

*Morris Review*  
of the Actuarial Profession

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Final Report

March 2005



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# CONTENTS

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	Page
Foreword	1
Executive Summary	3
Chapter 1 Introduction	11
Chapter 2 The Market for Actuarial Services	23
Chapter 3 The Profession and Regulation	39
Chapter 4 Education and CPD	47
Chapter 5 Actuarial Roles	63
Chapter 6 Standard-setting	71
Chapter 7 The Public Interest and Accountability	75
Chapter 8 Scrutiny and Discipline	85
Chapter 9 Government Actuary's Department	107
Annex A Membership of the External Advisory Panel	139
Annex B List of Contributors to the Review	141
Annex C The Current Regulatory Framework	147
Annex D Summary of Recommendations	149



# FOREWORD

March 2005

Dear Financial Secretary,

In March 2004, the Government asked me to undertake a wide-ranging independent review of the actuarial profession. The background to this was Lord Penrose's Inquiry into the Equitable Life, which highlighted a number of concerns with the actuarial profession.

In December 2004, I published an interim assessment. This summarised evidence to the review, sought to analyse a wide range of issues that emerged in the course of the review, and put forward a number of proposals for reform. The interim assessment should be viewed as an integral part of my report to you.

In the interim assessment I said that I had no reason to doubt that the overwhelming majority of actuaries in the UK are anything other than dedicated, skilled professionals, providing important and useful advice with commitment, integrity and a strong sense of professional duty. However, the interim assessment also identified a number of quite serious problems faced by the profession in the UK.

These problems included a degree of insularity in its methods and approach; insufficient emphasis on the uncertainties inherent in long-term financial planning; too little transparency in actuarial advice; concern about reserving certain roles to actuaries; and a widespread perception that the actuarial profession had not responded as effectively or as fast as might have been expected to major changes in both demographics or economic conditions in the UK in the last decade or more.

Against this background, my review has focused on three aspects:

- the extent of competition and choice in the market for actuarial services;
- the regulatory framework for members of the actuarial profession; and
- the future role of the Government Actuary's Department (GAD).

With regard to the first I have in general found sufficient competition and choice to be available in the market for actuarial services; but to some extent an 'understanding gap' between users and actuarial advisers which inhibits the exercise of choice by users of actuarial services. I have therefore put forward a number of proposals, to improve the scrutiny and challenge of actuarial work, to increase market testing, and to reduce some of the obstacles to a more effective market emerging.

With regard to the regulatory framework, I am proposing the introduction of a new regime of independent oversight of the regulation of the profession, exercised by the Financial Reporting Council. This would include a new Actuarial Standards Board; oversight of compliance with technical and ethical standards and also of new arrangements for actuarial training and continuing professional development; more effective scrutiny of actuarial advice; and clearer lines of accountability of actuaries to regulators, to the Profession and to clients and employers. I have also sought to address the potential conflicts of interest that surround the role of the Scheme Actuary to pension schemes.

With regard to GAD, I have looked in detail at its main activities. I have recommended that in order to achieve greater co-ordination and integration of some activities, three specific elements of GAD's work, none large, should be transferred elsewhere. Otherwise GAD should be free to continue with its other main functions, but in a modified framework which gives greater discretion to public sector pension scheme clients.

I believe that there is widespread support for these proposed changes. In particular, the Profession has responded in a very constructive way, pursuing reforms that it had itself seen as being necessary in the light of the Penrose Report, and providing useful input at all stages of my review to ensure effective and timely implementation of the proposed changes it contains. The response of the relevant regulators has also been very positive.

This is very much to be welcomed. The Profession is, in my view, at something of a crossroads. It has for a variety of reasons come under quite intense scrutiny, not least in this review, and will inevitably face change. There is a danger that this might involve retrenchment, a narrowing of focus onto its traditional areas of strength, bolstered by reserved roles, with relatively little innovation in its training, methods or breadth of application.

With strong leadership, however, I believe that the Profession can move forward, on the basis of reforms proposed in this review, to fulfil a wider remit in the field of financial risk analysis, bringing expertise, robust technical standards and the benefits of professional conduct standards to both traditional and new sectors.

Actuaries will, in either case, face increasing competition from other disciplines; but will, in my view, be much better placed to meet this if the Profession adopts and effectively implements the programme of change described in this report under the auspices of the FRC. This will be of the greatest importance not only to the Profession and its immediate clients, but also to customers and consumers more generally, and to the financial resilience of the economy more generally.

I would like to express my gratitude and the great debt I owe to Niki Cleal, who has led the review team with exemplary skill, drive and effectiveness. Not least was her talent for identifying and recruiting an able team, comprising Stephen Dickinson, Odette Fioroni, David Hobson, Paul Kennedy and Gemma Temple-Smithson. Their professionalism in all aspects of this review has been impressive, and I have much enjoyed working with them.

I should also like to thank the review's advisory panel, comprising Philip Broadley, Steven Haberman, Elaine Kempson, Paul McCrossan, Roger Munson, Peter Tompkins and Adair Turner, who at several stages have provided critical advice and comment on the work of the review.

Finally I would like to express my thanks to all those who submitted views to the review, to the large number of organisations and other interested individuals who spent time meeting with me or my team and, in particular, to leading members of the Profession for their assistance at a difficult time and the helpful way in which they responded to my questions. I believe that this bodes well for the Profession, and I wish it success in taking forward the reforms which I have proposed. I envisage that substantial progress on this agenda for reform could be made by the Profession, working closely with the FRC and the statutory regulators, within the next year.



Sir Derek Morris



# EXECUTIVE SUMMARY

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## Introduction

1. In March 2004 the Government asked Sir Derek Morris to undertake a wide-ranging independent review of the actuarial profession. The background to the review was Lord Penrose's Inquiry into the Equitable Life, which highlighted a number of issues and concerns with the actuarial profession. The review has focused on three main areas: the extent of choice and competition in the market for actuarial services, the current regulatory framework for members of the actuarial profession, and the role and future institutional status of the Government Actuary's Department.

2. The review has consulted widely with interested parties including: members of the actuarial profession; users of actuarial services; the pensions and insurance industries; the statutory regulators; and trade and consumer bodies. The review received around 100 written responses to the initial consultation document and almost as many responses to the interim assessment report. The interim assessment set out the consultation feedback that the review had received in the initial consultation phase, identified areas of concern and proposed alternative policy options for change. This final report summarises the feedback that the review has received on the policy options set out in the interim assessment and provides the review's final recommendations for change.

## Competition and choice

3. The review examined the extent of choice and competition available in the market for actuarial services. The review has paid particular attention to the markets for actuarial advice provided to pension schemes, and to life and general insurers, because these industries together employ 80 per cent of practising actuaries in the UK. The review recognises that increasingly actuaries work in other industries such as healthcare and banking.

4. The review has concluded that over the last decade there has been significant entry by small and medium sized independent firms into the actuarial services market as well as entry by the big four accountancy firms. As a result most users of actuarial services face a reasonable degree of choice of provider. There is however, a degree of market concentration in advice to the largest pension schemes. This market is also characterised by high levels of full-service appointments – the joint supply of actuarial, strategic investment and fund manager selection advice to pension scheme trustees – which may restrict competition from other non-actuarial professionals. The review did not receive any evidence or suggestion of explicit product tying or cross-subsidisation. However, the review supports the Government's recent proposed amendment to the Myners principle on expert advice, which proposes that pension scheme trustees should tender separately for actuarial, strategic investment and fund manager selection advice.

5. The review found that the market for actuarial advice is characterised by relatively low levels of market testing and actual switching of provider. Less than 10 per cent of contracts are re-tendered in any given year, and a similar percentage are subject to renegotiation. The review identified a number of constraints on market testing and switching, including: the difficulty for users in assessing the quality of actuarial advice; the importance of scheme-specific knowledge; the provision of full-service appointments; and the costs of market testing. The review recommends that, as a matter of best-practice, pension scheme trustees should (i) informally evaluate their actuarial adviser on an annual basis; (ii)

undertake a more formal evaluation following the triennial valuation; and (iii) undertake a formal market test of their actuarial advisers no less frequently than every six years.

**6.** The review concluded that given the complex and technical nature of most actuarial advice there is often a significant ‘understanding gap’ between users of actuarial services and their advisers. A significant proportion of users of actuarial advice acknowledged that they did not scrutinise or arrange for review of the actuarial advice that they received – often relying instead on the trust that they placed in their actuarial adviser. The review supports the initiative of the Pensions Regulator to increase trustee knowledge and understanding. In addition, the review recommends that the Pensions Regulator should ensure that trustees have access to good practice guidance on the effective management of their actuarial and investment advisers, including their Scheme Actuary. In parallel, the review recommends that the Association of British Insurers should consider how education and training might be provided for non-executive directors of insurance companies to assist them to challenge and question actuarial advice. The review believes that there is a responsibility on actuaries to communicate their advice in as clear a way as possible to users. The review recommends that a standard on communication should be produced that covers the information and advice users typically need, and how that can be conveyed in a manageable form so that clients can properly understand, scrutinise and probe the advice they receive.

### Regulatory framework

**7.** The review identified a number of weaknesses in the current framework of self-regulation by the actuarial profession including:

- professional standards that have been weak, ambiguous or too limited in range, and perceived as influenced by commercial interests;
- an absence of pro-active monitoring of members’ compliance with professional standards; and
- a profession that has been too introspective, not forward-looking enough and slow to modernise.

**8.** As a result, this self-regulatory framework proved to be inadequate to protect the public interest.

**9.** The interim assessment set out three possible models of regulation:

- continued self-regulation by the Profession;
- independent oversight – the Profession’s self-regulation overseen by an independent body; and
- full statutory regulation.

**10.** The review has concluded that continued self-regulation by the Profession is unlikely to restore public confidence in the actuarial profession. At the other extreme, statutory regulation by the existing statutory regulators – the Financial Services Authority (FSA) for actuaries advising insurers and the Occupational Pensions Regulatory Authority (Opra)/the Pensions Regulator (TPR) for actuaries advising pension schemes – may be unresponsive if it leads to standards being specified in legislation, could lead to different approaches to regulation of actuaries working in different practice areas, and would leave actuaries working outside these traditional areas unregulated. However, a dedicated statutory regulator for actuaries seems disproportionate and costly for a profession of only 4,500 fully qualified practising members. The review therefore concludes that independent oversight of the

Profession's self-regulation is the most appropriate regulatory framework. This model combines professional actuarial input into the regulatory framework with sufficient independence from the Profession to provide the necessary protection and assurance for the public. The review's central recommendation is that the Financial Reporting Council (FRC) should provide oversight of the regulation of the actuarial profession. The FRC already provides oversight of the regulation of the accountancy profession and the proposal received extremely strong support from the majority of respondents.

**11.** The regulatory framework for actuaries has five main aspects: the setting of appropriate education and continuing professional development requirements for members of the profession; the establishment of roles reserved exclusively to actuaries; the setting of high-quality professional and ethical standards; duties and obligations to protect the public interest; the monitoring of members' compliance with professional standards and the administration of disciplinary procedures in the event of possible misconduct. The FRC would have a role in oversight of the actuarial profession's performance in all of the above areas, although reserved roles are primarily an issue for the FSA and the Pensions Regulator.

**12.** The review recommends that the remit of the Professional Oversight Board for Accountancy (POBA), one of the operating bodies of the FRC, should be expanded to include oversight of the actuarial profession's role in administering the education system and continuing professional development. The review recommends that the actuarial profession should work with employers and universities to broaden the education options for prospective actuarial students – in particular, one entry route the review believes is worthy of early consideration is greater provision of 1-year post-graduate actuarial conversion courses.

**13.** In the life and pensions areas the statutory regulators have established certain defined roles that are reserved exclusively to members of the actuarial profession. These place duties on the role-holder to perform certain specific functions and to whistle-blow to the regulators in certain circumstances. Current roles have been substantially reviewed and reformed over the last few months: the FSA replaced the old Appointed Actuary role in life insurance; and the Pensions Act 2004 establishes the Pensions Regulator as the new regulator for pensions schemes, and further specifies the role of the Scheme Actuary.

**14.** The review considered whether there was a case for continuing to reserve roles to members of the actuarial profession in life and pensions and considered the case for or against a new reserved role in general insurance. The review concluded that, in life and pensions, actuarial work on valuing long-term liabilities – a core skill in which actuaries currently have a unique advantage – is of such critical importance that opening up these roles to non-actuaries would not be in users' best interests at the current time. The review therefore recommends that the existing reserved roles in life and pensions should continue to be reserved to members of the actuarial profession; however if others can acquire the appropriate skills and expertise, there is no reason why actuaries should have a permanent statutory monopoly and the Government and the statutory regulators should keep the position under review.

**15.** The review feels that the case for reserving a role exclusively for members of the actuarial profession in general insurance is different from the position in the life and pensions area. The arguments against reserving a role are that the liabilities are usually less long-term in their nature and many non-actuaries already provide advice on the reserves of a general insurer. However, arguments in favour include the fact that the demise of a large general insurer could have serious systemic effects. The review concludes that it is critical that senior management receive advice from someone with relevant skills in risk assessment and the valuation of liabilities. The review therefore recommends that the FSA should consult on introducing a requirement for general insurers to take advice from an approved person with relevant skills who may, or may not be, a member of the actuarial profession.

**16.** The review expressed concern about the potential for conflicts of interest when the Scheme Actuary advises both the pension scheme trustees and the scheme sponsor. The Scheme Actuary advises the trustees on the valuation of the scheme's assets and liabilities and the rate of contribution necessary to meet the liabilities. Trustees represent scheme members' interests and are likely to want to ensure that security for members' likely benefits is maximised, while scheme sponsors may be concerned about minimising the cost of the scheme. This may lead to potential conflicts of interest when the same actuarial adviser advises both parties. The review recommends that trustees, the scheme sponsor and the Scheme Actuary should explicitly agree that there are no material conflicts of interest prior to the Scheme Actuary advising both the trustees and the scheme sponsor. If at any point, any of the three parties i.e. the trustees, the Scheme Actuary or the scheme sponsor, deem that a material conflict of interest has emerged then the trustees should have the option to retain the existing adviser and the scheme sponsor should secure separate actuarial advice.

**17.** The review recommends that the FRC, in consultation with the actuarial profession, should establish an Actuarial Standards Board within the FRC structure with a remit to set technical standards for the profession. The Profession would continue to set ethical standards of conduct provided that the FRC and its operating bodies feel this to be appropriate.

**18.** Actuaries have obligations and duties to protect the public interest. The statutory regulators place whistle-blowing and reporting requirements on actuaries holding reserved roles. The review makes a number of recommendations to the Government and to the statutory regulators to clarify the reporting and whistle-blowing requirements to ensure that actuaries understand when they have a duty to report and that they have an appropriate degree of legal protection when they do so. In addition, all actuaries have a duty to comply with professional standards – both ethical and technical. Taken together, the duties upon actuaries to whistle-blow to the statutory regulators, and to comply with professional standards are the mechanisms through which the public interest is protected.

**19.** The review considered whether there was an appropriate degree of scrutiny of actuarial advice. A lack of expert scrutiny has been a persistent theme in concerns about the actuarial profession in recent years. This is particularly important when, as already noted, many users of actuarial advice find it difficult to challenge actuarial advice due to the understanding gap. The review therefore believes it is essential that actuaries' compliance with professional standards is monitored within the overall regulatory framework and makes a number of recommendation to this end.

**20.** In life insurance, the FSA abolished the old Appointed Actuary regime in December 2004 and introduced a requirement for auditors to take actuarial advice from a Reviewing Actuary when auditing life insurers. The review strongly supports the introduction of the Reviewing Actuary role as this introduces scrutiny of the work of the Actuarial Function Folder and indirectly provides scrutiny of their compliance with professional standards. However, the review notes that there are aspects of actuarial work that may fall outside the remit of the Reviewing Actuary and recommends that the Profession should identify any material gaps in compliance with actuarial standards and should report on them to POBA. In the meantime, the senior management of life insurers should consider whether further review would be appropriate.

**21.** In general insurance, the review recommends that the FSA should consider consulting on the introduction of a requirement for actuarial advice as part of the audit in both the company market and the Lloyd's market for general insurers.

**22.** In pensions, the work of the Scheme Actuary is not subject to any kind of formal, mandatory and external scrutiny. In December 2004 the actuarial profession introduced peer review of the Scheme Actuary's advice. The review supports the Profession's peer review but

notes that many firms have had internal peer review processes in place for some time and that there is no requirement for the peer reviewer to be independent of the Scheme Actuary. The review believes that independent scrutiny of Scheme Actuaries' advice is critical, given the importance of actuarial advice to trustees. The review therefore recommends that the Pensions Regulator should ensure that Scheme Actuaries' advice is subject to formal scrutiny by independent experts, either through its risk-based supervision, audit or external peer review. The Pensions Regulator may wish to adopt different approaches for large and small schemes.

**23.** In the light of the above, within the next 2-3 years, the FRC, working closely with the statutory regulators and the Profession, should satisfy itself that appropriate monitoring of compliance with professional standards and independent scrutiny of actuarial advice is occurring through direct supervision by the statutory regulators, audit or peer review.

**24.** The review notes that the Profession recently reformed its disciplinary procedures. The review does not therefore propose radical reform in this area, but proposes that the remit of the Professional Oversight Board for Accountancy should be extended to oversee the disciplinary scheme for actuaries and that the Accountancy Investigation and Discipline Board should assume a role in investigating and hearing actuarial public interest cases.

## Government Actuary's Department (GAD)

**25.** Historically, GAD advised on insurance regulation in the UK. This responsibility passed to the FSA in 2001. An initial key question for the review was therefore whether the loss of this responsibility left an important ongoing role or roles for GAD; if so what they were and whether GAD should remain in the public sector or transfer to the private sector.

**26.** This breaks down into two related but separate questions. The first relates to the future role of the Government Actuary as a government officer in his own right. The second relates to the overall scope and functions of the Government Actuary's Department.

**27.** On the first question, it was readily apparent to the review that there are certain activities where in the opinion of the review, it is essential that the UK has an expert and authoritative officer, appointed by Government, but acting independently, to report to Parliament and to provide proper oversight in relation to the National Insurance Fund.

**28.** On the second question, in broad terms, three main themes emerged. First, there is general satisfaction with the quality of advice provided by GAD; second, there are some concerns about certain aspects of the delivery of that advice; and third, there was general support for introducing more discretion for public sector users of GAD to choose the source of their actuarial advice. This would provide a means of ensuring that actuarial services supplied by GAD and others would be as efficient and effective as possible. The review believes that the proposals which have emerged from its investigation will provide public sector users of actuarial services with the right framework within which to work; and at the same time allow GAD to build on its historical strengths – its central role in advising Ministers, government departments and the wider public sector; the consistency of its approach across the public sector; and its standing as a public sector body – in order to meet its continuing aspirations effectively.

**29.** At a more detailed level, the review asked a sample of GAD's existing clients a number of questions about the quality of service GAD provides, and the rationale and continuing need for a separate Government Actuary's Department. GAD provides different services to its clients and the level of satisfaction expressed by clients varied according to the service used.

These services include:

- advice to pension schemes in the public sector;
- assessments of broad comparability of pension schemes and advice on pensions aspects of Public Private Partnerships (PPP)/Private Finance Initiatives (PFI) and machinery of government changes;
- pensions policy advice;
- social security;
- population projections and associated demographics;
- Occupational Pension Scheme Survey; and
- advice to overseas clients.

**30.** GAD is required in legislation to provide advice to the majority of major public service pension schemes, including the large public service schemes such as the NHS and the Teachers' pension schemes. Most clients believed that GAD offered value-for-money, consistency of approach, historical knowledge and understanding of the public sector. However, the review notes that where there was no legislative obligation to use GAD – as was the case for the Principal Civil Service Pension Scheme – private sector actuarial firms have been used with success. In line with the view of most schemes consulted, the review recommends removing the legislative requirement that GAD advises these public service pension schemes, so that the scheme administrators have a choice of provider.

**31.** GAD provides assessments of broad comparability of pension schemes when public sector staff are transferred from the public sector to the private sector. There was some misunderstanding that HM Treasury's Fair Deal policy requires GAD to sign-off certificates of broad comparability. The review recommends that the Government ensures that the principles of the Fair Deal are understood and explicit: that Government Departments have a choice as to their actuarial provider for assessments of broad comparability.

**32.** Government departments were satisfied with GAD's ad-hoc pensions policy advice. Recent demand for actuarial input has seen GAD actuaries located in-house within a government department and Opra, and also the use of private sector actuaries on pensions areas where GAD has less relevant expertise. The review recommends that the Government retains the existing situation whereby government departments have the flexibility to use the most appropriate provider of actuarial advice which may vary according to the nature of the pensions policy advice required.

**33.** The Government Actuary provides advice to Parliament on National Insurance contribution levels and benefits. Clients felt that the Government Actuary offered credibility and independence from the Government in providing this advice, which was important to retain public confidence in the system. However, the review notes that one key government department has already embedded part of the benefit forecasting work and some respondents suggested that this work does not have to be done by an actuary. For policy and operational reasons the review recommends that the Government should embed National Insurance Fund projections and any associated work in the Department for Work and Pensions (DWP) and the Inland Revenue. However, the Government Actuary should remain responsible for the statutory reports to Parliament on the National Insurance Fund.

**34.** GAD produces long-term population projections for the UK and conducts a survey on occupational pension schemes. On the production of population projections and associated demographic data the review believes there is unnecessary fragmentation of demographic expertise and potential efficiency and quality gains from relocation of the work. The review recommends that there would be potential benefits in transferring this work and building up demographic expertise in the Office for National Statistics (ONS). In relation to the Occupational Pension Scheme Survey there were concerns about the low response rates and it was noted that conducting surveys is not one of GAD's core functions. The review therefore recommends that DWP, the Pensions Regulator and ONS consider transferring the Occupational Pension Scheme Survey to either the Pensions Regulator or the ONS, although the review's preference is to transfer the survey to the ONS.

**35.** GAD's work overseas is largely won on the basis of competitive tender. Some concerns were expressed that the work that GAD conducts overseas in the area of insurance regulation is a function which they no longer undertake in the UK. Others questioned whether there was a UK benefit to GAD's overseas work. However, the majority of GAD's overseas clients were highly satisfied with the work. The review does not recommend any changes in this area but suggests that the Government should consider clarifying the circumstances and purposes for which the Government Actuary or the department provide actuarial advice to clients outside of the UK public sector.

**36.** Overall, the review recommends that the Government should consider converting GAD into a trading fund.

## Conclusion

**37.** The agenda for change for the actuarial profession, as set out by the review in this final report, is substantial. However, the Profession has provided useful input at all stages of the review and has responded in a very constructive way, pursuing reforms that it had itself seen as necessary in the light of the Penrose Report.

**38.** There has been broad support amongst a large number of respondents to the interim assessment to the review's central recommendation – that the Financial Reporting Council should oversee the regulation of the actuarial profession. The review therefore envisages that substantial progress on this agenda for reform could be made by the Profession, working closely with the FRC and the statutory regulators, within the next year.





# INTRODUCTION

In March 2004 the Government asked Sir Derek Morris to undertake a wide-ranging independent review of the actuarial profession in response to the criticisms of the actuarial profession made by Lord Penrose in his inquiry into the Equitable Life. The full terms of reference of the review are to:

Consider what professional and/or regulatory framework would best promote recognised, high-quality and continuously developing actuarial standards, openness in the application of actuarial skills, transparency in the professional conduct of actuaries, accountability for their actions and an open and competitive market for actuarial advice in the UK.

In doing so:

- take into account developments in the actuarial profession, in regulation, and in the financial services market, in the UK and abroad;
- examine the roles of actuaries in the financial services sector, including in providing actuarial opinions in relation to audited accounts;
- build on the work of recent government and regulatory initiatives;
- examine the relationship between the Government Actuary's Department and the actuarial profession and with other parts of government;
- recommend a framework that will be independent in representing the public and consumer interest, and be accountable, flexible, transparent, and no more burdensome or restrictive than is clearly justified;
- make recommendations on the future role of the Government Actuary, the functions of his Department and its future institutional status.

The review will deliver a final report to the Government with recommendations by spring 2005.

## BACKGROUND TO THE REVIEW

### Lord Penrose's criticisms of the actuarial profession

1.1 Lord Penrose identified a number of issues concerning the actuarial profession in his Inquiry into the Equitable Life Assurance Company, including:

- a lack of comprehensive professional standards;
- an over-reliance on the role of the Appointed Actuary;
- a lack of scrutiny and audit of actuarial calculations;
- reactive disciplinary procedures;
- a reluctance to challenge fellow actuarial professionals; and
- concerns about the Government Actuary's Department's (GAD's) role in advising on the prudential supervision of insurance firms.

**1.2** Perhaps the most serious of Lord Penrose's criticisms was that the Profession had failed to develop comprehensive professional standards in a number of key areas.<sup>1</sup> He was particularly critical of the Profession's failure to provide professional guidance to actuaries on how they should interpret the concept of policyholders' reasonable expectations (PRE). Lord Penrose argued that in the past the Profession's guidance notes had been consensus driven and had therefore tended towards the lowest common denominator and had been drawn too widely with too much discretion permitted for individual actuaries within the guidance.

**1.3** The second criticism was an over-reliance by the Board of the Equitable Life on the Appointed Actuary. This was a particular problem in the case of the Equitable Life because one person was both the Appointed Actuary and the Chief Executive Officer. Lord Penrose also expressed concern about the lack of scrutiny and audit of key actuarial calculations in life insurers under the old Appointed Actuary regime. The Appointed Actuary's calculations of the liabilities of the insurer were certified by the Appointed Actuary, were outside the scope of the audit, and were not subject to any formal requirements to be peer reviewed by an actuary. This meant that the calculation of the liabilities of a life insurance company was not subject to any form of external scrutiny.

**1.4** Lord Penrose also noted that the Profession's disciplinary processes were complaint driven and reactive in nature which he felt was inappropriate in a market where consumers and users are not well placed to understand the quality of the advice given, and where the products are long-term in nature and the implications of poor quality advice are unlikely to become apparent for many years.

**1.5** Two cultural issues, which Lord Penrose raised about the Profession, were that actuaries: first, in some circumstances had tended to operate beyond the scope of their discipline, by for example, making decisions which turned on matters of law; and second, that they demonstrated a reluctance to criticise fellow actuaries. In particular, he noted that there had been a Professional Conduct Standard in operation that prevented actuaries from criticising their fellow Appointed Actuaries.

**1.6** Finally, Lord Penrose was critical of the role which the Government Actuary's Department played in advising on the prudential supervision of the Equitable. He argued that although GAD actuaries did challenge the Equitable's senior management team, they failed adequately to follow up their concerns.

**1.7** Lord Penrose's inquiry was focused on one life insurance company, Equitable Life. The starting point for this review is the more general set of concerns which Lord Penrose raised about the actuarial profession. The terms of reference for this review have been drawn very broadly, to allow a wide-ranging investigation. Therefore, while the review to a considerable extent focused on the concerns raised by Lord Penrose, it has not been restricted to them.

## REVIEW'S METHODOLOGY

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**1.8** The review has investigated three broad aspects of the actuarial profession: the extent of choice and competition in the market for actuarial services; the current regulatory framework for members of the actuarial profession; and the role and future institutional status of the Government Actuary's Department.

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<sup>1</sup> Collectively the institutions of the Faculty and Institute of Actuaries are referred to as the Profession throughout this report. The profession is used in a broader sense to mean all actuaries in the UK who are members of the Institute or Faculty.

**I.9** The review published an initial consultation document in June 2004 which was sent to a wide range of stakeholders including members of the Profession, actuarial consulting firms, users of actuarial services, a sample of GAD's clients, the Government Actuary's Department, and other stakeholders with an interest.<sup>2</sup>

**I.10** The review received around 100 written responses to its initial consultation document – roughly one-third from members or organisations within the profession, a quarter from GAD's clients and the remainder from users of services, the pensions and investment community and other individuals.

**I.11** Sir Derek Morris appointed an external advisory panel to advise him on the conduct of his review. Members of the panel were chosen in their personal capacity, rather than as representatives of any of the organisations with which they have connections, as experts in the following fields: pensions; insurance; academia; international; practitioner; consumer and accountancy (see Annex A for membership of the external advisory panel).

**I.12** The review issued detailed questionnaires to three categories of users of actuarial services: pension scheme trustees, pension scheme sponsors and non-executive directors, to seek their views as users on how satisfied they were with the actuarial advice that they receive and the extent to which they consider there to be sufficient choice in the market. The review also issued a detailed market questionnaire to actuarial consulting firms to obtain basic information on the overall market for actuarial services including the extent of competition, the market's structure and its performance.

**I.13** In terms of international comparisons, the review attended meetings of the Professionalism and Education Committees of the International Actuarial Association (IAA) and met with representatives from a number of actuarial professions worldwide: USA; Canada; Australia; Italy and South Africa as well as many other member countries' representatives at the IAA's annual conference. The review also received a number of written submissions from European actuarial professions including the Groupe Consultatif Actuariel Européen.

## REVIEW'S INTERIM ASSESSMENT

**I.14** In December 2004 the review published its interim assessment. The interim assessment report summarised and reflected the consultation feedback that the review had received during the initial consultation phase. It outlined the issues that the review considered needed to be addressed and proposed a number of alternative policy options to address those issues. This section briefly outlines the review's initial conclusions in its interim assessment.

**I.15** In the interim assessment the review gave a brief overall perspective of the actuarial profession in the UK, and the context in which it operates. The defining feature of virtually all actuarial work is that it seeks to characterise, measure and analyse an uncertain future. Within this the core activity that actuaries are trained to provide is the assessment of long-term liabilities. The review has no reason to doubt that, in carrying out this work, the overwhelming majority of actuaries in the UK are dedicated, skilled professionals providing important and useful advice to the best of their abilities, with commitment, integrity and a strong sense of duty. However, the review also identified a number of quite serious problems faced by the profession in the UK.

<sup>2</sup> The review's consultation document is available at [www.morrisreview.org.uk](http://www.morrisreview.org.uk)

**1.16** The first concern that the interim assessment identified was that the profession has been too insular, with insufficient contact with other professions and too narrow a professional training, and has been slow to adopt new approaches and techniques. This has resulted in useful inputs from the disciplines of economics, statistics and demography, to name only some, having less impact than they should.

**1.17** Second, too much has been expected of actuaries and, explicitly or otherwise, too much has been promised by them. The future is inherently uncertain and a proper understanding of future risks, as analysed in actuarial work, can help people to cope with that uncertainty. However, it has repeatedly emerged that most of those involved have tended to avoid or resist clear presentation of the unavoidable risks and uncertainties that accompany most long-term projections in the fields of life and general insurance and pensions. Instead, clients have looked to actuaries to provide certainty, and actuaries have often appeared to provide it.

**1.18** Third, is an often repeated concern, that there is insufficient transparency in actuarial advice. For quite some time, if less so recently, many have regarded actuarial advice as having the characteristics of 'black box' analysis with the methodology and calculations lying behind the outputs and even the input assumptions being quite opaque. The Profession is aware of this problem and is seeking to deal with the issue; but it remains a significant contextual factor in much of the review's analysis.

**1.19** A fourth factor, is the delineation of the work undertaken by actuaries as opposed to that undertaken by other professions. Certain roles are reserved exclusively for actuaries, to ensure that the specialised task of valuing long-term liabilities is carried out by appropriately qualified people. However, much of what actuaries do overlaps, sometimes extensively, with the work of financial analysts, economists, statisticians, demographers and others. This is particularly true for the three-quarters of actuaries who do not hold reserved roles. The review acknowledges the critical role of actuaries' skills in assessing long-term liabilities but questions whether actuaries are necessarily best-placed to advise on asset allocation or fund manager selection. The review provides an opportunity to reflect on whether users have become over-reliant on actuaries for services beyond long-term liability analysis.

**1.20** The fifth and final observation is to note that this review has taken place against the background of widespread concern that the population's long term savings are substantially below the level required to meet their needs. A number of contributing factors have been identified in the review. However, actuaries have been actively involved in the pensions and insurance industry for many years and this review needs to take a view on the role of the actuarial profession in the emergence of such problems.

**1.21** Actuaries have been criticised in this context on three main grounds. These are: first, failing to allow adequately for the persistently downward path of inflation and interest rates in the 1990's; second, failing to allow adequately for the subsequent precipitate fall in the stock market; and third, more generally, for not questioning sufficiently the prevailing orthodoxy at the time that high equity returns could be expected to provide healthy long-term returns but with a degree of confidence only appropriate to bond investments. These criticisms may be thought all the more telling in that actuaries were relied upon as being particularly well qualified to assess such matters.

**1.22** Against this, actuarial expertise must not be confused with an ability always to forecast the future accurately. Moreover, an actuary who, in the early 1990's, persisted with forecasts of inflation and interest rates that in the event turned out to be correct would, at that time, have lost a substantial amount of credibility. But actuarial work emphasising such outcomes as (rather remote) possibilities would have been unlikely to have much impact.

**I.23** A more sustainable view, however, is that actuaries, as the relevant experts, were too slow to adjust to the changing circumstances; were, with some exceptions, too inflexible to consider or reflect sufficiently on the likelihood or the consequences of large adverse movements; and thereby provided, explicitly or implicitly, considerably more assurance to customers and consumers than was warranted.

**I.24** Against this background, the central question for the review, and indeed for the Profession, is how it can ensure efficient delivery of best-practice actuarial services to users. This relates, first, to how actuaries are trained; what standards are set and how they are enforced; and to what scrutiny they are subject. Second, to whom are they accountable; how does this incorporate public interest considerations; and how does an appropriate regulatory regime secure this. Third, how is actuarial advice made available so that, through market or other mechanisms, users are able to identify, select and evaluate the best advice.

**I.25** This review has taken place against a backdrop of considerable turbulence and change. The FSA has taken over various regulatory functions and introduced significant changes. The Pensions Act 2004 has established the Pensions Regulator and further specified the role of the Scheme Actuary. The actuarial profession, mindful of the concerns that have been raised, are pushing through a number of proposed reforms related to standards, training and discipline. Meanwhile attempts are in train to achieve a degree of international convergence of actuarial standards. The review has had to take all of these into account.

## Competition

**I.26** The review examined the extent of choice and competition available in the market for actuarial services. The review has paid particular attention to the markets for actuarial advice provided to pension schemes, and to life and general insurance companies, because these industries together employ 80 per cent of practising actuaries in the UK. The review recognises that increasingly actuaries work in other industries such as healthcare and banking.

**I.27** In the interim assessment the review concluded that over the last decade there has been significant entry by small and medium sized independent firms to the actuarial services market as well as entry by the big four accountancy firms. As a result most users of actuarial services face a reasonable degree of choice of provider. There is however, a degree of market concentration in advice to the largest pension schemes. This market is also characterised by high levels of full-service appointments – the joint supply of services. The review did not receive any evidence or suggestion of explicit product tying or cross-subsidisation. However, in the interim assessment the review expressed concern about the extent to which full-service appointments may restrict competition from other non-actuarial professionals such as fund managers who may wish to compete for some services, in particular advice on asset allocation. It may also restrict switching by users of actuarial services.

**I.28** The review found that the market for actuarial advice is characterised by relatively low levels of market testing and actual switching of provider. Less than 10 per cent of contracts are re-tendered in any given year, and a similar percentage are subject to renegotiation. The review identified a number of constraints to market testing and switching including the difficulty for users in assessing the quality of actuarial advice; the importance of scheme-specific knowledge; the provision of bundled services and the costs of market testing.

**I.29** The review concluded that given the complex and technical nature of most actuarial advice there often is a significant ‘understanding gap’ between users of actuarial services and their advisers. A significant proportion of users of actuarial advice acknowledged that they

did not scrutinise or arrange for review of the actuarial advice that they received – often relying instead on the trust that they placed in their actuarial adviser.

**I.30** The review notes that a number of the above issues were also identified by Paul Myners in his review of Institutional Investment in the UK and are addressed by the Myners principles – a set of principles of best investment practice for the trustees of occupational pension schemes. In the interim assessment the review put forward a number of alternative policy options to:

- encourage greater market testing of actuarial advice by users of these services;
- discourage the use of full-service appointments to pension funds;
- improve the way actuaries communicate with users in order to narrow the ‘understanding’ between actuarial advisers and their users;
- increase the level of user knowledge and understanding of actuarial matters; and
- introduce greater scrutiny and challenge of actuarial advice.

## Regulation

**I.31** In the interim assessment the review identified a number of weaknesses in the current framework of self-regulation by the actuarial profession including:

- professional standards that have been weak, ambiguous or too limited in range and perceived as influenced by commercial interests;
- an absence of pro-active monitoring of members’ compliance with professional standards; and
- a profession that has been too introspective, not forward-looking enough and slow to modernise.

**I.32** As a result, this self-regulatory framework proved to be inadequate to protect the public interest.

**I.33** The interim assessment set out three possible models of regulation:

- continued self-regulation by the Profession;
- independent oversight – Profession’s self-regulation overseen by an independent body; and
- full statutory regulation.

**I.34** The interim assessment suggested that the independent oversight model adopted for the accounting profession with oversight of the profession provided by the Financial Reporting Council (FRC) might be the best way to combine professional actuarial input with independence from the Profession to provide the necessary protection and assurance for the public. The review sought views on whether the FRC itself might be an appropriate independent body to provide oversight of the Profession’s regulatory functions.

**I.35** The regulatory framework for actuaries has five main aspects: the setting of appropriate education and continuing professional development requirements for members of the profession; the establishment of roles reserved exclusively to actuaries; the setting of high-quality professional and ethical standards; duties and obligations to protect the public

interest; the monitoring of members' compliance with these professional standards and the administration of disciplinary procedures in the event of misconduct.

**I.36** In the light of the Profession's changes to its education syllabus and its CPD requirements, the interim assessment presented a number of options aimed at: ensuring that the syllabus is kept up to date; reducing the time taken to qualify; addressing the balance between university and work-based education; and clarifying, and enhancing monitoring of, CPD requirements.

**I.37** The interim assessment considered the case for and against reserving particular roles to actuaries, in the light of the criticisms by Lord Penrose of the Appointed Actuary regime in his Inquiry into Equitable Life, and the FSA's discontinuance of this regime at the end of 2004. The interim assessment provisionally concluded that in the short term there is a continuing need to reserve specific roles for actuaries in the life and pensions areas, so as to ensure that technical and professional standards are met; and sought views on a possible regulatory role in general insurance.

**I.38** The interim assessment criticised the Profession's standard-setting process, which had produced weak and ambiguous professional standards, had not resolved contentious issues, and had led to inconsistent approaches across practice areas, and perceived conflicts of interest. The review welcomed the Profession's proposal for an independent Actuarial Standards Board, and suggested that independence could be achieved through oversight by the FRC.

**I.39** A number of commentators observed that actuaries face multiple and often conflicting responsibilities. The interim assessment concluded that there was a need to provide clarity over to whom actuaries are accountable and for what; to have a clear hierarchy of accountabilities; clear guidance on when actuaries must whistle-blow and act in the public interest; and clear protections and incentives for whistle-blowing.

**I.40** Finally, the interim assessment identified a lack of adequate scrutiny and challenge of actuarial advice. A number of ways to improve scrutiny were identified including better informed consumers, greater choice and market testing, enhanced supervision by regulators and formal scrutiny through either audit or peer review. The interim assessment put forward a number of options for introducing greater scrutiny of actuarial advice through audit or peer review.

## Government Actuary's Department (GAD)

**I.41** The review asked clients of the Government Actuary's Department a number of questions about the quality of service GAD provides, and the rationale and continuing need for a separate department. GAD provides different services to its clients and the level of satisfaction expressed by clients varied according to the service used. These services include:

- advice to public service pension schemes;
- broad comparability of pension schemes and advice on pensions aspects of Public Private Partnerships (PPP)/Private Finance Initiatives (PFI);
- general pensions policy advice;
- social security;
- population projections and associated demographics;
- Occupational Pension Scheme Survey; and
- advice to overseas clients.

**I.42** GAD is required in legislation to provide advice to the majority of major public service pension schemes, including the large public service schemes such as the NHS and the Teachers' pension schemes. Most clients believed that GAD offered value-for-money, consistency of approach, historical knowledge and understanding of the sector. However, in the interim assessment the review noted that where there was no statutory obligation to use GAD – as was the case for the Principal Civil Service Pension Scheme – private sector actuarial firms have been used with success.

**I.43** The Government requires the use of GAD's services for assessments of broad comparability of pension schemes when public sector staff are transferred from the public sector to the private sector. There was some dissatisfaction with the service that GAD provides but also a suggestion that an independent sign-off for certificates of broad comparability was important to retain credibility in the system.

**I.44** Clients were satisfied with GAD's ad-hoc pensions policy advice. Recent demand for actuarial input has seen GAD actuaries located in-house within the relevant government department. The review noted the use of the private sector in pension areas where GAD may not have all the expertise. The review recognised this to be a matter for the relevant government departments.

**I.45** The Government Actuary provides advice to Parliament on National Insurance contribution levels and benefits. Clients felt that the Government Actuary offered credibility and independence from government in providing this advice, which was important in order to retain public confidence in the system. However, the review noted that one key government department has already embedded part of the benefit forecasting work; some respondents suggested that this work does not have to be done by an actuary; and others were critical of the Government Actuary's calculation of rebates – although GAD disputed these views. The review recognised the need for independent sign-off of the National Insurance Fund advice which could be given by the Government Actuary but argued that government departments embedding some of the routine work was also an option.

**I.46** GAD produces long-term population projections for the UK and conducts a survey on occupational pension schemes. On the production of population projections and associated demographic data, the consultation feedback highlighted the potential for inefficiency and delay as the data is transferred from the Registrars-General to GAD. In the interim assessment the review suggested that there was unnecessary fragmentation of demographic expertise and potential efficiency and quality gains from a relocation of the work. In relation to the Occupational Pension Scheme Survey the review put forward options to relocate this work to the ONS or the Pensions Regulator.

**I.47** GAD's work overseas is largely won on the basis of competitive tender. Some concerns were expressed that the work that GAD conducts overseas in the area of insurance regulation is a function which they no longer undertake in the UK. Others questioned whether there was a UK benefit to GAD's overseas work. However, the majority of GAD's overseas clients were highly satisfied with the work.

**I.48** On the basis of the feedback received, the interim assessment indicated that the review was considering de-regulating the advice to public sector pension schemes and assessments of broad comparability, to enable users of these services to have a choice of actuarial service provider. For certain functions in reporting to Parliament on the National Insurance Fund and issuing statements of broad comparability, where there is a need to preserve public confidence in the system, the review considered the need to retain independent sign-off to be important and that it would take this into account in considering



the way forward. The review also indicated that it would look at the possible benefits of transferring demographic data collection to the ONS and the Occupational Pension Scheme Survey to the ONS or to the Pensions Regulator.

## RESPONSE TO THE REVIEW'S INTERIM ASSESSMENT

**I.49** The reaction to the review's interim assessment has been very encouraging in a number of ways. The review received approximately 70 responses to its interim assessment report; held open meetings with members of the Institute and Faculty of Actuaries in London and Edinburgh; held a large number of bilateral meetings with interested parties, including regulators; and met a substantial number of clients of the Government Actuary's Department to obtain views on the issues and options set out in the interim assessment.

**I.50** The responses received have indicated a broad, and indeed quite strong, level of agreement with most of the analysis of the interim assessment, both from clients, actuarial service providers and the profession itself. Particular exceptions to this are identified in this final report and, where they occur, the review's proposals have been modified to take account of legitimate concerns over various options put forward in the interim assessment.

**I.51** The response of the Profession itself has been particularly encouraging. It does not accept all the analysis of the interim assessment; but has nonetheless adopted a forward-looking stance, recognising that significant change is desirable, seeking to work with the grain of the options for reform and providing constructive input into the review's finalising of its recommendations. In a number of important respects, the review has built on changes already contemplated or initiated by the Profession; and the review would expect the Profession to introduce the reforms recommended in this report in a timely and effective manner.

**I.52** The review therefore hopes and believes, notwithstanding the difficulties inherent in a number of the issues involved, that it can act as a catalyst for significant reform over a relatively short period of time. The specific recommendations which comprise this programme for change are detailed in this report, covering all the areas of concern identified in the interim assessment. But it may be helpful to first briefly sketch out the overall future for the Profession which the review believes is achievable as a result of the proposed reforms, and which it believes the Profession itself envisages.

## FUTURE FOR THE ACTUARIAL PROFESSION

**I.53** As noted in the interim assessment, actuarial services, predominantly in insurance and pensions but increasingly in a much wider range of activities, are critically important, to the performance of clients, to the long term well-being of consumers, and to the stability of the financial system. These services are also highly technical, generally calling for a high degree of professional training and expertise, and frequently not easily understood by those who depend on them. As a result, there is a need to ensure effective competition in the market for actuarial services.

**I.54** However, given the asymmetry of information, knowledge and understanding between those who supply these services and those who depend on them, and given the critical nature of actuarial advice, there is also a need for effective regulation, to ensure that high levels of expertise are achieved and properly utilised; that high standards, both technical and ethical, are established and adhered to; that there is proper scrutiny of actuarial work, so that clients may be assured that they are obtaining best-practice advice; and more generally to ensure that the public's clear interest in these objectives being met is fully recognised and addressed.

**1.55** With regard to the functioning of the market for actuarial services, the recommendations in this review are designed to ensure vibrant, informed competition so that, subject only to the limitations of asymmetric knowledge which inevitably surround markets for the provision of expert advice, clients may exercise effective choice amongst suppliers. This is an important means by which clients can satisfy themselves, and those to whom they are accountable, that they have received best available advice on a timely basis and in a clear and consistent manner.

**1.56** This is designed to ensure that actuarial advice will be of the highest quality, in line with clear and robust professional standards, communicated in a clear and understandable way, and sensitive to client needs. This requires regular evaluation of actuarial performance, a pre-disposition to market testing, and well-informed clients with sufficient ability to probe actuarial advice in an intelligent and useful way.

**1.57** In the marketplace itself, there should be clear scope for firms of any size to grow, provided they are efficient and effective; minimum barriers to clients switching to more effective suppliers of actuarial services; and scope for clients to access the most effective suppliers of different actuarial, investment and other related services, irrespective of whether this involves one or more suppliers.

**1.58** As is clear from the interim assessment, the market for actuarial services is already quite competitive in a number of important ways, not least in terms of the choice usually available to clients. Effective exercise of this choice is less widespread, although this too is improving. The recommendations of the review, many of them directed at clients and employers of actuaries rather than at actuaries themselves, are designed to build on this and, with full implementation, are geared to ensuring maximum effectiveness in the provision and use of actuarial expertise.

**1.59** It will be important to achieve this but, as indicated above it will not be sufficient. Given the nature of actuarial advice, important elements of the actuarial advice which both clients and the public more generally need and expect cannot be generated by competition alone. An effective regulatory regime is therefore essential.

**1.60** The main elements of an effective regime are, this review believes, both clear and not to any appreciable extent disputed. They can be summarised under three headings. The first is a system of provision of education and training designed to ensure that able people are recruited to the profession; that they receive rigorous, demanding and stimulating training, which will give them a firm grounding in a broad range of areas where actuarial science can usefully be applied; and that this is backed by a properly designed and monitored system of continuing professional development, to keep actuaries fully abreast of new problems and new solutions as they emerge.

**1.61** The second is machinery for setting robust, consistent standards, including technical standards, ethical standards and standards of transparency and communication; a cost-effective system of scrutiny to ensure adherence to these standards; and a proportionate and effective disciplinary mechanism for dealing with breaches of those standards.

**1.62** The third is a clear structure of accountability, so that all actuaries know to whom they are accountable, for what, and how potential conflicts amongst the different accountabilities are to be resolved. This includes potential conflicts between different users of actuaries' advice, in particular those that pension Scheme Actuaries may face between trustees and sponsor companies; and more generally between clients or employers on the one hand and ultimate customers, consumers or the wider interests of society on the other.

**I.63** None of these is necessarily easy to achieve, but there is widespread common ground that each must be addressed and the best ways forward identified and adopted in the very near future. The review is aware that, in some areas at least, there will not be unanimity of view within the profession, and that major reforms are rarely, if ever, completely costless to all those involved. However, the review does not see this as an acceptable reason to dilute or delay action to implement its recommendations.

**I.64** The single most important recommendation of the review, to introduce independent oversight of the Profession's regulatory functions, is in part made to ensure that the complexities of some of the issues involved, and the reasonable differences of view that exist, will not inhibit progress towards the greater goal of a reformed regulatory regime and the benefits which the review anticipates will emerge from it.

**I.65** Lying only just behind these prospects and goals for the future of the profession is a broader and bolder perspective. Having received over 100 responses to the original consultation document, and almost as many to the interim assessment; having had extensive sets of meetings with the profession, with individual groups within the profession and with various user groups, there is a clear sense in which the actuarial profession is at something of a crossroads.

**I.66** Demographic changes and changes in the economy have put unprecedented pressure on the work of actuaries, particularly in the last fifteen years. In addition, while the interim assessment stressed the multiple origins of the current long-term savings crisis, the actuarial profession must accept some criticism with regard to its role in the course of events which have led to this crisis, and both factors have served to shine a spotlight on the profession in an unprecedented manner. The Penrose Report on Equitable Life exacerbated this, leading directly to this review, which in a number of ways has sought to crystallise the concerns arising from this greater degree of scrutiny of the profession.

**I.67** This means that a number of features of the way in which actuarial services were delivered in the past are no longer sustainable. The Profession will, as its representative bodies recognise, have to be much more open, to thinking from related disciplines, to scrutiny of its work, both at the micro level of audit and peer review and at the macro level of its standards of conduct. It will need to communicate better, in particular in relation to the characterisation and assessment of risk. It will need to demonstrate, on an on-going basis, that it is using the best analysis available, responding to changing circumstances and, as a result, addressing the needs of its clients and their customers as effectively as possible.

**I.68** There is no doubt, therefore, that the profession will change, possibly quite substantially, in the next ten years or so. This could result in a process of retrenchment, increasingly based on the protections afforded to the profession by reserved roles, meeting the demands of the current situation by a narrowing of focus onto the profession's traditional areas of strength. This would see the reformed standard setting process and new educational and CPD initiatives being heavily geared to liabilities work, making sure that past problems in this area were addressed, so that the profession could properly withstand the greater scrutiny which it will experience.

**I.69** A case for this type of response can be made, but the review has met few who would support it and, in the long run, it would be quite likely to lead to the demise of actuarial work as a separate profession. Greater familiarity with actuarial work, and greater scrutiny, are likely to lead to increasing encroachment on the work of actuaries by others, such that in time the existence of reserved roles would come further into question. There would be growing resistance to the privileged position which actuaries have, and the advantages this can give in competing for related work which does not necessarily require a qualified actuary. More

generally, it might no longer be credible to envisage support for a separate profession, already very small, with such a narrow focus within the whole spectrum of fields in which expertise on financial and others sorts of risk is valuable.

**1.70** Alternatively, reform can proceed on the basis that actuarial science can fulfil a wider remit, bringing expertise and robust standards of financial risk analysis and professional conduct to a range of less traditional fields. This will again see increased competition between those with actuarial qualifications and those with related but different expertise, but across a wider rather than narrow spectrum. The case for roles reserved to actuaries is still likely to come into question, and in time may need to be relaxed, so that any suitably qualified and approved person may hold such a role; but this would be in the context of a much stronger role for actuarial analysis, particularly if actuarial training, over a period, itself absorbed a wider set of skills.

**1.71** This would seem to offer a much sounder future for the Profession. Standard setting, education and CPD and other reforms proposed in this report would be no less needed in this case, indeed rather more, than in the retrenchment scenario, but the review regards this as entirely feasible, and would expect to see substantial progress on these initiatives within a year.

**1.72** The longer term outcome would then be very different. If the Profession, in the context of independent oversight and in conjunction with the role of the main regulators, can achieve this goal, the review believes that clients and their customers will be better served, and the public more generally will rightly have renewed confidence in the expertise, performance and value of the actuarial profession.

## PURPOSE OF THE FINAL REPORT

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**1.73** The final report summarises the feedback that the review received on the policy options it proposed in the interim assessment and sets out the review's final recommendations for change.

**1.74** The rest of the final report is arranged as follows:

- Chapter 2 – the Market for Actuarial Services
- Chapter 3 – the Profession and Regulation
- Chapter 4 – Education and CPD
- Chapter 5 – Actuarial Roles
- Chapter 6 – Standard-Setting
- Chapter 7 – Public Interest and Accountability
- Chapter 8 – Scrutiny and Discipline
- Chapter 9 – Government Actuary's Department

# 2

## THE MARKET FOR ACTUARIAL SERVICES

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### INTRODUCTION

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**2.1** Chapter 2 of the interim assessment considered the nature and extent of competition in the market for actuarial services. The analysis dealt separately with the pensions, life insurance and general insurance sectors. This reflected the fact that almost all pension schemes receive actuarial advice from external consultants appointed on an ongoing basis, while most ongoing advice to insurance companies is provided by in-house actuaries, with external advice generally provided on a one-off basis.

**2.2** In examining the characteristics of competition in the market for actuarial services, the review considered a number of factors:

- the extent of choice of provider;
- the degree of switching and extent to which choice is exercised;
- barriers to switching, including multi-service provision, and the degree to which the exercise of choice is constrained;
- the nature and extent of market testing in the absence of switching;
- the extent of scrutiny and user challenge, which would allow users to satisfy themselves and those whose interests they serve that actuarial advice is of the required quality; and
- the nature and extent of any constraints on scrutiny, namely degree of user understanding and clarity of advice.

**2.3** The review concluded that:

- there is adequate choice of provider across the pensions and insurance industries, although there is a relatively high degree of concentration in the provision of actuarial advice to large pension schemes where four firms share over 70 per cent of the market for statutory appointments;
- choice of provider might in the future be constrained if exposure to uncapped liabilities and a shortage of affordable professional indemnity insurance (PII) undermine the viability of smaller firms;
- the extent of market testing and switching between providers of recurrent advice is low. This is due to the benefit perceived by users of building long-term adviser relationships and the cost efficiencies that can be achieved by obtaining several services from the same provider;
- the widespread preference for multi-service provision could constrain the ability of single service providers to compete effectively, for example providers of investment advice, and may fail to ensure provision of best practice input across all aspects of expert advice received;
- most users have not employed regular formal adviser reviews and tendering exercises to test the market. Although informal market tests are sometimes employed, their effectiveness is unclear. There is some evidence that the use of market tests is becoming more widespread, as it is already for one-off adviser appointments; and

- the extent and quality of scrutiny of actuarial advice varies widely. For a significant proportion of users, there is inadequate scrutiny or challenge of actuarial assumptions and advice, both because of users' lack of understanding and the technical, expert, or in some cases, opaque nature of the advice provided.

**2.4** In summary, the interim assessment highlighted the following three issues, which are dealt with in turn below:

- limitations on the choice of provider;
- limited testing of the market by users; and
- failure of users to scrutinise or to challenge advice.

### CHOICE OF PROVIDER

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**2.5** The review found that over the last decade there has been significant entry by small and medium sized independent firms to the actuarial services market as well as entry by the big four accountancy firms. As a result most users of actuarial services face a reasonable degree of choice of provider. The only exception to this is in relation to the provision of actuarial and investment advice to larger pension schemes, which is dominated by four large firms.<sup>1</sup> There is no cost-effective way to address this directly, but the review highlighted a number of ways to make it easier for new and small actuarial firms to compete more effectively.

**2.6** The interim assessment proposed two policy options to promote greater competition in the market for actuarial services:

- Option 1: to the extent that the availability of professional indemnity insurance (PII) cover is acting or may in the future act to constrain entry and limit choice, ways could be explored of introducing liability caps; and
- 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.

#### Professional indemnity insurance

**2.7** Turning to the problems associated with the cost and availability of PII, the interim assessment described the concern of many providers of actuarial services about the rising cost of PII premiums. It was feared that the high, and rising, cost of PII might constrain the entry and expansion of smaller firms, should the liability insurance market not stabilise and premium rates return to more affordable levels.

**2.8** The review learnt that the advent of a number of major burdens upon the insurance industry, including the 9/11 attacks in the US, saw PII rates subsequently rise five-fold and cover halve simultaneously, which increased PII costs to the equivalent of roughly 2-4 per cent of turnover for many firms.

**2.9** Consideration was given by the consulting firms to the possibility of setting up a collective insurance scheme. However, the industry lacked sufficient scale. Instead, firms were advised to improve internal risk controls in order to achieve PII rate improvements. Currently the mid-sized and larger firms are negotiating liability caps and, in some cases, proportionate liability clauses with new clients. They are also seeking to renegotiate terms with existing clients. However, the review was told that smaller firms and sole traders continue to struggle to obtain adequate cover.

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<sup>1</sup> These four large firms are: Mercer HR; Watson Wyatt; Hewitt Bacon & Woodrow; and Hymans Robertson.

**2.10** The Office of Fair Trading (OFT) investigated concerns about the efficiency of the market for liability insurance in 2003. PII is the second most important component of this market, after employer's liability insurance. The investigation focused most closely on the employer's liability insurance market, reflecting the extent of the evidence the OFT received. No evidence was received by the OFT in relation to difficulties experienced by actuaries in obtaining PII cover. The OFT concluded that there was a good chance that prices in the overall market for liability insurance would stabilise as underwriting capacity returned to the market and buyers put in place suitable risk mitigation measures. The OFT is currently conducting a follow-up review to see if the situation has in fact stabilised. It is due to report in spring 2005.<sup>2</sup>

**2.11** The Government has considered the issue of liability caps in relation to auditors.<sup>3</sup> This is a contentious issue, with the Government deciding against the introduction of a cap on auditor liability but some auditors threatening to withdraw from the market, such is their concern for the potential losses they might face. The Government continues to consider proposals, including the possibility of limiting liability on a proportionate basis by contract, which can be demonstrated to significantly enhance competition, and to improve quality, in the audit market.

## Interim assessment feedback

**2.12** Feedback from respondents to the interim assessment highlighted the following points:

- artificially imposed liability caps are in principle a bad idea - the market mechanism works best. A major difficulty in this area is establishing accountability and liability, so the issue is best left to the market;
- PII availability is a problem which, if it persists, is likely to drive smaller players from the market and hasten consolidation;
- most firms are already including liability caps in all new contracts and seeking to introduce them to their existing client bases;
- liability caps pass risk from the provider onto the user, for example from the actuary to the pension scheme. The effect tends to be exacerbated because if one adviser caps his liability, then others tend to follow suit. This further reduces protection for pension scheme members; and
- what is needed is better guidance to those seeking PII cover on how to improve their internal risk controls in ways that will be recognised by the underwriters, and better guidance to underwriters on the sort of improvements to look for.

## Analysis and conclusions

**2.13** As noted above, the OFT is carrying out a follow-up review of the liability insurance market. The review arranged for members of the Association of Consulting Actuaries (ACA) to provide the OFT with information on their recent experiences in the liability insurance market place. This took the form of a questionnaire circulated by the OFT following the launch of the follow-up review in December 2004. At the time of writing, the OFT's findings have not been published.

<sup>2</sup> See the OFT website for more information on the original investigation into the liability insurance market and current follow-up review: [www.of.gov.uk](http://www.of.gov.uk)

<sup>3</sup> See the DTI website for more information on the auditor liability issue: [www.dti.gov.uk](http://www.dti.gov.uk)

**2.14** This review remains concerned about the PII issue. The liability exposure facing actuarial firms is substantial, even when capped, and it appears that the availability and cost of PII cover remain problematic for many actuarial firms. Market forces may in due course resolve the situation, but there must be a risk that leaving it to the market will not work. In which case there remains a possibility of increased concentration if smaller actuarial firms, with limited resources, exit the market in significant numbers.

**2.15** The review would, therefore, like the OFT to consider the circumstances facing firms in the actuarial services market seeking to obtain PII cover and evaluate the risk of market exit leading to undue concentration. It should consider whether the market mechanism alone can be expected to address any problems that it identifies and, if not, what measures can be taken to alleviate the situation. In any event, the OFT should revisit this issue in two years time to consider whether or not current concerns have been realised. The review recognises that the OFT's ability to carry out work in this area depends on the extent to which it receives evidence of a problem.

**2.16** In terms of ameliorating measures, the review believes that actuarial firms should, if necessary, with the assistance of the Profession and the ACA, look at the viability of the proportionate liability approach. Targeted and transparent guidance on measures that can be taken to mitigate risk – which enhance the scope of cover and ease premium rate inflation – should be available to the buyers of PII and to those underwriting the policies. The review believes that, in the light of the OFT's findings and recommendations, the Profession should work with the ACA, the Association of British Insurers (ABI) and other relevant industry bodies to ensure its availability.

### Recommendations

The review recommends that:

- the Office of Fair Trading (OFT), in its follow-up review of the liability insurance market, considers the circumstances facing firms in the actuarial services market seeking to obtain professional indemnity insurance (PII) cover, evaluates the related risk of market exit leading to undue market concentration, and recommends measures that might be taken to make the market function more efficiently;
- the OFT should review the market for actuarial services in two years time to assure itself that concerns about concentration have not been realised due to the persistence of alleged problems relating to the availability and cost of PII cover;
- the Profession, the Association of Consulting Actuaries (ACA) and its membership should consider in more detail the use of proportionate liability clauses in contracts; and
- the Profession should work with the ACA, the Association of British Insurers (ABI) and other industry bodies to ensure suitable guidance on risk mitigation is available to those underwriting PII and those seeking to buy it.

**Multi-service provision** **2.17** The interim assessment also identified the multi-service provision of actuarial and non-actuarial services as a potential constraint on the choice of provider and therefore on competition. It was suggested that the persistence of full service provision might constrain the entry and expansion into the market of single service or niche providers. So, for example, if pension scheme trustees invite joint tenders for Scheme Actuary advice, asset allocation advice and fund manager selection advice, then only larger providers, with the scale to offer all three services, are able to tender. This prevents niche providers from tendering for the particular area



of advice in which they might provide better service. If trustees invite separate tenders for different elements of the advice then they will maximise the choice available to them.

**2.18** In thinking about how choice might be maximised in this context, the interim assessment proposed, in the pensions area, the option of unbundling the provision of advice related to statutory roles from other types of advice (particularly investment consulting services) as a means of opening up the market to greater competition.

## Interim assessment feedback

**2.19** Feedback from respondents to the interim assessment highlighted the following views:

- the large consulting firms were opposed to any enforced separation of advice provision. They argued that this would reduce the range of services available to users and not necessarily increase competition because, in their view, users were already free to employ the services of specialists;
- indeed, it was pointed out, again by the larger consulting firms, that multi-service provision was customer-driven and delivered important cost and service-related synergies. This is particularly important given the need to consider assets and liabilities together in the context of a pension fund;
- it was further suggested that demand for multi-service provision was in fact growing among small and medium-sized schemes because of pressure to reduce costs. Cost pressures were also seen to be driving larger schemes towards measures that might encourage multi-service provision, such as outsourcing the running of closed schemes;
- some smaller consulting firms were in favour of separate contracts because they felt that they didn't have proper access to large clients and were sometimes invited to participate in tenders that were biased in favour of the incumbent; and
- other stakeholders were more generally in favour of separate contracts. The investment community was keen to see separate contracts for investment advice. However, it was pointed out by others that costs were a significant consideration, particularly for smaller pension schemes.

## Analysis and conclusions

**2.20** The review does not advocate any form of prohibition on multi-service provision, or suggest that firms should not be able to offer full service advice provision. This can be an efficient and appropriate manner in which to provide and obtain many types of service. However, given the availability of high-level expertise from non-actuaries for a range of related work, an efficient market should be able to generate a mixture of full service providers and bespoke service or niche players. It is therefore important that users are exposed to the full range of service providers and do not have that choice in any way constrained. They will not normally be exposed to the widest possible choice of potential provider unless they look to appoint each adviser on merit rather than automatically accepting advisers as components of a wider package.

**2.21** The review notes that the issue of separate contracts was considered as part of the original Myners review of institutional investment in the UK.<sup>4</sup> It was recommended that investment advice should be tendered for separately from actuarial advice. The Government, in a recent follow-up review of compliance with the Myners principles of best practice in investment decision-making, proposed an additional split.<sup>5</sup> It was recommended that pension funds should contract separately for actuarial, strategic asset allocation and fund manager selection advice and that these contracts should be opened to separate competition. The fund should be prepared to pay sufficient fees for each service to attract a broad range of potential providers. This review supports the Government's proposal.

**2.22** There is, evidently, a trade-off between the potential synergistic gains and cost savings of multi-service provision on the one hand, and the potential benefits of best advice in each area of expertise on the other. The review believes that users must make a reasoned evaluation of this trade-off, which requires separate tendering opportunities to be offered, allowing both single and multi-service proposals to be presented. Users should have an obligation to explain and justify a decision to accept multi-service where it has not been evaluated against competing single service proposals.

**2.23** Such disclosures should be made within the pension scheme's statement of funding principles or in a suitable alternative. The review believes that schemes should consider using the disclosure mechanisms recommended in the recent follow-up review of compliance with the Myners principles. Whichever mode of disclosure is used, it is important that scheme members are presented with a transparent mechanism by which they can register dissatisfaction with any aspects of the information provided by or on behalf of the trustees.

**2.24** The following recommendations are addressed specifically to users of actuarial services in the pensions industry. However, the review believes that the principle of tendering separately for each service, regardless of whether this results in multi or single service provision, applies across the actuarial services market so should also be observed by insurance companies employing external actuarial advisers.

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<sup>4</sup> Available at: [www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk). The Myners principles apply to pension schemes where trustee boards are responsible for investment decision-making. The Government estimates that 6,700 schemes fall into this category.

<sup>5</sup> Available at: [www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk)

## Recommendations

The review recommends that:

- it is best practice for pension fund trustees to invite tenders separately for actuarial advice, strategic investment advice and fund manager selection advice, as proposed by the Government in its recent revision of the Myners principle on expert advice.

The review recognises that in some cases it may prove cost-effective for trustees to award multiple contracts to a single supplier. However, the review recommends that:

- if only a multi-service contract is put out to tender, trustees should explain the reasons why they did not issue separate tenders in the scheme statement of funding principles.

## MARKET TESTING

**2.25** The interim assessment concluded that market testing and switching of actuarial services by clients, though growing, are still relatively limited. Less than 10 per cent of contracts are re-tendered in any given year, and a similar percentage are subject to renegotiation. Market testing has two important advantages:

- through the threat of switching it exerts competitive pressure on incumbent firms, encouraging best practice advice and innovation; and
- it can help to educate users about alternative actuarial approaches and methodologies.

**2.26** The major disadvantages associated with market testing are that:

- at least in relation to formal market tests, the tendering process can be costly, both for the pension scheme or insurer and the firms invited to tender; and
- other than in terms of cost and service level factors, it is difficult to judge the performance of firms providing long-term financial advice, in particular the appropriateness and robustness of their advice.

**2.27** As highlighted by the interim assessment, the review found that a number of factors are acting to constrain users from market testing or switching their providers of actuarial advice. These include both generic issues that apply across all three markets and some that are specific to practice areas. Generic issues include the difficulty for users in assessing the quality of actuarial advice about long-term issues over the short term; the costs of contract re-tendering or renegotiation; and the tendency of users to demand, and actuaries to supply, reports designed to comply with the requirements of the regulators. Such attention to the legality of advice focuses attention away from the quality of the advice.

**2.28** For life and general insurance ongoing actuarial advice is normally provided in-house. For pensions, barriers to switching include: the importance of establishing long-running adviser relationships and of advisers building up scheme-specific knowledge; the provision of multi-service appointments; and the limited access to actuarial software codes which can only be used by certain firms of consulting actuaries or under certain conditions.

**2.29** In relation to market testing, the interim assessment put forward two policy options: one recommending or requiring regular formal reviews of advisers every three to five years, the other more generally encouraging evaluation of the performance of actuarial advisers.

### Interim assessment feedback

**2.30** Few respondents entirely opposed the idea of market testing or re-tendering. The main concerns were about the level of compulsion, the frequency and the associated cost:

- many consulting firms were opposed to compulsory market testing, commenting on the high cost to them of participating in tendering exercises. One firm quoted a cost of up to £20,000 per tender for large pension scheme mandates;
- such costs, it was further argued, would tend to be recovered through higher fees charged to users;
- some firms also suggested that compulsory re-tendering in the local authority pension scheme market had resulted in purely price-driven competition, with the result that only the largest three or four providers could compete. Thus, they suggested, if anything it had reduced choice and competition;
- it was further argued that tendering too frequently would be seen as a compliance-driven exercise and non-incumbent firms would be discouraged from taking re-tendering exercises seriously;
- some stakeholders felt that it would not be fair to judge performance over fewer than two triennial valuations;
- several respondents pointed out that user demand for adviser reviews is increasing as, for example, trustees grow increasingly aware of the need to demonstrate that they have obtained and acted upon good advice; and
- respondents were broadly supportive of performance measurement, at least in principle. However, several respondents highlighted the difficulty of specifying the criteria that might be used to measure the performance of actuaries, in contrast to investment advisers whose performance was regarded as somewhat easier to assess.

### Analysis and conclusions

**2.31** The review believes it is essential that users regularly review the performance of all of their actuarial advisers. This will ensure that users can satisfy themselves that they are receiving high-quality actuarial advice. However, the review accepts that it would not be appropriate to seek to impose a market testing requirement. Rather, the review would like to see the use of market tests, whether formal or informal, recognised as best practice. Specifically, the review concludes that it should be regarded as best practice for pension scheme trustees to adopt the following approach to market testing:

- trustees would be expected to evaluate the performance of their actuarial advisers, however informally, on an annual basis. This should normally be in the light of agreed service standards, but should also pick up any more substantive concerns about the quality of the actuary's communication skills, or willingness to discuss assumptions, methodology, or risk parameters;

- a more formal actuarial adviser review should be linked to the triennial valuation cycle. This should be undertaken with input from a trustee with suitable expertise – e.g. a retired actuary or a professional trustee – or, in their absence, the assistance of a suitable expert should be enlisted.<sup>6</sup> If any problems are identified this should trigger a discussion with the actuary’s employer or, in more serious cases, a re-tender exercise;
- it should be regarded as best practice to perform a formal market test every other triennial valuation i.e. no less frequently than every six years. The review accepts that a degree of flexibility should be permitted in relation to the timing of the market test; and
- trustees should be expected to report their compliance with this approach or explain why it has not been adopted.

**2.32** The review is directing these recommendations at users of actuarial advice in the pensions industry and pension scheme trustees in particular. However, the principle of adopting a clear policy towards the evaluation of adviser performance relative to the rest of the market applies to all users of actuarial advisers and so therefore should be adopted by insurance companies using external actuarial advisers, including their non-executive directors.

## Recommendations

The review recommends that:

- as a matter of best practice, pension scheme trustees should:
  - (i) informally evaluate their actuarial advisers on an annual basis;
  - (ii) undertake a more formal evaluation every three years, with input from a suitably qualified expert if needed, leading to a market test if unresolvable problems are identified; and
  - (iii) undertake a formal market test of their actuarial advisers no less frequently than every six years. A degree of flexibility should be permitted in relation to the timing of the market test;
- trustees should report their compliance with this approach or explain why it has not been adopted; and
- the Government should amend the relevant Myners principle to reflect the substance of this recommendation.

## SCRUTINY OF ACTUARIAL ADVICE

**2.33** The interim assessment concluded that perhaps the most important issue arising from the consultation process related to the difficulty for many users of actuarial services in checking or assuring themselves of the quality of the actuarial advice that they receive. The review observed that, particularly in the pensions industry, there appears to be insufficient scrutiny of adviser performance. This leads to advice too often being insufficiently probed or challenged. Too often there appears to be a broad failure sufficiently or effectively to challenge the advice provided. Too frequently this reflects a gap in understanding between those providing advice and those receiving it.

<sup>6</sup> It is not envisaged that the ‘suitable expert’ would have to be an actuary.

**2.34** The review concluded that shortcomings exist both in relation to the ability of actuaries to provide information users can understand – a shortcoming in how actuaries communicate and, more importantly, what they choose to communicate – and the capacity of those receiving it to judge its quality. As a result, advice is too often taken on trust.

**2.35** Clearly there is a responsibility upon actuaries to communicate their advice and the underlying assumptions and key sensitivities in a manner that is understandable to a non-technical audience and to be sensitive to the requirements of the user when deciding what information to communicate. Equally it is the responsibility of those receiving the advice to satisfy themselves that they understand and can sensibly challenge it.

### **Increasing user understanding**

**2.36** As noted in the interim assessment, efforts to improve user understanding within the pensions industry are ongoing. The Pensions Act 2004 includes requirements for trustees to have knowledge and understanding of investment matters.<sup>7</sup> The Occupational Pensions Regulatory Authority (Opra) is currently consulting on the content of a code of practice governing how these requirements should be fulfilled.<sup>8</sup> The code will be issued by the Pensions Regulator, which will replace Opra on 6 April 2005. The Pensions Regulator will also be updating its published guidance material, though currently this material is focused on trustees' legal requirements rather than on the issue of how in practice they should conduct their adviser relationships.

**2.37** In relation to improving user understanding and expertise, the interim assessment set out three options:

- user knowledge and understanding should be encouraged by measures to raise the required standards of knowledge and expertise, of which several are already in train; and/or
- 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
- greater use of professional trustees or trustees who are members of several trustee boards.

### **Interim assessment feedback**

**2.38** Responses to the interim assessment relating to the user understanding proposal were as follows:

- there was strong support for and endorsement of the work underway for the Pensions Regulator to develop a code of practice governing trustee knowledge and understanding, both in relation to investment matters and funding principles;
- this was widely regarded as the most important piece of work in the pensions area and the appropriate focus for improving user understanding;
- it was envisaged that trustees would be encouraged to increase the amount of training they receive in order to demonstrate compliance with the requirements of the code of practice;

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<sup>7</sup> Available at: [www.dwp.gov.uk](http://www.dwp.gov.uk)

<sup>8</sup> Available at: [www.opra.gov.uk](http://www.opra.gov.uk)

- at present, the Scheme Actuary's employer provides most of this training. Some concerns were voiced about the appropriateness of exposing trustees only to that firm's 'house view'; and
- with regard to the life insurance industry, the Profession suggested that the new governance structures introduced by the Financial Services Authority (FSA) were already bringing about greater scrutiny of actuarial advice at board level and that this in turn was increasing demand for user education and training.<sup>9</sup>

**2.39** In relation to the proposal to provide trustees with the Profession's guidance notes so that they would better understand the professional standards actuaries are expected to meet, respondents expressed mixed views:

- on the one hand, it was argued that trustees already had access to the Profession's guidance notes but such guidance was written for professional actuaries rather than a lay audience; but
- on the other hand, the Profession was very supportive of the idea and said it would be happy to work with the NAPF or, perhaps, the Pensions Regulator, to provide suitable material for dissemination to trustees.

**2.40** Responses to the proposal to use professional trustees were as follows:

- the use of professional trustees was broadly supported. Many respondents argued that professional trustees had the capacity to add value;
- however, support was qualified with concerns about whether there was a sufficient supply of high quality professional trustees, how much it would cost to employ them, and about the danger that other users would too easily defer to such 'experts' and feel less of an incentive to acquire adequate levels of understanding themselves;
- some respondents suggested that insurance company boards were making increasing use of 'experts', for example by including at least one retired actuary among their non-executive directors; and
- it was suggested that the new life office governance structures introduced by the FSA were encouraging greater scrutiny and in this case driving greater use of 'expert' non-executive directors.

## Analysis and conclusions

**2.41** The review agrees that the provisions in the Pensions Act relating to trustee knowledge and understanding form the cornerstone of efforts to improve trustees' ability to make informed decisions and to scrutinise and challenge the advice they receive. Given this it is essential that the code of practice relating to trustee knowledge and understanding is properly constituted and implemented.

**2.42** Within the industry, the National Association of Pension Funds (NAPF) plans to publish a good practice guide for trustees that will consider trustees' relationships with their consultants and advisers. This piece of work was prompted by the Government's proposed revision to the Myners principles of institutional investment and so focuses specifically on trustees' investment advisers. However, it will be followed towards the end of this year with a second good practice guide that will address trustees' relationships with Scheme Actuaries.

<sup>9</sup> The Profession will be holding training seminars for non-executive directors.

**2.43** The review notes that there is currently limited guidance available to trustees on how they should manage their actuarial advisers and how best to question and challenge actuarial advice. Opra's existing guidance material tends to focus solely on what is required of trustees in relation to fulfilling their legal obligations. It does not offer practical guidance to trustees on how they should conduct relationships with their advisers.

**2.44** The review therefore recommends that the Pension Regulator should, with input from the actuarial profession and other industry bodies, ensure that trustees have access to good practice guidance on the effective management of their professional advisers, including their Scheme Actuary. Reference should, for example, be made to the good practice guidance on adviser relationships being developed by the NAPF. The Profession should take forward its offer of working with the Regulator to provide suitable material to disseminate to trustees.

**2.45** The review is also aware that the Pensions Act provides powers for the Pensions Regulator to formulate non-mandatory codes of practice. The review believes that the Pensions Regulator should in the long term consider producing a code of practice relating to how trustees manage adviser relationships.

**2.46** The review notes that the user education initiatives prevalent across the pensions industry are, by and large, absent from the insurance industry. The review understands that some insurance company boards provide their non-executive directors with training opportunities, typically arranged by in-house actuarial staff. The review believes that the ABI and the Profession should, together, consider what initiatives should be taken to bolster and help underpin such provision.

**2.47** Evidence to the review demonstrated that the use of professional trustees clearly adds value, but the review believes it should remain the responsibility of the trustee board to judge the appropriateness of their use on a case-by-case basis. Trustees should, as a matter of course, check the credentials of professional trustees and consider using only those in possession of appropriate qualifications. The review notes the 'expert' role that retired actuaries could perform as non-executive directors on insurance company boards, and believes there is scope for it to expand.

**2.48** In conclusion, the review believes that it is essential that users of actuarial advice are able to understand and question that advice. Measures that equip users to do so therefore need to be in place. The Pensions Regulator should be supported in its initiative to increase trustee knowledge and understanding.

**2.49** Measures that increase user knowledge and understanding more generally, including in the insurance industry, are also to be encouraged. The review recommends that the ABI should, with input from the actuarial profession, consider how education and training might be provided for non-executive directors of insurance companies to assist them to challenge actuarial advice.



## Recommendations

Measures that equip users of actuarial advice to challenge and question actuarial advice on an ongoing basis are to be welcomed. In particular, the Pensions Regulator should be supported in its work to increase the knowledge and understanding of pension fund trustees.

The review recommends that:

- the Pensions Regulator should, with input from the actuarial profession and other industry bodies, ensure that trustees have access to good practice guidance on the effective management of their professional advisers, including their Scheme Actuary. Information and case study material should be provided to help trustees to challenge their actuarial advice and should provide them with guidance on potential conflicts of interest; and
- the ABI should, with input from the actuarial profession, consider how education and training might be provided for non-executive directors of insurance companies to assist them to challenge actuarial advice.

### Actuarial communication and disclosure

**2.50** Although there is a clear requirement on the part of users to equip themselves with the ability to understand and challenge actuarial advice, the interim assessment also highlighted concerns about the clarity with which actuarial advice is provided. This is partly about how actuarial advice is presented and, perhaps more importantly, about what it is that actuaries choose to present to their clients. The review also recognises that problems arise simply because of the intrinsically complex nature of the subject matter.

**2.51** The interim assessment concluded that there was a responsibility upon the actuarial profession to communicate actuarial advice in a clear, non-technical way such that an intelligent lay person can understand the key aspects of the advice, its underlying assumptions and sensitivities to changes in these assumptions. Concerned that this responsibility is not always met, the interim assessment put forward the following policy 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 continuing professional development 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 reporting requirements might be simplified.

## Interim assessment feedback

**2.52** Respondents to the interim assessment expressed the following views on the options:

- many actuarial firms and some other respondents agreed with the premise underpinning Option 1, namely that greater scrutiny by users would effectively incentivise improvements in the quality of advice provision by actuaries;

- several respondents, mostly firms, felt that Option 1 would be sufficient on its own, but the majority of respondents disagreed and supported other options as well. Some expressed the view that leaving it entirely to the market was unlikely to be successful;
- there was widespread support for Option 2, improving actuarial training and CPD, and recognition of the efforts taken to date by the Profession to introduce business awareness and communication skills into its education programme. It was argued by some that these should be given time to bed in;
- however, there were calls for more to be done in boosting actuaries' communication skills and suggestions that evaluation should not necessarily be by written examination. It was argued that more innovative teaching and evaluation techniques should be considered by the Profession;
- Option 3, clearer disclosure of actuarial advice, received broad support. Many actuarial firms agreed that actuaries should face clearer disclosure requirements and called for the Profession to strengthen its guidance in this area. The Profession argued that its professional conduct standards and various of its guidance notes already contained specific requirements for actuaries on what should be disclosed to the client;
- some respondents made the point that it is not only important to consider what information actuaries should reasonably be expected to communicate, but also vital to recognise the responsibilities of the recipients of actuarial work not to misuse the advice;
- views were mixed on the usefulness of insurers using forward-looking financial condition reports as vehicles for clearer disclosure. It was argued by some that public disclosure should be resisted as it would lead to the production of anodyne reports. Others sounded a more positive note, arguing that their use would help improve the quality of disclosure; and
- respondents supported in principle the idea of simplifying regulatory reporting requirements. However, no specific areas of simplification were suggested.

### Analysis and conclusions

**2.53** The review believes that market forces will act to improve the quality of how actuarial advice is provided, particularly if, as we expect, users come to exercise greater scrutiny of advice and adviser challenge. However, the review does not believe that this mechanism alone will be sufficient to bring about the required degree of improvement. The Profession should therefore pursue its efforts to bolster actuaries' communication skills. This is addressed further in Chapter 4.

**2.54** Most importantly, though, the review believes that clearer disclosure requirements should be imposed on the profession in order to address concerns about what it is that actuaries communicate to their clients and how actuaries control the use to which their communications are put. This can be achieved by the development of a principle-based generic communication standard, which should inform subsequent revisions of existing professional standards and any new standards that are developed. The new communication standard should be developed by the Actuarial Standards Board, with close stakeholder involvement and, in particular, the involvement of users.

**2.55** The generic communication standard should cover:

- assumptions – there should be clear disclosure of assumptions used and an indication made as to the extent to which judgment has been exercised over the choice of assumptions (and methodologies);
- methodologies – what methods have been employed and why;
- nature of calculations – how the actuary has applied particular methodologies;
- sensitivity analysis – how outcomes vary in response to changed assumptions or methodologies;
- characterisation of risk – a probabilistic analysis of key variables or indicators under particular scenarios;
- relative risk-weightings – in other words, it is incumbent on the actuary to advise the client about the relative degree of concern they should have for various scenarios, bearing in mind the capacity of the client to cope with various types and levels of risk; and
- how actuaries control the use to which their communications are put.

**2.56** The review has also considered whether clearer disclosure requirements could be attached to any of the forward-looking financial reports that are prepared with input from actuaries within the insurance and pensions industries. Financial condition reports are an important part of insurance industry disclosure regimes in some countries, including Canada. Although they have only recently been introduced on a voluntary basis into the UK, they could given time acquire a similar status. The review believes that this would be a positive development and should be considered by the Profession. On the pensions side, the effective enforcement of the generic communication standard, and the revised practice area-specific guidance that flows from it, should be sufficient to encourage clearer disclosure within actuaries' reports to pension scheme trustees, scheme members and the shareholders of the sponsoring firms.

## Recommendation

The review recommends that:

- the Actuarial Standards Board should develop a generic standard on communication covering the content of actuarial communications and the use of those communications by others. The new standard should cover the need for actuaries to disclose relevant information on the following areas:
  - (i) assumptions;
  - (ii) methodologies;
  - (iii) nature of calculations and the exercise of judgment;
  - (iv) sensitivity and scenario analysis;
  - (v) characterisation of risk in relation to sensitivities and scenarios;
  - (vi) relative importance of risks and the capacity of the client to bear them; and
- the substance of the new standard should, where applicable, be reflected in all professional standards going forward.



# 3

## THE PROFESSION AND REGULATION

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### INTRODUCTION

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**3.1** The Institute of Actuaries (London) and the Faculty of Actuaries (Edinburgh) are the two professional bodies for UK actuaries.<sup>1</sup> The Profession has the twin roles of representing members to the outside world and regulating members for the benefit of the public interest. The Profession therefore currently sets, monitors and enforces professional standards, which include both ethical and technical standards.

**3.2** However, the majority of actuaries work within the broader financial services market. This means that they are covered by the Government's overall regulatory framework for financial services markets. In this area the Government has established two independent statutory regulators – the Financial Services Authority (FSA) which regulates financial services firms such as insurers, banks, fund managers, investment advisers and intermediaries; and the Occupational Pensions Regulatory Authority (Opra) which regulates pension funds, together with trustees, sponsors, their advisers and administrators. The Pensions Regulator (TPR) will replace Opra when the Pensions Act 2004 comes into force.

### THE REGULATORY FRAMEWORK

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#### Options for the regulatory framework

**3.3** The interim assessment identified three broad regulatory models for regulation of actuaries. These ranged from continued self-regulation by the Profession, through to full statutory regulation by the FSA and Opra/TPR. Between these lay a hybrid model involving independent oversight of the Profession's self-regulation.

- Model A (continued self-regulation) – a clearer and improved role for self-regulation by the Profession
- Model B (independent oversight) – the Profession's self-regulation overseen by an independent body
- Model C (full statutory regulation) – regulation either by the FSA (for financial services) and Opra/TPR (for pensions), or by a new statutory regulator for actuaries.

**3.4** The existing regulatory framework consists primarily of Model A (self-regulation by the Profession) with some elements of Model C (full statutory regulation) for statutory roles and the entities advised by actuaries. This regulatory regime was criticised by Lord Penrose and by respondents to the review's consultations as not having been effective, as a result of professional standards being insufficiently developed and an absence of monitoring of actuaries' compliance with professional standards.

**3.5** Efforts are being made by the Profession to improve the way Model A works, but there are limits on what the Profession can do on its own. Given the scale of the problems identified it is questionable whether changes to the current system of self-regulation would be sufficient to protect either the public interest or to engender sufficient public confidence.

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<sup>1</sup> Collectively the Faculty and Institute of Actuaries are the Profession.

**3.6** Model C, full statutory regulation, would mean that a statutory body would regulate all aspects of the professional work of actuaries. This would offer clarity and consistency of approach, and would minimise the possibility that regulatory objectives would be superseded by commercial or other interests. However, statutory regulation may be unresponsive if technical standards are specified in legislation while there may be a lack of practitioner input and a loss of commitment by members of the Profession. Statutory regulation may stifle innovation and the development of actuarial expertise. For example, the requirement for life insurers to use the net premium method for valuing liabilities may have limited the use of financial economics techniques.<sup>2,3</sup>

**3.7** If the FSA and Opra/TPR regulated actuaries working in insurance and pensions respectively this would leave some actuaries outside the scope of the regulatory framework and would be likely to lose the involvement of professionals. As the actuarial profession is so small, there is a risk that actuarial work will not be seen as high priority by statutory regulators with other competing priorities.

**3.8** The alternative would be to set up a dedicated independent statutory regulator, i.e. an ‘actuarial services authority’ to regulate actuaries. However, this would seem disproportionate for a profession of 4,500 practising members, even though actuaries play a critical role in long-term financial planning.

**3.9** By contrast, Model B (independent oversight) combines the input of practising actuaries into the regulatory process, with greater accountability. It is also of note that this model is closest to those which appear to be most successful in similar professions such as accountancy.

### Interim assessment feedback

**3.10** Almost all respondents to the review, which included the Profession, FSA, Opra, Association of Consulting Actuaries (ACA), Association of British Insurers (ABI), National Association of Pension Funds (NAPF) and many actuarial firms, were highly supportive of Model B, with only a couple of respondents arguing for a continuation of the current self-regulation regime. No respondents argued for Model C. Few substantive concerns were raised with the concept of independent oversight if sensibly implemented.

**3.11** The Profession wrote: “[we] agree 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”. The FSA described Model B as “promising”, while Opra described it as their “preferred” option.

**3.12** The interim assessment put forward two alternatives for the oversight body:

- a new body, with representatives from the FSA, Opra/TPR and the Department for Work and Pensions (DWP) as well as institutional users and consumers; or
- the Financial Reporting Council (FRC).

<sup>2</sup> Source: SI1994/1516, Insurance Companies Regulations 1994, revoked in 2001, and predecessor legislation.

<sup>3</sup> Net premium valuation involves valuing the contractual liabilities to date allowing for mortality and interest, and deducting the value of future notional net premiums.

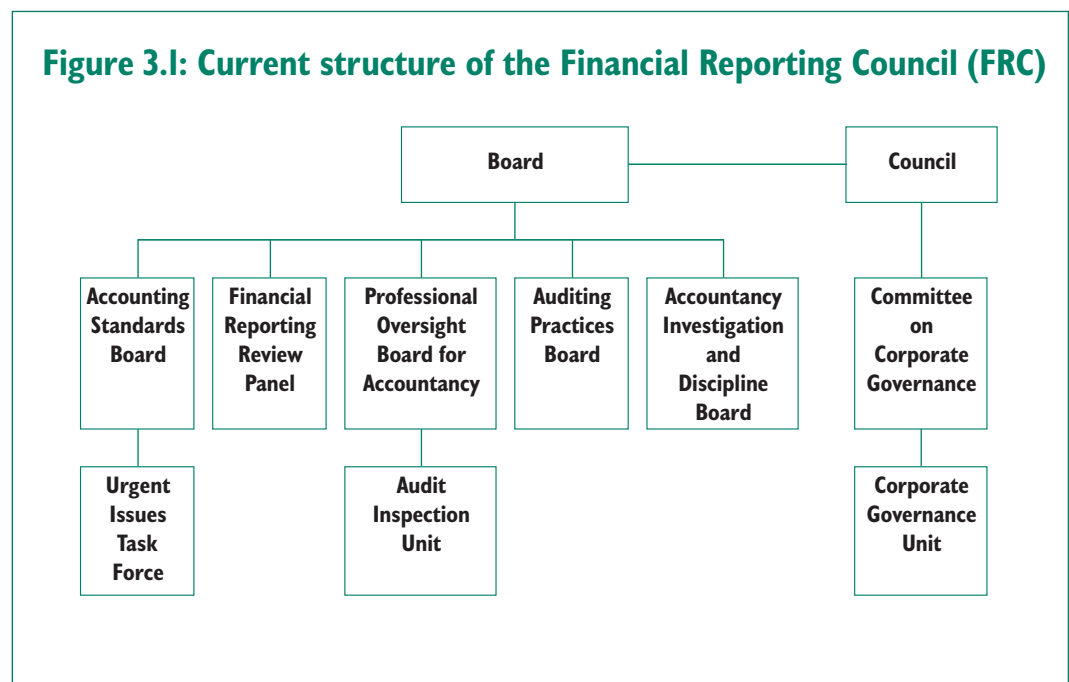
**3.13** A minority of respondents supported a bespoke oversight body. The majority argued that the associated costs would be too high for such a small profession to bear.

### THE FINANCIAL REPORTING COUNCIL (FRC)

**3.14** The interim assessment suggested that the FRC could be an appropriate oversight body. The FRC is the UK’s independent regulator for corporate reporting and governance. It exercises its functions through its operating bodies (the Accounting Standards Board, the Auditing Practices Board, the Professional Oversight Board for Accountancy, the Financial Reporting Review Panel and the Accountancy Investigation and Discipline Board) and the Council. The current Chairman of the FRC is Sir Bryan Nicholson. The FRC’s operating bodies and Council include wide representation from the business, investor, professional and other communities with an interest in corporate reporting and governance.

**3.15** The FRC was established in 1990 to promote good financial reporting. In January 2003, the Secretary of State for Trade and Industry announced a package of reforms to raise standards of corporate governance, strengthen the accountancy and audit professions, and provide for an independent system of regulation for those professions.<sup>4</sup> The FRC was given a central role in delivering these reforms – the Government recognised the FRC’s success in promoting high standards of financial reporting, and its credibility with the financial, business and accountancy professional communities. The Companies (Audit, Investigations and Community Enterprise) Act 2004 gives statutory recognition to these functions.

**Figure 3.I: Current structure of the Financial Reporting Council (FRC)**



<sup>4</sup> Source: Sections 16 and 18 of the Companies (Audit, Investigations and Community Enterprise) Act 2004 – the statutory exemption from liability in damages is available except in cases of bad faith or where this would prevent an award of damages on the ground that the act or omission was unlawful as a result of section 6(1) of the Human Rights Act 1998; the FRC and its operating bodies are subject to judicial reviews.

**3.16** The FRC currently has five broad functions:

- setting, monitoring and enforcing accounting and auditing standards;
- statutory oversight and regulation of auditors;
- operating an independent investigation and discipline scheme for public interest cases;
- overseeing the regulatory activities of the professional accountancy bodies; and
- promoting high standards of corporate governance.

**3.17** In relation to the work of this review, the functions currently undertaken by the Professional Oversight Board for Accountancy (POBA) are of particular interest. POBA provides independent oversight of the auditing and accountancy profession with a view to enhancing public confidence in their work and ensuring the UK profession and regulatory regime remains at the forefront of global standards. This includes overseeing the role of the professional accountancy bodies' ethical standards, education and training, continuing professional development, monitoring of compliance with professional standards, and disciplinary schemes.<sup>5</sup>

**3.18** POBA is chaired by the current Comptroller and Auditor General of the UK, Sir John Bourn. The other ten Board members include six qualified accountants with backgrounds in audit, wholesale banking, local government and academia, a qualified actuary specialising in investment, an investment banker and individuals with backgrounds in trades unionism and the pensions industry.

### Possible extension of FRC role

**3.19** The review has received very positive feedback on the proposal for an FRC role in setting actuarial standards and overseeing the regulatory and other activities of the actuarial professional bodies. This option has been supported by the Profession, the FSA, Opra, DWP, ABI, NAPF and the ACA which represents actuarial firms. Four main arguments have been given in support of this proposal:

- there are already significant overlaps between the accounting and actuarial professions, so this arrangement would ensure close working between, and a consistency in regulation of, the two professions;
- there are potential synergies with the FRC's existing operating bodies and the expertise that it has developed;
- the FRC is well respected and has a wide membership representing different interests; and
- although overseeing the regulatory and other activities of the actuarial professional bodies would be a new departure for the FRC in some respects, it would nonetheless appear to fit within the FRC's aim of "promoting confidence in corporate reporting and governance".

<sup>5</sup> See the FRC website for further information: [www.frc.org.uk](http://www.frc.org.uk)

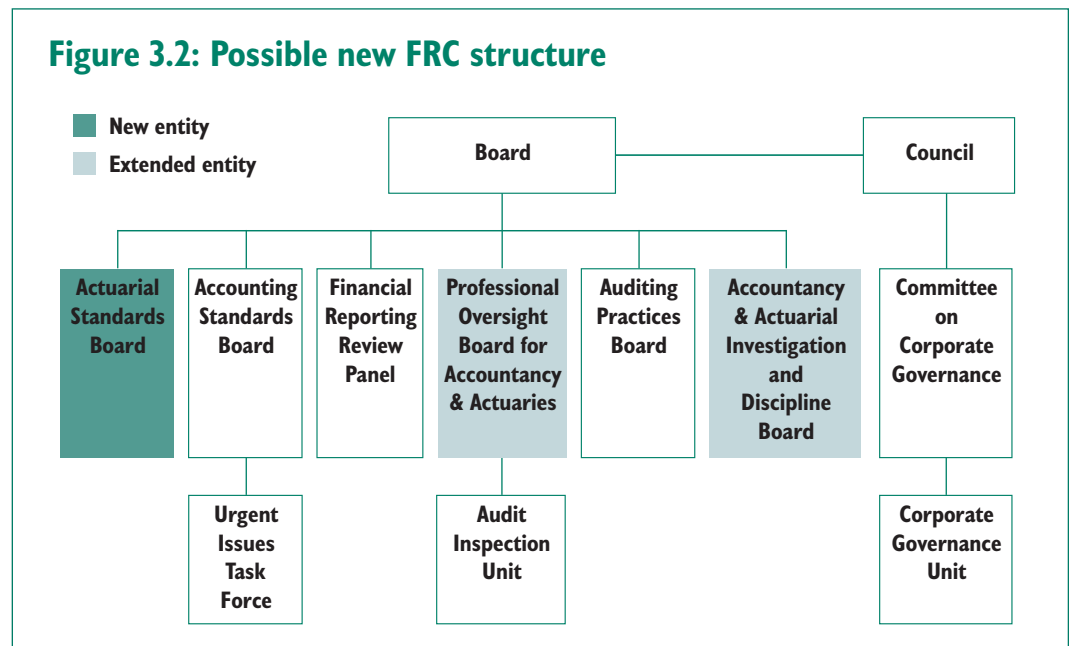


**3.20** However, the following reservations have been raised about operating bodies within the FRC setting professional standards and overseeing the actuarial profession:

- the size of the accountancy profession relative to the actuarial profession could mean little emphasis on actuaries within the institutional arrangements;
- actuaries and accountants perform different types of roles, require different types of reporting, and should therefore be regulated differently; and
- actuarial and consumer interests are not currently represented in the FRC.

**3.21** The review appreciates these concerns, but believes they can be addressed in the implementation of the proposals and that on balance they are outweighed by the benefits of oversight by the FRC. In its response to the review, the FRC wrote: “[we] recognise that there are strong connections between the work of actuaries and accountants. In addition, the FRC has developed considerable experience of providing a framework within which professional standards can be set on an independent basis. More recently, through its Professional Oversight Board for Accountancy, the FRC has been developing expertise in the oversight of professional bodies”.

**3.22** The exact nature of the oversight to be provided by the FRC of the actuarial profession is clearly a matter for further consideration by the FRC, in discussion with the Profession and the statutory regulators. However, the review believes that the structure shown below may be one possible way forward and would be likely to provide an effective and robust regime.



**3.23** This structure would mean a new FRC operating body to set technical standards – an Actuarial Standards Board. It would also mean an extension of the current remit of two existing FRC operating bodies: the remit of the Professional Oversight Board for Accountancy (POBA) would be expanded to include oversight of the actuarial profession; and the remit of the Accountancy Discipline and Investigation Board (AIDB) would be expanded to take on public interest cases in relation to the actuarial profession.

**3.24** The review anticipates that the FRC would need to alter the composition of certain bodies within the FRC to reflect the FRC’s new role with respect to the actuarial profession. The review anticipates that the actuarial profession would have representation on the FRC

Board and Council, the extended POBA and AIDB, and significant representation on the newly formed Actuarial Standards Board.

**3.25** The review has held discussions with a number of different parties over the funding of the new arrangements – the FRC and its subsidiaries are currently funded on a tri-partite basis by the accountancy profession, business and Government. However, financial services regulators, and certain other regulators, are financed through their industries without a Government contribution.

**3.26** Some stakeholders have argued that all funding for the new activities could come through the Profession, since the new regime is being created to regulate actuaries more effectively. However, the Profession has suggested that such a move could result in many actuaries, who do not occupy reserved roles, leaving the Profession.

**3.27** The review therefore believes that one possible model for funding would be for the main beneficiaries of the new regulatory framework to provide the funding – this could follow a tri-partite model, with contributions from:

- the actuarial profession;
- the life and general insurance industry; and
- the pensions industry.

**3.28** The review appreciates that the current sponsors of the FRC would not be prepared to meet any of the additional costs and agrees that there is no reason why they should do so.

## Recommendations

The central recommendation of the review is that regulation of the actuarial profession should be subject to independent oversight by the Financial Reporting Council (FRC). The FRC should:

- create an Actuarial Standards Board as a new operating body of the FRC to set actuarial professional standards;
- extend the remit of the Professional Oversight Board for Accountancy (POBA), an operating body of the FRC, to oversee the regulatory and other activities of the actuarial professional bodies, including oversight of the actuarial profession's role in:
  - setting ethical standards;
  - administering the education system and continuing professional development scheme;
  - the monitoring of compliance with professional standards; and
  - administering disciplinary procedures.
- develop a formal agreement with the actuarial professional bodies outlining the respective roles and responsibilities of the FRC, its operating bodies and the actuarial profession. In particular establish procedures to ensure the technical standards established by the Actuarial Standards Board are adopted, the recommendations of the oversight body are implemented and members of the actuarial profession are subject to the findings of the independent disciplinary arrangements.

The review recommends that the Government should, in due course, legislate to provide the FRC with statutory powers to set actuarial professional standards and oversee the regulatory activities of the actuarial profession.

## ROLE OF THE INSTITUTE AND FACULTY OF ACTUARIES

**3.29** Under the new regulatory regime the Profession would:

- provide input to, and members of, all actuary related bodies within the FRC structure;
- continue to set ethical standards, the education syllabus and provide a disciplinary mechanism to deal with possible non-compliance with technical or ethical standards;
- act as a forum for discussion on all actuarial matters; and
- promote the actuarial profession.

**3.30** The interim assessment questioned whether a profession of 4,500 practising professionals should have two separate bodies – the Institute and Faculty of Actuaries. The review has not received extensive calls for a merger of the two institutions, although a few respondents have suggested this on the basis that there are costs in having two bodies, in terms of complexity and brand dilution. However, benefits have also been argued – greater volunteer participation and engagement, and that the two bodies already operate effectively as a single body in certain areas, such as education and discipline.

**3.31** The review believes that the constitution of the profession is a matter for its members, provided that whichever bodies exist are effective at regulating their members, and cooperate with the FRC and other regulators.

## REGULATORY ISSUES DISCUSSED IN FOLLOWING CHAPTERS

**3.32** This chapter has outlined the review's recommended regulatory regime for actuaries in the UK. However, within such a regime there are a number of specific issues that must be addressed – many of these issues were outlined in the interim assessment.

**3.33** The following five chapters therefore address the more specific regulatory issues. The review makes a number of recommendations in each area:

- education and CPD: the review recommends reforms and a greater diversity in the provision of education; and enhanced monitoring of CPD (see Chapter 4);
- actuarial roles: the review recognises the need for roles to be reserved for actuaries in pensions and life insurance; recommends that the actuarial adviser to a pension scheme (Scheme Actuary) should not serve the scheme trustees as well as the scheme sponsor if either party, or the actuary, deem the potential for conflict to be material; and recommends that the FSA consider the introduction of a requirement that general insurers obtain relevant advice from an approved person with relevant skills, who may or may not be a Fellow of the Institute or Faculty of Actuaries (see Chapter 5);
- actuarial standards: the review recommends that the Financial Reporting Council establish an Actuarial Standards Board (see Chapter 6);
- public interest and accountability: the review outlines actuaries' duty to the public interest, recognises the importance of whistle-blowing and makes

recommendations to enhance and clarify the current regime (see Chapter 7);  
and

- scrutiny and discipline: given the difficulty for users in assessing complex actuarial advice and given limitations on market testing, the review recommends enhanced scrutiny of actuarial advice in the three major practice areas and a need to work with increasingly proactive supervision by regulators in these areas (see Chapter 8).

# 4

## EDUCATION AND CONTINUING PROFESSIONAL DEVELOPMENT

### INTRODUCTION

**4.1** Chapter 6 of the interim assessment looked at the Profession's approach to education and CPD. In summary, it noted that:

- the Profession is responsible for syllabus content and development. It is also responsible for assessment, which is by written examination. These arrangements rely quite heavily on voluntary input from members of the Profession;
- the education and training of actuaries is undertaken predominantly on a part-time study basis while in full-time employment. Study materials are supplied by a sole education provider in partnership with the Profession. Employers tend to bear all study costs;
- there is limited entry to the Profession through university-based, full-time courses. The granting of exemptions from the Profession's exams for those with alternative qualifications is not widespread. This process is controlled tightly by the Profession.
- employers have not objected to the prolonged time taken to qualify, at least in part because it provides them with a regular supply of trainees who can provide low-cost support for firms' activities;
- all qualified actuaries are encouraged to meet CPD requirements but these are compulsory only for statutory role-holders. There is limited monitoring of compliance with the CPD scheme; and
- the existing CPD scheme is hours-based with some constraints on the content of formal CPD, including, for example, the number of hours of employer-provided CPD that can be counted.

**4.2** The interim assessment highlighted a number of concerns in relation to the Profession's approach to education and CPD:

- existing institutional arrangements have limited the extent and effectiveness of expert and informed input on education matters from outside the Profession. The result has been a widespread concern that the syllabus has not adequately been kept up to date;
- the examination process does not have the full confidence of the student population. There has been little innovation in the method of assessment employed, at least until very recently. There is inadequate oversight of quality assurance;
- the existing work-based model of actuarial education acts as a constraint on the Profession's desire to encourage the use of actuaries in wider fields of practice. The employers that recruit student actuaries are almost entirely within the traditional areas of actuarial employment – pensions and insurance;

- the long time taken to qualify appears to deter many of the brightest graduates from entering the Profession. They can earn substantial salaries more immediately by gaining relevant post-graduate qualifications (for example, one or two year courses in finance or financial economics) and joining an investment bank;
- the CPD scheme suffers from undue complexity rendering its overarching objectives obscure and confusing to many members of the Profession. This serves to undermine respect for and appropriate compliance with the scheme; and
- existing institutional arrangements have failed to ensure that the CPD scheme is kept properly up to date or that there is adequate monitoring of scheme compliance and the process of professional revalidation.

**4.3** The following sections: put forward the policy options proposed by the review in its interim assessment in response to each of these concerns; consider the reactions to the respondents to the interim assessment; and propose final policy recommendations.

## EDUCATION SYLLABUS AND GOVERNANCE

**4.4** In its interim assessment the review highlighted concerns about the process by which the Profession has sought to keep its syllabus, and associated teaching materials, up to date. Thus, for example, the perceived failure to adopt latest developments in financial economics and financial markets was seen in large part to stem from the role played by entrenched commercial interests in the development of the Profession's education policy and an insularity that constrained the extent and effectiveness of input from academics, other professions and those in wider fields of practice. Additional worries were voiced about an apparent failure to recognise the need for the syllabus to address generic business awareness, communication skills, and more general professionalism considerations.

**4.5** In the light of these concerns, the review concluded that earlier reforms of the education system undertaken by the Profession had failed to:

- take full account of relevant developments in actuarial and non-actuarial theory or in non-traditional areas of actuarial employment;
- pay sufficient attention to the promotion of management and business awareness; or
- to recognise the need to address professionalism issues while training to be an actuary.

**4.6** In the interim assessment the review concluded that the outcome of the most recent education review, the 2005 Education Strategy, represented a well-formulated attempt to deal with these issues and is very much to be welcomed.<sup>1</sup> The interim assessment further argued that it made sense to give the reforms sufficient time to bed in. This view was widely shared by respondents to the interim assessment.

<sup>1</sup> The syllabus changes are described in paragraphs 6.17-6.22 of the interim assessment.

**4.7** Nevertheless, the review also concluded that the 2005 syllabus on its own was not sufficient to address the past shortcomings of the syllabus. Financial markets and the regulatory environment in which actuaries work are continuing to change rapidly. As a result, it is essential that appropriate arrangements should be in place to ensure that the syllabus is regularly reviewed and updated when appropriate. In addition it should be influenced appropriately by developments in academic actuarial science and in other disciplines and professions, in order to avoid the rather insular approach that was the subject of criticism in the past. There is also a need to ensure that teaching materials are kept continuously up-to-date.

**4.8** There is an important question therefore as to whether existing institutional arrangements are best suited to ensuring that the syllabus is properly and continuously kept up-to-date, and that the Profession maximises the benefits of cross-fertilisation with academia and other professions. In this context, the review argued that steps are required to open up the development of the syllabus to more systematic scrutiny and influence from outside the actuarial profession.

**4.9** The interim assessment put forward two options to promote improved ongoing syllabus development in the future:

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

## Interim assessment feedback

**4.10** These options, which are not mutually exclusive, each have pros and cons. The first option has the benefit of being potentially quite straightforward to implement. There would be little disruption to the Profession and resource costs would probably not be of concern. On the other hand, it might not provide sufficient assurance to users of actuarial advice, or the public at large, as to the effectiveness of the ongoing development of actuarial education. Option 2 would provide the necessary level of reassurance but could be regarded as more onerous.

**4.11** Respondents to the interim assessment expressed the following views:

- there was almost unanimous support for time to be given to let the latest syllabus revisions bed in;
- there was more support for Option 1 compared with Option 2. Several respondents argued that an independent oversight body could introduce an additional layer of bureaucratic cost without bringing tangible compensating benefits;
- a significant number of respondents, including the Profession, recognised the value that could be added by some form of oversight body and were supportive of Option 2; and

- certain academics pointed out that in fact Option 1 is a prerequisite for meaningful oversight. In the absence of reform of the existing governance structure to promote greater external input, Option 2 will only deliver oversight of an already flawed process. The Profession supported the implementation of both options.

## Analysis and conclusions

**4.12** The review accepts that time should be given to let the latest syllabus revisions bed in, but sees no incompatibility in pursuing both options now so that improved governance arrangements are in place by the time of the next syllabus review. Consequently, the review would like the Profession to consider how it might best amend its existing governance structures in order to ensure appropriate input from academic actuaries, overseas actuaries, and representatives of other academic disciplines and professions. The review sees this forming part of a wider consideration of the Profession's whole approach to education and training.

**4.13** In relation to Option 2, the interim assessment identified the Professional Oversight Board for Accountancy (POBA) as an appropriate body to provide independent oversight of the Profession's actuarial education and CPD initiatives. POBA was set up as an operating body of the Financial Reporting Council (FRC) to provide independent oversight of the auditing and accountancy profession with a view to enhancing public confidence in their work and ensuring that the UK profession and regulatory regime remains at the forefront of global standards.<sup>2</sup> This includes overseeing the role of the professional accountancy bodies in providing education, training and CPD.

**4.14** POBA is chaired by the current Comptroller and Auditor General of the UK, Sir John Bourn. The other 10 board members include six qualified accountants with backgrounds in audit, wholesale banking, local government and academia, a qualified actuary specialising in investment, an investment banker and individuals with backgrounds in trade unionism and the pensions industry.

**4.15** One of the issues considered by the review in relation to the possibility of following the POBA model was whether it would be preferable to set up a parallel body – the Professional Oversight Board for Actuaries – or to expand POBA's remit to give it additional responsibility for oversight of the actuarial profession.

**4.16** Discussions with stakeholders revealed overwhelming support for the latter configuration. It was argued that there were natural synergies to be gained from giving POBA a broader remit, not simply in terms of cost and input from a wider base of expertise, but in recognition of the growing importance of actuarial theory and practice in the development of international accounting standards. The review agrees with this analysis.

**4.17** However, there was also some concern at the possibility of the actuarial profession's unique characteristics being swamped alongside those of the much larger accountancy profession. Consequently, there was widespread agreement that, if oversight was exercised by the FRC, and POBA's remit was therefore expanded to include the actuarial profession, there should be appropriate representation of actuaries on the POBA Board. There is already one actuary on the POBA Board. The FRC and POBA will need to review their composition in the light of any new responsibilities.

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<sup>2</sup> See the FRC website for further information: [www.frc.org.uk](http://www.frc.org.uk)



**4.18** Stakeholders also recognised that the oversight function ascribed to POBA in relation to syllabus development and teaching materials fitted with the more general application of oversight to other aspects of the Profession's activities, such as professional revalidation and ethical standards. The review agrees and feels that such a body will help underpin public confidence in the actuarial profession.

**4.19** Unless stated otherwise, all subsequent references to POBA in this chapter assume that its remit has been expanded to oversee the regulatory and other activities of the actuarial professional bodies.

## Recommendations

The review recommends that:

- the remit of the Professional Oversight Board for Accountancy (POBA) should be expanded to oversee the regulatory and other activities of the actuarial professional bodies including: oversight of the actuarial profession's role in administering the education system, the CPD scheme and the professional revalidation programme.

**4.20** Specifically in relation to syllabus and teaching material development:

The review recommends that, subject to oversight by the Professional Oversight Board for Accountancy (POBA):

- the Profession proceeds as planned with recently introduced and forthcoming reforms of the education syllabus; and
- the Profession should seek to promote broader input into the development of the syllabus and associated teaching material.

## EXAMINATION PROCESS

**4.21** In addition to concerns about syllabus development, the interim assessment concluded that there had been problems in relation to the administration of the examination process. The current examination setting and marking model relies heavily on volunteers, but it is not clear to the review that there is sufficient oversight of the examination process to guarantee the necessary level of innovation or quality assurance.

**4.22** The review suggested a number of mutually inclusive options for improving the quality of the examination process:

- 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.

**4.23** As pointed out in the interim assessment, the first option might be less costly than the other two but it is debatable whether such internal reforms would provide stakeholders with sufficient assurance that the perceived problems had been dealt with adequately. The other two options might enhance the credibility of any subsequent reforms but costs could be a constraint.

### Interim assessment feedback

**4.24** Respondents to the interim assessment had the following views:

- there was broad support for Option 1 amongst most respondents, including the Profession;
- fewer stakeholders were convinced of the benefits of Option 2. Concerns were voiced about the risk of alienating the volunteers within the Profession and likely cost of the systematic involvement of external examiners; but
- a number of respondents did acknowledge that, subject to cost constraints, such an injection of professionalism would be welcomed and would instil greater confidence in the system;
- the Profession pointed out that it does already have professional external examiners, but didn't see how the examination workload justified their employment on a full-time basis; and
- there was mixed support for independent oversight of the Profession's exam setting and marking though, significantly, the Profession voiced its support.

### Conclusions

**4.25** The review concludes that the Profession should devise and deliver a strategy for improving quality control in relation to examination setting and marking. The strategy should consider how external expert involvement could best be facilitated.

### Recommendation

The review recommends that, subject to oversight by the Professional Oversight Board for Accountancy (POBA):

- the Profession should improve quality control in relation to examination setting and marking, if necessary through the greater involvement of external experts.

## EDUCATION DELIVERY: WORK-BASED LEARNING VERSUS UNIVERSITY EDUCATION

**4.26** The interim assessment highlighted a number of criticisms that have been made of the UK actuarial profession's education approach in the past. These included:

- an insular and inward looking approach to syllabus development in the past, with too few links with other academic disciplines and developments in academic actuarial science, which led the Profession to become out of touch with the latest thinking in other disciplines e.g. stochastic modelling and financial economics;
- too much emphasis on firm-sponsored research as opposed to independent, university-based research;
- a lack of innovation in teaching, with little recognition of the role played by learning (rather than teaching), possibly due to the virtual monopoly on the provision of actuarial tuition materials by the Actuarial Education Company (ActEd);
- a teaching system that is preoccupied with exam-based assessment; and
- the long time taken to qualify.

**4.27** The interim assessment observed that a number of these issues could be addressed by securing greater provision of actuarial education through the university system. Universities by their nature have easy access to the latest research and teaching methods of other disciplines. They are also more likely to conduct independent actuarial research free from the pressures of the commercial environment in which many actuaries practice. It was noted that the Australian system appears to benefit from healthy competition between university actuarial science course providers for innovation in teaching methods.

**4.28** In addition, as highlighted in the interim assessment, competition for graduates in the UK is intense and one way of attracting talent into the Profession is to reduce qualification times so that rewards are comparable to those in other areas of employment. The university-based model would appear to offer a means of reducing qualification times, thereby supporting the Profession's aim of attracting the brightest and best into the Profession.

**4.29** The university-based model is in principle well developed in the UK. A-level students can choose to study actuarial science at degree level, or mathematical degrees that incorporate modules in actuarial science, both of which exempt them from most of the Profession's core technical examinations. The changes to its qualification structure now mean that a student can achieve Associate status of the Profession within a year or two of graduating from university. Such individuals would of course still 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.

**4.30** However, as the interim assessment noted, the reality is that only 20 per cent of students use the undergraduate university-based model in the UK, while 80 per cent adopt the part-time, work-based approach. This reflects the fact that the university-based model is restricted to a relatively small number of UK universities and recruiting firms prefer the part-time work-based model. The review noted, however, that the existence of more fully developed university-based models in Australia and Ireland, for example, suggests that there is no overriding reason why the UK model should have to persist in its current form.

**4.31** The interim assessment concluded that employers have been a significant constraint on the greater adoption of the university-based approach. Employers repeatedly told the review team that they favoured the traditional work-based approach to education. It gives them greater control and influence over their actuarial students than would otherwise be the case, and an opportunity to shape their trainees. An oft-cited view was that they would rather take high calibre students with mathematics or physics degrees than take a less highly rated student with an actuarial science undergraduate degree.

**4.32** The university-based model was also viewed by employers as unnecessarily complicating their pay structures and as bringing few benefits because trainees still needed to undergo several years of on-the-job training before they could be regarded as fully qualified actuaries. The importance of gaining practical experience, which can only be obtained while in employment, is not to be underestimated. The relevance of internal salary arrangements is less clear to the review and should not to be regarded as a barrier to the promotion of the full-time university study model.

**4.33** It is acknowledged by the review that the potential benefits of any enhancement of the role of universities – better syllabus development, innovation in research and teaching methods and reduced qualification times – have to be set against a number of potential downsides, and an appropriate balance struck. A wider problem that is outside the scope of this review is the funding pressures currently placed on universities and the reluctance of universities to prioritise the development of mathematics-based syllabuses at a time when there is an alleged under-supply of suitable A-level talent.

**4.34** Nevertheless, the interim assessment concluded that the current education model:

- encourages the narrow application of actuarial skills rather than a broader appreciation of actuarial principles;
- encourages insularity because of the limitations of the teaching material and because the part-time, on-the-job approach discourages the exchange and questioning of ideas; and
- prolongs the time to qualification, making it harder for the Profession to attract the best students and employers, particularly in the less traditional areas where actuaries compete with high quality graduates who won't necessarily be expected to obtain professional qualifications.

**4.35** As the interim assessment suggested, the UK actuarial profession has a choice. Either it can maintain the current work-based educational approach and focus on traditional industries where demand for actuarial advice is likely to decline, or it could branch out into the growing non-traditional areas. This would allow actuarial skills to be more widely available in a range of areas where they could undoubtedly be usefully applied, and lead to greater integration of its core skills with other relevant disciplines. Growth in non-traditional areas is likely to be most easily achieved by a greater proportion of actuarial education being provided at least partially in the universities.

**4.36** The review put forward two options for increasing the diversity of actuarial education provision in the UK:

- 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.

### Interim assessment feedback

**4.37** There was generally broad support for both options amongst respondents. In relation to Option 1, it was recognised that a simpler system of accreditation by the Profession of particular university courses would bring advantages. It is currently difficult for students to work out what exemptions they will receive if they decide to pursue a particular course of study, as exemptions are granted by the Profession on a case-by-case basis. This is likely to make it difficult for students to make informed decisions about the relative merits of alternative entry routes into the Profession. It also imposes an inflexible regime on university departments that reduces their ability to innovate, particularly in relation to alternative methods of assessment.

**4.38** Option 2 had in mind the needs of students who hold an undergraduate degree in a non-actuarial subject but who would prefer to study for a shorter period of time on a full-time basis rather than on a part-time work-based basis. These students may not have initially considered entering the Profession or may want to switch career at a later stage. This option is analogous to the post-graduate CPE law conversion course. There are already a few such post-graduate diploma courses in existence but they are not currently a significant entry route into the profession.

### Analysis and conclusions

**4.39** The review believes that Option 2 in particular has much to recommend it. Its key attraction is that it is premised on the assumption that actuarial theory and principles are best acquired while in full-time education, while practical work experience and specialist skills are most appropriately obtained afterwards, on-the-job. It is envisaged that, in this case, employers would be free to recruit undergraduate students from university and then sponsor them through a full-time post-graduate conversion course before taking them on in full-time employment. In law, for example, such conversion courses last two years. However, following discussions with the Profession, the review believes that a one-year course could be promoted in order to emphasise the step change in behaviour being sought. The review envisages the Profession setting the syllabus and agreeing a suitable structure of exemptions in conjunction with the universities, and working with employers to develop sponsorship opportunities and refined recruitment practises. The benefits of the conversion course approach would be that:

- it would significantly speed up time to qualification;
- it would assist the Profession in broadening into non-traditional areas;
- employers would be more assured of being able to compete effectively for the best and brightest graduates; and
- the promotion of sponsorships should help secure demand for university courses and help promote new course development.

**4.40** The review believes that without some sort of move in this direction the Profession will continue to struggle to attract the best graduate talent and find it more difficult to move much beyond the confines of the pensions and insurance industries. It would potentially be left facing an uncertain future. With this in mind, the review believes that the Profession should take the lead in working with universities and employers of actuaries in producing and delivering a new education and training strategy. It should aim to ensure that:

- the actuarial profession continues to attract the best and brightest university graduates;
- actuaries are equipped with the skills and knowledge to provide high-quality actuarial advice in a wide range of situations and are exposed to broader thinking in related disciplines such as statistics, economics, demography and financial economics;
- actuarial skills are utilised in a broad range of areas of the economy beyond the traditional areas of pensions and insurance through increasing the provision of actuarial education in the university sector; and
- appropriate training is provided so that actuaries have sufficient specialist knowledge and practical experience with which to begin advising clients.

## Recommendations

The review recommends that, subject to oversight by the Professional Oversight Board for Accountancy (POBA):

- the Profession should take the lead working with universities and employers of actuaries in producing and delivering a new education and training strategy;
- the Profession, universities and employers should explore alternatives to the traditional education model of on-the-job part-time study, which has tended to restrict the use of actuarial skills to the insurance and pensions industries and has led to lengthy average qualification times;
- the Profession should promote one-year postgraduate actuarial conversion courses, in conjunction with the universities and employers, which would teach the core technical skills and which could be followed by a period of on-the-job training and part-time study to acquire the relevant work experience and specialist skills and exams for full Fellowship;
- the Profession should consider simplifying its exam exemption policy so that it is simpler for prospective university students to understand the levels of exemptions granted by pursuing alternative university courses; and
- the Profession should consider accrediting university departments rather than their individual courses in order to make it easier for university departments to offer innovative new courses.

## CONTINUING PROFESSIONAL DEVELOPMENT (CPD)

**4.41** The Profession's CPD scheme is, like many other CPD schemes, based on a requirement that actuaries obtain a specified number of hours of CPD. In considering the pros and cons of the scheme's hours-based requirement, the review looked at the CPD requirements of other professions in the UK, and of lawyers and accountants in particular, and of other international actuarial professions.

**4.42** In terms of the overall level of hours-based CPD required, the review found that the UK profession's recommended requirements are not markedly out of line with overseas actuarial professions' practices in countries that adopt formal CPD requirements. When compared to other professions in the UK, actuaries in general are required to perform more CPD than lawyers but less than accountants. Of note is that accountants working in the statutory areas of audit and insolvency have, until a recent move away from the hours-based approach, been required to obtain twice the amount of formal technical CPD that actuaries working in reserved roles are currently required to complete.

**4.43** On the content of the scheme, which has been subject to recent revision, the review noted the greater emphasis being placed by the Profession on professionalism requirements. This is clearly desirable, as is the broader aspiration of making the revised CPD scheme more outcome focused and principles based and less of a time counting, tick box exercise.

**4.44** However, the review also highlighted concerns about whether:

- the right types of formal CPD activities are being promoted and recognised;
- the formal CPD requirements for statutory role-holders are adequate given the nature of the responsibilities placed on these actuaries; and
- it is always appropriate for individual actuaries to prescribe their own CPD opportunities, or whether in some cases the Profession should assume a degree of prescriptive power.

**4.45** In particular, the review questioned whether the Profession's approach in this area has been effective in ensuring that important developments in thinking or in the regulatory environment have always been incorporated into the CPD programme in a timely fashion. Also of importance, therefore, is the extent to which syllabus developments are reflected in the CPD programme that qualified actuaries follow.

**4.46** The review also received some evidence that suggested that the purpose, scope and significance of the CPD scheme were not as clear as they could be. Nor was it clear to the review that the latest proposals for change had been adequately communicated either within the Profession or to interested external parties. Such confusion serves only to constrain the effectiveness of the scheme.

**4.47** Therefore, the interim assessment questioned whether the Profession's current governance arrangements in relation to CPD were best suited to ensure that, in the future:

- the objective of the CPD scheme, and how it relates to professionalism and work-based skills, is properly understood across the Profession and outside of it;
- the content of the CPD programme is updated and reviewed at appropriate intervals, with sufficient input from relevant technical experts, including from the regulators;

- in particular, the technical competence of actuaries in statutory roles is always kept up-to-date, and awareness of broader trends and/or new thinking ensured;
- the right balance between formal and informal CPD requirements is achieved;
- the level of CPD required stands comparison with that of other relevant professions;
- the needs of actuaries working in non-traditional areas are adequately catered for; and
- an appropriate distinction is made between the need to accommodate the in-house provision of CPD and the danger of over-reliance on employers.

**4.48** Given the criticisms of the actuarial syllabus in the past the review regards high-quality and up-to-date CPD requirements as a high priority for the actuarial profession as this represents a way of ensuring that existing actuaries' skills are updated and refreshed.

**4.49** The review suggested several non mutually exclusive options relating to the CPD scheme;

- 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 independent oversight body. 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 those working in traditional areas.



## Interim assessment feedback

**4.50** The review received broad support for all four options. The Profession itself was particularly supportive and few respondents dissented from the view that there was scope for clarifying the schemes objectives, promoting closer working, both within the Profession and between the Profession and external sources of expertise. Again, where concern was raised about the involvement of an independent oversight body, the focus was on costs and the potential for further bureaucracy, particularly if an entirely new body were set up to provide the oversight. The review accepts that this would be a costly option, which is why the lower cost option of expanding the remit of POBA has been preferred.

## Conclusions

**4.51** The review concludes that these options should be pursued and that oversight of the CPD scheme should form part of the remit of POBA. This should provide the wider public with the necessary degree of reassurance that actuaries' skills will be updated and refreshed more effectively than was the case in the past.

## Recommendation

The review recommends that, subject to oversight by the Professional Oversight Board for Accountancy (POBA):

- the Profession should clarify the objectives of the CPD scheme, consider increasing the amount and quality of formal CPD required for reserved role holders, and foster closer links between those within the Profession with responsibility for syllabus development, the actuarial research community and those concerned with CPD; and
- the Profession should ensure that the CPD scheme is relevant, up-to-date and takes account of developments in actuarial science, financial markets and other disciplines.

## MONITORING OF CPD

**4.52** The interim assessment noted that the credibility of any CPD scheme rests heavily on the effectiveness of the measures in place to enforce compliance and discipline the non-compliant. It also observed that the Profession's current scheme is mandatory only for the one quarter of actuaries holding reserved roles. They are also the only actuaries required to hold practising certificates, renewal of which requires CPD. Consequently, three-quarters of the Profession is not subject to any CPD compliance check.

**4.53** Fortunately, the Profession has recognised the need for reform and is in the process of finalising proposals to extend the scope of mandatory CPD to all actuaries. For statutory roles, the CPD requirement will remain quite stringent, with the introduction of a minimum CPD syllabus, and with annual renewal and an annual compliance check continuing as before. All other qualified actuaries will be required to complete CPD and, on a voluntary basis, may hold a new non-statutory practising certificate. Monitoring for those not in statutory roles will be of an annual 10 per cent sample. This initiative is widely regarded as a positive development and the review shares this sentiment. It is important to have regular compliance monitoring. The Profession's proposals mean that in future this will apply both to statutory reserved roles and non-statutory roles. These represent a marked step forward and are an important development in terms of building credibility.

**4.54** The interim assessment noted that if the Profession wishes to demonstrate to the public its commitment to CPD for all actuaries, rather than just those in reserved roles, then it may wish to consider whether it would be more appropriate for the non-statutory practising certificate and associated technical role-specific CPD requirements to apply to all working actuaries in their area of practice, rather than just to those who volunteer themselves.

**4.55** As the interim assessment pointed out, the public credibility of the new regime will rest in large part on the credibility of the processes in place to enforce compliance. In summary, the review was concerned that:

- the Profession has underestimated the importance of demonstrating to the public and other interested parties that the new CPD arrangements will be vigorously enforced and, therefore;
- insufficient attention has been paid to how compliance will be enforced in practice.

**4.56** The review concluded that there were three possible options going forward:

- 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 per cent per annum sample monitoring for the remainder of working actuaries; or
- Option 2: as Option 1 but the 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.

**4.57** It is the review's understanding that the Profession is still finalising its thinking in this area. It is likely that the Profession will settle on a revised version of Option 1, where the CPD requirement on non-practising certificate holders will no longer be hours-based but will require individual actuaries to decide for themselves what should count as CPD and, preferably with employer involvement, maintain a suitable CPD record.

## Interim assessment feedback

**4.58** There was widespread support from respondents for Option 1 and the review believes that the refined proposals would meet with a similar level of approval. Whatever the shape of the final proposal, it is essential that a credible monitoring regime should be put in place for each of the three levels of professional revalidation.

**4.59** The review proposed Option 2 as a more straightforward and therefore credible way of expanding CPD monitoring. It would have the benefit of clearly demonstrating to the public that the Profession is taking its CPD responsibilities seriously. However, as was pointed out by the Profession and others, it could be perceived by some qualified actuaries performing less traditional actuarial roles as unnecessarily onerous and could prompt some of them to leave the Profession. Alternatively, of course, the fulfilment of CPD requirements could, and arguably should, be looked upon as a badge of quality.

## Conclusions

**4.60** On balance, the review is content to support the Profession's emerging proposals, as set out in its response to the interim assessment.<sup>3</sup> The review believes, and the Profession has agreed, that the credibility of the CPD scheme will be significantly enhanced if the Profession's monitoring responsibilities are subject to oversight by POBA.

## Recommendation

The review recommends that, subject to oversight by the Professional Oversight Board for Accountancy (POBA):

- the Profession should proceed with its proposals for professional revalidation and related changes to the CPD scheme, ensuring that robust measures are put in place to monitor compliance with their respective requirements.

<sup>3</sup> The Profession's response can be found on its website: [www.actuaries.org.uk](http://www.actuaries.org.uk).



# 5

## ACTUARIAL ROLES

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### INTRODUCTION

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**5.1** Roles are currently reserved to actuaries within both life insurers and pension schemes. Roles are reserved in order to:

- ensure firms take advice from a qualified person;
- control who may give advice on certain matters;
- give the regulator a means of enforcing disclosure requirements and standards directly on individuals;
- make role-holders accountable to the wider public interest e.g. through whistle-blowing duties;
- create a counter balance to management; and
- engender and maintain public confidence.

**5.2** However, it is important that caution is exercised when reserving roles owing to the professional monopoly they create and the tendency to encourage over-reliance on the advice received.<sup>1</sup>

**5.3** The interim assessment concluded that reserving roles under certain circumstances is warranted, provided that:

- actuaries continue to be well-trained, keep up with best practice and have appropriate professional standards, and that these standards are met;
- that there is adequate scrutiny of the work of actuaries in reserved roles; and
- that mechanisms are in place to ensure that the protected position of actuaries in reserved roles does not give them an undue advantage in competing with other professionals for other types of activity for which actuarial expertise is not essential.

**5.4** The continuation of roles reserved to actuaries in the longer term therefore depends on the implementation of various reforms described in other chapters of this report.

### RESERVING ROLES IN PENSION SCHEMES AND LIFE INSURERS

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**5.5** The review believes that in the case of pension schemes and life insurers, because the calculation of liabilities is key to an assessment of the overall financial condition of the pension scheme or insurer, and because issues of wider public interest are at stake, it is necessary to reserve certain roles specifically to an individual who has the required technical skills. If one accepts the need to specify certain role-holders in life insurance and pensions, there is then the further issue as to whether roles should be reserved to actuaries alone or to other qualified professionals.

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<sup>1</sup> The arguments for and against reserved roles are outlined more fully on pages 63 and 64 of the interim assessment.

**5.6** The review accepts that in pensions and life insurance there is a continuing need to reserve the roles to actuaries. This is because a proper assessment and treatment of long-term liabilities is absolutely critical to these activities; the core of actuarial training and expertise is in this area; and no other academic or professional training focuses on it. Some aspects of accounting, finance and economics are relevant, and some non-actuaries with training in these fields may come to acquire sufficient expertise to carry out such work. However, at the present time the review sees no net advantage in removing the assurance, which the current reserved-role regime provides, that such expertise will be utilised.

**5.7** In light of progress with reforms recommended in this report, regulators will need to assure themselves that reserving roles exclusively to actuaries continues to be appropriate. As the Profession acknowledged to the review: “If others have (or can acquire) the appropriate skills and expertise, there is no reason, in principle, why actuaries should have a statutory monopoly over any work.” In due course, regulators will therefore need to consider whether such roles should be opened up to other professionals with the necessary skills to perform them.<sup>2</sup> The main advantage of opening up the roles to non-actuaries would be to increase competition, with its associated benefits; but this would require an alternative regulatory regime to ensure that approved individuals have appropriate qualifications, meet relevant professional standards and are subject to scrutiny and disciplinary rules, the costs of which could be significant.

## Recommendations

The review accepts that, at the present time, there is a continued need for roles to be reserved to actuaries in life insurance and pensions.

The review recommends that:

- in the medium term, the Government and the regulators should keep the roles that they reserve to actuaries under review, with a view to opening up the roles to other suitably qualified professionals.

## RESERVED ROLES IN LIFE INSURERS

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### Actuarial Function Holder

**5.8** The Actuarial Function Holder role is part of major reforms by the FSA to meet a number of problems that emerged with the Appointed Actuary regime. The Actuarial Function Holder provides actuarial advice to a life insurer’s senior management on the methods and assumptions for the actuarial investigation and on the risks being run by the insurer and its capital requirements.

**5.9** The review supports the FSA’s reforms and agrees with the scope of the Actuarial Function Holder role.

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<sup>2</sup> In practice, this may require changes to EU or UK primary legislation. For example, section 268(3) of the Companies Act 1985 requires an actuarial investigation to be undertaken by an actuary appointed under FSA rules.

## With-Profits Actuary

**5.10** The With-Profits Actuary role is a further part of major reforms by the FSA to meet a number of problems that emerged with the Appointed Actuary regime. The With-Profits Actuary, who may be the same person as the Actuarial Function Holder, performs two different functions:

- he provides ongoing advice to a with-profits insurer's senior management on its use of discretion – as part of this he provides the Board, at least once a year, with a private report on key aspects of this; and
- he provides assurance to the regulator and to policyholders – through a public opinion to accompany the insurer's annual report to with-profits policyholders on its compliance with its Principles and Practices of Financial Management (PPFM), including the way it has exercised discretion and addressed conflicting policyholder interests.

**5.11** The review accepts the rationale and scope of the With-Profits Actuary role. However, the interim assessment considered three aspects of the With-Profits Actuary role: the extent of independence of the role-holder; who should appoint the role-holder; and the reporting requirements of the With-Profits Actuary. The review identified four options for the future:

- Option 1: status quo – With-Profits Actuary role as specified by the FSA;
- Option 2: the With-Profits Actuary should be external to the insurer;
- 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.

## Interim assessment feedback

**5.12** Respondents to the interim assessment did not believe that With-Profits Actuaries should have to be external to insurers. The role requires an in-depth knowledge of an insurer's business which may be best filled by an internal candidate. The review concurs with this view.

**5.13** In the interim assessment the review noted a concern that the With-Profits Actuary, while having to opine on the insurer's use of discretion, is actually appointed, dismissed and remunerated by the insurer's Board. The review therefore put forward an option for the With-Profits Actuary to be appointed by a body within an insurer, that was not the Board: either the With-Profits Committee, if one exists, or otherwise the Audit Committee.<sup>3</sup>

**5.14** Respondents to the interim assessment were mixed in their reaction to this option as it was argued that the With-Profits Actuary should continue to be accountable to the Board,

<sup>3</sup> FSA guidance in Conduct of Business (COB) 6.1.1.4, 5, 6 states that a firm should maintain governance arrangements designed to ensure that in the conduct of with-profits business it complies with, maintains and records any applicable Principles and Practices of Financial Management (PPFM). The governance arrangements should: be appropriate to the scale and complexity of a firm's with-profits business; and involve some independent judgment in the assessment of compliance with PPFM and how any competing or conflicting rights and interests of policyholders and, if applicable, shareholders have been addressed. This independent judgment can be provided in different ways, one of which is through a With-Profits Committee.

given senior management responsibility.<sup>4</sup> The Profession and some actuarial firms put forward the idea that it may be more appropriate for the With-Profits Committee, if one exists, or the audit committee, to advise on the appointment and remuneration of With-Profits Actuaries (rather than actually make the appointment and determine remuneration). The review agrees with their proposal and is therefore recommending this as good practice.

**5.15** With regard to reporting requirements, the review believes it is sufficient for the With-Profits Actuary to express an opinion on the insurer's report to policyholders. The With-Profits Actuary must state whether in his or her opinion the insurer's full report and its exercise of discretion have taken policyholders' interests into account in a reasonable and proportionate manner.

**5.16** The current arrangements have only been in place since the start of 2005 and therefore a number of respondents to the review, including the Profession and actuarial firms, argued that it is too early to make any judgments on them. No respondents supported disclosure to policyholders of the With-Profits Actuary's private report to the Board, though respondents were supportive of a reporting line to the regulator. The FSA argued that the With-Profits Actuary's formal opinion (as opposed to his private report to the Board) is to be made publicly available; that the FSA would require notification of a qualified opinion (both from the insurer and through whistle-blowing duties for the With-Profits Actuary); and that the FSA can require the With-Profits Actuary's private report to the Board if it thinks it necessary.

## Review's conclusion

**5.17** The review believes that the With-Profits Actuary must have a clear line of accountability to the regulator since, if customers have not been treated fairly, then the regulator needs to investigate further and hold discussions with the insurer's management to ensure that corrective action is taken promptly. The regulator is in the best position to take effective action to protect policyholders. The review therefore believes that the FSA should, in line with its risk-based approach, make arrangements to pro-actively monitor a sample of insurers' with-profits annual reports and accompanying opinions as well as any issues that arise from them.

## Recommendations

The review recommends that:

- as a matter of good practice there should be independent input into the appointment and remuneration of the With-Profits Actuary, for example by the With-Profits Committee, if one exists, or otherwise the Audit Committee; and
- that the FSA should, in line with its risk-based approach, pro-actively monitor a sample of insurers' with-profits annual reports and accompanying opinions as well as any issues that arise from them.

<sup>4</sup> Senior management responsibility is a key principle of the FSA's reforms.



## Reviewing Actuary

**5.18** The Reviewing Actuary role is the third actuarial role introduced by the FSA as part of its December 2004 reforms. The Reviewing Actuary, who must be independent of the insurer, is retained by the auditor to advise on the insurer's calculation of its policyholder liabilities and any related matters. The exact scope of the role is agreed between the Reviewing Actuary and the auditor – the Auditing Practices Board and the Profession have both recently published guidance on the role.<sup>5</sup>

**5.19** The review put forward three 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.

**5.20** The review supports the FSA's introduction of the Reviewing Actuary role. Moreover, the review does not support a mandatory private management letter to the Board from the Reviewing Actuary since this could undermine the Reviewing Actuary's duty to the auditor – this is dealt with more fully in Chapter 8.

**5.21** Whistle-blowing by the Reviewing Actuary (Option 3) is dealt with in Chapter 7, and all other issues with respect to scrutiny of the work of actuaries in life insurers are dealt with in Chapter 8.

## RESERVED ROLES IN PENSION SCHEMES

**5.22** The Scheme Actuary advises pension scheme trustees on the valuation of the scheme's assets and liabilities and the rate of contribution necessary to meet the liabilities. Trustees are representing scheme members' interests and are likely to want to ensure that security for members' likely benefits is maximised whilst scheme sponsors may be concerned about minimising the cost of the scheme. This may lead to potential conflicts of interest when the same adviser advises both parties. The review therefore put forward four possible 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.

<sup>5</sup> Supplementary Guidance for Auditors of Insurers in the United Kingdom (Revised); published by the Auditing Practices Board December 2004. GN42: The Reviewing Actuary; published by the Actuarial Profession December 2004.

## Interim assessment feedback

**5.23** Respondents to the interim assessment have concurred with the review's belief that where a material conflict of interest, or even the appearance of a material conflict of interest, is evident then the actuarial role of providing advice to both the scheme trustees and sponsor should be separated.

**5.24** However, as outlined in the interim assessment, two arguments were given against the final option of mandatory separation of advisors at all times. The first was that in the event that both the trustees and the sponsor are willing to give their consent to having the same actuary, the imposition of a rule that required the separation of advice would then prevent clients from achieving an outcome that in many cases has caused no difficulty. The second issue is the cost of imposing such a rule. This would depend on the advice required by the sponsor over and above that provided by the trustees – in principle this could significantly increase the overall cost even though there would be many cases where that would not be necessary.

**5.25** A number of actuarial consultancies have argued that a separation of advisers would not mean a significant increase in cost since the calculations would be common to both sides. The increase in cost would therefore only relate to the advice, which would have its basis in one set of calculations.

**5.26** However, the review continues to believe that mandatory separation at all times is not a proportionate response to the possibility of conflicts, particularly in those cases where both trustees and sponsors want the same actuary to provide the advice. The review does however believe that while separation of advisers should not be mandatory in all cases, it should nonetheless be required where there is a material conflict, or even the appearance of a material conflict.

**5.27** The interim assessment therefore posed a number of options that may ensure separation where appropriate, but which do not make it mandatory at all times. The first option, of the status quo, whereby it is for the Scheme Actuary to deem that the conflict is material, was not seen by respondents as being sufficient. There was widespread support for an extension of discretion to trustees to identify a conflict (Option 2), although examples were given, including corporate transactions, when trustees may not be aware of possible conflicts. The third option, that of separation in certain circumstances, was also supported at the conceptual level, but was argued to be too difficult to define.

## Review's conclusion

**5.28** The review therefore proposes that that an explicit written agreement should be entered into between the trustees, the scheme sponsor and the Scheme Actuary, when a Scheme Actuary is engaged to provide advice to both the scheme sponsor and trustees. This agreement should outline why the parties involved believe that conflicts can be managed. The review believes that this agreement should be publicly available, and possibly circulated as part of the scheme's annual report to policyholders. If such an agreement is entered into, then it is important that the parties involved are able to withdraw the moment that any one of them feels the need to do so. Given that the Scheme Actuary's client is the trustees, the trustees would have the first right to continue receiving that individual's advice and the scheme sponsor would need to secure separate actuarial advice.

**5.29** The review also believes that the Profession, or another appropriate body, should develop guidance for actuaries on the issues that they should take into account when considering the materiality of potential conflicts.

## Recommendations

The review recommends that:

- pension fund trustees, the scheme sponsor and the Scheme Actuary should explicitly agree that they perceive no material conflicts of interest prior to the Scheme Actuary advising both the trustees and the scheme sponsor;
- if any of the three parties, i.e. any one of the trustees, the Scheme Actuary or the scheme sponsor, deem at any point that a material conflict of interest has emerged, in relation to the same actuarial advisor advising both parties, then the trustees should have the option to retain the existing adviser and the sponsor should secure separate actuarial advice; and
- the Profession, or another appropriate body, should develop guidance for actuaries on the issues that they should take into account when considering the materiality of potential conflicts.

## RESERVED ROLES IN GENERAL INSURERS

**5.30** As noted in the interim assessment there are a number of drawbacks to creating reserved roles, in particular the reduction in competition that may occur. However, reserved roles bring a number of benefits in that they ensure entities take appropriate advice and give regulators a means of enforcing disclosure requirements and standards directly on individuals.<sup>6</sup>

**5.31** The review's interim assessment therefore put forward options for establishing reserved roles in general insurance:

- 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).

**5.32** The review's interim assessment outlined arguments both for and against the introduction of a reserved role in general insurance. The arguments against were:

- there are no bonuses and policyholder liabilities are not affected by investment performance – there is therefore less discretion for the management of general insurers to make significant decisions that affect policyholders than in life insurers;
- the liabilities are usually less long-term in nature than in the life or pensions areas; and

<sup>6</sup> The arguments for and against reserved roles are outlined on pages 63 and 64 of the interim assessment.

- many non-actuaries already provide advice to general insurers on risk assessment and the valuation of liabilities.

**5.33** Arguments in support of a reserved role were:

- insurers and regulators are making increasing use of actuaries and actuarial techniques; and
- the sums involved can be substantial and problems can arise at any time – the demise of a large insurer can have serious systemic effects.

## Interim assessment feedback

**5.34** Respondents to the interim assessment have argued on both sides of this issue. Those who argued in favour noted recent general insurance failures in the UK (Independent Insurance) and Australia (HIH) while others argued that it is inconsistent to have a reserved role in life insurers and not in general insurers. The ACA argued for such a role, highlighting the successful introduction of actuaries into the Lloyd's market and arguing that the use of actuaries has increased confidence in Lloyd's.

**5.35** Those against reserving a role to actuaries in general insurers argued that little of the actuarial work is exclusively the preserve of actuaries, but most is instead the product of close working between actuaries, statisticians and risk managers. There are therefore a number of non-actuaries working in general insurance who have the requisite skills – to reserve such a role exclusively to actuaries would be unnecessary.

## Review's conclusion

**5.36** In light of the above, the review believes that the FSA is right to give serious consideration to requiring general insurers to take the advice of an appropriately skilled person. Such a role would reduce the risk that firms might unknowingly run foreseeable risks that could jeopardise their financial position. Such a person should also have public interest and whistle-blowing duties imposed upon them to secure additional protection of consumers and the market.

**5.37** The review believes that such a person should have the appropriate skills to fulfil such a role, but that he or she need not necessarily be a fully-qualified actuary. The review believes that, in line with life insurers, general insurers' senior management should continue to be fully responsible for their business.

**5.38** In line with FSA standard practice, the review believes that the FSA should consider consulting on this proposal.

## Recommendation

The review recommends that:

- the FSA consider consulting on introducing a requirement for general insurers to take appropriate advice from an approved person with relevant skills in risk assessment and the valuation of liabilities, who may or may not be a Fellow of the Institute or Faculty of Actuaries.

# 6

## STANDARD-SETTING

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### INTRODUCTION

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**6.1** The setting of high quality, continuously developing actuarial professional standards has been a critical concern of this review. Currently, the Profession sets both ethical and technical standards for actuaries, which are developed by its Practice Boards:

- technical standards set out how an actuary should undertake particular tasks, rules or functions – these are currently published by the Profession as Guidance Notes (GNs);
- ethical standards set out the professional conduct expected of an actuary – these are currently published by the Profession in its Professional Conduct Standards (PCS).

**6.2** In addition, the FSA sets rules which are relevant to actuaries working for insurers; and the DWP provides guidance and legislation, and Opra provides guidance, that apply to actuaries working in the pensions field.

**6.3** A number of criticisms have been levelled at the standards set by the Profession, which were outlined in the interim assessment. These included that standards:

- have at times been weak and ambiguous;
- have failed to resolve contentious issues;
- have lacked consistency across practice areas;
- have in some cases been dominated by commercial interests; and
- that there has been insufficient independent and lay input into the standard-setting process.

**6.4** The review concluded that the Profession's approach to standard-setting through separate Practice Boards failed to ensure a coherent, consistent and comprehensive set of standards.

### INTERIM ASSESSMENT OPTIONS

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**6.5** The interim assessment outlined three options for actuarial professional standard-setting, with varying degrees of independence:

- Option 1: Actuarial Standards Board which is quasi-independent of the Profession (as per the Profession's proposal); or
- Option 2: Actuarial Standards Board 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.

**6.6** The review believes that Option 1, the Profession's proposed Actuarial Standards Board, is a significant step forward from current arrangements and could address some of the concerns that have been raised about professional standards. In particular, it could reduce the inconsistency of technical standards between different practice areas and would introduce greater lay input. The review recognises that professional standards are perceived to have been set successfully in other jurisdictions through such a mechanism. However, the review questions whether this solution can provide sufficient independence from the Profession to restore confidence in the process of setting actuarial professional standards and their content in the UK. The review is concerned that there would be insufficient oversight of the Standards Board and that major firms may be seen to enjoy undue influence in the setting of actuarial standards.

**6.7** The review's concern with Option 3 is that this would reduce the involvement of members of the Profession in the setting of technical standards, while the allocation of the standard-setting process to different regulators could result in a lack of consistency between the different practice areas of the profession.

**6.8** Option 2 has the same advantages as Option 1 in terms of continued involvement by professionals in setting the professional standards, but addresses the accountability and oversight issue by making the Actuarial Standards Board accountable to an independent oversight body. This independent oversight body could be a new entity set up specifically for the purpose, but in a small profession it seems likely that the costs of this approach may be disproportionate.

**6.9** As outlined in Chapter 3 the review believes that the Financial Reporting Council (FRC) should establish a new operating body to set actuarial standards – this has been endorsed by the Actuarial Profession, the FSA, DWP, ABI, NAPF and the Association of Consulting Actuaries. The advantages of this approach are that:

- independent oversight and accountability of the Actuarial Standards Board would be obtained without losing the professional input to the technical standard-setting process; and
- since the FRC also has responsibility for the Accounting Standards Board and the Auditing Practices Board it would be likely to lead to closer working between the actuarial and accountancy professions.

## INTERNATIONAL STANDARD-SETTING

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**6.10** The interim assessment noted that in future international actuarial standards, like international accounting standards, will play a significant role in the setting of domestic actuarial standards.<sup>1</sup> International actuarial standards are still in the very early stages of development: the International Actuarial Association (IAA) recently released its first International Actuarial Standards of Practice as exposure drafts. However, the IAA is already working closely with the International Accountancy Standards Board and other international bodies. The review believes that the IAA and other international bodies should be encouraged in their work and that the FRC and its operating bodies will be well placed to work with the Profession and supervisory authorities to promote the development and application of international actuarial standards.

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<sup>1</sup> See paragraphs 7.15 – 7.25 of the interim assessment.

## DETAILS OF ACTUARIAL STANDARD-SETTING BODY

**6.11** The review believes that a useful early step for the actuarial standard-setting body would be to set out an appropriate conceptual framework, which would include the explicit objectives and characteristics of technical standards.

**6.12** The review believes that the Actuarial Standards Board should set actuarial technical standards but that the Profession should continue to set its own ethical standards. The Profession's standard-setting process and the ethical standards themselves would then be overseen by the extended Professional Oversight Board for Accountants (POBA).

**6.13** POBA should have the power to refer serious concerns in this area to the Actuarial Standards Board. Moreover, the review believes that the Actuarial Standards Board should have the power to set ethical standards if it believes it to be appropriate, or if it feels that the Profession's ethical standards are not sufficient. It is of note that the Auditing Practices Board, an operating body of the FRC, published ethical standards for the first time in December 2004 for auditors. Previously all ethical guidance had been a matter for the accountancy professional bodies.

**6.14** It is not the purpose of this review to provide detailed suggestions or specific changes to individual standards. The review anticipates that ideas for new standards will come from interested parties, including the Actuarial Standards Board itself, members of the actuarial profession and users of actuarial advice. However, as outlined in Chapter 2, the review has significant concerns about the communication of actuarial advice and would therefore expect the Actuarial Standards Board to develop a generic standard in this area.

**6.15** The review believes that the Actuarial Standards Board should be an operating body of the FRC and should be constituted in a similar way to the FRC's other operating bodies. The review also believes that the FRC may wish to consider whether an Urgent Issues Task Force, similar to that within the Accounting Standards Board, would be an appropriate part of the new Actuarial Standards Board. As a result of the Actuarial Standards Board's inclusion within the FRC structure, the review would anticipate actuarial representation on the FRC's Board and Council.

**6.16** The review believes that the Actuarial Standards Board should contain a cross-section of parties with interests in actuarial standards, and lay members. The review therefore envisages that the Actuarial Standards Board would have a majority of actuarial members which would include UK practising actuaries, and possibly some non-practising actuaries, academic or overseas actuaries. In addition the review envisages some representation of users of actuarial advice, consumers and regulators.

**6.17** The review believes that the Accounting Standards Board provides a good model on which to base the standard-setting process of the Actuarial Standards Board. A similar model for the Actuarial Standards Board would mean that the Actuarial Standards Board would:

- draft its own standards but engage advisers/consultants where required;
- require a majority for a standard to be passed;
- have a public and written dissention process for Board members;
- publish an explanation of the rationale behind each standard; and
- provide the FRC with reports on its activities.

**6.18** The appropriate funding basis for the Actuarial Standards Board has already been discussed in Chapter 3.

## Recommendations

The review recommends that:

- the Financial Reporting Council (FRC), in consultation with the Institute and Faculty of Actuaries, should establish an Actuarial Standards Board;
- the remit of the Actuarial Standards Board should be to set technical standards, which are broadly equivalent to the Profession's existing guidance notes and largely relate to specific actuarial roles and functions;
- the Profession should continue to set ethical standards, which are broadly equivalent to the existing Professional Conduct Standards (PCS), subject to oversight by the Professional Oversight Board for Accountancy (POBA);
- the Actuarial Standards Board should have reserve power to issue ethical standards if either:
  - (i) POBA has concerns about the quality of the Profession's ethical standards; or
  - (ii) the Actuarial Standards Board believes it to be appropriate.



# 7

## THE PUBLIC INTEREST AND ACCOUNTABILITY

### INTRODUCTION

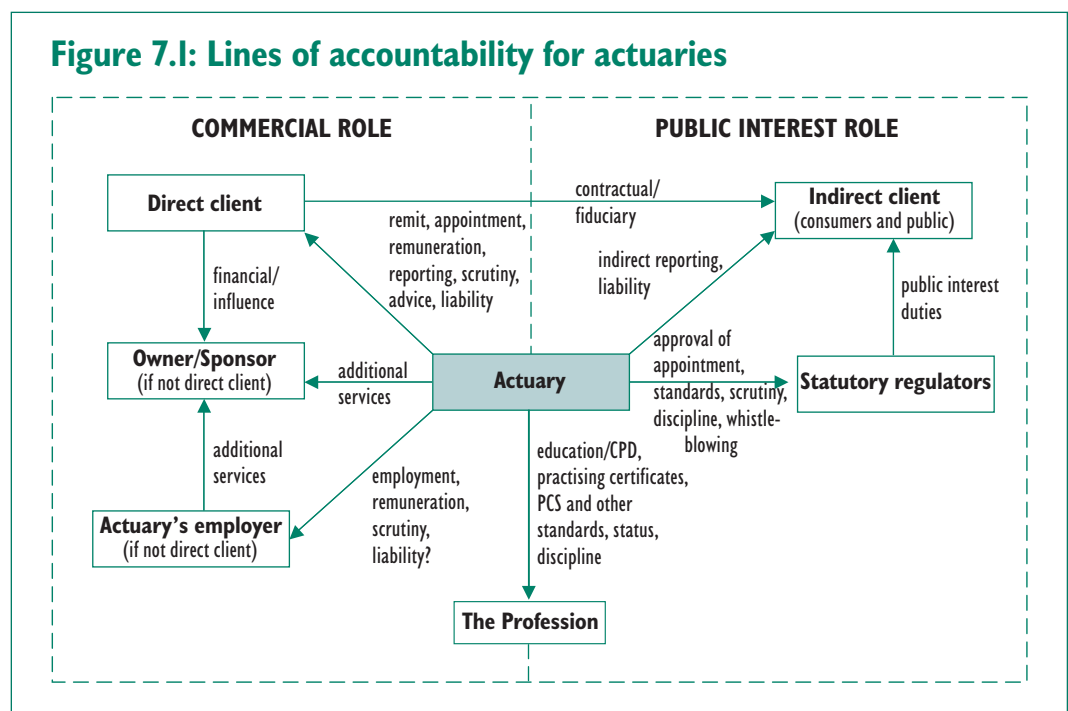
**7.1** Actuarial work inevitably impacts on the public interest. It can have very significant consequences not only for an actuary’s immediate client but also for the client’s customers, for financial conditions and stability in the economy and, more generally, for the well-being of the whole community. Actuarial professions around the world have recognised this and, to different degrees and in different ways, have a duty and an accountability to the public interest.

**7.2** Making this accountability clear, operational and effective is, however, difficult. Some have argued that it is impossible. Even if it can be given effect, it is necessary to be clear how such duties relate to other responsibilities which actuaries have. The review’s approach looks at the general structure of accountabilities and seeks to identify how, within that structure, public interest duties can best be met rather than seeking to identify an independent public interest accountability.

### ACCOUNTABILITY OF ACTUARIES

**7.3** As noted in the interim assessment, actuaries necessarily have multiple lines of accountability – every actuary, as a member of the Profession, owes a duty to the Profession, while he or she will also, at a minimum, owe a duty to his or her employer or client. If the actuary holds a reserved role then his or her lines of accountability will multiply with additional duties to the regulator and possibly to indirect clients. It is therefore inevitable given the work actuaries do and the environment within which they do it that they have multiple lines of accountability, and it is desirable that this should be explicitly recognised.

**Figure 7.1: Lines of accountability for actuaries**

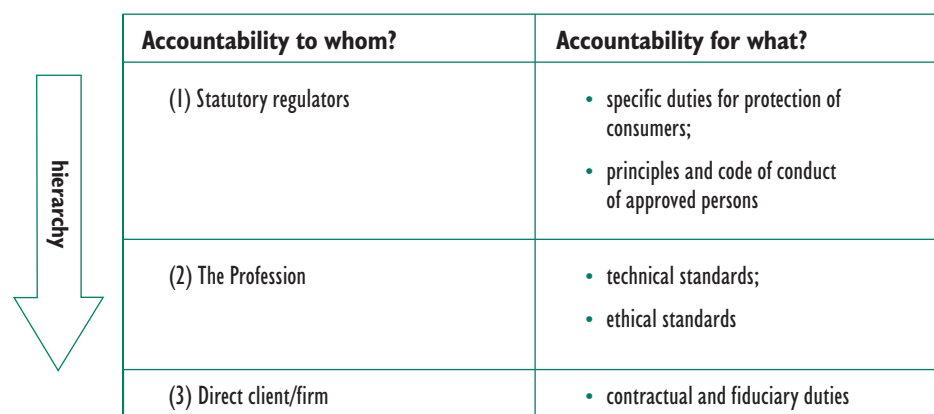


**7.4** Given the multiple lines of accountability, it is critical that these do not lead to ambiguity, confusion or inconsistency. The review proposed in the interim assessment, that:

- for each type of accountability it must be clear to whom the actuary is accountable;
- in each case it must be clear for what the actuary is accountable; and most importantly
- the hierarchy of accountabilities must be transparent, so that in any situation there is clarity as to which takes precedence.<sup>1</sup>

**7.5** In order to address these points, the review started by considering a simple overarching framework summarised in Figure 7.2. This relies on an important distinction between the actions and decisions of clients, be these companies, pension schemes or other entities on the one hand, and the advice provided by actuaries to them on the other.

**Figure 7.2: Hypothetical hierarchy of accountability**



Accountability to whom?	Accountability for what?
(1) Statutory regulators	<ul style="list-style-type: none"> <li>• specific duties for protection of consumers;</li> <li>• principles and code of conduct of approved persons</li> </ul>
(2) The Profession	<ul style="list-style-type: none"> <li>• technical standards;</li> <li>• ethical standards</li> </ul>
(3) Direct client/firm	<ul style="list-style-type: none"> <li>• contractual and fiduciary duties</li> </ul>

### Accountability to regulators

**7.6** The review endorses the view of the FSA that responsibility for the actions of firms must lie with their senior management. Equally, responsibility for the actions of pension schemes must be with their trustees or sponsoring firms, depending on the way the scheme has been established. It is the actions of these entities which are normally overseen by regulators through their rules and guidance, while regulators have statutory backing to intervene in entities' affairs to protect the public interest. One important way, therefore, in which actuaries can help protect the public interest is via duties to make known to the appropriate regulator matters which are relevant to the regulator's functions in protecting the public interest. Given the statutory backing involved, this type of duty and the accompanying accountability should, the review believes, take precedence over any other types of accountability.

<sup>1</sup> The elements of accountability to stakeholders were set out on page 81 of the interim assessment and included: appointment, remuneration, duties, scrutiny, and liability. This chapter focuses on duties to the public interest, regulators and the Profession; Chapter 5 focuses on specific duties, appointment and remuneration; and Chapter 8 focuses on scrutiny and liability.

**Accountability to the Profession** 7.7 A second level of duty is to the Profession. This relates to the conduct of actuaries themselves in giving advice, and is therefore concerned with identifying breaches of technical or ethical standards. As is explored further below, there are significant difficulties in devising clear, unambiguous and effective means of framing such a regime, but in principle this should constitute a second tier of accountability.

7.8 If these first two levels of accountability can be specified sufficiently precisely then they should take precedence over actuaries' contractual obligations to clients and employers.

7.9 In light of this framework the next section examines how actuaries should address public interest duties in relation to matters that are likely to be of concern to regulators, such as breaches of rules. The subsequent section looks at how public interest duties in relation to breaches of professional standards, both technical and ethical, can best be handled.

## Recommendations

To protect the public interest, actuaries have public interest obligations and duties. These include:

- duties to whistle-blow and report to the statutory regulators in specific circumstances; and
- duties to comply with professional standards – both ethical and technical standards.

The review makes a number of recommendations in relation to reporting and whistle-blowing below and makes a number of recommendations in Chapter 8 to ensure that there is compliance with technical and ethical standards.

## REPORTING AND WHISTLE-BLOWING TO REGULATORS

### Introduction

7.10 As mentioned earlier in this chapter, an important way in which actuaries can protect the public interest is by reporting when they find that things are going or have gone wrong. These reports – commonly known as 'whistle-blowing' – can alert key stakeholders, the appropriate authorities, the public or the Profession to the situation and enable them to take appropriate action. This section focuses on whistle-blowing to regulators, but the principles examined apply to whistle-blowing generally.

7.11 All actuaries have an incentive to whistle-blow if they think they will be held responsible for failing to do so. However, they also face obstacles: duties of confidentiality to their client and to third parties; concern about damage to their relationship with their client or with their employer; and concern about damage to their reputation with their peers and colleagues, their prospective clients and prospective employers.

**7.12** Imposing whistle-blowing duties on actuaries in particular circumstances removes some of the associated drawbacks, as do routine reporting requirements such as annual returns, and statutory relief from duties of confidentiality.<sup>2</sup> On the other hand, imposing too many reporting duties on actuaries undermines their commercial usefulness to their clients, can leave them isolated, and can undermine the reporting responsibilities of senior management and trustees.

**7.13** The Public Interest Disclosure Act 1998 protects whistle-blowers generally, not just actuaries. It gives protections from detrimental treatment, unfair dismissal, or action for breach of contract for any worker who discloses information which he reasonably believes indicates there has been or may be a criminal offence, breach of a legal duty, or other specified matters.<sup>3</sup> The Act protects disclosures to the worker's employer, his or her legal adviser, a prescribed person (including both the FSA and Opra), or to any other person if the worker is acting in good faith and not for personal gain, and the disclosure is reasonable in all the circumstances of the case.

**7.14** Although there are considerable safeguards for actuaries who whistle-blow, the interim assessment found there was still doubt among many actuaries about the circumstances in which whistle-blowing may, or should, occur. This is partly because of a lack of adequate guidance and partly because of inconsistency in the way whistle-blowing obligations and protections are expressed for actuaries performing different functions in similar situations.

## Options in the interim assessment

**7.15** The interim assessment put forward three options for clarifying the circumstances in which actuaries may or must disclose information to regulators:

- 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 (i.e. when acting in good faith) from actions in defamation.

<sup>2</sup> The regulatory duties on actuaries, as well as the statutory provisions overriding other duties, were summarised in paragraphs 5.7-5.16 of the interim assessment.

<sup>3</sup> Breach of a legal duty would include a breach of a regulator's rules. Other specified matters include miscarriages of justice, health and safety or environmental concerns, and concealment of information relating to such matters.

## Interim assessment feedback

**7.16** With respect to Option 1, most respondents agreed that whistle-blowing guidance and indeed requirements could be clearer, particularly in financial services, and that this would encourage whistle-blowers to make disclosures. Several respondents warned against being too prescriptive, and cited the latest more high-level Opra guidance with approval. The Institute of Chartered Accountants in England and Wales commended the guidance for auditors. The review urges the relevant bodies to work together to establish legislation, rules and guidance that provide a clear, consistent and conducive regime for appropriate whistle-blowing.

**7.17** Option 2 (clarifying whistle-blowing duties in legislation) was broadly supported, although a few respondents pointed out that the current obligations for whistle-blowing to the FSA had been made in 2003, and argued that they should be given time to settle. The review accepts that it is too soon to review the substance of the individual duties for whistle-blowing by actuaries. However, for duties to be enforceable, they need to be expressed in objective terms, such as whether the actuary had ‘reasonable cause to believe’ that a prescribed reporting condition applies. This is the formulation used to specify whistle-blowing duties to Opra. In contrast, the current trigger for whistle-blowing duties to the FSA is what the actuary ‘reasonably believes’, which is harder to enforce because it cannot easily be proved what the actuary believed.

**7.18** Option 3 (bringing whistle-blowing requirements for auditors and all actuaries more closely into line, and extending protections for whistle-blowers) was supported by the majority of respondents. Currently, whistle-blowing requirements for auditors of insurers are not directly triggered by long-term insolvency concerns or failures to take proper account of the interests of policyholders, while those for their actuarial counterparts are. However, under the FSA’s reforms, the Reviewing Actuary and the auditor are much more likely to become aware of such concerns. It is of note that whistle-blowing duties in these areas would still not require anyone to report matters they are unaware of, or have no reasonable cause to believe are a problem. Those that expressed concerns about this option, which included firms working in the pensions industry felt that consistency should not be an end in itself and that the work of actuaries and accountants is too different for them to have common triggers for whistle-blowing. However, the majority including several multidisciplinary firms argued in favour of greater consistency. The review believes that, where appropriate, auditors’ and actuaries’ duties to whistle-blow should be brought more closely into line.

**7.19** Furthermore, some actuaries who perform regulatory roles may not have sufficient protection for when they whistle-blow: these include Reviewing Actuaries themselves (when not acting through the auditor), syndicate actuaries, skilled persons appointed to report on insurance scheme transfers under section 109 of the Financial Services and Markets Act 2000 (FSMA) or under friendly societies legislation, reporting actuaries and funeral plan actuaries.<sup>4</sup> Consideration should then be given by regulators or by the FRC as to whether whistle-blowing duties should be imposed on these individuals and their employers.

<sup>4</sup> Funeral plan actuaries are actuaries appointed to perform the function in article 60(1) (b)(v) of the Regulated Activities Order (SI 2001/544) in respect of an exempt (or purportedly exempt) trust-based funeral plan. The reporting actuary appointed under paragraph 46(3) of Schedule 9A to the Companies Act 1985 may (if acting for an authorised person) already fall within the scope of the protections in sections 342 and 343 of FSMA. Other persons would have to be prescribed in regulations under section 353.

**7.20** The review believes that there is more that can be done to protect whistle-blowers. Whistle-blowing is a critical component of the current regulatory regime and can play a vital part in meeting regulators' objectives to serve the public interest. The review therefore believes that further consideration should be given to the appropriate protections, for example through supplementing the existing relief from duties of confidentiality with statutory provisions conferring qualified privilege (i.e. when acting in good faith) from actions in defamation.

## Recommendations

The review recommends that:

- the Financial Services Authority (FSA), the Pensions Regulator, and the Profession should work together and issue clearer guidance 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;
- the Government consider re-expressing whistle-blowing obligations on actuaries appointed to perform regulatory functions for FSA-authorized firms in terms of prescribed matters which an actuary has 'reasonable cause to believe' (as is already the case for Scheme Actuaries), rather than the current less enforceable formulation 'reasonably believes';
- the Government consider extending whistle-blowing obligations on auditors of insurers to include the circumstances which must be reported on by actuaries (including syndicate auditors and actuaries if the FSA introduces a statutory role in general insurance);
- the Government consider extending whistle-blowing duties and protections for disclosures to the FSA by other actuaries performing or supporting statutory or regulatory roles, such as the Reviewing Actuary, syndicate actuaries, reporting actuaries, funeral plan actuaries and skilled persons appointed to report on an insurance business transfer;
- in the longer term, the Government consider whether any additional protections can be given to whistle-blowers generally, e.g. supplementing the existing relief from duties of confidentiality with statutory provisions conferring qualified privilege (i.e. when acting in good faith) from actions in defamation.

## REPORTING TO THE PROFESSION

### Interim assessment feedback

#### A public interest duty for actuaries

**7.21** The interim assessment highlighted the issue of whether actuaries have a broad public interest duty, which should go beyond the Profession's current requirements, and 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.<sup>5</sup>

**7.22** The review believes, and no respondents argued otherwise, that those actuaries who hold reserved roles do serve the public interest through their explicit duties to statutory regulators, which in turn have explicit duties to protect policyholders and scheme members.

<sup>5</sup> See Chapter 5 paragraph 66 of the interim assessment.

**7.23** The concern is therefore those actuaries in non-reserved roles. Respondents in general did not support such a broad duty to the public interest. Many respondents argued that the concept of the ‘public interest’ is too amorphous and that for such a duty to be practical, it would need an explicit expression of what the duty is and when it applies. The Profession argued that any articulation of the public interest should refer only to the specific policyholders or scheme members in question. The Profession also argued that actuaries’ clients should normally be able to obtain advice concerning their own interests without having to pay for additional advice which reflects the interests of other parties.

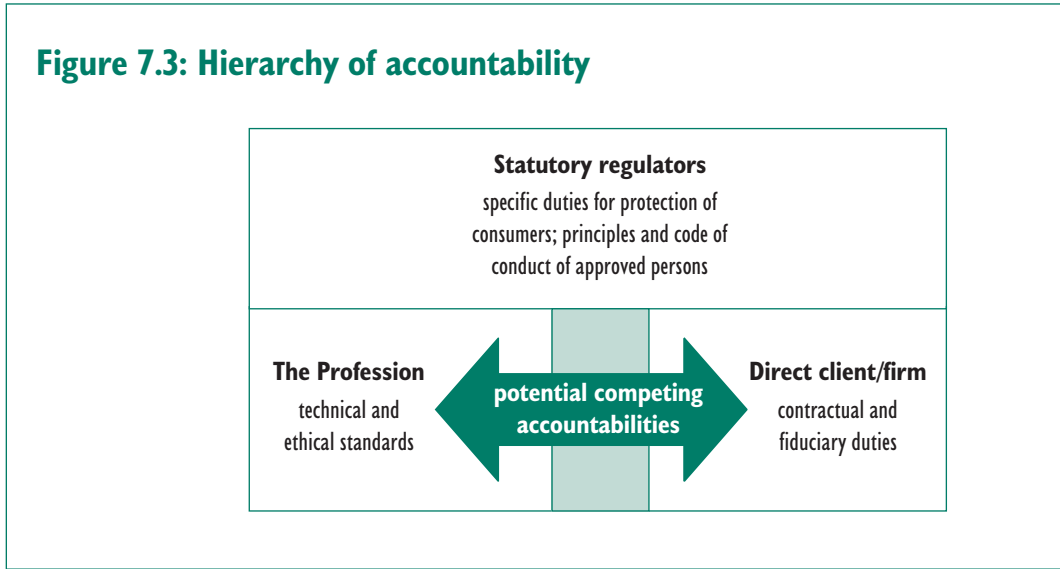
**7.24** The review accepts that the mere stipulation of an overriding public interest duty cannot, by itself, provide a robust or effective basis for ensuring that the interests of the public in actuarial matters are properly served. The case for such a duty therefore depends on whether an effective public interest accountability framework can be established, primarily through clear specification of the circumstances in which reporting to the Profession is required.

**Reporting professional misconduct**

**7.25** The Profession can receive reports of professional misconduct by actuaries from a wide range of sources: a dissatisfied client or employer may have concerns about the actuary’s conduct, as may policyholders or scheme members, statutory regulators, or another actuary. However, as noted in Chapter 2, an actuary’s client may not be in a position to assess the quality of an actuary’s work, and, furthermore, reporting duties are currently imposed only on actuaries.

**7.26** Under the Profession’s Professional Conduct Standards (PCS) an actuary must report on a breach of guidance by another member.<sup>6</sup> However, the PCS also emphasises that this duty to the Profession is subject to confidentiality restrictions as a matter of law.<sup>7</sup> Therefore, where there may currently be a contradiction between the Profession’s and a client’s requirements, the actuary may not be able to report or consult on a matter with the Profession.

**7.27** This is a significant constraint on the ability of the Profession to ensure that standards are being followed and also on individual actuaries in their desire to bring appropriate matters to its attention. In practice the hierarchy of duties is not as in Figure 7.2 but as in Figure 7.3.



<sup>6</sup> Professional Conduct Standards section 4.4

<sup>7</sup> Professional Conduct Standards section 2.5

**Confidentiality waivers** **7.28** A suggestion put forward by some respondents to the review has been to prohibit the creation of such duties of confidentiality to actuaries' clients – this would require all actuaries to insert a confidentiality waiver into their contracts so that any relevant information could be passed to the Profession.

**7.29** However, the review has been given a number of examples where this would not be appropriate, for example in takeover advice and advice to regulators, while it has been pointed out that such a blanket rule for actuaries could possibly contravene the Competition Act 1998 as it could distort competition between actuaries and non-actuaries. More generally, the Profession was particularly concerned over the behavioural implications of such a rule, arguing that non-reserved role holding actuaries might well reconsider their membership of the Profession if such a rule left their clients without access to confidential advice and themselves therefore at a commercial disadvantage. The review accepts that some actuaries might find it to their benefit to leave the Institute or Faculty in order to offer purely confidential advice, with no risk to the client of their confidentiality being breached.

**7.30** The review understands that the Profession considered this issue about five years ago, and, like actuarial professions in other jurisdictions and other professions for example accountancy, concluded that such waivers would not be appropriate. Although there is a public interest in the Profession maintaining high technical and ethical standards among its members, there is a clear difficulty in removing from commercial enterprises any assurance that their advisors are acting on a confidential basis. There are also problems in imposing burdens on the way actuaries compete with non-actuaries in providing commercial enterprises with their services.

## Review's conclusions

**7.31** If it is right, as the review accepts, that reporting duties to the Profession cannot override duties of confidentiality to the client, then the current framework for reporting to the Profession is not sufficient to establish an effective public interest accountability mechanism. The review does not therefore recommend an overriding public interest duty for actuaries. If there is a need for wider public interest duties in certain areas, because it is felt that these roles (though not reserved) are critical to the economic well-being of the community, then the review believes that duties should be placed on particular role-holders and entities rather than on actuaries alone.

**A framework for reporting and scrutiny of standards** **7.32** Actuaries play an important role in protecting the public interest through the reporting and whistle-blowing duties to regulators described above. Beyond that, the review believes that actuaries can and should continue to serve the public interest through compliance with ethical and technical standards. For example, the Profession says its standards are “intended for the protection of the public rather than for the protection of members of the actuarial profession”, with compliance against most standards being mandatory.<sup>8</sup> The mechanism to ensure that these standards are of a high quality has been discussed in Chapter 6. There also needs to be a mechanism for ensuring compliance with those standards.

**7.33** Given the confidentiality limitations on reporting to the Profession, the review believes that the most effective means of ensuring compliance with professional standards is by requiring independent external scrutiny of actuarial advice, through increased regulatory supervision, peer review or audit. This significantly reduces the problems arising from confidentiality restrictions. This enhanced scrutiny and the new role of the Financial

<sup>8</sup> Due Process for Approving Professional Guidance, published by the Profession February 2005.



Reporting Council (FRC) are discussed in detail in Chapter 8. The mechanisms described in Chapter 8 are designed to ensure that any suspected non-compliance with standards will be reported to either the Profession or the regulators.

**7.34** To oversee an effective framework for reporting and scrutiny of compliance with professional standards, the FRC will need to co-operate closely with the statutory regulators and the Profession, including sharing information they receive through supervision, investigations and whistle-blowing. To support this work, the review believes that the Government should either ensure appropriate gateways between the current statutory regulators, the FSA and the Pensions Regulator, and the FRC, or consider giving the FRC powers to confer whistle-blowing duties on actuaries in specified roles. The review also believes that the FRC should be designated as a prescribed person under the Public Interest Disclosure Act 1998 so as to encourage whistle-blowers to report apparent misconduct by actuaries. The FRC would need to be able to pass any information to the Profession, in order that an investigation of the apparent misconduct could be undertaken.

## Recommendations

The review believes that the public interest will be served through actuaries' compliance with high-quality professional standards, and that this can best be ensured through enhanced scrutiny supported by reporting and whistle-blowing to statutory regulators, the Financial Reporting Council (FRC) and the Profession.

In order to ensure that information is shared between the existing statutory regulators, members of the actuarial profession and the FRC the review recommends that:

- the Government should ensure there are appropriate gateways between the FSA and the Pensions Regulator, and the FRC; or consider giving the FRC powers to confer whistle-blowing duties on actuaries in specified roles;
- the Government should consider designating the FRC as a prescribed person under the Public Interest Disclosure Act 1998; and
- the Government should ensure there are appropriate gateways and reliefs from duties of confidentiality for communications between the FRC, statutory regulators and the Profession.



# 8

## SCRUTINY AND DISCIPLINE

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### INTRODUCTION

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**8.1** High-quality actuarial advice is critical to the sound management of insurers and pension schemes. To ensure that advice is of a high-quality, the Profession:

- seeks to set high entry standards through its exams;
- ensures that reserved role holders undertake continuing professional development (CPD); and
- sets Professional Conduct Standards.

**8.2** Between them, the Profession and statutory regulators:

- set technical standards; and
- determine the qualifications for actuaries to be reserved role holders.

**8.3** As the review concluded in Chapter 2, it is also necessary to have on-going assurance of quality, which may be provided by:

- informed clients and consumers;
- choice and market testing; and
- ex-ante or ex-post scrutiny.

The first two, which have been covered in Chapter 2 on the market for actuarial services, are important but face some obstacles, and cannot therefore be relied on to be sufficient. Ex-ante or ex-post scrutiny of actuarial advice is therefore crucial.

**8.4** Historically, however, the work of actuaries has rarely been scrutinised, whether through audit, external peer review or professional monitoring, and until December 2004 there were no formal scrutiny roles in the routine regulation of actuaries working in life insurance, general insurance or in pensions. The Reviewing Actuary, who from December 2004 is required by FSA rules to advise the auditor of a life insurer, is the first such role.

### The need for scrutiny of actuarial advice

**8.5** The lack of scrutiny of the work of Appointed Actuaries was a critical concern raised by Lord Penrose in his Report of the Equitable Life Inquiry.<sup>1</sup> This lack of scrutiny is partly as a result of:

- the complexity of the work of actuaries;
- the specialist nature of the actuarial profession;
- the existence of reserved roles; and
- the emergence of professional norms which discouraged critical assessment of one actuary by another.

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<sup>1</sup> Source: Report on the Equitable Life Inquiry, The Right Honourable Lord Penrose, March 2004.

**8.6** The review recognises that some firms have had internal peer review processes. However, there is a clear need for systematic and independent scrutiny of the work of actuaries performing reserved roles, particularly in light of the lack of expertise of users and the limited exercise of choice.

**8.7** Firms, institutional users, consumer groups and individual respondents to the review's initial consultation all supported an expansion and formalisation of the scrutiny of the work of actuaries. However, the need for an analysis of the costs and benefits associated with enhanced scrutiny was recognised by many respondents.

**8.8** The issues raised by respondents were therefore less about whether scrutiny should occur, but what its exact nature, extent and frequency should be. There was particular concern that there should be clarity as to:

- who should provide scrutiny; and
- what should be scrutinised.

## Forms of scrutiny

**8.9** The following main forms of scrutiny are, or could be, available in relation to advice by actuaries:

- challenge by board members and senior management of firms who have the responsibility for taking decisions in relation to actuarial issues;
- challenge by trustees and other users who receive or rely on actuarial advice, including policyholders and scheme members;
- supervision by or on behalf of regulators and professional bodies;
- review by another actuary, either informally by a colleague or line manager, or more formally as peer review – peer review is usually given privately for the benefit of the actuary, his client, the regulator or the Profession, and may occur before or after the advice is given;
- independent audit by another professional, for example as part of the audit of financial statements or as part of a due diligence exercise – an audit opinion is usually published or otherwise made available for the benefit of stakeholders such as investors, policyholders or scheme members;
- judicial inquiries (e.g. litigation, business transfers or insolvency), complaints arrangements, independent reviews and public comment, for example in the press, or by academics, consumer or trade bodies.

**8.10** The first two of these have been examined in Chapter 2 on the market for actuarial services. This chapter focuses mainly on the next four forms of scrutiny: supervision; review; independent audit; and judicial inquiries and public comment. Each of these is dealt with below before supervision, review and independent audit are dealt with in more detail for each of the three main areas in which actuaries currently work: life insurance, pensions and general insurance. The chapter concludes by making recommendations for the Profession's disciplinary procedures.

**Supervision by the statutory regulators** **8.11** It is important to note that the majority of actuaries work for, or advise, insurers and pension schemes. Both insurers and pension schemes are regulated entities. The Financial Services Authority (FSA) regulates insurers and occupational pension schemes are regulated by the current pensions regulator – the Occupational Pensions Regulatory Authority (Opra). The Pensions Regulator (TPR) will replace Opra under the Pensions Act 2004.

**8.12** The two statutory regulators therefore play an important role in scrutinising the work of actuaries, and in some instances they may provide an alternative to expert scrutiny via audit or peer review. Because of the scale and range of their responsibilities (e.g. the large number and widely varying size of firms and schemes subject to regulation) both regulators operate a risk-based supervisory regime. Supervisory resources are allocated to firms and issues which present the greatest risk to the achievement of regulatory objectives, taking into account the likely impact if a risk materialises.

**8.13** The FSA currently employs 16 life and 10 general insurance actuaries (including trainees) to support the work of its insurance supervisors. Regulated insurance firms are required to submit returns to the FSA, which are examined by actuaries and supervisors, taking into account the risk-based overall approach. In addition, the FSA's supervisors and supporting actuaries undertake regular risk assessments of all but the smallest insurance firms. These include visits to the insurance companies' offices and cover actuarial issues. These reviews are carried out annually for the largest firms and between once a year and every three years for others depending on the risks identified. Respondents to the review's initial consultation were supportive of the FSA's use of actuaries, although concerns were expressed that the FSA needs more actuarial expertise, particularly as it now sets more rules which incorporate actuarial matters, which can have powerful effects on the financial performance of insurers, and because there are few actuaries in senior positions within the FSA.

**8.14** Opra currently employs three actuaries, two of whom are on secondment from the Government Actuary's Department (GAD), with recourse to further GAD resources which Opra may call upon as required. Under the Pensions Act 1995, pension schemes are not required to submit financial returns to Opra although Opra may request them if it sees fit. Under the Pensions Act 2004 this will change and TPR will receive membership and valuation information from most of the UK's pensions schemes. TPR has yet to determine how many actuaries it is going to employ and the extent of scrutiny it will afford to pension schemes.

**Supervision by the Profession** **8.15** The Profession has no formal body providing pro-active monitoring of whether its members are complying with professional standards. If a complaint is made against an actuary then the Profession has a disciplinary scheme which was described in the interim assessment. Lord Penrose argued that relying on a disciplinary process triggered by complaints is inappropriate in a market where products and advice are long-term in nature and where users of actuarial services have substantially less information than advisers.

**8.16** The Profession has argued that, should a body be set up to proactively monitor the work of actuaries, the body should monitor actuarial firms, rather than individuals, although it should be noted that currently the Profession can only discipline individuals. The Profession has also put forward peer review proposals within the last year in both the life and pension area which are described further below.

**Supervision within the accountancy profession** **8.17** It is of note that the monitoring of compliance with professional standards within the accountancy profession is undertaken by the Audit Inspection Unit which is part of the Professional Oversight Board for Accountancy (POBA) an operating body for the Financial Reporting Council (FRC), and by the accountancy professional bodies themselves.

**8.18** The Audit Inspection Unit (AIU) monitors the audits of “those entities whose activities have the greatest potential to impact on financial and economic stability”.<sup>2</sup> The audits to be reviewed are selected using risk-based approach and to provide coverage across the audit firms.

**8.19** In addition, within a framework laid down by the Financial Services Authority and the Department of Trade and Industry, the Institute of Chartered Accountants for England & Wales (ICAEW) has a Professional Standards Group that is responsible for maintaining the reputation of the accountancy profession by ensuring that members of the ICAEW have the highest standards of integrity and professional competence.

**8.20** Within the Professional Standards group of the ICEAW there are two independent Directorates:

- Quality Assurance Directorate (QAD) – responsible for carrying out monitoring visits to firms registered with the Institute for audit and/or investment business. In broad terms, it assists firms in ensuring they maintain high standards and quality work, in a world where quality assurance is becoming increasingly important; and
- Professional Conduct Directorate (PCD) – responsible for carrying out the Institute’s quasi-judicial disciplinary responsibilities and for disciplining members or firms whose professional standards have fallen below the reasonable expectations of the public or other members.

**8.21** It should be noted that accountants are less likely to be working for, or advising, regulated entities than actuaries. Therefore, it is perhaps to be expected, that the accountancy profession takes a more pro-active role in monitoring its members’ and member firms’ compliance with professional standards in relation to audit. Nevertheless, it is of note that the Quality Assurance Directorate of the ICAEW is responsible for carrying out monitoring visits to firms registered with the Institute for audit and investment business.

**Review and independent audit** **8.22** Apart from direct supervision by the statutory regulators or the Profession, peer review and audit are the two main mechanisms for ensuring direct expert scrutiny of the work of actuaries. Peer review and audit are to some extent alternatives, and if they are both used there is an issue about potential duplication.

**8.23** Audit requirements are concerned primarily with material items and disclosures in financial statements. Auditors are required to be independent of those they are auditing and their opinion is disclosed to the public and to stakeholders.

**8.24** Peer review, on the other hand, is generally a commercial or professional matter and is usually concerned with adherence to professional standards – that is both technical and ethical standards. A peer reviewer may or may not be from a different firm than the person being reviewed, depending on the standard, and the process is generally private between the peer reviewer and the professional being reviewed. However, for a formal peer review requirement to be effective, there needs to be scope for the peer reviewer to report non-compliance to the Profession or the regulators.

<sup>2</sup> Source: Review of the Regulatory Regime of the Accountancy Profession Report to the Secretary of State for Trade and Industry, January 2003.

**8.25** The depth of an audit or peer review could vary depending upon the level of scrutiny required. For example, it could include one, some or all of the below:

- checking the appropriateness of due process;
- checking of calculations;
- assessing compliance with statutory requirements;
- assessing compliance with the Profession's standards; and
- assessing the reasonableness of assumptions and methodologies.

**8.26** It is however, important that any proposals for audit and peer review take into account regulators' supervisory functions when determining the suitable proportionate response to concerns that have been raised.

**Judicial inquiries and public comment** **8.27** Historically, courts and judicial inquiries have been reluctant to question an actuary's judgment. However, this is changing. Major recent examples have been Lord Penrose's Report and the House of Lords judgment in the case of *Hyman v Equitable Life* that preceded it. The use of actuaries in contractual terms and trust deeds is likely to increase the exposure of actuaries to judicial inquiries in future, for example through review by ombudsmen.

**8.28** Public comment on the work of actuaries is restricted because of the complexity of actuarial concepts. Comment therefore tends to be second-hand, for example through press comment on a court decision. An extension of university-based teaching might encourage more informed comment and analysis of actuaries' work, as noted in Chapter 4.

## Interim assessment

**8.29** The interim assessment recognised that many firms already have significant internal peer review processes in place and that these play a significant role in ensuring the provision of high-quality advice. However, the review believes that there is a clear need for formal, systematic and independent scrutiny of the work of actuaries performing reserved roles given:

- the complex nature of actuarial advice;
- the general lack of challenge provided by users of actuarial advice, particularly in light of the lack of expertise of users and the limited exercise of choice; and
- the importance of the work undertaken by actuaries, particularly those in reserved roles.

**8.30** This need for formal scrutiny has been recognised in the life insurance and pensions areas since December 2004. The FSA has extended the scope of audit to include long-term liabilities and has introduced the role of Reviewing Actuary, who under FSA rules advises the auditor of a life insurer; and for pensions the Profession has introduced the role of peer reviewer for Scheme Actuaries. The concern of the review is now therefore not so much whether scrutiny should be introduced, but the manner and extent of such scrutiny. However, the timing of the review in this regard is awkward – it is too early to assess the impact, effectiveness and adequacy of the new regimes.

**8.31** Scrutiny and disciplinary procedures can only be fully effective if there are clear and accepted standards to act as a benchmark. Going forward, the review envisages that the Actuarial Standards Board, a new operating body of the FRC, will have responsibility for setting technical standards, and that the Profession will retain responsibility for the setting of ethical standards subject to oversight by POBA. The review believes that this will provide a robust standard-setting framework that should ensure that standards are set which protect the public interest. However, as the review concluded in Chapter 7, the protection of the public interest will only occur if the actuarial profession adheres to those standards, and can demonstrate that adherence to the FRC and to the wider public.

**8.32** The review therefore believes it is essential that there is a robust and comprehensive framework for the monitoring of actuaries' compliance with professional standards – both technical and ethical. This is essential because, as set out in Chapter 7, the public interest can best be served by ensuring that high-quality, technical and ethical standards are set and that these standards are adhered to by the Profession's membership. The exact nature of the monitoring mechanisms should, however, take account of the existence of the two statutory regulators and the reporting and regulatory requirements that they place upon actuaries to ensure that the overall framework is proportionate.

## SCRUTINY OF ACTUARIES IN LIFE INSURANCE

### Audit

**8.33** Life insurers produce two sets of accounts: Companies Act accounts and regulatory returns to the FSA.<sup>3</sup> Companies Act accounts are primarily concerned with the financial performance and condition of reporting entities, while regulatory returns have historically been primarily concerned with solvency. The reporting requirements are therefore different for Companies Act accounts and regulatory returns.

### Companies act accounts

**8.34** The Companies Act accounts of life insurers are fully audited, although modifications to the usual statutory requirements mean that they contain only limited disclosures about long-term liabilities. Some listed insurers augment these disclosures by publishing additional information about the value of their life business, for example about embedded values.<sup>4</sup>

**8.35** The Companies Act 1985 requires an actuary, the Reporting Actuary, to compute the insurer's long-term liabilities that are presented in its accounts.<sup>5,6</sup> Auditors are not required to take any actuarial advice when auditing the long-term liabilities, although in practice they nearly always do so.

<sup>3</sup> There are separate reporting requirements for friendly societies under friendly societies legislation.

<sup>4</sup> The definition of embedded value is: shareholders' interest in the net assets plus the value (to shareholders) of the in-force life business less the cost of solvency capital.

<sup>5</sup> Source: Companies Act, schedule 9(a), paragraph 46, 1985.

<sup>6</sup> The Reporting Actuary will typically also be the Appointed Actuary.



**8.36** There have been recent changes to Companies Act accounts: the Accounting Standards Board has published Financial Reporting Standard (FRS) 27 which will require the realistic value of liabilities to be incorporated into financial statements from December 2005.<sup>7</sup> The actuarial work carried out as part of the audit is in turn subject to potential review by the Audit Inspection Unit or by the accountancy profession's own monitoring bodies.

## Regulatory returns

**8.37** Prior to December 2004 there was no statutory requirement that the long-term policyholder liabilities within regulated returns should be audited. These were instead certified by the Appointed Actuary.

**8.38** However, in response to a number of problems with the Appointed Actuary role, the FSA has made substantial changes to its regime. FSA rules which came into force on 31 December 2004:

- bring long-term liabilities within the scope of audit;
- require realistic reporting of long-term liabilities; and
- require each life insurer's auditor to engage a Reviewing Actuary who is independent of the life insurer.

### Role of the Reviewing Actuary

**8.39** The role of the Reviewing Actuary has been set out in the FSA's feedback text, which states that:<sup>8</sup>

- the Reviewing Actuary will report directly and privately to the auditor;
- the Reviewing Actuary will give his or her view of the reasonableness of the valuation of liabilities by the firm, the methods used, and the economic, market and actuarial assumptions on which the calculations are based; and
- the audit report will explicitly state that the auditor has been advised by a suitably experienced and qualified actuary, and that all relevant associated professional guidelines have been complied with.

**8.40** The audit of the regulatory return will therefore encompass a review of those aspects of the actuarial investigation that give rise to disclosures in the main reporting forms and the valuation reports. Such an audit will indirectly monitor compliance with actuarial standards, since the auditor, on the advice of the Reviewing Actuary, will report on whether the information in the returns, and the methods and the assumptions adopted for the actuarial investigation reported within those returns, properly reflect the FSA rules and guidance, which in turn requires compliance with "generally accepted actuarial best practice." Chapter 4 of the FSA's Supervision Manual states that the Profession's standards and guidance are important sources of actuarial best practice.<sup>9</sup> Therefore, although the purpose of the Reviewing Actuary role is not specifically to review the work of the Actuarial Function Holder, the role is likely to involve consideration of whether the Actuarial Function Holder has complied with relevant actuarial standards.<sup>10</sup>

<sup>7</sup> The ASB published FRS 27 in December 2004. The accounting practices set out in the FRS shall be regarded as standard for financial statements relating to accounting periods ending on or after 23 December 2005, subject to paragraphs 62 and 63 of the FRS. See [www.frc.org.uk](http://www.frc.org.uk) for further details.

<sup>8</sup> Interim Prudential Sourcebook, Chapter 9.

<sup>9</sup> Source: Supervision Manual Chapter 4 (Actuaries) Rule 3.21

<sup>10</sup> The governing body of the insurer is ultimately responsible for its regulatory returns, which are required by FSA rules to be prepared having regard to generally accepted actuarial best practice. The long-term liabilities are calculated by the Actuarial Function Holder, using methods and assumptions on which he has advised.

**8.41** The Auditing Practices Board’s guidance ensures that auditors are clear about their, and their Reviewing Actuaries’, duties to review compliance with actuarial standards: “...the reviewing actuary will perform their work having due regard to relevant guidance issued by the Faculty and Institute of Actuaries and will notify the auditor immediately he becomes aware of any matters that may indicate non-compliance with the guidance”.<sup>11</sup>

**8.42** The “relevant guidance” to which this refers includes actuarial Guidance Note 42: the Reviewing Actuary and any other guidance issued by the Faculty and Institute of Actuaries that is relevant to the work of the Reviewing Actuary. This implies that the Reviewing Actuary is not performing a comprehensive check that these role-holders have complied with all of the Profession’s guidance notes but is likely to review the Actuarial Function Holder’s and With-Profits Actuary’s compliance with relevant actuarial guidance notes.

**8.43** In future the review envisages that the reference to “guidance notes” would instead refer to actuarial standards as issued by the Actuarial Standards Board and ethical standards issued by the Profession under the oversight of POBA.

## Peer review

**8.44** In parallel with the development of the FSA’s reforms of the Appointed Actuary regime, the Profession consulted on proposals for an external peer reviewer role in October 2004.<sup>12</sup> The stated purpose of the peer review was to ensure that actuaries carrying out ‘reserved activities’ were complying with relevant legal and regulatory requirements and mandatory actuarial guidance, while also introducing a degree of external challenge to reduce the risk of ‘house views’ developing over time without adequate critical review.

**8.45** The Profession envisaged that the peer reviewer would:

- report to the member or body requesting the peer review, which is envisaged to be the Board of the insurer, on all advice, investigations and reports required from the Actuarial Function Holder and With-Profits Actuary by FSA rules; and
- provide an annual sign-off, though in practice it was expected that much of the work will be carried out throughout the year.

**8.46** The peer reviewer would not be asked to agree with the reserved-role holder, but would confirm that the chosen advice was in accordance with FSA rules and mandatory actuarial guidance. If after discussion with the role-holder the Peer Reviewer was unable to confirm that the chosen course of action met FSA rules and actuarial guidance, this would be reported to the Board of the insurer. To facilitate the work of the peer reviewer, Actuarial Function Holders and With-Profits Actuaries would not be able to provide oral advice on any matters subject to review without subsequently confirming the advice in writing.

<sup>11</sup> Paragraph 60 of the Supplementary Guidance for Auditors of Insurers in the United Kingdom (Revised), published by the Auditing Practices Board December 2004

<sup>12</sup> Source: See [www.actuaries.org.uk](http://www.actuaries.org.uk) for full details.

**8.47** Concerns have been raised about the Profession’s proposals for peer review. The Association of British Insurers argued, “peer review is an approach which boards may wish to consider but which should not be a requirement on them...in our view, so to do, would dilute board responsibility to ensure an adequate standard of actuarial advice to it and would effectively preclude alternative approaches on cost grounds.” The FSA responded similarly that “actuarial functions [are] more clearly advisory functions which, by definition, expose them to review and challenge by decision takers.”

**8.48** In the light of feedback received on the proposals for peer review, the Profession announced that it had decided not to introduce mandatory peer review in order to conduct more work on the practicalities. The Profession has established a small team to develop further proposals on introducing peer review in time for the 2005 year end.

### Initial consultation feedback

**8.49** The review initially consulted on whether, in the light of the FSA’s changes and the Profession’s peer review proposals, the level of scrutiny would be appropriate. Firms and individuals argued that further change was not needed. A number of consulting firms argued that they already have significant internal peer review and that the Profession’s proposals are merely a formalisation of what is already occurring. However, concerns were raised about having both external peer review and audit since there is:

- potential for overlap between the Reviewing Actuary role and the peer reviewer; and
- additional cost from having both audit and peer review.

**8.50** The Profession’s view was that the peer reviewer and the Reviewing Actuary could be the same person, thereby avoiding duplication. In the Profession’s view there would still be benefits from having a peer reviewer because:

- there are aspects of the work of the Actuarial Function Holder and most of the work of the With-Profits Actuary that are not directly relevant to the valuation of policyholder liabilities and are therefore not subject to scrutiny by the Reviewing Actuary;<sup>13</sup> and
- audit opinions have regard to the materiality of any issue in the context of the insurers accounts as a whole, whereas the peer reviewer would ensure that each element of the actuarial valuation basis is derived in accordance with FSA rules and actuarial guidance.

### Interim assessment

**8.51** The interim assessment indicated strong support for the FSA’s reforms to the Appointed Actuary regime, which from December 2004 for the first time:

- brought long-term liabilities within the scope of audit;
- required realistic reporting of long-term liabilities; and
- required each life insurer’s auditor to engage a Reviewing Actuary who is independent of the life insurer.

<sup>13</sup> For example: expected claims; adequate capital for uncertain events; and risk of default.

**8.52** The review also welcomed the Profession's recognition of the need to introduce greater scrutiny of actuarial advice given to life insurers. However, the review noted concerns that were raised about:

- potential for overlap between the Reviewing Actuary role and the peer reviewer;
- additional costs from having both audit and peer review; and
- whether a Reviewing Actuary would compromise his or her independence by also acting as a peer reviewer.

**8.53** The interim assessment therefore outlined four possible options for scrutiny of actuaries in life insurance:

- 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.

### Interim assessment feedback

**8.54** The ABI and some insurers argued for Option 1 – a Reviewing Actuary as currently specified by the FSA with no mandatory peer review as proposed by the Profession. Two arguments were put forward. The first argument is that the additional costs of mandatory peer review may not be justified by the benefits. The second is that it is the responsibility of senior management to determine the extent of additional scrutiny of the actuarial advice that insurers receive – such scrutiny may involve peer review or some other review process, but importantly the decision over its nature and scope should be determined by the Board of the insurer.

**8.55** The argument for Option 2 – a Reviewing Actuary as currently specified by the FSA, and peer review as proposed by the Profession has been put forward most strongly by the Profession.<sup>14</sup> The Profession argued that there are a number of aspects of actuarial advice to the Board that will not necessarily be scrutinised by the Reviewing Actuary – for example, elements of the actuarial advice relating to the with-profits fund and advice on the business risks to the insurer. The review is supportive of the Profession's desire to ensure that scrutiny of actuarial advice takes place but is also mindful of the need to prevent regulatory overlaps and hence duplication of costs. The Profession has put its peer review guidance on hold because until the scope of the Reviewing Actuary role has been observed in practice, it is difficult to determine whether the introduction of formal peer review for those aspects of actuarial work that are outside the ambit of the Reviewing Actuary role can be justified. The Profession is currently working on the practicalities with a view to introducing peer review by the end of 2005.

<sup>14</sup> See page 141 of the interim assessment for the Profession's reasoning

**8.56** Option 3 – the Reviewing Actuary’s remit is expanded to include an explicit duty to report on compliance with actuarial standards was supported by the Association of Consulting Actuaries. However, the FSA has expressed concern about a proposed expansion of the Reviewing Actuary role for two reasons. Firstly, the FSA is doubtful that a cost-benefit analysis case could be made for extension of the remit. More generally the FSA argued that care should be taken not to place excessive weight on regulatory requirements to deliver the objectives of increased scrutiny. In particular the FSA suggested there could be difficulties with extending the Reviewing Actuary’s role to report on compliance with actuarial standards generally since not all of these standards do now, or will in the future, have a bearing on the FSA’s regulatory objectives.

**8.57** The review believes that 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 is inappropriate given that responsibility for the assumptions and calculations prepared by the Actuarial Function Holder lies ultimately with the Board.

## Analysis

**8.58** It is clear from the feedback the review received that there are differences of view among respondents about the extent of potential overlap or duplication between the Reviewing Actuary’s role in advising the auditor and the role of a peer reviewer tasked with monitoring compliance with actuarial standards. This is perhaps unsurprising given that:

- the exact scope of the Reviewing Actuary role will be agreed between the auditor and the Reviewing Actuary and may therefore vary from one audit engagement to another;
- the Reviewing Actuary role was only introduced by the FSA in December 2004, and there is therefore only limited experience as to the depth and breadth of the Reviewing Actuary role in practice.

**8.59** The review fully endorses the FSA’s recent reforms of the Appointed Actuary regime and the introduction of the Reviewing Actuary role. In Chapter 7 the review recommended that consideration should be given to extending the duties and protections for the Reviewing Actuary to whistle-blow to the statutory regulators in the event of non-compliance with professional standards.

**8.60** A number of respondents to the interim assessment felt that there may be areas of actuarial advice to insurers’ Boards that are outside the scope of the Reviewing Actuary’s role and which should be further scrutinised, for example, the monitoring of business risks and solvency. In the short-term, the review believes that the nature of this scrutiny should be at the discretion of an insurer’s Board. However, the review believes that, as a matter of urgency, the Profession should identify whether there are likely to be significant and material gaps in the scrutiny of actuaries’ compliance with professional guidance. The Profession should report to POBA on this matter.

**8.61** The review believes that the FRC, working closely with the FSA, should – within 2-3 years – consider whether compliance against actuarial standards is being monitored appropriately within the overall regulatory framework. In chapter 3 the review proposed that the Professional Oversight Board for Accountancy’s (POBA) remit should be expanded to include oversight of the Profession’s monitoring of compliance with professional standards – in doing so, POBA should take account of the extent of direct supervision and regulatory requirements by the statutory regulators to ensure that there is a minimum of material regulatory gaps or overlaps.

**8.62** Therefore, if the FRC feels that the Profession and the overall regulatory framework are providing insufficient monitoring of compliance with professional standards, then the FRC should consider: (i) the oversight of an appropriate framework of peer review by the Profession; (ii) the introduction of an Actuarial Inspection Unit; or (iii) the extension of the remit of the current Audit Inspection Unit to undertake direct monitoring of actuarial firms and actuaries.

## Recommendation for scrutiny of actuaries in life insurers

The review recognises the need for independent scrutiny of actuarial advice and strongly supports the FSA's Reviewing Actuary role as currently specified.

However, the review notes that there may be some elements of actuarial advice, calculations and compliance with some professional standards that are not likely to be scrutinised by the Reviewing Actuary.

The review recommends that:

- as a matter of urgency, the Profession should identify any gaps in the monitoring of compliance with actuarial standards or significant actuarial calculations within an insurer that are unlikely to be scrutinised by the Reviewing Actuary, and might therefore benefit from peer review and should report to POBA on this matter;
- in the meantime, insurers should themselves consider whether peer review of the actuarial advice that they receive is appropriate; and
- in the light of the above, the Financial Reporting Council, working closely with the FSA and the Profession, should – within 2-3 years – satisfy itself that appropriate monitoring of actuaries' compliance with professional standards and independent scrutiny of actuarial advice is occurring through either direct supervision by the regulator, audit or external peer review.

## SCRUTINY OF ACTUARIES IN PENSIONS

**8.63** Until the Pensions Act 1995 there was no legislation which specifically required an employer to fund a pensions promise in advance other than in relation to contracting out of the State second tier pension, although for the most part employers did make contributions towards their future pension promises. An employer could, as a matter of law, promise a pension to an employee and make no financial provision for the benefit until it became payable.<sup>15</sup> Even within defined-benefit pension schemes' accounts, the long-term liabilities were not recorded.

**8.64** More recent legislation, including the Pensions Act 1995, has required that schemes provide many benefits that were previously discretionary and has imposed funding obligations.<sup>16</sup>

**8.65** Currently, various aspects of a pension scheme's financial condition are reported in three different reports:

- the sponsoring company's annual accounts which include both the assets and liabilities of its pension scheme(s) on a market-related basis under Financial Reporting Standard 17 (FRS17);

<sup>15</sup> Source: Tolley's Pensions Law Handbook, Nabarro Nathanson Pensions Team, sixth edition, chapter 11, 2004.

<sup>16</sup> This has been a gradual process starting with the Pensions Act 1973, but with a step-change since the Pensions Act 1995.

- the annual accounts of the pension scheme, which set out its assets and short-term liabilities; and
- the triennial valuation of assets and liabilities, which is required under the Pensions Act 1995 and is produced by the Scheme Actuary for trustees.<sup>17</sup>

**8.66** It is important to note that of these reports the Scheme Actuary is only responsible for the triennial investigation, which is produced for trustees. The Scheme Actuary’s advice may be sought with respect to the other reports outlined above, but this would depend upon any perceived conflict of interest and while in such a capacity the actuary would not be acting as the Scheme Actuary.

## Audit

**Pension scheme accounts** **8.67** Pension schemes’ annual accounts, which set out assets and short-term liabilities, are audited. However, since long-term (actuarial) liabilities are excluded, the auditor does not typically require actuarial advice.

**Sponsoring company’s accounts** **8.68** Companies Act accounts require the inclusion of an accounting valuation of the assets and liabilities of the company’s defined-benefit pension scheme(s) in the company’s balance sheet.<sup>18</sup> The Board appoint their own actuary to do the calculations, but it is often, though not always, the Scheme Actuary acting in a separate capacity as an adviser to the company. The audit of the long-term (actuarial) pension liabilities is performed by the company’s external auditor who may require the advice of an actuary who is independent of the pension scheme and is therefore not the Scheme Actuary.

**8.69** The extent to which the auditor scrutinises the pension figures is dependent upon its materiality to the company’s accounts. For example, for a small pension scheme relative to the rest of the company, this may only mean a focus on the numbers of scheme members and the major assumptions used, rather than a focus on issues such as data quality.

**Inclusion of long-term liabilities within pension scheme accounts** **8.70** The review had thought that the implementation of the IORP Directive would result in the inclusion of long-term liabilities within pension scheme financial statements.<sup>19</sup> The review now understands that, although the IORP Directive requires each pension scheme to draw up an annual report and accounts that provide a true and fair view of the assets, liabilities and financial position, there will not be a requirement for long-term liabilities to be reported in the pension scheme accounts themselves. The long-term liabilities therefore are only available to scheme members in the annual report.

**8.71** Some respondents to the interim assessment have argued that having long-term liabilities set out within the annual report is more appropriate than giving a single point-estimate that would have to be shown in pension scheme accounts – this will provide an opportunity to reflect the inherent uncertainty within the long-term liability numbers, with a range of different long-term liabilities shown under different assumptions.

<sup>17</sup> From September 2005 the Pensions Regulator will require funding information on scheme returns. If a scheme is underfunded then a Recovery Plan will have to be submitted to the Pensions Regulator.

<sup>18</sup> Source: Financial Reporting Standard (FRS) 17, the accounting standard on Retirement Benefits.

<sup>19</sup> Source: Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the Activities and Supervision of Institutions for Occupational Retirement Provision, article 10.

**8.72** The inclusion of the long-term (actuarial) liabilities in pension scheme financial statements is an issue that has ramifications well beyond the scope of this review. In principle it would provide scrutiny of the work of Scheme Actuaries, but in practice it could also lead to large additional costs. The review understands that the Pensions Research Accountants Group (PRAG) is currently considering this issue.

**Triennial actuarial investigation 8.73** The triennial investigation which is performed by a Scheme Actuary and which includes the long-term (actuarial) liabilities is not audited. There is therefore no scrutiny of the work of the Scheme Actuary by the auditor.

## Peer Review

**8.74** The Profession published a guidance note which took effect from 31 December 2004 on the peer review of Scheme Actuaries, GN48: Compliance Review: Pensions. Until the end of 2006 the guidance is recommended practice and is thereafter mandatory.

**8.75** Under the guidance a Scheme Actuary must ensure that all written advice provided in their capacity as Scheme Actuary, which is subject to any of the relevant Practice Standard Guidance Notes, is subject to either Type 1 review or Type 2 review:

- Type 1 review is carried out at a time that enables the outcome of the review to influence the decisions that flow from the advice; and
- Type 2 review covers written advice delivered over a single period not exceeding six months.

**8.76** The principal purpose of review is to determine whether the reviewer considers that the written advice delivered to the client complies with the relevant practice standard guidance notes and paragraphs 3.4-3.7 of the Professional Conduct Standards.

**8.77** The reviewer must also comment on:

- material inaccuracies or inconsistencies in the advice delivered to the client that are identified in the course of the review; and
- aspects of the advice that in his or her opinion might be unclear to the recipient.

**8.78** There is currently no guidance on the independence of the reviewer. Scheme Actuaries can therefore be reviewed by colleagues from within their own firms.

## Interim Assessment

**8.79** In the light of the above it is clear that there is currently only limited scrutiny of Scheme Actuaries' work.<sup>20</sup> The current forms of scrutiny which may occur include:

- challenge from the pension scheme's trustees;
- peer review as recommended (but not initially required) by the Profession in GN48; and

<sup>20</sup> The Profession's Scheme Actuary peer review is currently only recommended practice. It is to become practice standard (mandatory) in 12/2006. Source: GN48: Compliance Review: Pensions V1.0, available [www.actuaries.org.uk](http://www.actuaries.org.uk)



- audit of the FRS17 valuation of the long-term liabilities in the Companies Act accounts, the depth of which will depend on whether the size of the pension scheme is material to the overall Companies Act accounts.

**8.80** As set out in the interim assessment the review believes that the current lack of formal, mandatory, independent scrutiny is inappropriate given the importance of Scheme Actuary advice to defined benefit pension schemes. As a result, particularly for small schemes, there is a danger that little scrutiny of the Scheme Actuary’s advice may occur. This point of view was supported by respondents to the interim assessment. The question is therefore less whether scrutiny should occur but what exact nature it should take.

**8.81** The review has put forward audit, or peer review as being possible ways, beyond that afforded by the statutory regulator’s supervision, of providing the necessary scrutiny. In the review’s interim assessment four options were put forward as to how one might secure an appropriate degree of scrutiny of the Scheme Actuary’s advice.

- 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.

### Feedback on interim assessment options

**8.82** A number of respondents noted that option 1 – maintaining the status quo – is no longer an option because the Profession has now introduced recommended practice guidance for peer review of the Scheme Actuary with effect from 31 December 2004. The starting point is in effect option 3 – peer review of the Scheme Actuary as envisaged by the Profession.

**8.83** The second option put forward in the interim assessment was to include long-term (actuarial) liabilities in the financial statements of pension schemes. This would result in scrutiny of the work of the Scheme Actuary since the Scheme Actuary would play a significant role in their preparation and as part of a financial statement the long-term liabilities would have to be independently audited.

**8.84** Respondents have given three main arguments in support of the audit of long-term liabilities:

- auditors provide an independent, rigorous check;
- auditors are already often having to audit pension scheme assets and liabilities as part of sponsoring company audits, so the formalisation of this scrutiny at the scheme level would involve little extension;
- an audit brings the skills of auditors and actuaries to bear, since auditors will, and should, take the advice of an actuary during the audit process.

**8.85** However, respondents have given three main arguments against the use of audit to provide scrutiny:

- that there is no evidence to suggest that mistakes are made frequently enough, or with large enough ramifications, for an audit to be cost-effective;
- that the strength of sponsoring company covenants with respect to their pension schemes should mean that the audit of a whole entity, company and the pension assets and liabilities in that company's accounts, should be sufficient;
- that audit covers certain calculations, rather than all advice given, and does not provide scrutiny during inter-valuation periods; and

**8.86** The Profession said that they were 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 noted that a decision to change the accounting requirements for pension schemes is not within the Profession's powers, nor within the review's.

**8.87** The ICAEW noted that it has not yet reached a consensus view as to whether actuarial liabilities should be included in pension scheme accounts. If actuarial liabilities are required to be included in scheme accounts the ICAEW argued that the most cost effective way of introducing independent review of the actuarial advice would be for the auditor to be required to appoint a Reviewing Actuary. However, the ICAEW expressed concern that the cost benefit analysis of introducing these safeguards might not be borne out for smaller schemes, and so this approach might only be appropriate for larger schemes, for example, those with over 5,000 members.

**8.88** Option 3 – the profession's proposals for peer review – received strong support from respondents to the consultation. The Profession, the ACA, and a number of insurers and actuarial consulting firms supported this approach. Opra expressed concern that the peer review in option 3 is relatively weak because it does not require review by an actuary who is independent of the advising actuary. Indeed the current proposal might allow the peer reviewer to be subordinate to the advising actuary. Opra said they "would be prepared to support a more robust form of peer review system, which, required at least periodic independent sample, audit or peer review." A number of other respondents expressed the same point about the lack of independence of the proposed reviewer. However, a number of actuarial firms argued that if the peer reviewer were required to be external then this would raise issues regarding the commercial interests of firms.

**8.89** Option 4 – audit of the Scheme Actuary's triennial valuation. This option did not receive wide support, although one respondent supported it for schemes above a prescribed size, "say £25m", because they felt that the Profession's peer review proposals were considerably weaker than external audit. A number of respondents argued that until there are clearer standards for carrying out the Scheme Actuary's role there are only limited standards against which one could conduct an audit of the Scheme Actuary's triennial valuation. It was suggested that this was something which might be revisited once the Actuarial Standards Board was established and a clearer set of standards against which an audit could be conducted had emerged. Some respondents questioned whether the benefits of such an audit would outweigh the costs.

## Review's conclusions

**8.90** Currently long-term liabilities are not within the scope of pension scheme accounts and therefore fall outside the scope of the pension scheme audit. The review recognises that the FRS17 valuation of the liabilities will be audited in the Companies Act accounts of the sponsoring company – but only in so far as the overall size of the pension scheme is material to the overall size of the company. Long-term liabilities falling outside the scope of the audit is a matter of concern for the review as the implication is that there is no independent check on the Scheme Actuary's calculations of the long-term liabilities.

**8.91** The review believes that the Profession's current peer review proposal is a step in the right direction to provide a minimum level of scrutiny of actuaries' compliance with professional guidance at least in the short-term. Peer reviewers are required to report any suspected non-compliance with professional guidance to the Profession subject to any confidentiality requirements. However the review notes that the current proposals, as they stand, do not require independent scrutiny of the Scheme Actuary's advice and are therefore considerably weaker than the level of scrutiny that would be afforded by either independent audit or external peer review and this is a matter of concern for the review. The review also believes that it is essential that the peer reviewer is not prevented from reporting on any suspected non-compliance with professional guidance by confidentiality restrictions.

**8.92** The review believes that independent expert scrutiny of Scheme Actuary advice is critical, given the importance of actuarial advice to trustees. However, the review notes that the Pensions Regulator (TPR) is about to be established – the extent and nature of the direct supervision of pension schemes that the TPR will undertake is not yet clear.

**8.93** The review therefore recommends that the new Pensions Regulator should ensure that Scheme Actuaries' advice to pension schemes is subject to formal scrutiny by independent experts, through either risk-based supervision, audit, or external peer review. TPR may wish to adopt different approaches for large schemes and smaller schemes, for example, one approach might be to require independent expert scrutiny of all larger schemes and independent expert scrutiny of a sample of smaller schemes – but ultimately this will be a matter for TPR to decide. In the meantime, the review supports the Profession's current proposals for peer review.

**8.94** The Profession's proposals for peer review recommend that all of the Scheme Actuary's written advice should be reviewed and checked for compliance with relevant professional guidance. If at some point in the future, an audit approach is adopted, then the Profession would need to revisit its proposals to identify any gaps or overlaps.

**8.95** The Financial Reporting Council, working closely with TPR and the Profession, should – within 2-3 years – satisfy itself that appropriate monitoring of actuaries' compliance with professional standards and independent scrutiny of actuarial calculations is occurring through either direct supervision by the regulator, audit or external peer review.

**8.96** If the FRC were to find that the Profession and the overall regulatory framework was providing insufficient monitoring of compliance with professional standards, then the FRC might wish to consider introducing an actuarial inspection unit or expanding the remit of the existing audit inspection unit to undertake direct monitoring of actuarial firms and actuaries.

## Recommendations for scrutiny of actuaries in pensions

The review believes that independent expert scrutiny of Scheme Actuary advice is critical, given the importance of actuarial advice to trustees.

The review recommends that:

- the Pensions Regulator should ensure that Scheme Actuaries' advice to pension schemes is subject to formal scrutiny by independent experts, through either risk-based supervision, audit, or external peer review. The Pensions Regulator may wish to adopt different approaches for large schemes and smaller schemes;
- in the meantime, the review supports the Profession's introduction of peer review for Scheme Actuaries' advice; and
- in the light of the above, the Financial Reporting Council, working closely with the Pensions Regulator and the Profession, should – within 2-3 years – satisfy itself that appropriate monitoring of actuaries' compliance with professional standards and independent scrutiny of actuarial advice is occurring through either direct supervision by the regulator, audit or external peer review.

## SCRUTINY OF ACTUARIES IN GENERAL INSURANCE

### Options for scrutiny of actuaries in general insurance

**Company market 8.97** As in life and pensions there is no formal scrutiny of actuarial advice provided to general insurers. This advice is critical therefore the review believes that there is a need for enhanced scrutiny of actuarial advice to general insurers. The interim assessment therefore put forward two options for scrutiny of actuarial advice given to general insurers:

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

**8.98** The review concurs with respondents to the interim assessment, including the Profession, the FSA, actuarial firms and insurers, who supported the introduction of a requirement for actuarial advice as part of the audit of general insurers. The review recommends that the FSA should consider consulting on the introduction of a Reviewing Actuary regime in general insurance. In the meantime, the senior management of general insurers should consider whether they would benefit from review of the actuarial advice that they receive.

**Lloyd's 8.99** The interim assessment put forward three options for scrutiny of actuarial advice for Lloyd's syndicates:

- 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.

**8.100** In accordance with the reasoning outlined above, the review believes that a requirement for actuarial advice as part of audit should be introduced for the auditors of Lloyd’s syndicates. Such a requirement was supported by all respondents, including the Association of Lloyd’s Members.

**8.101** The review believes that the FRC, working closely with the FSA, should – within 2-3 years – consider whether actuarial advice is appropriately scrutinised and whether compliance against standards is being monitored appropriately.

## Recommendations for scrutiny of actuaries in general insurance

The review recommends that:

- the FSA should consider consulting on introducing a requirement for actuarial advice as part of audit, in both the company market and the Lloyd’s market for general insurers; and
- the Financial Reporting Council, working closely with the FSA and the Profession, should – within 2-3 years – satisfy itself that appropriate monitoring of actuaries’ compliance with professional standards and independent scrutiny of actuarial advice is occurring through either direct supervision by the regulator, audit or external peer review.

## DISCIPLINE

**8.102** Effective enforcement and discipline is a critical component of any framework that relies upon standards. Actuaries may be subject to discipline either through:

- the disciplinary scheme of the Profession; or<sup>21</sup>
- through discipline by the FSA or Opra, where actuaries have regulatory responsibilities under financial services and pensions legislation.

**8.103** The review is primarily concerned with the former mechanism, since the latter encompasses discipline for all regulated individuals, which is a far broader constituency than actuaries alone.

**8.104** As outlined in the interim assessment, the Profession established new disciplinary arrangements from 1 January 2004. The new schemes:

- are managed by an independently chaired Disciplinary Board at ‘arms length’ from the Faculty and Institute Councils;
- introduce lay participation at all stages of the process;
- mean that the Faculty and Institute’s disciplinary schemes effectively operate as one; and
- explicitly exclude all members of the Faculty and Institute Councils from any role in the formal disciplinary machinery.

<sup>21</sup> See Chapter 8 of the interim assessment. For full details please see the Faculty or Institute’s Disciplinary Scheme Schedule on [www.actuaries.org.uk](http://www.actuaries.org.uk), which has comprehensive details about all aspects of the schemes and guidance on how to make a complaint.

**8.105** Although the administration and management of the schemes have been removed from the control of the Councils, as a matter of law, the disciplinary process is still a function of the professional bodies. The interim assessment outlined feedback received from respondents to the consultation document, who argued that the new disciplinary process should be given time to work as it has been well received, including by Lord Penrose.

**8.106** The interim assessment outlined a number of factors that must be considered in assessing a disciplinary scheme and concluded that the Profession's new process is suitable. The review therefore focused on the accountability of the scheme and its relationship with statutory regulators.

### Interim Assessment Options

**8.107** The interim assessment outlined three options for the disciplinary scheme:

- Option 1: the disciplinary scheme remains accountable to the Faculty and Institute 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.

**8.108** The review believes it is essential that the Profession has, and is perceived to have, a strong and independent disciplinary process. Respondents to the interim assessment concurred with this sentiment, arguing that to "restore trust" and "provide...reassurance" the Disciplinary Scheme should be subject to an independent oversight body.

**8.109** As outlined in Chapter 3, the review believes that arrangements should be made to enable the Professional Oversight Board for Accountancy (POBA) to extend its activities to oversee the regulatory activities of the actuarial professional bodies, which would include the Profession's disciplinary scheme. POBA is well placed to do so, given its current oversight of accountancy disciplinary arrangements and its independence from the Profession.

**8.110** The review also believes that those cases that are of public interest should come under an extended Accountancy Investigation and Discipline Board (AIDB), which would bring it into line with the current practice of the accountancy profession. Hearings for public interest cases would therefore normally be heard in public, while the scheme would have greater independence from the actuarial profession than the Profession's own Disciplinary Scheme.

**8.111** The Profession and the majority of respondents were supportive of POBA oversight of the Disciplinary Scheme. The Profession expressed no objection to the principle that the AIDB should hear public interest cases, but observed that, in practice, problems in financial services tend to be picked up by the regulators before they escalate to that level. If the proposed set-up had been in place in the past, the Profession speculated that the AIDB might have taken only one actuarial case.

**8.112** The smooth-running of the disciplinary scheme requires close links between all interested parties. Appendix D of the interim assessment outlined some of the initiatives currently being undertaken as part of formalising the relationships between the Profession and regulators – the review is highly supportive of the enhanced transparency and clarity which such measures offer.

## Recommendations for discipline

The review recommends that:

- the remit of the Professional Oversight Board for Accountants (POBA) should be extended to oversee the disciplinary scheme for actuaries;
- the Accountancy Investigation & Discipline Board should assume a role in investigating and hearing public interest disciplinary cases involving actuaries; and
- closer links should be engendered between regulators and the disciplinary schemes.





## INTRODUCTION

**9.1** The review's terms of reference in relation to the Government Actuary's Department (GAD) were to make recommendations on: the future role of the Government Actuary, the functions of his department and its future institutional status. In order to do this, the review undertook a thorough consultation process. The review sent its initial consultation document to over 100 clients and users of GAD's services including: central government departments, the wider public sector, the ex-public sector and private sector and overseas public sector organisations, both in the UK and internationally. The review team also held over 40 bilateral meetings with GAD clients, including most of GAD's central government department clients. The review asked a number of questions about the clients' need for actuarial advice, the quality of service provided by GAD, the rationale and continuing need for a separate department and to what extent there are aspects to GAD's work which have the character of a so-called public good, such that they cannot easily, or at all, be provided through a market mechanism.<sup>1</sup>

**9.2** The review received 22 written responses to its consultation document from GAD's clients which, for reasons of client confidentiality, were not published on the review's website. The review also received 25 responses to the questions in the consultation document on GAD from non-GAD clients, including GAD itself, which have been posted, where confidentiality has not been requested, on the website.<sup>2</sup>

**9.3** Ministers, government departments and public sector organisations have specific needs for their actuarial advice depending on their area of interest. Responses to questions on the need for actuarial advice, the level of service delivery, and the need for GAD to provide that service, were different according to the specific service GAD was delivering. GAD delivers seven major services which account for the vast majority of its income. The consultation feedback focused heavily on the delivery of these seven services. The review therefore summarised the consultation feedback according to each of the major services in its interim assessment published in December 2004. The review considers the impact of its recommendations on other services GAD delivers at the end of this chapter.

**9.4** The seven key functions, in the four broad areas of GAD's activities – pensions; social security; demography and statistics; and overseas – are:

1. advice to pension schemes in the public sector;
2. assessments of broad comparability of pension schemes and advice on pensions aspects of Public Private Partnerships (PPP)/Private Finance Initiatives (PFI) and machinery of government changes;
3. pensions policy advice;

<sup>1</sup> A public good can be described as a service or product that the market may have difficulty supplying. Public goods are those that are non-rival or non-excludable when used or consumed;

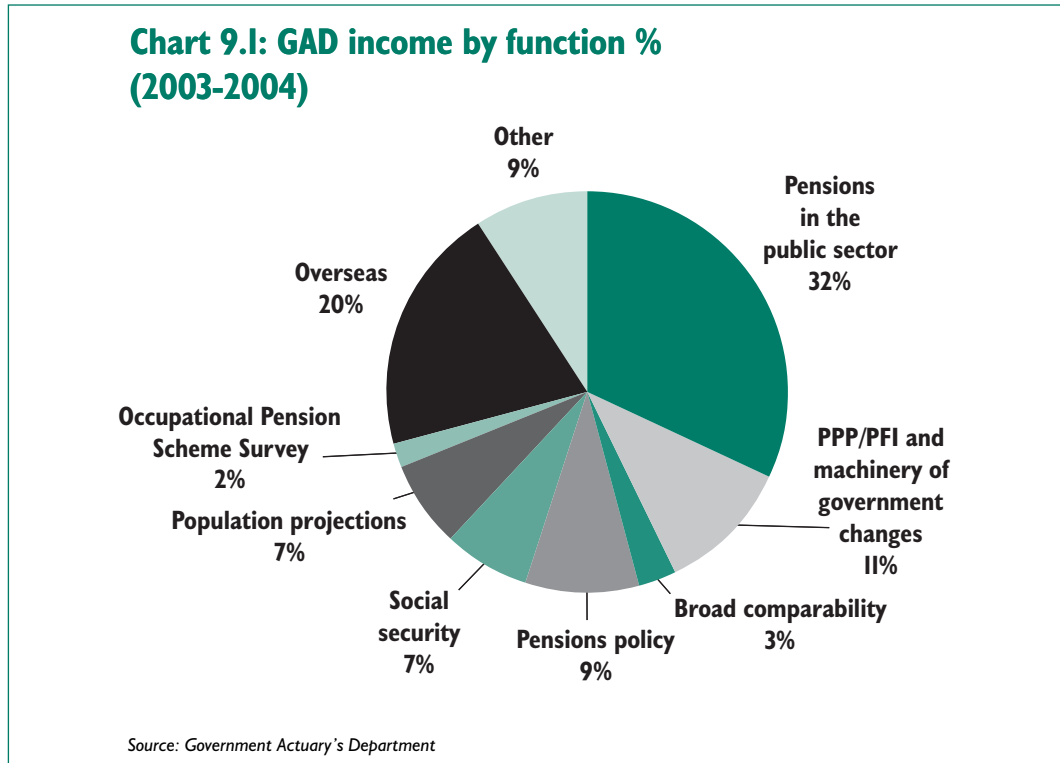
– 'Non-rival' means that the consumption of the good by one person does not prevent someone else using or consuming that good. Clean air is an example of a non-rival good.

– 'Non-excludable' means that if a public good is made available to one consumer, it is effectively made available to everyone. National defence is an example of a non-excludable good.

<sup>2</sup> Available at: [www.morrisreview.org.uk](http://www.morrisreview.org.uk)

4. social security;
5. population projections and associated demographics;
6. Occupational Pension Scheme Survey; and
7. advice to overseas clients.

**9.5** GAD's total income for all activities in 2003-2004 was £9.5 million, including those functions for which GAD received a Parliament Vote.<sup>3 4</sup> The chart below shows the percentage of this total that each of the seven functions listed above generated:



**9.6** The interim assessment set out the review's current thinking for possible options going forward. These options were discussed in roundtable meetings with representatives of government department clients, the wider public sector and the private sector.

**9.7** A number of Ministers, government departments and other organisations within the wider public sector require actuarial advice on an ongoing basis. Feedback to the review from public sector respondents stressed that they need actuarial advice that is high-quality, up-to-date, clear, consistent and impartial. The advice should provide value-for-money, be readily available and timely and clients of the advice should be informed and intelligent customers. This, therefore, has been an important consideration for the review.

<sup>3</sup> Source: Government Actuary's Department. This figure includes the elements of project support and client related training, both of which are absorbed into overheads when invoices are generated. It is the time recorded in the year and is not a statement of income in year as sales on individual projects may be made in subsequent years. It is therefore a comprehensive upper limit figure for all activities recorded in this period.

<sup>4</sup> GAD receives a Parliament Vote for the production of the Occupational Pension Scheme Survey and the Population Projections.

## Role of the Government Actuary and GAD

**9.8** Historically, GAD advised on insurance regulation in the UK. This responsibility passed to the FSA in 2001. An initial key question for the review was therefore whether the loss of this responsibility left an important ongoing role or roles for GAD; if so what they were and whether GAD should remain in the public sector or transfer to the private sector.

**9.9** This breaks down into two related but separate issues. The first relates to the future role of the Government Actuary as a government officer in his own right. The Government Actuary is appointed by the Chancellor of the Exchequer and approved by the Prime Minister.

**9.10** It was readily apparent to the review that there are certain activities where it is essential that the UK has an expert and authoritative officer, appointed by government, but acting independently to provide proper oversight primarily in relation to the National Insurance Fund reporting to Parliament. These are commented upon in more detail below.

**9.11** Second, the Government Actuary is answerable to the Chancellor, through the Financial Secretary to the Treasury, for the work of GAD. As the head of the department, the Government Actuary is also the Accounting Officer. He is personally responsible for the overall organisation, management and staffing of the department and for ensuring a high standard of financial management in the department as a whole, as well as for the quality of professional advice given by actuaries in GAD.

**9.12** The extent to which GAD continues to carry out numerous other activities must depend on its ability to provide high-quality services in a cost-effective manner, best suited to the needs of Ministers, government departments and the wider public sector. This is also considered in more detail below on a service-by-service basis.

**9.13** In broad terms, three main themes emerged. First, there was general satisfaction with the quality of advice provided by GAD; second there were some concerns about certain aspects of the delivery of that advice; and third, there was general support for introducing more discretion for public sector users of GAD to choose the source of their actuarial advice, as a means of ensuring that actuarial services supplied by GAD and others would be as efficient and effective as possible. The review believes that the proposals which have emerged from its investigation will provide public sector users of actuarial services with the right framework within which to work; and at the same time allow GAD to build on its historical strengths – its central role in advising Ministers, government departments and the wider public sector; the consistency of its approach across the public sector; and its standing as a public sector body – in order to meet its continuing aspirations effectively.

**9.14** As an ancillary point, although certain responsibilities of the Government Actuary are set out in primary and secondary legislation, it was not always clear to the review how far the role of the Government Actuary extends beyond the functions set out in legislation. The review therefore believes that, in the light of the reforms proposed in this review, there is scope for the Government to define clearly what the Government Actuary's role is or should be.

**9.15** To consider the extent to which GAD provides high-quality services in a cost-effective manner, best suited to the needs of Ministers, government departments and the wider public sector, the review analysed each of the seven major functions in turn:

## I. PENSION SCHEMES IN THE PUBLIC SECTOR

**9.16** The Pension Schemes Act 1993 defines 'public service pension scheme' as:

*"...an occupational pension scheme established by or under an enactment or the Royal prerogative or a Royal charter, being a scheme –*

*(a) all the particulars of which are set out in, or in a legislative instrument made under, an enactment, Royal warrant or charter, or*

*(b) which cannot come into force, or be amended, without the scheme or amendment being approved by a Minister of the Crown or government department,*

*and includes any occupational pension scheme established, with the concurrence of the Treasury, by or with the approval of any Minister of the Crown and any occupational pension scheme prescribed by regulations made by the Secretary of State and the Treasury jointly as being a scheme which ought in their opinion to be treated as a public service pension scheme for the purposes of this Act."*<sup>5</sup>

**9.17** Public service pension schemes are therefore characterised specifically. Public sector pension schemes are wider and cover all other pension schemes in the public sector. The Government Actuary's legislative obligations relate to public service schemes, although the Government Actuary and GAD also advise wider public sector schemes.

**9.18** The Government Actuary is currently required, in both primary and secondary legislation, to give actuarial advice to a number of major public service pension schemes, such as the NHS and Teachers Pension Schemes.<sup>6,7</sup> The role of the Government Actuary under legislation can range from acting as the Scheme Actuary, in the case of the NHS and Teachers Schemes, to providing transfer values for a scheme, as in the case of the Fire and Police pension schemes.<sup>8,9</sup> The Government Actuary is also required to be the Scheme Actuary for several pension schemes of ex-nationalised industries which have undergone privatisation, but are still guaranteed by the government, such as the Coal and Mineworkers schemes.<sup>10,11</sup> There are no such legislative obligations for public sector schemes which do not meet the criteria above in the Pensions Act. These schemes are therefore free to choose their actuarial advisers. Indeed, Government Departments have been encouraged to market test for their actuarial advice since 1989, when GAD adopted a full payment regime for its clients.

<sup>5</sup> Source: Pension Schemes Act 1993

<sup>6</sup> Source: Teachers Pensions Regulations 1997 (as amended by the Teachers Pensions (Amendment) Regulations 2002).

<sup>7</sup> Source: National Health Service Pension Scheme Regulations 1995, Regulation U3.

<sup>8</sup> Source: Firefighters Pension Scheme Order 1992 (SI 1992/129) (originally entitled The Firemen's Pension Scheme Order 1993).

<sup>9</sup> Source: Police Pensions Regulations 1987 (SI 1987/257).

<sup>10</sup> Source: British Coal Staff Superannuation Scheme (modification) Regulations 1994.

<sup>11</sup> Source: Mineworkers Pension Scheme (modification) Regulations 1994.

## Initial consultation feedback

**9.19** The review received feedback in its initial consultation phase from GAD's clients that on the one hand clients believe GAD can offer value-for-money, consistency of approach, historical knowledge and understanding of the ways of government in the delivery of advice on public service pension schemes; but on the other, some clients had not been able to market test because of legislation requiring that they use the Government Actuary for advice on certain aspects of their pension schemes. Respondents noted that the Principal Civil Service Pension Scheme had market tested and GAD had lost the tender to a private sector firm. Clients were also critical of the delays in receiving GAD's advice and of its inadequate invoicing procedures.

## GAD's response to initial consultation feedback

**9.20** GAD raised a number of important points in response to this feedback, including:

- HM Treasury and other government departments have placed considerable emphasis on the importance of different public sector schemes and particularly the major public service schemes adopting a consistent approach. A single, objective adviser has been the most effective and efficient means of reaching an overall view;
- only a modest proportion of GAD's work falls within the category of statutory roles, although several of the public service schemes do have provisions in regulations for certain tasks to be carried out by the Government Actuary. Many of the public sector pension schemes have taken the opportunity to make use of private sector actuarial firms for particular assignments;
- of the public service schemes, only the Principal Civil Service Pension Scheme has decided to appoint a private sector firm as Scheme Actuary. This has not been in place long enough to draw conclusions as to how satisfactory this arrangement is;
- public service pension schemes (other than the Local Government Pension Schemes) have no assets and are guaranteed by the government. They are vehicles for channelling government income to meet immediate benefit obligations. Consequently it might seem inappropriate for the private sector to provide advice as the private sector could have an undue influence on the determination of government expenditure patterns;
- confidentiality remains an important issue for many clients. GAD is on hand to step in as the Government requires where it is inappropriate for private sector consultancies to provide services; and
- GAD is able to offer good value-for-money actuarial advice.

## Interim assessment feedback

**9.21** The review took up these concerns and, in a second round of consultation, raised them with a large proportion of GAD's public sector clients and others.

**9.22** This generated a number of further observations on the actuarial advice received by pension schemes in the public sector:

- the need for consistency is recognised; however, it is not generally felt that this necessitates a single supplier, a principle which has already been breached;
- many public sector clients are unable to market test because of the legislative obligations, in both primary and secondary legislation, to use the Government Actuary for advice;
- if the Government Actuary is only obliged to advise on a certain aspect of the scheme, clients are unlikely to go to the market for advice on other aspects of the scheme;
- several public sector users of private sector actuarial firms, some of which have been using the private sector for actuarial advice for many years, are highly satisfied with the arrangements;
- whilst a small number of GAD's clients suggested it may be inappropriate for the private sector to provide advice on some schemes where there is a government guarantee, the majority of GAD's public sector clients do not believe the private sector is an inappropriate mechanism to deliver advice to government;
- confidentiality is important, although the private sector is also able to offer confidential advice. Experience of using the private sector has shown this is not a problem; and
- GAD is able to offer value-for-money advice, which is a very important consideration for public sector clients. With more discretion for clients, low-cost advice would be a distinct advantage for GAD.

**9.23** Taking all these points into consideration, the review considered various options for ensuring clients receive high-quality actuarial advice on their pension schemes. The first of these was to embed the actuarial advice needed within the relevant government department.

**9.24** It would in principle be possible to embed the actuarial advice needed within the relevant government department, but the review has rejected this option. It would constrain the public sector from being able to choose their actuarial advisers. Feedback from clients also suggested that the majority of government departments would have insufficient demand to employ a full-time actuary. Most pension schemes in the public sector only require actuarial advice at certain times, therefore to employ full-time actuaries within government departments would be costly and inefficient.

**9.25** The review therefore considered the option of removing the requirement for public service pension schemes to use the Government Actuary for actuarial advice from legislation, which would give clients a choice of an alternative provider. Clients would, of course, be free to continue to use GAD's services.

## Option for change: de-regulation

**9.26** The review received substantial support for the proposal to allow government departments the choice of actuarial service provider in this area and the option of market testing the advice that they receive. This was seen as in keeping with wider efforts to ensure cost-effective delivery of high-quality services to the public sector.

**9.27** Many clients saw this as a means by which they would ensure high-quality service delivery by GAD and a means of assuring themselves that they were obtaining the best service possible.

**9.28** Respondents suggested a key test in assessing the suitability of one provider over another would be cost. Some clients had concerns that the private sector could cost significantly more than GAD. However, the review also received feedback from public sector respondents with experience of using the private sector which suggested that while on a per hour charge out rate the private sector is likely to be more expensive than GAD, it may also offer a higher quality of service and better overall value-for-money. The key point is that it would be for the client to decide.

**9.29** A number of public sector clients had not tendered for their actuarial advice and questioned the costs involved in such an exercise. However, other public sector respondents who undertook regular tendering exercises suggested that the benefits of tendering, with the result that they receive the best value-for-money advice, significantly outweigh the costs of actually undertaking the exercise.

**9.30** Clients who supported the provision of choice warned that any new arrangements must not jeopardise the consistency of approach across advice to pension schemes in the public sector. The review received suggestions on alternative ways to ensure such consistency. In particular, HM Treasury as the responsible government department for developing policy, co-ordinating and advising on public sector pensions regularly chairs meetings of the major public service pension schemes and issues advice to all public service schemes. This provides an opportunity for guidance and advice on policy developments to be made available to public service pension schemes.

**9.31** The review therefore recommends that the Government removes the existing legislative obligations for public service pension schemes to use the Government Actuary, so that public service pension schemes may have a choice of actuarial provider. They should, of course, be free to continue to use GAD if they so choose.

**9.32** To ensure consistency of approach where it is necessary, HM Treasury should facilitate a consistent approach to public service pension schemes.

## Recommendations

The review recommends that:

- the Government should remove the legislative requirements for the Government Actuary to provide actuarial advice to public service schemes and allow government departments a choice of actuarial adviser. Government departments should remain free to use GAD's services if they so choose; and
- HM Treasury should, where necessary, continue to facilitate a consistent approach to public service pension schemes.

## 2. ASSESSMENTS OF BROAD COMPARABILITY OF PENSION SCHEMES AND ADVICE ON PENSIONS ASPECTS OF PPP/PFI AND MACHINERY OF GOVERNMENT CHANGES

**9.33** GAD highlighted in their response to the review's interim assessment that the market for Public Private Partnerships (PPP) or Private Finance Initiatives (PFI) advice is large. Advice is provided by private sector actuarial firms advising private sector bidders perhaps more so than by GAD actuaries. The review did not receive representations during the consultation process to suggest that either the function of providing advice on PPP or PFI arrangements, or the advice that is given to the public sector on the pensions aspects of machinery of government changes was in need of reform. As such, the review is not minded to propose any change to the existing situation for the provision of advice to contracting parties in PPP or PFI negotiations or for advice to the public sector in machinery of government changes.

**9.34** The remainder of this section will focus on the assessments of broad comparability and the corresponding certificates and passports of broad comparability that GAD currently issues.

**9.35** Participation in occupational pension schemes is excluded from the terms and conditions of employment protected by Transfer of Undertakings (Protection of Employment) regulations.<sup>12</sup> As such, since June 1999 HM Treasury has maintained policy guidance on the pension arrangements to be made when staff are transferred compulsorily from the public sector to the private sector, and since January 2000 the Cabinet Office has applied the same guidance to transfers from one part of the public sector to another. HM Treasury's Fair Deal requires staff to be given access in their new employment to an occupational scheme certified to be 'broadly comparable' to that available to them in their employment before the transfer.<sup>13</sup> The standard of broad comparability is defined in the Fair Deal such that no identified member of staff would suffer material detriment overall to the terms for their accrual of further pension benefits through their future service as a result of the transfer. This is prescribed in a statement of policy by GAD attached to the Fair Deal.

**9.36** Assessments of broad comparability can be for both the public and private sector. An 'ordinary' comparability certificate relates to a specific group of transferring staff with known demographic characteristics, whereas a 'passport' certificate covers all possible imaginable groups of staff. Passports must be recertified every two years and there are currently around 200 passports in operation.

<sup>12</sup> Source: Transfer of Undertakings (Protection of Employment) Regulations 1981.

<sup>13</sup> Source: Staff Transfers in the Public Sector: Statement of Practice, Cabinet Office, January 2000.



**9.37** The process of issuing certificates of broad comparability and passports requires: a proposal from the contractor; data gathering and comparison calculations; production of the initial broad comparability assessment; discussion with contractors about benefit improvements required to meet the broad comparability; and signed undertakings from the contractor, leading to issue of either the certificate of broad comparability or the passport.

**9.38** Ministers will not authorise a procurement contract and contractual commitments cannot be made until there has been an assessment of the broad comparability of the pension schemes. The assessment is open and available to trade unions and staff representatives, who can raise any concerns they may have directly with the Minister responsible for the affairs of the government department or agency.

**9.39** There are essentially two broad areas in which GAD is involved, in relation to broad comparability:

1. setting the standards of broad comparability; and
2. applying those standards in the case of staff transfers.

**9.40** The standards of broad comparability are therefore currently set by GAD and published by HM Treasury. HM Treasury is not obliged to use GAD to set the standard, but it has chosen to do so. HM Treasury considers itself free to put this function to competitive tender if it chooses, although currently it has no plans to do so. Any change to the standard of broad comparability incorporated into the Fair Deal would need to be the subject of consultation with unions and employers.

**9.41** On application, the Fair Deal document states clearly that any actuary can certify broad comparability, according to those published standards. However, the review has uncovered some confusion in this area. HM Treasury explains that the Fair Deal is written exclusively in terms of the Principal Civil Service Pension Scheme and at the time of writing (1999) the Scheme Actuary to this pension scheme was GAD. All subsequent references to GAD in the Fair Deal should therefore be read in this content. This means the Fair Deal document subsequently refers to GAD as the body that will certify broad comparability for the purposes of the Fair Deal.

**9.42** It is possibly for this reason that GAD's own literature reinforces the impression that it has been awarded a monopoly in this work:

*"The government has issued a statement of practice "Staff transfers in the public sector" (January 2000), describing the government's policy when staff are transferred within the public service, or from the public service to the private sector, with their work. Central to the process is an assessment of whether pension arrangements being offered to employees by their new employer are "broadly comparable" to those provided by their existing employer. This assessment relates only to service after transfer. The formal assessment is made and certified by actuaries working for the Government Actuary's Department."<sup>14</sup>*

**9.43** According to HM Treasury, the actuary undertaking an assessment should be appointed by the public sector and not by the private sector bidder. For convenience this may be the public service pension schemes' actuary, but it is not clear that this message is understood by all those involved. HM Treasury does not believe that only GAD actuaries can provide this advice.

<sup>14</sup> Source: Available at GAD's website: [www.gad.gov.uk](http://www.gad.gov.uk)

## Initial consultation feedback

**9.44** In the initial consultation feedback the review received, some respondents suggested that the independence of a GAD sign-off for certificates of broad comparability was important to retain credibility in the system and the confidence of the staff being transferred and of their trade unions; while some suggested that the private sector could provide this service, albeit potentially at a higher cost. Respondents involved in the process also expressed some dissatisfaction with the current service GAD provides, notably in the delays with which assessments are carried out and the level of technology used, such as GAD's inability to provide electronic passports.

## GAD's response to initial consultation feedback

**9.45** GAD thought that only GAD should be responsible for signing off the assessments of broad comparability on a number of grounds:

- it is difficult to see any other actuaries having the stature and authority to offer certification of broad comparability;
- most firms would be too conflicted to offer such statements as they would be advising one or more bidders in relation to any employer;
- certification by GAD could not be provided by relying solely on work carried out by other actuaries, who might have a current or potential future conflict of interest;
- delays are due to the time taken by contractors and their advisers to provide information on their pension proposals or to complete the associated undertakings; and
- GAD has for some time been issuing passports in pdf. files by email.

## Interim assessment feedback

**9.46** As a result of further consultation on these points, it was noted:

- whilst GAD is in a strong position to provide the assessments as an independent authoritative body, the Fair Deal text itself already confers the authority and stature to offer a certificate of broad comparability on 'any professionally qualified actuary';
- there is a need for independent advice in this area. The appointment would need to be made by the public service pension scheme rather than by the private sector bidder. However, private sector actuaries (who would clearly have to be separate from the bidders' actuary) would be able to offer independent advice as they already do in many other areas;

- GAD does not routinely record or track the time it takes to issue passports or certificates of broad comparability, nor has it been required to. However, this makes it difficult for the review to refute absolutely the claims that GAD is not responsible for delays; and
- on electronic passports, it appears there is a communication issue between GAD and its clients.

**9.47** In the light of these issues, the review thought it necessary to understand fully what the intention of the Government was in the Fair Deal policy.

### **Option for change: open the service up to the market**

**9.48** HM Treasury made it clear to the review that it was never the intention of the Fair Deal to preclude a public service pension scheme from appointing another actuary other than a GAD actuary to certify broad comparability, and reaffirmed that the function should be open to competition. For HM Treasury and from the perspective of staff protection it is important that the assessment of broad comparability is performed by a 'professionally qualified actuary' to a standard set by Ministers rather than whether the actuary is employed by GAD.

**9.49** The intention behind the Fair Deal was supported by respondents to the review. These respondents believed that whilst this work required actuarial skills, to understand the difference between pension scheme benefits, these skills were universal to actuaries, and not specific to GAD actuaries.

**9.50** Respondents also supported giving government departments the choice of actuarial adviser as they believed it empowered the departments to secure the best advice at a cost that represented value-for-money.

**9.51** Respondents reiterated the importance of ensuring a consistency of approach in assessing broad comparability, although some considered there were alternative ways of delivering consistency. In particular, ensuring that the principles of broad comparability annexed to the Fair Deal were robust and clear would facilitate a consistent approach to their application.

**9.52** Given the feedback the review has received and the clarification of the principles behind the Fair Deal, the review recommends that the Government should ensure the principles of the Fair Deal are understood and explicit: that Government Departments have a choice as to the actuaries service provider for assessments of broad comparability and GAD should make clear that it is a competitor in the market for assessment of broad comparability and is not the sole provider of this service.

**9.53** There is no suggestion that the Fair Deal be renegotiated, rather that clients should be clear on the terms of the existing Fair Deal. GAD's own literature needs to make clear that clients do have a choice as to the service provider for this function, and HM Treasury needs to bring this flexibility to the attention of those responsible for appointing actuaries to public service schemes.

## Recommendations

The review recommends that:

- the Government should ensure that the principles of the Fair Deal are understood and explicit: that government departments have a choice as to their actuarial adviser for assessments of broad comparability; and
- GAD should make clear that it is a competitor in the market for assessments of broad comparability and is not the sole provider of this service.

### 3. PENSIONS POLICY ADVICE

**9.54** The government needs actuarial input into pensions policy advice. GAD's role in providing pensions policy advice can be split into two parts:

1. ongoing demand, such as answers to Parliamentary Questions and ad-hoc requests from government departments for advice; and
2. specific projects, such as the design of the Pensions Protection Fund and the replacement for the Minimum Funding Requirement.

#### Initial consultation feedback

**9.55** In its initial consultation period, the review received feedback that clients of pensions policy advice from GAD were very satisfied with the service they received and viewed GAD as an independent source of advice. Public sector clients have taken a mixed economy approach to the actuarial advice they require. In some cases, Government Departments have used GAD's services on an ad-hoc basis, in other cases, they have used GAD secondees or secondees from private sector actuarial firms.

#### GAD's response to initial consultation feedback

**9.56** GAD put forward the following points in response to the initial consultation feedback:

- the demand for pensions policy advice has been strong over recent years and GAD has been able to respond to these increased demands in a flexible way, providing additional resources to the Department for Work and Pensions (DWP) as and when required;
- GAD has accommodated DWP's desire for more immediate access to actuarial advice by temporarily locating staff alongside the policy teams at DWP;
- this arrangement relieves DWP of the burden of developing an appropriate career and remuneration structure for a very limited number of actuaries; and
- GAD has also seconded two members of staff to work full-time at the Occupational Pensions Regulatory Authority (Opra).

## Interim assessment feedback

**9.57** The review received feedback from public sector clients that the current system gives the public sector the flexibility to use whichever means of actuarial advice is the most appropriate for them, supplied by the actuarial advisers with the highest level of expertise in that particular area, whether from the public or private sector.

**9.58** Given the feedback from both GAD and public sector clients of GAD, that the existing arrangements have worked well and have met clients' needs for actuarial advice, the review does not consider it necessary to propose any change in this area.

**9.59** The public sector's requirements for pensions policy advice are best served by adopting a flexible approach to contracting the most appropriate actuarial advisers.

## Recommendation

The review recommends that:

- the Government should retain the existing situation whereby government departments have the flexibility to use the most appropriate provider of actuarial advice on pensions policy i.e. including both GAD and private sector actuaries.

## 4. SOCIAL SECURITY

**9.60** The services GAD provides to government departments relating to social security are a mixture of statutory obligations and non-statutory work. There are statutory obligations on the Government Actuary to provide Ministers, predominantly the Secretary of State for Work and Pensions, with the following reports:

- Up-rating reports: whenever National Insurance benefit rates or contribution structures are altered, Ministers must present to Parliament a report by the Government Actuary. These reports look at the finances of the National Insurance scheme over the short term, showing the cost of increasing benefits or altering contributions;<sup>15</sup>
- Quinquennial review: every five years the Government Actuary must report to Parliament on the finances of the National Insurance scheme over the next 50 years or so. These reports consider the effects of changes in the demographic structure of the population, based on the population projections produced by GAD. The contribution rate necessary to pay a certain level of benefits is calculated for each future year, and the effects of different assumptions are also considered; and<sup>16</sup>

<sup>15</sup> Source: Sections 141 – 145, 147 and 150(8) Social Security Administration Act 1992.

<sup>16</sup> Source: Section 166 Social Security Administration Act 1992.

- five-yearly reviews on the factors affecting the cost to occupational pension schemes of providing benefits of an actuarial value equivalent to that of the State Second Pension (S2P) benefits that are foregone by members of salary-related schemes. Advice on any proposed changes to rates of reductions in National Insurance contributions ('rebates').<sup>17 18</sup>

**9.61** GAD carries out non-statutory work on the National Insurance Fund for the Department for Work and Pensions (DWP) and the Inland Revenue, such as long-term benefit projections for DWP and short-term contribution projections for the Inland Revenue. GAD also provides non-statutory services on rebates in regularly updating the projection models.

## Initial consultation feedback

**9.62** The review received feedback in the initial consultation period that while, on the one hand, the Government Actuary can offer credibility and independence from government, which respondents felt was important to retain public confidence in the system; on the other, GAD is removed from policy and operational considerations and has a lack of economic input into benefit forecasting work. These respondents had further concerns that GAD's remit only covered part of the social security system. Respondents thought it was an important development that DWP had already started to embed short-term benefit forecasting work, which they thought suggested this work did not necessarily need to be done by an actuary, but could be undertaken by economists or statisticians.

## GAD's response to initial consultation feedback

**9.63** In response to the consultation feedback, GAD noted that:

- GAD's role in reporting to Parliament on the future financial stability of the social security system is a vital one from a national interest perspective and one which is viewed as extremely important by MPs and key Parliamentary committees;
- GAD's independence from government means that its work commands considerable respect. Any move to diminish GAD's independence from the Government would risk undermining confidence in the social security system;
- long-term projections are dominated by the need for actuarial models and require an understanding of both demographic and financial assumptions;
- being involved in all aspects of social security costs, benefits and contributions, allows GAD to analyse any possible interactions between reforms to the benefits and contributions systems;

<sup>17</sup> Source: Section 42(1), Pension Schemes Act, 1993.

<sup>18</sup> Since the introduction of the state earnings-related pension scheme (SERPS) in 1978, employees who have adequate private provision have been able to 'contract out', that is to give up all or part of the benefits of SERPS (although this now relates to what is known as the State Second Pension (S2P)). In return they pay lower National Insurance contributions, or receive rebates of National Insurance contributions paid into their defined-contribution pension schemes or personal pensions. Rates of reductions in National Insurance contributions are decided by the Secretary of State for Work and Pensions, who is required to present an Order before Parliament to implement the proposed changes.

- social security work carried out by GAD covers two-thirds of the expenditure on social security or related tax and other benefits for the elderly;
- although it is a separate entity within government, GAD is not remote from the policy and operational considerations of the government departments it advises. GAD argues in practical terms it can be as closely involved in the policy development as the clients want, beyond the purely actuarial; and
- the Government Actuary would not be willing to sign a statement for Parliament on the back of work undertaken outside his or her control by non-actuaries.

**9.64** The review consulted with the relevant stakeholders on these points.

### Interim assessment feedback

**9.65** Taking the points GAD raises in turn, the review received the following feedback largely from within the public sector:

- Parliament is not uniquely interested in the National Insurance Fund, but in the long-term financial sustainability of all government expenditure;
- some independent oversight of the National Insurance Fund is an important factor in ensuring public confidence in this part of the social security system;
- long-term projections can be undertaken by numerate professionals, other than actuaries, such as statisticians or economists;
- the figure quoted by GAD of two-thirds of the expenditure on social security or related tax and other benefits for the elderly as the proportion of the social security system which GAD covers does not include those of working age. Assessing GAD's work on the National Insurance Fund as a proportion of the total social security system, it accounts for half. The forecasting and modelling for the other half of the system is done in-house within the relevant government departments;
- regular formal and informal dialogue between policy and operational officials in government departments, ensures the integration of policy and operational considerations. Such a dialogue, particularly informal, would be much more difficult for an external organisation such as GAD to achieve, and GAD would certainly need to broaden the range of specialists it employs beyond the actuarial profession; and
- the need for the Government Actuary to be satisfied that the reports to Parliament represent his views is paramount. However, the Government Actuary could sign-off reports to Parliament even if some of the work is undertaken outside of GAD. There is an interesting comparison with the Comptroller and Auditor-General, who signs statements for Parliament of work which may or may not have been undertaken by auditors within the National Audit Office.

**9.66** In light of all the points made, the review concluded that it should consider the alternative of embedding advice on the National Insurance Fund within DWP and the Inland Revenue.

## Option for change: embed National Insurance Fund work within government departments, retaining statutory responsibilities of Government Actuary

**9.67** This option foresees DWP taking in-house all long-term forecasts of contributions and benefits (DWP has already taken in-house short-term benefit forecasts). Inland Revenue would take in-house short-term contributions forecasts for the UK. The departments would also embed all associated work, such as costings of National Insurance contribution rates. However, the Government Actuary would remain statutorily responsible for the quinquennial review and the annual uprating reports.

**9.68** The Government Actuary would remain responsible for reporting to the Secretary of State for Work and Pensions on the effect of the rebate levels on the National Insurance Fund in the five-yearly review and GAD actuaries would continue to give ongoing advice on rebates.

**9.69** Feedback suggested the advantages of embedding this work would be that the social security system could be modelled as a whole within departments. DWP and the Inland Revenue's forecasts would be better integrated and these departments would be able to develop them to better meet business needs, particularly where that need was urgent. Integrated models would also allow DWP and the Inland Revenue to exploit the potential for improving the quality and explanatory power of forecasts. For example, in DWP's case allowing DWP to forecast a number of benefits simultaneously.

**9.70** Bringing the forecasting in-house would ensure that departments could make the best use of new databases becoming available. According to respondents, as the databases are drawn from the department's own administration systems, but because of their nature cannot be effectively anonymised, they are subject to stringent Data Protection Act controls. This means analysis using these databases, which could significantly improve the quality of the forecasts, can only be done in-house to those government departments.

**9.71** Respondents felt that embedding the work within the relevant government departments would build expertise within those departments which could be applied in other non-National Insurance Fund areas. Respondents also suggested that as a significant number of forecasting staff in the relevant government departments will have previously worked in policy development areas, this gives them: an appreciation of the way policies and operations can affect expenditure; a broader awareness of customer needs; a much wider range of analytical techniques; and a knowledge of data sources.

**9.72** Bringing the work in-house would also encourage the use of other disciplines' skills, such as economists and statisticians. The review received feedback that the quality of forecasts was enhanced when different professions were working together and that the poorest forecasting performances had occurred when the team wholly comprised one profession.

**9.73** An alternative view was also put to the review, that if the work was embedded within DWP and the Inland Revenue there would be a risk that these departments would build models in isolation from each other. Moreover, retaining the Government Actuary's statutory responsibilities could lead to duplication of effort. However, public sector respondents discounted this as they believed the nature of policy development in government was such that departments were used to sharing information and working together and would find ways to ensure this was achieved as efficiently as possible, within the existing statutory framework.



**9.74** A further risk of embedding this work could be that the forecasts on the National Insurance Fund were no longer perceived to be independent. Respondents agreed that independence was an important factor and considered the retention of the Government Actuary's statutory responsibilities would preserve this independence.

**9.75** The review also notes that, elsewhere in the public sector, there are interesting parallels to preserve the independence of reports to Parliament, such as the National Statistics arrangement.<sup>19</sup> The review also notes the engagement of outside organisations such as the Institute for Fiscal Studies, or the Pensions Policy Institute in quality assuring projections.

**9.76** The advice GAD provides on rebates is actuarial in nature. Respondents therefore suggested that the Government Actuary would continue to be well-placed, as an independent authority within the public sector, to continue providing on-going advice and the statutory five-yearly review of rebate levels. The review agrees that this function should rest with the Government Actuary and GAD.

**9.77** Overall, therefore, feedback supported the proposal to embed this work in DWP and the Inland Revenue whilst retaining the statutory responsibilities for the Government Actuary. The review therefore recommends that the forecasts of contributions and benefits of the National Insurance Fund and associated work currently undertaken by GAD should be embedded in the relevant government departments. The statutory responsibilities of the Government Actuary to report to Parliament on the National Insurance Fund should be retained. The provision of advice on contracting-out rebates remains unchanged. The review recognises that DWP, the Inland Revenue and GAD will need to work together to facilitate an open and transparent approach to the production of National Insurance Fund forecasts.

## Recommendations

The review recommends that:

- the Government should embed National Insurance Fund projections and any associated work in the Department for Work and Pensions (DWP) and the Inland Revenue; and
- the Government Actuary will remain responsible for the statutory reports to Ministers and Parliament directly on the National Insurance Fund.

## 5. POPULATION PROJECTIONS AND ASSOCIATED DEMOGRAPHICS

**9.78** The Government Actuary has, since 1954, produced the official national 'population projections' for the United Kingdom and its constituent countries and associated demographic products, such as the English and Scottish life tables. The raw population data comes from the Registrars-General for England and Wales, Northern Ireland and Scotland.

**9.79** This work is paid for out of the roughly £1million Parliament Vote that GAD receives.<sup>20</sup>

<sup>19</sup> Although much of National Statistics is located within a single non-policy department, a significant amount, including many of the more politically contentious areas, are located in policy departments with Ministers who are very conscious of their own and the Government's public image. Ministers have signed up to the National Statistics protocol, and that has permitted government departments to publish statistics free from political interference.

<sup>20</sup> GAD estimated that about three-quarters of the £1million would be spent on demographic work in 2004-2005.

## Initial consultation feedback

**9.80** The review received some concerns in its consultation feedback that the current system fragmented demographic expertise. As a result, it was suggested that there could be possible efficiency and quality gains from a relocation of this demographic work. During the initial consultation process the Pensions Commission published its first report.<sup>21</sup> This criticised GAD's life-expectancy projections for consistently underestimating longevity.

**9.81** Consultation feedback also questioned the efficiency of transfers of data between the UK's Registrars-General and GAD and some respondents perceived delays in the production of population projections. The review highlighted in its interim assessment that it would attempt to establish the validity of this perception.

## GAD's response to initial consultation feedback

**9.82** In its response to the consultation feedback GAD said that:

- GAD continues to be the most efficient way of organising UK-wide demographic work in a way which has the confidence of each of the constituent countries; a transfer of work to the ONS would not necessarily reduce fragmentation nor increase efficiencies; and GAD has not experienced any examples of inefficiency in data transfer with the Registrars-General;
- GAD has a strong concentration of demographic expertise to enable it to perform the projections;
- the dates for publication of the projections are decided a year or so in advance and have always been scrupulously adhered to. Perceptions by some respondents to the review of delays in the production of the population projections do not have any basis in fact;
- GAD is able to ensure consistency of approach across the UK countries;
- assumptions of future mortality improvement for each country of the UK have always been decided in close consultation with the respective Registrar-General. There is no reason to suppose that the assumptions would have differed significantly if they had been the responsibility of the ONS or separately of the three Registrars-General; and
- GAD has worked hard to improve its methods of projecting mortality and, in the 2002-based projections, adopted significantly more optimistic assumptions about future longevity.

**9.83** These points were taken up by the review, with users of the demographic data and other key stakeholders for their views.

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<sup>21</sup> Source: First Report of the Independent Pensions Commission, 12th October 2004.

## Interim assessment feedback

**9.84** Points arising from further feedback following the interim assessment included:

- all three Registrars-General and their staff have a close and constructive formal and informal relationship with GAD and there was satisfaction with the way GAD officials carried out their duties. The feedback supported GAD's submission that the constituent countries have confidence in GAD;
- but the existing arrangements are not the most efficient means of undertaking the population projections and associated demographic work. Fragmentation of demographic expertise across the public sector should be minimised; a transfer to the ONS would reduce fragmentation of demographic expertise and would make the production of the projections more efficient;
- whilst the professionalism and competence of the demographers at GAD is not in question, GAD relies on a very small team of people and therefore does not have a strong critical mass of demographic expertise to enable it to perform the projections;
- the review investigated the validity of perceptions that there were inefficiencies and delays in the process for producing the population projections. The review found that the Registrars-General and GAD work to a pre-arranged and published timetable, which is usually met. The timetable reflects the need for the Registrars-General to collect the base data, which is then passed across to GAD to undertake the projections;
- GAD is able to provide consistency of approach across all the UK countries, but there are alternative ways to ensure this consistency; and
- there is an overriding need to ensure demographic data is of the highest quality for policy development. Improvements are necessary.

**9.85** Whilst respondents in this area believed the population projections and associated demographic data should be considered a public good and therefore produced by a public sector organisation, some considered there were alternatives to the current arrangements which could produce a more efficient outcome. The alternative for which there was the most support was a transfer of the production of population projections and associated demographic data to the ONS on behalf of the Registrars-General of the UK. The review has therefore considered this option further.

## Option for change: transfer to ONS

**9.86** The transfer of population projections to the ONS was supported by a majority of respondents to the review, for a number of reasons.

**9.87** Bringing demographic work within ONS would increase the critical mass of demographic expertise that is available. There are currently 88 members of staff in the population and demography section of ONS, compared to around five within GAD.<sup>22</sup> ONS' demography section covers statistics and analysis and includes population estimates, sub-national population projections, migration statistics, families and family formation statistics, fertility statistics and other demographic analysis including high-level population estimates by ethnic group and the aged.

<sup>22</sup> The 88 staff within ONS comprise of 51 statistical/research staff and 37 in business operations.

**9.88** Ensuring a critical mass within a single organisation could deliver major benefits in the recruitment and retention of skilled demographers. It has been put to the review that the current, highly dispersed arrangements do not allow demographic experts to have easy access to the range of posts and opportunities that could be offered.

**9.89** The transfer of this work to the ONS would allow the ONS to improve the integration of demographic data with other statistical sources. For example, ONS could consider the labour market and migration in the context of what is happening to the population and its key characteristics such as age, gender, ethnicity, fertility and mortality. For England and Wales, there would also be the benefit of integrating the UK-level projections with the sub-national projections for these countries.

**9.90** Respondents suggested that by integrating the production of population projections within the ONS, all major official demographic statistics would be located within a single organisation, which could lead to a more co-ordinated approach to the release of demographic statistics and could mean a more effective response to challenges to population projections.

**9.91** A further argument for transferring the demography work to the ONS was that it would be more consistent with best international practice, where demographic services are typically carried out within the relevant population statistics offices.

**9.92** This work is currently funded from the roughly £1m Parliament Vote GAD receives. The review does not see any reason why the costs would rise if this work was transferred to the ONS. It is possible, that there could be small efficiency gains by rationalising some of this work. In practical terms, the Parliament Vote would simply be transferred across to ONS.

**9.93** The review therefore recommends that the production of the population projections and associated demographic data is transferred to the ONS.

**9.94** There is currently an open and consultative approach with the Registrars-General, ensured through existing mechanisms such as the existing National Population Projections Committee and underpinned by the Devolution Memorandum of Understanding. It would be essential to the success of any transfer that this is maintained.<sup>23</sup>

**9.95** Therefore, the review recommends that the ONS must ensure continuation of an open and consultative approach with the Registrars-General in the production of the population projections.

**9.96** The professionalism and expertise of the staff in GAD currently involved in demographic data collection has been praised and is certainly not in doubt. As such, the review recommends that the ONS consider taking on the existing demographic expertise within GAD.

**9.97** The success of this transfer to ONS will be measured by improvements to the quality of the population projections and associated demographic data. ONS should therefore commit to the improvement of this data.

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<sup>23</sup> Source: Devolution Memorandum of Understanding and Supplementary Agreements Between the United Kingdom Government, Scottish Ministers, the Cabinet of the National Assembly for Wales, and the Northern Ireland Executive Committee, January 2002. This Memorandum states: “the administrations will work together to ensure the provision of coherent, reliable, consistent and timely UK-wide statistics.”

## Recommendations

The review recommends that:

- the Government and the Devolved Administrations should agree to transfer the production of the national population projections and associated demographic data to the ONS; and
- the ONS should adopt an open and consultative approach with the Registrars-General in the production of the projections.

## 6. OCCUPATIONAL PENSION SCHEME SURVEY

**9.98** GAD carries out a survey of occupational pension schemes in the UK. The survey seeks to measure the extent to which employees in the UK are covered by occupational pension schemes and analyses the nature of the benefits provided, the contributions paid and other pension topics of interest to the government, employers and employees. GAD's work on the survey is paid for out of the roughly £1million Parliament Vote GAD receives.<sup>24</sup>

**9.99** The review recognises the important work that is currently underway through the Task Force on Pension Statistics in the ONS and the Advisory Group set up by GAD to look at ways to improve the Occupational Pension Scheme Survey and consider the most appropriate means of producing the survey.

### Initial consultation feedback

**9.100** The review received feedback from its initial consultation process that there was a need to: improve the response rates to the survey which at 28 per cent for the private sector and 40 per cent for the public sector were widely perceived to be too low from which to draw any significant policy conclusions; and ensure a more frequent and timely production of the data. The ONS review of pension statistics had called for a more co-ordinated approach to pension statistics in general and respondents to the review saw the potential for efficiency gains by a relocation of the survey.

**9.101** The Pensions Act 2004 gives the Pensions Regulator (TPR) increased powers to require information about occupational pension schemes. TPR will collect a database of core information on all pension schemes collected from the scheme return. With the exception of very small defined contribution schemes this information will be collected on an annual basis. To minimise the burden on business, TPR will ensure that the scheme return will be proportionate to the information that is required from all schemes to carry out its' regulatory functions. Therefore, to carry out a survey of pension schemes, TPR would have to ask for additional information.

<sup>24</sup> GAD had estimated that about a quarter of the £1million Parliament Vote would be spent on the Occupational Pension Scheme Survey in 2004-2005.

## GAD's response to initial consultation feedback

**9.102** GAD's response to the consultation feedback raised the following points:

- a new survey is already taking place under revised arrangements, working closely with an advisory group and using the latest internet technology. A good response rate has been achieved with a significantly improved quality of response. The GAD survey is probably one of the most accurate sources of pension statistics in the UK;
- the Occupational Pension Schemes Survey is very different and much wider in scope than anything ONS does in this field. The survey has always been the most comprehensive available of occupational pensions schemes in the UK; and
- the future role of the Pensions Regulator is critical and the exact nature of what is required will need to be worked out with TPR and other departments with an interest.

**9.103** These points were taken up in a second round of consultation.

## Interim assessment feedback

**9.104** The review received the following feedback largely from public sector stakeholders:

- the advisory group that GAD has set up to ensure that key users are consulted in putting the survey together, is an important development. However GAD's response rates for the current survey – 45 per cent for the private sector – even after the reforms it has undertaken, do not represent what is considered a high enough level to defend the accuracy of the data. GAD continues to attract low response rates because of its lack of questionnaire design expertise; a lack of experienced staff and established procedures for response chasing and a lack of tested methodology for grossing and handling issues relating to low response rates. GAD is also not classified as a 'competent authority' able to exercise powers under the Statistics of Trade Act, so whilst it remains responsible for the Occupational Pension Scheme Survey it cannot easily be brought within the scope of the Statistics of Trade Act to make it a statutory survey rather than voluntary as at present;<sup>25</sup>
- the Occupational Pension Scheme Survey is wide in scope, but the ONS undertakes two quarterly surveys and one annual survey of pension schemes. Its quarterly and annual surveys of insurance companies cover pension business handled by those companies. Three other surveys of employees or households (the Annual Survey of Hours and Earnings; the General Household Survey; and the Expenditure and Food Survey) also include questions on pension scheme membership and contributions from the perspective of the individual. The Occupational Pension Scheme Survey could not therefore be described as very different to anything ONS does in this field;

<sup>25</sup> GAD's own review of the Occupational Pension Scheme Survey states: 'full agreement to bringing the [survey] within the scope of the Statistics of Trade Act may be a lengthy process, and depends, in part, on the future control of the survey.' Available at: [www.gad.gov.uk](http://www.gad.gov.uk)

- the future role of the Pensions Regulator is important for the operation of the survey. The owner of the survey would need to have access to the register of pension schemes that TPR would develop, in order to have an accurate sampling frame from which to conduct the survey. The process of establishing which bodies can access the database would need to be worked through with TPR and government departments;
- respondents also noted the continuing demand for the statistics drawn from this survey, for example in monitoring trends in scheme closures and understanding the membership of different types of schemes; and
- however, respondents commented that setting up and running surveys is not part of GAD's core business. The Occupational Pension Scheme Survey is the only large scale statistical exercise GAD conducts, therefore, the statistical infrastructure, methodology and systems required for conducting a large scale survey are not in place in GAD, which has implications for both efficiency and the quality of results. These respondents noted as examples: GAD's lack of established procedures for validating contributor data; methodologies for dealing with the potential for bias in the survey; and only partial reconciliation of results against other government data which respondents considered was partly because of pressures on key staff.

**9.105** Overall, the review considers that there is a case for transferring this survey out of GAD, as there are potentially better equipped and more appropriate bodies to undertake this work. The review has therefore considered two options: transferring the Occupational Pension Scheme Survey to either TPR or the ONS.

### Options for change: transfer to the Pensions Regulator

**9.106** TPR would be in a position to ensure that information that had already been provided in the scheme return need not be collected, thus avoiding any duplication of scheme specific data. This would ensure that the administrative burden on the managers of schemes was kept to a minimum.

**9.107** The Occupational Pensions Regulatory Authority (Opra) has recently developed a research capability. There are currently around nine researchers working in Opra's research department, charged with conducting both surveys in-house and commissioning programmes of research to external agencies, to inform the regulatory approach. This will continue with TPR.

**9.108** TPR will have knowledge and expertise, based on its regulatory activities to feed in to the design of the survey to ensure it is asking the right questions.

**9.109** Opra informed the review that it achieves very good response rates to its surveys, even though the information is provided to Opra voluntarily, and quoted a recent example of 95 per cent to the latest occupational pensions survey of 444 schemes. The review notes that the current sample for the 2004 Occupational Pension Scheme Survey at 1,300 pension schemes is a larger exercise.

**9.110** In its response to the review Opra suggested that it would create an advisory panel of industry representatives, bodies and stakeholders, similar to that created by GAD, for the survey. Opra also suggested it would publish the findings from its surveys.

**9.111** However, by transferring the Occupational Pension Scheme Survey in its entirety to TPR, the costs for producing the survey would be transferred from the government to the levy payer (the pension schemes).

**9.112** Whilst TPR may have a research department, respondents did not consider producing surveys to be the Regulators' core business, as its focus will be on the regulation of occupational pension schemes.

**9.113** A further issue raised was that regulators are heavily restricted in the amount of information they can share outside of the organisation, even with other government departments. The review was informed that TPR would only be able to share information with DWP and the Inland Revenue. Respondents were very keen to ensure that the overall provision and availability of data in this important area should not deteriorate from the current position. Users also wanted to make sure that access to additional data, not included in a published report, would continue for key analysts, whilst respecting confidentiality issues, and that the survey would continue to be viewed as an intergovernmental resource.

**9.114** Some respondents had concerns about the level of consultation the Pensions Regulator would be permitted to undertake with government departments. Users valued the consultation and felt this allowed government pensions analysts, and other important users, to contribute to the development of the contents of the survey so that it remains focused on key pensions issues.

**9.115** The review therefore believes that whilst there are benefits from transferring the Occupational Pension Scheme Survey to TPR, there are also some disadvantages. The review therefore considered the option of transferring the survey to the ONS.

### **Options for change: transfer to ONS**

**9.116** The review received feedback that ONS already has the resources and skills to undertake survey work, which is its core business. There are 520 members of staff working on the data collection aspects of its business surveys, with a further 215 working on the results. These 735 members of staff are supported by a further 85 who manage the business registers on which the majority of the surveys are based. In addition there are teams of methodologists who are experts in areas such as survey sampling, questionnaire design, data editing and imputation and estimation, and also programming teams who write and maintain the survey processing systems. This is compared to the three full time equivalents in GAD working on the Occupational Pension Scheme Survey.

**9.117** Given ONS currently undertake about 70 surveys, 55 business and 15 social, representing the full range of monthly, quarterly, annual, continuous and ad-hoc surveys, respondents considered it was in the best position to understand existing burdens on business and to co-ordinate pension statistics in general.

**9.118** ONS are in a position, as a 'competent authority', to use the Statistics of Trade Act to make the Occupational Pension Scheme Survey a statutory rather than a voluntary survey. It has been put to the review that this could achieve overall response rates of up to 75-80 per cent.

**9.119** As a government department, ONS would have the same flexibility as GAD to undertake full consultation and in fact have also set up advisory groups to deal with the action plan following the ONS review of pension statistics. This would ensure that expertise and knowledge from other bodies, such as TPR, could feed into the design of the Occupational Pension Scheme Survey. The ONS are also in a position to be open with other



government departments (whilst respecting confidentiality) and ensure that the Occupational Pension Scheme Survey is viewed as an intergovernmental resource.

**9.120** It is unlikely that this transfer would mean an increase in costs, which would continue to be funded by the Government rather than pension schemes as in the case of a transfer to TPR.

**9.121** It was also noted that it is the national statistical office who would undertake an equivalent to the Occupational Pension Scheme Survey in many other countries. The transfer of this work to ONS would therefore be consistent with international best practice.

**9.122** The drawback with this approach is that to undertake as comprehensive a survey as possible, the ONS would need access to the register of pension schemes which TPR will develop under the Pensions Act, to ensure a robust sample frame and ensure the burdens on business were kept to a minimum. However, TPR as highlighted above will be restricted in terms of its ability to share such information.

**9.123** The review therefore sees a number of benefits in transferring the Occupational Pension Scheme Survey to the ONS, but recognises the importance of TPR's database in this process. On the basis of the evidence submitted the review concludes that its preference would be to transfer this work to the ONS, but that it should be for DWP, TPR and the ONS to consider whether this is the most practical option in the light of the access issues to TPR's database.

## Recommendations

The review recommends that:

- the Occupational Pension Scheme Survey be transferred out of GAD; and
- the Department for Work and Pensions, the Pensions Regulator and the Office for National Statistics (ONS) should consider the practicalities of transferring the Occupational Pension Scheme Survey to either the Pensions Regulator or ONS, although the review's preference would be to transfer the survey to the ONS.

## 7. OVERSEAS

**9.124** GAD's work overseas is mainly for public bodies and governments and covers:

- regulation and supervision of insurance companies;
- public sector pension schemes;
- social security reform; and
- actuarial training.

### Initial consultation feedback

**9.125** During the initial consultation phase the review received feedback which stated that, on the one hand, GAD wins the majority of its work overseas on the basis of competitive tender and client satisfaction with the service they receive; on the other some respondents had concerns that a significant proportion of the work GAD conducts overseas is in the area of insurance regulation, a function which GAD no longer undertakes in the UK. Respondents also questioned whether there was a benefit to the UK from the work GAD does overseas.

## GAD's response to initial consultation feedback

**9.126** GAD's response to these comments raised a number of points that the review paid close attention to:

- GAD's international activities are an important and growing area of activity; and
- GAD's international role does have very important advantages for UK clients, since GAD is an excellent source of information and advice on experiences in many countries around the world and makes it its business to keep well informed about pension reform issues, international accounting developments, insurance solvency discussions and so on.

## Interim assessment feedback

**9.127** The review received the following feedback from respondents:

- GAD, generally, wins overseas work by competitive tender and clients are satisfied with the service they receive; but
- respondents raised concerns that the basis on which advice is given to overseas clients and the extent to which the UK Government is ultimately responsible for that advice is unclear.

**9.128** The review understands concerns about the extent of the Government's liability and the difficulty in recognising the boundaries of what is and is not done for the UK Government by the Government Actuary and the department. The absence of any specifically laid out roles and responsibilities for both the Government Actuary and the department means that there are no clear limitations on the circumstance and purpose for which the Government Actuary or the department provides actuarial advice to clients outside of the UK public sector. This conflicts with the framework for other professional service providers in government, such as auditors and lawyers, where the parameters within which these services are provided to government are clearly set out. The Government should decide if it wants to remain responsible for the advice given by government actuaries outside of the UK public sector, and on what basis, or according to which policy framework, this advice should be given.

**9.129** Overall the review sees no reason why, in principle, the Government Actuary and GAD should not advise non-UK public sector clients, however, there is scope to clarify the basis on which the Government Actuary and GAD are operating when advising outside the UK public sector.

## Recommendation

The review recommends that:

- the Government should retain the existing flexibility whereby GAD is able to tender for overseas work, although the Government should clarify the basis on which the Government Actuary and GAD advises clients outside of the UK public sector.

## OTHER SERVICES

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**9.130** The review recognises that the assessment it has undertaken of the seven major services GAD provides has not considered other ad-hoc services, which generate small amounts of fee income, but which are undertaken for a variety of different clients.

**9.131** GAD's response to the review's interim assessment report stated:

- GAD undertakes a wide range of roles, many on an ad-hoc or one-off basis;
- a large number of clients incur annual charges well below £1,000, which may be said to be uneconomic; and
- these clients are not in a position to test the market.

**9.132** GAD lists examples of the services that it refers to as:

- advice to DTI on consumer credit;
- regular checking and independent certification of the randomness of the monthly premium bond draw;
- advice to the Inland Revenue on taxation issues in connection with the insurance industry and individual insurance companies;
- advice to the chairmen of employment tribunals on the assessment of the loss of pension rights in cases of unfair dismissal; and
- responsibility for advice to the Department for Constitutional Affairs on the discount rate for use in the assessment by Courts of damages and production of the Ogden tables required under the Damages Act 1996.

**9.133** The review received feedback that the cost to smaller clients of tendering for some of the services required from GAD would be disproportionate. Clients felt it was important therefore that there was an in-house actuarial advice provider ready to offer services, regardless of the fee-income that service generated.

**9.134** The review agrees but believes that the review's recommendations should not affect the ability of GAD to continue providing these ad-hoc services (see Conclusions below).

## INVOICING

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### Initial consultation feedback

**9.135** The review received extensive feedback that the invoicing procedures within GAD were inadequate. Complaints centred around both the lack of information on the invoice which meant clients had little or no idea what they were being charged for and the long delays in receiving the invoices after the work had been carried out.

### GAD's response to initial consultation feedback

**9.136** GAD responded as follows to this criticism:

- GAD readily concedes its invoicing procedures have not kept up-to-date with the increasing demands of clients, but this is not a valid reflection of the quality of service and advice GAD provides;
- the delegation of budgets within government departments often contributes to invoicing difficulties when there is inadequate communication between the budget-holder to whom the advice has been provided and the finance department to which invoices are submitted; and
- GAD has implemented an IT package. Additional capabilities from this software will very shortly permit more detailed billing to clients on a regular basis.

### Interim assessment feedback

**9.137** The review consulted GAD's clients who put forward the following points:

- the invoicing problem is one which is straightforward to overcome and whilst it does not impact on the standard of advice clients receive, it is an issue to resolve in terms of GAD's customer focus;
- clients felt it was less about inadequate communication with the client and their finance departments that has led to invoicing difficulties, and more about improving the information on the invoice;
- GAD clients want to see an invoicing system which is clear, timely and customer focused; and
- there were no specific comments made to the review on the impact of GAD's new IT package on the service.

## Recommendation

The review recommends that:

- GAD should ensure its invoicing of clients is clear, timely and customer-focused.

## CONCLUSIONS

**9.138** The review has undertaken a thorough consultation process, asking GAD clients what actuarial advice they required and how satisfied they were with GAD's services. Whilst the review received a broad range of feedback in support of the full range of options for the future of GAD, from retention of the status quo to privatisation of the department, it was evident that the majority of respondents saw clear value in the continued provision of actuarial advice from a public body such as GAD, in addition to the Government Actuary's statutory duties. The review's proposals are consistent with this even though they reflect a need for change in some specific areas. GAD is an important source of actuarial advice to Ministers, government departments and the wider public sector and will continue to be so provided it delivers a high quality service to its clients.

**9.139** The review's recommendations are broadly to de-regulate actuarial advice to pension schemes where currently the Government Actuary is required under legislation to provide it; to clarify that any professionally qualified actuary is able to undertake assessments of broad comparability; to embed the work on social security within the DWP and Inland Revenue, but retain the statutory responsibilities of the Government Actuary to advise Parliament on the National Insurance Fund; to transfer the work on population projections to the ONS; to transfer the Occupational Pension Scheme Survey to either the Pensions Regulator or ONS, although on balance, the review's preference would be the ONS; but otherwise to retain the status quo including on pensions policy advice, overseas work and other services GAD currently provides.

**9.140** The review has considered the impact of its recommendations on the overall viability of GAD as an organisation.

**9.141** The advice to public sector pension schemes as a whole accounts for 32 per cent of GAD's total income. However, this figure is an upper limit as it relates to all public sector schemes; only a proportion of these schemes are required in legislation to use the Government Actuary for advice.<sup>26</sup> Assessments of broad comparability account for 3 per cent of GAD's total income.<sup>27</sup>

**9.142** The impact of the review's recommendations will depend on whether GAD continues to provide a good quality service to its clients. If it does then clients will not, to any great extent, if at all, switch to the private sector and there will be little or no impact from these recommendations. If GAD does not provide sufficiently good quality service then clients will consider switching. It is therefore GAD's response to these recommendations which will determine their impact on the organisation. The review is clear that clients should not be forced to use GAD under legislation if they perceive their interests to be better served elsewhere.

<sup>26</sup> This figure has been calculated on the same basis as highlighted in paragraph 9.5 of this chapter.

<sup>27</sup> Ibid.

**9.143** The review has also recommended that a proportion of social security work is taken in-house to the DWP and Inland Revenue, but with the Government Actuary retaining statutory responsibilities and control of the rebates work. The total income it represents currently is 7 per cent.<sup>28</sup> However, this recommendation will require a continuing resource within GAD to fulfil the Government Actuary's statutory responsibilities and to undertake the rebates work.

**9.144** The review's recommendations to transfer the largely non-actuarial services of population projections to the ONS and the Occupational Pension Scheme Survey to either the ONS or the Pensions Regulator represent a movement of 9 per cent of GAD's total income.<sup>29</sup> Typically these functions have attracted specialist demographers and researchers rather than actuaries.

**9.145** The total effect of these recommendations would therefore be a combined loss of 9 per cent of GAD's income through the transfer of functions to the ONS, and a loss of a proportion of the social security work, which the review estimates could be just under half i.e. around 3 per cent. The total loss of income would be roughly 12 per cent. The review does not believe that these losses alone would materially affect GAD's ability to continue providing an in-house source of advice to other areas of government. For the rest of GAD's services, the amount of income GAD generates will depend on the extent to which it continues to meet its clients' needs.

## INSTITUTIONAL STRUCTURE OF GAD

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**9.146** Taking into account the recommendations the review has proposed, the Parliament Vote GAD receives to undertake the population projections and the Occupational Pension Scheme Survey will be removed. Assessing the overall structure of GAD, therefore, GAD will, for the most part, be a fee-generating organisation.

**9.147** Under the current arrangements, GAD must break even in a budget year and is not permitted to retain any surpluses. If GAD earns a surplus, it remits this back into the Government's central funds. If GAD wants to make any capital expenditure this has to be agreed by Parliament in the original estimate of spending that GAD puts forward for the budget year. HM Treasury must monitor GAD's performance to budget throughout the year to ensure GAD is not left with an 'excess vote', i.e. they have spent more than was agreed with Parliament.

**9.148** GAD will have to compete for more of its work following the review's recommendations. As a fee-charging public sector organisation restricted by the budget process of a government department, the review does not believe that GAD has sufficient flexibility to manage its finances, invest and respond to pressures and opportunities adequately.

**9.149** The review investigated a number of alternative institutional models within the public sector.

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<sup>28</sup> Ibid.

<sup>29</sup> Ibid.

**9.150** Alternative institutional models include:

- Executive agencies
- Executive Non-Departmental Public Bodies
- Statutory corporations
- Government-owned companies

**9.151** However, none of the above models afford GAD an opportunity to manage its own budget; retain the status of its staff as civil servants; and allow it to offer services outside of the public sector. The review therefore considered trading fund status which would offer all of these opportunities for GAD.

## Trading Fund

**9.152** The key characteristics of a trading fund are summarised as follows:

- it generates income from the supply of goods and/or services;
- it can retain its income, and has standing authority to meet its expenditure from those receipts;
- its income and expenditure are not subject to advance Parliamentary approval;
- it can build up cash reserves, and is not subject to the requirement to surrender cash;
- Parliamentary control is exercised through the approval of the Order establishing the trading fund, and by the laying of a Treasury Minute setting out the financial and non-financial targets set for the fund;
- the fees or charges made for the goods and/or services provided are driven by the need to achieve the financial target;
- it is statutorily required at least to break-even;
- on establishment of a trading fund, Crown assets and liabilities are appropriated to the fund at agreed values; the net value is matched by a combination of loan capital and public dividend capital and, in some circumstances, existing accounting reserves;
- it must pay for all of the services it receives and recovers the costs through fees and charges; and
- it has powers to borrow – for example from the National Loan Fund - to fund capital expenditure or short-term working capital requirements.

**9.153** The review believes that this structure would be of benefit to GAD. It would give GAD the ability to plan strategically over the long-term and would afford GAD the opportunity to retain its status as a public sector organisation, with its staff as civil servants, whilst giving it the flexibility to compete on more of a level playing field with the private sector.

**9.154** The review consulted some existing trading funds. The feedback was very positive. They felt they were able to respond faster to changing circumstances. They also believed trading fund status had provided them with a real focus on output and performance, with a management structure that reflected the needs of the business.

**9.155** The review fully understands that the process of setting GAD up as a trading fund is one which could be lengthy and requires a full business case to be put forward. The review recognises therefore that there is much more to do before the Government could establish GAD as a trading fund. The Government would need to consider whether there are any drawbacks to this approach although none were put to the review in the consultation. The review therefore believes there are considerable benefits to such a change in GAD's structure which warrant the consideration of Government.

## Recommendation

The review recommends that:

- the Government should consider converting GAD into a trading fund.



# A

## MEMBERSHIP OF THE EXTERNAL ADVISORY PANEL

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**A.1** At the start of the review Sir Derek Morris appointed an external advisory panel. Members were chosen in their personal capacity as experts in a particular area or field rather than as representatives of any of the organisations with which they have connections.

**A.2** The members of the external advisory panel are:

Philip Broadley: Group Finance Director and a Board member of Prudential Plc since 2000. Previously worked for the UK firm of Arthur Andersen where he became a partner in 1993. He is a chartered accountant.

Steven Haberman: Deputy Dean and Professor of Actuarial Science at the Cass Business School, City University. Fellow of the Institute of Actuaries, Royal Statistical Society, Institute of Mathematics and its Applications, and an invited member of the New York Academy of Sciences.

Elaine Kempson: Professor of Personal Finance and Social Policy Research, and Director of the Personal Finance Research Center at Bristol University.

Paul McCrossan: Fellow of the Society of Actuaries and the Canadian Institute of Actuaries. Served on the Council, and as President, of the Canadian Institute of Actuaries. Elected Chairman and President of the International Forum of Actuarial Associations representing professional actuaries worldwide, in 1995.

Roger Munson OBE: a chartered accountant, formerly a partner with the UK accountancy firm Coopers & Lybrand. Also held a number of other professional responsibilities, including membership of the Accounting Standards Board. Member of the Competition Commission 1996-2003. From 2002 has been an advisory director of Ofwat.

Peter Tompkins: partner in the Human Resource Services business of PricewaterhouseCoopers. Heads the practice's Investment Consulting Business and provides retirement and actuarial advice to a range of investment and insurance clients.

Adair Turner: Chair of the UK Pensions Commission, Vice Chairman of Merrill Lynch Europe, a director of United Business Media Plc, and Chair of the UK Low Pay Commission.



# B

## LIST OF CONTRIBUTORS TO THE REVIEW

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**B.1** The review received approximately 100 written contributions and reactions to its consultation document published on 28 June 2004, and around 70 to its interim assessment report published on 17 December 2004. The review also held a large number of meetings with a wide range of stakeholders.

**B.2** The following list of contributors includes those who have:

- given a written response; or
- met with the review team.

**B.3** The review has endeavoured to ensure that all organisations and individuals are included here. However, please note that the review held over 40 bilateral meetings with clients of the Government Actuary's Department and received written comments from 27, but for reasons of client confidentiality these names have not been published. A number of other contributors to the review requested that their submissions be kept confidential and are also not included in the list below.

**B.4** The review team wishes to express thanks for all contributions to the review.

### ACADEMICS

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Cass Business School

Heriot-Watt University

London School of Economics

University of Kent

University of Nottingham

University of Southampton

University of Warwick

### ACTUARIAL FIRMS AND PROFESSIONAL BODIES

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Actuarial Profession: Faculty and Institute of Actuaries

Aon Ltd

Association of Consulting Actuaries

Barnett Waddingham LLP

CheckleyFisher LLP

Deloitte & Touche LLP

EMB Consultancy LLP

First Actuarial Plc

Hewitt Bacon & Woodrow Ltd

HSBC Actuaries and Consultants Ltd

Hymans Robertson  
Ian McKeever and Co  
KPMG LLP  
KS Professional Services Ltd  
Lane Clark & Peacock LLP  
Mellon Resources & Investor Solutions Ltd  
Mercer Human Resource Consulting LLC  
Milliman UK  
Oxford Actuaries and Consultants Plc  
PricewaterhouseCoopers LLP  
Staple Inn Actuarial Society  
Punter Southall & Co Ltd  
Steve Dixon Associates  
Towers Perrin  
Watson Wyatt LLP

## **BUSINESS**

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Abbey National Plc  
Aviva Plc  
Barclays Life Assurance Company Ltd  
Equitable Life Assurance Society  
Friends Provident Life and Pensions Ltd  
GE Insurance Solutions  
HSBC Bank Plc  
Legal & General Group Plc  
Lloyd's of London  
Lloyds TSB Group Plc and Scottish Widows Plc  
Standard Life Group

## **GOVERNMENT**

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Department of Trade and Industry  
Department for Work and Pensions  
Economics in Government  
Government Accountancy Service  
Government Actuary's Department  
Government Legal Service  
HM Treasury

National Audit Office  
Office for National Statistics  
Office of Fair Trading

## INDIVIDUALS

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Mr Terry Arthur BSc  
Mr Anthony Asher FIA  
Mr Stavros Christofides  
Mr Graham Clay FIA  
Sir David Clementi  
Mr Paul Coombes  
Mr Roger Dix FIA  
Mr Lee Faulkner FIA  
Mr John Flowers  
Mr David Forfar FFA  
Mr Norman Freethy FIA  
Mr Alastair Ross Goobey Hon FIA, CBE  
Mr Paul Grace FFA  
Mr Solomon Green FIA  
Mr David Hart FIA  
Mr David Innes FIA  
Ms Julie Johnson FIA  
Mr Michael Josephs  
Mr C G Lewin FIA  
Mr Julian Lowe FIA  
Mr Peter Mansell FIA  
Professor JJ McCutcheon, CBE  
Sir Nick Monck  
Mr Paul Myners  
Mr Geoffrey Rashbrooke FIA  
Mr Ian Reynolds FIA  
Mr Rob Rowley  
Mr Junichi Sakamoto  
Mr Clifford Sharp FIA  
Mr Hugh Stevenson  
Mr David Stonebanks  
Mr Philip Taylor FIA

Mr Guy Thomas FIA

Mr M D Thornton

Dr Rudolph Vis MP

Mr Stuart Walker FIA

Mr Tony Walker MP

Mr David Wilkie CBE, Hon D Sc, Hon D Math, MA, FFA, FIA, FSS, FIMA

Mr John Woolhouse FIA

## **INTERNATIONAL**

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American Academy of Actuaries

Institute of Actuaries, Australia

Australian Government Actuary

Institute of Actuaries, Canada

Life and Health Insurance, Canada

Office of the Chief Actuary, Canada

Office of the Superintendent of Financial Institutions, Canada

Groupe Consultatif Actuariel Européen

Actuarial Association of Finland

Office of Statistics, Department for Population and Equality, Finland

Actuarial Association of Germany

Actuarial Association of Hungary

Ministry of Finance, Hungary

Actuarial Society of India

International Actuarial Association

International Underwriting Association of London

The Pensions Board, Ireland

Society of Actuaries, Ireland

Actuarial Institute of Italy

Ministry of the Economy and Finance, Italy

Actuarial Association of Mexico

Pensions and Insurance Supervisory Authority, the Netherlands

New Zealand Society of Actuaries

Actuarial Society of Singapore

Actuarial Society of South Africa

**OTHER**

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Accountancy Investigation and Discipline Board  
Accounting Standards Board  
Association of British Insurers  
Association of Lloyd's Members  
Centre for Effective Dispute Resolution  
CIPFA Scotland Pension Funds Group  
Committee of Unilever Pensioners  
Consumers' Association  
Equitable Members' Action Group  
Financial Reporting Council  
Financial Services Authority  
Financial Services Consumer Panel  
Independent Pensions Research Group  
Institute of Chartered Accountants in England and Wales  
Institute of Management Accountants  
Investment Management Association  
Investors' Association  
Law Debenture Pension Trust Corporation Plc  
National Association of Pension Funds  
Occupational Pensioners' Alliance  
Occupational Pensions Regulatory Authority  
Pensions Commission  
Pensions Management Institute  
Pensions Ombudsman  
Pensions Policy Institute  
Professional Oversight Board for Accountancy  
Prospect Trade Union  
Public and Commercial Services Union  
Society of Pension Consultants  
UK Society of Investment Professionals  
UNISON

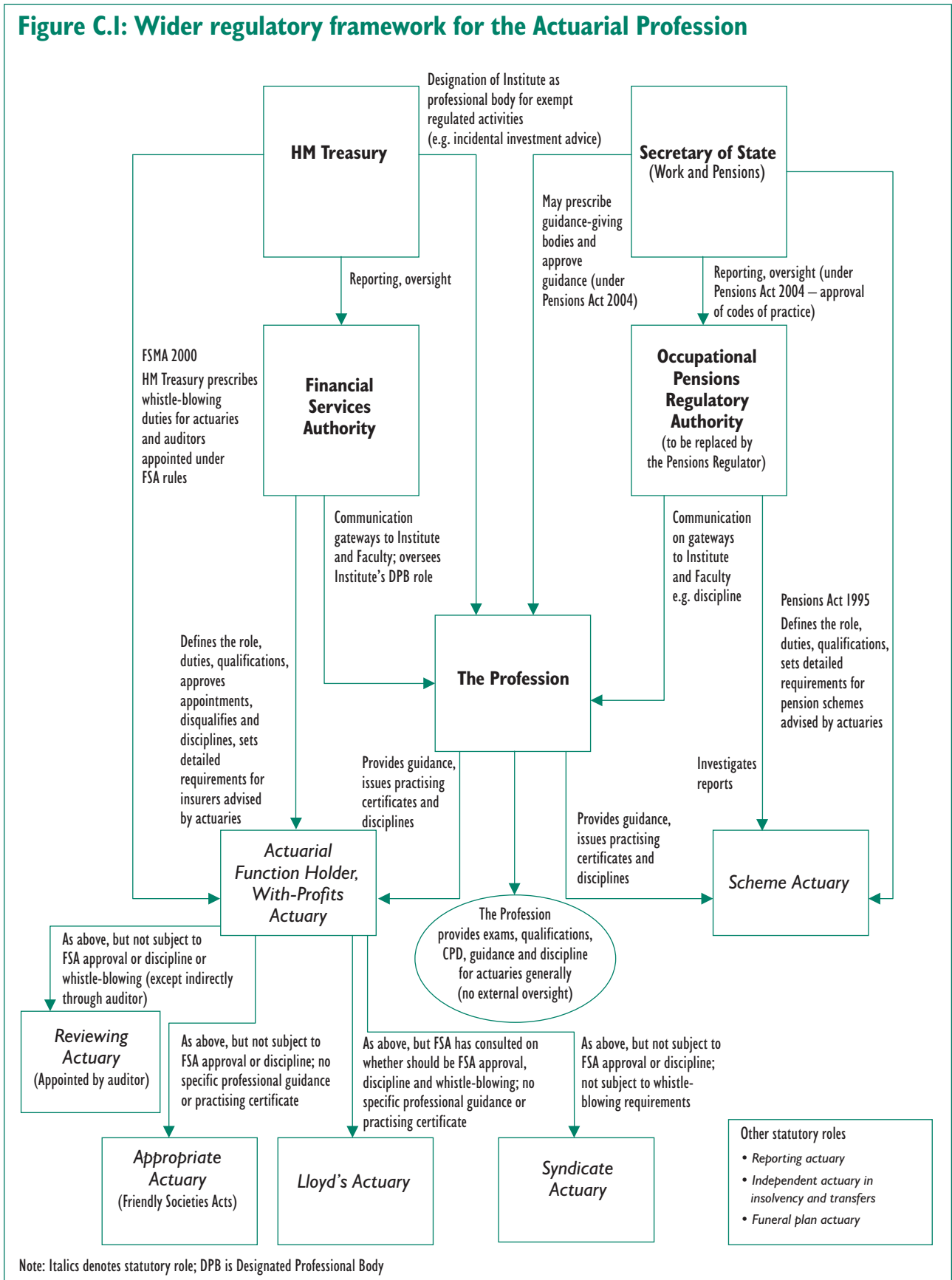
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## LIST OF CONTRIBUTORS TO THE REVIEW

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**Figure C.I: Wider regulatory framework for the Actuarial Profession**



**C.1** Statutory regulation of actuaries coincides with the Profession's self-regulation of its members in a number of respects:

- Statutory actuarial roles: financial services, pensions, companies, and friendly societies legislation and FSA rules all require institutions to appoint or use an actuary for various purposes, and define the qualifications required. Actuaries performing controlled functions require FSA approval.
- Whistle-blowing: specified actuaries are subject to requirements to report certain matters to the FSA and to Opra and have legal protections if they disclose matters to the regulators in good faith.
- Standard-setting: duties are imposed on actuaries performing regulatory roles. The FSA makes rules about the actuarial methodology adopted by authorised insurers. FSA rules require insurers to have regard to generally accepted actuarial best practice.
- Monitoring: FSA supervisors monitor the work of actuaries employed by an FSA-authorised insurer.
- Discipline: as well as taking action against actuaries performing specified roles, the FSA may prohibit any actuary it considers unfit from performing any function for a regulated or exempt financial services firm.
- Exempt professional firms: the FSA oversees the Institute as a designated professional body under FSMA, and may act to end the exemption of any actuarial firm it considers unfit or restrict the activities of a class of firms.

**C.2** The FSA and the Profession have published a memorandum of understanding covering the FSA's relationship with the Institute of Actuaries as a designated professional body under FSMA. There is no similar statement of the relationship or balance of responsibility between the Profession and the regulators in other areas.

**C.3** However, the Profession has informed the review that it and the FSA are working to develop an operating protocol covering how to share information on discipline and enforcement matters that are of mutual interest.

**C.4** Opra has agreed, but not published, procedures it follows before it passes cases by the Profession. They have also agreed that a memorandum of understanding between Opra and the Profession would be helpful but because of their other priorities this is unlikely to be until they have evolved into the Pensions Regulator.

**CHAPTER 2: THE MARKET FOR ACTUARIAL SERVICES****Choice of provider****a) professional indemnity insurance**

The review recommends that:

- the Office of Fair Trading (OFT), in its follow-up review of the liability insurance market, considers the circumstances facing firms in the actuarial services market seeking to obtain professional indemnity insurance (PII) cover, evaluates the related risk of market exit leading to undue market concentration, and recommends measures that might be taken to make the market function more efficiently;
- the OFT should review the market for actuarial services in two years time to assure itself that concerns about concentration have not been realised due to the persistence of alleged problems relating to the availability and cost of PII cover;
- the Profession, the Association of Consulting Actuaries (ACA) and its membership should consider in more detail the use of proportionate liability clauses in contracts; and
- the Profession should work with the ACA, the Association of British Insurers (ABI) and other industry bodies to ensure suitable guidance on risk mitigation is available to those underwriting PII and those seeking to buy it.

**b) multi-service provision**

The review recommends that:

- it is best practice for pension fund trustees to invite tenders separately for actuarial advice, strategic investment advice and fund manager selection advice, as proposed by the Government in its recent revision of the Myners principle on expert advice.

The review recognises that in some cases it may prove cost-effective for trustees to award multiple contracts to a single supplier. However, the review recommends that:

- if only a multi-service contract is put out to tender, trustees should explain the reasons why they did not issue separate tenders in the scheme statement of funding principles.

## Market testing

The review recommends that:

- as a matter of best practice, pension scheme trustees should:
  - (i) informally evaluate their actuarial advisers on an annual basis;
  - (ii) undertake a more formal evaluation every three years, with input from a suitably qualified expert if needed, leading to a market test if unresolvable problems are identified; and
  - (iii) undertake a formal market test of their actuarial advisers no less frequently than every six years. A degree of flexibility should be permitted in relation to the timing of the market test;
- trustees should report their compliance with this approach or explain why it has not been adopted; and
- the Government should amend the relevant Myners principle to reflect the substance of this recommendation.

## Scrutiny of actuarial advice

### a) increasing user understanding

Measures that equip users of actuarial advice to challenge and question actuarial advice on an ongoing basis are to be welcomed. In particular, the Pensions Regulator should be supported in its work to increase the knowledge and understanding of pension fund trustees.

The review recommends that:

- the Pensions Regulator should, with input from the actuarial profession and other industry bodies, ensure that trustees have access to good practice guidance on the effective management of their professional advisers, including their Scheme Actuary. Information and case study material should be provided to help trustees to challenge their actuarial advice and should provide them with guidance on potential conflicts of interest; and
- the ABI should, with input from the actuarial profession, consider how education and training might be provided for non-executive directors of insurance companies to assist them to challenge actuarial advice.

## b) actuarial communication and disclosure

The review recommends that:

- the Actuarial Standards Board should develop a generic standard on communication covering the content of actuarial communications and the use of those communications by others. The new standard should cover the need for actuaries to disclose relevant information on the following areas:
  - (i) assumptions;
  - (ii) methodologies;
  - (iii) nature of calculations and the exercise of judgment;
  - (iv) sensitivity and scenario analysis;
  - (v) characterisation of risk in relation to sensitivities and scenarios;
  - (vi) relative importance of risks and the capacity of the client to bear them; and
- the substance of the new standard should, where applicable, be reflected in all professional standards going forward.

## CHAPTER 3: THE PROFESSION AND REGULATION

The central recommendation of the review is that regulation of the actuarial profession should be subject to independent oversight by the Financial Reporting Council (FRC). The FRC should:

- create an Actuarial Standards Board as a new operating body of the FRC to set actuarial professional standards;
- extend the remit of the Professional Oversight Board for Accountancy (POBA), an operating body of the FRC, to oversee the regulatory and other activities of the actuarial professional bodies, including oversight of the actuarial profession's role in:
  - setting ethical standards;
  - administering the education system and continuing professional development scheme;
  - the monitoring of compliance with professional standards; and
  - administering disciplinary procedures.
- develop a formal agreement with the actuarial professional bodies outlining the respective roles and responsibilities of the FRC, its operating bodies and the actuarial profession. In particular establish procedures to ensure the technical standards established by the Actuarial Standards Board are adopted, the recommendations of the oversight body are implemented and members of the actuarial profession are subject to the findings of the independent disciplinary arrangements.

The review recommends that the Government should, in due course, legislate to provide the FRC with statutory powers to set actuarial professional standards and oversee the regulatory activities of the actuarial profession.

## CHAPTER 4: EDUCATION AND CONTINUING PROFESSIONAL DEVELOPMENT (CPD)

### Oversight of the Profession

The review recommends that:

- the remit of the Professional Oversight Board for Accountancy (POBA) should be expanded to oversee the regulatory and other activities of the actuarial professional bodies including: oversight of the actuarial profession's role in administering the education system, the CPD scheme and the professional revalidation programme.

### Education syllabus and governance

The review recommends that, subject to oversight by the Professional Oversight Board for Accountancy (POBA):

- the Profession proceeds as planned with recently introduced and forthcoming reforms of the education syllabus; and
- the Profession should seek to promote broader input into the development of the syllabus and associated teaching material.

### Examination process

The review recommends that, subject to oversight by the Professional Oversight Board for Accountancy (POBA):

- the Profession should improve quality control in relation to examination setting and marking, if necessary through the greater involvement of external experts.

## Broadening actuarial education provision

The review recommends that, subject to oversight by the Professional Oversight Board for Accountancy (POBA):

- the Profession should take the lead working with universities and employers of actuaries in producing and delivering a new education and training strategy;
- the Profession, universities and employers should explore alternatives to the traditional education model of on-the-job part-time study, which has tended to restrict the use of actuarial skills to the insurance and pensions industries and has led to lengthy average qualification times;
- the Profession should promote one-year postgraduate actuarial conversion courses, in conjunction with the universities and employers, which would teach the core technical skills and which could be followed by a period of on-the-job training and part-time study to acquire the relevant work experience and specialist skills and exams for full Fellowship;
- the Profession should consider simplifying its exam exemption policy so that it is simpler for prospective university students to understand the levels of exemptions granted by pursuing alternative university courses; and
- the Profession should consider accrediting university departments rather than their individual courses in order to make it easier for university departments to offer innovative new courses.

## CPD scheme

The review recommends that, subject to oversight by the Professional Oversight Board for Accountancy (POBA):

- the Profession should clarify the objectives of the CPD scheme, consider increasing the amount and quality of formal CPD required for reserved role holders, and foster closer links between those within the Profession with responsibility for syllabus development, the actuarial research community and those concerned with CPD; and
- the Profession should ensure that the CPD scheme is relevant, up-to-date and takes account of developments in actuarial science, financial markets and other disciplines.

## Monitoring of CPD

The review recommends that, subject to oversight by the Professional Oversight Board for Accountancy (POBA):

- the Profession should proceed with its proposals for professional revalidation and related changes to the CPD scheme, ensuring that robust measures are put in place to monitor compliance with their respective requirements.

## CHAPTER 5: ACTUARIAL ROLES

### Reserving roles in pension schemes and life insurers

The review accepts that, at the present time, there is a continued need for roles to be reserved to actuaries in life insurance and pensions.

The review recommends that:

- in the medium term, the Government and the regulators should keep the roles that they reserve to actuaries under review, with a view to opening up the roles to other suitably qualified professionals.

### With-Profits Actuary

The review recommends that:

- as a matter of good practice there should be independent input into the appointment and remuneration of the With-Profits Actuary, for example by the With-Profits Committee, if one exists, or otherwise the Audit Committee; and
- that the FSA should, in line with its risk-based approach, pro-actively monitor a sample of insurers' with-profits annual reports and accompanying opinions as well as any issues that arise from them.

### Pension schemes

The review recommends that:

- pension fund trustees, the scheme sponsor and the Scheme Actuary should explicitly agree that they perceive no material conflicts of interest prior to the Scheme Actuary advising both the trustees and the scheme sponsor;
- if any of the three parties, i.e. any one of the trustees, the Scheme Actuary or the scheme sponsor, deem at any point that a material conflict of interest has emerged, in relation to the same actuarial advisor advising both parties, then the trustees should have the option to retain the existing adviser and the sponsor should secure separate actuarial advice; and
- the Profession, or another appropriate body, should develop guidance for actuaries on the issues that they should take into account when considering the materiality of potential conflicts.

### General insurance

The review recommends that:

- the FSA consider consulting on introducing a requirement for general insurers to take appropriate advice from an approved person with relevant skills in risk assessment and the valuation of liabilities, who may or may not be a Fellow of the Institute or Faculty of Actuaries.



## CHAPTER 6: STANDARD-SETTING

The review recommends that:

- the Financial Reporting Council (FRC), in consultation with the Institute and Faculty of Actuaries, should establish an Actuarial Standards Board;
- the remit of the Actuarial Standards Board should be to set technical standards, which are broadly equivalent to the Profession's existing guidance notes and largely relate to specific actuarial roles and functions;
- the Profession should continue to set ethical standards, which are broadly equivalent to the existing Professional Conduct Standards (PCS), subject to oversight by the Professional Oversight Board for Accountancy (POBA);
- the Actuarial Standards Board should have reserve power to issue ethical standards if either:
  - (i) POBA has concerns about the quality of the Profession's ethical standards; or
  - (ii) the Actuarial Standards Board believes it to be appropriate.

## CHAPTER 7: THE PUBLIC INTEREST AND ACCOUNTABILITY

### Protecting the public interest

To protect the public interest, actuaries have public interest obligations and duties. These include:

- duties to whistle-blow and report to the statutory regulators in specific circumstances; and
- duties to comply with professional standards – both ethical and technical standards.

The review makes a number of recommendations in relation to reporting and whistle-blowing below and makes a number of recommendations in Chapter 8 to ensure that there is compliance with technical and ethical standards.

## Reporting and whistle-blowing

The review recommends that:

- the Financial Services Authority (FSA), the Pensions Regulator, and the Profession should work together and issue clearer guidance 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;
- the Government consider re-expressing whistle-blowing obligations on actuaries appointed to perform regulatory functions for FSA-authorised firms in terms of prescribed matters which an actuary has 'reasonable cause to believe' (as is already the case for Scheme Actuaries), rather than the current less enforceable formulation 'reasonably believes';
- the Government consider extending whistle-blowing obligations on auditors of insurers to include the circumstances which must be reported on by actuaries (including syndicate auditors and actuaries if the FSA introduces a statutory role in general insurance);
- the Government consider extending whistle-blowing duties and protections for disclosures to the FSA by other actuaries performing or supporting statutory or regulatory roles, such as the Reviewing Actuary, syndicate actuaries, reporting actuaries, funeral plan actuaries and skilled persons appointed to report on an insurance business transfer;
- in the longer term, the Government consider whether any additional protections can be given to whistle-blowers generally, e.g. supplementing the existing relief from duties of confidentiality with statutory provisions conferring qualified privilege (i.e. when acting in good faith) from actions in defamation.

## Reporting on compliance with professional standards

The review believes that the public interest will be served through actuaries' compliance with high-quality professional standards, and that this can best be ensured through enhanced scrutiny supported by reporting and whistle-blowing to statutory regulators, the Financial Reporting Council (FRC) and the Profession.

In order to ensure that information is shared between the existing statutory regulators, members of the actuarial profession and the FRC the review recommends that:

- the Government should ensure there are appropriate gateways between the FSA and the Pensions Regulator, and the FRC; or consider giving the FRC powers to confer whistle-blowing duties on actuaries in specified roles;
- the Government should consider designating the FRC as a prescribed person under the Public Interest Disclosure Act 1998; and
- the Government should ensure there are appropriate gateways and reliefs from duties of confidentiality for communications between the FRC, statutory regulators and the Profession.

## CHAPTER 8 SCRUTINY AND DISCIPLINE

### Life insurance

The review recognises the need for independent scrutiny of actuarial advice and strongly supports the FSA's Reviewing Actuary role as currently specified.

However, the review notes that there may be some elements of actuarial advice, calculations and compliance with some professional standards that are not likely to be scrutinised by the Reviewing Actuary.

The review recommends that:

- as a matter of urgency, the Profession should identify any gaps in the monitoring of compliance with actuarial standards or significant actuarial calculations within an insurer that are unlikely to be scrutinised by the Reviewing Actuary, and might therefore benefit from peer review and should report to POBA on this matter;
- in the meantime, insurers should themselves consider whether peer review of the actuarial advice that they receive is appropriate; and
- in the light of the above, the Financial Reporting Council, working closely with the FSA and the Profession, should – within 2-3 years – satisfy itself that appropriate monitoring of actuaries' compliance with professional standards and independent scrutiny of actuarial advice is occurring through either direct supervision by the regulator, audit or external peer review.

### Pensions

The review believes that independent expert scrutiny of Scheme Actuary advice is critical, given the importance of actuarial advice to trustees.

The review recommends that:

- the Pensions Regulator should ensure that Scheme Actuaries' advice to pension schemes is subject to formal scrutiny by independent experts, through either risk-based supervision, audit, or external peer review. The Pensions Regulator may wish to adopt different approaches for large schemes and smaller schemes;
- in the meantime, the review supports the Profession's introduction of peer review for Scheme Actuaries' advice; and
- in the light of the above, the Financial Reporting Council, working closely with the Pensions Regulator and the Profession, should – within 2-3 years – satisfy itself that appropriate monitoring of actuaries' compliance with professional standards and independent scrutiny of actuarial advice is occurring through either direct supervision by the regulator, audit or external peer review.

## General insurance

The review recommends that:

- the FSA should consider consulting on introducing a requirement for actuarial advice as part of audit, in both the company market and the Lloyd's market for general insurers; and
- the Financial Reporting Council, working closely with the FSA and the Profession, should – within 2-3 years – satisfy itself that appropriate monitoring of actuaries' compliance with professional standards and independent scrutiny of actuarial advice is occurring through either direct supervision by the regulator, audit or external peer review.

## Discipline

The review recommends that:

- the remit of the Professional Oversight Board for Accountants (POBA) should be extended to oversee the disciplinary scheme for actuaries;
- the Accountancy Investigation & Discipline Board should assume a role in investigating and hearing public interest disciplinary cases involving actuaries; and
- closer links should be engendered between regulators and the disciplinary schemes.

## CHAPTER 9 GOVERNMENT ACTUARY'S DEPARTMENT

### Public service pension schemes

The review recommends that:

- the Government should remove the legislative requirements for the Government Actuary to provide actuarial advice to public service schemes and allow government departments a choice of actuarial adviser. Government departments should remain free to use GAD's services if they so choose; and
- HM Treasury should, where necessary, continue to facilitate a consistent approach to public service pension schemes.

### Assessments of broad comparability

The review recommends that:

- the Government should ensure that the principles of the Fair Deal are understood and explicit: that government departments have a choice as to their actuarial adviser for assessments of broad comparability; and
- GAD should make clear that it is a competitor in the market for assessments of broad comparability and is not the sole provider of this service.

### Pensions policy advice

The review recommends that:

- the Government should retain the existing situation whereby government departments have the flexibility to use the most appropriate provider of actuarial advice on pensions policy i.e. including both GAD and private sector actuaries.

### Social Security

The review recommends that:

- the Government should embed National Insurance Fund projections and any associated work in the Department for Work and Pensions (DWP) and the Inland Revenue; and
- the Government Actuary will remain responsible for the statutory reports to Ministers and Parliament directly on the National Insurance Fund.

## Population Projections

The review recommends that:

- the Government and the Devolved Administrations should agree to transfer the production of the national population projections and associated demographic data to the ONS; and
- the ONS should adopt an open and consultative approach with the Registrars-General in the production of the projections.

## Occupational Pension Scheme Survey

The review recommends that:

- the Occupational Pension Scheme Survey be transferred out of GAD; and
- the Department for Work and Pensions, the Pensions Regulator and the Office for National Statistics (ONS) should consider the practicalities of transferring the Occupational Pension Scheme Survey to either the Pensions Regulator or ONS, although the review's preference would be to transfer the survey to the ONS.

## Overseas

The review recommends that:

- the Government should retain the existing flexibility whereby GAD is able to tender for overseas work, although the Government should clarify the basis on which the Government Actuary and GAD advises clients outside of the UK public sector.

## Invoicing

The review recommends that:

- GAD should ensure its invoicing of clients is clear, timely and customer-focused.

## Institutional Structure

The review recommends that:

- the Government should consider converting GAD into a trading fund.



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