

## **MONITORING COMPLIANCE WITH PROFESSIONAL GUIDANCE REVISITED**

**A FURTHER DISCUSSION PAPER  
PREPARED BY THE COMPLIANCE/PEER REVIEW WORKING PARTY  
OF THE PROFESSIONAL AFFAIRS BOARD**

[Presented to the Institute of Actuaries, 27 November 2000,  
and to the Faculty of Actuaries, at a Seminar, 13 December 2000]

### **EXECUTIVE SUMMARY**

The Compliance/Peer Review Working Party published a Discussion Paper in November 1999 (*B.A.J.* 6, 365-431). Consultation with members and employers took place, and this new paper sets out revised recommendations based on the comments on and the criticisms of the first paper. This paper invites further comment, with a view to finding an acceptable way forward.

The consultation indicated that many firms had procedures in place that covered the area of monitoring compliance, although they may be informal. Most were internal to the firm, rather than external, and the external review approach was clearly not welcomed by many. There was some support for the use of questionnaires from members as part of the process, and for reports from firms' Senior Actuaries. A firmer case for the introduction of the proposed measures was requested.

This paper sets out more fully the reasons for the review, and also gives, in outline, some of the areas of professional difficulty identified in the profession other than those already publicised as a result of disciplinary cases.

The paper's main recommendation is that peer review by an actuary's colleagues in his firm should be carried out on all relevant work before presentation to the client (whether an internal or external client). The situations in which this practice would become mandatory are set out. At least initially, these relate to mandatory guidance in Practising Certificate areas.

The earlier recommendation of post-release external practice review on a compulsory basis has been withdrawn, except for situations where internal review is not possible and in some disciplinary situations. External practice reviews are, however, encouraged on a voluntary basis, as are regular internal audits.

The paper covers the use of individual questionnaires and the Senior Actuary's report, in the light of the new main recommendations. It also deals with the special position of small firms in arranging reviews of the work of their actuaries.

The earlier discussions showed, amongst much opposition to the original proposals, substantial support for moving forward by internal peer review. A wish to retain self-regulation, but to avoid a 'tick box' approach to compliance, emerged from the consultation. However, a move to full quality monitoring as the ultimate alternative is not regarded as feasible or desirable. The Working Party considers that the revised proposals represent the appropriate position in that spectrum of approaches, and looks forward to hearing the further views of the profession's membership.

## 1. INTRODUCTION

The Working Party was set up by the Professional Affairs Board (PAB) to examine systems for the monitoring of compliance in professional matters. To enable a discussion to take place within the wider profession on these matters, the Working Party published a discussion paper entitled 'Monitoring Compliance with Professional Guidance', in November 1999. A link to the discussion paper can be found on the Professional Affairs Board page of the profession's website <[www.actuaries.org.uk](http://www.actuaries.org.uk)>. A consultation process ensued, comprising mainly:

- responses from employers whose views were explicitly sought by the Working Party in writing and in individual meetings;
- separate consultation meetings with the Institute and the Faculty at an Institute Seminar on 2 February 2000 and subsequently at a Sessional Meeting of the Faculty on 21 February 2000; and
- additional written comments submitted by members of the profession.

The original paper considered the monitoring of compliance with the Professional Conduct Standards (PCS), all guidance notes that are practice standards and certain ones that are recommended practice. It covered compliance generally, but, in particular, by the holders of Practising Certificates. It did not consider wider quality issues concerning actuarial advice. However, application of many of the procedures outlined to non-monitored activities would enhance both the perceived and the actual quality of all actuarial work.

A number of helpful comments were made in the consultation process. These have been considered further by the Working Party and the PAB, to which the Working Party reports, and noted by both Councils and the Faculty and Institute Management Committee.

The purpose of this subsequent discussion paper is to expose to members the results of consultation, and to offer substantially revised detailed recommendations for further discussion. For ease of reference the recommendations have been repeated in Appendix A. Definitions used will be found in the relevant parts of the paper in Sections 4-8.

While this paper has been written so that it can be read on its own, readers who wish to understand the development of these ideas are advised to read the original paper. A discussion group has been created on the website, accessed through the 'members only' section, where members are invited to visit and exchange comments.

*1.1 Objective and Terms of Reference (as determined by the Professional Affairs Board and approved by the Faculty and Institute Management Committee)*

Objective: to consider how the profession can be satisfied that its mandatory Guidance Notes are being adhered to by members.

Terms of Reference:

- (1) to review the present working arrangements and identify any problems;
- (2) to consider alternative compliance/peer review processes; and
- (3) to liaise with the Guidance Committees of the Practice Boards (to include the Regulation and Supervision Committees of the Life Board), who will be represented on the Working Party.

*1.2 Membership of the Working Party*

David Martin (Chairman), John Bannon, Wendy Beaver (Pensions Board), Roy Brimblecombe, Paul Grace, Michael Green (Life Board) and William Hewitson (General Insurance Board).

## 2. SUMMARY OF CONSULTATION

Prior to the February 2000 meetings mentioned in Section 1, discussions were held with a selection of employers, as it was considered that no alteration to the profession's monitoring arrangements could be achieved successfully without their support.

*2.1 Consultation with Employers*

2.1.1 Employers were asked about their existing procedures. It was apparent that most firms had procedures in place, although these were not always formalised. Some life offices found that their external auditors and the Government Actuary's Department (GAD) proved very helpful in this area. Some firms — notably auditors employing actuaries — regarded such arrangements as part of their risk management procedures. Clearly, in many instances the internal review procedures set out in the original paper could be incorporated without difficulty.

2.1.2 Employers were also asked if the measures suggested in that paper would enhance the standing of actuaries within their organisation. The majority view seemed to be 'No', although there was a small proportion who believed that there would be some enhancement. Most of the 'Nos' thought

that the effect would be neutral, with only a few commenting that it would have a negative effect. There was concern expressed by many as to the additional costs involved, both external and internal, and whether or not it would offer value for money.

2.1.3 Views were sought on which areas of actuaries' work should be monitored. Many, particularly those working with auditors, considered that only those areas of work covered by Practising Certificates should be monitored. This would tie in with the idea of the costs for the exercise being met through Practising Certificates fees. Some felt that picking out certain advisory notes for monitoring and not others was inappropriate. Clearly, the existence of a monitoring scheme would affect the drafting of future guidance. There was a number of responses suggesting that all areas of work should be monitored.

2.1.4 The question of costs, and how they should be borne, was raised. There was some support for a certain proportion of the costs being met by subscriptions and Practising Certificate fees, with the balance being paid by the firm in question, if a more detailed review were required. However, there was no consensus on costs, as some felt that the profession should meet the costs entirely (presumably from subscriptions) and some that the firms should meet all the costs.

2.1.5 The preferred body for undertaking the external review was discussed. There was a fairly even split among life offices between those who would prefer the GAD and those who preferred actuaries working for their auditors. The idea of other competitor consultants undertaking the review was most definitely not welcomed. Accountancy firms and some consultancy firms were supportive of the Joint Monitoring Unit (JMU) carrying out such a review. This body was set up to carry out reviews for the accountancy profession, and assists the Institute with Financial Services Agency (FSA) compliance matters.

2.1.6 There was a substantial amount of support for improved internal reviews. Some organisations felt that there was scope for tightening up their own procedures, and having a blueprint from the profession might be helpful. Codifying good practice and extending it to others was generally accepted.

2.1.7 There was a mixed reaction from employers to the idea of compulsory practice review. Some felt that external practice reviews should be compulsory, others thought that they should be voluntary, and some were completely against any external reviews. Some felt that only very small firms, with one or two actuaries, needed external review. A number of small firms were against external review, on the grounds of cost, time and confidentiality.

2.1.8 There was some support for the idea of the questionnaire, not necessarily to provide monitoring information, but as a means of reminding actuaries of their duties, and for them to express their views on areas where there were difficulties or scope for improvement in compliance matters.

2.2 *Consultation Meetings on 2 and 21 February 2000*

2.2.1 The following substantive views were expressed at the meetings, and have been fully considered by the Working Party in preparing this further paper:

- (1) A prominent feature of both meetings was the comment that the Working Party had not demonstrated the need for the proposals that it put forward. The profession must establish that there is a problem before proposing a solution to its membership.
- (2) There was a suggestion that a costed analysis of the alternative methods should be conducted, so that a 'business case' could be presented.
- (3) There was very little support for compulsory external practice review expressed at either meeting.
- (4) There was strong support from a majority of contributors for a more formalised peer review system.
- (5) As with employers, there was support for the idea of a questionnaire, particularly if this was largely in the form of 'open' rather than 'closed' questions, and could therefore encourage actuaries to consider broader issues.
- (6) There was almost universal disagreement with the concept that there should be any protection or amnesty for members taking part in any pilot exercise or other review as a result of any new monitoring procedures.
- (7) There were some specific concerns about sole practitioners and small firms, which are addressed in Section 9 of this paper.
- (8) There was very substantial opposition to introducing checklists with 'tick boxes', as this would not assist actuaries towards an improvement in standards.
- (9) Requests were made for greater clarity and for the introduction of the concept of materiality in guidance notes, particularly in the context of monitoring compliance. It should be noted that this is a matter being addressed by the PAB in the recently issued EXD 40.
- (10) There was a concern that the list of 'stakeholders' with an interest in this matter, referred to in the original paper, was too narrow, and that the list should be expanded to include individuals and bodies such as shareholders and auditors, as well as the Government and regulators.
- (11) It was observed that the International Accounting Standards Committee (IASC) had suggested that actuaries needed to be subject to comprehensive enforceable standards before the profession was allowed discretion by that committee on insurance liability valuations in accounts conforming with IAS standards.
- (12) A review of the disciplinary process was suggested.
- (13) The holding of a conference to discuss different peer review systems and the production by the profession of a best practice 'blueprint' was generally welcomed.

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2.2.2 In addition to the above, the discussion paper was also discussed more generally at the Pensions Conference, the General Insurance Convention and also at CILA, all in 1999, and at the Association of Consulting Actuaries Conference in 2000.

2.2.3 The Working Party is very grateful to those members who commented, and has attempted to address the issues raised in this further paper, which contains proposals revised in the light of the consultation process.

### 3. REASONS FOR REVIEW

3.1 The original paper from the Working Party highlighted several benefits from a system of review. A summary of the principal points is as follows:

- (1) It will strengthen the position of the profession and individual members, and will build upon procedures and good practices already in place.
- (2) It will maintain and strengthen confidence in actuaries among the public and the users of their services. This includes all the 'stakeholders' in the profession, particularly policyholders and pension scheme members.
- (3) The advent of the Financial Services and Markets Bill presents an opportunity to enhance the profession's profile, not only in traditional areas, where monitoring is seen to be key in avoiding further regulation, but also in new areas, where the presence of effective procedures can enhance the profession's case for involvement.
- (4) Guidance notes are used increasingly as an extension of legislation, which the profession needs to be seen to be monitoring.
- (5) There is increasing demand from the public for professions to be more accountable — the medical profession is but one high profile example.

3.2 A prominent feature of all the consultations was the comment that the Working Party had not demonstrated the need for the proposals that it put forward, and that the profession must establish that there is a problem that needs to be solved before proposing a solution to the membership.

3.3 There are two main reasons why the Working Party believes that the profession needs to put in place some system of the kind described.

3.4 The first is that there have been, and continue to be, problems, although they are not publicised, and the second is that the environment in which the profession works has changed radically from that in which the profession's guidance notes and disciplinary process were originally developed. These two issues are dealt with in ¶¶3.5 and 3.6.

3.5 Reference was made in the consultation process to problems identified internally by the profession, but not publicised for confidentiality reasons. Serious issues which lead to discipline are published, but less serious cases are frequently dealt with by the PAB Compliance Committee. An analysis of such individual cases shows that many cases involved alleged breaches of the PCS in such areas as change of adviser, conflicts of interest and publicity. However, there have also been cases of alleged breaches of guidance notes, most notably GN9 on actuarial reports for pension schemes and GN11 on transfer values.

3.6 The Working Party conclude that society increasingly requires a profession not only to regulate itself, but be seen to be doing so, in such a way that the process is open and capable of inspection. In this way we can demonstrate that self-regulation can work. In suggesting a way forward, the Working Party believes the key objectives to be as follows:

- (1) moving the profession forward by improving standards using compliance monitoring, along with other measures such as CPD, improved guidance and an effective disciplinary regime;
- (2) ensuring that we are seen as a profession that is dedicated to the public interest and continues to earn public trust in all of our actions;
- (3) seeking a greater role, not only nationally, but also on the international stage, by earning trust with comprehensive and enforceable standards; and
- (4) ensuring public confidence at a cost which encourages actuarial advice to be sought and taken.

3.7 One further suggestion made during consultations was that there should be a cost benefit analysis of the proposals before implementation. This is a very complex issue, as an evaluation of the benefits is a difficult one. However, particularly given the reduced scope of the current proposals, the Working Party is strongly of the opinion that it would be a difficult public relations stance for the profession to take, for it to indicate to the public that a system would not be introduced on cost grounds. A full qualitative assessment has, however, been made.

## 4. PEER REVIEW

### 4.1 *Definition*

4.1.1 For the purpose of this paper, peer review is defined as the review of work done by one member for a client (internal or external) by another member, with the following characteristics:

- (1) Normally peer review is carried out before work is released to the client. In exceptional circumstances it might be carried out afterwards, but, in this case, any correction required would be communicated to the client without delay.

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- (2) Peer review is carried out on *all* work for which it is mandatory. This distinguishes it from ‘actuarial audit’, which is an audit of selected items of work only.
- (3) Peer review is normally carried out by a colleague in the same firm (or group). This does not preclude it from being carried out by a member external to the firm.
- (4) Peer review is intended to confirm that the work conforms to relevant professional guidance in the opinion of the reviewer. It is not an audit, and therefore does not involve detailed checking of calculations or data, unless the peer reviewer believes that these are necessary.

4.1.2 *Notes on the above*

- (1) Peer review should be carried out by an individual with adequate experience and competence; this does not mean that the individual has to have the same experience or status as the actuary signing the report. It is the responsibility of the actuary signing the report to decide whether the proposed peer reviewer has the necessary attributes. If not, and there is no alternative, this should be stated in the report; it is better to have a limited peer review than none at all.
- (2) Where peer review has not been carried out for whatever reason, this should be stated in the report, with reasons (e.g. confidentiality, timescale).
- (3) The reviewer should be free of undue influence by the actuary signing the report. It is appreciated that this may be difficult to demonstrate in company situations.
- (4) The definition is in line with the concept of internal compliance review given in Section 6.1 of the earlier paper.

4.1.3 The mandatory review, where introduced, would not cover qualitative issues, but it is likely that any peer review will naturally lead to a discussion of these issues. The form for this could be established at the conference to discuss different peer review systems, referred to in ¶2.2.1(13) of this paper.

4.2 *Peer Review Revisited*

During the consultation process, support was expressed for a more formalised peer review system by a majority of contributors. The reasons included:

- (1) Peer review is normally pre-release rather than post-release.
- (2) Many firms already have peer review systems in place. Some firms felt that guidance from the profession would enable them to formalise and/or improve their current procedures.
- (3) Costs would be less onerous than for external review.



- (4) Confidentiality issues arising from external review would be avoided, except in the case of small firms or life offices, as discussed below.

It was noted that the Canadian Institute of Actuaries (CIA) has now approved proposals to introduce compulsory peer review in those areas which are 'mandatory'.

#### 4.3 *Peer Review Recommendations*

The Working Party, having regard to the contributions made during the consultation process, recommend that a system of peer review be developed along the following lines:

- (1) Voluntary peer review to be encouraged for all work.
- (2) Compulsory peer review to apply initially only to:
  - mandatory guidance; and
  - areas to which Practising Certificates relate.

The introduction of, and the scope of work covered by, compulsory peer review would be decided by the relevant Practice Board.

- (3) The Senior Actuary to report annually regarding peer review, as set out in Section 8.
- (4) Any material unresolved matter between a peer reviewer and an actuary to be reported to the Senior Actuary, and, by the Senior Actuary, to the profession.
- (5) External accreditation of peer review systems to be voluntary, but, where obtained, to be referred to in the report of the Senior Actuary.
- (6) Small consultancies and life offices unable to maintain an internal peer review system, because of a lack of appropriate peers, to seek review from other firms or their auditors, possibly on a *post-facto* basis.
- (7) Where there has been no record of peer review, the Senior Actuary's report to outline such cases, with explanations as to why one has not been performed.
- (8) The profession to produce a peer review best practice 'blueprint', after obtaining from, and discussing with, major employers of actuaries, details of their peer review practices and procedures, and holding a conference for interested parties to debate best practice. The blueprint to describe circumstances in which it would be acceptable for no peer review to be performed, and the process to be followed in such circumstances (e.g. because of confidentiality issues).
- (9) The profession to consider sanctions to be put in place for non-compliance with guidance notes and for non-compliance with the requirement to introduce an appropriate peer review system. Sanctions might include the requirement for an external practice review, or non-renewal of a Practising Certificate.

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A generic form for peer review was included as Form 2 in the previous paper, and is reproduced here as Appendix B. It would be customised by the relevant practice board.

### 5. EXTERNAL PRACTICE REVIEW

#### 5.1 *Definition*

Under this process, an ‘auditor’ would be given a list of clients and projects worked on during the year and would select certain of these for scrutiny. The auditor would be supplied with files, and would review these to check for compliance with professional standards. A report would be drawn up on the basis of the files reviewed. The audit would be carried out by a team appointed by the profession, or another organisation such as the Joint Monitoring Unit.

#### 5.2 *External Practice Review Revisited*

During the consultation process there was little support and a number of reservations expressed by many contributors for a formal practice review system, particularly at the meetings of members in Edinburgh and London. The reasons included:

- (1) Practice reviews would require the release of confidential information to an external reviewer.
- (2) The costs of review would be significant, with little apparent benefit for the firms.
- (3) Post-release reviews were of less benefit than pre-release reviews.
- (4) Reviews would be particularly onerous and objectionable for small practitioners, on the grounds of cost, time and confidentiality. However, they may still be necessary unless alternatives can be found (see ¶5.3.3(1)).
- (5) The actuarial profession (unlike some others) is only able to prescribe the conduct of individual members rather than firms, so that internal reviews would be acceptable and appropriate (although some occasional external benchmarking could still be worthwhile).
- (6) There was little consensus over who would be suitable to conduct practice reviews of the various types of firm.
- (7) It was also noted that the CIA has now moved away from its original proposal to introduce mandatory practice reviews, and, instead, is now introducing compulsory peer review in those areas which are ‘mandatory’.

#### 5.3 *External Practice Review Recommendations*

5.3.1 The Working Party, having regard to the contributions made during the consultation process, recommends that external practice reviews should not be made compulsory for all work, but should be retained as a

voluntary option to supplement internal peer reviews, internal actuarial audits and compliance questionnaires.

5.3.2 The following considerations would apply to the conduct of any such external reviews:

- (1) Guidelines for reviews should be drawn up in anticipation of reviews being carried out.
- (2) Pilot testing could be carried out on a voluntary basis, or, for high-risk areas, selected by practice boards (e.g. certificates for Lloyd's syndicates).
- (3) There should be a meeting with the FSA to discuss how these proposals interact with the likely FSA rules for insurers, and other regulated firms and institutions.

5.3.3 In addition, external practice reviews should be applied:

- (1) as an option (compulsory if other options not used) for small firms unable to carry out peer reviews; and
- (2) as a possible disciplinary sanction, or where there is evidence of possible non-compliance with professional guidance.

5.3.4 The following further considerations would apply to the conduct of any such compulsory external review:

- (1) A risk-based approach should be applied to ensure that the review is focused on areas of particular concern to the profession, and that available resources are applied to greatest effect. These areas would be selected by individual practice boards (e.g. in the past the range of quoted transfer value calculations for pension schemes has caused concern).
- (2) Some rule changes would need to be considered, to ensure that compulsory practice reviews could be implemented in high-risk areas as a part of the disciplinary process, or where peer review is not introduced.
- (3) Confidentiality remains an issue where a firm is unwilling to co-operate. However, where a serious case has arisen requiring review, the profession could possibly, in that event (subject to legal clarification), consider action against individuals working at that firm, which would be a strong incentive for the firms to co-operate.
- (4) All procedures for the conduct of a compulsory practice review would need to conform with the requirements of natural justice and relevant statutes, such as the Human Rights Act.
- (5) It is likely that the Joint Monitoring Unit could be contracted to undertake any compulsory practice reviews in accordance with some agreed procedures, and they, in turn, could sub-contract some of this work to members of the profession appointed by them. Under the revised recommendations in this paper, a relatively low number of such reviews is anticipated.

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- (6) Consideration would be needed over who should meet the cost of any compulsory reviews, and whether these should be the individuals concerned, their firms, or the profession, either as a whole or in part (e.g. those with Practising Certificates).

## 6. ACTUARIAL AUDIT

### 6.1 *Definition*

This process is defined, for the purposes of this paper, as a review of a sample of work done by another member of the profession working within the same firm or life office and, wherever possible, by a holder of a Practising Certificate. It would be carried out on an annual basis. The 'auditor' would be given a list of the clients and the projects worked on during the year, and would select certain of these. The auditor would be supplied with the files, and he would review those files, using a checklist, to check for compliance with professional standards. Selection of cases for internal audit would be on a risk profile basis, established by actuaries in the firm, based on their own experience of problems.

### 6.2 *Recommendations*

Actuarial audits should be encouraged on a voluntary basis where appropriate. This process should be reported in the Senior Actuary's report. An example of a suitable generic actuarial audit form can be found at Appendix C.

## 7. INDIVIDUAL QUESTIONNAIRES

7.1 There was some support from employers to the idea of a questionnaire for individual actuaries to complete. This was seen primarily as a means of reminding actuaries of their duties, and as a means for them to express their views on areas where there were perceived difficulties in the application or interpretation of guidance. It could also help to identify areas where there was scope for improvement in compliance matters.

7.2 There was also some interest in questionnaires expressed at the Institute Seminar and the Faculty Sessional Meeting, particularly if these were largely in the form of 'open' rather than 'closed' questions, and could, therefore, encourage actuaries to consider broader issues. These questionnaires have been adopted for some time by the CIA and are well accepted by Appointed Actuaries in Canada, but are seen as rather costly and bureaucratic for the more commoditised work of pension actuaries there.

7.3 Following consultation, the Working Party recommends:

- (1) that questionnaires with suitably ‘open’ questions are drafted by individual practice boards as an *aide-mémoire*, and for completion on a voluntary basis by individual actuaries;
- (2) that actuaries are encouraged to complete these on a voluntary basis, to discuss any professional issues arising with other actuaries in their firm (or with a member of the PAB, as appropriate), and to send any comments or suggestions for clarification of guidance notes to the relevant practice board;
- (3) that these questionnaires (or similar) with a range of appropriate ‘open’ and ‘closed’ questions, are drawn up and issued to applicants for Practising Certificates each year; and
- (4) that the questionnaires referred to in ¶7.3(3) are monitored by the secretariat, and that any cases of possible non-compliance brought to the notice of the Practising Certificate Committee.

7.4 In order not to increase the costs on the compliance monitoring unnecessarily, questionnaires should be designed such that most questions require a simple ‘Yes/No’ answer, and those to be reviewed for Practising Certificate purposes can be monitored by staff, whilst, at the same time, using the forms to encourage constructive suggestions. A generic example can be found at Appendix D. This will require to be customised by the relevant practice board.

## 8. SENIOR ACTUARY REPORT

8.1 This report, relating to professional matters in his or her firm, would be made by a Senior Actuary. This would be the Senior Actuary as defined in the PCS, if such a post exists. There may be more than one Senior Actuary in any firm, dealing with different geographical areas, or different areas of work. There was very little comment about these reports in the consultation process, but legal advice obtained by the Working Party suggests there might be problems for Senior Actuaries, individually, if they report in good faith that there are no compliance problems, but subsequently such problems are found. For this reason, it is intended to alter the approach to Senior Actuary reports suggested in the previous paper, by removing the requirement to report on whether there had been compliance, and simply stating that compliance monitoring procedures of various kinds are in place, and that the CPD requirements of the profession have been drawn to the attention of actuarial staff.

8.2 The Senior Actuary would also be free to comment on any aspect of compliance with guidance which he or she believes would be useful for the profession to be aware of.

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8.3 The Working Party considered that some firms might wish to have their internal compliance review arrangements reviewed and accredited by an outside organisation — such as those involved with ISO 9000 and IIP certification. It would not be the intention to make such certification compulsory, but, if it were in place, the means of reporting this to the profession would be through the Senior Actuary report.

### 8.4 *Recommendation*

A Senior Actuary report, along the lines set out in Appendix E, would be requested of all Senior Actuaries. Where a firm employing actuaries has no one with that title, they would nevertheless be encouraged to ask a senior member of the profession to submit a report along these lines.

## 9. SMALL FIRMS

9.1 Monitoring compliance of small firms, including, particularly, sole practitioners, was an area of particular concern arising during the consultation procedure.

9.2 Many actuaries felt that there was a greater need for compliance monitoring in this area.

9.3 By contrast, the greatest concerns about the introduction of monitoring were voiced by actuaries in this area.

9.4 Some of the biggest practical problems relate to the lack of availability of internal peer reviewers, and this leads to a need for external review. This, in turn, leads to confidentiality and commercial issues.

9.5 Recommending a form of peer review for all actuarial work is a likely first step, and small firms should be encouraged to participate in this. If internal peer review proves difficult, then encouragement to forge links with other small firms — such as exist between a number of these operations already — should be encouraged. Alternatively, voluntary arrangements with another organisation (e.g. company auditors) could be made. Such links require a large amount of trust between the firms concerned.

9.6 As referred to in ¶¶5.2(4) and 5.3.3(1), at a point in the future, should the relevant practice board decide that internal peer review should become compulsory for particular items of work, then, if small firms have been unable to put into place arrangements such as those described above, it would be necessary to require an external review procedure.

## 10. OTHER AREAS

As a result of its discussions, the Working Party made the following further recommendations:

- (1) Consideration should be given to reclassifying guidance notes in the light of their status regarding monitoring. The current moves to improve the style of guidance notes, to take into account feed back on their interpretation, should be strengthened.
- (2) Applications for Practising Certificates should include a question about monitoring compliance.
- (3) A review of the disciplinary arrangements would be appropriate, so that there is a clearer mechanism for dealing with 'modest' misdemeanours, so that they are neither ignored nor subjected to the full rigours of the disciplinary system as appropriate for more serious cases.
- (4) The Professional Affairs Board should oversee the documents produced by the practice boards, to ensure consistency among them.
- (5) The Professional Affairs Board should set up a Standing Committee, to oversee procedures, and a Compliance Questionnaire Committee (separate if necessary). The secretariat needs to budget resources to run the Committee and other aspects of the regime outlined. The Charter, Rules and Byelaws Committee should consider what changes would be required by the new arrangements.
- (6) The Professional Affairs Board needs to consider how to manage and monitor the progression of the recommendations.

## 11. CONCLUSIONS

It is clear from the consultations that we have held that, amongst much opposition to the proposals as set out in the earlier paper, there is a substantial amount of support for the concept of pushing standards forward by way of internal peer review. This support seems sufficiently strong that a move to make this compulsory might be acceptable to most members of the profession.

It is clear that there is a wide spectrum between, on the one hand, self-regulation and, on the other hand, statutory controls, and a wish by the profession to remain at the self-regulatory end of that spectrum.

Equally, there is another spectrum between, on the one hand, a 'tick box' approach to compliance, with monitoring advice in a qualitative way at the other end. Whilst the latter would be extremely difficult to do, many feel that a simple 'tick box' approach is unacceptable, and so a position somewhere along this spectrum needs to be established — perhaps at a different point in different practice areas.

The reaction of many is that the process of introducing monitoring compliance should continue, and that the profession should not be reactive — in other words, we should not wait for a disaster to happen before acting.

Accordingly, the Working Party has considered all of these matters again, and makes revised recommendations in this paper. For convenience, a summary of the recommendations, with cross-references to the relevant sections of this paper, is given in Appendix A. The Working Party looks forward to the next phase of the consultation process, for which this Discussion Paper has been prepared.



## APPENDIX A

## SPECIFIC RECOMMENDATIONS FOR DISCUSSION

For ease of reference the recommendations in the report are repeated in this Appendix.

A.4.3 *Peer Review Recommendations*

- (1) Voluntary peer review to be encouraged for all work.
- (2) Compulsory peer review to apply initially only to:
  - mandatory guidance; and
  - areas to which Practising Certificates relate.

The introduction of, and the scope of work covered by, compulsory peer review would be decided by the relevant practice board.

- (3) The Senior Actuary to report annually regarding peer review, as set out in Section 8.
- (4) Any material unresolved matter between a peer reviewer and an actuary to be reported to the Senior Actuary, and, by the Senior Actuary, to the profession.
- (5) External accreditation of peer review systems to be voluntary, but where obtained, to be referred to in the report of the Senior Actuary.
- (6) Small consultancies and life offices unable to maintain an internal peer review system, because of a lack of appropriate peers, to seek review from other firms or their auditors, possibly on a *post-facto* basis.
- (7) Where there has been no record of peer review, the Senior Actuary's report to outline such cases, with explanations as to why one has not been performed.
- (8) The profession to produce a peer review best practice 'blueprint', after obtaining from, and discussing with, major employers of actuaries, details of their peer review practices and procedures, and holding a conference for interested parties to debate best practice. The blueprint to describe circumstances in which it would be acceptable for no peer review to be performed, and the process to be followed in such circumstances (e.g. because of confidentiality issues).
- (9) The profession to consider sanctions to be put in place for non-compliance with guidance notes and for non-compliance with the requirement to introduce an appropriate Peer Review system. Sanctions might include the requirement for an external practice review, or non-renewal of a Practising Certificate.

A generic form for peer review was included as Form 2 in the previous paper, and is reproduced here as Appendix B. It would be customised by the relevant practice board.

**A.5.3 External Practice Review Recommendations**

A.5.3.1 The Working Party, having regard to the contributions made during the consultation process, recommends that external practice reviews should not be made compulsory for all work, but should be retained as a voluntary option to supplement internal peer reviews, internal actuarial audits and compliance questionnaires.

A.5.3.2 The following considerations would apply to the conduct of any such external reviews:

- (1) Guidelines for reviews should be drawn up in anticipation of reviews being carried out.
- (2) Pilot testing could be carried out on a voluntary basis, or, for high-risk areas, selected by practice boards (e.g. certificates for Lloyd's syndicates).
- (3) There should be a meeting with the FSA to discuss how these proposals interact with the likely FSA rules for insurers, and other regulated firms and institutions.

A.5.3.3 In addition, external practice reviews should be applied:

- (1) as an option (compulsory if other options not used) for small firms unable to carry out peer reviews; and
- (2) as a possible disciplinary sanction, or where there is evidence of possible non-compliance with professional guidance.

A.5.3.4 The following further considerations would apply to the conduct of any such compulsory external review:

- (1) A risk-based approach should be applied to ensure that the review is focused on areas of particular concern to the profession, and that available resources are applied to greatest effect. These areas would be selected by individual practice boards (e.g. in the past the range of quoted transfer value calculations for pension schemes has caused concern).
- (2) Some rule changes would need to be considered, to ensure that compulsory practice reviews could be implemented in high-risk areas as a part of the disciplinary process, or where peer review is not introduced.
- (3) Confidentiality remains an issue where a firm is unwilling to co-operate. However, where a serious case has arisen requiring review, the profession could possibly, in that event (subject to legal clarification), consider action against individuals working at that firm, which would be a strong incentive for the firms to co-operate.
- (4) All procedures for the conduct of a compulsory practice review would need to conform with the requirements of natural justice and relevant statutes, such as the Human Rights Act.

- (5) It is likely that the JMU could be contracted to undertake any compulsory practice reviews in accordance with some agreed procedures, and they, in turn, could sub-contract some of this work to members of the profession appointed by them. Under the revised recommendations in this paper, a relatively low number of such reviews is anticipated.
- (6) Consideration would be needed over who should meet the cost of any compulsory reviews, and whether these should be the individuals concerned, their firms, or the profession, either as a whole or in part (e.g. those with practising certificates).

#### *A.6.2 Actuarial Audit Recommendations*

Actuarial audits should be encouraged on a voluntary basis, where appropriate. This process should be reported in the senior actuary's report. An example of a suitable generic actuarial audit form can be found at Appendix C.

#### *A.7.3 Individual Questionnaires Recommendations*

Following consultation, the Working Party recommends:

- (1) that questionnaires with suitably 'open' questions are drafted by individual practice boards as an *aide-mémoire*, and for completion on a voluntary basis by individual actuaries;
- (2) that actuaries are encouraged to complete these on a voluntary basis, to discuss any professional issues arising with other actuaries in their firm (or with a member of the PAB, as appropriate), and to send any comments or suggestions for clarification of guidance notes to the relevant practice board;
- (3) that these questionnaires (or similar), with a range of appropriate 'open' and 'closed' questions, are drawn up and issued to applicants for Practising Certificates each year; and
- (4) that the questionnaires referred to in ¶A.7.3(3) are monitored by the secretariat, and that any cases of possible non-compliance brought to the notice of the Practising Certificate Committee.

A generic example can be found at Appendix D. This will require to be customised by relevant practice boards.

#### *A.8.4 Senior Actuary Report Recommendation*

A Senior Actuary report, along the lines set out in Appendix E, would be requested of all Senior Actuaries. Where a firm employing actuaries has no-one with that title, they would nevertheless be encouraged to ask a senior member of the profession to submit a report along these lines.

*A.10 Other Recommendations*

As a result of its discussions, the Working Party made the following further recommendations:

- (1) Consideration should be given to reclassifying guidance notes in the light of their status regarding monitoring. The current moves to improve the style of guidance notes, to take into account feed back on their interpretation, should be strengthened.
- (2) Applications for Practising Certificates should include a question about monitoring compliance.
- (3) A review of the disciplinary arrangements would be appropriate, so that there is a clearer mechanism for dealing with 'modest' misdemeanours, so that they are neither ignored nor subjected to the full rigours of the disciplinary system as appropriate for more serious cases.
- (4) The Professional Affairs Board should oversee the documents produced by the practice boards, to ensure consistency among them.
- (5) The Professional Affairs Board should also set up a Standing Committee, to oversee procedures, and a Compliance Questionnaire Committee (separate if necessary). The secretariat needs to budget resources to run the committee and other aspects of the regime outlined, including production of the standard materials referred to above. The Charter Rules and Byelaws Committee should consider what changes would be required by the new arrangements.
- (6) The Professional Affairs Board needs to consider how to manage and monitor the progression of the recommendations.

APPENDIX B

**(DRAFT) GENERIC COMPLIANCE REVIEW FORM**

*In preparing the standard form for a particular task, a Board should appropriately replace the working in italics, particularly the reference to specific Guidance Notes (GNs)*

**The wording in heavy type are reminders to the points to be taken into consideration in carrying out the review**

1. Nature of document being reviewed *e.g. report on GN22 expense factors; report on transfer value basis*
2. Client's name and reference
3. (a) Name of report's author  
(b) Name of actuary who will sign report
4. Name of reviewer
5. Comments on draft report
  - Objective (**clearly stated?**)
  - Data (**summarised?**)
  - Assumptions (**stated and explained?**)
  - Presentation of rationale (**clearly stated?**)
  - Conclusions (**stated? are they reasonable?**)
  - Reader friendly (**in all the above, is the material pitched at the right level to be understandable by the reader?**)
6. Professional guidance

Have you any reason to believe that the work is not in accordance with GN . . . and the Professional Conduct Standards (PCS) issued by the actuarial profession?

## APPENDIX C

### (DRAFT) GENERIC ACTUARIAL AUDIT FORM

*In preparing the standard form for a particular task, a Board should appropriately replace the wording in italics, in particular the reference to specific Guidance Notes (GNs)*

**The wording in heavy type are reminders as to the points to be taken into consideration in carrying out the review**

1. Nature of file being reviewed, e.g. *GN22 assumptions; XYZ C Ltd Pension Scheme*
2. Client's name, address and reference
3. Name and capacity of actuary responsible for file
4. Name of actuary leading team (if any) carrying out audit
5. File record
  - general appearance. **Is filing up to date? Is it chronological? How are faxes and e-mails recorded? Were deadlines met — if not, was explanation give to client?**
  - summary of contents
  - summary of earlier work
  - cross reference to other relevant files
  - reports in last twelve months. **Was ToR agreed? Was a plan of action drawn up? Is there evidence that work was checked? Were peer review procedures followed? Was any advice given over the telephone? If so, was it confirmed?**
6. Pre-report contact

What contact was made with the client prior to the report? **Was this by correspondence, telephone or attendance at meeting? If the latter did actuary attend? Was actuary accompanied by any other actuaries or member of staff? If so, what were their involvement with client?**

Were any meetings documented and client sent copy of meeting minutes?

7. Content of report in last twelve months

- Objectives (**clearly stated?**)
- Data (**summarised?**)
- Assumptions (**stated and explained?**). *Detailed questions will be required for each practice area and the various tasks within each area, e.g. in the life office area — solvency valuations, embedded value assessment, pricing, etc. These will need to be developed by the relevant Practice Board.*
- Checks on calculations. **Were dates of calculations recorded? Were any crosschecks carried out at the time of report?**
- Presentation of rationale of method and approach used (**clearly tested?**)
- Conclusions (**clearly stated?**)
- Was report prepared in accordance with any timetable?
- Did report refer to profession's guidance? Was the work in accordance with GN . . . and PCS?

8. Follow up to reports

- What contact was made following issue of report?
- If meeting took place, did actuary signing off the report attend the meeting? If not, why not? Who else attended? What was their previous involvement with the client?
- Was further work carried out as result of any meeting? Did this conform to standards?

# APPENDIX D

## GENERAL COMPLIANCE QUESTIONNAIRE

Name \_\_\_\_\_ ARN \_\_\_\_\_

### 1. Peer Review

In the last 12 months:

- |     |  |        |
|-----|--|--------|
| 1.1 | Has your work been subject to peer review?   | YES/NO |
| 1.2 | Was the reviewer in some or all of the cases one of your colleagues?                   | YES/NO |
| 1.3 | Was the reviewer in any or all of the cases employed by another firm?                  | YES/NO |
| 1.4 | Have you issued any advice without a peer review where one would normally be required? | YES/NO |
| 1.5 | If so, did you record this in the advice document along with your reasons?             | YES/NO |

### 2. PCS and GNs

- |     |  |        |
|-----|--|--------|
| 2.1 | Did all your reports meet the requirements of the PCS in terms of level of disclosure, etc.? | YES/NO |
| 2.2 | Did your reports meet the requirements of mandatory guidance, where appropriate?             | YES/NO |
| 2.3 | If no, what steps did you take in the appropriate cases?                                     |        |

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- |     |  |        |
|-----|--|--------|
| 2.4 | Did your reports meet the requirements of non-mandatory guidance, where relevant?        | YES/NO |
| 2.5 | If no, did you disclose that fact in your advice?  | YES/NO |
| 2.6 | Have you had difficulties interpreting any of the PCS or GNs in the last year?           | YES/NO |
| 2.7 | If 'Yes', please give details. Suggestions for improvements to the guidance are welcome. |        |

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APPENDIX E

**(DRAFT) STANDARD SENIOR ACTUARY REPORT**

The Report, to be signed by the Senior Actuary of the Company or Firm, shall state, if such be the case:

1. that procedures are in place to monitor compliance with the professional Guidance Notes applicable, as detailed in the attached documents;

*Copies of the Company's or Firm's monitoring procedures are to be appended.*

2. that he has drawn the CPD requirements of the profession to the attention of all actuarial staff within the Company or Firm.

If the Senior Actuary is unable to make any of the above statements, he should explain the circumstances and, if appropriate, append a plan by which procedures will be put in place to resolve deficiencies.

In addition, the Senior Actuary is invited to comment further on the above issues or other professional issues if he so wishes.