

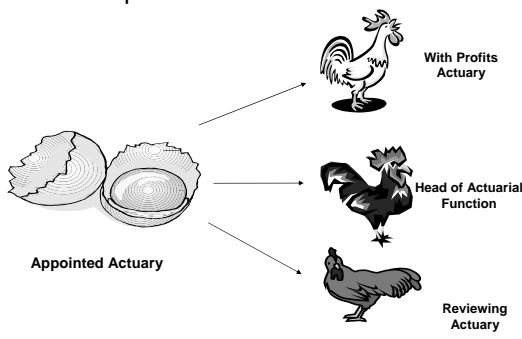
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CILA 2005

Role of Advisors: feedback from the big four

Derek Wright	Deloitte
John Jenkins	KPMG
Shayne Deighton	Ernst & Young
John Cummings	PwC

CP 167 Proposed



Appointed Actuary

With Profits Actuary

Head of Actuarial Function

Reviewing Actuary

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What changed in 2004? – scope of audit

The Audit Report PS04/16 [Appendix 9.6.4]

The report required by rule 9.35 must, in addition to any statement required under rule 9.35, state:

- (a) whether, in the auditor's opinion;
- (i) the documents referred to in rules 9.12, 9.13 and 9.14, together with Forms 40 to 45, 48, 49, 56, 58 and 60 and the statements, analyses and reports annexed pursuant to rules 9.24 to 9.27, 9.29 and 9.31 have been properly prepared in accordance with the *Accounts and Statements Rules* and *PRU*; and

What changed in 2004? – scope of audit

The Audit Report PS04/16 [Appendix 9.6.4] (continued)

- (ii) the methods and assumptions determined by the *insurer* and used to perform the *actuarial investigation* (as set out in the valuation reports) appropriately reflect the requirements of *PRU 7.3* and *7.4*.
- (b) that, in accordance with rule 9.35(1A), to the extent that any document, Form, statement, analysis or report to be audited under rule 9.35(1) contains amounts or information abstracted from the *actuarial investigation* performed pursuant to rule 9.4, the auditor ***has obtained and paid due regard to advice from a suitably qualified actuary who is independent of the insurer.***

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Reviewing Actuary's opinion

In my opinion

- The methods and assumptions used by the Company to calculate the mathematical reserves appropriately reflect the requirements of PRU 7.3;
- The methods and assumptions used by the company to calculate the "With-profits insurance capital components" ("WPICC") appropriately reflects the requirements of PRU 7.4;
- The statements made in the realistic valuation report prepared under rule 9.31(b) of IPRU(INS) (Valuation reports on long-term insurance business) are made in accordance with the requirements of Appendix 9.4(A) of IPRU(INS); and
- Nothing has come to my attention to indicate that Forms 18, 19, 48, 49, 56, 58 and 60 (and any other forms where the auditors have agreed to place reliance on the work of the actuary) (including the supplementary notes thereto) do not fairly state the information required by IPRU(INS) and PRU or have not been properly prepared in accordance with the provisions of IPRU(INS) and PRU.

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So what was different?

- Scope wider
- Realistic Balance Sheets
- Compliance with rules, not "true & fair"

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What did this mean?

- The Reviewing Actuary had to
 - consider controls over the data used by the valuation process
 - be able to demonstrate to the auditor that each of the assumptions satisfies regulations / best practice
 - be able to demonstrate to the auditor that the valuation methodology satisfies regulations / best practice
 - consider the results produced by the chosen valuation methodology in order to advise the auditor on the reasons for variation in the results from prior periods taking into account changes in methodology and assumptions from period to period

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How did it go?


- Insufficient documentation
- We got there – just!
- More management letter points than normal

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The rest of this session

- Controls / processes John Jenkins
- Technical issues Shayne Deighton
- Was it a success? John Cummings

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Controls / processes
John Jenkins

Overview

Processes

Controls

Analyses


Reconciliations

Documentation

- All key to preventing errors going undetected
- Actuaries traditionally not so hot in these areas as accountants

BUT

- Calculations now much more complex:
 - Asset shares
 - Stochastic modelling
- Plenty of scope for things to go wrong
- Having proper processes, controls, analyses, reconciliations, documentation will reduce the risk



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Feedback from 2004 year-end

- All four main audit firms had similar experiences
- Dry runs during 2004 proved essential
- Year-end went off well for the most part
- But "skin of the teeth" in some cases

However

- Some errors now emerging across the industry
- 2005 timescales tighter e.g. due to FRS 27

➔Need to look carefully at processes, controls etc
➔Learn from experience
➔Continuous improvement



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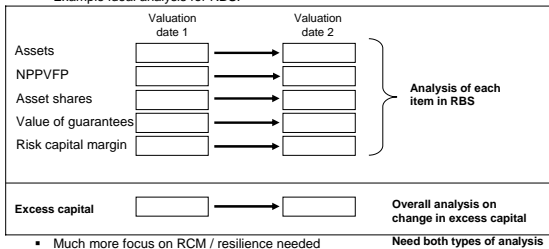
Extract from recently received request for proposal

"The aim of the RFP is to improve the current UK Life Finance and Actuarial processes and systems which currently involve considerable manual processing, with a large proportion of time spent in data extraction, data manipulation and manual spreadsheet work including duplication and rework. This results in little time being available for analysis or interpretation of the available financial data. Internal deadlines, within the Finance and Actuarial teams, are missed creating additional pressures on the teams' ability to meet external deadlines."

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Analyses - comments / suggestions

- Extent varies considerably for both Peak 1 and Peak 2
- Example ideal analysis for RBS:



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Process - comments / suggestions

- Look at which parts take the time
- Educate key actuaries on materiality – common sense approach
- Have proper process flow diagrams
- FSA returns:
 - Produce forms 51 / 52 / 53 / 54 as you go
 - Allocate responsibility for all forms
 - Have proper version control
 - Too much reliance on Formsgen or FSAssist
- Spreadsheets:
 - Too many
 - Can be dangerous
 - No hard coded adjustments
- Staff:
 - No holidays until after 31 March!
 - Control exam study leave, particularly for March 2006

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Controls / reconciliations - comments / suggestions

- Again extent varies widely
- Large number of checks / reconciliations which can be done
- Many errors would be spotted by simple checks
- For example:

No.	Control
1	Analysis of surplus - Peak 2 (pre and post-RCM test). Confirm that residual amounts in the analysis of surplus are a small percentage of overall surplus
2	Reconciliation of Peak 2 liabilities (opening balance to closing balance) (including with-profit benefit reserve, and cost of guarantees and options) (this may effectively be included in the above reconciliation)
3	Analysis of surplus for the present value of future profits
4	Analysis of asset share movements (from start to end of period)
5	Compare revenue items in asset share calculation with equivalent accounting information (premiums and expenses). We would not expect that this reconciliation is performed exactly, but rather that the comparison of these items is reasonable at a high level
6	Comparison of units held by investment managers compared to valuation records

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Controls / reconciliations - comments / suggestions (continued)

No.	Control
7	Data from investment administration system should reconcile to accountants' Trial Balance
8	Calculate asset shares independently for sample policies.
9	Check on the investment return allocated to asset shares, based on the information contained in Form 40 (revenue account, with non-profit business removed)
10	High level reasonableness check on total (movement in) asset shares from start to end of period, using total premiums, total expenses charged to AS in FSA return section 9.4a etc
11	Benchmark against appropriate indices the return on assets in with-profits fund (including the estate), as a check on the calculation
12	Independent sample policy checks of the cost of guarantees calculation
13	Comparison of FSA option value table for reasonableness relative to last valuation
14	High level reasonableness check on unit price movement during period using appropriate indices
15	Any cost of guarantees is split into intrinsic value and time value and the reasonableness of this split is assessed


NB: This list is not exhaustive

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Documentation - comments / suggestions

- Often put at bottom of pile
- Use time outside valuation period to improve this
- Will help to flush out issues
- Will help when staff change
- More user guide than "on bookshelf"
- Clear documentation of assumptions:
 - best estimate
 - MADs
- It's a requirement of FSA rules!

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Technical issues

Shayne Deighton

Difficult technical issues


- Tricky but glamorous new stuff
- Boring bits of Peak 2
- Old chestnuts in a new light
- Rules and guidance



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Tricky but glamorous

- Audit trail on options and guarantees
- Choice of model points
- Convergence
- Inadequate closed form testing



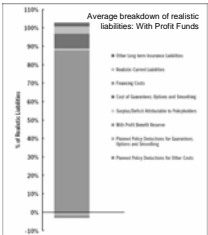
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Tricky but glamorous II

- ESG Issues
 - Lack of understanding
 - Option values
 - Zero vol files
 - Zero vol fixed interest
 - Rejected scenarios
- Policyholder behaviour
- Management actions
- Surplus in a closed fund

Boring bits – asset shares

- Historical audit problem
- Investment returns
- Reconciliation to revenue account
- Problem business



Old chestnuts

- MAD's
- Discretionary benefits in Peak 1
- Credit risk (including reinsurance)
- Asset mix in resilience
- Allowing for tax

Rules

- Contingent and interfund loans
- Pensions deficits
- Market consistent guarantees in Peak 1
- Cash flow matching
- How to fill in the forms!

Was it a success?

John Cummings

Was it a success?

"The valuation of liabilities is fundamentally important to the financial condition of life insurers. We consider that directors ought to satisfy themselves on these matters and that they should be brought within the scope of the audit."

CP 167

- Wide range of outcomes

Governance

- Did boards engage?
 - Bigger firms / smaller firms
 - External actuaries
- Difficult for directors to challenge actuaries
 - Complex and subjective work
 - Speak a strange language
 - Actuaries have to help!
- A way to go

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Systems and controls

- Roles:
 - Management: to calculate and certify the numbers
 - Auditor: to opine with reasonable assurance that the returns have been properly prepared
- Weaknesses in basic systems and controls
 - Documentation
 - Testing
 - Spreadsheets
- A way to go

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Relationships

- Very difficult process
- A number of difficult discussions
- Disagreed without being disagreeable?
- Lessons for peer review?
 - Well defined rules/guidance
 - Obvious sanctions

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Success?

- The challenge
 - Actuarial functions under strain
 - New rulebooks / technology / roles, responsibilities
 - First audit against rules and guidance
- Not surprising there were some problems
 - Few qualifications – but several “discussions” and lots of management letter points
- Quite a squeeze – but made it!

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Extreme auditing

- Still work to do
 - Systems development
 - Analysis of working capital
 - Management actions
 - ...
 - Governance, systems and controls, ...
- Please, get it done (and audited) before the year end!

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