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consultation response

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Response to The Groupe Consultatif

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UK Actuarial Profession response on The Position of the Actuary in a Solvency II Framework

18 August 2006

Faculty of Actuaries and Institute of Actuaries

Response to The Position of the Actuary in a Solvency II Framework document produced by the Groupe Consultatif

Introduction

The Faculty and Institute of Actuaries congratulate the authors of the Role of the Actuary paper on producing a very valuable piece of work on a vitally important subject. The suggestions in this response are designed to build on and strengthen the original paper and not to overturn or undermine it.

Background to Current Environment for UK Actuarial Profession

The UK actuarial profession has recently undergone an independent government sponsored review following the near collapse of a major life insurance company – the “Morris Review”. In March 2005 the final report was published, amounting to 160 pages of detailed analysis and recommendations. These recommendations covered all aspects of governance of the UK actuarial profession, including education, public interest and the role of the actuary. The review also covered the role of the Government Actuary’s Department. The final report and the Faculty and Institute of Actuaries’ (the Actuarial Profession) response can be found on the profession’s [website](#).

The UK actuarial profession’s response to the “The Position of the Actuary in a Solvency II Framework” naturally takes this thorough review into account. We believe that the recommendations of the report are also relevant in a European context, and set the standards of the actuarial profession alongside those of other professional bodies such as accountants and lawyers. Principles such as “independent oversight” and avoiding “conflicts of interest” are critical to confidence in the profession and it is appropriate to embrace these at a European level.

The current paper on the Solvency II actuary does not address many of these issues directly and we believe it should be reviewed in the light of the Morris recommendations.

Summary of Response

We strongly support the need for a European framework for the actuarial profession, and that this should be done to support the most complex and fast-moving financial markets. The actuarial profession is in competition with other professionals, many of whom may lack the somewhat old-fashioned set-up of a professional body but are perhaps faster to pick up new and complex risk management techniques. We are also in competition with other larger global professions such as accountants who may appear to be set up more professionally with accountability to independent bodies. The Profession has a uniquely favourable position from which to tackle the demands of the market for practical risk management skills and we must ensure that the profession does not sell itself short. We must build on our current skills base and seek to be proactive in adding to this skill set and marketing ourselves as global insurance risk management professionals.

We believe that although the current paper is headed in the right direction it falls short of what is required to set out a framework for the European actuarial profession which is flexible, fast moving and could be subject to the most detailed professional scrutiny from the public, government and other professions and technical experts. Things have moved on rapidly from the days when different standards could be set for "less developed markets". We are moving rapidly towards a global European market where only the highest standards will apply.

- We agree in principle with the role of the "Solvency actuary" but this needs to be put into the context of other statutory roles of the actuary. Looking at the role of the "Solvency actuary" in isolation does not fit well with the aims of Solvency II.
- The role of the "Solvency actuary" should be consistent with the underlying principle of a Solvency II framework which is embedded in the day-to-day running of the business. This would require the actuary to have a role which is integrated with the ongoing management of risk within the business rather than the "stand-alone" and "one-off" supervisory role implied in the paper. The paper should consider the actuary in the context of the company and highlight the links that should be in place with business managers.
- There should be a strong link to the company's planning process, and any actuarial report should tie in to that. When internal models are used and reported on, the use made of them in the company should be described to show management / the regulator that they are embedded.
- "Solvency actuary" sounds very regulatory. The paper mentions that one of its objectives is to focus actuaries work more on the effects of the company's strategy in relation to its risk profile. Other business managers hearing the name "Solvency actuary" may take a different view, which may make this objective a lot harder to achieve.
- Linked with the previous point and in line with embedding models within the firm and linking actuaries with business managers; we believe the best way to achieve this is to include within the financial condition report likely stresses around the mean (i.e. earning events) as well as plausible adverse scenarios (i.e. capital events).
- The scope of the "Solvency actuary" and his/her interaction with other professionals needs further clarification.
- The paper does not address professionalism issues of "conflict of interest" and "independent review" which are fundamental to good governance. Strict independence and "conflict of interest" frameworks are in place for actuarially related audit work. In order to ensure good governance this framework should be extended to non-audit firms where an actuary within that firm is giving an independent opinion to an insurance client under Solvency II.
- Another critical piece of governance from the Morris Review is the visible separation between advice and decision-making. This emphasis increases the responsibility on the advising actuary to enable the decision-maker to make an informed decision.

- We think the syllabus should be updated to include more detail on risk management for all actuaries and the opportunity to specialise in this field.
- This is not the right place to set out the syllabus - it needs more detail and confirmation of depth and standards. It needs to move rapidly with the times and respond to the complexity of the market. There needs to be far more emphasis on Continuing Professional Development ("CPD") and frameworks put in place to allow and monitor this. There needs to be more room for specialisms to develop (risk management being a critical one). The parts of the syllabus on a second commercial language and in-depth knowledge of EU law are likely to prove unworkable at present.
- The paper should be reviewed in the light of the "Morris review" of the UK profession which could set the European standard.
- We believe that the European actuarial profession will need to provide an appropriate framework to achieve greater consistency of approach across EU member states. The current structure and framework will not remove the divergence in practices identified by this paper.
- A clearer definition is needed of the roles and responsibilities of audit/reviewing actuaries.

Other Points of Detail

- There should be non-life insurance assumptions in the list in 2a.
- Where "best estimate" is mentioned in 2c this should be replaced with "mean, discounted".
- Mention needs to be made that any report should comply with professional guidance.
- We believe a legal part to the core competencies would also be important, particularly for those dealing in non-life insurance where a large part of the uncertainty in the reserves can rest on legal judgements.
- In relation to internal models we believe it is important explicitly to mention model weaknesses, how this may impact on the stability of results and what development plans are in place.

Response to Specific Questions

A. Report of the Solvency Actuary

A1. Do you agree with the proposed outline of the report?

The outline of the report is in three sections:

- Report of the Solvency Actuary

- Governance of the Actuarial Professional
- Role of actuary and auditor under Solvency II
- Annex A – Required core competencies
 - i. Part one – Guidelines
 - ii. Part two – Actuarial competencies

We agree that the report covers the most important aspects of the "Solvency actuary's" role. We would prefer it to be set out such that the report should start with principles and then how these might be applied in specific situations.

In terms of specifics we agree with the following:

Report of the Solvency Actuary:

- There is a role for a "Solvency actuary" which is forward looking
- There should be an annual "Report of the Solvency actuary" which is addressed to the Board of Directors with contents as set out on page 6 (includes market consistent valuation of assets and liabilities, available capital, risks and internal models, description of risk mitigation, MCR, SCR).
- There should be a Financial Condition Report (FCR) prepared by the "Solvency actuary" at least every 3 years including a base scenario and "plausible adverse scenarios", and including new business as well as in force. We think that production of this report should be mandatory.

However, the role of the "Solvency actuary" should be consistent with the underlying principle of a Solvency II framework which is embedded in the day-to-day running of the business. This would require the actuary to have a role which is integrated with the ongoing management of risk within the business rather than the "stand-alone" and "one-off" supervisory role implied in the paper.

Key Questions:

- Are these published? We assume the former is but the latter is not as it contains commercially sensitive information?
- Are these externally reviewed? We assume the former is reviewed by the auditors? Why should the auditors not review the FCR as well?
- What responsibility is the actuary taking? Do directors take responsibility for financial soundness of the company based on taking the advice of the actuary?

Governance of the Actuarial Professional

Note that we did not understand "personal appreciation" and "sensitivity of the personal consideration". We did not disagree with any of the reasons why governance is needed but we thought there were more important reasons which could be cited eg public interest.

See comments in B below.

Role of the actuary and auditor under Solvency II

This has been looked at in detail in the UK. For us it seems very surprising that the paper states "*It needs to be decided whether the realistic valuation of liabilities will be audited*". It is already audited in the UK, and given the importance of the results and the complexity of the calculations we would suggest that it is right that this is so.

We would also challenge the assumption that the auditor's role is not forward looking. Given that the auditor is signing off on the office as a financially solvent going concern the auditor must look at the future plans. It is impossible to assess the solvency of a long term insurer on an "in-year" basis only. As happened in the UK any collapse of an insurer is sure to leave the auditors under scrutiny and likely to be sued.

Nevertheless the two roles are different. The "Solvency actuary" is performing the work and ensuring sufficient controls are in place to check the answer is correct. The auditor is auditing this work. The reviewing actuary is also performing an independent review but to different standards and with a different purpose.

We found the descriptions in the paper confusing. We felt that the description of an actuarial auditor required clarification from the role of a reviewing actuary. We believe that the strict independence rules for audit firms should be extended to actuaries working for non-audit firms where an actuary within that firm is giving an independent opinion to an insurance client under Solvency II.

Another critical piece of governance from the Morris Review is the visible separation between advice and decision-making. This emphasis increases the responsibility on the advising actuary to:

- Communicate advice in a manner that the client/employer can understand.
- Be available to answer questions of clarification.
- Check that the decision-maker understands the assumptions, methodology, sensitivity and recommendations.
- Check that the advice places the decision-maker in a position (together with other advice) to make an informed decision.
- Monitor the decision of the decision-maker and point out the implications of the decision and other options.
- Follow-up on the outcome of the decision.

A2. *Are there any aspects that should be applied to the Report or excluded from it?*

- Principles
- Conflict of interest
- Independent review – we were not clear on what is being suggested here
- Standards/levels to be achieved in syllabus topics

A3. *It is suggested that the Guidelines would be provided by the supervisory authorities and /or the actuarial profession, for example on key variables to be tested. Would your association prepare such guidelines, alone or in conjunction with the supervisory authorities? Would your association welcome Guidelines prepared by the Groupe Consultatif for use by all member associations?*

In this situation we would prefer to leave the decision as to which are key variables to the actuary in the company. They are more likely to understand which are key to the particular office and products being sold. We suspect that any effort to second guess this by the supervisory authority will simply lead to mountains of worthless paperwork. We prefer to work by principles and guidelines, delivered through our existing system of technical guidance backed up by the close supervision of the reviewing actuary.

We believe that this system gives more flexibility in terms of changing parameters to be appropriate to company and the market at the time.

We would prepare any such principles in conjunction with the supervisory authorities through a formal consultation process and agree a practical way of implementing and reviewing them.

We think that high level principles set in conjunction with the Groupe Consultatif would be useful, as they would set a "level playing field" across Europe and they would save the local actuarial associations "reinventing the wheel". However in order to retain flexibility and relevance they would have to be at a high level e.g. "offices should have a reviewable process in place to ensure that key scenarios are identified and tested".

B. Governance of the Actuarial Professional

B1. *In the short paper on the Governance of the actuarial profession, do you agree with the statements about the responsibility of the local actuarial association and the role of the Groupe Consultatif? Please comment on the issues which the proposed governance process might cause for your association.*

It is no longer practical to have a number of local actuarial associations within Europe, each setting their own standards. We need to have a pan-European profession with globally applied standards. This must be set at the highest and fastest level – not the lowest. We realise that for some local associations this will cause short term problems, but unless we can do this we will find that we are unable to compete with other professions and experts.

We therefore agree that "*the local actuarial associations are part of the international actuarial coordination, for the purpose of European Solvency Actuary in hands of the Groupe Consultatif.*"

It would therefore follow as set out in the paper "*the Groupe Consultatif therefore is in charge of the definition of the general level of actuarial professional requirements in education (the syllabus), the code of conduct and the discipline.*"

However we strongly believe that the highest possible standards must apply and there is no room for a compromise solution here. As explained above the UK actuarial profession has just undergone a detailed independent review "the Morris Review" and we would suggest that the Group Consultatif model should consider this in detail before potentially "reinventing the wheel". We realise that there are some aspects of the review which are most relevant to the UK, but believe that the framework suggested within this, and currently being put in place by the UK profession, would be an excellent foundation for a pan-European framework.

B2. Do you agree that the implementation of actuarial standards should happen in a close interaction with the insurance and pension supervisors? Please comment on the implications of this for your association.

Yes, this already happens in the UK. The Financial Services Authority (FSA) has a "principles based" regime of regulation in place. These principles are backed up by detailed regulations set out in the Prudential Sourcebook (PRU). Further details are available on the [FSA website](#). Further guidance on how to apply the regulations is given by guidance issued by the Profession in [Actuarial Profession Standards](#).

The FSA has a process of issuing Consultation Papers before implementing regulations, and the Profession has the opportunity to comment and influence these. Similarly the Profession has a process for issuing draft guidance.

B3. Please comment on any other aspects of this short paper with which you agree or disagree and the issues it might raise for your association.

The paper does not appear to deal with "**conflicts of interest**". Would the "Solvency actuary" be expected to act in the shareholder or policyholder interest? If there is any conflict of interest we recommend that the roles be separated. In the UK we now have a separate "with profits actuary".

Similarly **independence** is another key concern of governance. In the UK we now have a "reviewing actuary" so that we can evidence that independent review has taken place.

Following the Morris Review of the Actuarial Profession, published in March 2005, HM Treasury asked the Financial Reporting Council (FRC) to take on responsibility for oversight of the UK Actuarial Profession and the independent setting of actuarial technical standards. The FRC is the UK's independent regulator for corporate reporting and governance. It exercises its functions through its operating bodies (the Accounting Standards Board etc) and the Council. The FRC's operating bodies include wide representation from the business, investor, professional and other communities with an interest in corporate reporting and governance. The Board for Actuarial Standards ([BAS](#)) is now responsible for independent setting of actuarial technical standards.

The legal representation in disciplinary proceedings was already a feature of our system before the Morris Review. The disciplinary schemes are overseen by a Disciplinary Board,

with a third of its membership being from outside the Actuarial Profession and it is chaired by a lawyer.

C. Core Competencies for Actuarial Professionals reporting on the financial position of insurance companies

C1. Do you agree with the summarized requirements (see section 1 of part two)?

Given that the reason for this document is to set out why actuaries are more competent than any other professional body at monitoring and mitigating risks for insurance companies, we need to be more proactive in adding risk management techniques to our syllabus. We are in direct competition with members of the Institute of Risk Management for example, and those with banking risk management skill-sets in particular. The core competencies should therefore be broadened to include expertise such as in VAR techniques, and techniques used in operational risk (such as Bayesian theory and Fuzzy logic).

As we say in the UK "Jack of all trades, master of none", it is perhaps too challenging to expect all actuaries to be experts in all things, all of the time. It would be more realistic to allow for specialisms to be built up through a CPD framework. In other words the profession would be able to provide certain individuals with exactly the right skill set to compete with other risk management professionals in certain field, though every actuary would not be able to do so. Of course a core set of skills would be needed for an actuary to use the basic qualification. In the UK a specific higher paper is set at examinations stage depending on a student's required specialism. A further specialism for "Risk management" would be an obvious extension of this. In any case some of the techniques eg VAR are so fundamental that they should form part of the basic syllabus for the actuarial qualification.

We were concerned that although Appendix II lists the syllabus requirements in considerable detail, it does not specify the depth of knowledge required to acquire competency. For example the items listed under the economic syllabus could equally apply to school or university studies, but would be studied to greater depth at university level. We feel that this needs to be dealt with more thoroughly off-line.

The requirement in point 9 that every actuary should be competent at a second business language, would in practice be a major difficulty for the UK actuarial profession. Due to the education system in the UK, and the fact that most UK actuaries find they do not use a second language to either conduct business or keep up-to-date with actuarial affairs, their language competence is low. We would however support a proposal where actuaries were encouraged to learn a second language, and obliged to in cases where they need to do so in order to maintain global competence.

Similarly the requirement in section 7 for actuaries to understand the workings of the EU legislative system would exclude most UK actuaries. Is it really necessary to include this on an already crowded syllabus?

C2. How would your association check if an actuary meets the core competency requirements? Would you expect this to be more than (simply) being a full member of your association?

- Exams/Exemptions supervised by both actuaries and external educational representatives
- Continuous Professional Development (CPD)
- Practising certificates
- Peer review
- Board for Actuarial Standards

D. Other Comments

D1. Please set down any other comments you have on the paper.

As referred to in the above paragraphs the Morris Review of the UK actuarial profession would serve as an excellent background reference for setting the agenda for "The Position of the Actuary in a Solvency II Framework". However the current paper does not appear to take this into account and as a result appears to be lagging behind the times. The UK actuarial profession now has an independent standards setting Board (the BAS) which is a key indicator of governance to anyone outside the profession, and we would expect this to be a key part of any European framework for the future.

Importantly the paper does not give details on what aspects of the "Solvency actuary's" reports will be published or whether they will be subject to independent audit or peer review.

Conclusion

We support the paper, but think it would benefit from further work particularly:

- Review it in the light of the Morris Review recommendations for the UK actuarial profession and the ongoing implementation of these. The result of these is to set a much higher standard of governance for the profession than has ever been done before.
- Establish the principles on a pan-European basis and then consider how to implement these in detail – which aspects are best done pan-European and which on a local basis.
- Take the education syllabus off-line and give more details of the standards to which the subjects will be studied. Reconsider the "second business language" and the "EU legislation" requirements.
- Introduce more relevant risk management techniques onto the syllabus.
- Introduce "specialisms" in the study schemes for new actuaries.
- Improve and certify CPD arrangements on a pan-European basis. Use this as an opportunity to increase knowledge of more recently developed techniques such as risk management.

- Reconsider the role of the auditor and the reviewing actuary in more detail and consider what information will be available publicly.