 1 and 2, we have considered the monitoring and scrutiny of actuarial work in life insurance under the three main headings identified by the Morris Review: regulation, audit and professional quality assurance (which the Morris Review described as external peer review), as well as assessing the challenge from direct clients and other independent scrutiny.

Regulation

3.3 The Financial Services Authority (FSA) regulates the activities of long-term insurers (covering life insurance and other long-term business such as sickness and personal accident) and intermediaries, using powers under the Financial Services and Markets Act 2000 (FSMA). The FSA uses supervisory powers and multi-disciplinary teams (including actuaries) to supervise

insurers and monitor and scrutinise the actuarial information they provide, including the additional work of the 'appropriate actuary' appointed by non-directive friendly societies established under the Friendly Societies Acts.

- 3.4 Actuaries who have been appointed to perform specified statutory or regulated roles are subject to whistle-blowing provisions under FSMA, although the Morris Review had concerns about the clarity and effectiveness of these provisions, and we found some support for this concern in our survey of actuarial firms.
- 3.5 In other respects, the Morris Review was generally satisfied with the FSA's risk-based approach to regulatory scrutiny of actuarial work in relation to life insurance. However, it recommended that:

The FSA should, in line with its risk-based approach, pro-actively monitor a sample of insurers' with-profits reports and accompanying opinions (from the With-Profits Actuary), as well as any issues that arise from them.

- 3.6 In the FSA's opinion it already reviews sufficient of the with-profits reports and other relevant material produced by insurers under its risk-based approach to meet this recommendation. The opinions produced by the With-Profits Actuary (WPA) seldom contain any additional information, since the WPA has usually ensured that any matters considered material are included in the insurer's main report.
- 3.7 Since the Morris Review, the FSA has developed a new supervisory approach (Arrow 2), which is more theme/sector based, so there may be less routine monitoring of actuaries' work. In 2006, the FSA published some examples of good actuarial systems it had identified in its supervisory work³, and in 2007 it published a review of the governance of with-profits business⁴.
- 3.8 The FSA does not directly monitor compliance with actuarial standards. However, some of its rules require long-term insurers to follow, or have regard to, generally accepted actuarial principles, of which actuarial standards are likely to be a significant part. So in monitoring compliance with its own rules, the FSA may well have regard to actuarial standards. However, the FSA increasingly relies on auditors to scrutinise the actuarial information in regulatory returns (see below).
- 3.9 The FSA does not directly scrutinise other aspects of the role of actuaries in insurance companies, and there are limited technical standards in these areas in any event, although actuaries' work is likely to be considered indirectly as part of the FSA's risk-based supervision of the firm.
- 3.10 In a recent sector briefing⁵ and consultation, the FSA signalled a move away from reliance on standard regulatory returns towards greater reliance on firms to assess their own risks, for

³ http://www.fsa.gov.uk/pubs/newsletters/li_newsletter6.pdf {page 4}

⁴ <http://www.fsa.gov.uk/pages/Library/Communication/PR/2007/103.shtml>

⁵ www.fsa.gov.uk/pubs/other/icas_isb.pdf

example in preparing individual capital assessments (ICAs) and other corporate documents such as business plans. These documents contain significant amounts of actuarial information, but because they are not reports for which actuaries have any formal responsibility, there are limited applicable actuarial standards for this work, apart from GN46: *Individual capital assessments*. The FSA indicated that it would increasingly make use of powers to appoint a skilled person (such as an actuary) to report on a particular aspect of a firm's business, and in particular its systems and controls.

- 3.11 The Profession has supported these initiatives by setting technical actuarial standards for all the main recognised actuarial roles (now the responsibility of the BAS), and introduced two practising certificates for actuaries undertaking such roles: depending on whether the insurer carries out with-profits business or not.

Audit

- 3.12 Long-term insurers' financial statements, prepared under the Companies and Friendly Societies Acts, are subject to audit, although commentators and auditors themselves frequently refer to the additional actuarial information provided in regulatory returns. Because of this, auditors started to take advice from actuaries even before the actuarial information in regulatory returns was subject to audit.
- 3.13 The Morris Review strongly supported the FSA's extension of audit to actuarial information in long-term insurance regulatory returns from December 2004, and the requirement for the auditor to take the advice of a qualified actuary (known as the reviewing actuary). GN 42: *The reviewing actuary* requires a review of the work of the insurer's in-house actuary against relevant actuarial standards. However, the Morris Review recognised that the auditor would not be primarily concerned with monitoring of compliance with actuarial standards in respect of matters outside the scope of the audit, which would have to be provided through other means.
- 3.14 The reviewing actuary role was felt by several of the actuaries in audit firms we spoke to in our survey to have significantly strengthened the emphasis on actuarial review in the audit of long-term insurers.

Professional quality assurance

- 3.15 Some form of mandatory professional quality assurance (described as 'external peer review') was a recommendation of the Corley Review commissioned in 2002 to consider lessons for the Profession from the Equitable case. This was a life insurance case, and so it was natural for the Profession to consider extending any requirements to this sector.
- 3.16 Following representations by the FSA, the ABI, and individual insurers and actuarial firms, the Profession was persuaded that mandatory external peer review would be disproportionate. This was because of the FSA's new requirement that the auditor of a long-term insurer should take

advice from a qualified actuary (the reviewing actuary), and the governance arrangements established for with-profits (including the role of the new WPA).

3.17 Given the introduction of the reviewing actuary role, the Morris Review did not recommend the extension of peer review to life insurance. Instead it recommended that:

The Profession should identify any gaps in the monitoring of compliance with actuarial standards or significant actuarial calculations within an insurer that are unlikely to be scrutinised by the reviewing actuary, and might therefore benefit from peer review and report to the [Oversight Board] on this matter. In the meantime, insurers should themselves consider whether peer review of the actuarial advice that they receive is appropriate.

3.18 The Profession has identified a number of gaps in the monitoring of compliance with actuarial standards or significant actuarial calculations within a life insurer that are unlikely to be scrutinised by the reviewing actuary, and might therefore benefit from peer review. The gaps identified were in respect of:

- the individual capital assessment required and reviewed by the FSA;
- continuous monitoring processes for risks and solvency; achieved profits/embedded value reporting (where not already subject to audit);
- use of discretion in non-profit business;
- control and monitoring processes established by internal audit within a firm; and
- bonus determination (on advice by the With-Profits Actuary).

3.19 Following our report in December 2006 on the Profession's implementation of the recommendations made to it by the Morris Review⁶, the Profession has been considering with the FSA the oversight of the with-profits actuary and the potential for an external review of aspects of the internal advice given by the with-profits actuary.

3.20 The Profession also undertook a survey of peer review arrangements undertaken by life insurers in respect of the recognised actuarial roles. This found widespread use of internal, and sometimes external, review. However, there was continuing opposition to mandatory peer review, because of the existence of audit and regulatory scrutiny by the FSA.

3.21 One option (which also addresses scrutiny by direct clients – see below) that the Profession is exploring with the ABI and the FSA is to enhance the use of external review of actuaries' work by developing industry guidance for the governing bodies of insurers on when it might be appropriate for them to use external review. This would take account of any work already being undertaken by the auditor and the reviewing actuary and the degree of independence of the actuary performing the underlying work.

⁶ <http://www.frc.org.uk/images/uploaded/documents/2006%2012%2018%20Morris%20publication%20draft2.pdf>

Direct clients

3.22 The regulatory responsibilities of insurers' governing bodies were significantly expanded in December 2004. FSA rules now require them to take responsibility for actuarial information and decision-making.

3.23 The Morris Review recommended that:

The ABI should, with input from the Profession, consider how education and training might be provided for non-executive directors of insurance companies to assist them to challenge actuarial advice.

3.24 The actuarial stakeholder group survey⁷ confirmed that non-executive directors (NEDs) of insurers felt confident in challenging the work of actuaries, and governance structures such as audit committees are likely to formalise internal compliance monitoring procedures. This was based in part on systems of independent scrutiny and challenge of actuarial advice before it was presented to the board.

3.25 The FSA also requires life insurers to maintain suitable governance arrangements for their with-profits business, including the role of the with-profits actuary, to ensure that there is appropriate regard to the interests of policyholders. Examples include a with-profits committee, a non-executive director, or an independent expert. These arrangements often involve one or more actuaries. The FSA published the results of a review of these arrangements in September 2007⁸, which highlighted ways in which these could be improved.

Other independent scrutiny

3.26 As evidenced by the Equitable case, insurers' management actions (based on actuarial information and advice) are increasingly being challenged by policyholders in the courts and through insurers' own complaints arrangements (which the FSA monitors). FSMA already provides for an expert (in practice usually an actuary) to provide a report to the FSA and the court in relation to business transfers, insolvency and other regulatory reviews of an individual firm. The financial strength of life insurers is also assessed by investment analysts, credit rating agencies, and potential investors' financial advisers.

3.27 Unresolved policyholder complaints may also be referred to the Financial Ombudsman Service (FOS), which will consider the acts or omissions of the insurer rather than any underlying advice that it may have received from an actuary. Typically, such complaints may turn on the advice given to the policyholder when the policy was taken out and whether or not the particular policy was suitable for the particular policyholder. Relevant issues may include

⁷ <http://www.frc.org.uk/bas/publications/stakeholder.cfm>

⁸ <http://www.fsa.gov.uk/pages/Library/Communication/PR/2007/103.shtml>

particular policy features – which may sometimes include a potential or actual market value reduction in surrender values.

- 3.28 Complaints to the FOS where the interests of the individual policyholder have to be considered alongside the interests of policyholders in general – such as management actions of insurers in with-profits funds – may be referred to the FSA under the wider-implications process <http://www.wider-implications.info/>. Such complaints may sometimes act as an early warning to the FSA about emerging problems where life insurers have acted on actuarial advice, although inevitably only after the advice has been acted on.

Conclusions

- 3.29 For the many actuarial activities in life insurance which are influenced by statutory regulation, there is extensive scrutiny both by governing bodies and independently through audit, FSA supervision and other mechanisms. There is also scope for monitoring of compliance with actuarial standards as part of that scrutiny, where applicable, with the specific assessment required of the reviewing actuary the most notable example. However, the extent to which this takes place in other areas is unclear.
- 3.30 Much of this scrutiny is potentially overlapping. This largely relates to regulatory requirements rather than to the Profession's own requirements, but we believe that the Profession can, through its activities and its work with its members, help the governing bodies of insurers and other bodies to clarify and coordinate - and actuaries themselves to perform - such review work more effectively.
- 3.31 The main gaps in the formal monitoring and scrutiny arrangements which have been identified are in relation to areas in which the work of actuaries is not specifically recognised in regulation or there are limited actuarial standards, or there is a lack of clarity over the role of the actuary or of the quality standards against which the actuary's work should be assessed. In practice, such work is still likely to be closely scrutinised, and there may be scope in due course – such as through recognition of BAS standards by the FSA - for more formal compliance monitoring with actuarial standards which are developed by the BAS.

Options for the monitoring and scrutiny of the work of life insurance actuaries

3.32 Against this background, we set out below a high level analysis of the advantages and disadvantages of the various strategies open to the Profession with regard to the monitoring of actuaries' compliance with professional standards and independent scrutiny of actuarial advice.

Strategy	Advantages	Disadvantages
Strategy 1: regulatory support	Provides proportionate mechanism for addressing gaps in existing arrangements for monitoring and scrutiny	Fails to address fully the concern that existing monitoring and scrutiny arrangements do not adequately consider monitoring of compliance with standards
Strategy 2: professional requirements	Could establish mechanisms for the explicit monitoring by other actuaries of compliance with actuarial standards	The facility already exists for the FSA to ask for skilled persons reports which could look specifically at compliance with actuarial standards The Profession's own review identified some gaps in the reviewing actuary's role but there were limited standards to monitor against Potential adverse cost implications
Strategy 3: active monitoring	Enhanced market confidence in the work of actuaries through independent monitoring of compliance with actuarial standards	Would significantly overlap with the FSA's activities The Profession's own review identified some gaps in the monitoring arrangements but, given the absence of regulatory guidance in these areas, there were limited standards to monitor against More significant cost disadvantages

3.33 Based on our assessment of the gaps in existing arrangements, the likely costs and possible benefits, we believe that the most appropriate approach is for the Profession to adopt Strategy 1 in the area of life insurance and develop additional tools for regulatory support.

3.34 Examples could include:

- the development of relevant skills through education and CPD, in particular for the role of the reviewing actuary;
- the development of quality assurance standards (for example through independently verified kite-marks) and of guidance on effective internal quality control procedures for firms of actuaries. This could be supplemented by increased transparency of professional review processes through publication of further research and statistics; and
- The development of more effective arrangements for reporting concerns about actuarial issues or actuarial work including, but not limited to, the AFH, WPA and the reviewing actuary.

3.35 A high level analysis of the advantages and disadvantages of these additional options for regulatory support, for life insurance, is set out below:

Options under Strategy 1:	Advantages	Disadvantages
<u>Option 1A:</u> Develop relevant review and audit skills through education and CPD	Anticipated high take-up Proportionate cost	Might be difficult to fit into already packed syllabus
<u>Option 1B:</u> Develop or encourage quality assurance standards (for example through independently verified kite-marks) or guidance on effective internal quality control procedures for actuaries and their firms <u>Option 1C:</u> Increased transparency of professional review processes through publication of further research and statistics	Flexible way to secure base-line standards Some useful precedents such as ISQC1 Builds on existing work by Profession and others	Might cut across existing quality assurance arrangements (particularly for firms which are part of an international network) No enforcement mechanism
<u>Option 1D:</u> Develop more effective arrangements for reporting concerns about actuarial issues or actuarial work	Cost-effective way to enhance this safeguard, involving consolidation of existing provisions	Might require further legislative change to resolve some confidentiality concerns Might undermine reporting responsibilities of senior management and commercial usefulness to clients, leaving actuaries isolated

Questions

- Q3(i) Do you agree that the effectiveness of monitoring and scrutiny arrangements in life assurance could be enhanced in the most proportionate manner through adopting Strategy 1? [3.33]
- Q3(ii) If not, why not?
- Q3(iii) Do you support any of the options identified for additional regulatory support under Strategy 1? [3.34]
- Q3(iv) Do you have any further suggestions of how the Profession could promote effective and proportionate monitoring and scrutiny of actuarial work?

Four - General Insurance

Introduction

4.1 Set out below is a high level summary of the various roles actuaries fill within general insurance, the nature of the activity, applicable standards and, in outline, the monitoring and scrutiny activity already taking place. Fuller details of the work of actuaries in general insurance may be found in the FRC's discussion paper *Promoting actuarial quality*.

General insurance - summary of monitoring and scrutiny of actuarial work			
Actuarial role	Nature of activity supported	Applicable standards⁹	Monitoring and scrutiny activity
Reserving: not a reserved role [Regulatory reporting] Other related activities	Regulatory reporting and financial management : Outstanding claims reserves Individual capital assessment Pricing Reassurance review	GN12 GN50 Standards primarily set by the FSA GN46 GN50 Best Practice methods from General insurance premium Rating Issues working Party (GRIP) and General insurance Reserving Issues Taskforce (GRIT) GN18 –US	Governing body is responsible for taking decisions, on the basis of advice from the reserving actuary. Actuaries are subject to internal quality assurance, some external review Risk-based supervision by the FSA, using its own actuarial expertise Main FSA returns are audited (with significant actuarial input) International Insurance Department of the National Association of Insurance Commissioners (US)
Reporting: not a reserved role [Corporate reporting]	Corporate reporting under the Companies Acts: Claims reserves	CA85 Sch.9A Insurance SORP GN12 GN50	Internal review and decisions are similar to those for reserving actuary External audit: Practice Note (PN20) <i>The audit of insurers in the United Kingdom</i> Generally reviewed by auditor's in-house actuary Some HMRC scrutiny
Syndicate actuary (Lloyd's)	Opinion on reserves Statement of actuarial opinion (on reserves) Accompanying report	SUP 4.6.16 GN12 GN20 GN33 - US Insurance Accounts Directive (Lloyd's Syndicates and Aggregate Accounts) Regulations 2004. Lloyd's valuation of liability rules	Review by the Lloyd's actuary Risk-based supervision by the FSA, using its own actuarial expertise External audit but, as an independent reviewer, syndicate actuary may be employed by the auditor

⁹ Reference Annex A for current actuarial Guidance Notes (GNs)

General insurance - summary of monitoring and scrutiny of actuarial work			
Actuarial role	Nature of activity supported	Applicable standards⁹	Monitoring and scrutiny activity
Lloyd's actuary	Individual capital assessment Reinsurance Reserves Regulatory reporting	GN12 GN50 SUP 4.6.8 Insurance Accounts Directive (Lloyd's Syndicates and Aggregate Accounts) Regulations 2004.	Council of Lloyd's Risk-based supervision by the FSA including thematic reviews External audit of regulatory returns Advice of a reviewing actuary taken
Expert advisory	Skilled person reports under Parts 7, 11 and 24 of FSMA (business transfer, insolvency, regulatory support) Post-retirement medical plans	GN18 GN24 (ethical and only applicable to independent expert, not skilled person) GN12 applies unless the actuary deems it impractical or disproportionate GN21	Generally reviewed by the FSA and subject to review and challenge in court or other proceedings

4.2 As explained in sections 1 and 2, we have considered the monitoring and scrutiny of actuarial work in general insurance under the three main headings identified by the Morris Review: regulation, audit, and professional quality assurance (which the Morris Review described as external peer review), as well as assessing the challenge from direct clients and other independent scrutiny.

Regulation

4.3 The Financial Services Authority (FSA) regulates the activities of general (also known as non-life) insurers and intermediaries, using powers under the Financial Services and Markets Act 2000 (FSMA). The FSA uses supervisory powers and multi-disciplinary teams (including actuaries) to supervise insurers and monitor and scrutinise the actuarial information they provide.

4.4 The FSA also regulates the Society of Lloyd's and oversees its regulation of the Lloyd's market, as well as regulating managing agents and advice on becoming a member of a Lloyd's syndicate. The only recognised roles for actuaries in general insurance in the UK are the Lloyd's actuary and syndicate actuaries, the appropriate actuary for non-directive friendly societies which carry out non-life business (see section 3), and roles required by foreign regulators. The Profession has responded to these roles through a practising certificate requirement and specific actuarial standards (now the responsibility of the BAS).

- 4.5 The Lloyd's actuary reviews the Statement of Actuarial Opinion (and associated actuarial report) for each syndicate and performs a benchmarking study each year. Lloyd's has a central actuarial team which scrutinises syndicates' returns and syndicate actuaries' reports, including the extent to which they demonstrate compliance with relevant actuarial standards.
- 4.6 The Morris Review recommended that the FSA should consider extending its recognition of actuarial roles at Lloyd's to include insurance companies, which the FSA has chosen to address informally through its supervision of insurers rather than through formal regulatory requirements.
- 4.7 Since the Morris Review, the FSA has developed a new supervisory approach (Arrow 2), which is more theme/sector based, so there may be less routine monitoring of actuaries' work. The FSA does not directly monitor compliance with actuarial standards. However, in monitoring compliance with its own rules, the FSA may, on occasions, have regard to actuarial standards. The FSA also relies on auditors to scrutinise the actuarial information in regulatory returns.
- 4.8 In a recent sector briefing¹⁰, the FSA signalled a move away from reliance on standard regulatory returns towards greater reliance on firms to assess their own risks, for example in preparing individual capital assessments (ICAs) and other corporate documents such as business plans. These documents contain significant amounts of actuarial information but, because they are not reports for which actuaries have any formal responsibility, there are no applicable actuarial standards for this work. In its consultation, the FSA indicated that it would increasingly make use of *ad hoc* powers to appoint skilled persons to report on a particular aspect of a firm's business, and in particular its systems and controls.

Audit

- 4.9 Both Companies Act financial statements and regulatory returns produced by general insurers are audited and, because of the risks involved, auditors make substantial use of actuaries in reviewing the actuarial information on claims and other reserves. Indeed, at least one auditor employs more actuaries specialising in general insurance than in any other sector, and is a major provider of actuarial consultancy, particularly in relation to insolvency. One non-executive director we spoke to, a non-actuary, said he placed strong reliance on the actuarial review of the reserves by the reserving actuary, included as part of the auditor's management letter to the insurer. However, there is no formal role for actuaries in this process, to ensure there is monitoring of compliance with actuarial standards.
- 4.10 The Morris Review recommended that:

The FSA should consider consulting on introducing a requirement for actuarial advice as part of audit, in both the company market and the Lloyd's market for general insurance.

¹⁰ www.fsa.gov.uk/pubs/other/icas_isb.pdf

- 4.11 The FSA says it believes that most auditing firms already employ actuaries with expertise in the assessment of technical claims provisions, but will review their use as part of its Arrow (risk assessment) and ICA reviews.
- 4.12 Although audit firms do not generally permit their actuaries to undertake actuarial roles for audit clients, the role of syndicate actuary, being that of an independent reviewer, is sometimes undertaken by an actuary from an audit firm, where the underlying work has been done by an in-house actuary or an external consultant. In such cases, the auditor's actuary inevitably needs to be satisfied that actuarial standards have been complied with.

Professional quality assurance

- 4.13 A form of mandatory professional quality assurance (described as 'external peer review') was a recommendation of the Corley Review commissioned in 2002 to consider lessons for the Profession from the Equitable case. However, following representations by the FSA, the ABI, the Society of Lloyd's and individual insurers and actuarial firms, the Profession was persuaded that mandatory external peer review would be disproportionate. This was because of the monitoring and scrutiny arrangements established at the FSA and at Lloyd's, as well as through audit.
- 4.14 In practice, actuaries undertaking actuarial work for insurers are subject to an element of quality assurance. If they are employees of the insurer, this will be through the insurer's own systems and controls which need to comply with the FSA's systems & controls (S&C) rules, including the use of external reviewers, including audit, as appropriate. If they are external consultants, they will be subject to their own firm's professional quality assurance arrangements, which will typically involve some checking against actuarial standards where applicable.

Direct clients

- 4.15 FSA rules require insurers and their senior management to take responsibility for actuarial information and decision-making.
- 4.16 The actuarial stakeholder group survey confirmed that non-executive directors (NEDs) of insurers felt confident in challenging the work of actuaries, and governance structures such as audit committees are likely to formalise internal compliance monitoring procedures. This was based in part on systems of independent scrutiny and challenge of actuarial advice before it was presented to the board.

Other independent scrutiny

- 4.17 Actuarial work in general insurance is sometimes reviewed in the courts, partly in relation to insolvency work, business transfers and litigation. The financial strength of insurers is also subject to scrutiny by analysts and credit rating agencies.
- 4.18 There is little or no scrutiny or challenge of actuarial work as a result of consumer complaints, which mostly relate to the insurer's handling of a claim or application for cover, rather than with

the pricing, reserving, financial reporting or other financial management issues for the insurer with which actuaries are mainly concerned.

Conclusions

- 4.19 As in life insurance, there is extensive scrutiny of actuarial work, both by governing bodies and independently through audit, FSA supervision, Lloyd's and other mechanisms. There is scope for monitoring of compliance with actuarial standards as part of that scrutiny, where applicable, with the work of Lloyd's the most notable example.
- 4.20 Some of this scrutiny is overlapping. This largely results from regulatory requirements rather than the Profession's own requirements, but we believe that the Profession can, through its activities and its work with its members, help the governing bodies of insurance and other review bodies to coordinate - and actuaries themselves to perform - such review work more effectively.
- 4.21 The main gap in the formal monitoring and scrutiny arrangements arises in relation to areas outside Lloyd's in which the work of actuaries is not specifically recognised in regulation. In practice, such work is still likely to be closely scrutinised and indeed, as the FSA has explained, insurers are expected to obtain actuarial advice. There may therefore be scope in due course, perhaps through more explicit recognition by the FSA, for more formal compliance monitoring with the actuarial standards which are developed by the BAS as part of its new conceptual framework.

Options for the monitoring and scrutiny of the work of general insurance actuaries

4.22 Set out below is a high level analysis of the advantages and disadvantages of the various strategies open to the Profession with regard to the monitoring of actuaries' compliance with professional standards and inadequate scrutiny of actuarial advice:

Strategy	Advantages	Disadvantages
Strategy 1: regulatory support	Provides proportionate mechanism for addressing gaps in existing arrangements for monitoring and scrutiny	Fails to address fully the concern that existing monitoring and scrutiny arrangements do not adequately consider monitoring of compliance with standards
Strategy 2: professional requirements	Could establish mechanisms for the explicit monitoring by other actuaries of compliance with actuarial standards	The facility already exists for the FSA to ask for skilled persons reports which could look specifically at compliance with actuarial standards The FSA recently concluded, following the Morris Review, that it was not necessary to implement a 'reviewing actuary' type role within general insurance because, in its opinion, it would impose costs on the industry which are not supported by its market failure and cost/benefit analyses Proposals for peer review previously rejected by the FSA, ABI and Lloyd's Potential adverse cost implications
Strategy 3: active monitoring	Enhanced market confidence in the work of actuaries through independent monitoring of compliance with actuarial standards	Extent of active scrutiny and monitoring already undertaken by the FSA and at Lloyd's Proposals for peer review previously rejected by the FSA and ABI More significant cost disadvantages

4.23 Based on our analysis of the gaps in existing arrangements, the likely costs and possible benefits, we believe that the most appropriate option is for the Profession to adopt Strategy 1 in the area of general insurance and develop additional tools for regulatory support.

4.24 Examples could include:

- the development of relevant skills through education and CPD;
- the development of quality assurance standards (for example through independently verified kite-marks) and of guidance on effective internal quality control procedures for firms of actuaries. This could be supplemented by increased transparency of professional review processes through publication of further research and statistics; and
- the development of more effective arrangements for reporting concerns about actuarial issues or actuarial work.

4.25 A high level analysis of the advantages and disadvantages of these additional options for regulatory support, for general insurance, is set out below:

Options under Strategy 1:	Advantages	Disadvantages
<u>Option 1A</u> : Develop relevant review and audit skills through education and CPD	Anticipated high take-up. Proportionate cost	Might be difficult to fit into already packed syllabus
<u>Option 1B</u> : Develop or encourage quality assurance standards (say through independently verified kite-marks) or guidance on effective internal quality control procedures for actuaries and their firms <u>Option 1C</u> : Increase transparency of professional review processes through publication of further research and statistics	Flexible way to secure base-line standards Some useful precedents such as ISQC1 Builds on existing work by Profession and others	Might cut across existing quality assurance arrangements (particularly for firms which are part of an international network) No enforcement mechanism
<u>Option 1D</u> : Develop more effective arrangements for reporting concerns about actuarial issues or actuarial work	Cost-effective way to enhance this safeguard, involving consolidation of existing provisions	Might require further legislative change to resolve some confidentiality concerns Might undermine reporting responsibilities of senior management and commercial usefulness to clients, leaving actuaries isolated

Questions

- Q4(i) Do you agree that the effectiveness of monitoring and scrutiny arrangements in general insurance could be enhanced in the most proportionate manner through adopting Strategy 1? [4.23]
- Q4(ii) If not, why not?
- Q4(iii) Do you support any of the options identified for additional regulatory support under Strategy 1? [4.24]
- Q4(iv) Do you have any further suggestions of how the Profession could promote effective and proportionate monitoring and scrutiny of actuarial work?

Five - Pensions

Introduction

5.1 Set out below is a high level summary of the various roles actuaries fill within pensions, the nature of the activity, applicable standards and, in outline, the monitoring and scrutiny activity already taking place. Fuller details of the work of actuaries in pensions may be found in the FRC's discussion paper *Promoting actuarial quality*.

Pensions - summary of monitoring and scrutiny of actuarial work			
Actuarial role	Nature of activity supported	Applicable standards¹¹	Monitoring and scrutiny activity
Scheme actuary (Defined benefit)	<p>Triennial and annual valuations</p> <p>Advice in respect of statement of funding principles, recovery plan and schedule of contributions</p> <p>Other statutory certificates such as freezing orders, technical provisions, actuarial equivalence, transfer values</p> <p>PPF levies and s143/s179 reports</p> <p>Occasional advice and external audit support, say in relation to insured benefits</p> <p>Contracting out certificates for salary-related schemes, adequacy of benefits for contracting out and calculation of scheme asset deficiencies for schemes in wind-up or subject to employment-cessation events</p>	<p>Pensions legislation</p> <p>GN3, GN4 GN9, GN11 GN13, GN16, GN19, GN26 GN28 GN29, GN48, GN49, GN51</p>	<p>Trustees are responsible for selecting the assumptions to be used by the scheme actuary for valuation purposes</p> <p>Analysis by the Pensions Regulator based on recovery plans submitted, sampling and tripping of triggers</p> <p>Some consistency checks in audit of pension scheme report and accounts - Practice Note (PN15): <i>The audit of occupational pension schemes in the United Kingdom</i> - but not directly audited</p> <p>GN48 compliance reviews</p>
Reporting (IAS26)	Advice to trustees in calculation of technical provisions for reporting by pension schemes	Pensions SORP	<p>Case specific scrutiny, where appropriate</p> <p>Whistle-blowing procedures</p> <p>Limited external audit review since long term liabilities not presently shown in the accounts</p>
Reporting (IAS19)	Companies Act disclosures by sponsors in respect of pension scheme liabilities	<p>FRS17 IAS19 GN17 GN26 GN36 FAS 87/88 132(US GAAP)</p>	<p>Anchor point for Scheme Specific Funding trigger range at the Pensions Regulator. Used as a potential criterion for clearance work by the Corporate Risk Management team at the Pensions Regulator</p> <p>Reviewed as part of audit (Practice Note PN15), subject to materiality, often by auditor's in-house actuary</p>

¹¹ Reference Annex A for current actuarial Guidance Notes (GNs)

Pensions - summary of monitoring and scrutiny of actuarial work			
Actuarial role	Nature of activity supported	Applicable standards¹¹	Monitoring and scrutiny activity
Advice to defined contribution schemes	Advice to trustees or sponsors Some advice is restricted to investment professionals (or those regulated by a DPB) Trust deeds may provide for actuarial advice on such matters	GN34	The Pensions Ombudsman provides opportunity for grievances to be investigated where financial loss can be demonstrated The Pensions Ombudsman may also refer personal pensions cases with wider implications about the conduct of an insurer to the FSA
PPF actuary	Actuarial valuation of Pension Protection Fund (PPF)	PA 2004, Sch4, s22	Parliamentary scrutiny including National Audit Office (NAO)
Government Actuary's Department	A significant number of public sector schemes Social Security work	GN9, GN11, GN16, GN26, GN28, GN29, FRS17 (interpreted in public sector context) International Actuarial Association's Guidelines of Practice	Parliamentary scrutiny including NAO
Expert advisory	Private reports Statutory reports S.71 reports (skilled person) Litigation and arbitration Statutory duties Deeds often specify matters requiring advice of the actuary Advice for trustees, beneficiaries or sponsors on transfer values or on modification of subsisting rights Pension splitting on divorce	GN24 GN26 Pension Sharing Regs	TPR/PPF review specific returns such as funding reports & levy data & request information for corporate transactions Limited review by HM Revenue and Customs (HMRC) and the PPF Subject to challenge in court

5.2 As explained in sections 1 and 2, we have considered the monitoring and scrutiny of actuarial work in pensions under the three main headings identified by the Morris Review: regulation, audit and professional quality assurance (which the Morris Review described as external peer review), as well as assessing the challenge from direct clients and other independent scrutiny.

Regulation

5.3 The Pensions Regulator was established under the Pensions Act 2004, and replaced Opra¹² as the principal regulator for work-based pensions in 2005. Its objectives as set out in the Act are:

- to protect the benefits of members of work-based pension schemes;
- to promote good administration of work-based pension schemes; and
- to reduce the risk of situations arising that may lead to claims for compensation from the Pension Protection Fund (PPF).

5.4 There are a very large number of small pension schemes, and trustees take overall responsibility for decisions taken. Within this context, the Pensions Regulator regards itself as a regulator and not a supervisor. Consequently its scrutiny of actuarial assumptions will be determined by the assessment of risk to the achievement of its objectives, particularly as it relates to the quality of the decisions made and information produced by trustees (see below in relation to scrutiny by direct clients) and also the sponsoring employers.

5.5 The Morris Review recommended that:

The Pensions Regulator should ensure that scheme actuaries' advice to pension schemes is subject to formal scrutiny by independent experts, through either risk-based supervision, audit or external peer review. The Pensions Regulator may wish to adopt different approaches for large schemes and small schemes.

5.6 The Pensions Regulator's response to this recommendation is that it has adopted a proportionate system of risk-based regulation. In protecting the interests of members, it is a priority for the Pensions Regulator to encourage scheme sponsors to meet their funding obligations. To advance this objective, it uses triggers based on a comparison with both FRS 17/IAS19 disclosures in the sponsors' financial statements and figures used for determining the appropriate Pension Protection Fund levy. Where triggers are tripped, the Regulator will perform a secondary assessment involving a review of the main assumptions made (including discount rates and mortality).

5.7 This does not include the monitoring of compliance with actuarial standards and provides only limited assurance on the contribution made by the scheme actuary, given the broader role of the regulator. Nevertheless, the Pensions Regulator has been benchmarking assumptions and, recognising the information asymmetry between many trustees and their advisers, it has told us that recent in-depth reviews of recovery plans of occupational schemes in deficit (and accompanying valuation summaries) by their actuaries have involved some cross-checking with actuarial standards in individual cases.

5.8 The Profession does not itself monitor the work of actuaries. However, pensions, and in particular defined benefits schemes, is the area in which it has probably done most, in terms of

¹² The Occupational Pensions Regulatory Authority

the imposition of practising certificate requirements for scheme actuaries, setting both technical standards (now the responsibility of the Board for Actuarial Standards) and ethical and conduct standards, and in terms of professional quality assurance requirements (see below).

- 5.9 The Morris Review highlighted the understanding gap between actuaries and lay trustees, and the need for guidance on handling conflicts of interest, particularly between members (represented by trustees) and sponsoring employers. These issues are discussed in more detail in the FRC's discussion paper *Promoting actuarial quality*.

Audit

- 5.10 The main place where audit impinges on actuarial work is the sponsoring employer's financial statements, which include information relating to the calculation of the pensions obligation as specified in FRS 17/IAS19. Where the deficit (or surplus) is material, the auditor may seek actuarial advice but is not required to do so.
- 5.11 GN17: *Accounting for pensions costs under SSAP24* and GN36: *Accounting for Retirement Benefits under FRS17* are the actuarial standards for the preparation of pensions disclosures in the sponsor's accounts. These are not covered by the compliance review requirements imposed by the Profession. Actuaries advising auditors may look at compliance with actuarial standards but the auditor's priority is compliance with accounting standards.
- 5.12 For pension scheme accounts, the relevant International Accounting Standard is IAS26 *Accounting and Reporting by Retirement Benefit Plans*. Auditors of pension schemes are required to comply with Practice Note 15 *The audit of occupational pension schemes in the United Kingdom* and perform consistency checks on other documents that form part of the financial statements. The actuarial liabilities are not required by IAS26 or by the Statement of Recommended Practice (the Pensions SORP) to be included in the balance sheet or notes to the accounts and are therefore not routinely subject to audit.
- 5.13 The audit of the pension scheme provides some assurance on the calculation of technical provisions (actuarial liabilities) where these are referred to in the trustees' annual report since the auditor is required to check the consistency of such information. On those occasions where reference to the technical provisions does appear in the notes to the scheme accounts, it is then subject to audit.
- 5.14 There is a continuing debate on whether scheme liabilities should be included on the face of the balance sheet of scheme accounts. This is under review by the Pensions Advisory Panel (PAP) of the Accounting Standards Board which has recently consulted on this subject and at a European level by a partnership of standard setters and the European Financial Reporting Advisory Group (EFRAG) as part of its Proactive Accounting Activities in Europe (PAAinE) initiative.

5.15 When the Pensions Regulator consulted in June 2006 on including actuarial provisions within a scheme's financial statements, it concluded the potential cost impact outweighed the benefits, particularly for smaller schemes.

Professional quality assurance

5.16 As a result of the Profession's requirements under GN48 *Compliance review: pensions*, the scheme actuary is required to submit for compliance review any statutory reserved work which is undertaken on:

- funding principles;
- valuations;
- equivalence statements;
- contracting out; and
- winding up.

5.17 Compliance review does not cover all the most important aspects of actuarial work in relation to pensions. In particular, work on the audited FRS17/IAS19 disclosures in the sponsor's financial statements is not covered but, if material to the accounts of the sponsor, will be subject to review by the sponsor's auditors.

5.18 The principal purpose of a *compliance review* is to determine whether the reviewer considers that the written advice delivered to the client complies with the relevant practice standard guidance notes and specific paragraphs of the Professional Conduct Standards (PCS), namely obligations to:

- consider the extent to which it is appropriate to carry out investigations to assess whether the data is sufficiently accurate and complete for the purpose for which it is being used - the advice should include an explanation or qualification if the member has any material reservations about the data;
- include in the actuary's advice, sufficient information and discussion about each relevant factor and about the results of the member's investigations to enable the intended recipient of the advice to judge both the appropriateness of the recommendations and the implications of accepting them, and any material implications for the beneficiaries of the retirement benefit arrangement;
- ensure that the client (and any third party who will have access to the advice) is aware of the name and professional qualifications of the member providing the advice; the name of the member's firm; and the scope, purpose and terms of reference of the advice provided by the member. A member giving advice which has been formulated for a particular client must ensure that the client is aware that the advice is of no broader applicability than intended by the member, and is not presented as if it were necessarily the advice that would be given to another client or to a third party whose objectives and requirements may differ.

In terms of priority for the *compliance review*, the reviewer must comment on:

- material inaccuracies or inconsistencies in the advice delivered to the client that are identified in the course of the review; and
- aspects of the advice that in his or her opinion might be unclear to the recipient.

The reviewer is not however required to:

- test the accuracy or completeness of the analysis that supports the advice;
- review the process followed by the scheme actuary in arriving at the final advice;
- review the quality of the documentation and files maintained by the scheme actuary;
- complete an editorial and stylistic review of the advice delivered to the client; or
- test the accuracy or completeness of the factual information contained in the document, subject to any obvious inconsistency or error.

5.19 In practice, although not a specific requirement in GN48, the review invariably involves scrutiny of the style and comprehensibility of the report prepared by the actuary as well as its content.

5.20 When granting or renewing practising certificates to scheme actuaries, the Profession looks for the scheme actuary to certify that all scheme actuary work in the twelve months prior to attestation has been subject to compliance review. The reviewer is required to hold a practising certificate, but there is no requirement for the reviewer to be independent of the scheme actuary or for the reviewer's name to be disclosed.

5.21 GN48 is less demanding than is found in some other disciplines, such as medicine, and permits considerable variation in:

- **timing** – either immediately before issue of the advice, sometimes known as 'hot' review and described as Type 1 review in GN 48, or some time after, known as 'cold' review, described as Type 2 review in GN48, which must be undertaken within 6 months;
- **independence** - internal or external – the Morris Review felt that peer review needed to be external, but this is not required by GN 48;
- **formality** – degree of documentation, and whether the review is undertaken privately for the benefit of the actuary and his or her firm, or more transparently for his or her client, the regulator or the Profession;
- **completeness** – for the renewal of a practising certificate, the scheme actuary is required to certify that all relevant work has been subject to review, but this is not currently checked by the Profession; and
- **scope and depth** – GN48 specifies the reports for which a review is required, the matters which the reviewer is expected to look at, and the guidance notes against which the review should be undertaken, but other options are possible.

- 5.22 As discussed earlier, the compliance review work that takes place is simply professional quality assurance; *external* peer review only occurs routinely for scheme actuaries who are sole practitioners. As our survey of firms has revealed more generally, there is considerable variation in the way that firms have sought to organise this review work.
- 5.23 Some firms have supplemented GN48 with their own checking procedures, and have incorporated this work into more comprehensive quality assurance arrangements. Many pensions consultancy firms which provide administration services or regulated financial advice are in practice subject to further quality assurance controls, which are inspected separately.

Direct users

- 5.24 The Pensions Act makes trustees responsible for much of the actuarial information and decisions relating to pension schemes, including the choice of actuarial assumptions used, although in some respects the scheme actuary still has a certification role.
- 5.25 The Morris Review recommended that:

The Pensions Regulator should, with input from the Profession and other industry bodies, ensure that trustees have access to good practice guidance on the effective management of their professional advisers, including their scheme actuary. Information and case study material should be provided to help trustees to challenge their actuarial advice and should provide them with guidance on potential conflicts of interest.

- 5.26 As part of its Trustee Knowledge and Understanding (TKU) initiative, the Pensions Regulator has made available, free of charge, a comprehensive trustee toolkit for use by pension scheme trustees. The Pensions Regulator's assessment, from its governance survey and other sources, is that information asymmetry remains.
- 5.27 The actuarial stakeholder group survey of the users of actuarial work found that the general level of understanding of pensions trustees has improved through such initiatives. However, there is in our view a limit to the scope for bridging the gap in user understanding through such means.
- 5.28 The Pensions Regulator has been consulting on draft guidance to pension trustees on handling conflicts of interest, including conflicts relating to advisers. They have also recently issued best practice guidance setting out key issues for trustees to consider in their relations with advisers.
- 5.29 As discussed in more detail in the FRC's discussion paper *Promoting actuarial quality*, there is considerable scrutiny and challenge of the actuary's work by the sponsoring employer. Indeed the actuary's work and assumptions may ultimately be a matter for negotiation between the trustees and the employer. However, given the conflicts of interest to which scheme actuaries and indeed trustees are subject, there is arguably a need to ensure that there is either fully independent advice or independent professional quality assurance.

Other independent scrutiny

- 5.30 As in other areas, actuarial work in pensions is increasingly being scrutinised and challenged by other independent bodies, including the courts in interpreting legal obligations under regulation and trust deeds. Although not formally within the Pensions Ombudsman's jurisdiction, the work of actuarial consultancies has been held to be part of the scheme administration in some cases and, to that extent, within the Ombudsman's scope. Following the Thornton Review, the Pensions Ombudsman is due to merge with the Financial Ombudsman Service, when legislative time allows.
- 5.31 The PPF and HMRC use actuaries to review and scrutinise actuarial information relating to the liabilities and allocation of surplus in pension funds. Information used to calculate the PPF levy is also used as a comparator by the Pensions Regulator as part of its risk-based approach. This scrutiny may involve some assessment against technical actuarial standards.

Conclusions

- 5.32 As in life and general insurance, we have found enhanced independent scrutiny of actuarial work across all pensions areas. This results from the combination of a new risk-based approach by the Pensions Regulator, supported by audit of actuarial information in financial reporting by sponsoring employers, enhanced responsibilities for scheme trustees, revised guidance on managing conflicts of interest, and the Profession's compliance review obligations (at least for sole practitioners who are required to obtain external review).
- 5.33 Our discussions with regulators and other stakeholders, and the responses to our survey of actuarial firms, have demonstrated a strong commitment to risk-based monitoring and scrutiny of actuarial work and to quality assurance generally.
- 5.34 However, there is no uniform framework of monitoring and scrutiny of actuarial work, with some confusion in particular areas, which could be improved. As the regulators move away from reliance on routine compliance monitoring, the Profession may itself need to do more to encourage the monitoring of compliance with actuarial standards in order to promote actuarial quality.
- 5.35 A number of gaps remain, particularly in relation to small pension schemes, as well as in much commercial transaction work.
- 5.36 In contrast to life insurance, a reviewing actuary role does not exist for pensions. Audit work is constrained by what appears on the face of the financial statements of the scheme and in the notes to the accounts and the assessment by the sponsor's auditor of the materiality of the pensions liability disclosures.
- 5.37 In common with most other regulators, the Pensions Regulator adopts a risk-based approach to its work. Although it currently carries out a relatively detailed scrutiny of actuarial assumptions used by trustees (normally under the advice of actuaries) in statutory returns and disclosures,

this may not always represent a priority for it. Much of the scrutiny that takes place at the present time is indirect, and there is only limited actual monitoring of compliance with actuarial standards. Such compliance monitoring as there is occurs primarily through internal compliance review within actuarial firms (particularly in relation to the statutory reserved work of pension scheme actuaries for whom this is mandatory under the Profession's GN48 *Compliance Review: Pensions*).

Options for the monitoring and scrutiny of the work of pensions actuaries

- 5.38 The Profession is already operating within Strategy 2 in the pensions sector in that it has established a requirement for compliance review in certain areas. There is no requirement however for this to be external, and training in the skills required by a peer reviewer is not readily available for those that take on this role; options for improvement within this strategy include further developments of these professional requirements.
- 5.39 We have included within Strategy 2, as options, administrative monitoring of compliance with quality assurance arrangements (Option 2C) and non-technical practice review by or on behalf of the Profession of the quality assurance procedures operated by individuals or in firms (Option 2E). Strategy 3 extends these two Strategy 2 options to include more in-depth monitoring of technical compliance with standards.
- 5.40 Strategy 3 would require a detailed understanding by the inspection staff of the underlying calculations for actuarial advice supplied and would therefore involve the appointment of actuaries to carry out the work. The comparable cost firm-for-firm is likely to be significantly higher for an Actuarial Inspection Unit than for the existing Audit Inspection Unit (AIU) of the FRC, requiring extensive industry sector knowledge, given the breadth of actuarial work that will need reviewing, and without the benefits of economies of scale.
- 5.41 We have given serious consideration to Strategy 3, which would involve a significant change in the regulation of the work of pensions actuaries. On balance, however, the provisional conclusion we have reached is that more proportionate actions are available to enhance how the existing system works; and the impact of these should be considered before concluding that active monitoring is needed. Our reasons are:
- monitoring is more easily applied to specific rules and regulations than subjective judgments;
 - monitoring of reliability of models and accuracy of data are aspects picked up by external peer review and quality assurance;
 - the cost of active monitoring by the Profession or independently may prove to be prohibitively high for all but the largest schemes;
 - the assumptions chosen, although they need to be selected in an objective manner by the trustees, are subjective in nature and, for schemes of higher risk, are subject already to review by the Pensions Regulator;

- other options such as external peer review (Option 2B) and stricter independence requirements for pensions actuaries with separate advisors for trustees and sponsors (Option 2D) offer an effective alternative form of independent monitoring and scrutiny.

5.42 Several of the options we have developed under Strategy 2 (and Strategy 3) would involve a greater regulatory emphasis on the role of firms. Our survey and discussions with stakeholders have revealed the importance of the professional quality assurance arrangements operated by consultancy firms in pensions; and the influence of a ‘house view’ in setting assumptions and methodology and more generally in the way scheme actuaries manage their relationship with both trustees and employers.

5.43 The importance of the working environment for actuaries has also been identified as a driver of actuarial quality in the FRC’s discussion paper *Promoting Actuarial Quality*. We think each of the options should be considered on its merits, and not all of them would require firms to be regulated directly; but there might be scope for introducing several of them as a package if a decision were made to permit or require firms to be regulated by the Profession.

5.44 The active monitoring options under Strategy 3 could be revisited when the intermediate options under Strategy 2 have been given an opportunity to take effect and have been assessed.

5.45 Set out below is a high level analysis of the advantages and disadvantages of various strategies available to the Profession for the monitoring of actuaries’ compliance with standards and the scrutiny of actuarial advice:

Strategy	Advantages	Disadvantages
Strategy 1: regulatory support	Although the Profession is already operating within Strategy 2 there are some aspects where existing regulation and market mechanism arrangements could be enhanced in a proportionate manner	The Profession is already operating within Strategy 2 Fails to deal with the gaps in scope of existing monitoring of actuarial standards or provide any requirement of peer reviews to be undertaken externally
Strategy 2: professional requirements	Provides a proportionate mechanism for closing existing gaps in the scope of peer review through GN48	Relies on indirect arrangements to deliver effective monitoring Unless carefully constructed, some options could impose a disproportionate cost to very small schemes
Strategy 3: active monitoring	Provides enhanced market confidence through independent monitoring of actual compliance with actuarial standards	Other regulatory options are available (see 5.41) Assumptions are ultimately the responsibility of the trustees Even with sampling, could impose a disproportionate cost to very small schemes

5.46 Based on our assessment of the gaps in existing arrangements, the likely costs and possible benefits, we believe the most appropriate strategy for the Profession in pensions is to build on existing strategies (under Strategy 1 and Strategy 2) to enhance the scope and application of GN48 and to develop additional tools for regulatory support in accordance with Strategy 2. We are however particularly interested in receiving comments on this preliminary assessment.

5.47 A high level analysis of the advantages and disadvantages of the options identified for pensions is set out below:

Options under Strategies 1 and 2	Advantages	Disadvantages
<u>Option 1A</u> : Develop relevant review and audit skills through education and CPD	Anticipated high take-up Proportionate cost	Might be difficult to fit into already packed syllabus
<u>Option 1B</u> : Develop or encourage quality assurance standards (say through independently verified kite-marks) or guidance on effective internal quality control procedures for actuaries and their firms <u>Option 1C</u> : Increase transparency of professional review processes through publication of further research and statistics	Flexible way to secure base-line standards Some useful precedents such as ISQC1 Builds on existing work by Profession and others	Might cut across existing quality assurance arrangements (particularly for firms which are part of an international network) No enforcement mechanism
<u>Option 1D</u> : Develop more effective arrangements for reporting concerns about actuarial issues or actuarial work	Cost-effective way to enhance this safeguard, involving consolidation of existing provisions	Might require further legislative change to resolve some confidentiality concerns Might undermine reporting responsibilities of senior management and commercial usefulness to clients, leaving actuaries isolated
<u>Option 2A</u> : Impose quality assurance requirements for relevant actuarial work - extend application of GN48 to corporate restructuring work & assignments for sponsoring employers	Ensures that what are often the areas of greatest risk are subject to review Most firms do this anyway	These assignments are often time critical but review can be retrospective Cost implications Limited standards
<u>Option 2 B</u> : Require external peer review which is independent of the actuary and his or her firm – possibly limited to schemes with 20 members ¹³ or more	Already operating in Ireland Ensures greater independence of the review	Practicality in its application (particularly with urgent assignments) – however review can be retrospective Cost Implications for firms Confidentiality if done by a competitor

¹³ With a threshold of 20 members (used by HMRC in context of pensions tax simplification), approximately one-half of all defined benefit schemes and one-tenth of all defined contribution schemes would be covered by this requirement.

Further Options under Strategy 2	Advantages	Disadvantages
<u>Option 2C</u> : Administrative monitoring of compliance with quality assurance requirements	Provides enforcement mechanism Profession could make use of existing relationship with the Quality Assurance Directorate (for DPB monitoring) Could be adopted as a voluntary arrangement	Cost implications for firms and the Profession There may be little incentive for firms to participate if administered as a voluntary scheme
<u>Option 2D</u> : Introduce stricter independence requirements for actuaries undertaking relevant work - requiring separate advisors for scheme and sponsor for those schemes with say 20 members or more	Allows for a meaningful challenge to preliminary assumptions chosen by scheme and sponsor Reduces the potential for conflict of interest Could be treated as an alternative or combined with 2B on the basis that, where the roles are split, there is less need for external peer review. Where the roles are not split, external peer review would give added assurance for more substantial schemes	There is an additional cost arising from the appointment of separate advisors, mitigated by the adoption of a threshold
<u>Option 2E</u> : Introduce additional requirements for individual actuaries holding practising certificates which relate to the practice environment in their firm	Builds on existing quality assurance arrangements within a number of firms & on existing senior actuary role Scope for cost savings in larger firms Could make use of an existing practice review product (suitably tailored)	Unless carefully constructed, may place a disproportionate burden on the smaller firm or sole practitioner
<u>Option 2F</u> : Require practising certificates for external as well as regulated actuarial advice	Added reassurance for users Consistent with some other professions (such as lawyers and accountants) which require practising certificates for external advice	Relies on a suitable definition for actuarial advice Limited scope for compliance monitoring outside the scope of BAS standards Cost depends on whether firms can hold certificates
<u>Option 2G</u> : Allow firms as well as individuals to obtain a practising certificate	Aligns more closely with the reality of a firm rather than an individual in a firm being appointed to act Potentially a de-regulatory measure Scope for cost savings in larger firms	Would require a change in legislation for scheme actuary role Could involve substantial set-up cost

Questions

- Q5(i) Do you agree that the Profession should build on existing strategies (under Strategy 1 and Strategy 2) to enhance the scope and application of GN48 and to develop additional tools for regulatory support in accordance with Strategy 2? [5.46]
- Q5(ii) If not, why not?
- Q5(iii) Do you support any of the options identified for additional regulatory support under Strategy 1 and for additional professional requirements under Strategy 2? [5.47]
- Q5(iv) What would your view be on the regulation of firms that employ actuaries as against regulating actuaries only as individuals? [5.42/5.43]
- Q5(v) In what circumstances should the Profession consider adopting Strategy 3 (active monitoring by the Profession, or independently, say through an Actuarial Inspection Unit) for pensions? Which additional options should the Profession consider? [5.40]
- Q5(vi) Do you have any further suggestions of how the Profession could promote effective and proportionate monitoring and scrutiny of actuarial work?

Six – Summary of findings and options

- 6.1 In our review, we have found enhanced independent scrutiny since the Morris Review reported across all mainstream areas of actuarial work:
- in life insurance, through continuing and new developments in risk-based supervision by the FSA, supported by audit (with specific actuarial input) of actuarial information, enhanced responsibilities for governing bodies, and with-profits governance arrangements;
 - in general insurance, through continuing and new developments in risk-based supervision by the FSA, supported by audit of actuarial information, enhanced responsibilities for governing bodies, and external scrutiny of syndicate returns by Lloyd's;
 - in pensions, through a new risk-based approach by the Pensions Regulator, supported by audit of actuarial information in financial reporting by sponsoring employers, enhanced responsibilities for scheme trustees, and the Profession's compliance review obligations for pension scheme actuaries.
- 6.2 Much of this scrutiny is indirect, without a formal role for actuaries, and there is only limited actual monitoring of compliance with actuarial standards. Such compliance monitoring as there is occurs primarily through internal 'compliance review' against actuarial standards within actuarial firms (particularly in relation to the work of pension scheme actuaries for whom this is mandatory under the Profession's *GN48 Compliance Review*), by the 'reviewing actuary' who advises the auditors in relation to FSA returns for long-term insurers, and by the Society of Lloyd's in relation to syndicate actuary reports.
- 6.3 A number of gaps remain including the limited nature of the Profession's compliance review obligations for pension scheme actuaries which only require 'internal' review for actuaries other than sole practitioners. Gaps also exist for actuaries working in most commercial transaction work.
- 6.4 The main areas in which formal compliance monitoring may be limited are:
- activities which are not subject to technical actuarial standards at all, so that compliance monitoring has no formal base against which to assess the work performed – these include general support for transaction pricing, financial and risk management, acquisition advice and investment matters;
 - activities which are so extensively regulated or scrutinised already that monitoring of compliance with actuarial standards (if any) is not regarded as a priority – for example, corporate financial reporting, fair treatment of customers, skilled person reports to the regulator or the court, the appropriate actuary role in a friendly society, individual capital assessments and the with-profits actuary role;

- activities which are subject to actuarial standards, but are not formally reserved to actuaries, as in general insurance (outside Lloyd's), so that there is no regulatory requirement for such activities to be subject to professional review; and
- non-core activities such as funding reviews for exempt pre-paid funeral plans.

- 6.5 Our discussions with regulators and other stakeholders, and the responses to our survey of actuarial firms, have demonstrated a strong commitment to risk-based monitoring and scrutiny of actuarial work and to quality assurance generally. However, there is no uniform framework of monitoring and scrutiny of actuarial work, with some confusion in particular areas, which could be improved. As the regulators move away from reliance on routine compliance monitoring, the Profession may itself need to do more to encourage the monitoring of compliance with actuarial standards in order to promote actuarial quality.
- 6.6 Our review has revealed the importance, most notably in pensions, of the professional quality assurance arrangements operated by consultancy firms; and the influence of a 'house view' in setting assumptions and methodology and more generally in the way scheme actuaries manage their relationship with both trustees and employers.
- 6.7 The importance of the working environment for actuaries has also been identified as a driver of actuarial quality in the FRC's discussion paper *Promoting Actuarial Quality*. Several of the options we are considering in the area of pensions would involve a greater regulatory emphasis on the role of firms. There is less scope for this in life insurance and general insurance although it might also be considered for consulting firms operating in these areas.
- 6.8 We would welcome comments by **30 September 2008** on our findings and our analysis of options to the Profession, and in particular on the following questions:

Q1. Do you agree with our conclusion that there is enhanced independent scrutiny of actuarial advice since the Morris Review reported in March 2005? [2.3]

✕

Q2. Do you agree with our conclusion that, at the present time, there is only limited monitoring of compliance with professional standards? [2.26]

✕

Q3(i) In life insurance [Section 3], do you agree that the effectiveness of monitoring and scrutiny arrangements could be enhanced in the most proportionate manner through adopting Strategy 1 (additional regulatory support for existing regulatory and market practices)? [3.33]

Q3(ii) If not, why not?

Q3(iii) If so, do you support any of the options identified for additional regulatory support under Strategy 1? [3.34]

- The development of relevant (audit/scrutiny) skills through education and continuing professional development (CPD) (Option 1A)

- The development of quality assurance standards (for example through independently verified kite-marks) and of guidance on effective internal quality control procedures for firms of actuaries (Option 1B). This could be supplemented by increased transparency of professional review processes through publication of further research and statistics (Option 1C)
- The development of more effective arrangements for reporting concerns about actuarial issues or actuarial work including, but not limited to, the AFH, WPA and the reviewing actuary (Option 1D)

Q3(iv) Do you have any further suggestions of how the Profession could promote effective and proportionate monitoring and scrutiny of actuarial work for life insurance?

⌘

Q4(i) In general insurance [Section 4], do you agree that the effectiveness of monitoring and scrutiny arrangements could be enhanced in the most proportionate manner through adopting Strategy 1 (additional regulatory support for existing regulatory and market practices)? [4.23]

Q4(ii) If not, why not?

Q4(iii) If so, do you support any of the options identified for additional regulatory support under Strategy 1? [4.24]

- The development of relevant (audit/scrutiny) skills through education and continuing professional development (CPD) (Option 1A)
- The development of quality assurance standards (for example through independently verified kite-marks) and of guidance on effective internal quality control procedures for firms of actuaries. (Option 1B). This could be supplemented by increased transparency of professional review processes through publication of further research and statistics (Option 1C)
- The development of more effective arrangements for reporting concerns about actuarial issues or actuarial work (Option 1D)

Q4(iv) Do you have any further suggestions of how the Profession could promote effective and proportionate monitoring and scrutiny of actuarial work for general insurance?

⌘

Q5(i) In pensions [Section 5], do you agree that the Profession should build on existing strategies (under Strategy 1 and Strategy 2) to enhance the scope and application of GN48 and to develop additional tools for regulatory support in accordance with Strategy 2? [5.46]

Q5(ii) If not, why not?

Q5 (iii) If so, do you support any of the options identified for additional regulatory support under Strategy 1 and for additional professional requirements under Strategy 2? [5.47]

- The development of relevant review and audit skills for actuaries through education and CPD (Option 1A)

- The development of quality assurance standards or guidance on effective internal quality control procedures for actuaries and their firms. (Option 1B). This could be supplemented by increased transparency of professional review processes through publication of further research and statistics (Option 1C)
- The development of more effective arrangements for reporting concerns about actuarial issues or actuarial work (Option 1D)
- Extending the application of GN48 *Compliance review* to corporate restructuring work and assignments for the sponsoring employer (Option 2A)
- Requiring external peer review which is independent of the actuary and his or her firm – possibly limited to firms with 20 members or more (Option 2B)
- Administrative monitoring of compliance with quality assurance requirements. (Option 2C)
- The introduction of stricter independence requirements for actuaries undertaking relevant work, requiring separate advisors for scheme and sponsor for those schemes with say 20 members or more (Option 2D)
- The introduction of additional requirements for individual actuaries holding practising certificates which relate to the practice environment in their firm (Option 2E)
- Requiring practising certificates for external as well as regulated actuarial advice (Option 2F)
- Allowing firms as well as individuals to obtain a practising certificate (Option 2G)

Q5(iv) What would your view be on the regulation of firms that employ actuaries as against regulating actuaries only as individuals? [5.42/5.43]

Q5(v) In what circumstances should the Profession consider adopting Strategy 3 (active monitoring by the Profession, or independently, say through an Actuarial Inspection Unit) for pensions? Which additional options should the Profession consider? [5.40]

Q5(vi) Do you have any further suggestions of how the Profession could promote effective and proportionate monitoring and scrutiny of actuarial work for pensions?

✘

Q6. What strategy should the Profession consider for other areas in which the activities of actuaries are not specifically recognised through regulation? What are the advantages and disadvantages of the various options?

✘

and **in respect of all of these:**

✘

Q7 We would welcome your assessment of the costs and/or benefits for your organisation, or generally, resulting from these proposals.

Next steps

- 6.9 We will continue to work with other FRC bodies, the Profession, the FSA and the Pensions Regulator, and other stakeholders, to promote an effective framework for the monitoring and scrutiny of actuarial work, by
- considering the representations we receive as part of this consultation before finalising our recommendations to the Profession;
 - providing input and comments to the Profession as it reviews the operation of GN48 in 2008;
 - following up existing recommendations in relation to conflicts of interest and whistle-blowing; and
 - in conjunction with BAS colleagues, encouraging a debate with actuaries and non-actuaries about the drivers of actuarial quality.

Annex A - Guidance Notes

[L: Life, G: General, P: Pensions, O: Other]

Adopted by BAS (to be replaced by BAS standards - <http://www.frc.org.uk/bas/publications/pub1599.html>)

- L GN01 The prudential supervision in the UK of long-term insurance business
- L GN02 Financial condition reports
- P GN03 Contracted-out pension schemes where wind-up commenced before 6 April 1997
- P GN04 Insolvency of employers safeguard of pension scheme contributions
- L GN07 The relationship with auditors in relation to long-term business
- L GN08 Additional guidance on valuation of long-term insurance business
- P GN09 Funding defined benefits - presentation of actuarial advice
- L GN10 Valuation of reversions and life interests
- P GN11 Retirement benefit schemes - transfer values
- G GN12 General insurance business - actuarial reports
- P GN13 Statements required in connection with FAS 87, 88 and 132
- P GN16 Retirement benefit schemes - transfers without consent
- P GN17 Accounting for pension costs under Statement of Standard Accounting Practice No.24
- G GN18 UK general insurance companies writing US regulated business
- P GN19 Retirement benefit schemes - winding-up and scheme asset deficiency
- G GN20 Actuarial reporting under the Lloyd's valuation of liabilities rules
- L GN21 Post-retirement medical plans
- L GN22 Disclosure - FSA rules
- L GN23 Life insurance company takeovers
- P GN26 Pension fund terminology
- P GN28 Retirement benefit schemes - adequacy of benefits for contracting-out
- G GN33 Lloyd's syndicates writing US business
- P GN34 Illustration of defined contribution pension scheme benefits
- P GN36 Accounting for retirement benefits under FRS 17
- O GN38 Pre-paid funeral plans
- L GN39 Reserved roles in long-term insurance business
- L GN40 The Actuarial Function Holder
- L GN41 The With-Profits Actuary
- L GN42 The Reviewing Actuary
- L GN43 The Appropriate Actuary
- L GN44 Mathematical reserves and resilience capital requirement
- L GN45 Determining the With-Profits Insurance Capital Component
- L GN46 Individual Capital Assessment
- L GN47 Stochastic modelling of economic risks in life insurance
- P GN49 Occupational pension schemes - funding matters on which advice of actuary must be obtained
- G GN50 General insurance principles and practice
- P GN51 Retirement benefit schemes - modification of subsisting rights without consent
- P TM1 Statutory money purchase illustrations

Retained by Profession

- O PCS Professional Conduct Standards
- L GN5 The prudential supervision outside the UK of long-term insurance business
- O GN24 The actuary as expert witness
- P GN27 Retirement benefit schemes – minimum funding requirement
- P GN29 Occupational pension schemes - advisers to the trustees
- O GN30 Compensation for professional shortcomings
- O GN35 Investment-related business activities
- L GN37 The Financial Services and Markets Act 2000 (Communications by Actuaries) Regulations 2003
- P GN48 Compliance review: pensions

Annex B - International peer review comparisons

Although external peer review is gaining ground internationally, in some ways it is not surprising that support from actuarial firms for mandatory peer review is at best patchy and for *mandatory external* peer review (as envisaged by the Morris Review) almost non-existent.

The Institute of Actuaries of Australia (IAAust) has been looking closely at the appropriate level of peer review required for actuaries practising in differing sectors and a number of papers were considered by the taskforce responsible for developing the Professional Standard on external peer review (PS100):

<http://www.actuaries.asn.au/ActuarialPractice/ProfessionalStandards>

As part of the debate on the subject at the time, one member prepared a paper¹⁴ setting out his view of the purpose and effectiveness of peer review. The main conclusions of that paper were that:

- peer review should be viewed as a value-adding process;
- independence on the part of the reviewer is also a value-added proposition;
- the benefits of peer review need to be assessed on a marginal cost versus marginal benefit basis;
- the value added is very noticeable for the small company, but is likely to be more specialised (but still just as important) the larger a company becomes;
- one of the keys to maximising value added lies in the professional relationship between the primary and reviewing actuaries.

In Canada, in life and general insurance, mandatory external peer review of the appointed actuary takes place every three years. In pensions, the regulator can appoint an external review actuary.

The American Academy of Actuaries has publicly endorsed the principle and practice of external peer review. However, we understand there are anti-trust provisions in the United States that prevent it from being mandated.

In Ireland, one in ten reports prepared by a pension scheme actuary is now the subject of mandatory external review. All statutory reports (funding certificate, transfer value report etc.) are covered by these provisions and the Pensions Board is also able to nominate a scheme and an adviser and demand external peer review.

Compliance Review	Australia	Canada	Europe	Ireland	United States
Life and general insurance	Mandatory external peer review in general insurance from 30 June 2006 (APRA: GPS310)	Mandatory external peer review of appointed actuary every 3yrs	Under Solvency II, governance requirements would include 'functions' for risk, compliance, internal audit and actuarial issues	Work of the appointed actuary (life)/ reporting or signing actuary (non-life) subject to review by the Irish Financial Services Regulatory Authority	Discussion papers on peer review published by American Academy of Actuaries in 1997 and 2005. In considering use of voluntary peer review, actuaries guided by Code of Professional Conduct
Pensions	Professional standards to be developed by IAAust	At the request of the regulator, an external review actuary may be appointed	Periodic surveys by Groupe Consultatif Actuariel Européen on Professional responsibilities of pensions actuaries	Mandatory external peer review (10% sample)	

¹⁴ External Peer Review. A value-added approach. P Stott. September 2006

Annex C – Survey of actuarial firms

To support our review, we undertook a *survey* between May and December 2007 of the quality assurance arrangements established by firms, namely:

- actuarial consultancy firms (including multi-disciplinary firms such as audit firms);
- pensions consultancy arms of insurers (in respect of the actuarial advice they provide to their pension scheme clients); and
- smaller firms, including sole practitioners (in small groups).

We sent questionnaires to 28 firms of consulting actuaries, the Big-4 accountancy firms (all of which employ significant numbers of actuaries), three mid-tier accountancy firms which employ in-house actuaries, and seven insurers that offer external actuarial advice.

We received 34 responses, representing a range of actuarial consultancy firms and others and met representatives from 24 firms (using the questionnaire as a basis for our discussions). Twenty smaller firms were invited to participate in the review and others have contacted us directly in response to the Profession's publicity of our work; we held three group discussions, in London, Glasgow and Edinburgh.

Aspects we invited firms to tell us about included overall governance, managing competence and conflicts, managing quality of underlying work, review processes, and client involvement. We looked at the arrangements established for actuarial work generally as well as any special arrangements established for regulated roles. The information, which we have not independently verified, was provided on a confidential basis.

We made use of a questionnaire to capture information on the quality review processes of firms:

<http://www.frc.org.uk/documents/pagemanager/pob/Quality%20assurance%20and%20firms%20draft%20questionnaire%20final.doc>

Responses were classified by the size and nature of firm:

Insurers	Small firms (<5 actuaries)	Medium-sized firms (5-15 actuaries)	Larger firms (15-50 actuaries)	Largest firms (50+ actuaries)
6	6	6	8	8

We looked for comparisons and distinctions between firms of different sizes and types and drew out the most important of these in the following section. In general, our use of the term 'few' in this analysis means one or two examples within a particular group, of 'some', three or four within a particular group and 'many' meaning more again. The term 'most' is used where a significant majority within a particular group, or overall, demonstrated those particular characteristics.

1 Governance

Participating firms were invited to tell us about the overall governance procedures they had in place, looking specifically at how the promotion of quality was built into their business strategy, the formal procedures adopted to control quality, how these are updated, measures of quality and lines of responsibility for monitoring performance.

We chose not to follow (or find parallels for) the categories set out in the combined code on corporate governance, namely directors' remuneration, accountability and audit, relations with shareholders (including institutional shareholders), but looked more generally at the tone at the top in respect of quality.

Taking each category used in the survey questionnaire under the heading of *governance*:

1(a) Business strategy

A high proportion of those we spoke to said they seek to differentiate themselves on quality when tendering for new business. Some larger or more heavily regulated firms have in place procedures, subject to accreditation, that conform to stringent quality standards set by external agencies, such as the International Standards Organisation (ISO).

Few of the largest firms are purely actuarial in the services they provide. The largest firms of consulting actuaries and the insurers said they draw their strategy from the group-wide vision and values for the organisation as a whole. They told us that the international nature of these organisations leads to a levelling up of standards to the most demanding encountered.

Many medium-sized firms (and some smaller firms) offered bundled services to their clients. Some small firms considered the greater personal exposure felt by an individual actuary within a small firm was an important driver of quality in itself. Small firms involved in pensions work made use of individual actuaries outside the firm for mandatory peer review purposes.

A management commitment to quality was expressed by all firms surveyed and we saw evidence of this when we were invited to take a look at the firm's intranet, staff handbook or manual. Only a small number of (particularly large) firms adopted recognised standards which involve external audit of compliance, whilst others (mainly at the smaller end, but not exclusively) work on the assumption that clients go elsewhere if faced with poor quality service.

1(b) Formal quality assurance procedures

Many firms described an integrated approach to quality. Some said they adapt their procedures in the light of the findings from internal audit and external reviews by professional indemnity insurers and others. The work of the Quality Assurance Directorate (QAD), under contract to the Institute of Actuaries (as a Designated Professional Body for licensing investment advisory work), was described as positive in this regard by a number of the firms we visited.

The very largest firms said they work to a nationally or internationally recognised standard such as ISO 9000, Investors in People (IiP) and Crystalmark and said they had common, comprehensive and well documented procedures, applied across the whole practice. Many medium-sized firms said they complied with the system and control (S&C) rules set by the FSA for regulated financial services.

Some smaller firms expressed concern that too much regulation was focused on the needs of the larger firms. Many believed that they were more economical for the client but over-regulated. Given their resources, work types and fee structures, they felt they already have, or should be able to establish, quality assurance systems, but in a way that was most appropriate to their size.

All firms were able to show us some documentation relating to peer review, either in hard copy or on their in-house intranet. The larger firms showed us that they maintained a comprehensive record of their procedures, in paper format or on-line. Most small firms had only limited *formally* documented arrangements, for example in relation to model design and testing, with much left to individual actuaries.

1(c) Updating of procedures

Several firms made use of external auditors and others (internal auditors, for example) to help trigger updates of their quality control procedures in a timely and effective manner, although others acknowledged that an update to their procedures was overdue and pending.

Some benchmarking occurs and a few firms also use strategic partnerships (with universities and other research bodies, for example). Many pointed to the use of work excellence review criteria or systems of continuous improvement; others spoke of an effective means of channelling suggested changes to procedure to a technical panel.

Regular updating of formal quality assurance procedures forms an essential component in an effective system of quality control within a firm. Few firms had well established structures for carrying this out; many were on the point of reviewing their procedures for incorporating updates.

1(d) Quality measures

Many firms that did adopt key performance indicators based on client feedback and accepted standards, such as the FSA's Treating Customers Fairly (TCF) principles, said they sought to benchmark (often using surveys) against competitors. Means of measuring quality and maintaining standards described to us included:

- professional quality assurance
- feedback from customers
- absence of complaints
- results of procedural reviews (such as ISO, internal audit)

Some firms had difficulty in responding to the question posed on measures used to evaluate the overall quality of their work and to monitor an improvement (or otherwise) in quality.

1(e) Responsibility for performance measurement

Most firms spoke of the importance of clear lines of communication and some had established a professional excellence committee (or equivalent) taking overall responsibility for quality in the firm.

Most firms had created some form of governance structure but these varied considerably and many firms delegated responsibility for the quality of the work to individual actuaries or assignment managers.

2 Managing competence and conflicts

Firms were invited to tell us about the approach they took to managing competence and conflicts, looking specifically at the human resource and other procedures in place to secure compliance with CPD requirements and general competence and to ensure that effective whistle-blowing occurs and quality is not adversely affected by conflicts.

Taking each category used in the survey questionnaire under the heading of *managing competence and conflicts*:

2(a) HR procedure and competence

Many firms said they reward quality (measured in a variety of ways, mainly qualitative) through bonus schemes and other incentives. Recruitment and retention of high quality staff was an important factor in maintaining quality and a progressive approach to working patterns with regular staff surveys was cited by some as a means of keeping staff turnover down.

Some small firms emphasised the importance of maintaining a diverse, inquisitive, intelligent and skilled team of individuals, offering a sensible work-life balance. Most said that they operate a culture of openness, transparency and 'no blame' and have an uncompromising stance with any who seek to hide errors, omissions or disclosable events.

The consensus view was that the quality of new recruits to the firm, supplemented by strong training and development programmes, including mentoring and coaching, provided the raw material needed to deliver a quality product. A minority of firms have formal participation in a scheme such as Investors in People (IiP).

There is evidence (from statistics maintained by the Profession, and reinforced in our survey) of continued demanding recruitment criteria being set by firms of all sizes. We also have evidence (from firms and from tutors and staff actuaries at the Profession) of well designed learning and development programmes, although these are not found everywhere. The absence of suitable *objective* measures of quality in our view could make some of the incentive programmes operated by firms less helpful than they might otherwise be.

2(b) Relevant CPD

Regular meetings of the actuaries in each firm allow for cross-fertilisation of ideas. Those firms with research departments encourage roadshows and teach-ins whilst the smallest firms operate within a network of actuaries to encourage knowledge sharing.

Larger firms offer in-house updates, whilst smaller firms make ample use of courses run by the Association of Consulting Actuaries (ACA), the National Association of Pension Funds (NAPF), the Pensions Management Institute (PMI), the Society of Pensions Consultants (SPC), the Profession and others to keep their actuaries in touch with new developments. A few large multi-disciplinary firms

had their own more demanding CPD arrangements. Some smaller firms felt that, where it doesn't already happen, they could share CPD opportunities.

The Profession's CPD requirements were not seen as particularly challenging by any of the participating firms; and attendance at sessional meetings, supplemented by the Profession's current issues seminars and annual sector conferences, received wide-scale support from the firms we visited.

The mandatory CPD requirements for actuaries in practice are not seen as demanding (at fifteen verifiable hours each year), either by practising actuaries or by reference to actuaries in other countries; in Canada, for example, the requirement is for 100 hours of verifiable CPD over a rolling two calendar year period.

2(c) Managing conflicts

All firms recognised the importance of handling conflicts, but they went about it in different ways. Many saw a culture of transparency and openness as the main protection against conflicts of interest.

For their pension scheme clients, most firms believe they are still able to manage, in an effective manner, the potential conflicts from acting for the sponsor (as auditor or as adviser) and for the scheme. They say they do this by following the existing guidelines set out by the Profession in the Professional Conduct Standards (PCS), supplemented by the use of their own arrangements for information barriers, where appropriate.

In some cases, separate offices of the larger consultancy firms (or a separate lead consultant for the smaller firm) will act for sponsor and scheme. This links with the emphasis the Pensions Regulator places on managing most conflicts rather than avoiding them, with the supplemental costs that would flow from always appointing a separate firm of advisers.

The PCS guidelines require actuaries to consider the situation carefully, to notify the client and, if appropriate, or when requested by the client, to stand down from acting for the sponsoring employer. The Profession is currently developing two standards on conflicts of interest; a generic standard and a specific standard for scheme actuaries.

Those involved in supplying advice in an expert witness capacity said that they did not take joint appointments. Certain other expert advisory work was seen by some to benefit from a joint appointment (mediation, for example). With M&A activity, some of the firms (mainly larger firms) said they were willing to act for more than one bidder, although none said they would act for both buyer and seller.

We found little consistency in the way firms manage potential conflicts of interest and a variety of interpretations of the guidance from the Profession and the appropriate regulator. Much rests on the clarity and effectiveness of the Profession's planned ethical and conduct standards.

2(d) Whistle-blowing

Whistle-blowing guidance is seen by many as confusing. Opra used to encourage reporting of the smallest of breaches. The Pensions Regulator has recently re-issued traffic light (red, amber, green) criteria, although feedback from some indicates that those who have sought to blow the whistle more recently have been advised that they have done so unnecessarily.

The larger firms will often have their own legal and compliance teams performing risk assessments, linked in with the mitigation of risk generally, and managing down professional indemnity premiums. Firms of all sizes expressed willingness, where appropriate, to blow the whistle on other actuaries under the requirements of the Professional Conduct Standards. Few appeared to have done so however.

Most firms explained how they operate a culture characterised by openness and sharing, having implemented a suitable 'no blame' culture.

Responses given to questions on whistle-blowing confirmed that this is an area of some difficulty. All spoke with confidence when asked if they had whistle-blowing procedures in place and many said they were familiar with the traffic light procedures adopted by the Pensions Regulator and the whistle-blowing obligations to the FSA, but most could not remember the last time they had made use of these to report a client. Many said they preferred to rely on persuading the client to make the report. Most said they would be robust in reporting another actuary to the Profession if the circumstances merited it, but again only a very few had done so.

3 Managing quality of underlying work

Firms were invited to tell us about the approach they took to managing the quality of underlying work, looking specifically at models, templates and systems, how and how far these arrangements constrain the work of actuaries in the firm through enforcement of internal standards, how updates are incorporated, whether the work of actuaries was subject to internal or external review and how reviewers were selected.

The categories used in the questionnaire for *managing quality of underlying work* were:

3(a) Models

Most firms use models and templates for their work. Some have developed their own models; others have bought in models from outside. For some firms, modelling was part of, or even the main part of, the service they offered to their clients.

Some of the very largest firms have specialist central support teams which make use of systems designed to perform the calculations and produce a first draft report.

Many firms were able to demonstrate the use of flexible templates, an electronic library of standard reports and written instructions for using automated procedures.

Many firms use spreadsheet models with the accompanying risk of unidentified error. Few operate what might be recognised as best practice procedures for User Developed Applications (UDAs) as outlined in ISO Information Technology standards.

3(b) Systems

Firms of all sizes use proprietary software packages for modelling and valuation, whilst scenario generators were more often used at the larger end. The more substantial firms had an up-to-date procedures manual maintained on the intranet and firms of all sizes had well developed information systems, making ample use of information feeds.

Larger firms were able to point to dedicated IT resource for maintaining software and stochastic models developed in-house (rather than off-the-shelf solutions more commonly seen in smaller firms). Effective controls, such as a no-delete policy for e-mails and an audit trail for systems changes, were also described to us by some of the very smallest as well as larger firms.

3(c) Enforcement of internal standards

Instead of internal *rules*, most firms tend to rely on developing a common understanding within the firm (a 'house view') through common training and development and sharing of know-how. Many felt that the discipline of compliance review within the firm deters divergence in practice; some preferred to rely on the judgment of individual actuaries.

Several firms adopt a multi-disciplinary approach with team-based working and learning for development. Under this arrangement, the actuaries and administrators work as a team to provide an integrated service to the client. Those that operate a more centralised approach argue that this leaves

the actuaries free to concentrate on the main messages to be included in the report for the client and the aspects that involve their professional judgment.

Many firms adopt the prepare-check-sign approach and calculations are checked either by a separate calculations team or as part of the internal review procedures where a senior actuary reviews the work of a more junior actuary.

The assumptions used will be checked against a house range in many firms, although others place little or no constraints on their actuaries. The absence of readily accessible benchmarks means that there can be a high level of divergence in approach between, and even within, some firms. However, anecdotal evidence, based on pensions returns, suggests a correlation between the advising firm and the assumptions used.

3(d) Updates

Technical meetings take place in firms of all sizes (small firms are often part of a network of small practitioners). The head of actuarial practice will usually take overall responsibility for updates to the practices adopted within the firm, but individual practice heads will often have delegated authority to maintain templates or guidance for particular aspects of the work.

Some firms make use of a firm-wide electronic forum as the means of communicating new ideas and drawing out changes that need incorporating. Larger firms have either an experienced technical team or a research facility, receiving feeds from inside and outside the firm.

For firms of all sizes, in-house technical meetings are supplemented by input from trade bodies and regulators. There would appear to be ample opportunity for those choosing to keep up-to-date to do so and the evidence (from CPD records and attendance at sessional meetings of the Profession) is that most take advantage of the opportunities to maintain expertise.

3(e) Review

There was a broad consensus that mandatory compliance review for the work of pensions actuaries was a good thing and most preferred to make use of Type 1 (pre-release) 'hot' reviews as the most cost-effective and useful way of carrying this out.

Many firms said the 'four eyes' approach has the benefit of combining peer review requirements with effective internal quality control of the work. Other than the smallest firms (who already operate it by necessity) there was little or no support for mandatory external review. Concerns were expressed over commercial confidentiality and also concerns about timeliness.

Some concern was expressed that individual capital assessments (ICAs) are unpublished and unaudited. In contrast, the Solvency Capital Requirement under Pillar I of Solvency II will be published and audited. Some firms told us that mandatory peer review of work of life actuaries could be accommodated and some also said the Profession could usefully extend the reviewing actuary principles to other areas of work performed by actuaries.

Hot reviews are more common than cold reviews with most smaller firms content simply to meet GN48 (compliance review) requirements. A review performed pre-release is viewed by most as a useful, if not essential, discipline and a deterrent to poor or sloppy practice. The general impression given, however, was that peer review rarely leads to fundamental changes in approach or in the underlying assumptions. In the main, peer review leads to a change in the draft wording of the report to make it more accessible and comprehensible to the reader.

3(f) Reviewer

The smallest firms naturally had more difficulty in rotating reviewers, particularly in specialist areas, and the firms that monitored this well had centrally generated rotas or colour-coded charts to highlight any anomalies. Some firms had established arrangements, some quite elaborate, for ensuring rotation.

No consistency in the selection of reviewers could be found across firms. For many, the choice of reviewer was based on their expertise, rotating as appropriate and appointing from local offices and elsewhere. There were examples from firms of all sizes of decisions being based on expediency with the reviewer chosen on availability or proximity.

4 Compliance review

Firms were invited to tell us about the compliance reviews performed on the work of their actuaries and specifically whether (and in what form) checklists were used, the level of resident expertise, the standards against which actuarial work is judged and the depth of the review performed.

The categories used in the questionnaire for *compliance review* were:

4(a) Checklists

At the most basic level, a system of checklists and stamps operate to demonstrate completeness of the review performed. Some maintained this information electronically, with work tagged to prevent anything being finalised without peer review (subject to override at the most senior level, when documents are marked up to show that they are in draft and a review is pending).

For work entered onto the system and submitted for review, there were in most cases adequate systems for recording the existence of a review and for monitoring the mix and quality of review performed by individual reviewers. Inevitably these involve an element of trust and most could not prevent the deliberate flouting of the control mechanisms if actuaries were to work 'off-line' and then omit to submit work for review.

4(b) Resident expertise

Many firms assign a portfolio of clients to each senior consulting actuary. Individual actuaries in most larger firms have access to a strong technical research team. Some had multi-disciplinary technical teams with strong knowledge transfer mechanisms to ensure that the skills, expertise and experience of the reviewer always at least match (and normally exceed) those of the primary actuary.

Those that adopted ISO principles (or equivalent) have structured procedures, not specifically geared to the work of actuaries. Others adopt procedures that either meet minimum standards as laid down by the Profession or their own set of criteria, either set group-wide (perhaps US-led) or by reference to risk as assessed by the firm's lawyers or compliance teams.

Most larger firms retain a research capacity, whilst the smaller firms often prefer to differentiate themselves based on specialisms.

4(c) Standards

For most firms, the review will be against the relevant GNs and the PCS. Some of the largest firms also reviewed against internal standards. Since actuaries are involved in a range of activities that are also carried out by non-actuaries, many said that it would be inappropriate (in non-reserved roles) to place greater constraints and burdens on actuaries. For these firms, principles-based guidance would be preferable to rules-based. Having standards for the review process was considered by many to be less important than making sure some form of review took place.

Those involved in pensions advisory work expressed the view that mandatory compliance review in the pensions field was a positive development and that they would undertake Type 1 reviews, whether required or not. There would be cost implications if *mandatory external* reviews were brought in; best practice guidelines were preferred.

We were told that compliance reviews should deter maverick behaviour. Delivering a quality product involves following procedure (and working within budget) to produce work that is well-documented, clear, conforms to any relevant standards and meets the purposes set out in the engagement letter.

Many felt that timescales demanded by the investment community were not conducive to good quality and that the main risk is the resource limitation by the client and inadequate time for conflict and issue resolution. Quality of administration can represent a risk and many operate a firm-wide risk identification that includes this aspect.

Most small firms and insurers carry out an entirely procedural review in accordance with a Guidance Note checklist approach. The standards the reviewer tests against vary and show little or no consistency across firms, even when grouped by size or type.

In undertaking peer review, most firms make use of basic process tests and reasonableness tests, looking for internal consistency in the report to the client. The primary objective is to confirm compliance with standards but also to make sure the report reads clearly although the precise level of review will differ markedly between firms.

4(d) Depth of review

The review is often risk-based with (among other things) a check on assumptions, calculations, format and content of report. Smaller firms spoke of building in up to five hours on peer review into pricing and making this transparent to the customer. For many firms, every piece of work is the subject of a post assignment job review. In addition, each assignment involves checks of compliance with Guidance Notes, internal standards and practices, and checks for clarity, appropriateness and relevance.

The annual submission required for renewal of a DPB licence for investment advisory purposes and periodic monitoring (on behalf of the Profession) by the Quality Assurance Directorate (QAD) of the ICAEW is seen as a useful discipline. Audit of work on asset transfers has also been helpful. The auditor will frequently find issues in the administration of the pension scheme or in underlying data for policyholders. We were told that visits (by the QAD) can last up to two weeks; these are often rigorous and wide-ranging in nature. For example, they look closely at the risk register of the firm.

The reviewer will often examine the content of the report/advice for accuracy, compliance with actuarial guidance, clarity, style, creativity and pro-activity of advice. The internal review will include assumptions, calculations, format and content of report. With expert advisory work, the report is often reviewed in great detail by the opposing side.

Peer review for all but the smallest firms offering external actuarial services was exclusively internal, although insurers will on occasions seek external review of the work of their in-house actuaries, either by their auditors or by a separate consultancy firm. Most firms regarded internal peer review as something they would want to do anyway, and that it was generally accepted by clients. Some also scrutinised a sample of closed cases ('cold' reviews), and incorporated results into performance measures, both at firm level and for individual actuaries.

5 Audit

We invited those involved in an audit support capacity to tell us about their experience in advising the auditor. For those actuaries that weren't involved directly in audit, we took the opportunity to ask about their experience in responding to reviews of their work by the client's auditor.

The categories used in the questionnaire for *audit* were:

5(a) Integration of actuaries

In most audit practices, consistent practices are operated throughout the firm. The actuary joins the audit partner's meetings with the client. The actuarial team is brought into the planning of audit engagements and monthly partner briefings are designed to help resolve technical audit issues.

In-house actuaries seemed to have an easier relationship with audit partners than external actuaries employed by the auditor; some external actuaries cited cases in which the relationship had ended because of disagreements between the auditor and the actuary.

The accountancy firms involved in both actuarial consultancy and audit appear to benefit from synergies. However, there can be tensions, both in budgeting adequately for the likely involvement of actuaries when agreeing the audit fee, and in making the relevant paperwork available to the actuarial team well ahead of the sign off date.

5(b) Process for resolving difficulties

For multi-disciplinary firms, actuarial sign-off is required as part of the audit process and ISQC1 is adopted for all audit work; the audit fee may be shared across all the participating areas in proportion to the time spent. A qualified opinion from the actuary impacts heavily on the audit opinion; with many firms the audit quality and risk management partner would then get involved.

Some firms of consulting actuaries provide a service to medium-sized accountancy firms and this has been considered by many to be more effective than applying the former auditor/actuary protocol, Tech 45/03, which some found difficult to use in practice. It has recently been superseded by Tech 02/08: <http://www.icaew.com/index.cfm?route=157088>

5(c) Cost constraints

With audit, the FSA has decided not to replicate the reviewing actuary role found in life insurance for general insurance. That said, many audit firms do have access to actuarial expertise and the reviewing partner and reviewing actuary roles are seen as complementary.

The cost of a concurring reviewer would normally be included in the budget; the introduction of the reviewing actuary role has resolved many scope budget issues at the planning stage.

5(d) Communication by audit team and perception of audit by other client advisors

Questions asked by auditors are often on the appropriate use of relevant mortality tables. The sponsor's auditors may challenge the basis of an FRS17 valuation, especially where they have their own in-house actuaries.

For smaller firms, scheduling to tight timescales (say for regulatory purposes) can be difficult. The nature of challenge from the auditor of actuarial methods and assumptions will depend on their assessment of materiality and risk. We were told by many that audit firms do ask questions on actuarial assumptions but that there is little if any feedback given on completion of the assignment.

We were told by many of the non-audit firms surveyed that external audit is more rigorous than in the past and that auditors increasingly look to in-house actuaries or actuarial firms for input. Internal and external auditors place reliance on peer review of actuarial work. Questioning on actuarial methods and assumptions comes from some auditors and, although audit involvement is seen as helpful by most, many told us that this tends to rely on a tick box methodology.

6 Client involvement

Firms were invited to tell us about their clients' involvement in quality assurance adopted by the firm, specifically whether clients were made aware that QA arrangements existed (and input to those arrangements), whether a compliance statement is prepared and passed to the client, what complaints procedure is adopted and policy on third party communications.

The categories used in the questionnaire for *client involvement* were:

6(a) Client awareness

We were told by most that the relationship manager will advise the client in a standard Service Level Agreement (SLA) of the existence of compliance review of work. Many firms spoke of this taking place at the tender stage for new work.

For smaller firms in particular clients show interest in peer review when they hear they are paying for it. With the larger more sophisticated client, they will sometimes ask for sight of the risk log and a sensitivity analysis.

6(b) Compliance statement

Some firms provide a fact sheet to clients, supplementing the details supplied in the engagement letter. The main purpose for any statement referring to compliance review appeared to be when advice was issued in draft, pending review.

Only sporadic use is made of compliance statements by firms of consulting actuaries which is seen as indicative of the relatively low level of interest shown by clients in the existence of peer review.

6(c) Client involvement in quality assurance

All firms arranged for regular feedback from their clients, by way of formal or informal surveys. Some adopted the approach of making use of another partner in the firm to test the views of the client, others made use of Error & Omission (E&O) records maintained for regulatory purposes to analyse issues of particular concern.

The insurers and smaller consulting firms have the greatest propensity to bundle services and they also demonstrate the highest number of clients per head. Scheme actuaries of fully insured schemes can maintain as many as 50 schemes each (although in practice the number is usually a lot smaller than this) and their firms generally offer administration, investment and other ancillary services. This is also seen as a cost-effective solution by medium sized consulting firms with small to medium sized clients.

All respondents saw good client relations as a priority and some made use of benchmark surveys in 'taking the temperature' of customer satisfaction more generally. However good client relations may not necessarily correlate with high quality actuarial work where, for example, an overly flexible approach to assumption setting might be taking place to meet the demands of the customer.

6(d) Complaints and disputes

The larger firms, those linked to large financial organisations, including the insurers, had formal FSA-compliant complaint procedures, and all actuaries in those firms received in-depth training on complaints handling. At least one of the largest firms adopted ISO compliant standards in handling customer complaints. Smaller firms were quick to emphasise that the need for regular dialogue with the client has the benefit of an in-built challenge.

For those with a heavy compliance emphasis (carrying out FSA-regulated business), the legal or compliance teams are intimately involved in handling customer complaints. For all firms we visited, we were told that errors and complaints are a regular agenda item at management meetings; they are seen as a valuable source of information for risk assessment and standards generally.

Complaints are unsurprisingly an area of particular interest to the professional indemnity insurers who sometimes perform in-depth reviews of their own to validate the effectiveness of the risk management procedure within the firm. The Profession has looked closely at the issue of liability limitation by actuaries which (unlike for auditors, until recently) has not been prohibited. In our report in December 2006 on the progress made by the Profession in implementing the recommendations made to it by the Morris review: <http://www.frc.org.uk/images/uploaded/documents/2006%2012%2018%20Morris%20publication%20draft2.pdf>, we emphasised the need for a balanced approach in any guidance given on this particular subject, reflecting legitimate needs of clients.

Complaints are seen by many as a primary source of feedback. Formal complaints procedures are adopted by most firms with customer feedback forms and customer surveys applied in the larger firms. It is recognised that maintaining a high quality service will involve some additional cost and most clients are advised that quality assurance is included in calculating the fee for actuarial advisory work. Some may be unwilling pay for a quality product and some may even complain at the additional cost.

6(e) Third party communications

All firms we spoke to recognised the risk of reports prepared for one particular purpose and for one particular audience, being passed on by the client to others (lenders for example), for a purpose not originally intended.

Most firms apply terms of business strictly by making it clear, in all reports submitted, to whom the report is addressed with an assertion that it should not be relied upon by others. A standard disclaimer and a prohibition on passing to third parties are also used.

Annex D – Acknowledgements

We are grateful to those firms that have participated in our monitoring survey and others who, as stakeholders, supplied input to our review.

We acknowledge the contribution of the following, recognising that their inclusion here does not of itself indicate agreement with our findings or support for our assessment of emerging options:

ACMCA	HSBC Actuaries & Consultants
The Actuarial Profession	Hymans Robertson
AEGON Actuarial Services	The Institute of Actuaries of Australia
Alexander Forbes Financial Services	Investment Management Association
Aon Consulting	Irish Department of Finance
Association of British Insurers	Irish Pensions Board
AXA Sun Life	Jagger & Associates
Gordon Bagot	Jardine Lloyd Thompson
Barnett Waddingham	KKW Pensions Management
BBS Consultants and Actuaries	KPMG
BDO Stoy Hayward Investment Management	Legal & General Assurance Society
British Standards Institute	Lloyd's of London
BWCI Group	Manor Park Financial Services
Canadian Institute of Actuaries	Mazars
Capita Hartshead	Mercer Human Resources
Chartered Insurance Institute	National Association of Pension Funds
Clerical Medical	Norwich Union Life and Pensions
Collins Actuaries (Scotland)	OAC Actuaries & Consultants
Confederation of British Industry	Pensions Management Institute
Deloitte	Pensions Ombudsman
Department for Work and Pensions	Pension Protection Fund
Steve Dixon Associates	The Pensions Regulator
EMB Consultancy	PGC Actuaries and Consultants
Ernst & Young	Pollock & Galbraith
Financial Ombudsman Service	PricewaterhouseCoopers
Financial Services Authority	Punter Southall
First Actuarial	Quantum
FRC Actuarial Stakeholder Interest Group	Richards Consulting
Garvins	SBJ Benefit Consultants
Gissings	Scottish Widows
Government Actuary's Department	Society of Actuaries in Ireland
Grant Thornton	Society of Pensions Consultants
Hamish Wilson	Tillinghast Towers Perrin
Hazell Carr	Watson Wyatt

© The Financial Reporting Council Limited 2008

ISBN: 978-1-84798-081-6
Code: UP/FRC-BI8019

The Financial Reporting Council Limited is a company limited by guarantee. Registered in England number 2486368.
Registered Office: 5th Floor, Aldwych House, 71-91 Aldwych, London WC2B 4HN.



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