

Our ref: Technic1/Letters/Morris

The Morris Review  
Room GC/08  
1 Horse Guards Road  
London  
SW1A 2HQ

Dear Sirs

### **Consultation Document: Morris review of the Actuarial Profession**

I set out below Aon Limited's comments on the above consultation paper.

#### **Introduction to Aon**

Aon employs over 100 actuaries in the UK who are primarily involved in the provision of advice to occupational pension schemes. Aon is the UK's largest insurance broker and provider of risk management services, a major force in reinsurance and number four in the UK human capital consulting market. With more than 10,000 staff spread across 90 UK offices, Aon combines an in-depth knowledge of the UK market with an unmatched global reach and perspective.

### **The Role of Actuaries, the professions and the Actuarial Services Market**

#### **Scope of the Actuarial role**

##### **Q 1.1**

*What do you see as the main value provided by actuaries and, conversely, what are their weaknesses? In general, are actuaries properly equipped for the roles that they perform?*

In the Collins English dictionary an actuary is defined as "a statistician esp. one employed by insurance companies to calculate risks, policy premiums and dividends, and annuity rates." This definition reflects the origins of the actuarial profession, which developed in response to the needs of financial entities whose principal activities involve the deliberate acceptance of risk. The concept of the mitigation of the effects of unavoidable risk by the combination of individual risk is a long established concept of insurance. This approach has served society well, and in reflection of this, the insurance industry is one of the few to which government has introduced specific measures to ensure the solvency of the operating companies.

The actuarial profession has developed specific techniques and studies of statistical data directly applicable to insurance, pension schemes and investment and in general are the most proficient practitioners in these areas, both through professional training and practical experience. However, no one person can be an expert in all areas. This is as true in the area of actuarial work as it is medicine or accountancy and all professionals (and indeed any

person holding a position of responsibility) need to consider whether they have the necessary expertise and experience to undertake particular roles.

Actuaries may be involved in acting in a professional advisory capacity or in the capacity of an executive or director.

When acting in an advisory capacity it is important that the professional makes the client aware of the scope of his advice and expertise and the possibility of differing professional views. If it is necessary in formulating any advice to rely on expertise in another area this needs to be recognised, and the need for such advice brought to the client's attention. In general actuaries are well equipped for this role by their professional training and professional conduct standards.

When acting as an executive or director the professional training and conduct standards should also have advantages. Although holding such positions do not require any statutory qualifications or professional training, actuaries are required to conduct themselves in an appropriate manner during all of their undertakings. The requirement for actuaries to uphold professional conduct standards combined with their familiarity with working with other professions should equip actuaries well to undertake the responsibilities of an executive or director. Whether or not requirements should be introduced for people holding the office of director is probably outside the scope of this question.

#### Q1.2

*Are there areas of business that you think actuaries should become more involved in or conversely are there areas of work you think actuaries should leave to other professionals?*

Professions should (and have) develop(ed) based on both need and demands of the areas they serve. Their requirements and standards should be consistent with these needs and demands, rather than being excessive and amounting to unnecessary restrictive practices. Entrants to the professions have a strong academic background and most would be capable of operating as a professional in a number of different areas. However the constraint of time has the result that today most professionals have only achieved the professional knowledge and experience to operate within one profession, and even within individual professions most practitioners specialise in particular areas of operation. Actuaries generally have a sound background in numeric skills, financial analysis and dealing with the assessment of risk and therefore should be suitable to undertake a wide range of roles. However, as with all professionals they should only operate formally as a professional in those areas in which they are professionally qualified.

#### Q1.3

*Do you think that there is still a need for particular roles for actuaries to be reserved by statute and, if so, which roles and for what reason? If not, why not?*

Yes. There is a need to ensure that certain calculations are prepared by a professional with sufficient technical competence to ensure proper information is given to the public and shareholders. In certain areas the actuarial profession is the only profession that has developed the requisite techniques and training, and actuarial expertise should be required for such calculations. These areas include:

- insurance company and syndicate reserving
- pension scheme liability and benefit conversion calculations
- assessments of damages for lost earnings
- the valuation of stock options for statutory reporting purposes

#### Q1.4

*What impact, if any, has the existence of reserved roles had on the effectiveness with which actuaries work with non-actuaries?*

There is no general answer to this question. However, it is common for many exercises to require professional co-operation. Actuaries commonly need to understand the contractual commitments made by clients that they are being asked to evaluate and may require legal input on this. Equally auditors have needed to rely on work undertaken by other professional experts, including actuaries, in the audit of company accounts. In the latter case both professions have recognised the issue and respective guidance is given by each profession on appropriate conduct.

#### Q1.5

*If roles reserved exclusively to actuaries are maintained, do you think that there is a need to introduce greater peer review and scrutiny of such work?*

There is a need to ensure that the work done by all professionals is objective, correct and capable of being understood by its recipients. This matter is considered further in the answers to Chapter 2.

#### Q1.6

*Could other professions work more closely with actuaries or in related functions to help maintain and improve actuarial effectiveness?*

As outlined in the answer to previous questions clients often require a combination of professional advice, which they are at liberty to commission in combination, in isolation or not at all. Actuaries need to be able to work in combination with other professionals and should (and do) advise clients to seek further professional advice on matters outside the range of actuarial expertise.

As will be covered later there would also be merit in non-actuaries playing a role in actuarial standard setting to avoid the possibility or appearance of introspection.

### **Accountability of actuaries**

#### Q1.7

*To what extent should actuaries accept some responsibility for their role in designing financial services products that have subsequently turned out not to be “fit for purpose” for consumers? Why were these issues not brought to light by the profession earlier and therefore*

*perpetuated to the detriment of consumers? What lessons can be drawn from these experiences for the future?*

In common with any professional providing services to a client, an actuary providing actuarial advice on any issue, such as the design of the product will have limitations placed on the advice provided by the scope of the agreement with the client or instruction within a company.

It cannot be argued that a “one size fits all” approach should be taken to financial products. By nature some individuals or entities will prefer to take more risk, others to be more conservative. What is important is that the product is designed to meet its objectives, and this is correctly communicated to the recipient. If products are later “sold” by a third party it is important that those risks are fully communicated, so that the most appropriate product is used, but this responsibility must fall within the remit of the seller and not the actuary involved in the original design.

Q1.8

*Are actuaries sufficiently accountable for their actions? To whom should actuaries be primarily accountable – to their clients or employers, to pension fund trustees or sponsors, or to a broader public interest, which encompasses the strength and stability of the insurance and pension sectors and the interests of those consumers involved?*

Actuaries have responsibilities to their client, their employer and the Profession. However, whilst acting in accordance within the commercial constraints placed by their client and employer, each actuary will need to be aware of the underlying requirements imposed by the Profession, and must act in accordance with these constraints where commercial and professional considerations conflict.

In the pensions arena actuaries are accountable to pension scheme trustees whose role is to uphold the interests of members and in the life assurance arena to directors who have a duty to uphold policyholders reasonable expectations.

Q1.9

*How would you characterise the current situation in the UK in this respect? Are there changes you would like to see introduced in terms of the accountability of actuaries to their employer or to the public interest?*

The balance on these areas seems to be correct and in line with other UK professions.

Q1.10

*Are actuaries sufficiently liable for their actions? If actuaries provide poor advice, to whom should they pay compensation?*

Yes, actuaries are responsible to their clients through their contractual agreements and the normal process of law, to their employers through their contract of employment, and to the Profession, which can take action through its disciplinary scheme. This gives actuaries wide accountability in common with other professions. If negligent, actuaries will therefore be liable to pay compensation to their client and would also be subject to disciplinary action.

## **The Profession**

Q1.11

*How effectively does the Profession engage with government, business, regulators and other professions?*

The Profession through the various Boards and committees has many links through to Government departments and seeks to engage with those departments on many areas, particularly those relating to statute. However, it does seem that as many initiatives are driven through political will, communication is not always as open or clear as it could be (for example if the policy intention is not clear.) It is important that this dialogue continues, with responsibility on the Profession to draw matters of concern to the attention of the appropriate Government department, and a willingness on the part of Government to make changes to policy in light of the matters drawn to their attention.

Q1.12

*Has the Profession successfully expanded the horizons of actuarial knowledge and promoted innovation?*

Many actuaries are involved in research in a variety of areas, ranging from those where we seek to better understand aspects areas of financial risk, such as mortality, or to develop new techniques (for example in modeling variability of outcome), or in expanding the application of existing actuarial techniques into new areas of operation.

Q1.13

*Has the Profession done enough to promote the work of the actuarial profession?*

We have no comment.

Q1.14

*Are there any aspects of the Profession's governance structure that you would like to draw to the attention of the review? Do the Profession's various decision-making bodies represent a diverse range of interests? Should there be greater lay input into the Profession's key decision-making bodies?*

We feel that a greater level of lay input in key decision-making areas would be beneficial, as it would allow the perspective of a wider range of interests and experience to be factored in. The Profession has established a system of honorary fellows; greater involvement by these individuals may achieve this objective.

## **Entry into the Profession**

Q1.15

*How important an influence on the Profession are the companies that recruit and train student actuaries? To what extent is the curriculum shaped by the needs of employers? Is this good or bad?*

Ultimately, the Profession comprises many individuals, the majority of whom work for large firms. They influence the development of the Companies in which they work and also the development of the Profession. Companies such as Aon do have an important role in the development of their employees who form part of the membership of the Profession. Aon has no direct influence on the curriculum, but individual employees who work for Aon will serve on committees or as examiners who will contribute to the development of the curriculum. The curriculum does contain practical experience based elements and these will be influenced by the work that is carried out for clients by, for instance, firms of consultants. This has to be a good thing – it is of mutual benefit to develop an actuarial qualification that is of practical use and reflects the needs of our clients.

Q1.16

*What is your view of the appropriateness of the current actuarial qualification syllabus (set in 1999) in preparing actuaries for their actuarial and broader business and management roles?*

The actuarial qualification syllabus is constantly assessed and evolves over time to meet changing circumstances. However, in addition to the core qualification, as a Company we strongly believe in the importance of providing further training and support to our staff in the areas of management and wider consulting skills to fully meet our clients' needs. We also provide regular additional actuarial training to both qualified and non-qualified actuaries to supplement formal training programmes as a necessary part of continuing professional development. We are committed to further develop our staff.

Q1.17

*In particular, do you think that it should take on average 5 or 6 years for an actuary to qualify? Is there the right balance between academic and practical experience, sufficient breadth of subjects studied or not studied and the appropriate degree of specialisation at the right time?*

The length of time taken to qualify reflects a number of factors including the fact that the exams have a large practical/ experience related element and are so typically undertaken whilst employed. The timescale also reflects the challenging nature of the exams, which in turn reflects the high standing associated with the qualification. The syllabus and examinations include a large practical element. This means that actuarial advice is properly relevant to clients reflecting their needs in the regulatory environment that exists and not a theoretical mathematical exercise. Indeed, irrespective of the average time to qualify, there is a minimum experience requirement for recognition as a fully qualified actuary to help ensure that newly qualified actuaries have sufficient expertise to properly apply those skills to appropriate actuarial advice. This is consistent with other professions such as the medical profession.

Q1.18

*Has actuarial education and training kept up with developments, particularly in the financial markets and in financial economics?*

Actuarial education and training is subject to continual development. Financial markets and financial economics do form part of the education syllabus. The process of continuing professional development also provides an opportunity to keep abreast of latest thinking in these areas. In particular, a number of well publicised papers and debates in the area of financial economics appeared in the mid to late 1990s and there continue to be a number of joint seminars between the Profession and other professional bodies and industry based organisations.

Q1.19

*Do you have any comments about the proposed new qualification syllabus that will come into effect in April 2005?*

We have no comments on the proposed new qualification syllabus that comes into effect in April 2005 that we believe are relevant to this review.

Q1.20

*Is there sufficient diversity in the composition of the student body and are there enough links with other professions' qualifications?*

By the technically demanding nature of the work and, the Profession is likely to attract those who are interested in and excel at more mathematical and finance related subjects including economics.

Q1.21

*Is it of concern that, apart from a few universities that offer degrees in actuarial science, there is only a single provider of actuarial education in the UK?*

Given the size of the Profession, the number of providers is likely to be restricted by the commercial economics of delivering an education service for the student population. The current provider is relatively newly established and it remains open to a new entrant to challenge the existing position. The key is to maintain high standards: this is monitored by the Profession and the examination process is separate from the provision of tuition material.

### **The market for actuarial services**

Q1.22

*What have been the main drivers of demand for actuarial services over the last ten years? How do you see the demand for actuarial services evolving in the future?*

The key drivers for the demand for actuarial services in the Pension Consultancy area is the last ten years have been the maturity of pension schemes, increased focus on risks and size of pension liabilities and Government reforms. The demand for actuarial services in the future will be driven by the continued development of pension related consultancy, and the

requirements for advice in the area of developing defined contribution and other solutions to clients' pension needs as well as in other areas, for example in advising on the valuation of share options.

Q1.23

*Do the consumers of actuarial services have access to a wide range of providers or is choice in this market in any way constrained? If so, in what way and why is consumer choice limited?*

The pension consultancy area is highly competitive with a wide range of suppliers from large companies to sole practitioners. A number of companies review their providers from time-to-time and some decide to switch actuarial providers and some decide to retain the existing provider, with all providers under an obligation to uphold a high level of professional standards. We are not aware that this places any restriction on consumer choice.

Q1.24

*Is it easy for consumers to switch between actuarial service provider? If not, what do you think could be done to encourage switching?*

We are not aware of any constraints on the ability of clients to switch actuarial providers.

Q1.25

*Do you think that those receiving actuarial advice sufficiently understand what they are being told and how the advice was produced? If not, what generates this informational shortfall, how important an influence on the market is it and what, if anything, do you think might be done about it?*

We spend a large training budget making sure that staff are developed in the area of communication of often complex and technical ideas, information and advice. In addition, our internal procedures are aimed at ensuring that the advice we provide, and the basis for that advice, is clearly articulated, comprehensible and transparent. A typical Trustee board will comprise a number of individuals with varying levels of financial knowledge and experience and this creates a need to communicate to all parties effectively. Of course, the requirements enshrined in the Pensions Bill will strengthen the requirements for trustees to have training tailored to the circumstances of their scheme. As a consultancy, we pride ourselves on the quality and clarity of our advice; provision of unintelligible information is not the basis of a successful long-term client partnership.

Q1.26

*Which factors have influenced the supply of actuarial advice over the last ten years? What are likely to be the most significant influences on the industry structure in the future?*

The supply of actuarial advice has been influenced by the growth of, for instance pension and investment consultancy services, as the demand from clients has increased. Over the next few years, as the defined benefit market becomes more mature, it is likely that the growth seen in recent years will moderate, but actuarial services in non-pension areas will develop.

Q1.27

*What determines whether actuarial advice is provided by in-house employees or external advisers or consultants? Does it reflect a clear difference in the actuarial role and function? Do firms employing in-house actuaries ever experience recruitment difficulties?*

Most pension schemes have insufficient need for actuarial advice to fully occupy in-house actuarial staff. Wider expertise gained through a range of experience, in particular of ongoing consultancy and technical developments, will mean that there is value added by employing an external consultant. It is also influenced, in certain areas, from the desire for advice independent of that provided by an in-house employee.

Q1.28

*What is your overall assessment of the degree of competition in the market for actuarial services? Is competition in any way constrained by existing professional rules or conventions? If so, which ones and to what extent could they be modified?*

Competition is extremely vibrant for actuarial services with a wide range of companies, large and small, all vying for various projects. We do not believe that there are professional rules or conventions that restrict competition– the Professional Guidance on the exchange of correspondence required on taking on or handing over a client are there to assist the process at the same time as maintaining high standards. Many clients will however take the view that they wish to employ an actuarial firm with a high quality reputation, breadth of experience and resources and client focus. This would lead them to the larger consultants such as Aon. This is merely a feature of client preferences and the fact that there is also a range of smaller consultancies is testament to the competitive market.

Q1.29

*Do you think that the Government Actuary's Department competes with private sector suppliers of actuarial services in the market? What impact do you think GAD has on competition in the market?*

Our understanding is that in the area of pension consultancy, the GAD provide actuarial services to a number of public sector pension arrangements and Non Departmental Public Bodies. Certain aspects of GAD's work has been opened up to private sector competition and a number of contracts have been awarded to external pension consultancies. As an employer of actuaries, GAD does compete with other employers for actuarial staff. However, it is sensible to review these details directly with GAD.

### **International Comparisons**

Q1.30

*How are the skills and professionalism of UK actuaries and the UK actuarial profession regarded internationally?*

This is best judged from the responses from overseas entities.

Q1.31

*How easy is it for actuaries to work across international boundaries?*

Aon is a global leader in risk management, insurance and reinsurance brokerage, insurance underwriting, human capital and management consulting, and outsourcing with offices in 120 countries and sovereignties. This wide base of base of experience means that it is possible to share ideas experience and efficiencies, and to gain knowledge of wider markets, with groups meeting across global boundaries to achieve this objective. In addition, Aon also employs a team of international specialist professionals with knowledge of certain countries to provide advice to multinational organisations, including co-ordination of actuarial activities within each market. From this experience we believe that the actuarial competencies and training have wide application, although knowledge of local markets is also a prerequisite for effective operation.

Q1.32

*Do you agree that there are lessons to be drawn from a consideration of the work of actuaries in Canada, Australia and the US? If so, on which aspects of the work of actuaries in these countries do you think the review should focus?*

There are clearly lessons to be drawn from the work of actuaries in other countries. However, we cannot comment on whether experience from these countries should be considered in preference to other countries.

Q1.33

*Are there any EU or other countries that the review should be considering in seeking to identify best practice?*

There is no single overseas country or region that would be generally be regarded as having the best practice.

### **Other Professions**

Q1.34

*Do you agree that the review can learn lessons from recent developments in the UK accountancy profession, for example, in areas such as standard-setting or in the establishment of a single unified and independent regulator – the Financial Reporting Council?*

There are always lessons that the actuarial profession could learn from other areas of operation, including the accountancy profession, and it is equally true that there are lessons other professions could learn from the actuarial profession.

Aon holds the work of the accountancy standards setting bodies in high regard and has participated in providing information to these bodies on development of certain standards.

The question on the Financial Reporting Council raises the most important questions of how prudent control should be undertaken. The options are from a combination of:

- common law
- Government regulation
- Professional control

and can be based on a combination of :

- principles
- detailed requirements
- quality assurance
- monitoring and supervision

The most important consideration is that responsibilities are clarified to avoid gaps remaining in the prudent control arrangements. Government (subject to agreed limitations on its powers under other treaties such as the Treaty of Rome) has ultimate control and can either exercise it directly, act in the knowledge that adequate professional control separately exists, or formally delegate responsibility to another body to establish arrangements for prudent control in particular areas. If an area has been reviewed by Government and legislation enacted, it is reasonable to assume that this would have been done with proper due diligence and that Government would have established the professional controls that existed in an area and may have relied on their continuance. In the absence of an agreement of delegated authority it is much less reasonable for a profession to subsequently decide to effectively impose additional regulations where the Government has specifically deemed the current arrangement to be adequate. The need for clarity of responsibility is absolute and unless this is achieved gaps will exist or emerge in prudent control arrangements simply due to lack of co-ordination. However it is ultimately for Government to decide for itself the extent to which control should be delegated.

It is important to note that in most areas where actuaries operate risk is inherent. It can be managed, controlled and sometimes mitigated, but is cannot be eliminated, and the prudent control arrangements need to strike a compromise between cost, and the respective interests of the stakeholders (which can be broadly categorised as customers or principals). Customers are afforded various protections but the concept of limited liability and release from bankruptcy (as an alternative to permanent retention in a debtors prison) both recognised that there is an overall benefit to society from risk taking commercial activity and that this should be encouraged, subject to customers not being deliberately misled. Alternative compromises are possible, however these should not hurriedly be adopted without considering the potential consequences. For example all financial entities could be required to hold their assets on deposit with the Bank of England to secure their capital value. However this would withdraw at least one third of the UK's capital base with severe macroeconomic consequences.

It is therefore necessary to keep in mind that prudent control arrangements are exactly that, and what ever arrangements are adopted occasional problems will emerge. These should

rightly be given attention to ensure that all relevant lessons can be learned. However the world is changing and it will continue to do so. It is therefore important to ensure that the prudent control arrangements are designed to be adequate for the current and the future, rather than being capable of addressing obsolete problems.

Turning now specifically to the operation of prudent control in the area of company accounts. Our understanding is that this is delegated to the Financial Reporting Council (FRC) subject to the requirement that the under Companies Act accounts are required to show a “true and fair” view of the state of a company’s affairs.

This “true and fair” requirement has been converted into a set of principles by the FRC and in its “**Statement of Principles for Financial Reporting**” it recognises that financial information is of interest to a wide variety of users for a variety of potential purposes. However it goes on to conclude that the investor’s interest in an entity’s future ability to generate cash is the predominant general interest and that information not needed by investors need not be given in the financial statements. It also recognises that information on solvency is necessary. However the principles go on to state that financial statements are usually prepared on the basis that the reporting entity is a **going concern**, because measures based on break up values tend not to be relevant to users seeking to assess the entity’s cash generational and financial adaption capability. This however overlooks the fact that certain users only have an interest in an entity’s ability to meet existing obligations in the event of its discontinuance and Aon’s view is that an entirely different conceptual framework may be appropriate for different users and different circumstances. Following on from this it should also be apparent that the conceptual framework operated by the FRC is an unsuitable basis from which to consider insurance companies for which solvency is of primary importance.

The choice of prudent control framework being principles or detailed requirements is not particularly clear. Both are helpful and have advantages and a combination is useful. Our understanding is that the UK has operated more on a principles-based system to address the “true and fair” requirement, supported by specific guidance on particular issues, whereas the US has operated more based on specific requirements. However under both regimes financial surprises have emerged.

In the case of insurance companies the Government has retained far greater involvement in the prudent control arrangements. The various Insurance Companies Acts are detailed and specific as are the additional regulations. Detailed returns in a specific format are required to be submitted to Government appointed regulators. The involvement of Government with Insurance Companies has therefore been far greater than for general commercial companies. With involvement comes responsibility, however this is not to say that Government is responsible for failure or indeed that failures could have been avoided. Indeed Government involvement may well have produced a substantial improvement on an alternative. That said failures arise infrequently and each should be taken as an opportunity to reflect on the adequacy of the existing arrangements. However, apart from the political need to be seen to take action a compromise will always be necessary in prudent control arrangements.

The other need in the area of prudent control arrangements is that of clarity of requirement. With due respect to Lord Penrose he rather glosses over this area. In reading Chapter 1 of his report it was apparent that a number of solicitors, legal counsel, the vice chancellor and lay Trustees believed that Policyholders Reasonable Expectations had been met, even though the House of Lords eventually ruled that they had not. Although Lord Penrose observes that this

is the nature of our civil justice system, which is undoubtedly true, no prudent control arrangements can be operated satisfactorily in the absence of clarity of the requirement.

Q1.35

*Are there any forthcoming EU directives or international accounting standards that are likely to impact on the actuarial role?*

Yes, EU Directive 2003/41/EC on the Activities and Supervision of Institutions for Occupational Retirement Provision is likely to impact on the role of Scheme Actuaries, depending on the way it is implemented by UK Government.

The International Accounting Standards set by the IASB are not fundamentally different from various existing national standards and it is difficult to conclude on their impact in isolation.

Q1.36

*Are there lessons for the actuarial professional and regulatory framework of the legal profession?*

Our understanding is that the legal professions operates based on codes of conduct, which are regulated by the Law Society.

Q1.37

*Which other professions' regulatory models, and what aspects of them in particular, do you think the review should consider?*

The most interesting model to consider is probably the regulation of corporate entities via the Companies Act, the FRC and the Stock Exchanges. In this model Government regulation is minimal and establishes simply a basic principle. The FRC expands the basic principle into further principles and detailed requirements and monitors reporting based on its own standards. Sanctions for non-compliance by professionals are dealt with by the FRC whilst sanctions for non-compliance by corporate entities are dealt with by the Stock Exchanges. A similar model could be adopted for actuarial work with an Actuarial Reporting Council being responsible for both standard setting and the monitoring of the work of actuaries. This would have to co-operate with Government regarding the extent of delegated responsibility for standard setting and the principles to be upheld. Ultimate regulation of the financial entities in question, such as insurance companies and pension schemes is better handled by Government entities such as the FSA or Pensions Regulator as they alone have sufficient powers in the event of non compliance.

## **The Current Regulatory Framework of the Actuarial Profession**

### **The regulatory role of the Profession**

Q2.1

*What should the objective of a regulatory framework for the actuarial profession be?*

The Regulatory role of the Profession should be to set the Professional Standards for advice that members give whilst practicing as an actuary. These should cover standards of general conduct, and may cover the appropriate approach to particular matters where responsibility for such matters rests with the Profession and is not covered by appropriate Government regulation.

Such standards setting should not be such to stifle innovation but to give guidance on minimum standards – otherwise the danger is that that advice never develops in line with new ideas and ways of working. The Profession should also act to provide a disciplinary framework.

## Q2.2

*What is your overall view of the strengths and weaknesses of the current self-regulatory approach as applied to actuaries by the professional bodies? Does it adequately protect the interests of consumers? If not, are there key aspects of the regulatory framework that you think should be changed? Is there too much emphasis on reserved roles for individual actuaries?*

The regulatory role of the professional body takes many forms and each needs to be considered separately. The overall governance structure (being the Charter and bye Laws) is subject to approval by the Privy Council, and our understanding is that changes may only be made with their approval. The training, examination and licensing of actuaries (in the form of practicing certificates) is a self-regulatory approach, which operates well and it is difficult to see a realistic alternative for a professional body. The issue of professional guidance and adherence to it is large self-regulatory with the exceptions that:

- certain professional guidance is subject to approval by the Secretary of State
- actuaries have full legal responsibility for their advice.

Furthermore the professional body operates as a regulatory body for financial advice under the Financial Services Act.

In those areas where the actuary is not engaged directly by the people ultimately affected by their advice (direct third parties) the review may wish to consider whether the legislation provides sufficient protection. However, our view is that the main issue to be considered is whether in these positions the individual or body that contractually engages the actuary has sufficient responsibility and accountability for the direct third parties that they represent.

## Q2.3

*Does the Profession's dual responsibility for representing its members to the outside world and regulating them in the public interest create a conflict of interest? Is this conflict acceptable?*

Promotion by the Profession is largely focused on professional issues whereas promotion of a more commercial nature is undertaken either by individual firms or by industry bodies. We have not seen any evidence of any conflict between public promotion and standard setting being reflected in practice but note that the Profession is seeking non-actuarial input into the areas of discipline and standard setting.

## Q2.4

*Are there areas where you believe the burden of regulation is disproportionate and should be reduced? Are there areas that you believe should continue to be self-regulated by the professional bodies?*

The contrasting experience of the accountancy profession in the UK and US in recent years provides an interesting case study of the merits or otherwise of a rules based and principles based approach to regulation. Parallels may also be drawn with prescriptive regulation in the pensions arena which has often had the opposite effect to the originally declared intention. Our preference is for the prudent control framework to be based on a combination of principles supported by detailed requirements

### **The role of the Scheme Actuary**

Q 2.9

*Should the Scheme Actuary's role be reserved exclusively for actuaries? Could other professional provide similar advice?*

Aon believes that pension schemes should be subject to prudent control and that their operation in accordance with these arrangements should be confirmed by an appropriately qualified person. In the areas currently reserved for Scheme Actuaries, the actuarial profession is the only profession that has the necessary combination of training, qualification and practical experience to undertake these roles.

Q 2.10

*Do pension scheme trustees have the expertise and information to question and challenge the advice of Scheme Actuaries? In the absence of effective challenge from trustees are Scheme actuaries effectively making policy decisions by default on the distribution of benefits between different generations of pensioners and on funding strategies?*

The ability to question is not derived from expertise and information, but is an innate human attribute which can readily be observed from young children asking simply "why?" Indeed teaching is both advantageous and dangerous as it increases knowledge but often reduces questioning and consideration of matters from first principles. To be effective, trustees need to have the independence to question and not to act until that they are satisfied that the advice they have received is sound and logical.

Unless there are surplus funds the distribution of assets amongst beneficiaries on the wind up of a pension scheme is largely prescribed and not a matter on which actuaries are able to exercise judgment. As far as the distribution of the assets of an ongoing pension scheme is concerned the question was of greater relevance when the extent of specified scheme benefits was lower and surplus assets existed. At these times the award of discretionary benefits was more common and some of these awards had the potential to affect different generations of beneficiaries in a different manner. However surpluses were used to finance a wide variety of benefit improvements. For this reason it is difficult to generalise regarding the distribution of benefits except to observe that direct Government legislation has had the greatest impact in scheme benefit provision.

Funding strategies have been influenced significantly in recent years by the Minimum Funding Requirement (MFR). In this respect it has been difficult for some Trustees to

understand why contributions should be set at anything other than the MFR level. It has also been difficult for Trustees to understand why, if assets are matched to the MFR liability distribution and invested in index funds, losses are likely to arise compared to the underlying MFR assumptions. MFR has had a significant impact on funding and is subject to Government approval. In recent times the actuarial profession has recommended strengthening of MFR, which have been rejected by Government.

#### Q 2.11

*Is there sufficient audit or peer review of the Scheme Actuary's advice to provide checks and balances on the influence that could potentially be exerted by the Scheme Actuary?*

The work of Scheme Actuaries is not subject to a requirement of independent audit or peer review from an independent organisation. In this respect comparison with audit requirements are worthy of consideration. The preparation of accounts is an internal responsibility and the auditors are an external party who hold general responsibility for the accuracy of the audited accounts. The audited accounts constitute public documents and are readily available from Companies House. To our knowledge there is no formal independent audit or peer review of the work of an auditor although the FRC has certain responsibilities for monitoring financial reporting. In comparison, Scheme Actuaries are generally independent from the pension scheme and hold full responsibility for the accuracy of actuarial valuations. The actuarial firms all generally have sound internal production quality controls and the reports do not constitute public documents. It is an open question whether there should be a requirement for independence of the Scheme Actuary from the sponsoring company, but such an approach is equivalent to a requirement of independence of the civil service from advice to the public sector. In conclusion the need for separate audit of Scheme Actuaries seems no greater than the need for audit of auditors.

#### Q 2.12

*To whom should the Scheme actuary be accountable? What will be the effect of the intended removal of the minimum funding requirement on the potential for conflicts of interest if the same Scheme Actuary is advising both the trustees and the pension scheme sponsor? Is there a need for a separation of these roles?*

The Scheme Actuary should and is accountable to his clients as a matter of contract law. However pension schemes are established under trust with the Trustees and sponsoring companies being direct parties to the trust, and the members the beneficiaries of the trust. In turn the trust documentation may determine the party or parties to whom the actuary should report on the financial position of the scheme, and the relevant powers regarding the setting of contribution rates. However, trust deeds do not generally grant Trustees the power to make a charge over company assets except in limited circumstances. From the perspective of Trustees, in the absence of restriction or adverse consequences, it would obviously be preferable for the scheme to always have sufficient assets to be able to secure the liabilities with a reasonable margin of contingency. However Trustees have few powers of enforcement, the amounts concerned considerably exceed the accounting liabilities under FRS17 and most companies do not have the cash generational or credit facilities to meet such liabilities. In other words it is necessary to reach a compromise between the various considerations. Aon believes that it is important for both trustees and companies to be given the full range of professional advice and reach an appropriate compromise themselves, rather than being given compromised advice which presents them with a single option.

Finally, companies operate pension schemes on a voluntary basis, do so under a trust structure (managed by Trustees) largely for tax and security reasons. It is sensible that these arrangements should be able to continue as the practical partnership they are intended to be, subject to appropriate controls. These appropriate controls should be framed at those necessary to avoid abuse rather than being excessive and acting as a deterrent to the operation of such arrangements.

Q 2.13

*To what extent has actuarial advice contributed to the way occupational pension schemes are funded in the UK? How will the Pension Bill's proposal affect the role and power of actuaries advising pension scheme sponsors and trustees?*

Actuarial advice has undoubtedly had an influence on how pension schemes are funded in the UK and the Inland Revenue specially requires contribution payments to be based on actuarial advice. This advice had concentrated on the appropriate rate of contribution to achieve a stable contribution over time. However, changing Government legislation regarding minimum benefit provision, maximum funding levels for tax approval purposes, minimum asset requirements on discontinuance, Minimum Funding Requirements and the abolition of ACT have all had a much greater effect. The other significant impact has been external economic factors such as inflation, interest rates and stock market returns as well as man's success in extending his own survival by medical and environmental advance.

Legislation regarding scheme specific funding will have a significant impact on actuaries, although the exact extent will depend upon how the UK implements EU Directive 2003/41/EC.

Q 2.14

*Are there any other issues relating to actuaries' statutory or non-statutory roles in advising pension fund trustees and pension fund sponsors that you would like to bring to the attention of the review?*

None that lie within the scope of the review

### **Maintenance of professional competence**

Q2.20

*Is there the right balance between the Profession issuing practicing certificates and regulators giving their approval?*

It is important that an actuary acting within a specific role has relevant experience to carry out that role and keeps up to date with developments in the appropriate field. The system of practicing certificates is simply a way of keeping a check that this basic rationale is complied with. The position of regulators is really an issue for Government – for example if they wish to impose additional constraints on individuals that are permitted to undertake specific roles. Our view is that the basic “relevant experience” indicator is of more fundamental importance.

The concept of government regulation of professional bodies is more interesting as this would require government to delegate the responsibility (as it does now through the Privy Council)

or to supply directly a professional staff. We believe that the current structure is preferable, but that is not to say that improvements cannot be made within this structure.

Q2.21

*In your view are the current CPD requirements and the provision of CPD appropriate?*

As stated above, we feel that it is important that actuaries keep abreast of developments within their field, although aligned to this we feel that it is also important to keep abreast of developments within the Profession and wider fields. The requirement to undertake a minimum amount of CPD of differing types (depending on the role an individual actuary undertakes) is wholly in keeping with this principle, and is supplemented by a mandatory programme that Aon runs inhouse.

Q2.22

*Do you support the Profession's proposals to extend the concept of practicing certificates to cover all actuaries who give advice on actuarial matters?*

We would support the development of practicing certificate to the extent that they discourage actuaries from undertaking work for which they are ill-equipped. However it would be important that the programme was administered with care and did not become merely a revenue raising exercise (the costs of which would ultimately be passed on to the users of actuarial services), and that it did not discourage actuaries from expanding their area of expertise (with suitable monitoring) in order to best serve the needs of their client.

Q2.23 *Are there any other changes to the CPD programme that you would like to see?*

No.

### **Whistle-blowing**

Q2.24

*Are there appropriate legal and professional duties and safeguards for disclosures by actuaries to protect the public interest in regulated sectors?*

At present legislation requires a "scheme actuary" to inform the pensions regulator (OPRA) when "any duty relevant to the administration of the scheme imposed by any enactment or rule of law on the trustees or managers, the employer, any professional adviser or any prescribed person acting in connection with the scheme has not been or is not being complied with", and "the failure to comply is likely to be of material significance in the exercise by the Authority of any of their functions". It is proposed under the Pensions Bill currently before Parliament that this obligation will be strengthened and will apply to other parties, including actuaries acting other than in the "scheme actuary" capacity.

This requirement does provide a certain safeguard where deliberate abuse of the law or trust is taking place, but its usefulness is constrained by the power of OPRA to take action, although the proposals in the Pensions Bill should go some way to addressing this. In addition, it is important that the Authority is seen to take a pragmatic approach and it is clear which areas

are “likely to be of material significance”. If this is not the case actuaries may feel a need to report in cases where this would not really serve any interest – for example where suitable corrective action has been taken and measures put in place to ensure that the problem will not recur.

The concept of whistle-blowing however, should perhaps be extended (as proposed in the current Pensions Bill) to the scheme’s legal advisers. The reason for this is that UK trust law is largely uncodified but based on principles of equity and previous case law. Effective whistle-blowing in this area may therefore require full knowledge of trust law, which is an expertise held by lawyers.

Q2.25

*Is it sufficiently clear to actuaries and others when they should report concerns to the regulators and the Profession?*

The revised guidance published by OPRA this year has been useful in this regard, but as stated above it is important that the regulator and Profession work in partnership so that actuaries are able to take a sensible and effective approach to reporting.

Q.2.26

*Is there an appropriate level of disclosures by actuaries to protect the public interest?*

Public interest is more directly affected by the prudent control arrangements that are being operated and whether these are adequate. Whistle-blowing only arises in the case of abuse, which are thankfully reasonably infrequent.

## **Standard-setting**

Q2.27

*Does the Profession’s technical guidance, as set out in the Manual of Actuarial Practice, provide unambiguous, up-to-date and clear standards for practicing actuaries and other professionals e.g. auditors, who work with them? Do you agree with Lord Penrose’s view that professional guidance in the past has not protected policyholders’ interests?*

It is a requirement of due process that the guidance provided by the Profession is required to be unambiguous. In addition, where developments mean that there is a need for guidance as a matter of urgency can be issued through the “fasttrack” route. However, the need for Secretary of State approval for some guidance can mean that this is hard to achieve within the necessary timescales.

Despite this objective, there are of course, times when the guidance is ambiguous or unclear. In such cases we feel it is our duty as professionals to bring this to the attention of the relevant bodies, both to seek clarification and to enable the necessary corrective action to be taken.

The issue of protecting policyholders’ interests and the responsibility for this is at the centre of the reason for the recent Government Reviews. It is an open question of whether the concept of Policyholders’ Reasonable Expectations (PRE) introduced directly by legislation

was adequately explained, and if further interpretation was necessary, which party was responsible for its interpretation and ensuring compliance. Without wishing to comment directly on the Equitable case, it is interesting to observe that from the Penrose Report it is obvious that the concept of PRE held different meanings to different people including actuaries, solicitors, Council and Lord Justices including the Vice Chancellor. It is also suggested that Treasury/GAD were in some way involved in considering PRE. Our sole observation on this matter is that prudent control arrangements are likely to be seriously challenged when such fundamental concepts remain ambiguous. Lord Penrose appears to conclude in 1.117 that this is the nature of our civil justice system and must be accepted. This is, of course, unquestionably true but it fails to address the issue of whether prudent control can be effective in the absence of clarity.

It is also worthy of observation that the comments made by Lord Penrose regarding the failure to address PRE must apply directly to the regulator responsible for ensuring that this legal requirement was being observed.

Q.2.28

*Does the technical guidance need to be updated more regularly and are fasttrack processes required to provide guidance on urgent issues?*

It is clearly desirable that the guidance is amended to be as up to date as possible. However, as with legislation, a balance needs to be sought and action taken where absolutely necessary, since there must be a cost attached to both producing amended guidance and considering its application (at both an individual and corporate level.)

Q2.29

*Who should provide the guidance: the Profession, the regulators or the government?*

Insofar as the guidance reflects the application of actuarial principles and professional restrictions on actuaries, guidance should be produced by the Profession. However, guidance must not be tertiary legislation: any matters falling within the sphere of Government policy should sit within legislation or guidance produced by regulators. In particular it must be possible to reach a clear understanding of the requirements emanating from fundamental principles. The responsibility for this must be clearly allocated by Government and clarified by either regulation, or professional standards in the case of delegated responsibility.

Q2.30

*Is there a need to reduce the level of discretion permitted within the guidance to come to some generally acceptable professional practices?*

In many areas the exercise of actuarial judgement can result in wide variation depending on the view of the individual actuary. It is important that the actuary can exercise judgement in certain areas, for example where these relate to knowledge of a particular market or client.

Q2.31

*Will the Profession's own proposals for an actuarial standards board go far enough to improve the quality and timeliness of standard-setting to protect the public interest? Is there a need for even greater independence from the profession or a statutory underpinning to bring greater credibility to the technical standard-setting process?*

The introduction of an actuarial standards board should help the Profession by giving a wider perspective on the issues in question. Too much regulation in this area could put the Profession in the position of being unable to regulate itself where it felt necessary.

Q2.32

*Does the Profession work closely enough with other professions e.g., accountancy, to ensure that its standards are widely recognised and to influence other profession's standards where appropriate, and to ensure that there are no regulatory gaps or overlaps in standards?*

The Profession already communicates with other professions, such as the audit profession. However, the issue of ensuring that complete regulation is properly a matter for government and not individual professions.

### **Openness, peer review and audit of actuarial work**

Q2.33

*Do you agree with Lord Penrose's assessment of the lack of openness and transparency of the profession to non-actuaries, including other professionals, and their clients?*

In the context of pension scheme advice we do not believe that Lord Penrose's assessment is appropriate. We are constantly striving to improve our communications and actively seek our client's feedback. Consultants must deliver advice that clients understand and are comfortable acting upon. This does not mean reducing the advice to too simple a level, but helping our clients to understand the options and implication of often complex and technical issues. Advice that is not clearly formulated, open and transparent is not accepted by clients.

Q2.34

*What steps can be taken to improve communications between the actuarial profession and their clients or other professionals?*

We actively seek our client's views on the appropriateness of our communications and advice delivery to help continually improve our service offering. Written communication skills has been examined as part of the education syllabus for some time and as employers, we actively support further development of our staff. In terms of improving links with other professions, there are already a number of joint seminars and events with other professions, notably with the legal profession and investment community. In addition, many auditing firms employ actuaries to assist in the review of pension scheme audits and there are other links with accountancy bodies through participation in various joint projects.

Q2.35

*Given the Profession's recent proposals on peer review, and the FSA's proposals for the reviewing actuary function in life assurance, will there be an appropriate level of peer review and scrutiny in the actuarial profession to protect consumers' or policyholders' interests in the future?*

The proposed Peer Review guidelines will build upon existing internal review and audit guidelines that we employ to continually monitor the quality of advice we provide to our clients.

Q2.36

*When should actuarial opinions be directly addressed or otherwise communicated to members of the public, such as policyholders or scheme members?*

Our client typically is the Scheme Trustees or the Employer and it is to them that our advice is primarily addressed. Legislation already requires certain statements to be addressed to defined benefit pension scheme members and the Pensions Bill envisages extending the information provided to members by Trustees. We believe that it is appropriate for Trustees to decide what additional information is usefully provided to pension scheme members, bearing in mind the nature of the scheme, provisions of the Trust Deed and Rules and their fiduciary duties to beneficiaries.

Q2.37

*Is there a need to further widen the scope of actuarial activities that are subject to peer review or other forms of scrutiny – for example into Lloyd's syndicates and general insurance?*

We have no comment on this issue.

### **Monitoring, complaints and disciplinary schemes**

Q 2.38

*Do the new disciplinary processes implemented by the Profession from 1 January 2004 address the issues that Lord Penrose raised?*

Lord Penrose raises many issues however it is assumed that this question refers to his comments in Chapter 20 paragraphs 37 to 63. The direct reference in the review is to paragraph 60 which concerns whether the Profession should have a monitoring role in respect of the reporting and operations of insurance companies. This is not a matter of discipline but rather appropriate prudent control arrangements. These were formerly operated by the Government Actuary and are currently operated by the FSA. The objectives of prudent control could be achieved by a variety of means and the most important aspect is that they are properly co-ordinated and that responsibilities are clear.

Q 2.39

*Is the Profession's past record of 17 complaints over 15 years a sign of a successful profession or an indication that monitoring and disciplinary procedures were not effective?*

A qualified answer is necessary to this question. The fact that anyone has suffered as a result of actuarial advice cannot be classed as a success. Although the number of upheld complaints is low it must be remembered that the profession is small and it is the incidence of complaints rather than the absolute number which is important. It also needs to be remembered that professional complaint is not necessarily the best remedy and other recipients of potentially negligent professional advice will have relied on legal action as the method of redress. Furthermore although the professional conduct standard requires reporting by one actuary on another, most actuarial work is not in the public domain. In other words we do not believe that any clear conclusion can be reached from this statistic.

Q 2.40

*Should the review consider whether a fully independent disciplinary process is needed?*

The review should act within its remit and conduct itself as it thinks fit.

Q 2.41

*In the accountancy profession the joint monitoring unit verifies whether firms are complying with audit standards. Given Lord Penrose's criticisms and the long-term nature of actuarial advice, is there a need to move away from reactive complaint-driven disciplinary procedures to a more proactive regime of monitoring of compliance with professional actuarial standard? If so, who should have responsibility for overseeing the monitoring and disciplinary proceedings and who should bear the associated?*

This is a question relating to prudent control arrangements on which extensive comment has already been made.

Q 2.42

*Should discipline be undertaken by the Profession or by regulators?*

Discipline could be undertaken by either the professional, a regulator or by law. In the UK regulators tend to regulate particular industry specific entities and the professions regulate professional conduct. The UK profession itself operates under Royal Charter which requires approval from the Privy Council. Aon believes it would be sensible for prudent control arrangements including the issue of professional standards and discipline to be operated by the profession. An extended monitoring role based on delegated authority from Government would also be possible but is likely to require Government finance.

Q 2.43

*Do regulators make appropriate use of actuarial expertise to supervise the work of actuaries?*

We are not fully acquainted with the extent of actuarial expertise used by regulators other than in the area of pensions. In this area OPRA does employ actuaries on its staff and involves them with cases as appropriate.

Yours faithfully

**Nigel Bankhead**  
Head of Actuarial Practice