



23 February 2005

Sir Derek Morris  
Room G/37  
HM Treasury  
1 Horse Guards Road  
London SW1A 2HQ

Dear Sir Derek,

### **Review of the Actuarial Profession – Interim Assessment**

We are pleased to enclose the final response of the Institute of Chartered Accountants in England & Wales to the initial assessment of your Review of the Actuarial Profession. As you may know, the Institute responded to your initial consultation document. We have limited our response to your interim assessment to commenting upon certain of the options you propose. As you will be aware, we submitted a working draft of our response in time for your deadline of 4 February, as we were unable to complete all of our internal due processes at that stage. We have now completed our approvals procedures with only a small number of minor amendments to the working draft submitted earlier. For your convenience, we attach a marked up copy of our response, showing changes made to the earlier draft.

We would be happy to discuss any aspects of our response or to arrange a meeting with your review team if you would like to discuss further any aspects of the education, professional standards, regulation or oversight of the accountancy profession, which might be of interest to your Review. If you would like any further discussions, please contact Liz Cole, Business Law Manager (020 7920 8746 [liz.cole@icaew.co.uk](mailto:liz.cole@icaew.co.uk)) or Iain Coke, Financial Services Industries Manager (020 7920 8674 [iain.coke@icaew.co.uk](mailto:iain.coke@icaew.co.uk)) in the first instance.

Yours sincerely

Iain Coke  
Secretary  
Insurance Industries Committee

Liz Cole  
Secretary  
Pensions Committee



## Appendix

### Morris Review of the Actuarial Profession: Interim Assessment ICAEW Comments on SUMMARY OF OPTIONS

#### CHAPTER 2: THE MARKET FOR ACTUARIAL SERVICES

##### Increasing competition

- *Option 1: to the extent that the availability of professional indemnity insurance cover is acting or may in the future act to constrain entry and limit choice, ways could be explored of introducing liability caps; and/or*
  - *Option 2: in the pensions area, unbundling the provision of advice related to statutory roles from other types of advice (particularly investment consulting services) would help open up the market to greater competition.*
1. We welcome moves to increase the availability of PII. We note that there are no barriers to prevent actuaries from capping their liability. We understand that some actuarial firms are already limiting their liability, and there is therefore an urgent need to review the knock-on effect this may have on other stakeholders. Auditors of pension schemes are similarly allowed to cap their liability, although the statutory auditors of companies sponsoring pension schemes are not. The capping of liabilities by actuaries might cause auditors of pension schemes to cap their liability also. This might result in reduced protection for policyholders or increased risk for other parties, such as the company auditors who are currently not be allowed to limit their liability.
  2. We note that Option 2 would be consistent with the Myners recommendations and subsequent FSA regulatory developments in respect of the unbundling of investment research. Actuaries are not uniquely qualified to provide investment consulting services. Unbundling of these services might not only open up investment consultancy work to other professional advisors but might also increase the focus (or perceived focus) of actuaries and their clients upon the quality of investment advice provided.

#### CHAPTER 4: ACTUARIAL ROLES

##### Reserved role 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 whistleblowing 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).*
3. Auditing standards require auditors only to undertake work within their competence and to obtain expert advice where appropriate. This is supported by the ICAEW Members' Handbook and equivalent standards for members of other professional accounting bodies. On certain types of short-tail general insurance business, for example motor or home contents insurance, auditors might not require specialist

## Appendix

actuarial advice since claims are either known or can be predicted with reasonable reliability at the time of audit. In the case of short-tail general insurance business, the status quo is acceptable.

4. The assessment of long-tail insurance liabilities, however, requires the specific expertise of actuaries. Under some of these risks, for example to employers liability or asbestos and environmental risk, liabilities might be far less certain than under life insurance policies since there may be a longer time frame and wider range of outcomes involved. In practice, the assessment by insurers of long-tail insurance liabilities will be carried out by actuaries and most auditors of this type of business will obtain expert actuarial advice on these long-tail liabilities, particularly in larger businesses. We would, however, support making this general and implicit requirement specific and explicit in the case of long-tail general insurance business. We consider Option 4 to be the most appropriate option for long-tail general insurance liabilities. To ensure consistency with the regime for life insurance, this might be combined with Option 3.
5. We note that the role of the Reviewing Actuary of life insurers is to provide assurance to the auditor (not management) upon regulatory returns. We consider this to be an appropriate level for general insurance business also. FSA reporting forms split insurance by class of business. The categories of general insurance risk for which a Reviewing Actuary would be required might be set by the FSA with reference to the classes in their reporting forms.

### CHAPTER 5: PUBLIC INTEREST AND ACCOUNTABILITY

#### With-Profits Actuary

- *Option 1: status quo – With-Profits Actuary role as currently specified by the FSA; or*
  - *Option 2: the With-Profits Actuary should be external to the insurer; or*
  - *Option 3: the With-Profits Actuary should be appointed by the With-Profits Committee, if one exists, or otherwise the Audit Committee; and/or*
  - *Option 4: the With-Profits Actuary makes a full report to the regulator. Policyholders receive a copy of the With-Profits Actuary's opinion and have access to the full report.*
6. We support the current role of the With-Profits Actuary, in combination to that of the Reviewing Actuary, as developed by the FSA after extensive consultation with stakeholders. In theory, this model appears to be state of the art and to provide cost effective control. The model should be given time to allow a proper assessment of how effectively it operates in practice.

#### Reviewing Actuary

- *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.*

## Appendix

7. We are satisfied with the current arrangements for the Reviewing Actuary, which were developed only recently by the FSA and after extensive consultation with stakeholders. As noted above, we consider this to represent the current state of the art. We do not consider Option 2 to be appropriate, since it implies that the Reviewing Actuary has a responsibility to review compliance with professional guidance. The responsibility of the Reviewing Actuary is to report to the auditor on the output of the actuarial models rather than on the processes followed with a view to supporting the numbers included in the regulatory returns, not to report on compliance with professional guidance. Requiring the Reviewing Actuary to report privately to the Board on compliance with professional guidance would significantly extend the scope of their work. While this work might be performed by the Reviewing Actuary, there would be significant cost implications which we do not think would be justified.
8. Auditors are required to “communicate relevant matters relating to the audit of the financial statements to those charged with governance” under SAS 610 *Communication of audit matters to those charged with governance*. This would include any significant matters reported to the auditor by the Reviewing Actuary during the course of their normal work as Reviewing Actuary. This is an appropriate method for the normal communication between the Reviewing Actuary with the Board. If an explicit reporting requirement is to be made upon the Reviewing Actuary, this should be firstly to the auditor.
9. We consider whistle-blowing arrangements to be a separate matter and one for the actuarial profession to consider from the perspective both of individuals and of the standards of behaviour expected of a member of a professional body. This might include similar provisions to SAS 610 and SAS 620 *Right and duty to report to regulators* on the action that should be taken by the Reviewing Actuary if they believe that the auditor has not appropriately communicated significant matters.

### CHAPTER 7: STANDARD-SETTING

#### Actuarial standard-setting

- *Option 1: Actuarial Standards Board (ActSB) which is quasi-independent of the Profession (as per the Profession’s proposal); or*
  - *Option 2: Actuarial Standards Board (ActSB) subject to oversight by a suitably independent body, for example the Financial Reporting Council; or*
  - *Option 3: the FSA sets standards in life and general insurance, and DWP/Opra sets standards for pensions.*
10. Actuaries work in public interest areas. Given the highly specialised nature of their work, significant reliance is placed upon actuaries, their work and competence. Professional standards provide a framework to support this reliance. We consider that independent oversight is an important feature in high quality standard setting and would add credibility to any ActSB set up. We would therefore favour Option 2.
  11. The actuarial profession is a relatively small profession, and, while a parallel body to FRC dealing solely with actuarial matters might provide effective oversight, this is unlikely to be cost efficient. In the absence of establishing a new independent body, the

## Appendix

FRC would appear to be best placed to assume this role, as there are many similarities between the actuarial and auditing professions. We do not consider the FSA or DWP/Opra to be appropriate standard setters since these bodies are not geared up to setting principles based standards for professionals. The FSA tends to take a quasi legal approach and issues complex and detailed rules which may not be appropriate where the exercise of professional judgement is required.

12. If the FRC was to assume responsibility for oversight of the actuarial profession, the actuarial profession should be required to fund the costs of setting up the new Actuarial Standards Board within FRC, the costs of setting up any other bodies under FRC to deal with regulation of the actuarial profession and an appropriate proportion of the FRC oversight costs and general overheads. It should be noted that FRC currently is focussed upon financial reporting and auditing matters although its role is expanding. Bringing ActSB under FRC oversight would change that focus and require additional actuarial skills to be brought on board. Consideration should also be given as to whether further expansion of the remit of FRC might have implications for its effectiveness and efficiency as a regulator in its existing areas.

### CHAPTER 8: SCRUTINY AND DISCIPLINE

#### 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.*
13. We would favour option 1. Although not generally used in the UK, peer review has been used in other countries but is now falling out of favour as, despite any internal vigour, it was not seen as being sufficiently independent or in the public interest. . If a second layer of review is to be provided, it should be truly independent. The independence of a peer review can be compromised if the reviewer is appointed by and/or reports to the With-Profits Actuary. The most effective way of guaranteeing actual and perceived independence is to have a separate review body, similar to the Audit Inspection Unit, under an independent body such as FRC (see also our comments in paragraphs 18-19 below).

#### Scrutiny of actuaries in pensions

- *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.*

## Appendix

14. The Institute has not yet reached a consensus view as to whether actuarial liabilities should be included in scheme accounts. If actuarial liabilities are required to be included in scheme accounts (ie if Option 2 were to be adopted), we believe 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. The cost benefit analysis of introducing these safeguards may 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.
15. If actuarial liabilities are not required to be included in scheme accounts, we believe the most cost effective way of introducing safeguards would be option 3, ie introduction of a requirement for peer review of the actuary. Again, the cost benefit analysis of introducing such safeguards may 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.

### Scrutiny of actuaries in general insurance

#### *Options (for the company market)*

- *Option 1: introduction of requirement for actuarial advice as part of audit; and/or*
  - *Option 2: introduction of peer review.*
16. As noted in our comments under Chapter 4, we would support the creation of a required Reviewing Actuary role for long-tail general insurance business along similar lines to the current role for life insurance. If a second layer of peer review is to be introduced, this should be truly independent, as noted above.

#### *Options (for Lloyd's)*

- *Option 1: if the Statement of Actuarial Opinion is produced internally then it must be externally peer reviewed; or*
  - *Option 2: introduction of external peer review of the work of all Syndicate Actuaries; and/or*
  - *Option 3: introduction of a requirement for actuarial advice as part of audit.*
17. The appropriate level of review should be determined by the type of work rather than the structure of the entity. We would suggest a similar approach is taken to the scrutiny of the work of Syndicate Actuaries is taken as to that of general insurance companies. Our favoured approach is set out above.

### Discipline

- *Option 1: the disciplinary scheme remains accountable to the Faculty and Institute's Councils; or*
- *Option 2: the disciplinary scheme is accountable to a suitable independent oversight body; and/or*

## Appendix

- *Option 3: encouragement of closer links between whistle-blowing to regulators and the disciplinary scheme.*
18. Actuarial reports are currently signed by individual actuaries in a personal capacity, rather than doing so in the name of firms. A further consideration is the different nature of the reserved roles of actuaries and accountants. The only reserved role for accountants in this area is that of auditor. Auditors are required to be independent of the reporting entity while actuaries in reserved roles may be directly employed by that entity. This might have implications for the ease of oversight or regulation of actuaries, for example by limiting access to working papers which might be owned by an employer not subject to oversight in the manner contemplated.
  19. If the review is considering the parallels to the accountancy and auditing profession, it should be noted that auditors are subject to two layers of discipline. Auditors are subject to independent oversight and discipline through various layers of the FRC (including the Audit Inspection unit) for areas of public interest and to discipline through their respective Recognised Supervisory Bodies, which may also have further disciplinary powers as professional bodies. An independent disciplinary scheme adds credibility to the process, particularly in public interest areas. However, it is appropriate for a professional body issuing professional qualifications and potentially practicing certificates to maintain its own separate disciplinary mechanisms.
  20. We have no further comments.

LC / IDC [23.2.05]