

THE MORRIS REVIEW OF THE ACTUARIAL PROFESSION

OUR RESPONSE

Barnett Waddingham LLP is a firm of consulting actuaries. We have 25 partners and about 250 staff many of whom are actuaries or actuarial students.

We are active advisors on actuarial matters in pensions and in life insurance. We do no work in general insurance.

Against that background it will be apparent that the Review is an important matter for us and so we felt it necessary to offer our own response.

Adrian Waddingham of this firm is currently Chairman of the Association of Consulting Actuaries which we understand to be making its own response to the Review. Another partner, Nick Salter is a member of the council of the Institute of Actuaries who will also be submitting their own response. Adrian and Nick are content that our response may be made on behalf of the firm as a whole.

The views expressed in this response are those of the partners of Barnett Waddingham LLP generally and, although individual partners might vary as to emphasis, the generality of what is expressed is agreed by us all.

We do not comment on the more general issues of section 1 as we believe that is best dealt with by the Actuarial Profession itself but we have replied, in particular, to questions 1.1 and 1.7.

Section 3 deals with the GAD which is not an organisation with which the firm has much professional contact. As such, we have responded to only question 3.1.

The questions have been set out in italics first and our response follows each question.

9 September 2004

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?

The main value provided by actuaries is in assisting their clients to understand the financial risks and uncertainties affecting their organisations, to understand the potential consequences of those risks materialising and to help them manage those risks.

The main weakness of actuaries is the difficulty they have in communicating what is often the very complex nature of their work to non-actuaries.

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?

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?

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

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?

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

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 a pensions context, actuaries were indeed slow to point out the risk that defined benefit pension schemes were vulnerable to the effects of winding-up that have now become apparent – namely, that the deferred pensioners were legally bound to subsidise the current pensioners – regardless of the cost of buying the annuities of the latter.

Having said that, the vast majority of members of defined pension schemes have very much to be grateful for in that they continue to draw and accrue reasonable pension rights and it would have been wrong (even had actuaries been prophets) for membership of such pension schemes to have been denied to many simply because of the effects of the failure of some schemes on what is, in fact, a relatively small number (65,000 deferred pensioners are affected according to the government compared to the many millions who are members of defined benefit schemes).

Turning to insurance companies, the difficulties experienced in recent times by the life insurance industry have not generally been because the insurance products themselves are not “*fit for purpose*” but because the sales process has been deficient.

Consumers have been persuaded to buy products that were not suitable to their circumstances at the time but those consumers thought that they were.

Moreover, consumers have been mis-advised to buy the wrong product (for example, pension transfers and opt-outs) or they have not appreciated the risks of what otherwise could well have been a perfectly adequate product (for example, endowments to back mortgages).

The description of “*unfitness*” in many circumstances is given with the benefit of hindsight. Mortgage endowments, for example, have been a very successful means of repaying very many mortgages. It is only in recent times that they can be said to be “*unfit for purpose*” and then only on the basis that additional savings might be required if investment markets continue to under-perform (and even that ignores the effect of reduced interest payments on the total outlay made by the consumer).

Actuaries should shoulder some responsibility in some of these areas but they should not be required to bear this burden alone. Some of the responsibility should be shared with government, with regulators, and with insurance company management as well as with intermediaries and so on.

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?

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?

Q1.10 Are actuaries sufficiently liable for their actions? If actuaries provide poor advice, to whom should they pay compensation?

The Profession

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

Q1.12 *Has the Profession successfully expanded the horizons of actuarial knowledge and promoted innovation?*

Q1.13 *Has the Profession done enough to promote the work of the actuarial profession?*

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?*

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?*

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?*

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?*

Q1.18 *Has actuarial education and training kept up with developments, particularly in the financial markets and in financial economics?*

Q1.19 *Do you have any comments about the proposed new qualification syllabus that will come into effect in April 2005?*

Q1.20 *Is there sufficient diversity in the composition of the student body and are there enough links with other professions' qualifications?*

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?*

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?*

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?*

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?*

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?*

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?*

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?*

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?*

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?*

International comparisons

Q1.30 *How are the skills and professionalism of UK actuaries and the UK actuarial profession regarded internationally?*

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

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?*

Q1.33 *Are there any EU or other countries that the review should be considering in seeking to identify 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?*

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

Q1.36 *Are there lessons for the actuarial profession from comparison with the professional and regulatory framework of the legal profession?*

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

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?*

The objective of a regulatory framework for the actuarial profession should be to ensure adequate levels of training, maintenance of professional standards, set guidelines for “best practice” in different circumstances, internal professional regulation as to continuing competence and discipline for professional offences.

We do not hold the view that the framework should refer to the public interest because it is difficult to define that term without being specific about the context in which it is being used.

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?*

Our view is that the current self-regulatory approach runs the risk of being compliance-driven with the result that being able to claim that “a box has been ticked” is sufficient when the true test is not that the box had been ticked but rather that the advice given was sound.

Procedure is in danger of overcoming content (this might be true of other professions and organisations, too). The strength of the present system is that it commands the support and respect of the profession as a whole – albeit reluctantly from time to time – because the profession is greater than the sum of its members.

It is difficult to claim that the present approach adequately protects the interests of consumers. If the word “consumer” is intended to be “the man in the street” then the answer is probably yes, the system does protect him. However, there are other aspects of the institutions advised by actuaries and which that “man in the street” relates to which have failed but this is not necessarily the fault of the current self-regulatory approach applied by actuaries.

There is from time to time a conflict between the best advice we can give our client and the consequences of that advice being applied insofar as the “man in the street” is concerned. The man in the street is not our client. The profession helps us to balance these interests although it might not always be successful or indeed appear to be so to the outside world.

We hold the view that professional standards should be set against a set of very simple and straightforward principles. Those principles might, from time to time, be translated into a set of technical rules but we believe that a principles approach to regulation in terms of a profession is to be preferred to a rules-based approach.

There is indeed an emphasis on the reserved roles of individual actuaries. This emphasis is essential to ensure that the public interest is protected by the profession requiring standards to be set within specific contexts. However, the individual actuary will also benefit because of the more easily identified limits that are set on the actuary’s conduct when performing those roles. We would not wish to say that this emphasis is “too much”.

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?

There is potentially a conflict in that “the public interest” is not always as clear as it might seem to be. An example might help:

An actuary might very properly advise a predator company in seeking to acquire a target company at least cost. This might not necessarily be to the benefit of the individual members of the target company’s pension scheme but the actuary advising the predator has a duty to his client and not to those members. In this context “the public interest” could mean the continuation of a free market in capital.

The converse of the above situation would be an actuary advising the trustees of the target's pension scheme seeking to ensure that, notwithstanding the potential acquisition by a predator, he helps his client to set up as formidable a defense as possible in the interest of the pension scheme members. This is contrary to "the public interest" as described above but is totally in line with "the public interest" if that is defined in terms of the interests of the particular individual pension scheme members.

In one context the public interest has been met but in the other it has not (although the public interest will have been met if it were differently defined).

Other examples of actuaries appearing to act in a manner that contradicts the public interest would be "capital units" and "with profits" policies. Each of these were complex inventions that had the effect of disguising the initial cost of savings products. The fact that the costs were not apparent (and were discovered only on early termination of the contract does not of itself make the products inappropriate savings vehicles). People saved using these products that might not otherwise have saved at all. It is just as easy to argue, therefore, that the actuaries involved acted in the public interest in making these products available as it to argue that the public interest was not served because the costs were hidden.

The profession has to ensure that its members are aware of the effects of their conduct as well as the nature of their conduct but having said that, it is not for the profession to define the public interest (unless it is prepared to do so in all possible situations, which is of course impossible).

The "Public Interest" is not an easy concept to define in general terms. If actuaries are to be required to take responsibility for the "Public Interest" then they should be required to do so only in well-defined circumstances.

Provided issues of "professionalism" are fully understood by actuaries then we believe the potential for conflict between the professional representing its members and regulating their conduct is manageable and acceptable. Professionalism is taken seriously by the profession and courses on that subject are organised regularly.

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?

Some of the detail of regulation relating to pension schemes, in particular, is the result of an amalgam of past regulation which has been "patched" from time to time. The result is a very complex litany of detail (much of which, in our opinion, was and remains ill advised and counter productive). This detail has to be followed on pain of professional failure. It would be extremely helpful to have some of this regulation simplified.

There are areas where self-regulation has not produced a consistent approach by individual members of the profession. We have in mind, for example, the calculation of transfer values for members of pension schemes.

An Actuarial Standards Board could help as a bridge between formal statutory regulation and professional self-regulation. This could apply, in particular, to setting standards of a technical nature relating to such matters as transfer values in pension schemes.

Self-regulation is better in areas that are at early stages of development (for example, realistic balance sheets for insurance companies) or when dealing with technical issues requiring very specific skills (for example, accreditation of stochastic models).

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?

The FSA's proposals go some of the way to addressing Lord Penrose's concerns.

In particular, that the mathematical reserves should be subject to statutory external scrutiny is welcome.

In terms of making the Directors responsible for the reserving basis, we believe that this is also to be welcomed but only in principle. We are concerned that many Directors will not be able adequately to grasp the detail of such bases in order to make informed decisions. Realistic balance sheets are helpful in understanding the complex guarantees and options within life funds but the FSA has done little to ensure that Directors have the necessary skills to understand them or to ask the right questions. Moreover, without peer review of non-reserving issues, the risk has not been reduced that an internal actuary might mis-interpret those issues and is not challenged on the work.

Q2.6 Do you have any other concerns about the role of actuaries working in life assurance?

The division of responsibilities between the new roles of "Head of the Actuarial Function" and the "With Profits Actuary" is still not entirely clear and there is potential for conflict or for issues to fall between gaps.

We believe that there is also scope for confusion on the part of both actuary and board as to the depth of understanding required by the board in order to make a decision. At what point does the board stop seeking to understand the rationale behind an aspect of the actuary's recommendation and say "You're the expert – we'll take your advice"? How much will it be incumbent on the actuary to explain the details in any report etc.?

Q2.7 Do non-executive directors in life insurers have sufficient expertise and information available to them to enable them to challenge the actuarial calculations of the value of the insurer's assets and liabilities or whether policyholders are being treated fairly?

We believe that expertise is still lacking in many non-executive directors to be able to challenge the actuarial calculations or to gauge whether they are receiving sufficient information. This lack of expertise is probably most acute in smaller insurance companies and friendly societies.

Q2.8 Will the FSA's realistic reporting basis make actuarial calculations more accessible for non-actuaries?

No, in our experience, non-actuaries already struggle to understand the current calculations - which are less complex than the "realistic" calculations.

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?

If the Government is prepared to set down precise parameters for the valuation of reserves and the Scheme Actuary's role is limited to certifying that the calculations have been made correctly then that arithmetic function could be delegated to someone who is not qualified as an actuary.

However, it is important to note that data checking represents a very important element of the work in an actuarial valuation and we doubt that an arithmetician untrained in actuarial work could be certain that the data used was correct (or have the degree of judgement necessary to decide that inaccuracies can be tolerated). The analysis of the results (the so-called "analysis of surplus") is a complex mathematical process that requires so much knowledge of the workings of a pension scheme that an untrained person could not do the work. Having said that, it is not necessary for a Scheme Actuary to know the detailed workings of insurance companies to the extent now required by the actuarial exams.

Many in the profession hold the view that a Scheme Actuary is such a responsible role that it must be held by a senior and experienced actuary in the organisation. This is not necessarily the case as the more important, wide-ranging, consulting advice can be given by such a senior actuary (for which role experience and knowledge is as important as technical skill) with the Scheme Actuary function being limited to the very technical arithmetic function, which requires little by way of advice to be given.

Actuarial training and education is such that it develops the skills necessary to facilitate acting as a Scheme Actuary. Unless similar training and education (and professional discipline) was adopted by other professions we feel that it would not be appropriate (and possibly dangerously against the public interest) for the role to be opened to other professions.

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?

The expertise of pension scheme trustees varies substantially between different pension schemes. In our experience some pension scheme trustees are very “wise” even with little experience and are quite capable of making sensible decisions and asking embarrassingly simple questions, which can be a considerable challenge for the actuary. Other pension scheme trustees would not ask such questions for fear of exposing their own ignorance of the subject. In that situation it is up to the Scheme Actuary to ensure that the pension scheme trustee is made fully familiar with the circumstances of the particular pension scheme and in doing so he may find himself helping to direct the trustees in making policy decisions.

As regards the distribution of benefits between “different generations of pensioners” this is rarely an issue because the rules of a pension scheme are normally quite specific on the level of benefits to be provided. Discretionary pension increases are frequently the source of very careful advice by the actuary to allow the trustee to make decisions as between the interests of different generations and that is part of the training that the actuary receives. When a pension scheme falls to be wound up (through the collapse of the employer or otherwise) the investments of the fund then become a significant issue as regards the different generations of member. However, legislation forces the issue to a large extent and policy decisions are largely of a technical nature only.

The generational aspects of actuarial work tend to be limited to the distribution of surplus in insurance companies.

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?

Legislation requires the Scheme Actuary to be an individual person who gives advice and there is no provision for that advice to be subject to any checks or balances. Having said this, an actuary who is not the Scheme Actuary can provide advice to pension scheme trustees and in that situation there is no system for providing audit or peer review as to the level of that actuary’s influence.

So far as direct peer review of work is concerned, individual firms should already require any significant work to be subject to both a checking and peer review procedure. This is necessary both to ensure the accuracy and relevance of the work and to protect the business risk of the organization giving the advice.

It is always open to pension scheme trustees to seek a second opinion on particular pieces of advice and, in our experience, this does happen from time to time. It is not, however, common practice.

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 law requires the Scheme Actuary to be accountable to the trustees.

There has always been a potential conflict of interest when the actuary advises both the employer and the pension scheme trustees. In the past, this conflict has been the point of “elasticity” to relieve the natural tension that would otherwise exist between “the pushes and the pulls”. However, since 11 June 2003 this conflict has become such that in cases where the trustees have the power to wind up a scheme it is probably very much more difficult now for an actuary to advise both trustees and the employer. For example, if the trustees ask “Should we wind up the scheme and claim a large debt from the employer?” then it is difficult for the actuary advising the employer to say “Yes” as his client would then be subject to what might be an unnecessarily large payment. The actuary advising the trustees, on the other hand would find it difficult to start from a point that is not a “Yes” (although the considered advice might turn out to be different).

We do not think that the removal of the minimum funding requirement should make this any different although it is difficult to comment without more details of the replacement legislation.

There is a problem, however, with separating the roles.

The role of the actuary advising the pension scheme trustees is likely to be reduced to a technical Scheme Actuary function as currently defined if we are not careful. In that case the only structured proactive advice will be available to the employer. That employer will wish to make minimum contributions even if it is at the expense of long term funding of the pension scheme.

Attempts to separate the two actuarial roles have, in the past, been received by claims of actuaries seeking to double up on fees.

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?

The way pension schemes are funded in the UK is almost entirely the result of actuarial advice. Contributions have long been set against the background of investment in equities which are expected to be more remunerative than investment in bonds. This belief has been borne out in practice until the last few years.

The extent to which equities have been held at the expense of bonds within a pension scheme has often been as a result of the advice given by an actuary specializing in investment matters.

It is not possible to judge how the Pensions Bill's proposals will affect the role of power of actuaries until we know exactly what the detail of the bill relating to the new Minimum Funding Requirement requires and how this relates to the Pension Protection Fund. We do not yet know what freedom will be available for professional judgment.

Q2.14 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?

The interaction of the role of the actuary in advising the trustees and the Financial Services Act can sometimes create anomalies where the actuary (unless he has a different kind of license to advise) is sometimes prevented from advising in areas where he would consider his training to be sufficient permission for him to give that advice.

The interaction of statutory compliance regulations and professional standards can sometimes lead to more time being spent on how something is done rather than what is being done.

General insurance and the role of the Syndicate Actuary

Q2.15 What are the implications for actuaries of the FSA's moves to a realistic reporting regime in general insurance?

We do not work in the area of general insurance and so do not offer any reply.

Q2.16 Do you agree that a reserved role for actuaries in general insurance is unnecessary?

We do not work in the area of general insurance and so do not offer any reply.

Q2.17 Are there any other issues specifically relating to the role, responsibilities or regulation of actuaries working in general insurance that you would like to draw to the attention of the review?

We do not work in the area of general insurance and so do not offer any reply.

Investment

Q2.18 Are there any specific issues faced by actuaries working in institutional investment that you would like to draw to the attention of the review team?

We do not work in the area of institutional investment and so do not offer any reply.

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 believe that the Institute's role as a designated professional body has been helpful in providing a framework that is appropriate to actuarial consultancies. It provides the same level of protection to the "consumer" as the FSA's regime but without the regulatory burden that the latter undoubtedly imposes on firms regulated by them.

Barnett Waddingham has established a separate company to give mainstream investment advice but this separation may not always lead to the most efficient service being provided to our clients and we believe it can lead to confusion.

We strongly support the continuation of the current designated professional body status but would like to see the list of exempt regulated activities extended to include others that we consider fall naturally within our professional competence (as tested by actuarial training and examination as well as CPD requirements).

This extension should include risk benefits, pensions administration (to the extent that these activities will become regulated next year) and any arrangements that fall under the heading of "pensions" (such as Stakeholder and Group Personal Pension arrangements). The list could also reasonably include (within certain limits) advice to individuals that would not currently be permitted.

We would not expect broader personal financial planning advice (such as the purchase of mortgage endowment policies or other saving vehicles) to fall within an extended regime for the designated professional body. However, in areas such as pensions - which have an actuarial content by definition (and for which actuaries have been subject to extensive training) we hold the strong view that the current regime prevents competent professionals from explaining the working of these contracts to consumers.

This is not in the best interests of the public.

Maintenance of professional competence

Q2.20 Is there the right balance between the Profession issuing practising certificates and regulators giving their approval?

The introduction of new products and the development of new techniques requires that it should be the Profession and not the regulators that issue practising certificates because it is the Profession that has to demonstrate the continuing competence of the practitioners to hold that certificate to the regulators and to discipline practitioners who are deemed to have failed.

Q2.21 In your view are the current CPD requirements and the provision of CPD appropriate?

The current CPD requirements are considered to be annoyingly onerous and therefore to some extent one can claim that they are appropriate. However, we believe that the CPD relating to statutory functions should be far more technical than it currently is and that for this purpose “general” CPD should be of less interest. The self-certification CPD is currently adequate but if a more stringent set of CPD requirements were to be introduced for the statutory functions then we believe there is some argument for making this less reliant on a self-certification process

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?

One of the difficulties the Profession faces in extending practising certificates is how one defines “actuarial matters”.

We have heard it said that any actuary carrying out any function is, by definition, carrying out an actuarial function. We would disagree strongly with this. For example, there are actuaries who have been appointed as a pension scheme trustee because of his knowledge and possible expertise in an area rather than because he holds particular actuarial qualifications. We believe strongly that practising certificates should not be required of actuaries who are not directly involved in mainstream actuarial activity but are simply undertaking roles because they happen to have “FIA” after their name.

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

If CPD of a technical nature is to be introduced for the statutory functions of actuaries then there should be no provision for carrying the CPD time forward into another year and so average it out over a period. Whilst this is acceptable for general CPD it should not in the normal course of events be acceptable for technical CPD.

The profession should make attendance at a formal “teaching” seminar a requirement for every actuary holding a statutory certificate. These seminars should be held once a year in a rolling programme.

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?

We believe there are appropriate professional duties set down to protect the public interest in regulated sectors but we are not sure that the same protection is afforded to the actuaries in those areas.

If an actuary were to complain about the conduct of his client (or another actuary) and that complaint turned out to have been misplaced then we believe that the complaining actuary might be vulnerable to litigation.

The disclosure of information to the profession (even within a client relationship) is another area where we are concerned that the Profession is seeking to impose more rigorous “public interest” duties on actuaries than Parliament has sought fit to impose on citizens generally.

The FSMA protects actuaries who become whistleblowers in relation insurance companies.

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

We believe the answer to this is probably “no”. We have had experience of complaints being made in respect of our own conduct and by sitting on various committees investigating the conduct of other actuaries. It seems that there might not be a clear understanding by the public at large as to what the process is for making complaints.

We have many examples of apparently entirely valid complaints being made by a member of the public but there are big gaps in regulation so that the complaint is bounced from one regulator to another – each denying responsibility. These gaps could be plugged.

The threshold as to when an actuary should complain about the conduct of another actuary is not clearly defined and this could be better identified. If, however, a principles-based system of regulation is to be adopted by the profession then the quid pro quo must be some element of vagueness would remain.

We can quote an example of pension scheme contributions amounting to less than £200 being more than 6 months late in being paid. The effect on the pension scheme was negligible but it was felt necessary to report this to OPRA who then decided to levy a fine of £50. The cost of this exercise was substantially in excess of the damage that might have been done had the contributions not been paid at all. There appears to be very little by way of a “de minimus?” application of rules.

Q.2.26 Is there an appropriate level of disclosures by actuaries to protect the public interest?

Actuaries are encouraged to disclose information.

In many cases the information that is disclosed is opaque and of little value to the person who reads it. However, “the public interest” is served by having the disclosure made – regardless of its being opaque.

Having said this, there are examples of the work of actuaries not being disclosed in full (possibly with the knowledge of the actuary) with the effect that the public interest might not have been well served. Examples of this will be the creation of capital units and precipice bonds. But these are example of the effect of the work of the actuary being fully disclosed to the actuary’s client (the insurance company) but not being passed on to the insurance company’s client – the consumer. The actuary cannot force the insurance company to disclose such matters to their customers. Whilst this might appear to show the actuary “hiding” behind the insurance company (in terms of the “public interest”), it is nevertheless, a reflection of the current interpretation of the professional relationship that exists between the actuary and the client.

One of the difficulties here is distinguishing between the actuary’s duty to his clients and helping him create such vehicles even though his “conscience” might be touched by the work he is doing.

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 practising 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?

In our opinion, the answer to the first question has to be no. For example, the calculation of transfer values remains the subject of deep division within the profession despite the technical guidance. The fact that actuaries have to conform with a minimum funding requirement that was known to be broken but it nevertheless did conform to technical guidance. Each of these are examples of the public interest not being served by the technical guidance. Ambiguous and unclear legislation makes it difficult for the profession to set unambiguous professional guidance.

In many respects however, the guidance does provide clear standards for practicing actuaries even if there are some ambiguous elements to parts of it.

It should be acknowledged that professional guidance has played a big part in protecting policyholders' interests over many years. It cannot be argued that such guidance has absolutely protected them (or else there would have been no problems at Equitable Life). All professions encounter problems in the exercise of its duties over many years but we believe that the actuarial profession has a particularly honourable record in this regard.

We do not agree with Lord Penrose's view. We believe that the view is largely based on hindsight. The work of actuaries has indeed protected policyholders' interest for many years and it is only the failure of the Equitable that has caused this question to be asked.

So far as pension scheme members are concerned there are very many examples of actuaries warning the government over the past 10 to 20 years that the legislation it was introducing would damage the pensions of members. Governments regularly dismissed our warnings as being complaints by vested interests.

Q.2.28 Does the technical guidance need to be updated more regularly and are fast track processes required to provide guidance on urgent issues?

There is a distinction as between the principles of professionalism that should be applied by an actuary and the technical rules which need to be set within the parameters of those principles. The technical rules ought to be able to be changed relatively quickly. The same does not apply to the principles, however.

There is sometimes a confusion of the two in that a guidance note appears to lay down both principles and rules and there can be a delay in preparing a new guidance note simply because one or other of the elements constituting that new guidance note requires debate.

Perhaps the introduction of an actuarial standards board will enable a faster process for changing the rules.

A further complication is the interaction between regulation and guidance. This is particularly true in the area of pension schemes where changes to the guidance – even on a technical nature – appear to have to be discussed with government departments before they can be implemented.

This discussion ought to be limited only to the principles, not to the technical rules.

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

Following from the above we believe the profession should provide the principles and the regulators or government (or possibly an actuarial standards board) ought to provide the rules. It is possible that changes to the rules should be left to technicians without the involvement of regulators or government.

Here we have in mind, for example, the basis of projecting benefits in pension schemes and under insurance policies. It is quite often the case that projection bases are totally out of line with reality and yet are the only bases on which projections are permitted.

The government should not involve itself in the parameters in setting the parameters of such projections but neither should the actuarial profession be the standard setter in all circumstances. Rather this should be left to an independent body such as an actuarial standards board which would include lay persons with appropriate expertise.

In the life insurance field, the dialogue between profession and regulator needs to be improved to identify urgent issues in the industry and deal with them quickly, particularly in regard to matters relating to particular products. The use by the actuarial profession of ad hoc working parties with volunteers working to ill-defined deadlines should be replaced by a more efficient system of review.

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

We believe that the guidance currently results in “generally acceptable professional practices”. In some areas this may still result in different calculations and if this is not appropriate the specific guidance should remove elements of discretion. An example of a guidance note which largely removes discretion is GN27 – Minimum Funding Requirement which reflects legislation and an example of one which does allow for discretion is GN11 – Transfer Values.

In many cases discretion is appropriate - for example, when calculating transfer values the mortality experience of blue collar workers in Glasgow might be assumed to be different from that of white collar workers in Guildford.

In the life insurance sector it is very desirable that standardisation takes place in appropriate areas to improve comparability and reduce the likelihood of “maverick” approaches being taken.

This should apply principally in the application of economic models and relevant assumptions. For example, it does not make sense for actuaries to use a variety of different assumptions for future RPI inflation when calculating mathematical reserves. As in pensions, there needs to be recognition that many assumptions will be company-specific (for example, mortality or the level of future administration expenses) but there should be more standardisation of approach to the way these assumptions are derived.

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 professional guidance given to actuaries must relate only to the principles by which they apply their skill and expertise. The detail of the application of that skill ought to be set by, for example, an Actuarial Standards Board.

So, for example, the requirement to include in an actuarial valuation report certain matters is something that should be left to the Profession but the way in which With Profits policies proceeds are projected in a particular set of circumstances need not be the responsibility of the profession. Whilst we believe the proposals for the Actuarial Standards Board will improve the quality and timeliness of standard-setting we do not know if it will "go far enough" to achieve these ends. This is a matter of judgment that could be made only after the event when comparisons can be made with what fell before.

We believe there should be some independence from the Profession by appointing to the Actuarial Standards Board economists, investment specialists and so on who are not themselves actuaries. The same might apply as regards some of the principles that are applied by the Profession. We can envisage situations where, for example, pensions lawyers could helpfully be included in the discussion of what should be included in an actuarial report, for example.

We do not believe that Government has much to contribute on this front.

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?

Probably not and it seems that the regulators might be the bridge between the different professions involved.

Our view is that the purpose behind regulators must be to ensure a proper understanding of financial products and a proper reporting of financial reserving (where this is appropriate) and this involves a team effort. Regulators should be encouraged to help different professions to work together rather than seek advice from each independently and then hope to put together the pieces of advice in only a regulatory framework.

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?

No, we do not agree that there is any lack of openness or transparency of our profession.

We would accept a criticism that the work that we do is complex and opaque but that is not the same thing.

We hold the view that “professionalism” requires that the professional is a guardian of the public interest simply because a member of the public cannot do what that professional does. This is a matter of training and experience. There is no need to be coy about this, it is a matter of fact. However, if professionals are not permitted to have this role then it is incumbent upon them to ensure that as much as possible is explained in lay terms..

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

Actuaries, almost by their nature, tend to be quiet, cautious and reserved. They are at their happiest sitting at a computer puzzling over numbers and problems. This image, whilst a stereotype, has an element of truth about it. To the extent that it is an exaggeration then actuaries need to create a change in that image.

Another view of an actuary is that of a businessman who happens to have particular training. Such a person knows full well the value of good communication. It helps to build confidence and trust with clients in that the client knows and fully understands what the actuary does, even if he (the client) cannot himself do that work.

Every effort should be made to ensure that actuaries are properly trained in the skills of communication. They should also be encouraged to interact as much as possible on a professional and a social level with fellow professionals by arranging seminars and other training sessions on a joint basis on subjects of mutual interest.

Any improvement in communication is a two-way process: the people with whom we communicate need to be encouraged to make an effort to understand the issues, and not just “turn off” and categorise the subject matter as being too complex because it is being presented by an actuary.

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?

Peer review is a thorny subject within the profession. Every commercial organisation that sells its advice to its clients must have a system of peer review if it is to avoid damaging mistakes. However, peer review means different things to different organisations and we believe that the profession should limit its requirement to a statement that work relating to mandatory guidance notes should always be peer reviewed.

If an organisation is then not able to demonstrate that the peer review system that it has applied is adequate then it will have failed in terms of the guidance note. That is a commercial risk taken by the firm and the individual client (and therefore the public interest) may not be damaged by such inadequacy to the extent that recourse to the courts will protect the public interest when an actuary fails.

The process within the profession has been bogged down, we believe, because of the attempt to impose particular types and styles of peer review on organisations that already have perfectly adequate systems.

We believe the profession would serve the public interest better if it were to make an immediate statement on the lines given above about peer review being required – but leaving it to the particular organisation to define how that is to be achieved.

It should be remembered that peer review comes at a price and that must be borne by the clients. We believe an internal peer review process to be the most cost-efficient solution to this issue.

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

In the context of a pension scheme actuarial opinions should be shared with pension scheme members when a pension scheme is closed, when it is wound up, when an actuarial valuation is made and so on. These are well defined events where it is apparent that the individual member has an interest in what is being said. However, one must be careful to ensure that the statements that have to be made are carefully drawn up so as to avoid unnecessary anxiety on the part of pension scheme members but at the same time being open as to the possibility of inadequate reserve.

As far as insurance companies are concerned, we believe that there needs to be a public statement or certificate from the Reviewing Actuary aimed at the policyholders to give them comfort as to the adequacy of the reserves.

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 do not work in the field of general insurance but would add that any work that is subject to a mandatory guidance note should be subject to peer review.

Monitoring, complaints and disciplinary schemes

Q2.38 Do the new disciplinary processes implemented by the Profession from 1 January 2004 address the issues that Lord Penrose raised?

It is too early to answer this question but the design of the new arrangements should meet the issues raised – at least to what we believe to be an acceptable degree.

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?

We are not familiar with these statistics.

If only 17 complaints have been made then this could be a reflection of the fact that the client in the vast majority of cases is a “financially sophisticated” organisation that understands the nature of what actuaries do. We do not know how many of the 17 complaints fall into the other category of “the man in the street”. Nor are we aware of how many of the 17 complaints were upheld. We know of no evidence that actuaries have failed their clients in some way but that such failure has not been reported to the profession.

We understand from recent reports that the Royal College of Paediatrics (with a membership of some 6,500 - about the same as the number of qualified actuaries – 7,050) had 85 complaints against members in the past 5 years – but 84 were dismissed.

We believe that the low number of complaints reflects a successful profession rather than an inadequate disciplinary procedure.

Q2.40 Should the review consider whether a fully independent disciplinary process is needed?

No.

The review need only consider the extent to which the disciplinary process adequately protects the public interest. We do not believe that the review should impose a new disciplinary structure on the profession. That is a matter for the profession.

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?

There is a difficulty in monitoring only compliance for professional standards. That is that the professional standards may themselves prove to be wrong over the long term. The minimum funding requirement is an example of this. It would seem to be perverse to have disciplined an actuary for failing to follow something which, in the event, turns out to have been wrong. Having said this, if "ticking the box" is all that is required then we see no reason why we should not demonstrate that we have indeed "ticked the box".

As we have said earlier, we believe this is not the way to proceed and is not in the public interest simply to tick boxes in this way, it is far better to set professional standards which are defined by reference to principles with the onus of demonstrating compliance with those principles lying on the shoulders of the actuary.

To the extent that there is monitoring and disciplinary proceedings then the profession should bear these costs. This will be reflected in the cost of being an actuary and that in turn will be reflected in the fees charged to clients or the salaries demanded of employers.

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

Discipline should be undertaken by the Profession.

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

Regulators should not "supervise" the work of actuaries.

The regulators' principal role should be to satisfy themselves that the rules and technical standards to which actuaries aspire are sound and remain so (because they are reviewed and updated in a timely manner to reflect changing circumstances) in order to remain relevant to the protection of the public interest.

From a life insurance perspective, actuaries have a role in advising the regulators on the actuarial aspects of their work. The current system of regulation is changing so fast in the insurance sector that it is difficult to form a view as to whether proper use is currently being made of the actuarial resource available to the regulators.

CHAPTER 3 - ROLES AND RESPONSIBILITIES OF THE GOVERNMENT ACTUARY'S DEPARTMENT

Q3.1 What is your relationship with the GAD? Have you used, or do you currently use the GAD's services? If you are a client of GAD, have you put the provision of actuarial services out to competitive tender? If not, what process do you use and why is it preferable?

It does seem to me that the role of the GAD ought to be limited to the actuaries who can advise the government without the need for concern for any commercial conflicts that might arise because they have no clients. This would then mean that the government would not need to turn to the Profession to help set its views. Any actuarial information needed to help government in this context should be provided by the GAD.

Q3.2 If you are currently, or have been in the past, a client of GAD's are you satisfied with the quality of service that you receive(d) from the GAD? How could it be improved? If you also have experience of working with private sector providers, how does GAD's service compare to that of private sector providers? Do you have any comments on the basis on which GAD charges for its services?

Q3.3 The Government Actuary plays a public interest role in reporting to Parliament on social security matters and preparing the national population projections. Are you satisfied with how this role is currently performed? Could the market or anyone else perform these functions?

Q3.4 Are there any other services which are better provided by the GAD and/or the Government Actuary than by other providers of actuarial services?

Q3.5 In your view, which of the 10 reasons in para 3.20 highlighting the rationale for a separate GAD remain valid? Are there any other reasons for maintaining the GAD as an independent entity?

Q3.6 Overall, in your view is there a continuing need for a separate GAD? Are there alternative institutional structures for the provision of actuarial advice to government departments, Ministers and the wider public sector that the review should consider?

Q3.7 If you think that GAD should not remain as a separate entity, do you think there would still be a continued need for the role of the Government Actuary?

Q3.8 How does the GAD compare with structures used in other countries for the effective provision of actuarial services to government?