

## A SINGLE EUROPEAN MARKET FOR ACTUARIES

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### 1. SETTING THE SCENE

1.1 1992 has become a symbol. A symbol of change in a Europe which feels itself threatened by the economic might of America in the West and Japan in the East. 1992 really does mean that millions of people, despite wide gulfs of language and culture, and a history of often bloody conflict between them, are making one more effort of collective will to club together in the belief that the one thing they have in common, geography, is sufficient reason to disguise differences and create a powerful economic union for the greater benefit of European suppliers and consumers.

1.2 In any period of major change there will be winners and losers. The objective in seeking a single European market is to benefit European consumers. However, sometimes the result of major change does not live up to the best intentions held at the outset. Some would argue that the Financial Services Act is a case in point. Actuaries, particularly in the United Kingdom and Ireland, have for two centuries and more played an important rôle in protecting and promoting the interests of life assurance consumers. Our responsibility in this area is needed now, in the European context, as much as ever before. The more that the profession is seen to influence new legislation and events to the greater benefit of consumers, the more its reputation and stature will be enhanced. It is perhaps even more important that the legislative and supervisory framework in Europe should recognize that actuaries should play this important rôle in the future.

1.3 This paper has been produced by a working party set up by the Institute of Actuaries in December 1988 with active encouragement and involvement from the Faculty of Actuaries. The first stage of our work was to gather information on current actuarial involvement in life assurance supervision and control, statutory and non-statutory, in the 12 countries of the European Community ('the E.C.'). The results of this research are given in the Appendix. The paper draws on this research and aims to set the scene for a debate on the future involvement of the actuarial profession in a 'harmonized' European life assurance industry.

1.4 It was never our intention to extend the scope of the paper to actuaries working in the pensions field, although the legislative changes which presage

harmonization of life insurance might be an important precedent for pensions legislation. We did carefully consider extending the scope to non-life insurance. However, apart from noting that actuarial certification of non-life reserves is already a statutory requirement in Italy and has been provided for, but is at present not insisted upon, in the Netherlands since 1985, although it will be a requirement by 1995, we have in the event restricted the paper to life assurance considerations. The gaps left by this paper in both non-life insurance and pensions might usefully be the subjects for research by others.

1.5 The content of the paper follows the major headings under which each country's practice is summarized in the Appendix: Methods of Supervision; Premium Rates and Product Design; Reserving Bases and Profit Participation; Investments; and the Statutory and Professional Position of Actuaries. However, before turning to these specific areas we make a few general points.

1.6 The first point to note is the wide diversity of practice. Some of this could already have been gleaned from the National Reports to the last two International Congresses of Actuaries.<sup>(1)</sup> For the Sydney Congress in 1984 nine of the 12 E.C. countries (excluding Luxembourg, Portugal and Italy) submitted reports on the environment in which actuaries work, with particular reference to relationships with governments and other professions. For Helsinki in 1988 seven countries (further omissions being from Greece and Spain) reported on "the present situation concerning the status and duties of an actuary and also opinions on how these will develop in the near future and whether the development corresponds to the aims of the national organization and/or the aims of the actuaries themselves". A paper by the Faculty of Actuaries European Research Group in 1984 on Life Assurance in Four European Countries has also provided much information on current practices.<sup>(2)</sup>

1.7 In 1984 the British delegation to Sydney reported that the principle of 'Freedom with Disclosure' was already under scrutiny and being modified although it still had an appropriate (sic) part to play in the British insurance regulatory system. One might now ask whether its death knell had already been sounded by adoption of the theoretically questionable position of a minimum net premium valuation basis allied to market values of assets. This was accepted at the time as the least onerous response to the need for a minimum valuation basis to add to the explicit solvency margin required following the First Life Directive in 1979.<sup>(3)</sup> It is worth remembering at a time when new E.C. Life Directives are on the horizon that this minimum valuation basis, with which many actuaries are still uncomfortable, came in as a result of E.C. legislation. The Financial Services Act has knocked several more nails in the 'Freedom with Disclosure' coffin. What we now have is more controls, less freedom and more disclosure. Freedom with Disclosure is not yet dead in Britain, but it is wounded and its proponents need to prepare their arguments for defending it; never more so than now as the debate to find common methods of insurance supervision gets under way in the E.C.

1.8 The Irish system is similar, but not identical, to the British. Irish insurance

legislation has always tended to follow that in Britain after an interval for reflection and improvement. The only other country where there has always been substantial freedom in relation to premiums, investments and reserves, is the Netherlands. This is still the case, but the Dutch actuarial profession is not as strong as it would like to be. Despite the arduous practical and academic training of Dutch actuaries they are still not recognized by law. Anyone can call himself an actuary in the Netherlands and the Dutch actuarial association is taking steps to try and achieve an improvement to the status of Dutch actuaries. To this end a Code of Conduct was introduced in 1984.<sup>(4)</sup>

1.9 Despite these differences, one can argue that in the U.K., Ireland and to some extent the Netherlands a liberal system of supervision of insurance operates effectively because it is backed by the knowledge that a strong actuarial profession will act as guardians of the public interest. At the other extreme lie West Germany and the Scandinavian countries. The guiding principle there is one of tight supervision on conservative bases as the best means of protecting consumers. Hitherto, the supervisory laws and regulations have left little room for variation in products. All companies must use the same premium bases, invest their funds the same way, calculate their reserves the same way and distribute profits the same way. Competition is restricted to the proportion of profits and the rate of profits distributed. In this environment there is little scope for actuarial judgement and the actuary in West Germany (literally an insurance mathematician) has a supervisory rôle akin to a mathematical compliance officer rather than a fully-fledged professional in the British sense of the word.

1.10 France and some of the other Latin countries have systems of supervision which are becoming more liberal. Often this is not so much a change in the law or the regulations but a lighter touch by the supervisory authorities and greater inventiveness in the market-place. In France, for example, there are still rules to govern the premium rates and reserves of ordinary branch business but 'open groups' and other innovations are all outside the categories of insurance covered by restrictive legislation. Considerable freedom exists in practice. This greater freedom will doubtless result in greater disclosure and actuaries ready to play a fuller rôle involving professional judgement.

1.11 The European Commission is faced with the daunting task of creating a single European market for insurance. The objective is not in question and the Commission is committed to giving consumers access to a very wide range of products which can be purchased and sold anywhere in the E.C. Freedom of services was a principle enshrined in the Treaty of Rome. As early as 1974, the European Court of Justice declared that the right to freedom of services was directly applicable as from the end of 1969.

1.12 The difficulty is that some countries have argued that they have a duty to protect their policyholders which overrides their duty to allow freedom of services. Their argument was substantially upheld when the European Court delivered some important judgments on 4 December 1986. The main judgment (case 205/84 Commission v Federal Republic of Germany), while confirming

that the requirement of establishment was contrary to the Treaty-given freedom to supply services across frontiers, nevertheless ruled that insurance was a sensitive area and that, until there was more harmonization, countries were entitled to protect their citizens by requiring insurers to be locally authorized and to comply with local supervisory rules, including those relating to the constitution of technical reserves, the representation of those reserves by appropriate assets, the localization of those assets and general and special policy conditions.

1.13 The Single European Act, which came into force on 1 July 1987, officially enshrines the commitment of the E.C. to achieve a single internal market by the end of 1992, but the Commission is still hampered by the December 1986 judgments and unable to meet that deadline for insurance. Their quest (encapsulated in §3.2.1) is not total harmonization, which is widely regarded as being an impossible and probably undesirable goal, but rather sufficient harmonization to allow 'home country control based on mutual recognition of standards'. However, they are now obliged to adopt a phased approach whereas a single freedom of life services directive had previously been envisaged.

1.14 It is against this background, and in the light of the forthcoming liberalization of capital movements, that the proposed Second Life Directive<sup>(5)</sup> will only allow consumers to buy across borders but not allow insurers to sell across borders except on the same basis as for establishment. This Directive could come into force by the end of 1992. It would cover individual insurance and deliberately excludes 'life mass risks' and 'group pensions'. It is intended that the latter be covered by a Third Life Directive with a target date of 1993. The target for life mass risks seems optimistic.

1.15 True freedom of services, i.e. the right of insurers to design products and meet supervisory standards which are subject to home country control and to sell those products freely throughout the E.C., will therefore be left to a Fourth Life Directive. That Directive cannot realistically come into force before the end of 1992 but there is a possibility that the Commission will make a proposal for such a Directive by that date.

1.16 The major problems to be addressed before such a Directive could come into effect are:

- (i) whether national taxation differences on premiums, the investment income of life funds, and policy proceeds, as well as tax relief on premiums, need to be reduced or eliminated;
- (ii) what controls, if any, can each country impose on the sale and marketing of life assurance products which are not locally supervised; and
- (iii) what are the minimum standards of supervision necessary to permit the principle of home country control subject to mutual recognition of standards.

1.17 It is the last of those three which represents a potential danger both to the British insurance industry and to the actuarial profession. Mutual recognition will be better than harmonization, but the danger is that it may only come about

if there is agreement on minimum reserving bases and, arguably, premium rates. Agreement may also have to extend to asset restrictions. Given the diversity of current practice in the 12 countries, a consensus is likely to mean a measure of convergence which, for the U.K., Ireland and the Netherlands, would mean stronger minimum valuation bases and premium rates and hence greater implicit margins. If this were to happen market forces in these countries might well dictate that the minima become the maxima and then all offices would use the same valuation and premium bases. Were this to happen, there would be no need for actuarial judgement in relation to valuation and premium bases for statutory purposes. Neither, it is argued, would consumer interests be best served. It would also mean that the work and professional status of the British actuarial profession would be severely diminished for future generations of actuaries.

1.18 Conversely, if the European norm were to be based on the British model then it is argued that consumers would be better served in several E.C. countries and, at the same time, the work of the actuarial profession there would be enhanced. We believe that actuaries from these countries would welcome such a move.

1.19 By comparing the current position in each of the 12 member states this paper aims to provide a basis for informed discussion as to which scenario might arise in a 'harmonized' European life assurance market. We believe that the British system is under threat and that arguments therefore need to be advanced as to why the British insurance industry is strong, and its policyholders in particular have benefited, as a result of our native system of Freedom with Disclosure backed by a reliance on the quality of actuarial judgement to protect policyholders.

## 2. METHODS OF SUPERVISION

### *2.1 The Level of Statutory Control and its Impact*

2.1.1 In the member states of the E.C., insurance business is supervised by one or more of the following means:

- (i) statute (Acts and associated Regulations);
- (ii) professional codes of conduct; and
- (iii) industry codes of practice

2.1.2 The balance between these supervisory methods varies markedly from state to state, but the fundamental objective of all supervisory regimes is the protection of the policyholder—the consumer.

2.1.3 Protection of the consumer is generally achieved:

- (i) by establishing and monitoring minimum standards of financial management (including minimum standards of solvency);
- (ii) by defining acceptable standards and styles of marketing; and
- (iii) by ensuring, as far as possible, that the consumer is properly and adequately advised as to the nature of the product being purchased.

2.1.4 The level of supervisory control influences the whole nature of the insurance industry within the state. The freer the control the wider tends to be the range and diversity of products and hence the choice to the consumer. But, it could be argued, the freer the control the greater the risk to the consumer that his contractual obligations might not be fulfilled due to the financial inadequacies of the insurer. In practice, if minimum standards of solvency are prescribed and policed, and if the professional managers of the industry, including actuaries in particular, have high and strong professional standards, the risk of contractual obligations not being fulfilled should not be material, while consumer choice is maintained.

2.1.5 Johnston<sup>(6)</sup> referred to a 'double harness' system with the regulatory authorities and the profession pulling together, and with significant responsibilities devolved to the actuarial profession. He pointed out that the underlying reason why other countries are considering such a system is that the rigid regulatory systems which are in force cannot cope with the variety of products now on the market, nor with swift changes in the investment scene. Actuarial discretion is seen as the key to a more flexible system, provided that the professional arrangements are such that the regulators can have confidence in the system.

2.1.6 The impact of the supervisory regime on the insurance industry within the state can be illustrated by two extremes.

2.1.7 Insurance business in West Germany is primarily supervised by detailed statute. There is material control of all major items of an insurance company's activities. Statutory supervision is carried out by the BAV, a government department which has existed for over 100 years and which has built up a considerable volume of rules, guidelines and precedents. The overriding aim of the BAV is to protect the interests of policyholders. In simple terms, the BAV achieves this primary aim by applying three main principles:

- (i) ensuring that no company can become insolvent, by insisting upon very cautious premium bases, valuation bases, etc.;
- (ii) ensuring fair and sufficient distribution of the large surpluses and profits which emerge as a result of the cautious bases;
- (iii) standardizing policy conditions in order to achieve as much clarity for the potential customers as possible.

2.1.8 In order to implement these principles, no product may be sold in West Germany before all important items, including premium bases, valuation bases, policy conditions, surrender bases and bonus distribution methods, have been submitted (in the form of a very detailed business plan) to the BAV and approved by it. Mortality, morbidity and interest rate assumptions are laid down by the BAV, and there is little scope for discretion in regard to expense loadings. Indeed, the BAV publishes standard business plans which ensure approval of a product with a minimum of delay. The only significant decision left to the company is the

method and level of bonus distribution and even this is subject to close scrutiny by the BAV.

2.1.9 From this climate of detailed and comprehensive statutory supervision has emerged a market which is heavily standardized and in which there is little product differentiation. The dominant life product, by far, is the classical with-profits endowment assurance. '*Transparenz*' is the catchword and clarity and simplicity of choice for the consumer have been achieved by extensive standardization. Simplicity of choice has almost become no choice.

2.1.10 Standardization by state control, and the absence of consumer choice, has left little or no room for actuarial judgement and the profession in West Germany suffers as a result.

2.1.11 At the other extreme is the U.K. Statutory supervision concentrates upon the initial authorization of companies (and subsequent authorization of new classes) and annual scrutiny of prescribed returns which show the company's financial position at a point in time. Within the statutory framework substantial discretion is given to the Appointed Actuary and to the managers of the business with regard to premium rates, product design, reserving bases, surrender bases and other factors. But this substantial discretion carries with it substantial responsibility and obligation, particularly for the Appointed Actuary, and the status of the actuarial profession is accordingly enhanced.

2.1.12 From this climate of freedom of business management and development, provided that the financial condition of each company satisfies certain minimum standards, has emerged an innovative insurance industry providing an immense range of products for the consumer.

2.1.13 It should be noted, however, as a cautionary point, that recent financial services legislation in the U.K. has been more detailed and comprehensive, although there have been moves of late to mitigate some of the excesses. The rules and regulations imposed by the acronymic offspring of the Financial Services Act 1986 (SIB, LAUTRO, IMRO *et al.*) have been much more precise and detailed than those imposed under the Insurance Companies Act and other statutes affecting the industry.

## *2.2 The Rôle and Influence of the Actuary in the Supervisory System*

2.2.1 Across the E.C. the rôle of actuaries in the supervisory system varies widely, and a distinction should be drawn between the supervisory actuary and the company actuary.

2.2.2 As already stated, West Germany has the most heavily supervised insurance industry in the E.C. The supervisory authority, the BAV, is largely made up of actuaries and lawyers. In the U.K., where professional discretion and obligation form a significant part of the whole system, the supervisory authority is advised by a government department which can be viewed as a consulting actuary to government.

2.2.3 Between these extremes of actuarial involvement in the supervisory authority lie the other member states. Two are worthy of particular mention.

2.2.4 In Ireland the authorities have tried for some years without success to bring actuaries into the supervisory areas, and have resorted to obtaining actuarial advice on a consultative basis from time to time.

2.2.5 In France there is a body of external insurance commissioners (the *commissaires contrôleurs*) who are high level civil servants attached to, but not part of, the government department responsible for supervision of insurance. The external commissioners, of whom about half are actuaries, play a rôle which is in some ways analogous to that of the Government Actuary's Department (GAD) in the U.K. An interesting feature is that the *commissaires* practice a '*contrôle sur place*', that is to say they systematically visit insurance companies in order to report on compliance with regulations laid down in statute or in circulars from the supervising department.

2.2.6 Turning to the statutory duties of the company actuary in the total supervisory system, in those member states which are subject to detailed and precise statutory supervision, the statutory duties of the company actuary comprise little more than the calculation and certification of premium rates or reserves using prescribed formulae and assumptions. In some instances, for example in West Germany and in Italy, the responsibility is simply to certify that reserve calculations have been carried out correctly. In these member states, as stated in the introduction, the company actuary, in his or her statutory rôle, could be viewed as a 'mathematical compliance officer'.

2.2.7 In the U.K., on the other hand, the statutory rôle of the company actuary appointed under the Insurance Companies Act 1982 is very significant. Supervision in the U.K., and countries such as Ireland, Australia and South Africa which have modelled their legislation on that of the U.K., has developed around a concept of 'delegated supervision'. The approach to supervision in the U.K. has been to avoid detailed all-embracing regulations and instead to concentrate on principles, as far as possible. Concentration on principles in statute allows greater flexibility in the market. This encourages competition and is to the good of the consumer.

2.2.8 The power to interpret and apply the principles in practice is delegated to the 'Appointed Actuary'. This position is defined by statute and has to be carried out by a Fellow of the Institute of Actuaries or Faculty of Actuaries. The Appointed Actuary to a U.K. life office is either employed by the office or is a consultant. In either case he or she would be regularly involved in the financial affairs of the office. An Appointed Actuary is expected to be able to wear many hats at once. Most significantly, on the one hand he or she is a member of the office's financial management team, whilst on the other he or she also has obligations to the supervisory authorities. It is essential for the system to work that the Appointed Actuary is allowed power independent of the company in order to express, if necessary, concerns about a course of action which might jeopardize the security of the office. If not satisfied, the Appointed Actuary must report the position to the Department of Trade and Industry, the supervisory authority for the insurance industry. These responsibilities are spelt out in professional guidance notes.



2.2.9 Responsibility is thus delegated to the Appointed Actuaries and, through them, to the professional bodies. The professions are then able to consider and issue further guidance to members which amplifies the statutory framework. Members are bound to follow such guidance, so this is as effective as statute, provided that the profession's disciplinary procedures are adequate. Unlike statute, changes to professional guidance notes can be made relatively easily, thus allowing the rules to be kept up-to-date with changes in the environment. Professional guidance also ensures that supervisory monitoring by the Appointed Actuary is continuous, rather than being carried out once a year through a perusal of the statutory returns to the supervising authorities.

2.2.10 The key question is: which approach most favours the consumer? As stated earlier, concentration on principles in statute allows greater flexibility in the market, which encourages competition and is for the good of the consumer. However, responsibility cannot be delegated by the supervisory authority unless there is a professional body of sufficient strength to shoulder the responsibility. But, if a detailed and centralized system of supervision has been built up, there is little scope (or need) for such a profession to develop.

### *2.3 Influence of Professional Codes of Practice*

2.3.1 In most of Europe a 'liberal profession' is a loose description relating to all those who have studied and practised a certain skill (such as actuarial mathematics). In the U.K. the term is better defined and, strictly, describes a group granted a Royal Charter conferring certain rights in exchange for accepting certain obligations. The primary obligation is to organize those practising a skill in order better to serve the public by setting minimum standards of conduct and monitoring to see that these are maintained. A profession is also expected to seek to further the knowledge of its members.

2.3.2 In the U.K. the actuarial profession is strong, and has a substantial body of professional code and associated guidance. As a consequence of this tradition and strength, and the respect that goes with it, the actuarial profession plays a key rôle in the supervision of insurance.

2.3.3 In other member states, such as Spain where the actuarial profession and its practice are regulated by decree, or Denmark where a life assurance company must employ an actuary (the Responsible Actuary) approved by the supervisory authority, or Belgium where a royal decree on the practice of life assurance specifies certain jobs which must be done by an actuary, there is again a significant involvement of the actuary in the supervisory process.

2.3.4 At the other end of the spectrum lie West Germany and Portugal. In West Germany there is no statutory definition of an actuary: certification of reserves is carried out by 'mathematical experts', many of whom are not members of the national actuarial association. In Portugal, whilst there is a national actuarial association to which most, if not all, practising actuaries belong, actuaries are not obliged to be members and the statutory duties of actuaries are minimal.

2.3.5 In the Netherlands, where there is no statutory definition of an actuary and the life assurance law provides for the signing of a statement by 'assurance mathematicians', or by the directors' 'mathematical advisers', and where the supervisory authority will, at their discretion, accept statements by a person other than an actuary, there is great concern amongst actuaries about the status of the profession. A new professional code was introduced in 1984 as the first step in the process to enhance the status of actuaries. In due course, the profession in the Netherlands hopes to gain statutory recognition, and this is the ultimate aim.

## *2.4 Impact of Industry Codes of Practice*

2.4.1 Consideration of the methods of supervision of the insurance industry would be incomplete without including the impact of industry codes of practice which play a part, often a major part, in the control of the insurance industry. The practice across the member states is diverse, ranging from the U.K. with a number of industry codes, for example, those issued by the Association of British Insurers and the Council of Lloyds, through to countries such as Portugal and Greece where industry codes are apparently few, if any. Between these extremes come countries such as Denmark where premium rates are determined by cartel, which involves consensus agreement between the authorities and the industry, and Italy, where premium rates are determined by the Association of Insurers (ANIA) using the technical bases allowed by the supervisory body, the ISVAP.

2.4.2 It might be reasonable to expect that an industry which establishes self-regulatory systems through codes of practice would experience a lighter level of statutory supervision. Whilst this appears to be generally true, there are some interesting exceptions, including the U.K., where, despite the existence of a significant body of industry codes of practice developed over periods of years through a number of bodies, the Financial Services Act 1986 created a self-regulatory regime which has adopted detailed statutory regulations to enforce various codes of practice.

2.4.3 Industry codes of practice are currently, or will shortly be, under scrutiny by the Directorate General of the European Commission which deals with competition (DG IV). Industry codes of practice will be removed or changed if they are not considered to be in the interests of the consumer.

## **3. PREMIUM RATES AND PRODUCT DESIGN**

### *3.1 The Issues*

3.1.1 Are consumers better off where there is substantial freedom in the design of life insurance products or do they need protection through a considerable degree of standardization in product terms and conditions?

3.1.2 E.C. competition law is generally against industry or cartel agreements which are anti-competitive. Should life assurance be any different?

### 3.2 *E.C. Position*

3.2.1 W. F. Pool, who retired at the end of 1988 as Head of Insurance in DG XV, the Directorate General which deals with Financial Institutions and Company Law, has stated that:

“the aim is to create a single internal insurance market for the Community having the following characteristics:

Insurance companies situated in any one member state must be free to set up branches in any other member state, but must also be able to sell the full range of their products throughout the Community, from any base wherever situated, without having to use branches. Insurers would compete on price, the nature of the product and the service offered, in fair and equal conditions. They would all be subject to essentially the same supervisory rules, applied by separate national authorities; the main purpose of such rules would be to ensure that the insurance undertakings were always able to meet their financial commitments.

The purchaser of insurance, whether business or private, would be able to buy his insurance wherever he liked in the Community. He would have access to a very wide range of products. There would be enough control over selling methods and the nature of the products to protect the public from being led astray, but not so much as to stifle innovation, which would flourish in the competitive atmosphere.

The market would be transparent enough for purchasers of insurance and their advisers to make intelligent choices. Brokers and other intermediaries would not only be free to operate on equal terms throughout the market but would also be motivated to seek out the most suitable insurance wherever it might be in the whole Community. They would be helped by adequate and comparable financial information about all the insurers in the market.

There would be uniform contract law, or, more probably, rules on the choice of law which protected the public and eliminated choice of law as an element of competition.

Premium taxation, if any, and other aspects of taxation bearing upon the attractiveness of insurance would either be uniform throughout the market or at least there would be arrangements to prevent differences in taxation from disturbing competition.

Finally, there would, of course, be no restrictions on the currency movements of any of the parties involved in the transactions.”

3.2.2 The limited scope of the Proposal for a Second Life Directive laying down provisions on freedom to provide services in ‘own-initiative insurance’ is a disappointment to many but not unexpected since progress will depend upon agreement on what should be the minimum supervisory rules. At present there are wide differences in how supervision operates in the member states and in the rôle of the actuary, and these differences must be reduced if progress is to be made.

### 3.3 *Extent of Growing Freedom*

3.3.1 The U.K. and Irish markets are the freest regimes in the E.C. Considerable freedom also exists in the Netherlands, even though there are agreements between the larger companies. There is growing freedom in product design in countries such as France, where the use of open groups provides a means of avoiding tariffs, Portugal where an increasingly open attitude by the supervisory authority permits innovation and Spain where new products can be proposed and if the authority does not object they can go ahead. It is suggested that Belgium may soon allow unit-linked products. Even West Germany, hitherto the most strictly regulated market, now permits a choice of four different expenses loadings, further innovations are being discussed, and the merits of West German life assurance compared with other countries have been debated on television.

### 3.4 *Need for Disclosure*

3.4.1 Freedom has encouraged competition and permitted a greater degree of consumer choice. In order for this to be effective, consumers either need access to information on product terms and conditions in a form they can understand so that they can exercise the choice themselves or they need access to sound advice on what is available.

3.4.2 In an environment of independent intermediaries required to know their customers and to give each 'best advice' suited to his particular needs, this element of consumer choice is real. Even if the consumer cannot identify the significance of differences in product design, the independent intermediary should be able to help him do so or to exercise judgement on behalf of a particular consumer.

3.4.3 A more limited consumer choice exists with exclusive agents, yet even here the agent should have an obligation to match product to customer and disclose product information to help the customer to understand what is being bought or to ask further questions.

### 3.5 *Benefits of Freedom*

3.5.1 The effect of competition upon pricing in some of the markets may be quite substantial. The Cecchini Report on the Benefits of a Single Market<sup>(7)</sup> and an earlier study carried out by the Belgian consumer's association on behalf of the Bureau Européen des Union de Consommateurs,<sup>(13)</sup> both published in 1988, have made comparisons of the cost of term life insurance. These have showed that similar protection costs as much as ten times in one country what it costs in another.

3.5.2 In relation to product design, consumers are not all the same and different products are required to satisfy different needs. The world is changing and innovation in product design is in the interest of consumers and helps to keep insurance companies alive to the needs of their market. Insurance products do not exist in isolation and they have changed in response to influences such as legislation, consumer attitudes, technology, types of investment available to life

assurers and AIDS. These changes have been most marked in markets such as the U.K. and Ireland where maximum freedom exists. However, all markets are now responding to changing consumer demands. For example, attitudes to risk vary across Europe. Many consumers have traditionally been risk averse. Yet, as capital markets become more accessible, attitudes change and, in this context, unit-linked products can be designed to give the consumer a wider investment choice.

### *3.6 Problems of Excessive Control*

3.6.1 If product terms and conditions are laid down by law, such as in Belgium or Greece, or are in accordance with practice acceptable to a government body or cartel, such as in Denmark, Germany or Italy, then consumers are well protected against malpractice but lack the benefits of market forces. Change is slow and consumer choice is narrowed. There is less opportunity for niche markets to develop and for small innovative companies to grow, by being different, where 'the system' does not countenance differences.

3.6.2 Fixed tariffs do not permit companies to reflect lower operating expenses, lower mortality from different target markets, or a different investment policy in their premium rate structure or product design. Some of these differences may emerge via profit participation, but even here a rigid bonus structure may not be flexible enough to cope with changing types of insurance company investment or major changes in investment conditions.

3.6.3 In markets such as the U.K. where insurance company investments are not constrained, and consumers have accepted risk investments, the practice of investing heavily in ordinary shares and property has resulted in enhanced returns for policyholders. Since this involves substantial amounts of unrealized appreciation on the ordinary share and property investments, policyholders have only been able to benefit because accounting systems have permitted this appreciation to be recognized and because bonus systems have evolved via the introduction of terminal bonuses to provide equity between policyholders and to distribute the surplus.

3.6.4 However, a corollary of risk investments serving the long-term interests of the consumer seeking the best return at maturity is that it is inconsistent with guaranteed surrender values. A surrender value basis which is required to be consistent with the premium basis has an element of simplicity but it results in guaranteed surrender values. In changing times this is tenable only if the bases chosen are conservative and there is a severely constrained investment policy. At the very least consumers seeking the best long-term return should be free to choose policies without guaranteed surrender values which hold out the prospect of substantially higher maturity values than those with guaranteed surrender values.

3.6.5 If we consider how detailed controls might be imposed across Europe, some of the difficulties appear enormous. National supervisory authorities would have to agree what the common policy terms and conditions should be. In

Europe there is not yet a single investment market, tax laws or currency to support such a standardized approach. Where current freedoms exist these would need to be reduced or taken away. Consumers would need convincing that competition in product design and pricing should be withheld.

### *3.7 Consequences for the Actuarial Profession*

3.7.1 In some countries freedom of product design and pricing operates to the benefit of consumers, and their security is protected in a competitive environment, because this freedom goes hand in hand with a strong actuarial profession required to ensure the use of premium rates and other terms and conditions which are sound. If freedom of services leads to harmonization in the E.C. based on this principle, then the actuarial profession in certain countries may need to develop its competence, and its influence upon insurance company management, in order to meet additional responsibilities. It may also need greater statutory recognition. It is vital for consumers that proper control of a freer environment takes place and the actuarial profession will need to respond to this challenge.

3.7.2 If, on the other hand, as a result of E.C. harmonization, the freedom in product design and pricing which has been a feature of the U.K. and Irish markets is substantially reduced, then the rôle of the life assurance actuary in these markets will be correspondingly diminished.

### *3.8 Conclusion*

3.8.1 The choice for Europe is simple. Consumers can be allowed to benefit from a market competing freely on product terms and conditions with a strong rôle for the actuary, being able to obtain independent 'best advice' in the exercise of their choice, or being at liberty to make their own 'right' or 'wrong' choice. Alternatively the market can be restricted so that all consumers pay the price of lack of competition by the denial of any real choice.

## **4. RESERVING AND PROFIT PARTICIPATION**

### *4.1 The Statutory Bases for Reserving for Liabilities*

4.1.1. Regulation of reserving exists ultimately to benefit the consumer by reducing the risk of a company becoming unable to meet its liabilities to an acceptably small level. How all-embracing do the statutory regulations have to be to achieve this?

4.1.2 There are two main approaches taken to the supervision of reserving:

- (i) 'Tight Regulation' where most components of the methods and bases to be used are laid down by the supervisory authority. As the rules have to cope with all eventualities, there is a tendency for them to be very detailed and conservative.
- (ii) 'Broad Regulation' where the principles to be adopted and an acceptable minimum standard are laid down. Companies are free to select their own

methods and bases subject to a high degree of public disclosure of their actions.

4.1.3 In both cases it is usual for the actuary to certify the results of the calculations to the Supervisory Authority; in the second case this extends to an expression of opinion on the adequacy of the reserves held.

4.1.4 'Tight Regulation' operates by requiring strong implicit margins within the main valuation parameters, possibly with additional explicit margins against specific contingencies. Many states using 'Tight Regulation' specify that the valuation basis used must be the same as the premium basis, which itself is heavily constrained by regulation. There is little, if any, scope for judgement by the actuary.

4.1.5 As the reserving basis will affect product design it is likely that 'Tight Regulation' will lead to a reduced level of competition within the industry, with less incentive for offices to control expenses given the buffer of high premiums charged. The result is likely to be poorer value for consumers, even where rates of profit participation appear to be generous.

4.1.6 'Broad Regulation', on the other hand, makes use of a statutory minimum standard, with control based around the concept of 'freedom with disclosure'. Substantial returns are required setting out all aspects of the methods and bases used together with the data and the results obtained. These returns are publicly available and the objective is that they should contain sufficient information to allow an independent observer to reassess the results obtained. Under a broader regime of regulation, the actuary might choose to use a basis stronger than the minimum required in some respects, thus creating implicit margins. A nonsense can arise if a mixture of the two cultures is used, where explicit margins are required to be held on top of a freely chosen valuation basis. This will tend to 'squeeze out' the implicit margins, and gradually turn the minimum basis into a statutory one.

4.1.7 There are risks in the 'Broad Regulation' approach. If only principles are laid down, a strong profession is essential to ensure that suitable standards are maintained. This should then minimize the risk that too liberal an interpretation will be placed on the statutory principles by some practitioners, resulting in loss to policyholders.

4.1.8 In the U.K. the second level of control is then provided by the Department of Trade and Industry (the DTI). The Insurance Division of this Government Department is responsible for the monitoring of insurance business carried out in the U.K. With respect to reserving, this control is effected by scrutinizing the Returns provided by each company. The Government Actuary's Department (the GAD) advises the DTI whether they should take any action, and the DTI has various levels of intervention in the business of insurers that it may invoke, ranging from informal discussions with the Appointed Actuary to requiring the company to cease writing new business. There is a close relationship between the profession and the GAD with joint working parties of the Institute,

Faculty and GAD to consider issues of mutual interest, such as possible changes to the reserving regulations.

4.1.9 As a final fall-back measure, further protection to consumers in the U.K. is provided by the Policyholders Protection Act. Broadly this limits the reduction in guaranteed benefits that can be suffered by a policyholder to 10%, subject to a proviso that allows larger reductions if the benefits promised are deemed to have been 'excessive'. To finance claims under the scheme, which covers both life and general insurance business, a levy is made on all offices based on their premium income.

4.1.10 Whilst this approach is designed to minimize the risk of damage to a policyholder's guaranteed benefits, 'Tight Regulation' could be said to be designed to ensure that offices would never fail. As we have shown, however, 'Tight Regulation' is achieved at the cost of choice and performance for the consumer. If the overriding benefit is the avoidance of failure, 'Tight Regulation' would appear better (as it is stronger), but it could be argued that 'Broad Regulation' is likely to allow better value for policyholders with minimal additional risks.

4.1.11 Belgium, Denmark, West Germany, Greece and Italy operate a 'Tight Regulation' system. While there is naturally some variation there is very little room for judgement. In West Germany, for example, it is only necessary for a mathematical expert to certify that the reserves have been correctly calculated according to the relevant bases and methods.

4.1.12 The U.K., Ireland and the Netherlands have 'Broad Regulation' systems. The Netherlands has a minimum basis but, because the taxation rules are related to reserving, this also tends to become the maximum basis as the tax authorities do not encourage over-reserving (as they see it). Thus the Netherlands in practice behaves more like a tightly regulated state. It is possible that, under the newly proposed U.K. tax rules, the U.K. position may become closer to that of the Netherlands.

4.1.13 France, Spain and Portugal fall somewhere between these two extremes. In France the situation is complex as tariff business is regulated tightly but there is an increasing amount of non-tariff business written where the regulations give no guidance at all. It is interesting to note that the mathematical reserves are contained within the scope of the normal accounting audit process. Spain and Portugal used to operate tight regulation but are now moving towards systems of control that allow more freedom of action of the companies and their actuaries.

4.1.14 A peculiarity of the U.K. and of Ireland is the statutory differentiation of the Long Term Business Fund from the Shareholders' Funds. The Appointed Actuary is put in the position of being a guardian of the long term fund, being professionally required to advise the directors before any transfer of surplus is made to shareholders' funds.

4.1.15 It is also worth noting that many actuaries in the U.K. make use of other methods of valuation internally for the financial management of life



offices. While the statutory valuation is almost always prepared using a net premium valuation allied to market values of assets, additional investigations will be carried out using bonus reserve valuations or cash flow projections using model office techniques. These internal valuations will form the basis for the advice given by the actuary to the directors, including advice on the bonuses to be declared.

## 4.2 *A Look to the Future of Reserving*

4.2.1 Looking to the future, we should consider how far the U.K. might go towards a minimum valuation basis in the event of harmonization. The valuation regulations made under the Insurance Companies Act 1982 create an uneasy framework of explicit margins on top of a reasonably freely chosen valuation basis that may itself contain implicit margins if the actuary desires. Competitive pressure may mean that there is a tendency to offset explicitly required reserves against some of the implicit margins contained in the valuation (as is done in some cases with the mismatching or resilience reserve and additional AIDS reserves). If this process continues, U.K. companies will be publishing valuations which, in total, are no different from a basic valuation calculated following the minimum bases that would satisfy the regulations plus explicit additional reserves as required by the regulations. Is this so very different from the position in the tightly regulated states? Given the use of other techniques for the actuarial management of a life office in the U.K., the statutory valuation may be viewed as little more than a mathematical diversion required only to prove that the regulations can be met. In this case perhaps we should ask whether it might not be beneficial in the long run if the present complex regulations were replaced with a more directly stipulated fixed minimum valuation basis common to all companies. The danger is that such a minimum basis would become a *de facto* standard used by all companies.

## 4.3 *Profit Distribution*

4.3.1 Other than in the U.K. and Ireland it is usual to distribute investment income and realized capital gains only. In many cases the profit-sharing formulae are laid down in the technical notes filed with the supervisor when seeking approval to write a new class of business. This leaves little room for judgement in the determination of the method of calculation or the amount of the bonus.

4.3.2 In France a two-stage calculation is specified. First an analysis of surplus is conducted against the premium basis, crediting the assets with the technical rate of interest only, to determine the 'technical surplus' arising from actual mortality and expense experience. Regulations specify the minimum proportion of this profit that must be distributed, which is currently 90%. Interest earnings in excess of the rate assumed in the premium basis are taken into the financial account; there is a minimum proportion of the interest surplus required to be distributed as bonus which is currently 85%.

4.3.3 In Germany the BAV is very concerned with the maintenance of equity between policyholders and profit distribution rules must be agreed with the

authorities for individual classes. In the Netherlands and Denmark companies issuing similar contracts on similar terms tend to operate similar bonus systems, although not required to do so by regulation. In several countries, including Belgium and Portugal, a bonus cannot be declared until it has been approved by the authorities.

4.3.4 While there is no regulation in the Netherlands, there appears to be considerable agreement between the larger companies. In Belgium and Luxembourg bonuses are declared as a rate of interest applied to the increase in reserves since the last declaration. In Belgium each year the company must submit to the control authority for approval, a bonus plan prepared by the actuary.

4.3.5 The greater degree of equity investment in the U.K. and Ireland creates additional problems of fairness of distribution of surplus between policyholders as a result of the significant levels of unrealized capital appreciation present in the assets. This has led U.K. actuaries to take credit for a part of the unrealized gains within the market value of assets when determining the surplus available for distribution.

4.3.6 The Appointed Actuary has freedom to determine the surplus to be distributed and to recommend the scales of bonus to be declared. The responsibility to ensure equity between policyholders rests with the Appointed Actuary, there being no regulations on the subject. There is no statutory minimum level of distribution. On the contrary the DTI are concerned to make sure that companies are not over-distributing as a result of competitive pressures.

4.3.7 Non-guaranteed terminal bonuses are used to facilitate the equitable distribution of what is frequently significant capital appreciation.

4.3.8 The distribution of profits arising from capital appreciation is becoming more of an issue in other states largely as a result of appreciation of property investments. In West Germany, for example, this has led to an arbitrary retention of surplus since the regulations do not allow for the distribution of such appreciation until it is realized.

4.3.9 Surplus may be held back under the U.K. system; the difference is that this is recognized as being a deliberate part of the planned distribution policy of the life office.

4.3.10 The recent development of unitized with-profits funds in the U.K. is a step towards the methods in many E.C. countries of allocating bonus in proportion to reserves, although the amount of surplus is freely determined. The change could be in part due to competitive forces causing the actuary to look for ways to reduce the valuation strain on with-profits business at a time of very rapid growth.

#### *4.4 A Look to the Future for Profit Participation*

4.4.1 While the actual method of profit distribution is not particularly important, the U.K. principle of returning 'full value' to policyholders, including a share of any unrealized appreciation, must be safeguarded if policyholders' interests are to be protected.

4.4.2 In recent years there has been a trend in many E.C. countries towards forcing companies to disclose surplus, and to submit a plan to the authorities showing how this is to be distributed. However, because assets are required to be included at book value, nowhere other than in the U.K. and Ireland is there a system for distributing unrealized capital appreciation to those policyholders to whom it belongs.

4.4.3 Moves towards harmonization are certain to address the question of how to make bonus distribution more equitable. We would argue that the key rôle played by the actuary in this area should be perpetuated and enhanced rather than be replaced by regulation.

## 5. INVESTMENTS

### 5.1 *Asset Mix for Non-linked Business*

5.1.1 Table 1 gives an approximate breakdown of life assurance company assets by asset type for the major E.C. life assurance markets. Assets matching unit-linked contracts are excluded.

Table 1

<i>Asset Type</i>	<i>West Germany</i>	<i>Spain</i>	<i>France</i>	<i>U.K.</i>	<i>Italy</i>	<i>Netherlands</i>
Real Estate	14	23	19	15	20	9
Shares	7	2	15	48	10	11
Bonds	44	53	59	27	60	49
Other*	35	22	7	10	10	31
	<u>100</u>	<u>100</u>	<u>100</u>	<u>100</u>	<u>100</u>	<u>100</u>

\* Includes cash, mortgages and miscellaneous loans.

5.1.2 The most striking feature of Table 1 is the very high proportion invested in the U.K. in shares compared to other countries shown. There are a number of factors which help to explain this phenomenon:

- (i) regulatory constraints on freedom of investment (see § 5.2). The U.K. regime is much more liberal in this regard than is generally the case elsewhere;
- (ii) the much greater size of the U.K. stock market relative to that of other E.C. countries. Among the countries listed in the table Spain's stock market is particularly immature;
- (iii) regulatory constraints on product design. The U.K. provides a striking exception to most other E.C. countries in not insisting on guaranteed surrender values. Such guarantees are difficult to reconcile with a policy of very significant equity investment;
- (iv) competition with unit-linked business which is much more developed in the U.K. than elsewhere.

5.1.3 There are probably other, less obvious, factors which play a rôle in explaining this fundamental difference. For example investors in many E.C. countries may be, for historical reasons, more risk averse than their counterparts in the U.K. and Ireland. Thus in West Germany, with a relatively well-developed stock market, only 7% of life insurance company assets are invested in shares although between 20% and 25%, depending on contract type, may be so invested.

## *5.2 Taxation of Policyholder Funds*

5.2.1 Another important factor is taxation. In the U.K. and Ireland policyholder investment income on qualifying life assurance business is subject to basic rate tax (currently 25%) within the insurance company. Elsewhere in the E.C. policyholder investment income is either tax free or, as in West Germany, subject to a low rate of tax.

5.2.2 It is not known to what extent these two distinguishing features of U.K. and Irish investment returns (a higher gross return, on average, from historical investment in equities and property offset by the tax on investment income) have resulted in higher or lower returns than would have been achieved with an asset mix similar to that in most other E.C. countries where tax is not suffered. However, this comparison will be relevant to consumer choice when barriers to freedom of services are eventually removed.

## *5.3 Regulatory Constraints on Investment Freedom for Non-linked Business*

5.3.1 These constraints are of four kinds:

- (i) Definition of what counts as an admissible investment backing the mathematical reserves.
- (ii) Constraints on the maximum admissible amounts held in any one investment.
- (iii) Constraints on minimum or maximum amounts held in any particular category of investment.
- (iv) Constraints on the currency of the investments.

5.3.2 In general E.C. states are subject to (i) and (ii), with the choice in (i) being particularly liberal in the U.K. (iii) also applies to most E.C. states with the exception, as usual, of the U.K. Generally the constraints in (iii) are of the form:

- a *minimum* investment as a percentage of the mathematical reserves in government bonds;
- a *maximum* investment as a percentage of the mathematical reserves, for other categories of investment.

5.3.3 No constraint is placed on the investment of assets backing the E.C. explicit solvency margin, except in the U.K. where there is no distinction between the solvency margin and mathematical reserves.

5.3.4 It may be argued that the constraints of type (iii) are unnecessary. In

particular forced investment in government bonds could lead to artificially low interest rates and so harm consumer interest.

5.3.5 However, as explained in §5.1.2, there are other factors at work which have to be taken into account, in particular the general requirement, outside the U.K. and Ireland, to grant guaranteed surrender values. U.K. style investment freedom can only then come about hand-in-hand with the other changes needed to move from a 'tight' to a 'broad' system of regulation. In particular, as described later, it will be important that actuaries have responsibilities for both sides of the balance sheet.

5.3.6 Constraints on currency are acceptable when they relate to currency matching but less so when they are a regulatory attempt to restrain foreign investment. They would prevent companies from issuing policies in foreign currencies and such policies will be in demand when freedom of services eventually applies.

#### *5.4 Matching of Assets and Liabilities*

5.4.1 Other than in the U.K. and Ireland (and to a very limited extent, for particular 'non-tariff' contracts, in France and Spain) investment policy is not taken into account in setting actuarial reserves. Indeed, where minimum premium rates are controlled at low technical rates of interest and investment policy is largely a matter of investing in government bonds, mismatching is not an issue.

5.4.2 It can be seen from §5.2.1 that there is nothing to stop a U.K. life insurance company from investing the entire mathematical reserves in equities, even for contracts, such as regular premium endowments, with extensive long-term financial guarantees. In these circumstances it is no surprise that Appointed Actuaries in the U.K. and Ireland, through legislation and through their professional code of conduct, are obliged to make prudent provision for potential mismatching of assets and liabilities. As premium tariff regulation breaks down, and as investment restrictions are relaxed, asset liability matching is likely to become much more of a preoccupation for E.C. actuaries.

#### *5.5 Unit-linked Business*

5.5.1 Unit-linked business is subject to much less constraint on investment freedom than non-linked business. This reflects the absence of investment guarantees.

5.5.2 In the U.K. there is a wide range of permitted links, the aim of regulation being to exclude only very speculative investments, for example commodity funds. In France unit-linked contracts may only be linked to certain pooled investment vehicles, such as SICAVs, a kind of open-ended investment company. The current restriction limiting permitted SICAVs to those at least 50% invested in French securities (i.e. in essence French SICAVs) will presumably disappear when the Freedom of Circulation of Capital Directive<sup>(8)</sup> comes into force on 1 July 1990.

5.5.3 It must be said that the unit-linked market is not yet significant on the Continent of Europe, with the exception of the Netherlands and, increasingly, France. The pace of development of this business depends, *inter alia*, on the further development of local stock markets.

### *5.6 The Rôle of Actuaries in Investment Policy*

5.6.1 As was mentioned in Section 5.3, Appointed Actuaries in the U.K. and Ireland are obliged to take into account investment policy in setting actuarial reserves. They have therefore an indirect influence on investment policy since if the directors of a life company wish to pursue an imprudent investment policy the Appointed Actuary will be obliged to increase the reserves, to such an extent perhaps as to call into question the technical solvency of the company. In these circumstances the investment policy will be modified. In practice this situation is rare. It is much more likely that the Appointed Actuary will set broad guidelines for the major categories of investments, e.g. gilts and equities, together with more detailed requirements in relation to gilts matching guaranteed liabilities.

5.6.2 The above rôle hardly exists for actuaries in other E.C. countries although, as stated in Section 5.4, it is likely to develop as more flexible regulatory systems emerge. However, actuaries in the U.K. and Ireland and in some other E.C. countries, particularly France, already play a significant investment rôle in a more general, non-statutory sense working within insurance company investment departments, or in banks or on the stock market as equity fund managers or as bond specialists. (Actuarial involvement in equity investment is much more limited outside the U.K. and Ireland.)

5.6.3 The increased interest of E.C. actuaries in investment, or more generally in the measurement of financial risk, is shown by the recent creation in July 1988 of AFIR, the financial section of the International Actuarial Association (IAA). This was at the initiative of ISFA, one of the two French actuarial associations. The first AFIR conference is to be held in Paris in April 1990 with the general theme 'the actuarial approach to financial risks'.

## **6. THE STATUTORY AND PROFESSIONAL POSITION OF ACTUARIES**

### *6.1 The Statutory Background*

6.1.1 In many E.C. countries, the actuarial profession is not afforded the formal state recognition of a statutory definition. In those that do, the U.K., Italy and Spain have specific definitions, while in Ireland legislation refers to the possibility of regulations prescribing qualifications and in its practical effect is specific. In Greece, the Ministry of Commerce specifies the qualifications and experience requirement for a licence to practise. On the other hand, West Germany, the Netherlands and Denmark do not define the actuary by statute although reserves must be certified by persons having certain skills, which are those normally associated with an actuary. In France, there is no statutory

definition although actuarial skills are in practice expected by the authorities for certain functions. In Belgium, there is no clear legal responsibility.

6.1.2 Overall, however, the actuarial function is generally recognized whether explicitly in statute or in the practical operation of supervision as indicated earlier in this paper. Consequently, the lack of specific statutory recognition in many cases is surprising considering the prevalence of legislation in the Community specifying responsibilities and the discharge of duties which are actuarial in nature. On grounds of consumer protection, a strong case could be made for statutory responsibility to be limited to a profession defined by statute or equivalent.

## *6.2 Training, Qualifications and Experience*

6.2.1 The most common method of training in the E.C. is a university actuarial course but in several countries there is substantial involvement of the national actuarial association.

6.2.2 Training is wholly or primarily at university in Italy, West Germany, Denmark, Belgium and Spain. Greece has followed the same route, although the actuarial association also sets professional exams and the first Greek actuary to qualify by this route qualified in 1989. University courses are also given in France, the Netherlands and the U.K. Examination by a local association is the principal method of qualification in the U.K.

6.2.3 An experience qualification for membership is required in Greece, by the Institute of Actuaries in the U.K., in Ireland and generally in West Germany, but otherwise exercise of the profession is usually sufficient.

## *6.3 National Associations*

6.3.1 National actuarial associations exist in all E.C. countries apart from Luxembourg. In addition to representation of their members, their functions include the development and dissemination of actuarial knowledge. Detailed information can be found in the 1985 Groupe Consultatif paper edited by A. D. Wilkie.<sup>(9)</sup>

6.3.2 A code of professional conduct applies in Belgium, Italy, the Netherlands, Spain, the U.K. and Ireland and in all countries there are provisions for the expulsion of members from the association.

6.3.3 U.K., Irish and Italian supervisory laws effectively limit performance of some statutory tasks to members (by examination) of the national associations (in the case of Ireland the U.K. national associations). Elsewhere in the Community it is not a condition of performance of certain statutory functions to be a member of the respective national association, although in practice a person suitably qualified will generally be a member.

## *6.4 Ability to Practise in Other Member States*

6.4.1 The E.C. directive of December 1988 on a general system for the recognition of higher-education diplomas<sup>(10)</sup> provides for mutual recognition of professional qualifications to be implemented by member states by January 1991.

6.4.2 At present, however, acceptance for statutory purposes of actuarial qualifications acquired in a different member state will be subject to individual consideration. In Greece an operating licence would only be granted to a Greek national. Spain would require the local qualification in addition.

6.4.3 Most national associations provide for some sort of special membership for actuaries practising in their country who qualified in other member states. Special associated or correspondent status would be given in Belgium, France, Italy, the Netherlands, Denmark and the U.K. Local qualifications would be needed to belong to the local associations and to practise in Spain and Italy but not in West Germany.

6.4.4 U.K. legislation requires the Appointed Actuary to be a member by examination of one of the national associations but in certain circumstances the authorities can dispense with this restriction.

### *6.5 The Higher Education Directive*

6.5.1 The higher-education directive referred to in §6.4.1 will enable a wide range of professionals, including actuaries, to practise from 1991 onwards in member states other than that in which they obtained their professional qualifications. It will apply to qualifications obtained at university or elsewhere, full-time or part-time, provided the qualification is equivalent to graduate level.

6.5.2 Such professionals, termed migrants, may be required to complete a period of supervised practice of up to three years in a second (host) member state, termed an adaptation period, or to take a limited test of professional knowledge considered to be necessary in the host state and not covered by previous formal qualifications. The directive provides for the migrant to be allowed the choice of adaptation period or aptitude test unless a precise knowledge of national law is required in which case the host member state may stipulate which applies. The position for actuaries has yet to be established.

6.5.3 In addition the host member state may require the migrant, if the period of education and training has been at least a year shorter than required in the host state, to provide evidence of up to four years' practice as a fully qualified professional, but not in addition to the adaptation period.

6.5.4 The Directive specifically refers to the Institute of Actuaries and Faculty of Actuaries as professional bodies for its purposes. It will give the right to actuaries from other member states to become full members of the Institute or Faculty, subject to the adaptation period or aptitude test. Similarly Fellows of the U.K. bodies will be able to obtain full professional access to other member states subject to corresponding conditions.

6.5.5 Each member state will designate the competent authorities responsible for assessing membership applications. As professional codes of conduct, where they exist, only apply to members of national associations, it is important that individual states take steps to require practising actuaries qualified abroad to belong to the local association. An individual member association may wish to create a category of European members. Such members would be full members but the classification would recognize their special background.



6.5.6 Clearly the extent to which actuaries move across borders will depend on actual and perceived opportunities in other states, on lack of opportunity at home, on economic factors and many other considerations. There may be flows between particular countries where experience in one state is of particular application or value in a second. There may or may not be a significant movement immediately but in the long run, the Europeanization, formal or informal, of the actuarial profession will become a considerable force for change.

## *6.6 Other Forces for Change*

6.6.1 As actuaries are enabled to practise more freely in other member states, so will supervisory authorities be under pressure from Brussels to accept modifications to their supervisory regimes which will render mutual recognition of standards of supervision feasible. Brussels is committed to encouraging competition, yet is equally concerned with consumer protection and it is not possible to predict in which half of the field the ball will come to rest: tight regulation or broad regulation. The proposed Second Life Directive issued in December 1988 has brought the debate closer although in due course it is the Fourth Life Directive which will determine the outcome.

6.6.2 In the competitive markets of Canada and the U.S.A., changes in supervision are tending to place more responsibility on the actuary as the previous tighter regulations have proved less able to handle product innovation and this trend may be expected to emerge elsewhere.

6.6.3 Within Europe, the life assurance industries of both West Germany and Italy have been exhorted by Government bodies to prepare for the wind of competition. Pressure to seek reduction of the protection and hindrance of tight supervision may be the result.

## *6.7 The Issues*

6.7.1 The professional status of the actuary is not independent of statutory responsibility. The statutory responsibility devolved to the actuary in the U.K. may have been made possible by a strong profession. Alternatively the regulatory attitude which recognized that the profession could be given such responsibility may have helped to create a stronger profession. Either way it can be argued that statutory recognition, professional responsibility and market responsiveness go hand in hand.

6.7.2 The training of the actuary, once the provisions of the Higher Education Directive are effective, will be subject to pressure to standardize levels of both skill and experience qualifications, particularly if markets and supervisory regimes are at the same time becoming more similar, the latter as they are adjusted to accommodate the compromises of mutual recognition. Will the weakest common standards or the strongest examples prevail?

6.7.3 The code of professional conduct of the Institute of Actuaries in the U.K.<sup>(11)</sup> applies to its members practising outside the U.K. unless it is replaced by the code of a local association of which membership is also held and which has

been recognized by the Council of the Institute of Actuaries. Council has not yet so agreed for any other E.C. state. On the other hand any E.C. actuary will, on becoming a practising member of the Institute of Actuaries, be bound by the Institute code of conduct.

6.7.4 The principles to be followed by the U.K. Appointed Actuary enshrined in professional Guidance Note GN1 are applicable to U.K. actuaries advising insurers overseas (Guidance Note GN5)<sup>(12)</sup> even if they result in a more stringent approach than local statutory requirements. Conflicts can arise between the professional code and local requirements and practice. These may increase rather than lessen when members practising abroad become, as a consequence of the Higher Education Directive, members of a local association with a different code of conduct.

## 7. CONCLUSION

7.1 By contrasting the current diversity of insurance supervisory practice in the 12 E.C. countries we have indirectly speculated on the future of a single European life assurance market, and what it might mean for consumers and for our profession.

7.2 To quote from the recent Institute of Actuaries paper by Sir Edward Johnston,<sup>(6)</sup> "the public is best served by life assurance companies which are at once financially sound and free to innovate". The validity and implications of this statement will be the core of the emerging debate on the future of supervision and of the professional rôle of the actuary.

7.3 We are drawn to the conclusion that European consumers will be best served by a liberal system of supervision and that the minimum standards necessary to ensure mutual recognition should not be too onerous, for this would stifle a competitive market offering consumers a variety of products and good value for money.

7.4 Such a system will only be acceptable if there is a strong actuarial profession acting as guardians of the consumer interest both from within insurance companies and through the supervisory body.

7.5 The profession will be best able to fulfil this rôle in countries which give statutory recognition of the profession, but this will only be merited if there are strong codes of professional conduct and practice in place.

7.6 Such a system exists in the U.K. and in Ireland and we believe it is worth preserving in a wider European context. It is our hope, and belief, that many European actuaries will concur with these views.

## 8. ACKNOWLEDGEMENTS

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8.2 We are also indebted to Betty and Joanna for the cheerful and efficient way in which they have dealt with innumerable drafts in different hands under intense time pressure.

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## APPENDIX

### BELGIUM

#### *Methods of Supervision*

Supervision of all insurance companies operating in Belgium is carried out by a government agency, the OCA (Office de Contrôle des Assurances). Returns are made at least once a year to the OCA containing details of revenue accounts, assets and reserves.

The basic objectives of the OCA are to protect the insured, to ensure that insurance companies abide by the law and that different categories of insured are treated on a fair basis.

Several actuaries are employed by the OCA, mainly concerned with insurance supervision.

#### *Premium Rates and Product Design*

In practice the employed actuary or the company's consulting actuary establishes the tariffs used by the company subject to legal restrictions.

A tariff containing the company's premium rate bases has to be filed with the OCA. Mortality and expense assumptions are laid down by Royal decree and interest assumptions must lie within a range permitted by Royal decree. The surrender value basis is consistent with the premium rates basis. Most companies use the same minimum tariff.

Once filed the tariff is binding on the company, although duly justified discounts may be granted for large groups.

The OCA is very concerned about equity between various categories of policyholders. It is very difficult to have more than one series of policies and when a new tariff is introduced, the premiums charged for existing business are changed to apply the new tariff.

There is little scope for product innovation because the OCA is influenced by the practice of the largest companies in determining what is permitted.

New tariffs are expected shortly. These will permit unit-linked products for the first time. It is believed that the new tariffs will be minimum levels and there may be more freedom in product design.

#### *Reserving and Profit Participation*

Unzillimerized mathematical reserves are calculated on the same mortality and interest assumptions as the premium rates.

The company's actuary is required to check the reserves and certify their amount to the OCA. He also determines the amount of surplus. Each company's distribution plan has to be checked by the actuary and approved by the OCA. The actuary then checks that the profits are paid or additional reserves set up.

*Investments*

Investment policy is subject to a number of restrictions including a minimum of 15% in Belgian gilts and semi-gilts, and a maximum of 25% in ordinary shares. Assets corresponding to technical reserves must be held in Belgium.

The reserving basis is independent of the investment policy since it is laid down in the tariff structure. There is an understanding that the actuary who signs the reserves has checked that the investment restrictions have been followed.

*Statutory and Professional Position of Actuaries*

The title of actuary is not protected under Belgian law and there is no statutory definition. A Royal decree on the practice of life assurance specifies certain jobs which an actuary does, without defining who is an actuary. It is associated with the actuarial qualification (Licencie en Sciences Actuarielles), which is acquired through a two- or three-year postgraduate university course, but the OCA can also recognize a person as having actuarial knowledge for the purposes set out in the Royal decree.

The Association Royale des Actuaire Belges/Koninklijke Vereniging van Belgische Aktuarissen is a legally recognized Professional Union which admits as Effective Members qualified Belgian nationals who are practising actuaries. FIAs and FFAs resident in Belgium can become Associate Members.

**DENMARK***Methods of Supervision*

The Insurance Supervision Service (ISS) ensures compliance with the Act on Insurance Business. Companies are required to apply to the ISS for approval of policy conditions, premium basis, reserving basis and the basis of calculation and distribution of profit to policyholders.

The ISS has employed several actuaries. It is not mentioned in the current Act that there has to be actuarial expertise in the supervisory body, although there is a law (specifying the number of public servants) which provides for a 'chief actuary' to be attached to the Service.

In practice the supervisory actuaries scrutinize and approve the technical basis (the basis for calculating assurance premiums and the premium reserve) of life insurance companies and pension funds. In this connection it must ensure that the basis for calculation is adequate both in its entirety and in respect of its separate elements, for example mortality, probability of disablement, rate of interest and loadings. They also approve, amongst other things, the rules for calculating and distributing profits to policyholders, maximum retention for a single risk, the rules for calculating surrender values and paid-up policies and the rules for granting loans secured on the company's own policies.

The ISS also has statutory approval duties in health insurance.

In general insurance the actuaries do not have any duties but it is planned to establish supervision of loss reserving.

*Premiums and Product Design*

Premium rates for life assurance and pensions have to be determined according to the Act. The basis for calculation must be adequate both in its entirety and in respect of its separate elements. The present premium rates have been determined by consensus agreement between the authorities and the industry.

The actuary does not have a statutory rôle in determining the premium rates, but must ensure that after approval the technical basis is complied with, reporting any deviation to the ISS.

There is opportunity to innovate in product design subject to approval by the ISS, although in practice freedom seems to be limited to repackaging existing approved features in new combinations. To launch a completely new product design, consensus within the industry is likely to be needed before ISS approval is possible.

The actuary does not have a statutory rôle in product design, but in practice will be heavily involved.

*Reserving and Bonus Policy*

The Act specifies the minimum acceptable mathematical reserve, being a net premium valuation on the original premium basis for each contract, with provision for zillmerization up to a clearly defined limit. The present technical basis has been prepared by consensus.

The actuary has to certify the mathematical reserve for compliance with the specified approved basis and write a report to the ISS regarding the calculations, indicating any amendment to the approved basis.

The method, formula and amount of profit distribution is determined by each company, although the method appears to be influenced by consensus. The rules for calculating and distributing profits to policyholders must be approved by the ISS.

The actuary does not have a statutory rôle in profit distribution, but in practice he will be heavily involved and must ensure that after approval the company complies with the approved basis. He must report any deviation to the ISS.

*Investments*

Investments other than government or municipal securities, mortgage credit institute securities, bank deposits, mortgages secured on property and property itself are strictly limited by statute. The actuary does not have a statutory responsibility in relation to investment policy. In practice he may or may not be involved. He does not have any regard to the asset structure in determining the mathematical reserving basis.

*Statutory and Professional*

There is no statutory definition of the actuary, although a life assurance company must employ an actuary (the Responsible Actuary) approved by the

ISS for technical calculations and investigations. The Responsible Actuary does not have to be a member of the national association, but all actuaries belong to the Danish Actuarial Society. Actuaries qualified in other member states can join the Society as associate members.

#### WEST GERMANY

##### *Methods of Supervision*

In West Germany, the approach to supervision seeks to achieve material control of all major items of an insurance company's activities. The basic guidelines are set out under the law on insurance supervision, *Versicherungsaufsichtsgesetz* (VAG) and are implemented in detail by the supervisory authority, *Bundesaufsichtsamt fuer Versicherungswesen* (BAV).

The BAV has existed for over 100 years and has built up a considerable amount of rules, guidelines and precedents. The overriding aim of the BAV is to protect the interests of the policyholders. At the danger of oversimplification, the BAV aims to achieve this primary aim by applying three main principles.

It first seeks to ensure no company can become insolvent, by insisting on very cautious premium and valuation bases. As this results in high profits, it leads to the second principle, namely fair and sufficient distribution of resulting surpluses. Thirdly, standardization of policy conditions is imposed in order to achieve as much transparency for potential customers as possible, which is meant to simplify the choice for the customer.

In order to implement these principles, no product may be sold in West Germany before all important items including premium basis, valuation basis, policy conditions, surrender value and methods of calculation and distribution of bonus have been approved by the BAV. All these items have to be submitted in full detail, right down to the rounding of the various calculations, in a business plan to the BAV. Only once this business plan has been approved can the product be sold. In addition there are general rules on investments, levels of commission and various other items.

The BAV publishes standard business plans, which would be approved with a minimum delay and also effectively lays down the minimum premium basis. Mortality, morbidity and interest rates are specified and there is also very little room for manoeuvre on expense loadings. The result of all of this has been standardization in the market and very little product differentiation.

Major changes in the main elements of the premium basis have only occurred every 25 years or so and are generally discussed between the BAV and the life offices association. This procedure tends to maintain the status quo. The most important life assurance product has been and still is the classical with-profits endowment policy. Given the tight control of the BAV, the main actuarial decision left to the company is the method and level of bonus distribution and even this is subject to close scrutiny by the BAV. Companies have historically built up large free reserves.

The BAV is split into various departments covering the different types of insurance, including life and sickness, and in each of these departments there are people responsible for checking the technical details of the business plan and the policy conditions. They are normally divided into two groups, the mathematicians, or German actuaries, and the lawyers.

### *Premiums and Product Design*

As described before, premium rates are effectively a combination of regulation and consensus: there is little scope for companies to deviate from the minimum requirements laid down by the BAV. Actuaries within offices are involved in designing the business plans including premium rates, negotiating the details with the BAV and making technical changes.

Historically, there had been relatively little product innovation, but recently certain companies have shown that a certain amount of product innovation is possible. This can be a long process and all innovations must currently conform with the basic BAV principles. For example, to comply with the currently cautious approach of the BAV, all products must be with-profits, even unit-linked. It is likely that the companies' actuaries would be involved in any product innovation work.

### *Reserving and Bonus Policy*

The method of calculating mathematical reserves is, generally speaking, the same as the premium basis and is laid down in the business plan. A mathematical expert is required to certify that the reserves have been calculated in accordance with the business plans. As there is, however, no room for discretion in this process, it is merely a statement saying that the mathematical calculations have been carried out correctly. This job of certification would normally be carried out by one of the company's actuaries but there are no legal requirements in this respect; it merely needs to be somebody who is mathematically competent.

Companies are required to carry out an analysis of surplus on the premium/valuation basis each year and to transfer at least 90% of the resulting surplus into a special reserve which can only be used to distribute profits to policyholders. In practice, most companies transfer between 97 and 98%. Furthermore, the BAV requires the companies to commit themselves to various rules to ensure equity, according to BAV standards, between different generations of policyholders and different classes of business.

The company's actuaries would be involved in recommending what level of bonus to declare and therefore the rate of withdrawal of money from the special fund. They would carry out all the calculations and determine how best to live with the BAV rules.

### *Investments*

The insurance law lays down certain limits on types of investment, for example equities are limited to a maximum of 20 or 25% of total assets according to the



type of liabilities they are covering. This limit will be increased to 30% from 1 January 1990, and the limit does not apply to investment fund linked policies. All assets are valued at book value. Actuaries would have no automatic rôle in defining or constraining investment policy, but depending on their position in the company may of course influence it.

Due to the statutory nature of the valuation basis for both liabilities and assets, the asset structure is not relevant for this purpose.

### *Statutory and Professional*

There is no statutory definition of the actuary. The mathematical expert required to certify the reserves is referred to in paragraph 65 of the VAG.

The national association is the Deutsche Gesellschaft fuer Versicherungsmathematik (DGVM) but membership is not compulsory in order to carry out the statutory functions and a number of those doing so are not members of the DGVM.

## SPAIN

### *Methods of Supervision*

Supervision of insurance is exercised by the Ministry of Economics and Finance through the 'Direccion General de Seguros' (DGS) (insurance supervisory authority). Powers of supervision are contained in a number of statutes, for example the Insurance Law of 1984, and include scrutiny of annual and quarterly returns and technical notes for products.

There are a number of actuaries working within the DGS. Some work in the 'Seccion de Bases Tecnicas y Tarifas'; their work includes scrutinizing technical bases and policy documentation for both life and non-life insurance products. Others work in the 'Seccion de Analisis de Balances'; this involves scrutinizing the returns received from the insurance companies.

### *Premium Rates and Product Designs*

Premium rates and product design are left to each company to determine, but must be submitted to the DGS in the form of a technical note for comments. The DGS has 60 days to respond if it does not approve of the rates or design.

There is no formal limit on the scope of a company to innovate in product design. However, design will have to take account of the market, tax framework and other legislative features of the environment. Some details of the insurance regulations, for example concerning the circumstances in which a technical interest rate can be permitted to exceed 6%, or relating the reserving basis to the premium basis, can indirectly impinge on design.

### *Reserving and Bonus Policy*

Regulations link the calculation of reserves to the premium basis specified in the appropriate technical note.

An actuary has to be responsible for calculation of the reserves, and the published reserves must be certified by the actuary.

Profit is distributed to policyholders as specified in the technical note for each product.

### *Investment Policy*

Certain classes of investments are specified in regulations as suitable for investment of technical provisions, for example quoted stocks. There is no restriction on the investment of assets in excess of technical provisions, other than exchange control. The rules for computation of assets for solvency margin purposes are complex, but tend to take into account assets that are outside the classes of investments specified for technical provisions.

Legislation does not require any identified actuary to have a rôle in or be responsible for investment policy. However, in some cases actuaries can be involved in fixing and controlling investment policy.

For many products the asset structure, or proposed asset structure, is an essential component in fixing the premium and reserving basis. The insurance regulations also foresee this point and stipulate that one of the conditions in which the 6% technical interest rate can be exceeded is when the insurance is linked to simultaneous investment.

### *Statutory and Professional*

The actuarial profession and its practice are regulated in the 'Estatuto Profesional del Actuario, por Decreto 1216/1960 de 23 de junio'. This decree stipulates that the actuarial qualification, awarded by the state, gives entitlement to carry out such functions as are attributed by legislation to the actuary. The decree also specifies that the actuary, 'en exclusive' (i.e. and only the actuary), is to resolve all questions relating to mathematical and economic 'tecnicá' (procedure and calculations) in the field of insurance companies.

The official Spanish actuarial qualification is awarded by the state to citizens of E.C. member states on completion of appropriate university studies.

## FRANCE

### *Methods of Supervision*

State control is exercised by the Direction des Assurances (DA) which is attached to the Ministère de l'Economie et des Finances (MEF), with the assistance of the Conseil National des Assurances (CNA). The DA is responsible for the supervision of French and foreign companies established in France, its essential rôle being the protection of policyholders.

The DA controls an insurance company through analysis of the 'états ministériels', or annual returns, prepared by each insurance company or branch. A particular feature of the French system is a body of external insurance

commissioners, the 'commissaires contrôleurs', who are high-level civil servants attached to, but not part of, the DA. These practise a 'contrôle sur place', that is to say the commissioners systematically visit insurance companies in order to report on compliance with regulations laid down in the Code des Assurances or in circulars from the DA.

There are no actuaries working for the DA (although there is one at the MEF). On the other hand, the body of external commissioners play a rôle which is in some ways analogous to that of the GAD. The total staff of the commissioner body, the 'Service du Contrôle des Assurances', amounts to some 35 people, of whom perhaps 10 are actuaries. All classes of insurance business are included in the scope of their activities, which comprise both control and surveillance of insurance companies and responsibility for special studies.

Although it may seem paradoxical there is an important class of institutions, the Caisses de Retraite, which are entitled to offer group insurance to their members but whose insurance activities are not subject to the system of control described above. The Caisses de Retraite operate the compulsory pay-as-you-go retirement regimes for salaried personnel, in addition to the basic state pensions regime. These Caisses are subject to the Code de la Sécurité Sociale which in so far as insurance is concerned differs significantly from the Code des Assurances. It is no wonder that the President of the Fédération Française des Sociétés d'Assurance (FFSA) insists on harmonization within France before European harmonization can proceed!

### *Premiums and Product Design*

There is no statutory rôle for actuaries; however, actuaries play the same commercial rôle as in the U.K.

In theory life insurance premium rates must be calculated according to specified mortality tables and with interest rates restricted to specified maxima (higher for certain kinds of single premium contract); although there are no restrictions on expense and commissions these are subject to approval by the DA who requires them to be 'justifiably reasonable'. In a circular dated 29 July 1969 from the DA, however, group contracts were exonerated from these requirements. This exoneration extends to so-called 'open group' contracts, membership of which is voluntary and whose members have no interest in common from the point of view of premium rating. An example of an open group contract would be an individual pension plan sold by a bank life insurance subsidiary to clients of the bank. The net impact of this is that there is considerable scope for a company to innovate in product design, even for contracts supposedly subject to tariffication.

A full description of each new life product, including the policy documents, publicity material and a technical analysis must be submitted to the DA, and the visa or 'prior authorization' received, before the product is launched. However, the DA, in the same circular mentioned above, exonerated genuine group business from this requirement.

*Reserving and Bonus Policy*

'Traditional formulae' are used for individual contracts, on the same basis as for the calculation of the premium given in the visa application (but excluding explicit profit loadings). Zillmerization is compulsory but only where commission is paid up front. Where the tariff system does not apply, which is increasingly the case, the regulations give no guidance whatsoever.

Mathematical reserves are calculated by a life insurance company's actuaries in France as in the U.K., but no certificate is required from an actuary.

Individual contracts, but excluding unit-linked contracts, and group pensions contracts are subject to regulations specifying the minimum participation of policyholders in surplus. These rules apply *globally* to the contracts subject to the regulations. The concept of 'reasonable expectations' by class of business or within a class does not exist.

In brief the process is as follows:

Profits in which policyholders are entitled to share arise from two main sources. The *Financial Result* is the investment income plus realized gains deemed to have been earned on the average technical reserves established during the year. The *Technical Result* is the equivalent of what a U.K. actuary would call miscellaneous surplus, that is mortality, lapse and loading surplus.

The minimum policyholder participation in surplus is then, if the Technical Result is positive, 90% of the Technical Result plus 85% of the Financial Result less 100% of the technical interest credited to the mathematical reserves. If the Technical Result is negative then all of it may be deducted in the above calculation.

An important difference between the U.K. and France is that shareholders are entitled to up to 15% of the investment income plus realized gains, not simply a percentage, say 10%, of the excess over the technical rate of interest. Note also that there is no mechanism in France for the distribution of unrealized gains to policyholders.

The determination of bonus is, as in the U.K., a process subject to marketing as well as actuarial and regulatory constraints. Actuaries play a major rôle but it is not a statutory one.

*Investment Policy*

The regulations cover two main areas, namely the admissibility of assets held and the relative proportions held in each category. Only assets backing mathematical reserves and certain other privileged debts are regulated, the assets backing shareholders' funds are not subject to any control whatsoever. Admissible assets include, amongst the more important categories:

Government bonds.

Property.

Shares quoted on the French stock exchange.

SICAVs.

Commercial mortgages.

The assets must be denominated in the same currency as the liabilities.

Regarding the relative proportions in which prescribed assets must be held as a proportion of total admissible assets, the more important rules are as follows:

a minimum of 34% for fixed interest securities;

a maximum of 40% for property.

There are limits on the percentage of total admissible assets which can be placed in any one investment, depending on the category of investment.

Investments are generally valued at cost. For fixed interest investments however, if the redemption value is less than cost, the higher of redemption value and market value is taken (but subject always to a maximum value equal to the cost price). For equities and property only, if market value is less in aggregate than cost, then the difference must be set up as a provision on the liability side of the balance sheet.

The above regulations do not apply to unit-linked contracts. For these at least 50% of unit-linked assets must be invested in French securities. Assets are valued at market value.

For certain kinds of single premium contract with guaranteed interest rates in excess of the standard 'tariff' rate, segregated assets must be held. Additional special contingency reserves must be set up if the yield on these segregated assets falls by too much in relation to the guaranteed rate.

The actuary has no specific responsibilities in relation to investment policy and, other than for the single premium contracts mentioned above, the actuary is not required to have any regard to the asset structure when calculating mathematical reserves.

### *Statutory and Professional*

There is no statutory definition of the actuary and the very name will be sought in vain in the Code des Assurances. Recently, however, the Ministry of Social Security (responsible for the insurance activities of the Caisses de Retraite) has raised the possibility of actuaries playing a statutory rôle in the certification of company's pension fund liabilities.

All French actuaries are members either of the Institut des Actuaire Français (IAF) based in Paris or the Association des Actuaire diplômés de l'Institut de Science Financière et d'Assurances (ISFA) based in Lyons. A third association is being set up at Strasbourg.

There is nothing to stop a U.K. actuary practising locally as long as he does not hold himself out to be a French actuary.

It is unlikely that an application to be a full member of either IAF or ISFA has ever been received from a U.K. actuary. There are a number of 'membres adhérents' of ISFA however.

## UNITED KINGDOM

*Methods of Supervision*

Insurance business is supervised by means of:

- (i) statute (Acts and associated Regulations);
- (ii) industry codes of practice; and
- (iii) professional codes of conduct.

Statutory supervision is carried out by the Department of Trade and Industry (DTI), the Registry of Friendly Societies (Registry) and the Securities and Investment Board (SIB) and its associated self-regulatory organizations (SROs), primarily the Life Assurance and Unit Trust Regulatory Organization (LAUTRO) and the Investment Management Regulatory Organization (IMRO).

Industry supervision is carried out by a variety of industry bodies and trade associations, e.g. the Association of British Insurers, the Council of Lloyds.

Professional supervision is carried out by a number of professional bodies whose members are involved in insurance business, most notably the Institute of Actuaries, the Faculty of Actuaries and the Institute of Chartered Accountants in England and Wales.

The Government Actuary's Department (GAD) is a branch of the government and civil service. *Inter alia*, the GAD advises the DTI and the Registry on matters relating to insurance business. According to the paper 'The Appointed Actuary'<sup>(6)</sup> presented to the Institute of Actuaries by Sir Edward Johnston, the then Government Actuary, on 28 November 1988 the normal routine of the GAD focuses on the receipt and scrutiny of annual returns for life and non-life insurance business. There is also a great deal of work arising from policy matters; advice on the interpretation of existing, and preparation of new, legislation; overseas and other general matters.

With regard to the scrutiny of annual returns, the GAD carry out an initial scrutiny as a result of which the company is allotted a priority rating. The next stage is a full examination of the returns, the objectives of which are twofold:

- (i) to monitor that the appropriate Acts and Regulations have been complied with; and
- (ii) to look at the company dynamically, by which is meant an assessment of the way in which the financial state of the company is developing.

If the examination should show up any problems these will be discussed with the company, and the GAD would play a part, often a major part, in the discussion. Much senior time at GAD is spent on questions such as restructuring or other major changes in a company.

As well as having actuaries on their management boards, SIB and LAUTRO each employ their own actuaries and LAUTRO also makes use of an actuarial advisory panel. The major areas of activity of the actuaries are advice on interpretation and preparation of new rules for selling practices and product disclosure, and assistance with the monitoring of rules.

### Premiums and Product Design

Premium rates and product designs are determined by each company, subject only to the following constraints.

- (i) In order to become authorized, a new insurance company must, *inter alia*, submit details to the DTI of the technical bases for calculating premium rates the Appointed Actuary to the company proposes to employ for each class of business. The other information supplied to the DTI would allow the supervisory authority to assess the adequacy of the proposed premium bases.
- (ii) Authorization can be withdrawn from a company or the authorities can intervene in the affairs of a company if there exist grounds for protecting policyholders or potential policyholders against the risk that the company may be unable either to meet its liabilities or to fulfil the reasonable expectations of policyholders. Inadequate premium rates would presumably constitute such a ground.
- (iii) Guidance Note 1 (GN1) was issued by the Council of the Institute of Actuaries as guidance to the professional responsibilities of actuaries appointed to companies in terms of the Insurance Companies Act 1982, but all actuaries responsible for long-term insurance business are expected to follow the same principles. The profession regards it as the Appointed Actuary's duty to take all reasonable steps that he or she is, at all times, satisfied that if he or she were to carry out and report on an investigation of the financial condition of the company, the position would be satisfactory. GN1 states that the financial condition of the company is particularly affected by, *inter alia*, the premium rates on which existing business has been, and current new business is being, written. It is the Appointed Actuary's duty to advise the company as soon as he or she is of the view that a course of action is being, or is proposed to be, followed which seems likely to lead him or her to withhold subsequent actuary's certificates (as requested by legislation) in the normal form. (Such a state of affairs could not be construed as a satisfactory position.) It is also his or her duty, if the company persists in following such a course of actions, to advise the DTI, after so informing the company.

It is clear from the constraints described above that the actuary plays an important rôle in the determination of a company's premium rates. However, a life company could, and often does, choose to divide the actuarial input to premium rates between at least two actuaries, the 'marketing actuary' or 'product development actuary', and the actuary statutorily appointed under the Insurance Companies Act 1982.

Because premium rates are not determined by law or regulation, or by cartel, and because of the freedom of action of the actuary within his professional code of conduct, the scope for innovative design is immense, and the rôle of the

actuary—Appointed Actuary or product development actuary, or both—in innovative product design is very significant.

### *Reserving and Bonus Policy*

Mathematical reserves are prepared by each company and certified by the actuary appointed to the company under the Insurance Companies Act 1982, subject to the following constraints.

- (i) The Insurance Companies Regulations 1981:
  - set out statutory margins of solvency;
  - require that the amount of the liabilities shall be made on actuarial principles and on prudent assumptions in regard to the relevant factors;
  - and require that the amount of the liabilities shall, in the aggregate, not be less than the amount calculated in accordance with the Regulations.
- (ii) The *minimum* valuation basis in the Regulations makes provisions for:
  - account to be taken for the nature and term of the assets;
  - the avoidance of future valuation strain;
  - the way in which valuation premiums are determined;
  - allowance for acquisition expenses;
  - the maximum rates of interest;
  - the appropriate rates of mortality;
  - the calculation of expenses reserves;
  - the allowances to be made for options;
  - the treatment of negative liabilities; and
  - the allowances to be made for voluntary discontinuance.

In many of the provisions described above significant discretion is allowed to the actuary as to methods and assumptions.

The Insurance Companies Act 1982 requires every insurance company to which it applies to cause an investigation to be made into its financial condition, once in each year, by the actuary appointed under the terms of the Act.

The Insurance Companies (Accounts and Statements) Regulations 1983 require the Appointed Actuary to prepare a valuation report which must cover at least the information stated in the Regulations. In addition, the same Regulations require the Appointed Actuary to certify that proper records have been kept, and that the mathematical reserves and liabilities are adequate and comply with the Regulations.

The methods and amounts of profit distribution to policyholders are determined by each company, subject to the following constraints.

- (i) The method of profit distribution is subject to market constraints. The uniform reversionary bonus system coupled with the terminal bonus system is very widely used in the U.K.
- (ii) The Insurance Companies Act 1982 prevents the distribution of profits to



- policyholders unless an investigation of the financial condition of the company has been carried out by its Appointed Actuary.
- (iii) Changes to the proportion of total surplus which is allocated to policyholders is controlled by the Insurance Companies Act 1982.
  - (iv) The authorities have the power to intervene in the affairs of a company if they consider it desirable to protect policyholders or potential policyholders against the risk that the company may be unable to meet the reasonable expectations of policyholders or potential policyholders. What constitutes 'reasonable expectations' is a subject for debate, and for concern amongst many actuaries. It has not been tested in the Courts. In practice, reasonable expectation has been taken to include the future prospects for distribution of profits to policyholders.
  - (v) The professional obligations of the Appointed Actuary include the duty to take all reasonable steps to ensure that the company will not allocate profits before the directors of the company have obtained from him and considered a written report containing his observations and recommendations on the subject.

As the constraints above indicate, the Appointed Actuary to the company performs a central rôle in determining the methods and amounts of profit distribution.

Through the investigation of the financial condition of the company and recommendations on the amount to be distributed, the Appointed Actuary could be considered to lead the thinking of the directors of the company on profit distributions. In practice, directors will also take market factors into account before making a final decision, but in the event that the directors decided to distribute an amount which the Appointed Actuary considered excessive, he would be obliged, by statute and by his professional code, to advise the DTI of the fact.

### *Investment Policy*

The investment managers of insurance companies are free to invest in any assets they choose (except for assets matching property linked benefits). However, the Insurance Companies Regulations 1981 specify the admissible values of assets for the purpose of assessing the financial condition of the company. Certain classes of assets will have an admissible value of zero, and other assets will have their value restricted to a maximum amount, expressed as a proportion of the liabilities.

The same Regulations specify the permitted assets by reference to which property linked liabilities may be determined.

The Appointed Actuary to a company has a professional duty to have information about the existing investments and the continuing investment policy, and he is required to decide whether the investment policy is or could become inappropriate. If this is the case, he must advise the company on the investment policy necessary to protect the policyholders.

The Appointed Actuary is obliged by statute and by his professional code to take into account the nature and term of the assets and the value placed upon them when determining the liabilities. He or she is also required to make appropriate provision for the effects of possible future changes in the value of the assets and the GAD has issued quantitative guidelines on this subject.

In determining the rates of interest to use in the valuation of the liabilities the Appointed Actuary is permitted notionally to apportion assets between different categories of contract.

### *Statutory and Professional*

An actuary for the purposes of the Insurance Companies Act 1982 is defined as a person who is a Fellow of the Institute of Actuaries or of the Faculty of Actuaries and who has attained the age of 30 years. This definition appears in the Insurance Companies (Accounts and Statements) Regulations 1983, which regulations were made under the Insurance Companies Act 1982.

Within the statutory framework substantial discretion is given to the actuary ('the Appointed Actuary') appointed under the Insurance Companies Act 1982 with regard to premium rates, product design, reserving bases, surrender bases and other factors. Johnston<sup>(6)</sup> referred to the 'double harness' system with the regulatory authorities and the profession pulling together, and with significant responsibilities devolved to the actuarial profession.

Guidance notes issued by the Institute of Actuaries and Faculty of Actuaries set out detailed professional standards for the Appointed Actuary. In this way, the profession plays a significant rôle in the supervision of insurance.

Actuaries make up the Councils of the Institute and Faculty of Actuaries. However, the disciplinary procedures include provision for non-actuaries to participate in disciplinary tribunals.

## GREECE

### *Methods of Supervision*

Supervision of all insurance companies' activities is the responsibility of the Actuarial and Insurance Companies Department of the Ministry of Commerce. Exchange control so far as it relates to insurance companies' activities is, however, the immediate responsibility of the Bank of Greece.

Supervision by the Ministry is conducted through annual returns that each insurance company has to submit, consisting of:

- (i) balance sheet and profit and loss account;
- (ii) notes accompanying the accounts detailing the accounting practices followed;
- (iii) statistical returns encompassing reserve, investment and solvency margin requirements.

All items in the above reports relating to life activity including statistics must be signed by a Greek qualified actuary.

On the basis of experience and examination requirements actuaries are granted permission to work by the Ministry which is also responsible for supervising them. Supervision is, however, in practice minimal and there are no cases of Ministry action against actuaries for misconduct of duties.

The supervisory body has an actuarial section where about six or seven actuaries are currently employed. Their duties are very wide and cover all aspects of the conduct of life business. Thus they are responsible for approving new premium rates, checking the accuracy of actuarial reserves, assessing the adequacy of solvency margins and investigating the investment policy in relation to bonus distribution policy.

In practice the volume of work does not permit supervision to extend beyond the mere checking of new premium rates and policy terms submitted for approval and the backing of reserves by admissible assets.

For general insurance, supervision covers all aspects including reserves, reserving methods and determination of statutory premium rates (for motor and fire).

### *Premiums and Product Design*

Life premium rates are regulated by Ministerial Decision 4381/79 which specifies within very narrow bounds the premium loadings, mortality tables and interest rates that can be used by actuaries in their calculations.

The actuary's rôle is thus restricted to selecting the appropriate combination of loadings and calculating the premium schedule. In his approach he would be very much influenced by market pressures and he is more likely to select the lowest possible loadings.

The supervising body would be prepared to examine and approve any new product that would be submitted provided that its construction was framed within the constraints mentioned above. The Ministry would be prepared to examine a submission for a non-traditional product, although the limited prospects in the equity market and the limited freedom in valuation bases have prevented companies from moving towards, for example, unit-linked products.

The Greek market is not, however, as yet developed enough to offer opportunities for launching sophisticated products.

Two major innovations were the introduction of a Universal Life type of product in 1977 and the general adoption in 1981, encouraged by the Ministry, of a with-profits product. Since then all new products are issued on a with-profits basis. Accident and health insurance riders are widespread and typically account for between a quarter and a half of total premiums.

Lately interest has been shown in permanent health insurance plans but such a product may be expected to present difficulties as there are no standardized morbidity tables nor approved premium loadings for such a product. Other problems to be overcome are the lack of an agreed definition of disability and the absence of PMA reports.

As the area is unexploited the actuary has a very significant rôle to play both in

assisting the sales forces in market research and new product design and in influencing the Ministry in formulating new policy decisions.

### *Reserving and Bonus Policy*

Mathematical reserve calculation is regulated by the same Ministerial decision which governs the calculation of premium rates and is thus subject to the same constraints as far as net premiums, mortality tables, interest rates and zillmer are concerned. The actuary is thus restricted in simply using the correct mathematical formulae to calculate the reserves but has no flexibility in exercising judgement as to the basis of calculation. Mathematical reserves have to be signed by a qualified Greek actuary.

There is only one accepted method of distributing 'surplus' in Greece, namely adding a proportion of excess interest to reserves. This was introduced by law in 1981 and since then no company has attempted to apply a more scientific and equitable approach. The bonus distribution method is accepted by the Ministry which, however, would be open to considering another approach if so requested. The actuary again is simply responsible for calculating the bonuses declared and accumulated. He rarely participates in the determination of the interest rate earned on funds invested, a straightforward procedure, as funds are normally invested in fixed interest Government Bonds.

### *Investments*

Life funds can be invested as follows:

- (i) cash deposited with a bank and outstanding premiums, up to 20% of the company's annual premium income;
- (ii) Treasury Bills;
- (iii) State Bonds or private companies bonds (the latter are quoted on the stock exchange);
- (iv) stocks or shares of quoted companies on the Athens stock exchange up to 20% of the insurance company's share capital for each share held;
- (v) property and mortgages, each up to 75% of the value of the property, but not more than 50% of the mathematical reserves in total;
- (iv) life policy loans.

At least 15% of the above investments should be in Treasury Bills and State Bonds.

The actuary's rôle and responsibilities for investment are limited to the mathematical determination of the average interest rate earned on the life funds.

### *Statutory and Professional*

There is no statutory definition of the actuary. His duties and responsibilities as far as insurance companies are concerned are defined in the legislation and form an indirect definition of the term. There is, however, no such legislation governing the responsibilities of a pension fund actuary.

Another piece of legislation indirectly defining the status of the actuary is the Presidential Decree 56 of 1985 which determines the necessary qualifications for obtaining a licence to operate as an actuary. New requirements including an actuarial examination have recently been introduced.

The actuary does not have to join the national association but 85-90% of the actuaries actively practising their profession are currently members.

According to the Presidential Decree members of foreign actuarial associations are exempted from the actuarial examinations and *provided they have Greek nationality* may on the basis of this qualification obtain a licence. No action has yet been taken to change the nationality requirement as a result of Community membership.

## IRELAND

### *Methods of supervision*

The supervisory body for insurance matters, life and general, is the government Department of Industry and Commerce (DIC). Supervision is managed through regulations which require the productions of returns to the Department on at least an annual basis. It is more often than once a year for young companies. Authorization of insurance companies is under the aegis of this Department.

The relevant regulations in respect of life assurance are:

- (i) European Communities (Life Assurance) Regulations, 1984;
- (ii) European Communities (Life Assurance Accounts, Statements and Valuations) Regulations 1986;
- (iii) Insurance Act 1989, which was formally passed by the Irish Parliament in March, 1989.

The 1984 Regulations gave effect to the solvency margin requirements of the 1979 E.C. Life Directive. The 1986 Regulations introduced valuation of assets and liabilities rules on the lines of those in the U.K. with some alterations. The 1989 Insurance Act gives the appropriate Minister more powers in relation to the authorization and revocation of insurance licences and extra powers to intervene in the running of a business. The Act also sets out some statutory requirements in relation to insurance brokers and agents and provides the Minister with power in relation to commissions paid to intermediaries. At the moment there is an industry wide Commissions Agreement to which all life companies adhere.

There is no equivalent of the U.K. Government Actuary's Department, but the DIC obtains actuarial advice on a consultative basis from time to time, generally employing someone from one of the leading U.K. firms of consulting actuaries dealing in life assurance matters. The main visible sign of a consulting actuary's input to the DIC in recent times was the production of the 1986 Valuation of Assets and Liabilities Regulations and the accompanying guidance notes. The Government have stated publicly that they intend to bring some actuaries into

the supervisory areas on a full-time basis, and they have advertised for such over the past couple of years. They have been unsuccessful to date and the short-term prospects of success in recruiting someone seem remote.

The insurance industry, through its representative body the Irish Insurance Federation (IIF), maintains close contact with the DIC and, in particular, the Actuarial Committee liaises with the Department on supervisory matters. The Society of Actuaries in Ireland also maintains contact with the DIC, although the actuaries involved are usually the same as those on the IIF Actuarial Committee.

The DIC has some contact with the few (about four) actuaries involved in general insurance and again uses U.K. consultants for actuarial assistance in this field.

There is only one health insurance company (VHI), which is state run, and recent Ministerial announcements indicate that they have employed U.K. actuarial consultants to assist with the current financial recovery programme. The company is not supervised by the DIC.

### *Premiums and Product Design*

Premium rates and product design are left to each company to determine.

There are no overt regulatory constraints other than those implicit in, for example, being aware of the levels of reserves and solvency margins required for the business. The actuary's rôle in this will be similar to that of any F.I.A. or F.F.A. in the U.K. fulfilling the same rôle, account being taken in particular of professional guidance notes.

There are statutory requirements to provide information on premium rates and product design when a new life company is seeking authorization, and these include an actuary's certificate confirming the substance of the proposals.

### *Reserving and Bonus Policy*

The regulations in relation to mathematical reserves and rules on profit distributions are similar to those operating in the U.K. There are some small differences but liabilities are determined on actuarial principles, making proper provision on prudent assumptions with regard to the relevant factors, and not being in any case less than the amount calculated in accordance with Articles 27 to 36 of the 1986 Regulations. The net premium is afforded a high profile for non-linked business and a maximum long-term rate of interest is prescribed.

The regulations allow scope for the Appointed Actuary to apply his judgement in making various valuation assumptions with similar limitations to those in operation in the U.K.

Profit distribution mirrors U.K. practice, mainly because the major with-profits offices are Irish branches of some of the larger U.K. life offices. There are no offices using any profit distribution methods which are not in use in the U.K. The responsibility on the actuary will be the same as in the U.K., in particular, guidance notes such as GN1 will apply since the actuaries are members of the Institute or Faculty.

### *Investment Policy*

Investment policy and valuations of assets are similar to U.K. practice. There are admissibility rules in the valuation of asset regulations which go beyond the U.K. rules of restricting individual assets to certain limits, by including maximum limits on the proportion of business which may be admitted for each category of asset. There are localization of assets rules which require at least 80% of all mathematical reserves in respect of Irish business, both linked and non-linked, to be invested in Ireland. There were quite strict exchange control regulations in force up to the end of 1988 which severely limited the extent to which new money could be invested overseas so that the localization rules did not bite hard. Since 1 January 1989, however, the exchange control rules have been very largely eliminated and the industry is now lobbying for relaxation of the localization requirement.

The actuary must take account of the nature and term of the assets backing the liabilities when performing the valuation. Resilience tests must be performed and reserves established if necessary. Similar requirements to the working rules issued by the U.K. GAD are laid down in the DIC guidance notes to the 1986 Regulations.

Because of all this, the actuary has a rôle to play in determining investment policy. To what extent this materializes is a matter for each company and its actuary but there are no statutory or other barriers standing in his or her way.

### *Statutory and Professional*

The 1989 Insurance Act lays down the latest definition of an actuary, being the rules on the appointment, duty and qualifications of the actuary. It requires all life offices with their head office in the State to appoint an actuary whose duty will be to perform the actions required under the Insurance Acts. It does not set out specific qualifications and refers to the possibility of the Minister prescribing such by regulation. This is in line with similar non-specific definitions in previous legislation, including the 1909 Act, the 1936 Act and the 1986 Regulations.

There is, therefore, no requirement for the Appointed Actuary to be a member of the Society of Actuaries in Ireland. It is possible that this may change at some stage in the future as the Society has prepared a new constitution which will turn it into a 'company limited by guarantee and not having a share capital'. Most of the legal paths have been covered in this process and the new constitution is expected to take effect later this year.

Since all actuaries in Ireland are either F.I.A.s or F.F.A.s, the new Society format was sent to the Institute and Faculty for comments. The proposed rules were acceptable to both bodies. The Society intends at some stage to introduce codes of conduct for members while working in Ireland which will be enforceable on those members. It further hopes to include among its members all actuaries working in the country. This would include actuaries responsible for the Irish operations of overseas companies, mainly from the U.K. but including other E.C. countries in particular.

Currently 100% of the actuaries working in Ireland are members of the Society. This has always been so and it is intended to maintain this level. Its new constitution will permit membership to any qualified actuary wishing to join and in particular membership will be offered to any U.K. actuary with an interest in actuarial and industry matters in Ireland. The present rules restrict membership to Fellows only, who are resident in Ireland, or such other persons deemed suitable for membership. The new constitution will include Fellow members, Associate members, Student members and Honorary members.

The Society's committee had considered introducing at this stage a category of European member. It was eventually decided to leave this out for the time being and to reconsider it when both the new constitution and the Diplomas Directive<sup>(10)</sup> had come into being.

## ITALY

### *Methods of Supervision*

The supervisory bodies are the Ministry of Industry and Commerce and the Institute for the Supervision and Vigilance of Individual and Group Insurance (ISVAP) and control is relatively strict. In practice the Ministry 'stamps' its approval after hearing the opinion of ISVAP.

ISVAP controls and verifies that:

- quotations produced by insurance companies comply with the regulations laid down by ISVAP;
- the technical bases of the tariffs are adequate (it will request modifications if it deems it to be necessary);
- the shareholders of insurance companies have a sound financial situation.

Business plans which are submitted to the control authorities for approval must contain a detailed account of net and tariff premiums, surrender values, paid-up sums and mathematical reserves and must be signed by an actuary in the professional register. Calculation is subject to certain provisions and is continuously supervised.

All life companies operating in Italy, including foreign companies, must submit a quota (i.e. reinsure) to the state company INA. In the past this was a major impediment to the establishment of a new life business in Italy. However, in 1987 new laws required INA to give 'reasonable reinsurance commission' which while still not equivalent to normal commercial rates is certainly more realistic. This practice of compulsory state reinsurance was criticized in the First Life Directive and Italy was urged to drop it, with the position to be reviewed after ten years. The proposal for the Second Life Directive requires Italy to abolish it.

ISVAP has the power to call for an assembly of the shareholders in order to implement modifications so as to comply with any regulations laid down (at the expense of the insurance company).



The 178 staff of ISVAP is made up of lawyers and actuaries and there is a specific actuarial section of 6. Their duties are to control the technical basis of tariffs, etc.

### *Premiums and Product Design*

Premium rates are determined by each company but must be approved by the Ministry on the advice of ISVAP. ISVAP has tended to be conservative in its outlook, slowing the emergence of new ideas and leading to the major companies operating as a cartel in practice, with all companies charging the same rates as determined by the Association of Insurers (ANIA) using the technical basis allowed by ISVAP.

Individual companies may modify slightly the 'common' tariff but must once again obtain approval from ISVAP. Theoretically each Appointed Actuary could determine premiums using the technical basis given by ISVAP.

Any proposal for new premium rates has to be accompanied by a technical note from an actuary explaining the bases, etc.

An actuary has complete freedom to propose new products to ISVAP, and ISVAP must reply within three months. Up to the present time there has not been much innovation, but the fact that companies can now modify slightly the product given to them by their association shows a desire to differentiate. ISVAP themselves have stated that they wish to encourage product innovation and competition and are looking for ways to do this without putting the consumer at risk.

The Appointed Actuary would be involved in the modification of the product developed by the leading company (usually INA). Consulting actuaries in Italy are usually also involved in the development of new products and tariffs for companies as well as the Association of Insurers.

### *Reserving and Bonus Policy*

Mathematical reserves are calculated according to precise formulae approved by ISVAP. By law and regulation, they must be not less than the premium basis. Zillmerization has recently been allowed, and is spread over the premium term subject to a maximum of 10 years. They must also be sufficient to provide for the liabilities assumed.

The main rôle of the Appointed Actuary is to sign a declaration certifying that the reserves are adequate to meet the liabilities. The Appointed Actuary would check that the calculations are correct. A technical note must also be inserted in the accounts of the company signed by the actuary to the company.

In addition, the auditors retain another actuary who certifies to the correctness of the reserves (this is a legal requirement).

Profit distribution is determined by each company. Only interest profit is distributed (usually in the form of 80% of the yield of the fund net of the technical interest rate).

Up to the present time there have been no restrictive actions by ISVAP on the

maximum percentage of the yield given to policyholders, subject to the company having sufficient capital.

The actuary would determine the percentage of the fund yield to be given to the policyholder according to the profit criteria of the company.

### *Investment Policy*

All assets covering the technical reserves are subject to constraints. In general, these constraints consist of maximum percentages investible in asset types.

Examples of the maximum percentages are:

	% of technical reserves
Government Bonds	90%
Bonds issued by special credit organizations	50%
Property	50%
Mortgages	50%
Debentures and shares	50%

In addition the power also exists to direct that a minimum holding in government bonds must be present. However, to date this power has not been used as the yields available on such bonds make them attractive to offices.

These constraints can (and do) change, but do not currently constitute a significant restriction to investment freedom in practice.

### *Statutory and Professional*

Italy has two actuarial associations. The National Order of Actuaries is the legal roll of actuaries upon which an actuary must be entered before he can sign off balance sheets. To become enrolled it is necessary to have an Italian degree in actuarial science (a four-year course) and have passed the state exam.

The Italian Institute of Actuaries (Istituto Italiano degli Attuari) is primarily a scientific body. Most actuaries belong to both organizations.

There is no statutory definition of the actuary (other than indirectly through the need to be enrolled in order to practise).

In Italy an enrolled actuary is required to certify both non-life and life technical reserves.

## LUXEMBOURG

### *Methods of Supervision*

Insurance companies are controlled by the Commissioner of Insurance, who has access to an actuary also employed by the Ministry of Finance.

Legislation is similar to Belgium. The Luxembourg authorities are trying to establish Luxembourg as an international centre which leads to the adoption of more liberal attitudes to insurers issuing policies in foreign currencies to non-nationals. New companies are required to submit quarterly returns. Single page annual returns are required after one year showing premiums, interest, expenses,

claims, reserves and profit participation. The authorities are also able to look at an annual valuation and E.C. solvency margin calculations, which are prepared in an agreed form.

### *Premium Rates and Product Design*

Premium rates, policy terms and conditions and the quotation basis must be submitted to the Commissioner for approval. Deviations from current market practice must be justified. Interest rates are laid down and approved population mortality tables must be used. Companies can reflect their own expense levels. If there is a change in tariffs, premium rates for existing business are recalculated. The actuary is essentially a technician.

Surrender values are laid down on a basis consistent with the premium rates. Domestic unit-linked products in Luxembourg francs are not currently permitted, although a change in the law is under consideration.

### *Reserving and Profit Participation*

The basis for unzillmerized reserves is consistent with the premium basis. A 3% zillmer may be shown as an asset for the purpose of the solvency margin. Zillmerization of reserves is currently being considered. Bonus rates are determined as part of the interest in excess of the technical rate of interest used in the premium rate basis. Approval is required for the level of participation, which is usually shown in the policy conditions.

### *Investments*

Insurers are required to deposit assets equal to the unzillmerized reserves with the State Bank. Approved assets only are allowed, and where these relate to domestic policies written in Luxembourg francs these are invested primarily in Grand Ducal fixed interest securities. There are limits on property investment and on the level of cash on deposit.

### *Statutory and Professional Position of Actuaries*

There is no actuarial association and there is no statutory rôle for an actuary. More importance is placed on the auditor.

## NETHERLANDS

### *Methods of Supervision*

Legislation delegates the supervision of insurance companies to an independent government agency, the Verzkeringskamer or VK. The VK authorizes an insurance company to write particular lines of business.

Insurance companies are required to submit annual statements to the VK (giving details of the profit and loss account, balance sheet, profit distribution, solvency margin, investments, the actuarial valuation and its method). The VK can make enquiries about completed returns and it audits each insurance

company's books at least every 10 years including checks on policy data and actuarial calculations.

The VK employs several actuaries to check the actuarial work of insurance companies. Some actuaries specialize in life or in health and general insurance.

### *Premium Rates and Product Design*

Companies are free to determine their own premium rates, which are normally determined by an employed actuary or a consulting actuary using a formula method. A group of insurance companies, which accounts for a substantial portion of the life insurance market, have agreements to operate on the same premium rates and contract terms. In addition, there is a minimum term insurance premium basis to which most companies adhere.

Premium rates and policy terms have to be filed with the VK, who can object. Therefore, in determining premium rates an actuary will bear in mind the views and requirements of the VK as well as operating in line with professional education and training.

There is scope for product design and a considerable range of products are on offer. Companies have tended to be conservative by U.K. standards, probably because of the need to convince the VK of the soundness of their terms and perhaps because of the nature of the Dutch investor. Usually the actuary is only responsible for pricing, but on other occasions the actuary can be responsible for both setting premium rates and for designing new products.

### *Reserving and Profit Participation*

No explicit regulations govern the determination of mathematical reserves, rather the basis has to be acceptable to the VK. A particular requirement of the VK is that the rate of interest must not currently exceed 4% and this has had some influence on product design. A maximum zillmer of 3% of sum assured for main classes of business is also understood to apply. Market practice is for a 2% zillmer together with regarding as an asset the unearned part of initial commission paid in advance. This unearned commission is reduced to zero over a period of five years, while it is recoverable on discontinuance. An actuary who is acceptable to the VK will have to sign for the mathematical reserves.

As companies are taxed on profit, the tax authorities are keen to restrain the use of mathematical reserves which are unnecessarily high. If he can, the valuation actuary will want to use a basis acceptable to both the VK and the tax authorities. This has resulted in the usual practice of valuing on the premium basis.

Where a premium has been calculated using a higher interest rate than 4%, then insofar as the premium is backed by high yielding investments, credit is allowed on the asset side of the balance sheet for the value of the interest surplus over 4%.

The actuary will take full responsibility for the method and accuracy of the mathematical reserves which he has to certify.

Each insurance company determines the method and the amount of profit distribution to policyholders. Where companies are operating on the same premium rates they will also tend, within agreed margins, to operate on the same profit distribution system, with the level of profit an area of competition between companies.

Although the management of the insurance company is responsible for the profit sharing system, they will normally seek advice from an actuary. Should the actuary be dissatisfied with the method or the amount of distribution, he can submit his views to the company's board of directors.

### *Investments*

There are no statutory constraints on the investment policy, although in practice supervision by the VK will normally lead to a fairly secure investment policy being adopted with a large proportion being in quoted and unquoted fixed interest investments and mortgages. The VK would object to too high a proportion of investments being in equities unless there was a good reason, e.g. they are backing unit-linked contracts.

The actuary does not generally play an active rôle in determining investment policy. Given the high proportion of investments in fixed interest and mortgages and the maximum rate of interest of 4%, little consideration is given to the assets when setting the valuation rate of interest.

### *Statutory and Professional Position of Actuaries*

There is no statutory definition of the actuary. The Law of Life Assurance Business (1922) provides for the signing of a statement by 'assurance mathematicians' and by the directors' 'mathematical advisers'. The VK will at their discretion accept statements by a non-qualified actuary.

It is not necessary for an actuary to be a member of the Actuarieel Genootschap (Actuarial Society), although in practice almost all of them are. Actuaris AG (Fellow of the Society) requires either completion of a university diploma course over at least six years or of a course with the Foundation for Education in Actuarial Science, which lasts even longer and permits office work during the day combined with evening study. Members of the Actuarial Society are bound by a code of conduct which sets out their functions, status and responsibilities. Membership as 'belangstellend lid' (interested member) is possible for F.I.A.s and F.F.A.s, who can practise locally providing there is no objection from the VK.

## PORTUGAL

### *Methods of Supervision*

Until 1982 the ISP -- 'Instituto de Seguros de Portugal' (Portuguese Insurance Institute) based its supervision mainly on the control of tariffs.

In April 1982 a law (Decreto-Lei no 98/82) setting out the financial guarantees

that should be provided by the insurance companies was enacted. That law established the 'technical provisions' that the insurance companies should maintain and also the rules for the calculation of the 'solvency margin' and the 'guarantee fund'. Minimum levels have been set up and are announced each year.

Since 1983 the ISP, besides controlling tariffs and the calculation of the technical provisions, has also begun to control the calculation of the solvency margin and the type of assets that represent it (capital and reserves).

There is a strong tendency in the Portuguese market towards a liberalization of tariffs and, to a certain extent, to control based on the margins mentioned above. However, it is only in the transportation branches, excluding automobile, that the tariffs are really free.

The Portuguese Insurance Institute has an Actuarial Department composed of three actuaries that work only with life insurance. In practice, they study and propose all the technical legislation related to life insurance and they are also responsible for the technical analyses of all the life products sold in the Portuguese market.

### *Premiums and Product Design*

Premium rates for life insurance sold in Portugal are determined by each company. Having, in the past, been heavily constrained by regulations, the ISP have been moving towards a more liberal approach coupled with regulation of minimum reserving levels. However:

- (i) mortality tables and interest rates are imposed by the ISP;
- (ii) the maximum commissions that can be paid to agents and brokers are also regulated.

Subject to the constraints mentioned, the actuaries calculate premium rates which are submitted for the approval of the ISP.

The attitude of the ISP has been quite open concerning new product designs and, therefore, the rôle of the actuary in innovation is very important.

### *Reserving and Bonus Policy*

The mathematical reserves are calculated according to formulae that are approved by the ISP for each product. Actuaries are responsible for the correct calculation of mathematical reserves on bases the same as those used for the calculation of the tariffs.

The methods and amounts of profit distribution to policyholders are determined by each company according to rules proposed to, and approved by, the ISP for each product (or group of products). The single restriction is that at least 75% of the profits shall be distributed to policyholders. Only for some types of group policies the percentage of distribution can be lower.

The actuary proposes to his company a method of profit distribution for each product and is responsible for the proposal that is sent to the ISP.

### *Investment Policy*

The types and the 'mix' of assets that can represent the technical provisions of the insurance companies established in Portugal are determined by legislation. The legislation refers to the types of assets that are acceptable and the minimum and/or maximum percentages of the total amount of assets that they can represent.

In Portugal the rôle of actuaries in investment policy is negligible.

The amounts of the mathematical reserves are not dependent on the asset structure of the companies.

### *Statutory and Professional*

According to the General Labour Agreement of the Portuguese insurance activity the actuary is "the employee that has a university degree in mathematics or in other science, with a specialization in actuarial science, that studies tariffs, does the appropriate actuarial calculations, controls or elaborates the technical basis of the mathematical formulations of the statistical processes or executes the corresponding statistics and the related studies".

Currently actuaries are not obliged to be members of the National Actuarial Association (Instituto dos Actuários Portugueses) but almost all (if not all) of those working in the Portuguese market are members of the Association.

Candidates wishing to join the Portuguese National Actuarial Association shall prove that they have a university actuarial degree and/or that they have practical experience as actuaries. They must be proposed by two members who can certify their professional competence.

## **A SINGLE EUROPEAN MARKET FOR ACTUARIES**

Summary of the discussion at a joint meeting of the  
Institute of Actuaries and Faculty of Actuaries, held at the  
Institute of Actuaries, 27 June 1989

### **INTRODUCTION**

An Institute Working Party, under the Chairmanship of Mr D. G. R. Ferguson, presented the above paper to the meeting. Some 150 members and guests of the Institute and Faculty were present, including many guests from overseas. Actuaries from ten of the twelve E.C. countries were represented. The President of the Institute (Mr R. D. Corley) chaired the meeting, assisted by the President of the Faculty (Mr J. M. Souness). There was a wide-ranging discussion on many questions of fundamental importance to both the profession and the life assurance industry throughout the European Community. It was agreed that major changes were looming over the horizon and that it was essential that adequate notice was taken of the profession's views if these changes were to be of real benefit to consumers throughout Europe.

More than twenty persons spoke at the half-day meeting, many of them overseas visitors, and a number of letters from distinguished European actuaries and actuarial bodies were read out. This report aims to summarize the main points which were raised in the discussion but does not claim to be a full record of the proceedings. Apologies are offered to all those whose contributions have not been given adequate mention, particularly to those who have not been named.

Four main themes dominated the deliberations and this summary groups the views expressed on each of these in turn before drawing some general conclusions. The themes were: the status of the actuary, the conflict between laissez-faire and dirigiste regulatory approaches, the prognosis for harmonization and the need for improved communication.

### **THE STATUS OF THE ACTUARY**

Overseas contributors felt that the report has been too narrow in its description of the rôle of the actuary in their particular countries. Mr G. Drude, in a letter, pointed out that German actuaries had a deeply felt responsibility to ensure that the valuation basis was adequate, and thus their tasks involved substantially more than merely the certification of the correctness of the calculations for the returns. There had been significant innovative product development in Germany, and in each case the actuary was responsible for satisfying the authorities that the technical bases were adequate. Investigations to ensure the equity of bonus distributions were carried out in a similar manner to the United Kingdom. Dr M. Helbig amplified those comments, adding that not



only were the underlying principles identical in both countries, but that also very much the same degree of skill and understanding was required. The German Actuarial Society had recently introduced an examination-based training programme. Mr P. J. Turvey felt that the differences between U.K. and German actuaries were no greater than those between different U.K. members. Mr M. Lacroix feared that not sufficient attention had been paid to the rôle of the actuary outside life assurance, and in particular explained that French actuaries were centrally involved in supervising the assets where this was relevant to policy design. In practice actuaries and regulators worked closely in France. Professor A. D. Wilkie pointed out that whatever the formal position, many actuaries were involved at the very highest levels in the management of life companies throughout the Community.

Mr P. N. S. Clark did not think that the U.K. profession should view this debate in terms of protecting vested interests. Many subsequent speakers agreed, stressing the profession's duty to the consumer as being of paramount importance, and highlighting its responsibility to establish how this could best be fulfilled.

#### LAISSEZ-FAIRE AND DIRIGISME

One of the topics raised in the paper was the question as to whether the consumer was better served by the U.K. system of freedom with publicity or by the more dirigiste approach of overseas regulators. Mr C. D. Daykin was clear that a market could only be said to be free if there was freedom to sell products with different policy conditions and premium rates, and hence that an adoption of the U.K. system throughout the E.C. would represent the best possible way forward. In a letter Mr T. J. J. van den Heiligenberg went further, and suggested that the introduction of a minimum reserving basis, a move which had been strongly resisted by all parties in the Netherlands, would serve no useful purpose and would merely lead to increasing restrictions on the ability of the actuary to apply his judgement. The President (Mr R. D. Corley) invited those Appointed Actuaries who were present to explain their rôle for the benefit of overseas guests. Mr A. G. O'Leary and Mr M. A. Pickford described the system of supervision through extensive disclosure of information in Returns to the Department of Trade and Industry from their perspectives as Actuary and regulator. Mr Pickford informed the meeting of changes that the DTI would like to see introduced—these included company visits by DTI personnel and changes to the Institute's disciplinary code. Mr B. R. Macdonald, however, questioned the practical usefulness of the DTI Returns. Mr H. H. Scurfield explained that, as Appointed Actuary to a mutual, he saw his task as ensuring that the maximum possible benefits were obtained for policyholders, with the proviso that their guaranteed benefits were paid in full. His responsibility to the regulators was merely another incarnation of his responsibility to policyholders. Historical evidence indicated that a policy of investment in equities and property could be shown to double the total yield available relative to fixed interest assets, and he

wished to retain the freedoms which had enabled his office to pursue such a policy in the past.

Other speakers, from both sides of the Channel, were less Manichean in their views. Professor A. D. Wilkie expressed the view that there was a spectrum of possible regulatory stances, the extremes of which would be generally unacceptable to all parties, but that there was a range of acceptable solutions in the middle ground. Mr R. B. Akhurst saw convergence of approach arising through transference of technology and product design, particularly by multinationals, and suggested that the increasing competition between different financial media would provide pressure for a solution to be found, and Professor S. Benjamin added that it was the practical application rather than the theoretical framework of a regulatory system which was of importance. Mr T. J. Ward perceived that it was not the inflexibility of the German supervisory authorities but the attitude of the major Companies that was responsible for the generally-held view of the lack of flexibility in that market. However, in another section of his letter, Mr G. Drude explained that German insurers, whilst restricted on premium rates and policy conditions, were very competitive on profit sharing and Dr P. Iona felt that the Report had likewise been less than fair in its description of the Italian system. Mr A. G. O'Leary foresaw that the opposing forces of increasing consumer pressure and the need for consumer protection would act on the two extremes of the regulatory spectrum, causing each to regress to an intermediate mean.

Mr P. N. S. Clark called for a working party to assess the merits of both regimes, and this was echoed by Professor S. Benjamin who had clear doubts as to whether the U.K. system had provided adequate returns to policyholders terminating their contracts early. The idea was also welcomed by other speakers, who had fewer doubts as to the benefits of freedom with publicity but saw the need to produce evidence to justify their beliefs. Suggestions were advanced that this working party be composed of actuaries and regulators from all the countries of the Community, together with a representative of the Commission.

#### HARMONIZATION

Many contributors reminded the meeting of the enormous task involved in harmonizing life assurance in the Community. Professor A. D. Wilkie called for the adoption of the ecu, and for the replacement of national restrictions on foreign investments by restriction on investment outside the E.C. Mention was also made of the need for contract law to be unified. Mr C. A. Evers reminded the meeting of the effects on current U.K. practice of the Insurance Accounts Directive. Mr W. E. Pool, formerly of DG XV at the Commission, noted that the Commission was duty bound to make proposals for home country control with mutual recognition by 1992, although it was unlikely that the harmonization process would itself be fully completed by that date. The measures would be adopted by majority voting, and thus the British and Irish representatives would

not be able to veto an approach acceptable to the other members. Certain member states did not find the current British system adequate as a protection for their own consumers. Taxation measures, on the other hand, could only be adopted through unanimity and would not, therefore, precede the harmonization of the regulatory process. Mr T. J. Ward feared that a single system would contain the worst excesses of each country's regime, and felt that unification would not be practicable until agreement had been reached on taxation. Mr A. G. O'Leary expressed the hope that it would be possible to reach a position where both systems would be permitted to co-exist. One uniform regime throughout the E.C. might prove to be founded on an unsatisfactory compromise, whilst his suggested approach would produce a solution with the minimum disruption within a relatively short time frame. Mr H. H. Scurfield had misgivings as to whether this co-existence could be achieved, and Mr B. Duncan felt that not only was this initially appealing approach not compatible with the aim of creating a single market, but also that anomalies would arise which could be exploited.

However, Mr M. H. Field was of the opinion that the industries on either side of the Channel were so different in nature that the only solution was for the two systems to be allowed to continue side by side. Dr P. Iona reiterated that care should be taken to ensure that environments which thrived under different conditions were not destroyed, and that this was a strong argument for a gradual approach.

#### COMMUNICATION

It was generally felt that greater communication by all parties was essential for progress to be made. Many speakers supported Professor C. Angela's call for a united approach by the actuarial professions, although this would have to be preceded by an agreed consensus between these bodies. Mr C. D. Daykin called for the need to develop relations between actuaries in member states and for a greater understanding of the various environments in which they operate, whilst dialogue with the regulators was also essential. Mr B. R. Macdonald reported on the Faculty's efforts to promote such links and asked for support for their European Research Group. Mr W. E. Pool advocated a clear exposition of the British and Irish systems to the European Commission and Parliament who were more familiar with the Continental regimes. This should be carried out either through the Groupe Consultatif or, if necessary, separately. The ultimate beneficiary of the actuaries' stewardship of a life company was the consumer and therefore national consumer associations should be fully involved in any discussions so that they could knowledgeably influence their governments. He also contrasted the ease with which the insurance industry could express its views on these topics in official quarters with the more indirect lobbying power of the consumer groups. Mr R. E. Brimblecombe mentioned the rôles of the Association of British Insurers and Comité Européen des Assurances in this

context, and hoped that the large number of actuaries involved in these bodies would provide a conduit for communication. He also reminded the meeting of the plagues which had recently been sent down upon the life industry in the U.K. and that these might have been avoided had the industry been more actively communicative in the past. Mr L. J. Martin drew attention to the fact that the Groupe Consultatif existed to represent the unanimous views of the profession in the Community and had already drafted a paper on life assurance which would explain the issues to E.C. officials. It was important to explain the strengths of the U.K. system to Continental colleagues and to supervisors, not only at this meeting and at similar meetings held abroad but also at the Colloquium in Amsterdam in September 1989.

The Groupe Consultatif was also examining the Higher Education Diplomas Directive and would be making recommendations to the national bodies.

#### GENERAL CONCLUSION

There appeared to be a number of views which were repeatedly expressed and met with little or no opposition. This subject is a very important one which requires speedy but thoughtful action on the part of all interested bodies. An educational process is an essential first step. The European professions must understand each other's systems more deeply in order to appreciate the advantages of each. A multinational working party is needed to establish how the benefits to the policyholder have been influenced by the nature of each regime. Whilst some contributors made a plea for mutual recognition of very different systems and argued against hasty standardization which might undermine the well-being of currently thriving industries, others foresaw the historical inevitability of a convergence driven by forces more powerful than even those of European harmonization. Regulatory, industry and consumer organizations should be kept fully informed of the situation and of the professions' consensus, as should government and community institutions. It should be remembered throughout that, whilst each man is a debtor to his profession, the profession itself owes a duty to the public, and that the narrow-minded protection of vested interests is not a motive which should influence these deliberations.

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