

Canary Wharf (8th Floor)
1 Canada Square
London E14 5AG
United Kingdom

Tel +44 (0) 207 785 6199
Fax +44 (0) 20 7694 2340
DX 38050 Blackfriars

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

Your ref

Our ref jj/la/710

Contact John Jenkins
020 7311 6199

4 February 2005

Dear Sir Derek

Morris Review of the Actuarial Profession: Interim Assessment

Please find attached KPMG's response to your Interim Assessment. We confirm that this response may be included with those to be made public.

Yours sincerely



John A Jenkins FIA
Partner, KPMG LLP



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.**

Option 1: Our understanding is that most actuarial firms now do seek to impose liability caps on clients. It would be useful if this fact was highlighted in the next report.

Option 2: Unbundling has always been possible. Trustees need to be convinced that it is a good idea and that there are good justifiable reasons from their point of view for it to happen. If the 'big three' consultants do not serve their clients well, they will lose market share. The fact that the pensions market is a relatively concentrated one (for large schemes) does not in itself appear to us to be a good reason to force such change. We have competed against the 'big three' for large clients, but often find that large clients usually insist on appointing large consultancy firms who already advise other large schemes, whether for bundled or unbundled advice.

The Myners Review acknowledged that there were no significant barriers to entry for new entrants to the investment consulting marketplace.

In relation to paragraph 2.28, it is not clear who has put forward the argument in relation to sub-standard investment performance, but it is not an argument which we believe has any foundation.

Increasing market testing

a) greater scrutiny of performance

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

Options 1-3 are mainly relevant to Pensions Consulting. In Insurance, we find that users of consulting actuarial services are experienced and knowledgeable about the level of service provided.

Peer review is covered in later questions.

In the Pensions arena:

Option 1: We agree that increased education and expertise are a good thing. These aims are currently being pursued via Pensions Act 2004 (s.247) and the Pensions Regulator's Codes of Practice.

Option 2: The belief seems to be that because of what are seen as relatively low rates of change of advisers by trustees, trustees should be forced to consider change whether they want to or not. This will increase costs for trustees, and so we believe this should only be a recommendation – and with as long a gap as possible (i.e. at least 5 years, if not 7 or more).

Option 3: In principle we agree that clients should monitor their advisers. However the concept of performance measurement implies a clear measurement process and clear benchmarks against which to be measured, which is at best very difficult to implement when long-term advice is being given. Some measures of performance are clearly inappropriate as they may encourage behaviour which meets short term objectives but does not satisfy client requirements in the long-term - for example, the setting of aggressive assumptions.

Option 4: We agree that peer review is a good thing, and support Guidance Note GN48 which has begun this process in Pensions.

b) improving user understanding

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

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

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

This question mainly applies to Pensions. In the fields of Life Insurance and General Insurance there is a more pressing requirement to ensure that non-executive directors on the board have the appropriate experience, although it is also necessary to provide sufficient education to those with little or no experience.

With regard to Pensions, we agree with Option 1, as per Option 1 in a) (greater scrutiny of performance) above.

Option 2: This is part of the education of users. It is in our view best taken up by the Pensions Regulator, as part of their education role.

Option 3: This is 'buying-in' expertise, as opposed to the education of existing trustees. It does already happen to a certain extent, but it has cost implications for pension funds. The market for this is still very limited (partly because of liability insurance reasons).

Improving clarity of advice

- **Option 1: leave it to the market, on the basis that if users can be encouraged to challenge more effectively, actuaries will stand or fall by their ability to respond positively; or**

- **Option 2: improve actuarial training and CPD requirements to equip actuaries with improved communication skills; and/or**

- **Option 3: require clearer disclosure of actuarial advice, assumptions and key sensitivities. For example by requiring the disclosure of forward-looking financial condition reports; and/or**
- **Option 4: explore means by which regulatory requirements might be simplified.**

Options 1, 2 and 3 are all sensible aims.

Option 3 mentions Financial Condition Reports (FCRs). These are not performed for Pensions, and any requirement to do so will create additional cost. In Life Insurance we do not think that the FCR should be disclosed publicly, as its purpose (which is to provide tests of the company's resilience to adverse economic and other scenarios) would be defeated and result in anodyne and less useful output.

We would support Option 4 with regard to Pensions Regulation. However, the regulatory environment in the arenas of Life Insurance and General Insurance have only recently been revised so the new requirements need to be given time to bed in.

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 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).**

Rather than comment on the above 4 options, we can more concisely state our views as follows:

We believe that the system on the general insurance side should as far as possible mirror that which now applies on the life side. So there should be a requirement for directors to take actuarial advice in relation to the reserves, and there should be a requirement for auditors to take into account actuarial advice from a suitably independent actuary when carrying out their audit. We do not believe that the actuarial advice to the auditor necessarily needs to be as formal as in the life reviewing actuary situation, as most auditors on the non-life side will be experienced in assessing the variability of claims reserves.

Although the term actuarial advice has been used above, we believe that in principal there is no reason why any suitably technically qualified and experienced person, operating within a professional framework, should not be able to provide the advice. In practice, however, we believe that this will in most cases be an actuary.

We believe that the above is consistent with directors taking responsibility for the reserves, as opposed to the responsibility being with an actuary (as was the case with the previous Appointed Actuary regime for life companies). We note however that for Lloyd's syndicates, US requirements may mean that the status quo has to continue.

CHAPTER 5: PUBLIC INTEREST AND ACCOUNTABILITY

Reporting and whistle-blowing

- **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.

Option 1: This is our favoured option. However we believe that whistle-blowing should be used as a last resort. The relevant rules, regulations and actuarial guidance taken together should be comprehensive enough so that any bad practice contravenes these standards. Thus any issues would be picked up as part of the normal production of Actuarial results, leading to a qualified opinion for non-compliance with established standards.

The Pensions Regulator is currently consulting on new whistle-blowing practices, and the Review should input its views to them.

Option 2: We agree that duties to whistle-blow should be ‘clear, objective, and enforceable’. The Pensions Regulator appears to be making a good initial job of this, building on its experience since 1987.

Option 3: Any further protection for whistle-blowers must be a good thing. But it always takes a brave person to whistle-blow, regardless of such protections, hence our preference expressed above under option 1. In a recent television documentary about aviation safety in the US (and aviation safety surely requires whistle-blowing more than most other areas), an airline maintenance engineer was being complimented for his whistle-blowing by the FAA investigating official, who also said to him ‘you know you’ll never work in this industry again’.

Actuarial Function Holder

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

Option 1: As this position has only been in place since the start of 2005, we cannot form a judgement on its success. We are however in agreement with the FSA that its new regime is an improvement on the previous one, and this we feel it should remain in place for several years at least.

Option 2: See response to ‘Reporting and Whistle-blowing’ above.

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.**

We support Option 1. As above, as this position has only been in place since the start of 2005, we cannot form a judgement on its success. We feel it should remain in place until its effectiveness can be better judged.

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.**

KPMG has a number of reviewing actuaries providing advice to audit directors in relation to our diverse range of life company audit clients.

As good practice, most audit firms would make available to the Actuarial Function Holder detailed feedback and advice on areas of improvement that arose as part of their investigations.

Option 2 is acceptable if applied to year-end reporting only. Currently, the Reviewing Actuary has to review compliance as it relates to the year-end valuation process and results. However, we think it would be inappropriate to extend this review to the Actuarial Function Holder’s compliance with all guidance without a full cost/benefit analysis. See also peer review comments below.

Option 3 would result in duplication, as the Reviewing Actuary reports to the Auditor, and the auditors themselves have whistle-blowing duties.

Pensions

- **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.**

This reflects the discussions the profession has already started to have about conflicts, and the increasing awareness of these conflicts by actuaries.

Options 1 and 2 (if we read it correctly) are in effect the status quo, although perhaps with more education of trustees than currently exists (which should be provided by the regulator). However if Option 2 means that trustees can require the Scheme Actuary to resign from his employer appointment, even if he resigns his trustee appointment, this seems to go beyond normal practice in any other area.

Option 3 is possible, but would need either statutory or regulatory backing. We would not object to this if it can be defined with sufficient clarity, but it would lead to increased costs for schemes in some cases.

Option 4: This is the hard-line approach. It introduces unnecessary cost for the majority of the work for scheme sponsors. Smaller schemes and employers in particular (of which there are a large number, albeit less significant in terms of asset size) will feel that this is an undue burden.

CHAPTER 6: EDUCATION AND CPD

The syllabus and governance

- **Option 1: minor reform of the existing governance structure to promote greater academic and non-actuarial input; or**
- **Option 2: establish an independent body with oversight of the Profession's syllabus development along the lines of the accountancy profession's Professional Oversight Board for Accountancy (POBA).**

We would support Option 1, as we believe that Option 2 is disproportionate to the size of the profession.

Examinations issues

- **Option 1: reform of the existing governance structure to improve quality control; and/or**
- **Option 2: involvement of full-time and dedicated professional examiners; and/or**
- **Option 3: involvement of an independent oversight body in exam setting and marking.**

Option 1 is clearly a good thing – there should be a search for continuous improvement in this and all other areas. We believe it is necessary as there needs to be increased development in quality control with regards to the running of exams and the results process.

Option 2 is attractive, if it could be achieved in a practical and cost-effective way. However, we do not feel that the examiner role could warrant continuous full-time involvement. Rather, we feel other methods of increased participation from professionals could be explored - for example, marking of exams by (paid) volunteers could take place during a pre-arranged block sabbatical, rather than being marked part time after work.

As above, we believe that Option 3 would be disproportionate to the size of the profession.

Broadening actuarial education provision

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

We do not agree with the thrust of these proposals.

While we appreciate the desire to broaden actuarial education provision, we feel there is much merit in maintaining the current system, where graduates who have studied actuarial science enter the working environment alongside those who have studied other numerate, non-specific disciplines such as mathematics and physics. Actuarial courses are fine for those who have made up their minds on entering university to follow some form of actuarially based career. However, many highly successful and skilled actuaries will not have decided on an actuarial career (or indeed any specific career at all) at the time of entering university.

Actuarial courses already exist at several universities. We further fear that an increase in university actuarial provision, and encouraging employers to accept graduates predominantly from these courses, will result in a smaller range of able candidates to select from, particularly those who (as noted above) do not wish to make a vocational decision at the age of 18.

In terms of priorities, we believe the profession should address the examinations and syllabus issues first.

Continuing professional development (CPD)

- **Option 1: the Profession should set out clear objectives for the CPD Scheme and clarify what constitutes formal CPD. The Profession should ensure that CPD that qualifies as formal CPD is meeting an objective of the CPD Scheme, and is not simply a tick-box exercise based on attendance at meetings or conferences; and/or**
- **Option 2: the Profession should consider increasing the amount and quality of formal CPD required for reserved role holders, in recognition of the importance of these roles. For example, the Profession, with regulator input, could develop tailored CPD opportunities ahead of key changes in the regulatory environment for actuaries in reserved roles; and/or**
- **Option 3: closer links could be fostered between those within the Profession with responsibility for syllabus development, the actuarial research community and those focused on CPD to ensure that the CPD Scheme is kept-up-to-date and reflects recent developments in other disciplines and actuarial research; and/or**
- **Option 4: greater input to the CPD Scheme could be given to research-oriented actuaries, overseas actuaries and non-actuaries, for example through involvement in an oversight body, constitutionally independent of the Profession containing a mix of actuaries and non-actuaries. This could monitor the Profession's performance in relation to CPD Scheme development to ensure that the scheme is kept up-to-date, that links to other disciplines and actuarial research are made and that CPD is available to all actuaries, not just to those working in traditional areas.**

All of the above are 'good things'. There should be encouragement for all of them to happen, with the exception of formalising other input to the CPD scheme from an oversight body as in option 4 above. This could easily become too bureaucratic and expensive, and we do not think it is a proportionate response. We do however think that there should be a higher requirement for holders of reserved roles and practising certificates, than for other actuaries.

CPD monitoring

- **Option 1: the Profession implements its three-tiered professional revalidation proposal as currently envisaged, which introduces technical CPD requirements and annual monitoring for reserved role holders, technical CPD requirements and three-yearly monitoring for holders of the new voluntary non-statutory practising certificates, and basic CPD requirements and 10-yearly monitoring for the remainder of working actuaries; or**
- **Option 2: as Option 1 but non-statutory practising certificate regime is expanded to cover all actuaries (except those performing statutory roles) so the technical CPD requirements and three-yearly monitoring apply to all working actuaries; and/or**
- **Option 3: the task of monitoring CPD requirements and monitoring of compliance with the CPD scheme should be made part of the remit of the independent professional oversight body referred to above.**

We would support Option 1. We believe this to be the most appropriate response. Imposition of a strict regime on non-statutory actuaries could lead a number to withdraw from the profession altogether, and could be seen to be anti-competitive since many of these actuaries work alongside non-actuaries performing the same roles (e.g. in investment). However, we feel there needs to be strict guidance on what is an appropriate amount of CPD. We feel that 25-30 hours is an appropriate level for holders of practising certificates, with formal records maintained by the actuarial profession.

CHAPTER 7: STANDARD-SETTING

Actuarial standard-setting

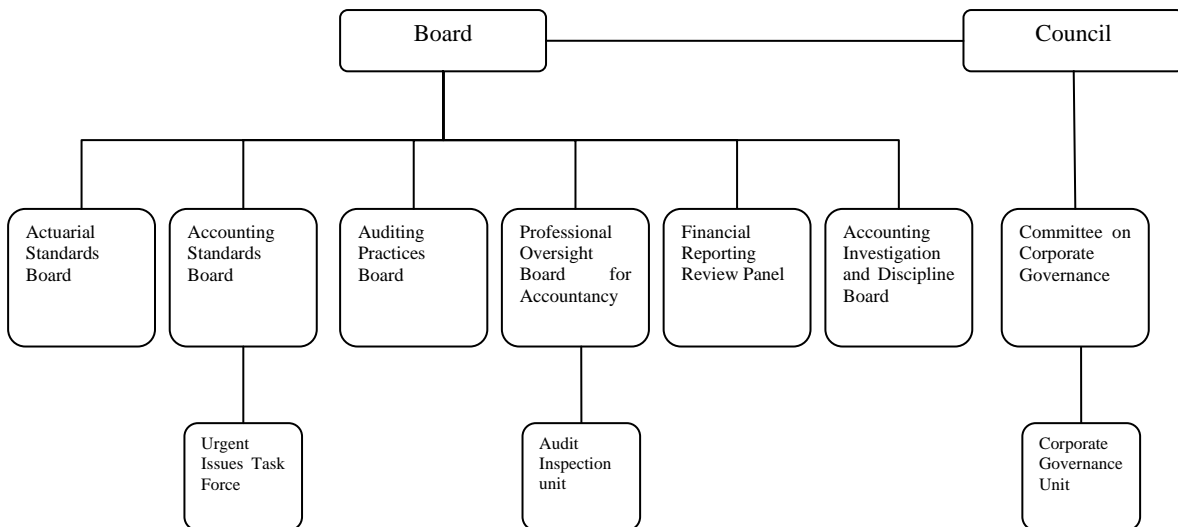
- Option 1: Actuarial Standards Board (ActSB) which is quasi-independent of the Profession (as per the Profession’s proposal); or
- Option 2: Actuarial Standards Board (ActSB) subject to oversight by a suitably independent body, for example the Financial Reporting Council; or
- Option 3: the FSA sets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

We do not agree with Option 3 (that the FSA/DWP/Opra should set standards, beyond their current statutory and regulatory remits). That will inevitably lead to a box-ticking approach to standard setting and compliance.

In Life insurance we feel that the FSA has set out detailed rules, and has presumably gone as far as it wishes to go, and so any professional guidance needs to fill the gaps left (deliberately) by the regulator.

We can foresee option 2 being selected. If the FRC is used as a forum for hosting the Actuarial Standards Board, we believe there should be at least two actuaries on the Council of the FRC.

The Actuarial Standards Board should in our view sit alongside other groups which report to the board rather than being subsidiary to them. Thus, the structure should be as shown in the diagram below. We believe there would be advantage in having one or more members of the accounting profession on the Actuarial Standards Board.



Issues such as discipline could be dealt with within the existing structure of the FRC by being combined with the relevant boards.

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.**

Option 1 is the status quo.

We do regard option 3 as an "expansion", although it should be understood that the Reviewing Actuary does consider compliance with actuarial standards in relation to the year-end processes. The issue is whether this role should expand to deal with wider actuarial work throughout the year e.g. Pricing or Individual Capital Assessment.

There are advantages and disadvantages to extending this role beyond the year end. Currently, where a company wants additional review, efficiencies can usually be gained by using the Reviewing Actuary, but it is not mandatory - the board can decide whether it is appropriate to use the Reviewing Actuary depending on its preferences.

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.**

We support the current peer review proposals, and indeed think they could and should go further (this has already been acknowledged in the Pensions area). We do not therefore support Option 1. Indeed, Guidance Note 48 has recently changed the status quo in Pensions from that described above.

So far as audit is concerned, it needs to be made clear what any audit is intended to achieve. There are two possible types of audit – the first is a 'mathematical' audit, in that the actuary's calculations are checked for accuracy, using the assumptions he has made. This has very limited value, and we are not aware that lack of mathematical accuracy is or has been a significant concern (although we do occasionally come across errors or omissions when auditing pensions figures in companies' accounts).

The second type is a 'standards' audit – has the valuation been conducted in line with statutory, regulatory, and professional standards? Again, we are not aware that this has been a concern in the past, and we are unsure that a worthwhile audit could be conducted against current standards. Rather, the primary issue is having clearer and stronger standards than exist now. This requires an Actuarial Standards Board, and clear standards against which valuations are auditable, before audit

can become worthwhile. Therefore, this is an issue which could and should be returned to, after the commencement of an Actuarial Standards Board. At this time, we would see merit in valuations being subject to audit.

Option 3 already exists, and should get stronger over time with closer review. The present scope of GN48 is work carried out in relation to all Practice Standard guidance notes, so it already covers more than just valuation work.

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.**

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.**

For the company market we support Option 1.

For the Lloyd's market we support Option 3.

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**
- **Option 3: encouragement of closer links between whistle-blowing to regulators and the disciplinary scheme.**

In order to provide strong public reassurance, we acknowledge that Option 2 is preferable, possibly forming part of the Financial Reporting Council as discussed earlier. However it will still need to have strong links to the profession – it cannot work in a vacuum. Further, we would argue for consistency with other professions – if the legal profession does not follow this route as a result of the Clementi Review, that weakens the case for the actuarial profession doing so.