



## **Morris Review of the Actuarial Profession ICAEW Response**

### **GENERAL COMMENTS**

The Institute of Chartered Accountants in England and Wales welcomes the fact that a comprehensive review of the actuarial profession is being undertaken, and we are pleased to contribute our comments, from the point of view of the accountancy profession. If there is any further way we can assist, please let us know.

We have not responded below to consultation questions on aspects of the actuarial role where we feel we do not have sufficient knowledge or experience to provide a comment. However, we believe we could make a useful contribution, representing the accountancy profession and as a regulator, and we would therefore welcome meetings to discuss our views.

In particular, representatives from our Ethics department could be of assistance in discussing Q1.7 to Q1.10, representatives from our Education and Training department could be of assistance in discussing Q1.15 to Q1.21 and Q2.20 to Q2.23, representatives from our Ethics department and those dealing with regulatory developments in our Professional Standards department could be of assistance in discussing Q1.34 and Q2.1 to 2.4, and representatives dealing with monitoring complaints and discipline within our Professional Standards department could be of assistance in discussing Q2.38 to Q2.42.

We note that the consultation does not appear to distinguish between actuaries taking a role in management and those providing independent over-sight or reporting functions. The "Appointed Actuary" function in insurance companies ran the danger of confusing these functions, and one of the main recommendations of the Penrose Enquiry into Equitable Life was that they should be clearly separated. The ICAEW agrees with this approach, and has been working with the FSA on the implementation of resultant changes.

## **SPECIFIC RESPONSES**

### **CHAPTER 1**

#### **THE ROLE OF ACTUARIES, THE PROFESSION AND THE ACTUARIAL SERVICES MARKET**

##### **The scope of the actuarial role**

**Q1.1 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?**

Actuaries bring very valuable specialist skills to a sizeable range of functions, in particular, in life and general insurance, pensions and in investment management functions. In respect of defined benefit pension schemes, the main value provided by actuaries is their assessment of the future funding position and future liabilities and, in respect of insurance, it is their actuarial valuation of long term insurance business. Actuaries are by their training better equipped to carry out these specialised roles than members of other professional bodies.

**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?**

The role actuaries perform is very specialised and so requires a high degree of expertise and training. However, this should not preclude actuaries from carrying out a wide range of other functions provided they obtain appropriate training and/or experience. See also Q2.9 below.

**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 reasons? If not, why not?**

As we mention in our General Comments above, following from the Penrose recommendations the FSA has been changing its Rules to the effect that actuaries employed by insurers should not have specific and distinct roles imposed by the regulator or by law, but have the same over-all rights and responsibilities as any other employee, including one of openness with the regulator. This puts them in a similar position to employees of regulated firms with other professional qualifications, such as accountants and lawyers, who are also expected to employ their specialist skills and be bound by ethical requirements of their profession, but not bound to any particular function. The ICAEW agrees with this approach. In practice, given the highly specialised nature of actuarial work, it may not matter whether the roles are reserved by statute since few other professionals have sufficient actuarial skills to carry out the roles currently reserved. However, we recognise that in some complex areas of high public reliance, restrictions are necessary, such as where the actuary has responsibilities to multiple stakeholders whose interests may differ or where the actuary effectively forms part of the independent audit team. We think it is necessary for particular roles for actuaries in relation to pension

schemes and the new review actuary of life insurers to be reserved by statute. This is equivalent to the requirement that corporate audit reports must be signed by registered auditors.

**Q1.4 What impact, if any, has the existence of reserved roles had on the effectiveness with which actuaries work with non-actuaries?**

It can be difficult for non-actuaries to fully understand actuarial numbers and at times there has been some defensiveness by actuaries over their work which has not helped other professionals, such as auditors, to properly understand and rationalise actuarial models. In the past, there was an attitude in many professions of “trust me, I’m the expert”. It has taken longer for this assumption to be challenged than in other professions but such a challenge is appropriate. The reserved roles may have contributed to this by concentrating significant responsibilities in the hands of the actuary, particularly under the old appointed actuary regime for life insurance. Other factors include the specialised and complex nature of actuarial work and the relatively small number of practicing actuaries.

In the area of pension scheme accounting, the reserved role does not directly impact on auditors as currently there is no need to include actuarial valuations in scheme accounts. However, the actuarial role might have more impact for scheme auditors in future if a requirement for scheme accounts to include actuarial valuations is introduced, for instance, pursuant to EC legislation. See also Q1.35 below.

In the context of life insurance, the new FSA regime which requires auditors to appoint an independent actuary to review and report to them on insurance liabilities will require greater and more effective co-operation between auditors and actuaries. By giving auditors explicit responsibility for the liabilities they will need to be able to better rationalise the outputs of actuarial models. The internal actuarial function should be able to explain their work to the review actuary, who would then report to the auditors.

**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?**

Yes, we think that actuaries should be subject to greater monitoring, which could be by central monitoring (as used in the accountancy profession) or by peer review. We view the new FSA regime for life insurers as a positive step forward which introduces independent scrutiny of the work of the former appointed actuary. If in future auditors are required to audit actuarial valuations of pension schemes, auditors should be given the right to request a second opinion on the actuarial valuation. We note that this will lead to increased costs that will ultimately be borne by consumers and therefore a cost benefit analysis should be carried out when determining whether actuarial liabilities should be included in scheme accounts. See also Q1.25, Q2.1, Q1.34 and Q2.12 below.

**Q1.6 Could other professions work more closely with actuaries or in related functions to help maintain and improve actuarial effectiveness?**

Please see our answers to the questions above.

**The Profession**

**Q1.11 How effectively does the Profession engage with government, business, regulators and other professions?**

Actuarial representatives currently sit on various ICAEW technical committees. We believe that their involvement is valuable and we would welcome the opportunity to offer our services on the equivalent actuarial committees and boards. The ICAEW is currently discussing this with the Institute and Faculty of Actuaries with a view to having reciprocal representation.

See also Q2.32, Q2.33 and Q2.34 below.

**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?**

We anticipate that demand for actuarial services will increase in the accounting and audit domain; in accounting due to the move towards fair value reporting of assets and liabilities (partly driven by IFRS); and in auditing, to audit the new valuation models and satisfy regulatory requirements, for example, in the need for the auditors to appoint an independent actuary for FSA returns of life offices.

**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?**

Clearly, choice is important, but if actuaries are to have a public interest role, objectivity is important. Safeguards would therefore be necessary in respect of roles where this is needed, to ensure switching is not used to subvert that objectivity.

**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?**

Those receiving actuarial advice have not traditionally understood it well, particularly the management and non executives of small insurers. Some actuaries have difficulty in explaining the effects of their methods in simple and penetrable language. The

introduction of a second actuarial review via the auditors could assist the situation but at a cost. See also our answers at Q1.5, Q2.1, Q1.34 and Q2.12.

**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?**

There appears to be an insufficient supply of actuaries to satisfy current demand. This may be due to the demanding recruitment and training programme and to the fact that the actuarial profession is more highly specialised than other professions, which might impact upon both its attractiveness to trainees and the availability of training places.

**International comparisons**

**Q1.31 How easy is it for actuaries to work across international boundaries?**

In practice, there appears to be little cross recognition between the UK and the continent (except Ireland) of actuarial service potential. We anticipate this may to a certain extent be due to language barriers.

**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?**

It is not for the accountancy profession to say whether another profession should follow the same model as we have. The standard setting and regulatory model that applies to accountants is new and evolving. We set out below the key elements of this.

It is important to appreciate that, in the model used by the accountancy profession, the FRC is not a unified single regulator. The Institutes provide monitoring, disciplinary procedures and set certain ethical standards. The FRC sets professional standards for auditors and financial accountants to follow, monitors the Institute's public interest activities and (under the Companies Bill) will monitor the largest public interest audits.

We consider that the important features of the regulation of the accountancy profession are:

- the independent setting of standards by the FRC, which ensures that standards are set in consideration of a wider context;
- there is practical input from members who are experienced in the work of the profession;
- the ethical standards that require auditors to maintain their independence; and

- the regulatory functions of the Institute are carried out using a pro-active risk-based approach, with the largest 20 firms visited on an annual basis;

Within this framework, the Institutes regulate their own members, thus retaining the efficiency of self-regulation. This process is overseen by the FRC.

It is important for the actuarial profession to have sufficient safeguards in place (both with standard setting and monitoring) to ensure that actuaries provide independent advice. See also our answer at Q2.12 below.

**Q1.35 Are there any forthcoming EU directives or international accounting standards that are likely to impact on the actuarial role?**

**i) Pension Scheme Accounts**

Article 10 of the EU Pensions Directive requires that the annual accounts and the annual report ‘*shall give a true and fair view of the institution’s assets, liabilities and **financial position**. The annual accounts and information in the reports shall be consistent, comprehensive, fairly presented and duly approved by authorised persons, according to national law.*’.

The DWP consultation on implementing the Directive suggests that the DWP are content that the EU Directive has been implemented here if enhanced actuarial information is included in scheme annual reports rather than in the accounts themselves. We are concerned as to whether the DWP’s approach really deals with the Directive’s requirements of disclosing ‘financial position’, a term which many believe means all the assets and all the liabilities in the accounts, rather than in separate statements of net assets and an actuarial statement of liabilities.

We note that the Pension Research Accountants Group (PRAG) reissued the SORP on ‘Financial Reports of Pension Schemes’ in December 2002 and the ASB drew attention to the absence of actuarial liabilities in scheme accounts. PRAG put the arguments to the industry in a consultation last year and most respondents favoured exclusion.

**ii) Corporate reporting of pensions obligations (FRS 17 and IAS 19)**

We note that a new and potentially turbulent era in the corporate reporting of pensions obligations is approaching, both in the United Kingdom and internationally. Firstly, in the UK the provisions of FRS 17 *Retirement Benefits* are due to become mandatory for UK GAAP users in 2005, which requires that actuarial gains and losses are recognised in the accounts.

Secondly, listed companies across Europe are required under the terms of the European Union IAS Regulation to apply European-endorsed International Financial Reporting Standards (‘IFRS’) in their consolidated financial statements from 2005, including IAS 19 *Employee benefits*. Unlisted UK companies will be provided with the option of

applying IFRS rather than UK GAAP from 2005; companies electing to use this option will apply IAS 19, rather than FRS 17. IAS 19 is, however, subject to change, both in the short and longer terms.

Whilst FRS 17 and IAS 19 require a different basis of valuation than that generally used for funding purposes, actuarial involvement is necessary in deriving the FRS 17 and IAS 19 numbers and inclusion of such numbers in the primary financial statements may result in much more focus on the work of actuaries.

For more information, please see the attached ICAEW pensions accounting briefing paper on accounting for pensions obligations under FRS 17 and IAS 19, and TECH 29/04 commenting on the latest exposure draft of IAS 19.

### **iii) IASB Insurance Contracts Project**

The impact of IFRS 4 *Insurance Contracts* upon actuaries is likely to be limited, since many of the more complex issues surrounding the measurement of insurance liabilities have been deferred until Phase II of the project, which is likely to be introduced in 2007 or 2008. Phase II is likely to have a more significant impact upon the work of actuaries, since the IASB is looking to develop and introduce an internationally consistent method of measuring insurance liabilities. It would be premature to predict the likely shape of Phase II, other than by noting that the general direction of IASB thinking is towards the fair value model.

### **iv) Solvency II Directive**

The European Commission is in the process of developing a new capital directive for insurers, known as Solvency II. Solvency II is likely to introduce a capital regime for insurers similar to the Basel II regime for banks. Solvency II is currently less well developed than Basel II, since the Commission was effectively starting from scratch, rather than updating and replacing a previous internationally accepted model. Solvency II is likely to follow a three pillar approach, with Pillar 1 based upon regulatory capital requirements, Pillar 2 based upon regulatory supervision and Pillar 3 based upon market discipline through disclosure requirements. The Solvency II regime will introduce greater consistency in the regulation of insurers across Europe and may, consequently, require changes to be made to actuarial techniques in the UK.

### **Q1.37 Which other professions' regulatory models, and what aspects of them in particular, do you think the review should consider?**

See Q1.34 above.

## **CHAPTER 2 - 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?**

Within the overall market system, we believe the purpose of regulation is to protect the integrity and quality of services provided by actuaries and to provide safeguards against market abuse, to the extent that the benefit gained outweighs the overall cost of regulation. See also Q1.34 above.

#### **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?**

See Q1.34 above.

#### **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?**

See Q1.34 above.

#### **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?**

See Q1.34 above

### **Scope of actuaries. statutory or reserved roles**

#### ***The role of the Appointed Actuary***

#### **Q2.5 Do you think that the FSA's proposals to change the appointed actuary regime address the concerns that Lord Penrose raised in this regard? Is there a need to do anything further to address Lord Penrose's concerns?**

Yes. As we mention in our General Comments above, the consultation does not appear to distinguish between actuaries taking a role in management (equivalent to accountants in business) and those providing independent over-sight or reporting functions (equivalent to external auditors or reporting accountants). The "Appointed Actuary" function in insurance companies ran the danger of confusing these functions, and one of the main recommendations of the Penrose Enquiry into Equitable Life was that they

should be clearly separated. The ICAEW agrees with this suggestion, and fully supports the FSA in bringing life insurance liabilities under the scope of the audit report on regulatory return and creating the new role of independent actuary to report to the auditors. We have been working with the FSA on the implementation of resultant changes.

### *The role of the Scheme Actuary*

#### **Q2.9 Should the Scheme Actuary's role be reserved exclusively for actuaries? Could other professionals provide similar advice?**

This specialised role should be reserved exclusively for actuaries. As we mention at Q1.2 above, the level of technical competence necessary to perform this role precludes it being undertaken by other professionals.

#### **Q2.10 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?**

Actuarial calculations are likely to be too complex for persons other than actuaries to understand and so it would be unreasonable to expect trustees to fully understand such calculations. However, particularly in larger schemes, trustees are likely to have the expertise to question and challenge the advice they receive from actuaries, which although based on such calculations, should be in a form that a lay person can understand.

#### **Q2.11 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?**

See Q1.5, Q1.34 and Q1.35(i) above and Q2.12 below.

#### **Q2.12 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 interests 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 be accountable to the trustees and this should be evidenced by the Scheme Actuary's engagement letter.

Given the advisory nature of the actuarial role, which has a financial impact on the performance of their clients (whilst that of auditors does not), it is important for the actuarial profession to have sufficient safeguards in place to ensure that actuaries provide objective and independent advice. In practice, efficiency and cost considerations often

dictate that there is no separation of roles between the Scheme Actuary and the actuary advising the employer (for instance, where the employer follows the recommendations of the Trustees, the Scheme Actuary will share his advice to the Trustee with the employer), and if such separation were to be enforced this would lead to increased costs. It is worth noting that trustees will often be directors of the employer, and thus the actuary will often be advising persons representing both entities.

Greater monitoring or peer review and the setting of appropriate ethical standards should mitigate the adverse consequences of the same actuary performing both roles. We note that sections 5.2 and 5.3 in the Profession's "Professional Conduct Standards (PCSs) require actuaries to '*consider ... whether it is... improper for [them] to give advice to one or more clients*' in a conflict situation, and to notify the clients of any such conflict and, '*if any advice given to a client is, or will be, influenced by interests other than those of the client ... this must be disclosed*'. If the same actuary is advising both the Scheme and the employer, and either party contests the actuarial advice, there may be merit in the actuary advising the engagement of an independent actuary to provide a second opinion.

**Q2.13 To what extent has actuarial advice contributed to the way occupational pension schemes are funded in the UK? How will the Pensions Bill's proposals affect the role and power of actuaries advising pension schemes sponsors and trustees?**

As far as we are aware, the Pensions Bill will not amend significantly the actuarial role.

***Investment***

**Q2.19 Do you have any observations about the Institute's role in regulating investment business by actuarial firms as a designated professional body under FSMA?**

We understand that the type of work that can be conducted under the DPB arrangements is limited in nature. Therefore, we have no further comments on this question.

**Maintenance of professional competence**

**Q2.22 Do you support the Profession's proposals to extend the concept of practising certificates to cover all actuaries who give advice on actuarial matters?**

Before there is consideration of the need for a practising certificate, the situation of the actuary providing the advice needs consideration. If the actuary is employed in an insurer, we do not see the need for a practising certificate. If the actuary is providing services as principal, or providing public over-sight, such as a scheme actuary or review actuary, then a practising certificate should be held.

## **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?**

Pension scheme actuaries and auditors are subject to the same legislation and guidance (issued by Opra), and we are satisfied that the guidance is clear in this area.

Review actuaries of life insurers will effectively become part of the audit team. As such, they will have a similar requirement to disclose matters of significant regulatory impact to the FSA to that of the auditors.

However, we note that external accountants and auditors are subject to the suspicion reporting requirements of the Proceeds of Crime Act but that actuaries are not. We recommend that the obligations of these professions be brought into line.

### **Q2.25 Is it sufficiently clear to actuaries and others when they should report concerns to the regulators and the Profession?**

See Q2.24 above.

## **Standard-setting**

### **Q2.29 Who should provide the guidance: the Profession, the regulators or the government?**

See Q1.34 and Q2.12 above.

### **Q2.30 Is there a need to reduce the level of discretion permitted within the guidance to come to some generally acceptable professional practices?**

It is clearly important in any standard setting to achieve the right balance. Certainty is important, but too much rigid rule-making often reduces desirable levels of professional judgement to inappropriate box-ticking, resulting in compliance to the letter of the rule, rather than the spirit.

### **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?**

There is a need to balance independence (and thus public interest protection) with knowledge (and thus workability). There are a number of means of achieving this. See Q1.34 for example.

**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 worked with the ICAEW to issue a Joint Protocol prepared by a joint working party on inter-professional communication between the actuary and the auditor in the context of accounting requirements relating to pension scheme accounts (and relating to retirement benefits in employer accounts), issued in December 2003. The profession has consulted with the ICAEW on other draft guidance but in finalisation of the standards it is not always transparent as to why some comments have been accepted and others rejected. See also Q1.11 above.

The Financial Reporting Committee and the Pensions Sub-Committee of the ICAEW have included representatives of the Institute of Actuaries for a number of years. We have also sought actuarial representatives for various working parties, including on insurance matters. The Auditing Practices Board has a representative of the actuarial profession on its working party seeking to develop professional guidance for auditors of insurers in light of recent changes to the FSA regulatory regime. We recently approached the Institute of Actuaries to seek a permanent representative of the actuarial profession to sit on our Insurance Sub-Committee and proposed that we should be given reciprocal representation on actuarial committees, which we do not currently have. Discussions are continuing over this, but we would view it as a positive development likely to improve mutual understanding between the 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?**

The Joint Protocol mentioned at Q2.32 above was issued to improve communications between pension scheme auditors and actuaries. We note there is a need for both professions to promote awareness of this Protocol amongst their members.

The new review actuary regime for life insurers will require greater understanding between auditors and actuaries. Actuarial models and techniques have often been difficult to penetrate for non-actuaries.

**Q2.34 What steps can be taken to improve communications between the actuarial profession and their clients or other professionals?**

As we note at Q2.33, both the auditing and actuarial professions should promote awareness of this Protocol amongst their members.

**Q2.36 When should actuarial opinions be directly addressed or otherwise communicated to members of the public, such as policyholders or scheme members?**

This depends upon the type of opinion offered. In respect of pensions, we believe that actuarial opinions should be addressed to the trustees, as they are at present. These opinions are already available to scheme members through legislation and we do not consider any changes to this are required.

We had concerns over FSA proposals that the new review actuary of life insurers should issue a public report to stand alongside the auditors' report on regulatory returns, not only because the proposed form of report went further than the audit report which it was intended to support, but also because such a report would undermine the value of a single audit report covering all areas of regulatory returns. We support the FSA decision to drop this requirement but can see some merit in a public report by the internal actuarial function.

**Monitoring, complaints and disciplinary schemes**

**Q2.39 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?**

This could be interpreted either way, which can only be answered by knowledge of the individual circumstances and any action taken by the Profession to reduce complaints.

**Q2.41 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 standards? If so, who should have responsibility for overseeing the monitoring and disciplinary proceedings and who should bear the associated costs?**

The JMU acted as agent for the three Chartered Institutes in reviewing the work of auditors registered by them. The Institutes now have different arrangements and do not operate a joint unit but do work closely together. See also Q1.34 above.

**Q2.42 Should discipline be undertaken by the Profession or by regulators?**

See Q1.34 above.

**Q2.43 Do regulators make appropriate use of actuarial expertise to supervise the work of actuaries?**

In our view, the answer to this question should be evident from the resources available to the regulator of actuaries.