The Actuarial Profession
making financial sense of the future

SUBMISSION BY THE ACTUARIAL PROFESSION

In Response to the Morris Review's Interim Assessment of December 2004

4 February 2005

The Actuarial Profession
making financial sense of the future

Sir Derek Morris
Morris Review
GC/08
1 Horse Guards Road
London
SW1A 2HQ

4 February 2005

Dear Sir Derek

On behalf of the Institute of Actuaries and the Faculty of Actuaries, working together as The Actuarial Profession, we enclose a response to your Interim Assessment of December 2004. None of the content is confidential. As you would expect, we are placing a copy of the response on our web site in addition to the copy that you will be placing on your own site.

Yours sincerely

M. Pomery

Michael Pomery
President, Institute of Actuaries

Harvie Brown
President, Faculty of Actuaries

Institute of Actuaries
Staple Inn Hall
High Holborn
London WC1V 7QJ
Tel: 020 7632 2100
Fax: 020 7632 2111
e-mail: institute@actuaries.org.uk
www.actuaries.org.uk

Faculty of Actuaries
Maclaurin House
18 Dublin Street
Edinburgh EH1 3PP
Tel: 0131 240 1300
Fax: 0131 240 1313
e-mail: faculty @actuaries.org.uk
www.actuaries.org.uk

CONTENTS

1 INTRODUCTION

The context for this submission

At the time the Review was announced, the Profession had commenced a series of initiatives which, as the Review has acknowledged, represented an extensive programme of change. We went into the review process with confidence in the changes we had envisaged, but with our minds open to new proposals.

In its interim assessment, published last December, the Review expressed support for both the new Education Syllabus, on which students will be examined for the first time this April, and the new Disciplinary Scheme, which came into effect at the start of 2004. The Review also indicated that it shares our view that the actuarial standards-setting body should be independent of the Profession, with the Review making a specific recommendation (the “FRC model” discussed in Chapters 3 and 7) which would enable this to happen more decisively than the Profession is able to deliver under its own powers.

Our proposals for peer review were still in development when the Review began and our ideas on the revalidation of professional competence were at a very formative stage. The principle of scrutiny and the need for continuous updating of actuarial skills have not been questioned, but the Review has challenged our ideas on these topics and shone new light on both these areas.

The Review’s interim assessment also made a number of additional proposals and identified a wide range of options for the way forward. In essence, the Review has expressed the view that the pace of change should be accelerated and the proposals for the future should go further, and in some cases wider, than the Profession had envisaged or was able to deliver under its own powers. Our comments on those options form the substance of this submission.

The Review has also expressed a number of criticisms of actuaries and of the professional body. But the Review set those criticisms in the context that both the Review and those who responded to its consultation found actuaries almost always to be “dedicated, skilled professionals providing an important and useful service … with commitment, integrity and a strong sense of professional duty” and the UK profession to be “well respected and … a world leader in moving the profession forward globally”.

Our response to the Review’s interim assessment

In our view, the general tone and direction of the Review’s interim assessment reflects the very thorough way in which the Review has assimilated information about actuaries and the work that we do. We consider that the overall balance of the interim assessment is fair, both in terms of its criticisms of, and its support for, the profession.

That is not to say that we agree with every detail of the Review’s assessment. In a different forum, we might have wished to dispute some of the findings, but the purpose of this submission is to focus on the profession’s future, not its past. We have commented on the Review’s findings of fact, and on its opinions, only where it is essential to an understanding of this response.

We consider the Review’s central proposal – the combination of independent standard-setting, coupled with independent oversight of the professional body’s remaining self-regulatory functions (the FRC model referred to above) – is one that we can support. The details need to be worked through: some of them are addressed in the options articulated by the Review and we comment on those in this response. Other details remain to be worked out in due course.

Finally, the Review has asked some searching questions on the duties of individual actuaries to the public interest and on the accountability of individual actuaries. The Review has offered some possible answers in relation to the range of specific roles reserved to actuaries by statute, but left the question open in relation to other actuarial roles. It is the Profession’s view that obtaining clarity on this issue will be one of the most critical outputs from the final report. The success and the endurance of the other proposals may depend on a clear resolution of this issue.

2 THE MARKET FOR ACTUARIAL SERVICES

General remarks

Chapter 2 of the Review's interim assessment addresses the efficiency and competitiveness of the actuarial services market. In large part, the issues raised in the Chapter are matters for firms providing actuarial services to comment on, individually and/or through the Association of Consulting Actuaries, the representative body for consulting actuaries. Nevertheless, several of the options which the Review has set out for consultation raise issues of public interest and we have the following observations.

Increasing competition

Options

- Option 1: to the extent that the availability of professional indemnity insurance cover is acting or may in the future act to constrain entry and limit choice, ways could be explored of introducing liability caps; and/or
- Option 2: in the pensions area, unbundling the provision of advice related to statutory roles from other types of advice (particularly investment consulting services) would help open up the market to greater competition.

Option 1: Liability caps

The issues surrounding liability caps are notoriously difficult. The Review's assessment is that litigation risk acts as a disincentive to entry (paragraphs 2.30 and 2.76), which seems self-evidently true, especially since new entrants would, initially at least, tend to be small firms or sole practitioners.

There is, however, a trade-off between creating protection for advisers, so as to encourage more firms to enter the market, and removing from clients some of the protection they have from the consequences of negligent advice. We would not want to encourage an environment in which actuarial advisers became complacent about the consequences of giving negligent advice. We imagine that this is the point alluded to by the Review in paragraph 2.120 of the assessment.

An additional argument in favour of liability caps which is not articulated in the Review's interim assessment is that, even for the largest of firms, there are monetary limits to the insurance cover that is available. A very substantial claim will go through the top of even the largest policy currently available, with the result that, if a court determines the advice to be negligent and the losses to be substantial, a firm may be rendered insolvent. The effect may, therefore, reduce competition in the market without adding significantly to the compensation obtained for those who lost out.

Ideally, liability caps would be introduced in such a way as to encourage into the market advice that would not otherwise be available, without in any way lowering incentives for those who are present in the market to be very diligent over the quality of their advice.

Option 2: Unbundling advice related to statutory roles from other advice

The fact that some advice is restricted, by statute, so that it can be given only by actuaries ("reserved advice") creates the potential for anti-competitive behaviour and/or conflicts of interest when the actuary, or colleagues in the same firm as the actuary, also provide other, non-reserved advice. This situation is not, of course, unique to the actuarial profession.

Anti-competitive behaviour

The Review has looked at the question of anti-competitive behaviour and has expressly reported its assessment that it "did not receive any evidence or suggestion of explicit product tying or cross-subsidisation" (paragraph 16 of the Executive Summary).

That is to say, the Review has investigated and found that:

- neither actuaries nor their firms are imposing a condition that clients who purchase reserved advice must also purchase non-reserved services from the same firm; and that
- neither actuaries nor their firms are selling non-reserved services at a price below the economic cost, so as to eliminate competition from other providers whilst recovering the shortfall on those non-reserved services by charging a rate above economic cost for the reserved services.

Conflicts of interest

There is also the possibility that advisers, or their firms, may find themselves facing a conflict of interest in that advice given on one issue may increase or decrease the likelihood of obtaining further work in another area.

The Review refers (at paragraph 2.67) to the findings of Paul Myners in his 2001 Review of Institutional Investment in the UK and, in particular, Principle 4 of the "Myners principles" – a set of principles of best investment practice for the trustees of occupational pension schemes. Principle 4, as originally articulated in 2001, advocated that "Contracts for actuarial services and investment advice should be opened to separate competition."

The Government has since reviewed the working of the Myners Principles and now proposes to amend Principle 4 so that the contract for investment advice should be split further so that advice on strategic asset allocation and advice on fund manager selection should also be opened to separate competition (leading to three separate contracts: scheme actuary services; strategic asset allocation; and fund manager selection).

It is important to note that the principles, both in their original form and as now proposed by the Government, are principles to be adopted by pension funds and their trustees. The principles do not call for any specific action, or avoidance of action, by actuaries. It is not suggested by Myners or by the Government that actuaries should refrain from bidding for contracts in which two or more of these services are bundled together, if clients or prospective clients invite them to do so. The Profession's ethical code, the Professional Conduct Standards (PCS), will, of course, continue to prohibit an actuary from advising a client where there is a conflict of interest, or even the appearance of a conflict, unless the client gives its express consent.

The Morris proposals

In general, the Review is satisfied that the market for actuarial advice has no undue concentration, ie that there is a sufficiently wide choice of service providers (see paragraph 2.118). The only exception cited by the Review is in relation to the provision of actuarial and investment advice to larger pension schemes, which is dominated by four large firms, but as noted above, the Review has found no evidence of anti-competitive behaviour.

The Review has suggested that, in the pensions area, unbundling the provision of reserved advice from other types of advice, particularly investment consulting services, would help to open up the market to greater competition.

Our understanding is that, as with the Myners Principles, this particular proposal is one recommended to be adopted by pension funds, their trustees and, where applicable, their sponsoring employers (for example, where scheme administration services are contracted out by the employer).

It is not suggested, as we understand it, that actuaries should refrain from bidding for contracts in which reserved and non-reserved services are bundled together if clients or prospective clients invite them to do so (and provided that the provision of related services does not put any of the advising actuaries in breach of the PCS rules on conflicts of interest). Nor is it suggested that the same firm of actuaries should be prohibited from providing two or more services.

Whilst we have no qualms about the proposal as it stands, we would be concerned about any rule in which pension schemes were effectively to be policed by actuaries (or by firms) at the stage when they were bidding for work and had not yet been retained as advisers.

Increasing market testing

a) greater scrutiny of performance

Options

- Option 1: increased education/expertise of users; and/or
- Option 2: regular formal reviews of advisers could be recommended or required every 3-5 years; and/or
- Option 3: performance measurement of actuaries could be encouraged; and/or
- Option 4: effective peer review of actuarial advice could provide actuaries with a set of incentives that encourages them to improve the clarity of advice they provide, both technical and in relation to underlying assumptions.

Option 1: Increased education/expertise of users

We agree that it can only be of benefit if users of actuarial advice have greater expertise in actuarial matters. The Review has noted that the Pensions Act 2004 requires trustees to have knowledge of investment matters (paragraph 2.130). The Act also requires trustees to have knowledge of the principles of pension funding. No doubt, the legislation will encourage trustees to acquire more knowledge in such matters. The Review has noted that some initiatives are already under way (paragraph 2.130 again).

In the case of life assurance, the FSA has introduced new governance structures which are already bringing about greater scrutiny of actuarial advice at board level. This, too, is likely to increase demand for education which the market is responding to. The Actuarial Profession, itself, will be holding seminars for non-executive directors.

Option 2: Formal review of advisers every 3-5 years

We have a number of concerns about the viability of this proposal.

Actuarial advisers to pension schemes
The Review argues that re-tendering of actuarial services has a benefit in that the users will have satisfied themselves that they are obtaining value-for-money, even if the result of the tender is that the incumbent firm of advisers is reappointed (paragraph 2.33). The Review also reports the evidence obtained from users of actuarial advice that the costs of a tendering process were not high (paragraph 2.39).

The inference is that the Review considers the benefits of this proposal outweigh the costs. But the costs the Review has looked at appear to be only the costs directly observed by the user. The Review does not appear to have taken into account the additional costs to the actuarial firms, part of which – most likely a large part – will, through normal market forces, end up being recovered through higher fees charged to users. Our analysis is as follows.

The main cost to firms tendering for new contracts is the time cost of staff putting together a proposal, ie the costs of employing staff for the time during which they are researching and writing proposals. Clearly, this time cost has to be recovered (along with other costs) through the fees charged to clients. If the number of proposals increases significantly, the time cost relating to proposals will also increase significantly. An effective proposal for consultancy work is rarely – and arguably never – an off-the-shelf document. Currently, it is not unusual for firms to be invited to submit one or more new proposals per week – and this frequency arises in an environment which the Review apparently considers to have insufficient tendering. Analysis is needed to explore whether the increase in competition which this proposal may bring about can be expected to reduce fee rates by more than is needed to recover the additional cost of producing the proposals.

In addition to the cost issue, there will almost certainly be adverse behavioural consequences if this proposal is followed through. If pension schemes routinely re-tender the work, even when they are satisfied with the advice they are getting, with the result that a significantly high proportion of tenders end up leading to retention of the incumbent advisers, firms will naturally become quite sceptical about entering into the tendering process. It is one thing to bid for work which is genuinely up for tender; it is quite another to bid for work where all the indications are that the prospective client has little inclination to change unless one of the bidders can offer something unexpected.

Over time, consultants (of all professions) become quite astute at spotting the pointless invitations to tender and either decline to bid or else submit a bid whose purpose is to signal to the market an increase in fee rates. The Review will appreciate that this response is entirely to be expected of players in a market which is functioning as it should do and not, in any way, a suggestion that actuaries would misbehave to frustrate an otherwise effective mechanism.

Actuarial advisers to life and general insurers
In the case of insurance, there may be additional complications. The contracts of external advisers can be drawn up to include periodic re-tendering, but the same may not be true of employed actuaries.

On the face of it, employed actuaries whose position is to be reviewed periodically would need to be on fixed term contracts. But UK employment regulations (brought in to comply with the *EC Directive on Fixed Term Work*) require that employees on fixed term contracts should be treated no less favourably than comparable permanent employees, unless objectively justified. The regulations also place limits on the use of successive fixed term contracts. The regulations may not prevent this option being brought into effect, but the point needs to be examined.

Plainly, the protection that policyholders gain from the regulatory requirement on companies to appoint an Actuarial Function Holder and a With-Profits Actuary (in the case of life offices) or Syndicate Actuaries (in the case of syndicates at Lloyd's) should not be undermined as a result of unsuitable individuals remaining in post simply as a result of employment protection laws, but it is a matter for the FSA to decide (as they have apparently already done in the case of life offices) whether it is acceptable for companies to appoint employees to these posts.

Other than the three roles mentioned above (Actuarial Function Holder, With-Profits Actuary and Syndicate Actuaries), there is no requirement on insurers to take actuarial advice.

Option 3: Performance measurement of actuaries to be encouraged

Performance measurement of those providing actuarial services is very much to be encouraged.

It is not immediately obvious how one might measure the quality of advice, especially in those cases where the advice is, of necessity, subjective and long-term in nature, but measures to test the quality of service and the delivery of value for money should not prove difficult to devise. If users of actuarial services show any interest in such monitoring, we expect that various measures will be devised and offered to users.

Option 4: Peer review as an incentive to improve the clarity of advice

Hitherto, peer review has been discussed by the Review in the context of compliance with actuarial standards and the underlying legislation or regulation. This proposal takes the concept of peer review to another level: the suggestion is that the peer reviewer will comment, either directly or indirectly, on the quality of communication, leading to increased clarity of advice.

Bearing in mind that the issue of peer review (as currently drawn) is already a contentious one, with many commentators, including some user groups and regulators, undecided about, or even opposed to, the introduction of peer review, a proposal which extends the ambit of the review (or even just the expectations of what might be delivered) may make any form of peer review less likely, rather than increasing the benefits.

Moreover, whilst we welcome anything that helps to improve actuaries' communication skills and, thereby, increases users' understanding of actuarial advice, we are not convinced that this proposal would deliver the intended results. The proposal seems to be predicated upon either or both of the following assumptions:

- that actuaries generally have the necessary communication skills, but need to be reminded (by their reviewer) to use them; and/or

- that those actuaries who are peer reviewers typically have the requisite communication skills which they can pass on, directly or indirectly, to those who provide advice.

Both of those assumptions seem to be at odds with the Review's findings (see, for example, paragraph 1.24) and at odds with our own experience.

The Actuarial Profession is committed to seeing an improvement in actuaries' communication skills and, as we said in our September submission, the real communication problem lies in choosing what to communicate, not in the use of language for the communication. We offered some reasons why the problem exists and explained what the professional body has been trying to do to remedy it, for example through the *Communications* exam, albeit not entirely successfully as yet. We are not at all convinced that peer review provides a helpful mechanism in this particular context and we would be disappointed if the existing opposition to peer review was exacerbated by a proposal to extend its scope or raise expectations of what might be delivered.

b) improving user understanding

Options

- Option 1: user knowledge and understanding should be encouraged by measures to raise the required standards of knowledge and expertise, of which several initiatives are already in train; and/or

- Option 2: in relation to pensions, trustees could be given information on the Profession's own guidance notes, to better understand what actuaries are supposed to do. This could be used as a basis for encouraging more systematic challenge; and/or

- Option 3: greater use of professional trustees or trustees who are members of several trustee boards.

Option 1: Measures to raise the required standards of knowledge and expertise

We support this proposal and make the same observations as for Option 1 under part (a) above (increased education/expertise of users).

Option 2: Provision of information to trustees on the Profession's guidance notes

We support this proposal and would be very happy to work with the NAPF, or perhaps the incoming Pensions Regulator, to provide suitable material for dissemination to trustees.

Option 3: Professional trustees or trustees who are members of several trustee boards

In principle, we support this proposal. Our understanding is that the supply of these services is limited, in part because of the difficulty in obtaining liability insurance. (Although many trustees are given a degree of indemnity, there is often an exception where the trustee is a professional.) If liability caps are introduced for actuaries, there may well be a case for introducing them for trustees also, subject to the same considerations as mentioned in our comments above on that proposal (see options for increasing competition at the beginning of this section).

Improving clarity of advice

Options

- Option 1: leave it to the market, on the basis that if users can be encouraged to challenge more effectively, actuaries will stand or fall by their ability to respond positively; or
- Option 2: improve actuarial training and CPD requirements to equip actuaries with improved communication skills; and/or
- Option 3: require clearer disclosure of actuarial advice, assumptions and key sensitivities. For example by requiring the disclosure of forward-looking financial condition reports; and/or
- Option 4: explore means by which regulatory requirements might be simplified.

We agree with the Review that improving the clarity of advice is a critical issue for the profession as a whole. The importance of this issue is stressed in our comments in Chapter 5 where the "understanding gap" (to use the Review's term) is discussed in terms of its impact on accountability and consequences for the public interest. In that Chapter we suggest that, just as the *Accounting* Standards Board and its predecessors have addressed the issue of defining the form and content of accounts so that they can be understood by their users (which include the lay public and not company directors or pension trustees), so the proposed Actuarial Standards Board might do likewise for actuarial reports.

So far as the review's specific Options are concerned, we comment as follows.

Option 1: Leave it to the market

The market should certainly be encouraged in the manner described in the proposal (ie encouraging users to challenge more effectively, so that actuaries stand or fall by their ability to respond), but so far it has failed to deliver.

This is, perhaps, understandable. If, as we indicated in our September submission, the ability to communicate actuarial concepts to non-actuarial audiences calls for a skill which is not a natural fit with being a person attracted to an actuarial career (whom we described as a "mathematically oriented problem solver"), the market is unlikely to deliver the necessary remedy. The time lag between an individual's decision to embark upon an actuarial career and the attainment of sufficient standing to be in a position to provide actuarial advice is too great. We, therefore, favour the implementation of the other options suggested by the Review – see below.

[Note: It is not the time to qualify that is relevant here; it is (to quote from paragraph 6.86 of the Review's interim assessment) the "need to acquire the relevant on-the-job practical experience before being eligible for full qualification as a Fellow and to work in reserved roles."]

Option 2: Actuarial training and CPD to improve communication skills

As noted above, and in our September submission, the Actuarial Profession is committed to seeing an improvement in actuaries' communication skills. Any improvement in actuarial training or CPD which has this outcome is to be welcomed.

Option 3: Requiring clearer disclosure of advice, assumptions and sensitivities through forward-looking financial condition reports

As attractive as this proposal looks at first sight, we wonder whether it can be delivered – and, if so, how. We don't wish to appear defensive about this issue (indeed, we consider we have been extremely open to the Review about communication difficulties), but we suggest that:

- Disclosure of actuarial assumptions and sensitivities is already a requirement in several places within actuarial standards. There is a general requirement in the Professional Conduct Standards[1] and several specific requirements in Guidance Notes.[2]
- To "require *clearer* disclosure" [our italics] is to suggest that actuaries know how to make clearer disclosures, but currently lack the willingness to do so. We do not believe that to be the case and we do not believe that the Review is of that view either.
- The introduction of forward looking financial condition reports would not be a new departure, as such. The Review notes in paragraphs 5.8 and 8.46 that the financial condition of insurers and of pension schemes is already the subject of reports.

  In the case of pension schemes, as the Review notes (paragraph 8.46), the financial condition is described in three reports, viz the employer's accounts, the pension scheme accounts and the triennial valuation. As the Review no doubt appreciates, each of those reports is directed at a different audience (shareholders, scheme members and the trustees, respectively) and the information requirements of each group may well be different. If the suggestion is that a single financial condition report would bring all the information together in one report shared by the disparate groups of users, we are not at all convinced that this would increase clarity. Indeed, we rather suspect that the reverse might be the case.

Option 4: Regulatory requirements might be simplified

Simplification of regulatory requirements is generally to be welcomed (so long as simplification does not undermine the objectives of what is otherwise good regulation). We are not sure,

---

[1] PCS, para 3.5: "Advice should normally include sufficient information and discussion about each relevant factor and about the results of the member's investigations to enable the intended recipient of the advice to judge both the appropriateness of the recommendations and the implications of accepting them …"

[2] For example, in life assurance, GN1, paragraph 2.2, requires the disclosure of "all material valuation methods and assumptions". A similar requirement is found in GN43, relating to friendly societies.

GN40 includes: "The actuarial function holder has a duty to advise the [insurer] on the methods and assumptions used …. This advice must include sufficient information and discussion about each relevant material factor to enable the [insurer] to judge both the appropriateness of the advice and the implications of accepting it, including the implications for the policyholders of the firm."

GN2, paragraph 1.6, recommends that financial condition reports to life offices should include dynamic solvency testing, ie "projecting the office's revenue account and balance sheet forward … to establish the sensitivity of the office to changes in that particular assumption or assumptions."

In pensions, GN9, paragraph 2.44, requires the actuary's report on a pension scheme to "contain a summary of both the demographic assumptions and economic assumptions made" and to "describe or illustrate how the results … will differ if these assumptions are not borne out so that the reader may understand the sensitivity of the results to the assumptions chosen."

GN16, paragraph 3.1(e) requires a Bulk Transfer certificate between pension schemes to disclose "the key actuarial assumptions that have been used to value the rights, transfer credits and any discretionary benefits or increases in benefits."

GN21, paragraph 3.4 requires the actuary's report on post-retirement medical plans to "state, with explanations, the methodology and all assumptions used to calculate plan liabilities including what (if any) allowance for tax has been made."

however, that regulatory simplification provides a solution to the communication issue. We have two reasons for saying this.

First, experience shows that simplifying regulations is easier said than done. For example, the "self-assessment" tax regime introduced in the 1990s began life as "simplified assessment", before being officially re-named . There are other examples also.

Secondly, although we said in our September submission (in our answer to Qu 1.25) that one of the factors contributing to a lack of clarity might be a tendency for actuarial reports to be written from a compliance point of view, rather than a communications perspective, we do not think that it is necessarily the complexity of the compliance regime that leads to this result.

To repeat what we said last September: "The fear of regulatory sanctions or negligence litigation encourages actuaries to write defensively, just as it encourages all professions to think about ways to minimise claims, rather than maximising delivery." It is not the complexity of the regulations that leads to this result; it is the complexity of the material being communicated, coupled with the sanctions for not complying.

3 THE PROFESSION AND REGULATION

General remarks

The Profession agrees with the Review that self-regulation of professions by their own professional body has weaknesses which are being exposed in a number of disciplines. The transition to independent regulation has begun in other professions and we consider the actuarial profession should follow that lead. This requires legislative and other external changes which are beyond the powers of the Profession to deliver on its own. We hope that the Review's interim assessment will be followed through into a final recommendation and be taken up by Government.

The Model B Option (described by the Review as "independent oversight") is the model preferred by the Review. We agree and discuss the model in more detail below.

The remaining model discussed in Chapter 3 of the Review's interim assessment is Model C (described by the Review as full statutory regulation). We agree with the Review that full statutory regulation of the actuarial profession attracts difficulties. As the Review points out, regulation may be unresponsive if standards are specified in legislation.

Moreover, the specific suggestion that statutory regulation of the actuarial profession might be carried out by existing regulators suffers from the difficulty (noted by the Review) that there is no single statutory authority for the work of actuaries. The Financial Services Authority and the Occupational Pensions Regulatory Authority (and its successor, The Pensions Regulator) between them regulate insurance and pensions, which immediately introduces two regulators working in parallel, but not necessarily with the same objectives or priorities.

Model B applied to the actuarial profession

The Review identifies the Financial Reporting Council (FRC) as an example of Model B regulation and suggests that the FRC might be expanded to incorporate responsibility for actuarial regulation. We have looked at the way the FRC currently operates and can see several parallels with the actuarial profession. We are very supportive of the idea that the FRC might become a regulator of the actuarial profession and discuss below how this might be made to work in practice.

The FRC currently has five operating boards:

- The *Accounting Standards Board* (ASB), which issues accounting standards, and the *Auditing Practices Board* (APB), which sets auditing standards.
- The *Professional Oversight Board for Accountancy* (POBA), which has oversight of the regulatory functions which remain with the professional accountancy bodies, including, for example, the education syllabus and process to qualify as an accountant.
- The *Financial Reporting Review Panel*, which monitors compliance with accounting and other requirements for public (and large private) companies.
- The *Accountancy Investigation and Discipline Board* (AIDB), which provides an independent investigation and discipline scheme for matters which raise important public interest issues.

The Review's interim assessment has proposed an Actuarial Standards Board (ActSB) which has features in common with the ASB and APB and also an oversight body with features in common with POBA.

The Review discusses the ActSB in more detail in Chapter 7. At this point, we simply observe that, if the ActSB is embedded within the FRC in the manner described in paragraphs 7.63-7.68, the ActSB will be the body which actually sets actuarial standards and not simply an oversight body. POBA, and its actuarial equivalent as envisaged by the Review (see Chapters 6 and 8), would have purely an oversight role, with The Actuarial Profession continuing to be the body responsible for matters relating to education (including continuing development post-qualification) and discipline.

Governance under Model B

The FRC has a board of (currently) five members and a Council of thirty. The functions of the FRC Board include setting strategy, budgets, overseeing delivery by each operating board and appointing members of the Council and operating boards. The Council gives advice on such matters as strategy, budgets and structural issues, as well as monitoring activities.

The membership of the Board and the Council is currently driven, of course, by the FRC's current responsibilities which relate mainly to corporate reporting and the like. Any expansion of the FRC's role to embrace actuarial matters would necessitate a review of the composition of both bodies to ensure that they contained sufficient numbers who have an understanding of the areas in which actuaries operate, including some members of the actuarial profession (just as the two bodies currently include members of the accountancy profession).

It is premature to go into details regarding the composition of the 30-member Council. It is, however, worth considering the composition of the FRC Board. At present, three of the members are representative of:

- the six professional bodies for accountants;
- the Investment Management Association; and
- the CBI.

The remaining two board members are an independent chairman and deputy chairman.

Although the actuarial profession is very much smaller than the accountancy profession, the quantum of assets and liabilities which are directly affected by actuarial advice makes up a very substantial proportion of the assets and liabilities of entities which fall within the purview of the FRC. It would be important, in our view, to consider carefully how to ensure that the FRC Board included individuals who are sufficiently able to represent the interest of the financial services industry and the actuarial profession (whilst, at the same time, recognising that all members of the Board must be equipped to address all the FRC's responsibilities, not just sectoral aspects).

Funding under Model B

The FRC is currently funded by three equal contributions from Government, the accountancy profession and the business community.

It is premature to asses what the cost would be of an actuarial standards board and oversight body. A preliminary guide may be gained from the knowledge that the current budget of the FRC and its five operating boards is approximately £10m pa (not including various case-related or firm-related costs which are recovered separately). It is not unreasonable to suppose that an actuarial standards board and oversight body might cost somewhere in the range £1m-£3m, or say £2m as a very rough first estimate.

Another indicator is the number of staff employed by each of the ASB (15 staff), APB and POBA (seven staff each), representing 50% of the total FRC staff. It is difficult to see how an actuarial standards board and an oversight body could operate with fewer than 10 staff, but are unlikely to need more than 20, suggesting a figure of 15, say, as a reasonable first estimate. If these 15 staff were paid proportionately the same as existing FRC staff, the staff costs would be £1.65m.

When one looks at the costs per member of the accountancy profession, one can see that the costs of the FRC in its current form amount to less than £50 pa per practising member. The profession's contribution to that is one-third, or some £15 pa per head. We are aware that the accountancy bodies do not recover their costs of regulation by way of a simple monetary amount per head, but we show the figure to demonstrate that the amount involved is well below the level that might deter members from remaining within the accountancy profession.

The equivalent calculation for actuaries is rather different. If the cost is £2m pa, the cost per head would be some £450 pa. Simply importing the three-way split of costs into this arrangement would suggest a contribution by actuaries of £150 pa per head (nearly ten times the cost for accountants). This is on top of a subscription which is already £600 pa.

It is not possible for us to know how members would react to such a sharp increase. For those members whose ability to gain employment (or to gain clients) requires them to continue as an actuary, the extra cost is a relatively small price to pay. But for those members whose area of work does not require them to be an actuary – a group which the Review is keen to expand, rather than diminish (see, for example, paragraph 6.89 of the interim assessment) – an increase of this level may be sufficient to cause them to withdraw from the profession.

One also has to bear in mind that there are non-monetary costs which members will face. One of the options identified by the Review (and ourselves) is for all actuaries to do CPD and to maintain records for monitoring purposes. (This is discussed in Chapter 6.)There is a time cost to this which some individuals will factor into their decision whether to renew their membership each year.

It is tempting to suggest that the extra costs of the regulatory model could be imposed only on those actuaries for whom it is a requirement that they be a Fellow of the profession, for example the 25% of the profession who do work which is reserved, by statute, to actuaries. This would increase the cost to £600 pa per head.

Once again, however, the point is not that simple. Although most, if not all, of the actuaries doing reserved work in life or general insurance (approximately 220) could not give up their Practising Certificate, many of the 1,000 Scheme Actuaries could do so, if their firms re-organised their affairs so that a much smaller number held Practising Certificates.

For example, there are three firms which currently employ (or have as partners) more than 100 Scheme Actuaries each. Faced with a cost of £150,000 to pay for the increased regulatory costs, they might be motivated to reduce the number with Practising Certificates quite considerably. Such a concentration may not be a desirable outcome in a profession which, in the Review’s opinion, has not benefited from its small size.

It is not our intention to suggest that actuaries would deliberately act in such a way as to frustrate the regulatory model. Our point is simply that, in a free society, individual members and individual firms are likely to act in a way which maximises the benefit to themselves and to their own clients, which may not be the ideal result for the profession and its users, at large. It is for the regulators, and those who appoint the regulators, to construct a model that is robust to individual choice.

At the present time, we have no data from which to draw a fact-based conclusion on how members and firms will behave. We suggest, however, that the regulatory proposals may break down if the costs (whether monetary or time-based) are such as to create incentives for behavioural change which is not conducive to an effective system. We encourage the Review to recommend a funding model which (as for the accountancy profession) is designed to avoid incentives for adverse behavioural change.

4 ACTUARIAL ROLES

Reserved role in general insurance

Options

- Option 1: continue with the status quo – no reserved role; or
- Option 2: no reserved role, but require certification of the reserves by an approved person with appropriate skills, who may or may not be an actuary; or
- Option 3: a full role reserved to actuaries, with associated public interest duties and whistle-blowing requirements; and/or
- Option 4: a requirement that the auditor take appropriate actuarial advice when auditing general insurers (a role akin to the Reviewing Actuary role for life insurers).

In general, we believe that, if there were to be a reserved role in general insurance (in addition to the Lloyd's market, which already has one), it should not be reserved specifically to members of the Actuarial Profession. Other suitably qualified individuals should also be allowed to carry out the role(s), with the FSA responsible for approving such individuals (as part of its role as regulator, which includes responsibility for determining whether or not there is to be a reserved role). The individuals concerned should be subject to the same standards as actuaries when doing the same work as actuaries.

An approach that is most consistent with the recently introduced regime for life assurance would be for the directors to take advice from a reserved role-holder, with the auditors required to do likewise (taking advice from a different appointee). In terms of the options proposed, this would be a combination of Option 4 with a hybrid of Options 2 and 3 (the hybrid being that the role is not necessarily reserved to an actuary, but the role-holder advises the directors, rather than producing a certificate of his or her own).

An alternative, would be to adopt Option 4 on its own (ie the auditor to take advice from a Reviewing Actuary) and to leave insurers to decide for themselves whether they need an actuary to advise them.

We note that paragraph 4.27 of the interim assessment reported comments from consultees who cited the difficulty in delineating between short- and long-tail liabilities as a reason for *not* having a reserved role. We agree with the comment to the extent that we do not consider that separating long-tail and short-tail requirements is helpful. But we do not think this militates against a reserved role, which would extend to all general insurance liabilities, not just the long-tail.

5 THE PUBLIC INTEREST AND ACCOUNTABILITY

Reporting and whistle-blowing

Options

- Option 1: more comprehensive guidance from the Profession or from regulators on the circumstances in which whistle-blowing is permitted and when it is required, covering all relevant statutory, regulatory and professional provisions, matters which regulators are likely to regard as significant, and the safeguards and sanctions available; and/or
- Option 2: ensuring that, on the one hand, legal protections for whistle-blowers are wide and give appropriate room for individual judgment, based on good faith and what an actuary "reasonably believes"; while nonetheless ensuring that, on the other hand, duties to whistle-blow are clear, objective and enforceable, for example based on what an actuary has "reasonable cause to believe"; and/or
- Option 3: bringing whistle-blowing requirements for auditors and all actuaries more closely into line, and extending protections for whistle-blowers, e.g. supplementing the existing relief from duties of confidentiality with statutory provisions conferring qualified privilege (ie when acting in good faith) from actions in defamation.

Option 1: More comprehensive guidance from the Profession or regulators on when to whistle-blow

More guidance from the regulators would be welcome, perhaps including examples and trigger points. The Profession would be very happy to co-operate with the various regulators in compiling such a list. The danger in a comprehensive list produced *solely* by the Profession is that something will inadvertently not be included in the published list, thereby exposing individual actuaries to serious penalties at a later date. Whilst the Profession will always do what it reasonably can to advise members, it is not competent to provide legal advice and it must be careful not to give the impression that its own list is authoritative.

Option 2: wide legal protection based on good faith and *reasonable belief****; duties to whistle-blow are clear, objective and enforceable, based on*** *reasonable cause to believe*

The Profession is generally supportive of Option 2. We agree with the Review that it would be more helpful if the trigger was the same for both Opra and the FSA. In the context of such a re-alignment, we consider it would be more appropriate if a defence of "reasonable justification for not suspecting" a reporting condition applied rather than "no reasonable cause to believe".

Option 3: bringing whistle-blowing requirements for auditors and actuaries more into line and extending protections

We are content with this option. Our understanding is that the whistle-blowing requirements for actuaries and auditors are already as closely aligned as is likely to be possible given the differing responsibilities and duties of each (and subject to some updating to reflect the new triple-actuary regime in life assurance introduced at the end of 2004).

Actuarial Function Holder

Options
• Option 1: status quo – Actuarial Function Holder role as currently specified by the FSA; or • Option 2: greater protections for whistle-blowers.

We are content with the current protection for whistle-blowers, but if additional protection can be made available without the costs exceeding the benefits, we would support that. We are also content with the current role of the Actuarial Function Holder.

With-Profits Actuary

Options
• Option 1: status quo – With-Profits Actuary role as currently specified by the FSA; or • Option 2: the With-Profits Actuary should be external to the insurer; or • Option 3: the With-Profits Actuary should be appointed by the With-Profits Committee, if one exists, or otherwise the Audit Committee; and/or • Option 4: the With-Profits Actuary makes a full report to the regulator. Policyholders receive a copy of the With-Profits Actuary's opinion and have access to the full report.

Option 1: No change

The no-change option is the current position, as specified by the FSA. Subject to one caveat, we see no compelling reason why the regime should be changed before the FSA and the market have had an opportunity to see how effective it is. The caveat is that, as currently drawn, the FSA's rules will require, from the end of 2005, the With-Profits Actuary's report to be made to policyholders. We have a serious concern that this will create a relationship between the With-Profits Actuary and policyholders, which runs against the thrust of the FSA's central policy that only directors have a direct relationship with policyholders.

Option 2: The With-Profits Actuary to be external

The Review's rationale for having an external With-Profits Actuary is that the pressures on an internal appointee may make it too difficult to report to management that policyholders are not being treated fairly (paragraph 5.83). We recognise this problem, but we consider that there will be pressures on the With-Profits Actuary, regardless of whether the appointee is internal or external, albeit slightly different ones in each case.

Until there has been an opportunity to observe the effectiveness of both internal and external appointees to the role, we think it would be a mistake to insist that all appointments be external (or the reverse).

Option 3: The With-Profits Actuary to be appointed by the With-Profits or Audit Committee

Whilst this proposal may work very well in some cases, we do not think it should be made into a universal rule.

For example, if the members of the With-Profits Committee are all external, non-board appointments (as is publicly known to be the case for at least one major assurer), the proposal would, in effect, remove the responsibility for the appointment of the With-Profits Actuary from the ultimate control of the board. In some cases, this proposal would entail the responsibility being given to a Committee which acts in a part-time, advisory capacity. This seems counter to the FSA's move to make Boards more explicitly responsible for the decisions which impact on the company. In these circumstances, the involvement of the With-Profits Committee should probably be limited to an advisory capacity.

The position of the Audit Committee is a little different, because it is a sub-committee of the board, albeit a sub-committee of non-executives. In some cases, however, the Audit Committee may be a committee of the parent company board, rather than the relevant operating company. This does not rule out the appointment being made by the Audit Committee, but in strictly legal terms, it means that the appointment is being made by (a sub-committee of) the shareholder.

If this proposal is to be taken forward, we think it may need to be relaxed a little to ensure that it can be complied with in all cases. One option would be for the Audit or With-Profits Committee to *advise* on the appointment, rather than having executive authority for it.

Option 4: The With-Profits Actuary makes a full report to the regulator, with a copy to policyholders

Our preference, as articulated under Option 1 above, is that there should be no change before the FSA and the market have had an opportunity to see how effective the current regime is. So far as this option is concerned, we comment as follows.

Report to the regulator
If the proposal is that the regulator should also have a copy of the full report from the With-Profits Actuary to the board, we concur. If the proposal is that the regulator should have the report *instead of* the board, we think the existing regime should be given a chance to work, before such a change is made.

Copy to policyholders
We share the Review's concern that "making the [full] report available to policyholders might constrain the matters on which the With-Profits Actuary feels able to report" (paragraph 5.85). The current regime requires only that the policyholders are shown the With-Profits Actuary's *opinion*, not the full report. This is not dissimilar to the long-standing arrangements by which the auditors opinion (for all companies, not just life assurers) is sent to the shareholders, with a more detailed report (known as a "management letter") is sent to the board.

Reviewing Actuary

Options

- Option 1: status quo – Reviewing Actuary role as currently specified by FSA, with the Reviewing Actuary reporting privately to the auditor; or
- Option 2: Reviewing Actuary role as currently specified by FSA, with additional duty to provide a private management letter to the Board on the Actuarial Function Holder's compliance with professional guidance; and/or
- Option 3: Reviewing Actuary to have direct whistle-blowing duties.

Option 1: No change

Once again we see no compelling reason why the regime should be changed before the FSA and the market have had an opportunity to see how effective the FSA's new regime is.

Option 2: Additional duty for the Reviewing Actuary to provide a management letter

The Reviewing Actuary reports to the auditor, who will prepare a management letter as part of the normal audit process. Our expectation is that the auditor will ask the Reviewing Actuary to draft a section of the management letter relating to the Actuarial Function Holder's role. If that is not going to be the case, it may be that it would be appropriate to make the practice compulsory, but it would be prudent first to explore with auditors (or the Auditing Practices Board) whether there are any good reasons why the auditor wouldn't ask the Reviewing Actuary to make a contribution to the overall management letter.

Option 3: Extend whistle-blowing duties to the Reviewing Actuary

For a Reviewing Actuary who is an employee or partner of the audit firm, the whistle-blowing regulations relating to those working for auditors will apply. Our understanding is, therefore, that this option would only bite if some auditors use external Reviewing Actuaries. It may, nevertheless, be worth introducing to cover those (possibly exceptional) cases.

Pensions

Options

- Option 1: status quo – Scheme Actuary advises both the scheme sponsor and trustees, unless the actuary deems there to be a conflict, in which case the Scheme Actuary only advises the trustees; or

- Option 2: Scheme Actuary advises both the scheme sponsor and trustees, unless the trustees deem there to be a conflict, in which case the Scheme Actuary only advises the trustees; or

- Option 3: role of advising the scheme sponsor and the scheme trustees is separated in some clearly defined circumstances e.g. during scheme wind-up; or

- Option 4: role of advising the scheme sponsor and the scheme trustees is separated at all times.

Option 1: No change

Option 1 does not address the problem and is not, therefore, very attractive unless the other options all have worse outcomes. We do not think that is the case.

Option 2: The actuary's primary loyalty is to the trustees

Under Option 2, the Scheme Actuary would be permitted to advise both the scheme sponsor and trustees (if they both wished to appoint him), but only so long as the trustees deem there to be no conflict. If the trustees determine there to be a conflict, the Scheme Actuary would be required to resign from advising the employer.

The crux of this proposal is that it gives one client (the trustees) the right to demand that the actuary withdraws from advising the *other* client. At present a client can terminate its own relationship with an adviser, but cannot lay claim to an adviser and insist that another client withdraws. But the proposal is more subtle than that. In order for the trustees to be in a position to determine whether or not the actuary is burdened by a conflict of interest, the trustees must have as much information as the actuary. In short, under this proposal, there can never be an occasion when the employer can tell the actuary something and demand that it is kept in confidence from the trustees. The normal duty of confidentiality owed by the actuary to the employer, as client, would have to be overridden by the actuary's duty to the trustees.

We would anticipate that the loss of confidentiality owed by the actuary to the employer would change the behaviour of employers. As and when employers saw themselves facing the need to consult an actuary in confidence, they would realise that they needed to select another actuary in order to achieve that. In short, the very existence of the trustees' power to terminate the actuary's relationship with the employer would, in practice, cause the employer to do so before the conflict arose.

This option seems to us to be very attractive. We are not sure what legal mechanism is needed to achieve it, but we think that, at the very least, it should be tried out.

Option 3

See below

Option 4: Separate appointments at all times

Option 4 would involve splitting this dual role into two separate appointments. It is notable that the opportunity to legislate for such an outcome presented itself in the Pensions Act 2004, but was not taken up by the Government. Our understanding is that this was a deliberate decision by Government, as a matter of public policy, and not an oversight.

The Review acknowledged, in its interim assessment (paragraph 5.96), two reasons against this option. The first was that it would deny the trustees and the employer the opportunity to share an adviser where they both wished to do so. The second was the added cost.

Another argument against the requirement always for a dual appointment is that it increases the likelihood of a confrontational relationship between the employer and trustees becoming the norm, even where there is common ground and common objectives. It is well-known from other professions that two parties who might otherwise have agreed can be brought into conflict as each party's adviser seeks, quite properly, to achieve the best outcome for his client.

Final salary schemes have worked well – and been seen to work well – through cooperation and collaboration between trustees and employer. That position has undoubtedly come under strain in certain circumstances, for example when the scheme falls into deficit, as has happened in recent years, and it may be wiser for more schemes to have dual appointments now than was the case five years ago. But we doubt that it is appropriate for *all* schemes to do so at all times. Unlike Option 2 above, which we see as having permanent applicability, a compulsory dual appointment regime, if appropriate at all, may be suitable only temporarily.

Option 3: separate appointments in certain specified circumstances

Option 3 reduces the problems, but it doesn't appear to eliminate them entirely.

If the specified circumstances were to include occasions where conflicts were likely, but not necessarily guaranteed, there would still be some occasions where the downsides to Option 4 persisted. On occasion, the employer and trustees would still be forced to take separate advice, and incur higher costs in aggregate, even though no conflict actually arose.

To address this, the specified circumstances would need to be restricted to those where conflicts were unavoidable. On that basis, the rule would avoid the downside of unnecessary costs and compulsion against the clients' preference, but there would be many occasions which fell outside the specified circumstances and where conflicts arose without the rule biting. The rule would almost certainly be criticised as insufficiently effective and pressure would mount to extend it, with the result that the problems associated with Option 4 would begin to manifest themselves once more.

If Option 3 were the only viable option, its imperfections might be tolerated so as to achieve a better result than at present, albeit not a perfect one. But Option 2 seems to provide a greater likelihood of success and, in our view, is to be preferred.

Accountability and the public interest

So far, this section has addressed the specific options identified by the Review in Chapter 5 of its interim assessment. There is, however, an additional issue which is signalled in the chapter, without any specific options being set out. The point is summed up in paragraph 5.68 with the words: “a further explicit public interest obligation may well be necessary.”

This is of some concern to the Profession and to its members – not because there is a reluctance to serve the public interest, but because the term “public interest” is so often ill-defined and because the term is often used in a way to suggest that the duty to “the public interest” is somehow an over-arching duty which takes precedence over the duty to one’s client. If there is to be a public interest obligation placed on actuaries as individuals, there needs to be both an explicit expression of what that duty is and when it applies.

We are reassured that the Review does say, quite plainly, that clarity is paramount, for example, in paragraph 5.1: “The review believes that there must be clarity over whether and to what extent individual actuaries and the Profession should serve the public interest.”. We wish to work with the Review to identify what, if any, “public interest obligation may … be necessary” and, if so, what meaning is to be attached to “the public interest.”

Defining the issue

In our September Submission, we argued against the proposition that: every decision made by a professional should take into account the public interest (or, stronger than that, that every decision should be *in* the public interest). Our argument was set out in Section C of that submission and need not be repeated here. Suffice it to say that we set out in some detail the economic rationale behind our conclusion that “it is counter-productive to ask one group in society – those called “professionals” – to abandon the interest of their clients in favour of the community as a whole” (page 11 of our September Submission).

So far as we can tell, that argument has not been challenged by the Review. The Review has, however, raised a concern which is quite specific to actuaries and which can, we believe, be summarised as follows:

> Individuals have choices to make about whether to buy savings and protection products and, if so, which ones (or, in the case of occupational pension schemes, whether to participate and what options to select). This requires the individuals to have meaningful information about the policies and/or pension schemes they are participating in or opting out of. But not only do individuals find actuarial information too technical and complex, their proxies (ie non-executive directors and pension fund trustees) may not fully comprehend the advice either. If that is so, some regulatory intervention is, or may be, needed to remedy the situation.[3]

[3] Our summary is based on the following passages in the Review’s interim assessment:

> “3.18 … The primary market failure in the market for actuarial services is the gap in information or understanding that exists between the actuarial adviser and the ultimate beneficiary of the advice. Consumers of financial products are very far removed from the actuarial advice that is provided to the insurance company that has written their policy or from the advice to the pension fund that will ultimately pay their pension.”

> “3.19 Consumers and their proxy users – such as pensions fund trustees and non-executive directors – find it difficult to assess the quality of the advice provided, because it is technically difficult, often complex, and relates to long-term issues which are not straightforward to assess over the short term. Yet the consequences of poor or inappropriate advice may be very far reaching for consumers. It is these factors which suggest a need for regulatory intervention …”

> “5.67 … [A]ctuarial advice is complex and technically challenging, is frequently not market-tested or scrutinised adequately, and is critical to the economic well-being of the community, and is provided to users, many of whom are not expert in assessing its implications. If this is so, then there is at least a case for placing some wider public interest obligations on actuaries in non-reserved roles, as well as those in reserved roles, via regulatory or professional conduct rules.”

> “5.66 … [S]hould there be … a duty on all actuaries to inform or act in ways which reflect an accountability to the public more generally, primarily in the sense of indirect clients such as policyholders and scheme members, but possibly to the community more generally?”

Whilst we acknowledged in our September Submission that communication has not generally been a strength of actuaries, we expect that many of our members would challenge whether the problem is so great that the effect is a “market failure” (to quote paragraph 3.18).

For the purposes of this submission, however, we think it is more important to engage with the Review on the regulatory question – *Is intervention needed and, if so, what?* – than it is to debate the Review’s factual findings on the quality of actuarial communications and that is what we do in the following paragraphs.

Analysis

If the problem is that neither the ultimate beneficiaries of actuarial advice, nor their proxies, are able to comprehend actuarial advice sufficiently, it would seem that, logically, the remedy has to be one or more of the following:

- *improve the clarity of advice* so that the proxies (and, perhaps, the ultimate beneficiaries) can understand it; or

- *train the users of the advice*, ie the proxies (and, perhaps, the ultimate beneficiaries), so that the advice is no longer impenetrable; or

- *transfer the decision-making responsibility* to someone who can understand the advice.

[The third option above is set out in the interests of completeness, but it seems plain that directors and trustees (ie the proxy users) are the group which has the responsibility in law for making the relevant decisions and there is little prospect in a free-market society for that to change. Legislation already contains provisions to require that the appointees are suitably knowledgeable for the roles they play. It is difficult to see who else – other than actuaries themselves – could play the required role. We do not, of course, suggest that the directors’ and trustees’ roles should be reserved to actuaries.]

The first point to draw out from the analysis above is that, in this context, “the public interest” can only mean *the ultimate users or beneficiaries of the advice* and not members of the public at large or, as the term is most often used in the regulatory context, the community as a whole. In other words, as we argued in our September Submission, there is no reason to believe that each actuary, in writing a report or giving advice, should be (or could be) expected to weigh up the conflicting interests across a range of players in society and decide between them. [Indeed, if one accepts the premise that actuarial advice is seldom understood sufficiently well, it would be quite astonishing if clients had to make decisions based on advice which contained an impenetrable analysis of complex balancing arguments.]

This point needs to be clearly stated, because it is a challenge that is often put to actuaries by the press and by other commentators and is, itself, the cause of much confusion. If any new obligations on individual actuaries are to be recommended in the Review’s final report, we suggest that they need to be articulated in terms of the specific policyholders or scheme members in question and not “the community more generally” (to quote from paragraph 5.66).

The second point to make is that, so far as *non-reserved roles* are concerned, clients who commission actuarial advice must be entitled to commission advice that advises them on their own interests without having to pay to have additional advice which reflects the interests of other parties. Still less should that advice be subordinated to the interests of other parties. After all, non-reserved advice is, by definition, advice which the client is not required to obtain from an actuary. If actuaries were to be constrained in the advice they could give in a non-reserved a capacity, a market would immediately open up for those who had trained as actuaries to leave the profession and use their training to advise clients in an unconstrained way. This is an outcome which we believe the Review would wish to discourage.

The third point is that, so far as *reserved roles* are concerned, it is plain that the authority responsible for reserving the advice to actuaries is in a position to dictate what the form and content of that advice must be.

These three observations lead us to propose the solution set out below.

Suggested way forward
It appears to be universally accepted that there needs to be an independent Actuarial Standards Board (ActSB), probably embedded within the Financial Reporting Council, alongside the Accounting Standards Board and other similar bodies. Without wishing to anticipate how the ActSB will do its job, it seems safe to suggest that one of the first priorities will be to set standards for advice given by actuaries in roles reserved to them by statute.

The *Accounting* Standards Board and its predecessors have addressed the issue of defining the form and content of accounts so that they can be understood by their users (which include the lay public and not just trained proxies). We see no reason why the ActSB should not do so for actuarial reports. If the understanding gap (exists and) cannot be closed, there seems little point in imposing yet more obligations on actuaries.

The Canadian comparison
The Review reports that the Canadian Institute of Actuaries (CIA) "have what is perceived to be a stronger, over-riding public interest duty that they place upon their individual members." The Review goes on to quote several passages (paragraphs 5.36-5.39).

We think the Review is right to say "perceived" to be stronger. In fact, the Canadian duty is no stronger than the duty we impose on our members. Taking each of the quoted passages:

- *"In carrying on its activities and programs, the Institute holds the duty of the profession to the public above the needs of the profession and its members."* This is a duty to put the public ahead of *actuaries*, not a duty to put the public ahead of clients. Moreover, the duty is ascribed to the collective "profession", not to each actuary as an individual. The UK Profession also describes its public interest roles as a collective duty, not an individual one.

- *"A member shall act honestly, with integrity and competence, and in a manner to fulfil the profession's responsibility to the public and to uphold the reputation of the actuarial profession."* This requires individual members to act with honesty, integrity and competence and to uphold the reputation of the profession. The "responsibility to the public interest" is ascribed to the collective profession. Once again, this is exactly the position adopted by the UK Profession.[4]

- *"These Rules of Professional Conduct identify the professional and ethical standards with which a member must comply and thereby serve the public interest."* This is a statement that a member must comply with the Rules, coupled with an assertion that the professional and ethical standards encompassed in the Rules serve the public interest. The Rules in this case are very similar to the UK Profession's own code (the PCS). Crucially, there is nothing in the Canadian Rules (or the UK PCS) which requires the individual actuary to take account of the public interest when formulating advice.

[4] Under the terms of the UK Profession's Disciplinary Scheme, a member is liable to disciplinary action if he or she "fail[s] … to comply with the standards of behaviour, integrity, competence or professional judgement which other Members or the public might reasonably expect of a Member."

More specifically, paragraphs 2.1-2.3 of the Profession's ethical code (PCS) require that : "Individually members must maintain and observe the highest standards of conduct. The standing of the profession depends on the judgement of individual members. … A member has a duty to the profession and must not act in a manner which denigrates its reputation or impugns its integrity. … Users of a member's services … are entitled to have absolute confidence in the skill, objectivity and integrity of the member."

6 EDUCATION AND CPD

General remarks

The Profession is very supportive of the suggestion that an independent body might be established along the lines of the accountancy profession's Professional Oversight Board for Accountancy (POBA). Broadly speaking, POBA has oversight of those aspects of the accountancy profession which remain within the six accountancy professional bodies and we envisage a similar body for The Actuarial Profession, with this new body having oversight of education and discipline.

Our support for this idea is predicated upon the assumption that the proposed body would be embedded within the Financial Reporting Council, along with the proposed Actuarial Standards Board, in line with the Review's preferred option for standard-setting (see Chapter 7). If the Review's proposals for the ActSB were not followed up, for any reason, we would wish to have the opportunity to re-visit whether a POBA-like body would remain a practical proposition.

For the purposes of this submission, we shall assume that the POBA-like body for actuaries sits within the FRC and we refer to it as POBAct. In practice, there seem to be two ways in which POBAct might be created:

- POBAct might exist as a separate operating body, sitting alongside the ActSB and the other (accountancy) operating bodies; or

- the roles and responsibilities might be given to POBA, alongside POBA's existing duties, perhaps with a change or expansion of the membership of the board.

For the remainder of this submission, we leave that decision open and simply refer to the body as POBAct, regardless of whether it exists as a separate entity or as part of POBA.

The syllabus and governance

Options

- Option 1: minor reform of the existing governance structure to promote greater academic and non-actuarial input; or

- Option 2: establish an independent body with oversight of the Profession's syllabus development along the lines of the accountancy profession's Professional Oversight Board for Accountancy (POBA).

For the reasons discussed in the general remarks above, we support Option 2 (POBAct). We think that Option 1 has merit also and envisage pursuing that proposal in addition to Option 2.

Examinations issues

Options

- Option 1: reform of the existing governance structure to improve quality control; and/or

- Option 2: involvement of full-time and dedicated professional examiners; and/or

- Option 3: involvement of an independent oversight body in exam setting and marking.

Option 1: Improved quality control

Naturally, we support the principle of continuously striving to improve quality and quality control. We carry out a review of the exam processes after each exam session (ie twice a year). Where problems are identified, we take action to mitigate or eliminate them.

For example, the Review refers to consultation feedback expressing “concern about the frequency with which errors occurred in relation to the setting of examination questions and the marking of exam papers.” This is something that we addressed by employing full-time staff actuaries whose role includes checking and monitoring for precisely these problems. So far as we are aware, the errors of the type referred to have been eliminated and the Review has made no finding of its own that the problem persists.

Option 2: Involvement of full-time and dedicated professional examiners

Professional examiners
The Profession’s Director of Education (appointed in 1992) was recruited from HM Inspectorate for Education, where she had responsibility for Mathematics in Higher Education. The five full-time staff actuaries also play a key role in exam-setting and quality control of the marking scheme.

In the early subjects (Core Technical) subjects, 19 out of the 24 examiners are academics or former academics. In the later, applications papers, we believe we need practising actuaries.

Dedicated examiners
We operate two exam sessions per year, in April and September, with the exams marked and results published in July and December. There is simply not sufficient work throughout the year for examiners to be “dedicated” (in the sense that they do no other work).

The academics, referred to above, who form part of our examiner group are full-time in their careers, contributing to the profession on a part-time basis.

Balance between professional and volunteer examiners
Plainly, there is a balance to be struck between the number of professional examiners and the volunteer force,[5] bearing in mind that some of the volunteers – the 19 examiners referred to above – are professional academics. We believe we have the balance broadly right by having a predominance of professional examiners (including professionals who volunteer) for the technical exams and a predominance of practising actuaries for the applications exams (subject to oversight by the full-time, professional, dedicated staff actuaries (who, in turn, are overseen by the Director of Education) to ensure that the marking schemes adhere to modern standards.

Option 3: Involvement of an oversight body

As indicated above, we support the proposal for an oversight body (POBAct). For the avoidance of doubt, our understanding is that POBAct’s brief in this area would be the overarching oversight of the Profession’s exam process (including our own monitoring and reviews). It is not envisaged that POBAct would directly monitor the exam papers themselves or the marking of individual papers.

[5] Although we use the term “volunteer” to describe some of our examiners, even the volunteers are paid an honorarium.

Broadening actuarial education provision

Options

- Option 1: wider provision and accreditation of degrees that grant exemptions from the Profession's exams; and/or
- Option 2: promotion of post-graduate fast-track law-style conversion courses for those with university degrees.

We support both the options suggested and have endeavoured to bring them about at various times in the past, but with limited success so far. Market forces do not seem to support the views held jointly by the Review and the Profession. The problems we have encountered are as follows:

- *The willingness of universities:* It has proved difficult to persuade universities to put on the required courses. One reason given to us for this reluctance is that the departments are heavily focussed on the Research Assessment Exercise required by the Higher Education Funding Council and do not want to take on extra teaching. Given Sir Derek Morris' status within the academic community, we are hopeful that this Review may encourage universities to be more enthusiastic about providing actuarial modules.
- *The supply of teaching actuaries:* It is difficult to get actuaries to teach at university salaries. This does not rule out non-actuaries teaching some or all of the core technical material, especially topics that are not uniquely actuarial, for example Core Technical subjects such as statistics and financial economics. But for the application papers, actuarial skills are necessary at least in those areas where practitioners are all actuaries.
- *Reluctance on the part of the employers:* The reluctance of many employers to take on students with a large number of exemptions is another obstacle, which the Review has identified through its own research (paragraph 6.88). The Profession has been trying for several years to get employers to change their minds, but it has been found difficult to overcome long held views. This seems to be the experience of the Review also (again see paragraph 6.88). Even where courses are put on, the places are often taken by overseas students who go home on finishing their academic study.
- *The preference of students:* At the undergraduate level, we have no doubt that, if universities could be encouraged to provide more actuarial modules within the undergraduate degree courses that are already popular amongst future actuaries, those modules would be popular also. [Full-time undergraduate courses in actuarial science are unlikely to prove popular at the stage when applicants are choosing which degree courses to apply for.]

  So far as the post-graduate fast-track conversion course is concerned (Option 2), our experience is that it is much less popular than the work-based study route, simply because work-based learning helps graduates to start earning money after a first degree course and thereby limits the amount of debt they incur.

The Review suggests that the UK profession has a stark choice. Actuaries (and their employers) can maintain the work-based educational approach, which equips actuaries largely for work in traditional areas. Or the profession can branch out into other areas, in which actuarial skills could usefully be applied, but this is only likely to happen if actuarial training is delivered before the actuaries embark upon a traditional career path.

This argument is set out in paragraph 6.89 of the interim assessment, apparently supported by a statistic in paragraph 6.87 that, in Australia (where university education is the norm for actuaries), some 35% of actuaries pursue a career outside traditional areas, contrasted with the UK (with its work-based model), where only 20% of actuaries work in non-traditional fields.

Whilst we accept the logic of the argument, ie that the work-based model is likely to entrench actuaries into a more traditional career path, we are not sure that the data demonstrates that it actually happens in practice. The statistics we have for Australia and the UK are as follows:

	Australia	*UK*
Pensions	17%	40%
Life assurance	31%	30%
General insurance	21%	10%
Sub-Total	69%	80%
Investment/banking	17%	7½%
Sub-Total	86%	87½%
IT and management	6%	Not recorded
Other	8%	12½%
Total	100%	100%

The table shows that in Australia, investment/banking demands 10% more of the actuarial profession than in the UK. Whether this is classed as a migration from traditional fields into new pastures is debatable, given the profession's long history (and training) in the investment field. But certainly the educational choice facing the profession is rather less stark than first appears. It may be that changing from a work-based model to a university-based one will facilitate an increase in investment actuaries, but there may be other ways of achieving that result without having to push to change the minds of so many players in the market.

Continuing professional development (CPD)

Options

- Option 1: the Profession should set out clear objectives for the CPD Scheme and clarify what constitutes formal CPD. The Profession should ensure that CPD that qualifies as formal CPD is meeting an objective of the CPD Scheme, and is not simply a tick-box exercise based on attendance at meetings or conferences; and/or

- Option 2: the Profession should consider increasing the amount and quality of formal CPD required for reserved role holders, in recognition of the importance of these roles. For example, the Profession, with regulator input, could develop tailored CPD opportunities ahead of key changes in the regulatory environment for actuaries in reserved roles; and/or

- Option 3: closer links could be fostered between those within the Profession with responsibility for syllabus development, the actuarial research community and those focused on CPD to ensure that the CPD Scheme is kept-up-to-date and reflects recent developments in other disciplines and actuarial research; and/or

- Option 4: greater input to the CPD Scheme could be given to research-oriented actuaries, overseas actuaries and non-actuaries, for example through involvement in an oversight body, constitutionally independent of the Profession containing a mix of actuaries and non-actuaries. This could monitor the Profession's performance in relation to CPD Scheme development to ensure that the scheme is kept up-to-date, that links to other disciplines and actuarial research are made and that CPD is available to all actuaries, not just to those working in traditional areas.

In principle, we agree with all four options. We have some comments on implementation.

During the period leading up to publication of the Review's interim assessment, we were consulting on proposals for the maintenance and revalidation of professional competence. These proposals included an extension of compulsory CPD to a very much wider range of actuaries than at present (nearly all actuaries as opposed to only those carrying out statutory roles). It was at this time that much of the consultees' confusion arose over the objectives of CPD and what constitutes "formal" CPD. We are working to remedy that, in line with the feedback we have received from the consultation and from the Review's interim assessment, both of which have given rise to consideration of further change to the proposals, as outlined in our comments on the three options below.

Option 1: Clear objectives for CPD Scheme; clarify formal CPD; avoid tick-box exercise

Clear objectives and avoidance of tick-box approach
It was a common theme across the comments of respondents to our consultation and those of the Review that the extension of CPD across a much wider group in the profession could not be achieved with a "one-size-fits-all" scheme. Whilst all members of the profession need to be up-to-date in the work they do, the way to achieve that may vary enormously according to the nature of their work.

We have been considering whether it is practicable to adopt the approach that (subject to the caveats in Option 2 below for actuaries carrying out reserved roles) the CPD requirements should be based on planning and outcomes, not on hours worked. Having seen that the Institute of Chartered Accountants in England and Wales (ICAEW) has introduced just such a scheme this year, we are minded to adopt the idea ourselves.

In principle, the common aim of CPD should be for each actuary to identify what is needed to fulfil his or her role(s) and to undertake the necessary development activities to ensure that he or she has the necessary skills to meet those needs. The aim is not only to learn new material, but also to check that existing knowledge remains valid. This may vary considerably from one actuary to another and cannot be defined in terms of hours (but see also Option 2 below).

Clarify formal CPD
The feedback from our own consultation on competence revalidation, and from the Review's interim assessment, have caused us to think further about the nature of "formal" CPD. Hitherto, the definition of formal CPD focussed too heavily on attendance at a (quality) event and on the time spent, rather than on what the actuary got out of the event. So, for example, attendance at one of the Profession's Sessional Meetings would rank for two hours of formal CPD, whereas reading the full transcript, which would typically take less than an hour and would allow the actuary an opportunity to re-read any key passages, would not qualify at all as formal CPD.

Our current thinking contains two new elements relating to "formal" CPD:

- One goal of formal CPD is to capture the element of *strict relevance* to the actuary's work, as opposed to background or general CPD. This suggests a label such as *core*, rather than *formal* CPD.
- CPD should also include an element of testing one's knowledge or ideas against those of other people. This might be done by attending an event which was participative, but could equally well be achieved by reading something that stimulated thought or debate as opposed to, for example, a paper describing new regulations, which may be highly relevant but not thought-provoking.

With a movement to outcomes and away from box-ticking and counting hours (subject to the caveats in Option 2 below for actuaries carrying out reserved roles), the CPD Scheme would make it clear that members should give careful thought to designing their CPD to include both of these factors (relevance and testing knowledge against other people) and be able to demonstrate in their CPD plan (see monitoring below) that they have done so.

Option 2: Increased amount and quality of formal CPD for reserved role holders and tailored CPD opportunities ahead of regulatory changes

This option is really two separate points. The first (increased formal CPD) relates to the work that actuaries must do to complete their CPD. The second option (tailored CPD opportunities) is about the provision of learning opportunities. We agree with both and make the following additional comments.

Increased formal CPD for reserved roles
We agree with the Review that there is a strong case for saying that, for those who carry out reserved roles, the CPD requirements may need to be more tightly defined in either or both of the following ways:

- Although the CPD should be based on outcomes, the Profession might specify a minimum number of hours which it either expects or requires of reserved role-holders in any given year (or an average over, say, three years).

  The minimum number of hours could be split between the different aspects of CPD, ie a minimum number of hours for (a) CPD strictly relevant to the member's work; (b) background CPD; and (c) testing ideas against others.

  Once again, to make it clear that the figure is a *minimum*, not a norm, it could be made clear that any member whose time spent on CPD was consistently at the minimum over a number of years would be challenged to justify that their CPD was sufficient. (CPD is monitored annually for all actuaries carrying out roles reserved by statute – see *CPD Monitoring* below.)

- A defined CPD "syllabus" could be set by the Profession for those in statutory roles. The "syllabus" concept would be designed to address the concern expressed by the Review that the current CPD Scheme left it too much to individuals (or their employers) to decide what is appropriate CPD (paragraph 6.118). The syllabus would vary for each statutory role.

  Bearing in mind that a member's work on a reserved role seldom (if ever) comprises the totality of the work that he or she does, the syllabus would be a core *minimum*, not the norm, to be added to by each member based on their needs. As with the minimum hours, any member whose CPD was consistently no more than the minimum would be challenged to justify that their CPD was sufficient.

The possibility of setting minimum hours or a core syllabus need not be restricted to statutory roles. These concepts, especially the core syllabus, could be extended to other areas of work so long as they can be carefully defined. So, for example:

- The proposed attendance periodically at one of the Profession's *professionalism* events might be made a compulsory part of the syllabus for a defined group of actuaries. Current thinking is that this would be a requirement every ten years.

- More selectively (and purely to illustrate the concept), there might be a syllabus for a specific task such as preparing pension scheme figures under FRS 17.

- A minimum syllabus and/or hours could be a requirement for the award of a practising certificate – see our comments below on practising certificates under *CPD Monitoring*.

Tailored CPD opportunities ahead of changes in the regulatory environment
We do not dissent for a moment from the proposition that there should be tailored opportunities for CPD, especially at times of regulatory change. The Profession is, however, somewhat surprised by the adverse findings in the interim assessment on this particular issue, first because we believe that we do provide many opportunities for CPD tailored to changes in the regulatory environment and, second, because the Profession is not the only provider of CPD events (nor should it be).

On the first point, we would cite the numerous conferences and events organised throughout the year addressing current issues. In assessing the volume of events, it is important to bear in mind that only 50 general insurance actuaries and 170 life assurance actuaries hold statutory roles. In the pensions area (1,000 actuaries with statutory roles), the *Current Issues in Pensions* seminar is being run on five separate dates from February to April this year.

On the second point, there are many external courses and conferences, including those which compete with the Profession's own events. The Profession does not see itself as equipped to provide all forms of CPD, even for statutory roles, if there are other organisations better able to provide the relevant training.

Option 3: Closer links between syllabus development, actuarial research and CPD

Most (if not all) research sponsored by the Profession leads to the publication of a paper, which means that written CPD material is automatically available from research projects. The same is true of universities' actuarial departments. In addition, many firms carry out research of their own, some of which they make publicly available (for a variety of reasons).

Where there is scope for improvement is in building stronger links between the qualification syllabus and CPD to ensure that developments in actuarial training for students reach the community of qualified actuaries more speedily.

Option 4: Greater input to the CPD Scheme through involvement of POBAct

As indicated above, we support the involvement of POBAct in an oversight capacity.

We also recognise the need to institutionalise the involvement of a wider range of actuaries than is presently the case. The CPD Committee is currently dominated by UK practising actuaries. We accept the Review's suggestion that overseas actuaries and non-actuaries could be more involved. The same might, perhaps, be true for university-based actuaries with a strong research orientation, but it needs to be recognised that there are a limited number of actuarial academics and they already contribute a very significant amount of their time to the Profession in relation to the training and examining of students and in actuarial research programmes.

Who should do CPD?

A number of respondents to our consultation on competence revalidations, at the end of 2004, expressed a concern that, if the requirement to complete CPD was extended from the present regime (compulsory only for statutory roles) to all actuaries, the profession might suffer the loss of a number of actuaries who do not need to maintain their Fellowship status for the work that they do. This would, potentially, be a significant loss to the profession, because (regardless of the numbers involved) the resignations would most likely be those who have used their actuarial qualification as a springboard to a broader career. These are people that the profession can ill-afford to lose, a view which, by inference from paragraph 6.89, the Review appears to share.

The analysis under Options 1 and 2 above points a way forward for dealing with this challenge. If the CPD regime is based on planning and outcomes (in essence, *What do you need to know in order to do your job properly? Make sure that you know it.*), it becomes clear that it is not possible for an individual to remain a member of a profession which has a requirement for competence as one of its basic ethics, unless the individual agrees to comply with the principle. On that basis, the basic CPD principle must apply to *all* members. The principle of having additional requirements for those who carry out statutory roles (and perhaps some other well-defined roles, also) is accepted, as discussed under Option 2 above.

How would that work in practice?

- For those members who are *fully retired or on a career break*, the answer to the question, *What do you need to know etc?* is "Nothing" and the CPD requirement is automatically complied with. In theory, therefore, even inactive members are "in" the scheme. In practice, it is wasteful of administration time (and an inconvenience to elderly members) for the CPD monitoring scheme (discussed below) to require inactive members to complete periodic (nil) returns and so those who are fully retired or on a career break would be exempt.

- For those who are in *part-time* work and/or do only *pro bono* work, the need for competence is not diminished. Just because the actuary works only part-time (however that is defined) and/or does not charge for services rendered does not mean that the client or employer should tolerate advice based on inferior or out-of-date knowledge. The need to comply with the basic principle remains and members should be subject to monitoring in the same way as other members doing the same type of work.

- For those members whose work is at or beyond the fringes of what might be considered "actuarial" – in ordinary parlance, "non-practising actuaries", but a difficult group to define with accuracy – the basic principle still needs to be complied with for the reasons articulated above. A practical difficulty arises only when the type of work carried out by the member, and the CPD required, is beyond the range that can plausibly be monitored by the Profession. This is, ultimately, a matter for the CPD monitoring team to determine, based on the member's response as and when called upon to submit evidence.

CPD monitoring

Options

- Option 1: the Profession implements its three-tiered professional revalidation proposal as currently envisaged, which introduces technical CPD requirements and annual monitoring for reserved role holders, technical CPD requirements and three-yearly monitoring for holders of the new voluntary non-statutory practising certificates, and basic CPD requirements and 10-yearly monitoring for the remainder of working actuaries; or

- Option 2: as Option 1 but non-statutory practising certificate regime is expanded to cover all actuaries (except those performing statutory roles) so the technical CPD requirements and three-yearly monitoring apply to all working actuaries; and/or

- Option 3: the task of monitoring CPD requirements and monitoring of compliance with the CPD scheme should be made part of the remit of the independent professional oversight body referred to above.

Option 1 or 2: Current proposal or extend practising certificate so all members do CPD

Practising certificates

The difference between the Review's Options 1 and 2 above is based on a misunderstanding that practising certificates are awarded to all those (and only those) who have satisfied the CPD requirements.

It is in the nature of a "practising certificate" that it can serve two different purposes: a *licence to practice* or a *certificate of merit*. The current actuarial practising certificates for statutory roles are, by their very nature, licences to practice in the statutory role for which they are awarded.[6] An additional regime of voluntary certificates, as proposed in our recent consultation, is clearly in the nature of a *certificate of merit*.

The extension of compulsory practising certificates to all actuaries is effectively to turn the practising certificate into a confirmation of membership renewal. The practising certificate would be indistinguishable from a statement such as "Fellow (not retired and not on a break)". If such a

---

[6] The roles are reserved to actuaries by statute and the Profession requires an actuary taking on any of the roles to hold a Practising Certificate. An actuary who defies the rule faces suspension or expulsion from the Profession, which immediately renders him or her ineligible, in law, for the post.

proposal were to be amongst the Review's final recommendations, we would have no objection to it, but we struggle to see the purpose.

Frequency of monitoring

The statutory practising certificates for those carrying out roles reserved to actuaries, by statute, are renewable *yearly*, at which time the Profession monitors the member's compliance with the conditions for granting the certificate. This includes monitoring of CPD; it also includes reviewing the member's work experience.

If the Profession introduces any additional practising certificates, whether as a *licence to practice* or a *certificate of merit* (see above), the intention is that they will be renewable *three-yearly*, again with monitoring to ensure compliance with the CPD and work experience requirements. The less frequent renewal compared with the renewal of statutory practising certificates is proposed as a practical matter, given the Profession's limited resources, but the monitoring will review all three of the previous years.

For all other members (ie those without a practising certificate of any kind), other than those who are inactive, the proposal consulted on last year was that 10% of this category of members would be subject to monitoring each year. The scale of the monitoring would be limited to 10% as a practical matter, again reflecting the Profession's limited resources. To avoid any loss of incentive in the years between each review, the 10% would be selected at random and the monitoring would look at all years' records since the previous occasion. The practical effect is that each member in this group can expect to have their CPD monitored, on average, once every ten years, but the actual frequency will vary for individual members and members will need to keep their CPD and their CPD record-keeping continuously up to date.

Option 3: Oversight by POBAct

As indicated above, we support the proposal for an oversight body (POBAct). For the avoidance of doubt, our understanding is that POBAct's brief in this area would be oversight of the Profession's CPD monitoring and practising certificate renewal processes. It is not envisaged that POBAct itself would directly monitor the CPD or work experience records.

7 STANDARD-SETTING

Our comments in this Chapter follow on from our more general remarks on regulatory models in Chapter 3.

Actuarial standard-setting

Options

- Option 1: Actuarial Standards Board (ActSB) which is quasi-independent of the Profession (as per the Profession's proposal); or
- Option 2: Actuarial Standards Board (ActSB) subject to oversight by a suitably independent body, for example the Financial Reporting Council; or
- Option 3: the FSA sets standards in life and general insurance, and DWP/Opra sets standards for pensions.

Choice of options

The Review has indicated its preference for Option 2 (the FRC model) and we agree. The reasons are very similar to those set out in Chapter 3 of the interim assessment and Chapter 3 of this submission.

[Although Option 1 is described as the Profession's own proposal, the proposal was articulated before the Review was announced, at which time we were exploring possibilities within our own powers to deliver. This Review has opened up alternatives which require external intervention and, in the case of the standards board, this has allowed the basic ideas behind our proposal for an ActSB to be developed into a more independent body.]

The FRC as regulator

If the ActSB is embedded within the FRC, it is natural to expect that comparisons will be drawn with the existing operating bodies under the FRC and existing procedures will be followed where applicable. In this way, the existing governance structures of the FRC can be disturbed as little as possible.

The natural comparators for the ActSB are the ASB (Accounting Standards Board) and APB (Auditing Practices Board). These two bodies are similar to each other in that they both set standards under statutory authority, but different in one key respect: the ASB sets standards for *accounts*, whereas the APB sets standards for *accountants* (when acting as auditors).

If the ActSB does no more than take over standard-setting from the Profession, it will be setting standards – both technical and ethical – for *actuaries*, not their clients or employers. The Profession has no power to direct any particular behaviour by persons other than actuaries. We understand, however, that the Review envisages the ActSB would also set actuarial standards to be adopted by pension schemes and insurers under powers delegated to them by statute.

This would constitute an important difference from – and, in our view, an improvement on – an ActSB that the profession could set up on its own. Quite rightly, and as noted above, the Profession has no power to mandate the behaviour of pensions schemes or insurance companies. This has restricted the scope of the standards that the Profession has been able to lay down without narrowing the options open to trustees or directors in the exercise of their duties. At the same time, Government departments have been understandably reluctant to draw up technical actuarial standards.

A properly constituted ActSB, with statutory authority delegated to it, will have both the intellectual capacity and the legal authority (within defined limits) to issue actuarial standards which have an effect on pension schemes and insurance companies equivalent to the effect which accounting standards have on companies.

8 SCRUTINY AND DISCIPLINE

Scrutiny of actuaries in life insurance

Options

- Option 1: Reviewing Actuary as currently specified by the FSA, with no mandatory peer review as proposed by the Profession; or
- Option 2: Reviewing Actuary as currently specified by the FSA, and peer review as proposed by the Profession; or
- Option 3: Reviewing Actuary's remit is expanded to include an explicit duty to report on compliance with actuarial standards; or
- Option 4: Reviewing Actuary as currently specified by the FSA, with additional duty to provide a peer review letter to the Actuarial Function Holder and/or the Board.

The Profession accepts that, for the range of work covered by the scope of the Reviewing Actuary's investigations, there is no need for any further (peer) review. What concerns us is the absence of any review of work which falls outside the ambit of the Reviewing Actuary's work.

We believe that for some of the other actuarial work in life offices, compliance with actuarial standards may be sufficiently important to protect the interests of policyholders that it justifies the expense of an independent review. Options 3 and 4 would meet some of these concerns by expanding the remit of the Reviewing Actuary to report on compliance with actuarial standards and/or to report to the company (either the Actuarial Function Holder or the Board) in addition to a private report to the auditor. Once we have experience of peer review for reserved roles, we can see whether an extension to other roles would be appropriate.

We are well aware of the arguments articulated, for example by the Financial Services Authority and the Association of British Insurers, against extending the peer review in line with our preference and we have deferred, for the time being, our proposals to introduce any additional peer review. This is not, however, a solution: it is merely the postponement of a solution to allow time for further discussion once there has been an opportunity to see how the FSA's new regime is settling down.

Scrutiny of actuaries in pensions

Options

- Option 1: maintain the status quo of no formal scrutiny; or
- Option 2: include long-term liabilities within pension scheme financial statements, which are then audited; and/or
- Option 3: introduce peer review of the Scheme Actuary as envisaged by the Profession; and/or
- Option 4: audit the Scheme Actuary's triennial valuation.

The Review seems to favour Option 2, ie including the long term liabilities within the pension scheme accounts, which are audited (see paragraph 8.62). Until that happens, the Review supports either Option 3 (the Profession's proposals) or option 4 (an audit of the triennial valuation).

By inference, the Review does not support Option 1 (no scrutiny). The Profession shares that view and the option effectively fell away with effect from the end of 2004 when the Profession introduced Guidance Note 48. This new GN reflects proposals previously trailed in Exposure

Draft 52 (see paragraphs 8.52-8.54), subject to some changes which were as a result of the feedback from the exposure exercise. In short, therefore, Option 3 is now in place and will remain so unless a decision is taken to adopt an alternative.

We are not against the possibility that the actuarial liabilities might be disclosed in the pension scheme accounts (Option 2), which would bring them within the ambit of the audit, but a decision to change the accounting requirements for pension schemes is not within our powers nor, as the interim assessment indicates, the Review's.

The remaining option is to have the triennial valuation audited (Option 4). It is not entirely clear what the scope of such an audit would be. Outside the context of a set of "true and fair" accounts in which the liability would be included, there are, so we understand, several other standards of audit that might apply, for example, "properly prepared [in accordance with the rules]", which is a fairly mechanical test that the rules have been applied. There are other standards of audit to consider.

In short, we are not sure whether the objective of Option 4 is to carry out the same testing as a GN 48 peer review, but with the review in the hands of an actuary appointed by an auditor, who would, in turn, be appointed by the trustees, or is the intention to change the nature of the test and, if so, in what way? At the present time, we are somewhat sceptical about this proposal, but if the Review wishes to explore it further, we would welcome the opportunity to discuss it with the Review, probably in conjunction with input and guidance from the Auditing Practices Board. It has not been practicable to achieve that in time for the 4 February deadline for this response.

Scrutiny of actuaries in general insurance

Options (for the company market)

- Option 1: introduction of requirement for actuarial advice as part of audit; and/or
- Option 2: introduction of peer review.

These options are necessarily tied in to the options discussed in Chapter 4, where the Review addresses (and we comment on) the question of a reserved role for actuaries in the general insurance (company) market. If there are no roles reserved to actuaries, there seems to be no justification for requiring peer review in those cases where the company elects to retain an actuary. Indeed, the requirement for peer review of actuaries' work, but not of other professionals' work, would create an obvious disincentive to using actuaries.

If a role is introduced which is reserved to actuaries (and, perhaps, other suitable qualified experts), it would seem logical to require the auditor to include a team member with the same qualifications. Indeed, our experience is that many audit firms already use actuaries to assist with the audit, even where the client sets its reserves without any actuarial input.

Option 1 (actuarial advice as part of the audit) is the same as Option 4 in Chapter 4. In our response to that chapter, we said that it may make good sense to adopt this option and to leave insurers to decide for themselves whether they need to appoint an actuary to advise them.

Options (for Lloyd's)

- Option 1: if the Statement of Actuarial Opinion is produced internally then it must be externally peer reviewed; or
- Option 2: introduction of external peer review of the work of all Syndicate Actuaries; and/or
- Option 3: introduction of a requirement for actuarial advice as part of audit.

If Option 3 were introduced (actuarial advice as part of the audit), it would effectively address Options 1 and 2 and would not (contrary to implications of "and/or") be needed in addition. It would also be consistent with the approach taken in the supervision of life offices and with one of the options we favour for the company market (see above).

So far as we are aware, however, the Council of Lloyd's is considering Options 1 and 2 and not Option 3. The rationale for Option 1, as opposed to Option 2 (peer review of the actuarial opinion, but only if the opinion-giver is internal to the company, as opposed to peer review of all actuarial opinions), is that the opinion may not be sufficiently independent if it is expressed by an internal actuary. This does not address, however, the possibility that the opinion-giver may make an error, either accidentally or through misunderstanding – or perhaps an error of judgement. Problems of that type are not limited to internal actuaries.

Discipline

Options

- Option 1: the disciplinary scheme remains accountable to the Faculty and Institute's Councils; or
- Option 2: the disciplinary scheme is accountable to a suitable independent oversight body; and/or
- Option 3: encouragement of closer links between whistle-blowing to regulators and the disciplinary scheme.

Option 1 vs Option 2

We agree with the Review that, if the Profession's Disciplinary Scheme is subject to an independent oversight body (Option 2), this would create greater trust in the process. At present, there is no such oversight (Option 1).

If the FRC model is adopted, as discussed in earlier chapters, with POBAct having responsibility for oversight of various regulatory functions which remain with the Profession, it would be efficient for POBAct to be the body which has oversight of the Profession's Disciplinary Scheme.

Beyond Options 1 and 2

The Review has posed the additional question as to whether the Profession's Discipline Scheme ought to be subsumed within the Accounting Investigation and Discipline Board (AIDB) of the FRC. This proposal goes beyond oversight; it amounts to discipline being taken away from the Profession and carried out by a body embedded within the FRC.

We are not experts on the way the AIDB functions, but we are aware that it is responsible only for those accountancy discipline cases "which raise or appear to raise important issues affecting the public interest" (source: the FRC's *Regulatory Strategy*, December 2004, Annex C). The remaining discipline cases remain to be dealt with by the accountancy bodies themselves. A similar division of responsibilities might be more appropriate if the AIDB is to maintain its focus on public interest cases. Just how many actuarial cases would transfer to the AIDB on that basis depends on future events. If the proposed set-up had been in place in the past, it seems that the AIDB may have taken on only one actuarial case. (This is not to suggest that actuaries have a better track record than accountants. It is simply a reflection of the fact that the regulation of financial services is more proactive than it is for the corporate sector in general, with the result that problems are much more frequently picked up by the regulators before they become "public interest" cases.)

Option 3: Closer links between whistle-blowing to the regulators and the disciplinary scheme

It is not entirely clear to us what is intended by this option. It is certainly the case that regulatory default by an actuary is *prima facie* evidence of misconduct, warranting a disciplinary investigation. Such investigations already take place and at least one of the statutory regulators notifies us when there is a matter it considers we should look into. Our intention is to explore with all the relevant regulators (FSA, the incoming Pensions Regulator and Lloyd's) how we can best co-operate on this issue, with a view to entering into Memoranda of Understanding where appropriate.

Option 3 seems to go beyond that, however, to suggest that when an actuary whistle-blows to a regulator regarding a company, the Profession should run an investigation in parallel with the regulator's investigation, proactively and ahead of any complaint, to see whether there are grounds for action against any actuary connected to the company on which the whistle has been blown. It is not clear to us that parallel investigations are efficient. We are also hampered by the lack of any legal powers to *demand* papers other than those which, in law, belong to members personally, whereas the statutory regulators have powers in this regard, but may not be able to pass the papers on to us.