Oversight of the Profession by the Financial Reporting Council (FRC)

Life Convention
6th November 2006

Paul Seymour, BAS Chair
Nigel Bankhead, BAS Director
Paul Kennedy, Head of Actuarial Oversight (POB)

---

Agenda

- The work and structure of the FRC
  Paul Seymour
- The Board for Actuarial Standards
  Nigel Bankhead
- The Professional Oversight Board
  Paul Kennedy

---

The work and structure of the FRC

Paul Seymour
Chair, Board for Actuarial Standards
The FRC’s Aim

... is to promote confidence in corporate reporting and governance

Our objectives & powers

To promote:
- high quality corporate reporting
- high quality auditing
- high quality actuarial practice
- high standards of corporate governance
- the integrity, competence and transparency of the accountancy & actuarial professions
- the FRC’s effectiveness as an independent regulator

We have significant statutory powers but some of our activities are based on market consensus

Promote high quality actuarial practice

- Developing a conceptual framework (BAS)
- Adopting technical standards, including for communication (BAS)
- Promoting scrutiny/monitoring of quality (Oversight Board)
- Encouraging wider debate on quality (FRC)
Promote the integrity, competence and transparency of the actuarial profession

- Overseeing the Profession’s regulation of its members (Oversight Board):
  - education, CPD, ethics, compliance, discipline
  - progress implementing Morris recommendations
  - public information about the actuarial profession

- Operating an independent investigation and disciplinary scheme for public interest matters (AADB)

Our Regulatory Philosophy

- A well-informed market is the best regulator
- Targeted use of powers (proactive, risk-based)
- Principles and clarity in standards and codes
- Consultative, practitioner decision-making … but independent
- Recognise the importance of professional judgment
- Fairness in decision-making
- Transparency, accountability and awareness

Organisational Structure (April 2006)
Our Powers
We have a mix of statutory and non-statutory powers:

- **Statutory** powers (given by UK Government)
  - Accounting & reporting standard-setting & enforcement
  - FRC levy

- **Obligations** on other parties to meet our requirements
  - Auditing standards, Audit inspection
  - Investigation & disciplinary scheme for public interest cases

- **Non-statutory**
  - Combined Code on Corporate Governance
  - Oversight of the accountancy profession
  - Standard setting for and oversight of the Actuarial Profession

Some Facts & Figures

- The FRC’s budget for 2006/07 is:
  - Core operating costs £10.5m
  - Audit inspection £2.5m
  - Actuarial standards & regulation £1.7m

- The core operating costs are funded equally by the business community, the accountancy profession and the government

- The audit inspection costs are funded by audit firms

- The actuarial costs are split:
  - 10% profession, 45% each insurers and pension funds

- The FRC expects to have 78 employees by March 2007, all working from central London

- The FRC has over 120 part-time market participants and lay people on its operating bodies and sub-committees

Regulation of the Actuarial Profession - Why the FRC?

- Equitable Life, Penrose, Morris (Myners, FRS 27)
- Actuarial issues are central to corporate reporting & governance
- Developing expertise in overseeing the regulatory activities of professional bodies
- Lower cost than stand-alone regulator
- Market-led regulation more flexible than statutory regulation
- Increase influence of actuaries in UK business & investment community
Extending the FRC’s Responsibilities to the Actuarial Profession

- Board for Actuarial Standards established (April 2006)
- Extend the role of POB (April 2006) & AADB (early 2007)
- Involve actuaries in FRC governance & decision-making
- Implement funding arrangements
- Review the new regime 2007/08

Regulatory Comparison

<table>
<thead>
<tr>
<th></th>
<th>Accounting</th>
<th>Actuaries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Education, training, CPD</td>
<td>Profession Oversight Board</td>
<td>Profession Oversight Board</td>
</tr>
<tr>
<td>Technical standards</td>
<td>ASB, BAS (much still FSA, DWP, and even ABI!)</td>
<td></td>
</tr>
<tr>
<td>Practitioner standards (ethical, procedural)</td>
<td>APB, BAS</td>
<td>Profession, BAS, FSA, TPR, some audit</td>
</tr>
<tr>
<td>Review of reporting/returns</td>
<td>Audit, some FSA, TPR, FRRP</td>
<td>FSA, TPR, some audit</td>
</tr>
<tr>
<td>Practitioner quality review</td>
<td>Profession, AIU, Oversight Board</td>
<td>7 (some peer review), Oversight Board</td>
</tr>
<tr>
<td>Complaints/discipline</td>
<td>Profession, AADB, Oversight Board</td>
<td>Profession, FSA, AADB, Oversight Board</td>
</tr>
</tbody>
</table>

Delivery!

- Part of the FRC’s added-value is being “more than the sum of the parts”
- Work with other regulators globally (eg European policy on better regulation - RIAs etc)
- Collaborative approach with the profession … but there has been a real transfer of responsibility to the FRC
Board for Actuarial Standards

Nigel Bankhead
Director

Board for Actuarial Standards

• BAS established under the FRC
• 14 Board members, (7 actuaries incl. me), Academics, User reps, Practising Actuaries, Consumer representative, Finance Directors.
• 5 observers, including FSA and TPR
• First inaugural meeting 20th April 2006
• Second (adoption) meeting 16th May 2006
• Four subsequent (conceptual framework) meetings

[Second Monday at 1.30pm www.frc.org.uk/bas/about]

Regulation of Actuarial Practice
“Control Cycle”

POB
What did BAS inherit?

• Profession’s and FRC’s heritage
  Standard setting “framework”
  Existing Guidance Notes
  Development and consultative arrangements
  Scrutiny Committee Report
  Volunteers
  Profession’s research
• External recommendations & observations

External Observations - Morris

• Weak, ambiguous, partial, incoherent, inconsistent, incomprehensive, outdated standards
• Insular (and polarised) profession
• Failed to provide a clear presentation of the unavoidable risks that accompany most long term projections

External Recommendations - Morris

• Develop conceptual framework
  objectives & characteristics of standards
• Communication content
  assumptions
  methodologies
  nature of calculations and exercise of judgement
  sensitivity and scenario analysis
  characterization of risk
  client risk bearing capacity
Conceptual Framework Objective
• Develop a conceptual framework establishing the principles and concepts that underlie actuarial practice.
• Thereby:
  ➢ provide clear direction on the matters that should be upheld by actuarial practice (judgement).
  ➢ achieve common understanding, intention and approach (consistency)
  ➢ help users understand the nature and limitations of actuarial practice (communication)

ASB Conceptual Framework
• Objectives of financial statements
• The reporting entity
• Qualitative characteristics of financial information
• Recognition in financial statements
• Measurement in financial statements
• Presentation of financial information
• Accounting for interests in other entities

Discussion Paper Objectives
• Identify, explore and define the different characteristics, philosophies, principles and concepts relevant to actuarial practice
• Compare and contrast the different approaches and identify their strengths and weaknesses
• Consider the matters on which external consultation should be conducted. Form preliminary conclusions where appropriate
Developmental Approach

- Working Groups
  - On Stakeholder Interests, Risk, Value and a Production Group
- Broad Participation
  - actuaries, users, journalist, Trade Union etc
  - General Insurance, Life, Pensions, Investment, Banking, Risk Management and Food Standards
- Stakeholder Interest Group
  - Research/Questionnaire/Personal Interviews
- Consulted Bodies
  - Profession, FSA, TPR

Outline Timescale

<table>
<thead>
<tr>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>JAN</td>
<td>FEB</td>
</tr>
<tr>
<td>AUG</td>
<td>SEP</td>
</tr>
<tr>
<td>Risk Working Group</td>
<td>Value Working Group</td>
</tr>
</tbody>
</table>

Consultation Phase

<table>
<thead>
<tr>
<th>2007</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>AUG</td>
<td>SEP</td>
</tr>
<tr>
<td>CONSULT on Discussion Paper</td>
<td>ANALYSE responses, draft Exposure Draft</td>
</tr>
<tr>
<td>CONSULT on Exposure Draft</td>
<td>ANALYSE responses</td>
</tr>
</tbody>
</table>
Stakeholder Questions/Considerations
- Environmental Background
  - regulatory structure, governance structures, commercial market, financial markets
- Stakeholders
  - categories?
  - needs?
  - understanding?
  - Public interest requirements?
- Implication for Actuarial Practice
  - what is quality?
  - communication implications?

Value Questions/Considerations
- What is the value measurement philosophy underlying actuarial practice (externally unique or consistent)?
- Are current actuarial valuations (and discounted cash flows) a value determination, or something else?
- Is value an objective or a subjective measure, and can it be context constrained?
- Should value include a risk cost?
- What measurement philosophies fulfil the needs of different users?

Risk Questions/Considerations
- What is risk, what are its characteristics and effects?
- How should risk be measured, what are the risk metrics?
- Does risk have a cost/value?
- What can users readily understand and how should risk be communicated?
- Which risks can be measured and which cannot?
- Scope - measurement, advice on control/mitigation, management?
- Should risk be controlled by prudent measure, or prudent action ie capital reserves, hedging?
FRC: pre-Enron statutory framework for audit regulation

- Financial Reporting Council (companies)
- Secretary of State (audit)
- Accounting Standards Board (ASB)
- Financial Reporting Review Panel (FRRP)
- Recognised Qualifying Bodies (RQBs)
- Recognised Supervisory Bodies (RSBs)

The Accountancy Foundation Ltd: pre-Enron voluntary oversight

- Review Board Ltd
- Auditing Practices Board Ltd (APB)
- Ethics Standards Board Ltd (ESB)
- Investigation and Discipline Board Ltd (IDB)

- Professional bodies' own investigation and discipline
- Pubs' own training, monitoring qualification, registration

Professional Oversight Board

- Statutory oversight
  - RQBs: bodies awarding audit qualifications
  - Foreign qualifications: recognition
  - RSBs: audit supervisory bodies
- Voluntary oversight
  - Accountants (education, training, ethics, CPD, complaints, discipline)
  - Actuaries (except DPB)
- Hybrid audit inspection role
  - Statutory obligation on RSBs to subscribe to independent inspection arrangements for auditors
  - RSBs overseen by Oversight Board
  - RSBs subscribe to Board's Audit Inspection Unit
11 Board members and 23 staff

Sir John Bourn, Comptroller and Auditor General
Paul George, Executive Director
3 NEDs (audit, banking backgrounds)
1 academic
1 actuary in private practice
1 chief executive of an NHS trust
1 former investment manager and actuary
1 lawyer with experience of pensions regulation
1 senior administrator at the TUC
23 staff (16 at the Audit Inspection Unit)

Major POB projects

- Monitoring RQBs/RSBs
- Audit quality reports (AIU)
- EU cooperation: 8th directive
- Accounting needs of SMEs
- Competition and choice
- Audit quality (with APB)
- Complaints and discipline
- Key facts and trends
- Transparency of audit firms
- Education and training
- Profession’s progress in implementing Morris
- Understand Profession’s regulatory systems
- Public information about actuaries
- Monitoring and scrutiny
- Regulatory liaison (FRC)
- User needs (with BAS)
- Profession’s reviews of PCS and discipline

The Profession’s response to Morris

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Response</th>
</tr>
</thead>
<tbody>
<tr>
<td>Education and training</td>
<td>Implement 2005 strategy</td>
</tr>
<tr>
<td></td>
<td>More external input</td>
</tr>
<tr>
<td></td>
<td>Promote university route</td>
</tr>
<tr>
<td>CPD</td>
<td>Clarify scheme objectives</td>
</tr>
<tr>
<td></td>
<td>Keep CPD up to date</td>
</tr>
<tr>
<td></td>
<td>More rigorous, validation</td>
</tr>
<tr>
<td>Ethical standards</td>
<td>Clarify pensions conflicts</td>
</tr>
<tr>
<td></td>
<td>Clarify whistleblowing</td>
</tr>
<tr>
<td>Scrutiny and discipline</td>
<td>Review life scrutiny gaps</td>
</tr>
<tr>
<td></td>
<td>Liaise with regulators</td>
</tr>
</tbody>
</table>

... and the Strategy Review!
Scrutiny of life actuaries

- Actuarial function holder
- With-profits actuary
- Appropriate actuary
- Other e.g. reporting actuary
- Reviewing/audit actuary
- Independent actuary
- Internal peer review
- External peer review
- Board/WPC/FSA actuaries

Major concerns

- Competence: keeping skills up to date
- Competence: communication skills
- Integrity: PCS review, conflicts
- Integrity: discipline review
- Transparency: regulator soup
- Transparency: recognising a good actuary
- Quality: do actuaries meet user needs?
- Quality: pensions a bigger challenge?