

“Compliance Review”

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Synopsis

The UK profession has been seriously considering procedures for formal Monitoring Compliance with Professional Standards since early 1999. A working party produced two papers, taking evidence from, inter alia, the Canadian Institute of Actuaries' considerations of the matter. The first paper made a range of recommendations, particularly that compulsory external review be introduced for work only actuaries can legally perform in the UK. Discussions led to the second paper with revised recommendations; principally that compulsory peer review be performed, internally to the actuary's firm, instead of externally. On acceptance of these recommendations, the boards responsible for Life Assurance, Pensions and General Insurance were charged with drawing up implementation plans for their own areas. Some progress is being made in the latter two fields of work, but in the Life Assurance arena, developments at UK mutual Life Assurer, Equitable Life, has caused delays to the emerging procedures. Consideration has been given again to external review for this area only, and this is amongst the recommendations made in a report published on 28 September 2001, prepared by a special inquiry established by the UK profession into lessons to be learned from the Equitable situation in respect of professional guidance to actuaries.

Résumé

Depuis le début 1999 les professionnels britanniques ont sérieusement pris la décision de mettre en place des procédures d'évaluation en conformité avec les standards de la profession. Un groupe de travail a produit deux articles, en se basant entre autres sur les délibérations de l'Institut Canadien des Actuaire. Le premier document a émis une série de recommandations, portant en particulier sur la nécessité d'introduire un audit externe obligatoire, là où seulement les actuaire peuvent agir légalement au Royaume-Uni. Des discussions ont conduit à l'élaboration d'un deuxième document révisant les recommandations; celles-ci portent principalement sur l'obligation de mettre en face de façon interne (et non pas de façon externe) un système d'évaluation entre collègues. Une fois ces recommandations acceptées, les commissions responsables de l'Assurance-Vie, des Fonds de Retraite et de l'Assurance en général ont été chargées de mettre en place des plans d'action dans leurs domaines propres. Des progrès ont été réalisés dans les deux derniers domaines, mais en ce qui concerne l'assurance-vie, des développements chez la compagnie britannique mutualiste d'assurance-vie, Equitable Life, ont entraîné un retard des procédures émergentes. Un audit externe uniquement dans ce domaine est à nouveau à l'étude. Celui-ci est un des recommandations d'un rapport d'enquête de la profession britannique publié le 28 Septembre 2001 quant aux enseignements à tirer de la situation chez Equitable Life en vue d'émettre des recommandations professionnelles aux actuaire.

1. Introduction

For many years in the UK, as well as in other lands, the actuarial profession has had a written code of conduct and has provided written guidance to actuaries. Much of this is mandatory. Any material breach of which an actuary becomes aware must be reported to the profession. These, and any other breaches noticed by members of the public, would become the subject of investigations of professional misconduct. To date, however, the profession has not required any formal check on work done, either before or after it is issued, except for reported breaches. In 1999, on an initiative of the Professional Affairs Board in the UK, a working party was set up to consider this matter and examine systems for the monitoring of compliance in professional matters. Their work considered, among other research, the developing position in Canada, by the Canadian Institute of Actuaries (CIA).

This paper considers how matters have progressed since then and summarises the current position in the UK.

2. History

The written code of conduct referred to above is currently called “Professional Conduct Standards” (PCS). It, and the supporting Guidance Notes (GNs), have been developing over more than 25 years.

As stated above, following the 1999 initiative, the Professional Affairs Board of the Actuarial profession in the UK set up a working party. After considerable research and consideration of the matter, to enable a discussion to take place within the wider profession on these matters, the Working Party published a discussion paper entitled 'Monitoring Compliance with Professional Guidance', in November 1999. (Bibliography 3.1). A link to the discussion paper can be found on the Professional Affairs Board page of the UK profession's website. A consultation process ensued, comprising mainly:

- responses from employers whose views were explicitly sought by the Working Party in writing and in individual meetings;
- separate consultation meetings with the Faculty and the Institute at an Institute Seminar on 2 February 2000 and subsequently at a Sessional Meeting of the Faculty on 21 February 2000; and
- additional written comments submitted by members of the profession.

A number of helpful comments were made in the consultation process, and it was clear that the thrust of much of the initial recommendations were not acceptable to UK actuaries generally. These were considered further and taken into account in a second paper “Monitoring Compliance with Professional Guidance Revisited”. (Bibliography 3.3, also on the website). The purpose of this subsequent discussion

paper was to expose to members the results of consultation, and to offer substantially revised detailed recommendations for further discussion.

These were more widely accepted by the profession, and the process of implementation began, by three of the UK “Practice Boards” - the bodies responsible for the profession’s affairs in Life Assurance, Pensions and General Insurance respectively. Events in the Canadian profession in this area, in other UK professions (particularly medical and accounting), and at two UK institutions - UK mutual life assurer, Equitable Life - and general insurance company, Independent - occurring during the period since this study began all impacted on the process. Progress continues on all three boards and will have regard to a report published on 28 September by an Inquiry under the Chairmanship of Roger Corley established by the UK profession into lessons to be learned from the Equitable Life situation in respect of professional guidance to actuaries (Corley Inquiry). That report inquiry is relevant to the future conduct of compliance review, at least in the Life Assurance area.

3. Benefits

The original paper from the Working Party highlighted several benefits from a system of review. A summary of the principal points is as follows:

3.1 Reputation Issues

- (1) It will strengthen the position of the profession and individual members, and will build upon procedures and good practices already in place.
- (2) It will maintain and strengthen confidence in actuaries among the public and the users of their services. This includes all the 'stakeholders' in the profession, particularly policyholders and pension scheme members.
- (3) The resulting increased professionalism will lead to business advantages for actuaries
- (4) There is increasing demand from the public for professions to be more accountable - the medical profession is but one high profile example.

3.2 Public Authorities

- (5) The existence of the profession’s own arrangements for compliance review may pre-empt the imposition of such procedures by outside authorities.
- (6) The process presents an opportunity to enhance the profession's profile, not only in traditional areas, where monitoring is seen to be key in avoiding further regulation, but also in new areas, where the presence of effective procedures can enhance the profession's case for involvement.

3.3 Policing Statutory Professional Guidance

- (7) Guidance Notes (GNs) prepared by the UK profession for its members, referred to in national legislation, are used increasingly as an extension of that legislation, and which the profession needs to be seen to be monitoring, as there is no other “policing” of adherence to that guidance.

3.4 Guidance review

- (8) Introduction of Compliance Review introduces a framework requiring clear guidance, and by its existence should lead to improvements in the clarity of guidance and more thorough and frequent review of it.

4. Reasons for Compliance Review

There are two main reasons why the Working Party believes that the profession needs to put in place some system of the kind described.

The first is that there have been, and continue to be, professional problems, although they are not often publicised unless complaints complete the disciplinary process by giving rise to the complaint being upheld, and the second is that the environment in which the profession works has changed radically from that in which the profession's guidance notes and disciplinary process were originally developed.

The Working Party concluded that society increasingly requires a profession not only to regulate itself, but be seen to be doing so, in such a way that the process is open and capable of inspection. In this way we can demonstrate that self-regulation can work. In suggesting a way forward, the Working Party believes the key objectives to be as follows:

- moving the profession forward by improving standards using compliance monitoring, along with other measures such as Continuous Professional Development (CPD) by attendance at relevant events such as conferences and seminars, improved guidance and an effective disciplinary regime;
- ensuring that we are seen as a profession that is dedicated to the public interest and continues to earn public trust in all of our actions;
- seeking a greater role, not only nationally, but also on the international stage, by earning trust with comprehensive and enforceable standards; and
- ensuring public confidence at a cost which encourages actuarial advice to be sought and taken.

5. What should be monitored?

The Working Party's papers considered the monitoring of compliance with the Professional Conduct Standards (PCS), all Guidance Notes (GNs) that are practice standards and certain ones that are recommended practice. They covered compliance generally, but, in particular, by the holders of Practising Certificates (PCs). Those undertaking work where legislation requires a report signed by an actuary must hold a PC. The Working Party did not consider wider quality issues concerning actuarial advice. However, application of many of the procedures outlined to non-monitored activities would enhance both the perceived and the actual quality of all actuarial work.

6. Ways of Monitoring

6.1 Current Ways

One obvious way of monitoring is dealing with professional issues raised by other actuaries or members of the public. These may be or may become complaints. These matters are dealt with by the relevant disciplinary procedure. The subsequent progress of those members subject to discipline may be followed, but this is done only in an informal way.

Non adherence to a GN may require an actuary to report this to his client, and give an explanation. This is a form of self monitoring.

A system of Appointed Actuaries applies in the UK, and their work is already more subject to informed external scrutiny than is that of most other actuaries subject to mandatory guidance. Actuaries employed by the Financial Services Authority (FSA - UK Regulator established by statute) examine each year on behalf of FSA, the financial returns for all life insurers authorised in the UK. This examination, which was formerly carried out by the Government Actuary's Department, includes consideration of whether the valuation methodology and assumptions are consistent with regulations and professional guidance. They are also able to monitor in broad terms other internal reports prepared by the Appointed Actuary or presented to them during a visit to the life office.

In the event of any possible non-compliance being found, action taken would range from a written warning from them to a formal complaint being made to the profession's Investigation Committee.

A further level of monitoring relates to that done by actuaries working for the external auditors of life offices where the auditors have access to their firms' actuarial team. Their role expressly excludes that of monitoring valuation and certification by the Appointed Actuary under insurance company legislation, but there is scope for possible challenge of certain other items by the auditing firms in relation to Company Act accounts. The role is not specifically to monitor the work of the actuary.

Their role does not extend to monitoring the work of the Appointed Actuary in his role in the production of the Supervisory Returns. Although the auditors (and any actuaries working for them) must speak with the Appointed Actuary to form a view as to the ongoing status of the office as part of their review of the Financial Statements, they cannot imply from this that any evidence obtained from the Appointed Actuary (such as Financial Condition Reports) is subject to audit. However, with regard to the production of the long-term business provision for the Companies Act accounts, the actuary is open to challenge from the auditors. The auditor would normally endeavour to understand any trends within figures which might indicate changing financial circumstances, and any contingent issues, whether internal or external to the organisation, which might alter materially the finances of the organisation. This latter requirement would usually be fulfilled by consideration of any Financial Condition Report.

In summary, existing monitoring is limited, and where it exists at all it is reactive rather than proactive.

6.2 Possible Methods of Compliance Monitoring

The Working Party considered a number of methods, listed below:

6.2.1 Internal Reviews

6.2.1.1 Peer Review

Peer Review is defined as the review of work done by one member for a client (internal or external) by another member, with the following characteristics:

- (1) Normally peer review is carried out before work is released to the client. In exceptional circumstances it might be carried out afterwards but, in this case, any correction required would be communicated to the client without delay.
- (2) Peer review is carried out on all appropriate actuarial work. This distinguishes it from 'actuarial audit', which is an audit of selected items of work only.
- (3) Peer review is normally carried out by a colleague in the same firm (or group). This does not preclude it from being carried out by a member external to the firm.
- (4) Peer review is intended to confirm that the work conforms to relevant professional guidance in the opinion of the reviewer. It is not an audit, and therefore does not involve detailed checking of calculations or

data, unless the peer reviewer believes that these are necessary.

Peer review should be carried out by an individual with adequate experience and competence; this does not mean that the individual has to have the same experience or status as the actuary signing the report. It is the responsibility of the actuary signing the report to decide whether the proposed peer reviewer has the necessary attributes. If not, and there is no alternative, this should be stated in the report; it is better to have a limited peer review than none at all. Where peer review has not been carried out for whatever reason, this should be stated in the report, with reasons (e.g. confidentiality, timescale).

The reviewer should be free of undue influence by the actuary signing the report. It is appreciated that this may be difficult to demonstrate in company situations.

6.2.1.2 Actuarial Audit

This process is defined as a review of a sample of work done by another member of the profession working within the same firm or life office and, wherever possible, by a holder of a relevant Practising Certificate, issued by the UK profession. It would be carried out on an annual basis. The 'auditor' would be given a list of the clients and the projects worked on during the year, and would select certain of these. The auditor would be supplied with the files, and he would review those files, using a checklist, to check for compliance with professional standards. Selection of cases for internal audit would be on a risk profile basis, established by actuaries in the firm, based on their own experience of problems.

6.2.2 External Practice Review

Under this process, an 'auditor' from outside the actuary's firm, would be given a list of clients and projects worked on during the year and would select certain of these for scrutiny. It could involve a sample monitoring of a limited number of actuaries, perhaps on some kind of cycle of inspection. The auditor would be supplied with files, and would review these to check for compliance with professional standards. A report would be drawn up on the basis of the files reviewed.

There has been much discussion about whether an external team should be appointed directly by the profession, either as individuals or a separate organization appointed by the profession. Alternatively a separate firm could be appointed by an actuary or his firm to do the external review. A formally appointed team of individuals – perhaps recently retired actuaries – would provide a formal and very official review – as originally envisaged by the Canadian profession in its early discussion of this subject. Concern was expressed about the logistics and financing of the arrangements, the availability of such actuaries, the process by which they could be selected, and the appropriateness of retired actuaries, if used, as their knowledge of current thinking diminished into retirement.

In the consultation process, as described more fully later in the paper, arguments against external firms included cost, confidentiality of client's affairs, and commercial aspects. Firms are unlikely to be happy if they have their work reviewed by their rivals. Some felt that external practice reviews should be compulsory, others thought that they should be voluntary, but most were completely against any external reviews. Some felt that only very small firms, with one or two actuaries, needed external review. A number of small firms were against external review, on the grounds of cost, time and confidentiality.

6.2.2.1 The External Practice Review of Life Office Actuaries proved to be one of the most controversial areas in the discussion in the UK. The current role of the FSA's actuaries and the auditing firm's actuaries is covered in the previous section 6.1.

The proposed new role would involve the FSA's actuaries reporting to the profession as well as the Government. This role would be different and distinct from the one they carry out for the Government. However, the two roles could be carried out in conjunction, leading to economies of scale. Complimenting the role to ensure that all relevant professional standards have been adhered to would be, in the view of the Working Party, an appropriate and satisfactory extension of their existing role.

An alternative suggestion relates to the role currently fulfilled by actuaries employed by the firms carrying out the audit of the life office's financial affairs. At present these actuaries assist the accounting partners carrying out the audit by reviewing the relevant actuarial work. The role of these actuaries could be extended, by asking them to report on compliance with professional actuarial standards. Concerns were expressed that this might diminish the role of the appointed actuary.

The use of a separate consultancy firm which carries out work of a life office nature would be appropriate as a further alternative. This firm might, or might not be involved in giving consultancy advice to the life office in question.

Use of a Team Appointed by the Profession would also be available. Naturally the reviewers would be those familiar with life office practice, and to whom the practising certificates committee has, or would have granted a practising certificate, had such application been made.

6.2.3. Compliance Questionnaire

Questionnaires have been adopted for some time by the CIA and are well accepted by Appointed Actuaries in Canada, but are seen as rather costly and bureaucratic for the more commoditised work of pension actuaries there. The definition of this questionnaire considered for the UK would be similar to that used by the Canadian taskforce set up to consider this matter. It would have 3 purposes - education, monitoring and feedback of views on professional matters. The education aspects involve reminding members of the professional guidelines to which they should be adhering. The monitoring aspects allow the profession to gauge the extent of compliance. Actuaries may not always disclose whether compliance has been properly implemented, but it will have brought the matter to their attention, and compliance is more likely on a future occasion. By creating a route for feedback of views on professional matters, it would be helpful to the profession in deciding what changes to professional guidance might be appropriate in the light of practical issues in the application of the existing guidance.

Compliance questionnaires could be completed by all actuaries, but the working party felt that a return of a compliance questionnaire could be mandatory for actuaries applying for Practising Certificates. The compliance questionnaire for a particular practice area would be designed by the relevant Practice Board

There was some interest in questionnaires expressed in the consultation process in the UK, particularly if these were largely in the form of 'open' rather than 'closed' questions, and could, therefore, encourage actuaries to consider broader issues.

6.2.4. Annual Report from the Senior Actuary of a Firm

This report on professional matters in his firm or life office would be made by a Senior Actuary in a firm. There may be more than one Senior Actuary in any firm, dealing with different geographical areas,

or different areas of work. This report might include reporting on adherence to professional guidance and it might be the means by which non-compliance with Guidance Notes, as reported to clients, could be reported to the profession

Legal advice obtained by the Working Party suggests, however, that there might be problems for Senior Actuaries, individually under European Law, if they report in good faith that there are no compliance problems, but subsequently such problems are found. For this reason, it is intended to alter the approach to Senior Actuary reports suggested in the first Working Party paper, by removing any requirement to report on whether there had been compliance, stating instead that compliance monitoring procedures of various kinds are in place, and that the CPD requirements of the profession have been drawn to the attention of actuarial staff.

The Senior Actuary would also be free to comment on any aspect of compliance with guidance of which he or she believes would be useful for the profession to be aware.

The Working Party considered that some firms might wish to have their internal compliance review arrangements reviewed and accredited by an outside organisation such as those involved with ISO 9000 (international process quality standard) and IIP (Investors in People – a UK quality standard relating to staff). It would not be the intention to make such certification compulsory, but, if it were in place, the means of reporting this to the profession would be through the Senior Actuary report.

6.2.5 Compliance Certificate

The concept of a compliance certificate has emerged from considerations of the future of the Appointed Actuary regime with the FSA. The suggestion is that these certificates should be issued to those who wish to apply for, or renew, a practising certificate. The actuary would be required to certify that he holds such a compliance certificate. This idea could be of wider application to all fields not just to the life area. It might be appropriate for it to be issued by the profession based on the appropriate mixture of compliance monitoring procedures. This therefore raises the issue in the UK of a “life office practising certificate”, which would be required for all Appointed Actuaries. If many actuaries, who are not currently acting as Appointed Actuaries, had such a certificate, this would ease succession planning and other problems for Life Offices.

7. Practical Aspects

7.1. Pilot Testing

The working party believed that pilot testing of the External Practice Review process would be both appropriate and necessary. A formal pilot testing exercise would enable regular two-way feedback between the membership and the responsible Board in charge of the project. It would therefore help to build confidence on the part of members that their views would be constructive in developing the processes that will ultimately emerge. It would also ensure that the final processes which emerge are truly workable.

7.2 Costs

Costs were also considered; for Internal Compliance Review and Internal Actuarial Audit, fees for the services of actuaries conducting reviews, fees for external audit of actuarial work for Life Office review work and secretariat fees for reviewing questionnaires. The question of who pays was also addressed - ultimately the client, customer or consumer of the services. Will that person appreciate what is paid for?

7.3 Proposals in the first paper

Implementation of the proposals in the first paper was envisaged in three stages. Stage 1 involved internal compliance review and internal actuarial audit, being put in place as soon as practicable by firms and life offices on a voluntary basis, actively promoted by the profession. A compliance questionnaire prepared by the profession would be compulsory for members applying for, or reapplying for Practising Certificates. An annual report from the Senior Actuary would also be compulsory.

Stage 2 would commence after pilot testing carried out in Stage 1 had been reviewed. External Practice Reviews would be introduced on a wider basis possibly using a team employed by the profession. The review would include a decision for which practices or fields compulsory practice review should be introduced and the precise timescale for its introduction. A cycle of 3 years would be appropriate for life offices, carried out by the profession's team, the FSA or an external firm, at the choice of the life office. Priority for practice review would be given to firms and life offices without adequate internal procedures.

In stage 3, a review of procedures would be conducted by after an appropriate time to see how they are working.

7.4 Publicity

Publicity issues were considered, both internal and external to the profession. It was thought there should be (and be seen to be) transparency and openness with the membership each step of the way. The issue needed widespread consultation amongst the membership of the profession. Contact with the membership would need to demonstrate effectively that the reactions and suggestions of members are important and will be considered carefully by those in charge of the project. This would help to build confidence on the part of the membership in the processes that are to be put into place. This part of the process could be tailored more closely to the specific areas and needs of the Practice Boards. For example, the issue would be included for practice-specific discussion at the specialist conferences of the Practice Boards.

A key objective of the initiative was that the profession should be, and be seen to be, more accountable to the public. This is all the more important given that we are essentially dealing with the monitoring of our professional code rather than more public issues like life product design and pension mis-selling. As the project gets underway, it would be helpful to find ways to publicise the initiative externally, so as to inform the public as to the important steps being taken by the profession with respect to this compliance monitoring initiative. The public relations aspects of this initiative would need to be handled carefully, sensitively and positively. There is a risk that, unless successfully presented, we might achieve the opposite of what we intend. This could arise, for example, if those who are suspicious of actuaries see the initiative too much as a defensive move on the part of the profession, or even as the manifestation of a lack of confidence on the part of the profession's governing body, in the ability of actuaries to do their jobs properly and professionally.

8. Consultation on the first paper

Members were consulted at meetings for the profession in London and Edinburgh. These were preceded by discussions with employers. Further discussions took place at other actuarial conferences. Many felt that the Working Party had not demonstrated the need for the proposals that it put forward. It was felt the profession must establish that there is a problem before proposing a solution to its membership.

It was apparent that most firms had procedures in place, although these were not always formalised. Some life offices found that their external auditors and the Government Actuary's Department (GAD) proved very helpful in this area. Some firms - notably auditors employing actuaries - regarded such arrangements as part of their risk management procedures. Clearly, in many instances the internal review procedures set out in the original paper could be incorporated without difficulty.

8.1. Concerns expressed

During the consultation process there was little support and a number of reservations expressed by many contributors for a formal external practice

review system, particularly at the meetings of members in Edinburgh and London. The reasons included:

- (1) Practice reviews would require the release of confidential information to an external reviewer.
- (2) The costs of review would be significant, with little apparent benefit for the firms.
- (3) Post-release reviews were of less benefit than pre-release reviews.
- (4) Reviews would be particularly onerous and objectionable for small practitioners, on the grounds of cost, time and confidentiality
- (5) The actuarial profession (unlike some others) is only able to prescribe the conduct of individual members rather than firms, so that internal reviews would be acceptable and appropriate (although some occasional external benchmarking could still be worthwhile).
- (6) There was little consensus over who would be suitable to conduct practice reviews of the various types of firm.
- (7) It was also noted that the CIA has now moved away from its original proposal to introduce mandatory practice reviews, and, instead, is now introducing compulsory peer review in those areas which are 'mandatory'.

There was a mixed reaction from employers. Some felt that external practice reviews should be compulsory, others thought that they should be voluntary, and some were completely against any external reviews. Some felt that only very small firms, with one or two actuaries, needed external review. In particular, a number of small firms were against external review, on the grounds of cost, time and confidentiality.

8.2 Support for Internal Review

Support was expressed for a more formalised peer review system by a majority of contributors. The reasons included:

- (1) Peer review is normally pre-release rather than post-release.
- (2) Many firms already have peer review systems in place. Some firms felt that guidance from the profession would enable them to formalise and/or improve their current procedures.
- (3) Costs would be less onerous than for external review.
- (4) Confidentiality issues arising from external review would be avoided, except in the case of small firms or life offices.

Some organisations felt that there was scope for tightening up their own procedures, and having a blueprint from the profession might be helpful. Codifying good practice and extending it to others was generally accepted.

It was noted that the CIA has now approved proposals to introduce compulsory peer review in those areas which are 'mandatory'.

8.3 Questionnaire

There was support from employers and members for the idea of a questionnaire, particularly if this was largely in the form of 'open' rather than 'closed' questions, and could therefore encourage actuaries to consider broader issues.

8.4 Small Firms

There were some specific concerns about sole practitioners and small firms. Many actuaries felt that there was a greater need for compliance monitoring in this area. By contrast, the greatest concerns about the introduction of monitoring were voiced by actuaries in this area.

Some of the biggest practical problems relate to the lack of availability of internal peer reviewers, and this leads to a need for external review. This, in turn, leads to confidentiality and commercial issues.

The working party felt that small firms should be encouraged to participate in the process. If internal peer review proves difficult, then encouragement to forge links with other small firms, such as exist between a number of these operations already, should be encouraged. Alternatively, voluntary arrangements with another organisation (e.g. company auditors) could be made. Such links require a large amount of trust between the firms concerned. If small firms are unable to put into place arrangements such as those described above, it may be necessary to require an external review procedure.

8.5 Practical Issues

There was very substantial opposition to introducing checklists with 'tick boxes', as this would not assist actuaries towards an improvement in standards.

It was observed that the International Accounting Standards Committee (IASC) had suggested that actuaries needed to be subject to comprehensive enforceable standards before the actuarial profession was allowed discretion by that committee on insurance liability valuations in accounts conforming with IAS standards. Some thought that a peer review system would provide this standard.

The idea of holding a conference to discuss different peer review systems and the production by the profession of a best practice 'blueprint' was generally welcomed.

There was concern expressed by many as to the additional costs involved, both external and internal, and whether or not it would offer value for money.

With respect to the profession's costs, there was some support for a certain proportion of the costs being met by subscriptions and Practising Certificate fees, with the balance being paid by the firm in question, if a more detailed review were required. However there was no consensus as some felt that the profession should meet the costs entirely (presumably from subscriptions) and some that the firms should meet all the costs. There was a suggestion that a costed analysis of the alternative methods should be conducted, so that a 'business case' could be presented.

8.6 Conclusions from Consultation

It is clear from the consultations that we have held that, amongst much opposition to the proposals as set out in the earlier paper, there is a substantial amount of support for the concept of pushing standards forward by way of internal peer review. This support seems sufficiently strong that a move to make this compulsory might be acceptable to most members of the profession.

It is clear that there is a wide spectrum between, on the one hand, self-regulation and, on the other hand, statutory controls, and a wish by the profession to remain at the self-regulatory end of that spectrum.

Equally, there is another spectrum between, on the one hand, a 'tick box' approach to compliance, with monitoring advice in a qualitative way at the other end. Whilst the latter would be extremely difficult to do, many feel that a simple 'tick box' approach is unacceptable, and so a position somewhere along this spectrum needs to be established - perhaps at a different point in different practice areas.

The reaction of many is that the process of introducing monitoring compliance should continue, and that the profession should not be reactive - in other words, we should not wait for a disaster to happen before acting. Accordingly, the Working Party considered all of these matters again, and produced its second paper "Monitoring Compliance with Professional Standards Revisited". (Bibliography 3.3). It considered the reactions for the first paper and made revised recommendations which are summarised below.

9. The Second Paper

9.1 Peer Review Recommendations

- (1) Voluntary peer review to be encouraged for all work.
- (2) Compulsory peer review to apply initially only to mandatory guidance; and areas to which Practising Certificates relate. The introduction of,

and the scope of work covered by, compulsory peer review would be decided by the relevant practice board.

- (3) The Senior Actuary to report annually regarding peer review.

9.2 External Practice Review Recommendations

External Practice Reviews should not be made compulsory for all work, but should be retained as a voluntary option to supplement internal peer reviews, internal actuarial audits and compliance questionnaires. In addition, external practice reviews should be applied:

- (1) as an option (compulsory if other options not used) for small firms unable to carry out peer reviews; and
- (2) as a possible disciplinary sanction, or where there is evidence of possible non-compliance with professional guidance.

A risk-based approach should be applied to ensure that the review is focused on areas of particular concern to the profession, and that available resources are applied to greatest effect. These areas would be selected by individual practice boards. Confidentiality remains an issue where a firm is unwilling to cooperate. However, where a serious case has arisen requiring review, the profession could possibly, in that event (subject to legal clarification), consider action against individuals working at that firm, which would be a strong incentive for the firms to cooperate.

9.3 Actuarial Audits

Actuarial audits should be encouraged on a voluntary basis, where appropriate. This process should be reported in the senior actuary's report.

9.4 Individual Questionnaires Recommendations

- (1) Questionnaires with suitably 'open' questions should be drafted by individual practice boards as an aide-memoire, and for completion on a voluntary basis by individual actuaries;
- (2) Actuaries should be encouraged to complete these on a voluntary basis, to discuss any professional issues arising with other actuaries in their firm (or with a member of the UK Professional Affairs Board, as appropriate), and to send any comments or suggestions for clarification of guidance notes to the relevant practice board;
- (3) Questionnaires with a range of appropriate 'open' and 'closed' questions should be drawn up and issued to applicants for Practising Certificates each year

- (4) The questionnaires should be monitored by the secretariat, and any cases of possible non compliance brought to the notice of the Practising Certificate Committee.

9.5 Senior Actuary Report

A Senior Actuary report would be requested of all Senior Actuaries. Where a firm employing actuaries has no-one with that title, the profession will suggest to the firm who should perform the task, having regard to the age and experience of the actuaries employed at the firm.

9.6 Discussions following the second paper

The discussions at two further meetings in Edinburgh and Glasgow in December 2000 were much more positive. There was appreciation that account had been taken of comments made at the first set of meetings. There remained opposition to the concept in some quarters, but the idea of internal, rather than external mandatory review proved much more acceptable.

There was concern that the new regulatory authority in the UK – the FSA – may force actuarial review on the profession. These concerns were heightened by emerging issues at Equitable Life – referred to below.

Members attending began to discuss practical points concerning the operation of internal peer review, such as the need to ensure Peer Reviewers are free from undue influence, and concerns that peer reviewers should be as qualified and experienced as the person carrying out the work.

9.7 Conclusions from Second Paper

The Faculty President, David Kingston in closing the Edinburgh meeting, made the following statement “I think the message is clear, both from Staple Inn and from here that we should proceed. Clearly there is a lot to be done in the details. I have no doubt that these proposals have general support”.

The Faculty and Institute Management Committee, drawn from Institute and Faculty Councils accepted the recommendations of the second paper and charged the Practice Boards - the Life Board, the Pension Board and the General Insurance Board with implementing the second paper’s proposal in ways suitable to their particular areas of operation. Their progress to the date of writing is noted below, after a short summary of recent relevant events in the actuarial world.

10. UK Events

10.1 Equitable Life

Events at Equitable Life – a UK mutual life assurance company have had a major impact to actuarial practice in the UK. Some with profit policyholders challenged the company's treatment of certain guarantees at maturity, which - when changed economic conditions made the guarantees particularly valuable - applied different bonus arrangements to those exercising the guarantees from those who had no guarantees, to create a more uniform return on assets invested for all policyholders. A test case in the High Court found in favour of the company, but this was overturned on appeal by a majority decision of judges. A final appeal by the company to the House of Lords was lost by the company on a unanimous decision.

The company's approach to distribution of investment earnings had led to relatively smaller reserves in excess of liabilities compared to other UK companies. The resulting returns to policyholders in a time of high investment returns generally helped the flow of new customers, including many wealthy and influential individuals. The increase in liabilities resulting from the judgment meant the company decided to seek a purchaser. This proved impossible initially, but a subsequent arrangement with a UK bank has been made, and the new management is, at the time of writing, consulting interested parties on a compromise deal to policyholders, removing the guarantees in return for a policy value uplift.

Criticisms have emerged of the company and its legal, accountancy and actuarial advice, as well as of its regulator. The extent of its reserves, in particular its treatment of guarantees whose outcome depends on inflation related economic scenarios, along with its management style and policyholder communication have been attacked.

Some actuarial commentators have observed that none of these would have been affected by an internal monitoring regime, but that an external review procedure might have improved the outcome.

There are several inquiries underway in respect of the Equitable Affair. These include one by the UK actuarial profession which set up an internal Committee of Inquiry to focus in particular upon the issue of whether there are any implications for professional guidance from the events leading to the closure of Equitable Life to -'new business-'. This announcement was covered in the Financial Times, The Times and The Guardian on 22 December 2000. A further press release was issued on 19 January 2001, which gave details of the Membership of the Committee of Inquiry (the Corley Inquiry), and its Terms of Reference. Under the Terms of Reference the Committee of Inquiry is considering implications of "relevance for the roles of Appointed Actuaries and other actuaries who are directors or senior employees of long term insurance companies".

The Committee was expected to report in Spring 2001, but delays occurred and the report of the Corley Inquiry was published on 28 September 2001. The profession is giving careful consideration to the report's recommendations, which are likely to have a strong bearing on future development of this issue in the UK – at least in the Life field as the Inquiry Report recommends that an external peer review of the work of an Appointed Actuary be made a requirement.

10.2 Independent Insurance

Slightly less high profile has been the failure in 2001 of Independent Insurance, a major UK insurance company specialising in commercial lines. Although not required to do so, the directors of Independent had taken external actuarial advice on their claims reserves for several years. In May 2001 the company discovered information about its claims data that led the external actuaries to conclude that they could no longer project its liabilities. Additional reinsurance agreements which had an adverse effect on the company's financial position also came to light. The company closed to new business in early June and was placed in provisional liquidation later that month. Although it was their actuaries who "blew the whistle" on certain data inconsistencies, finally leading to the collapse, there has been some criticism over whether an earlier warning would have been appropriate. The actuaries involved already use internal peer review procedures, and it is difficult to draw any firm conclusions about compliance monitoring from this event.

10.3 South Africa

Events in other countries, of interest to the UK profession, have included the high profile questioning of the use of pension fund surplus in South Africa. A number of vocal former pension scheme members have complained about the treatment of their transfer of assets and liabilities from pension schemes there, and have suggested that pension fund assets, in particular those surplus to what they consider are inadequate values placed on their entitlements by actuaries, have not been transferred to their new (largely money purchase) alternative arrangements. As many of the actuaries concerned are fellows of the UK actuarial bodies, the debate has reached the pages of "The Actuary, the magazine of the UK actuarial profession". The matter is subject to an investigation by the Actuarial Society of South Africa, and it is possible that the outcome could offer some pointers to future monitoring of actuarial practice.

10.4 Whatever the roles of the actuaries in the above situations, I am convinced that the existence of a monitoring process, of whose existence the public is aware, would help maintain and improve the public perception of actuaries. These cases seem to me to belie the assertion made during some of the consultation meetings of UK actuaries on the working party's papers that there had been no problems, and until such problems were proved to exist, no move should be made in the direction of compliance review.

10.5 Canada

The CIA in the Exposure Draft of its Standard of Practice on Peer Review (Bibliography 3.7) states that any piece of work legally requiring the signature of one of their Fellows must be peer reviewed. However, the peer review does not have to be carried out by an external actuary - only by an actuary who is determined to be competent and objective with regard to the work being peer reviewed.

11. Life Board Progress

The Life Board has set up a committee to implement Compliance Monitoring in their area of operation. This group has drawn up proposals and discussed these with the FSA. It is felt appropriate to ensure that the profession acts in concert with the FSA in this matter if possible. The less desirable alternative might be for them to have their own separate requirements, which would undoubtedly acquire a greater significance, diminishing the value of the profession's requirements.

The committee has considered a number of issues, including the following important points:

Whether the peer review should be external to the actuary's own organization. As mentioned above, the Equitable Affair suggests this external approach, rather than the internal review apparently favoured in the earlier consultations with members. The Corley Inquiry, as stated above, recommends the external approach. Problems of internal review in small offices are also likely to be a consideration.

Whether peer reviewers should be required to meet the same requirements as Appointed Actuaries and obtain Practicing Certificates from the profession. This may introduce the concept of a Practicing Life Actuaries Certificate, as a pre-requisite for an Appointed Actuary's Certificate, but issued to a much larger group of suitably qualified actuaries.

Which areas of actuarial work would be subject to the review – possible candidates would be mandatory guidance relating to the statutory valuation, the Financial Condition Report (FCR) and product disclosure. These last two items feature in the Corley report also.

What scope there is for pre-event monitoring, and how much after the event.

How to promulgate the required conduct of peer reviews

How much detail should be included in an annual review, and how much over a longer period.

The extent of peer review on overall controls and methodologies used.

The relationship between signing off the peer review and renewal of Appointed Actuary's Practising Certificate.

The relationship between the Appointed Actuary and his reviewer

The arrangements for appointment and replacement of a reviewer, to allow continuity of information.

What formal reporting (if any) of reviews to the profession.

The following principles have been set out by the Life Board:

1. Compliance reviewers should be required to meet the same requirements as Appointed Actuaries and to obtain a Practising Certificate from the profession.
2. Compliance review should only cover mandatory guidance.
3. A new Guidance Note will be issued setting out the required conduct of compliance reviews.
4. Compliance review will result in an annual sign-off by the reviewer to coincide with signing of FSA returns.
5. The reviewer sign-off will refer to his reasonable belief.
6. There should be a duty to consult a predecessor and to report to FSA similar to the Appointed Actuary duties.
7. There should be no formal reporting of each review to the profession.

The Life Board intends to draw up more detailed proposals for compliance review of Appointed Actuaries once it has given full consideration to the recommendations of the Corley Committee of Inquiry.

This, and the need to work closely with the FSA on any proposals is likely to affect the timescale of the introduction of arrangements for Compliance monitoring in the Life area.

12. General Insurance Progress

The General Insurance Board has also set up a committee to move forward in this area. Discussions have been held with representatives of actuaries at Lloyds of London, and a workshop was being planned for a General Insurance Conference in October 2001, after the time of writing. The proposal is to use a form of internal peer review for such actuaries – most have such a form of review already. The intention is that the reviewer would hold the relevant Practising Certificate. It is currently thought in-house actuaries at General Insurance Companies might be reviewed by

actuaries working for the companies' auditors. Furthermore, actuaries working for Friendly Societies would be reviewed in a similar way to what is finally proposed for Life Actuaries, as these Societies will transact Life business too.

13. Pensions Board Progress

The equivalent committee for the Pensions Board has held a discussion meeting at the last Pensions Convention to gauge the best way forward. Implementation is likely to be on an internal basis, building on the many existing processes, but with special considerations for small firms.

The committee has decided to propose a formal peer review system only in respect of work covered by Guidance Notes, Professional Conduct Standards and Practising Certificates. It intends to put proposals to the November meeting of the Pensions Board. Subject to the agreement of the Pensions Board the Working Party proposes to consult with the relevant membership of the profession early in 2002.

14. Conclusions

When this subject was first discussed seriously by the profession, there was considerable opposition to the proposed arrangements for Compliance Monitoring. This was due to a number of reasons, and I believe the position has altered substantially since then.

Much of the opposition was from actuaries who felt that action should only be taken if an identified problem existed. Recent events at Equitable Life, and other discussions such as the worth of the with profits concept have led to more public criticism of actuaries than before. This has happened in a context where other professions are under closer scrutiny by the public, with attentions from the press and government. The appendix gives more detail. In the different climate, perhaps more are persuaded of the need for monitoring to improve the profession's image and standing.

The change in the recommended route from mandatory external to internal review has won more acceptance from actuaries. Notwithstanding this, external review is very likely to be introduced for life office actuaries, as a result of the Equitable Life Affair and the subsequent Corley Inquiry. This may also lead to the concept of a Practising Life Actuaries Certificate, as a pre-requisite for an Appointed Actuary's Certificate, but issued to a much larger group of suitably qualified actuaries. This would be a useful development in my opinion, as among other advantages, it will help succession planning in life offices' management.

The Canadian profession has gone through a similar process a little way ahead of the UK, and has arrived at an internal system, but, I understand, considerable external monitoring on a voluntary basis.

I would expect to see the start of a phased introduction of Compliance Monitoring in the UK during 2002. I wonder whether actuaries in any other nation will follow Canada and the UK down this path.

Appendix 1

The experience of others.

1.1 Other UK professions

1.1.1 Medical Profession

No research was done into this profession – the accounting and legal professions were thought to have more relevant experience for the actuarial profession – since their areas of operation are closer to ours. However, this subject has developed in the UK against a background of difficulties for the medical profession, which have a bearing on all professions. Among a number of cases which have hit the headlines, surgeons operating on children in Bristol with particularly high rates of fatal outcomes, the removal of children's organs without parental consent after death at a Midland Hospital, and the discovery that a notorious Dr Shipman had been responsible for the deaths of many tens, perhaps hundreds of his patients, have all caused public alarm, and government action. Tests of competence for doctors are now under consideration.

A comparison between actuaries responsible for with profits policies and Dr Shipman, made by Sheila McKechnie, Chief Executive of the Consumer's Association, who was expressing concerns about the operation of such policies, created quite a stir.

1.1.2 Accounting Profession

The government has intervened in this profession too, ensuring majority lay participation in the relevant ethics committee. The profession has reorganised itself into a complex structure to deal with these and related discipline issues. The new bodies created are independent of the profession's own bodies themselves.

All three Institutes of Chartered Accountants in UK and Ireland have, or are presently seeking to introduce, some form of Practice Review.

ICAI, the Irish Institute, has had Practice Review in operation for five years. It is carried out on a voluntary basis and Irish inspectors working for the Joint Monitoring Unit (JMU) are involved. A report is submitted to the Irish Institute, however, this does not name the individual firms subject to review.

ICAS, the Scottish Institute at its Special General Meeting on 16 April 1999 approved a compulsory system of "Activities Review". This applies not just to firms regulated for Audit and/or Investment Business but to all accountancy firms in Scotland. It was introduced with effect from 1 January 2000. Any

firm which is subject to audit or investment business review will automatically be subject to a Practice Review at the same time as that other review.

This will be undertaken by JMU inspectors. All other firms will be subject to Practice Review to be carried out by Inspectors employed by ICAS. Reports from the Inspectors are submitted to an ICAS Committee who will be able to determine whether or not the firm can continue as a “quality accountancy firm”. All accountancy firms have a “CA mark of quality” on their letterheads and this would disappear in the case of those firms who failed to meet the required Practice Review standard within the first five years of its operation. It would be possible for a firm that failed to obtain the required standard to reapply at anytime within the five years and if successful the quality mark would not be removed. ICAS see this review as an education programme which will lead to an enhancement in professional standards. It is being operated under the auspices of its Professional Standards Committee. The costs are recharged to the firms being reviewed.

ICAEW (English and Welsh Institute) Council has approved a voluntary Practice Review system which will focus on quality control and how this is carried out within practising firms. It should be stressed that, unlike ICAS, this will be voluntary but will also be paid for by the firms subject to review. It will focus on Practice Management and concentrate on various types of client services where the annual service fee income is 10% or more of the total annual practice fee income. It would also look at any other areas that firms may volunteer and the intention is that up to 50% of the total practice fee income will be reviewed.

1.1.3 Legal Profession

Core Practice Management Standards are the basis for assessment. These standards were developed by the Law Society as a management tool to address the particular business needs of legal practices and have gained wide acceptance as an aid to efficient practice and improved client care. They form the basis for the Legal Aid Board’s franchising specification and, therefore, have gained recognition as a credible quality standard.

The standards cover:

- management structure
- services and forward planning
- financial management
- managing people
- office administration
- case management.

A set of procedures named Lexcel provides a methodical and professional approach to management and administration which will reduce the risk of mistakes and wasted effort particularly in the areas of case work and communication with clients, where failings tend to lead to the largest volume of complaints and claims upon the solicitors indemnity fund (SIF). Failures in administration, not lack of legal knowledge, tend to lead to most claims on SIF. Establishing the systems and procedures required by Lexcel will assist practices to ensure compliance with the professional conduct rules.

Assessment is carried out by certification bodies already accredited for the purpose of assessing ISO 9000 and by a number of Investors in People assessment units. Assessment includes a review of a sample of files.

1.2 Actuarial Bodies other than in UK

1.2.1 The experience of the USA

The Society of Actuaries confirmed to the Working Party that it had no formal process for monitoring adherence to professional requirements, relying on self-regulation, publicising the Code of Professional Conduct, and a discipline process. In the US the Actuarial Board for Counselling and Discipline (ABCD) investigates complaints regarding members of the US-based Actuarial organisations, and provides counselling or recommends disciplinary action by the appropriate organisations. A key element related to professional practice requirements in the US is the Actuarial Standards Board, which issues Actuarial Standards of Practice (ASOP). Again, adherence to ASOPs is generally based on self-regulation, publicising of the ASOPs and the discipline process.

1.2.2 The Experience of Canada

The Canadian Institute of Actuaries (CIA) set up a task force in June 1997. This followed an earlier task force on compliance review which had reported early in 1996. The second task force published a report in June 1998. This proposed a review system. Tier 1 was an annual questionnaire for all practice areas, and tier 2, the review of practices named the 'Practice Review' by actuaries independent of the firm. The report and the sample questionnaires were examined by our working party, and the Canadian experience provided substantial information and material for discussion.

A comprehensive summary of the proposals, and the reaction to them is given by McKay in item 3.5 in the Bibliography. As a consequence of the strength of opposition voiced by the membership, the task force was given a revised mandate to explore alternatives to practice review that would give a greater emphasis to education, and was no longer under any obligation to implement the practice review recommendations.

That task force studied internal peer review, and recommended it to be mandatory for public opinions (after a suitable transition period) and voluntary for all other work with the CIA issuing guidelines for peer review.

In Bibliography item 3.6, Della Penna distinguishes peer review from practice review as follows “the key distinction is that practice review is an official CIA act. It is always post release and deliberately so. Its subject is the practice of a member or a group of members. On the other hand, peer review is something that members arrange themselves. It is commonly pre-released and addresses a specific report or opinion.” It is clear that the CIA considered adopting practice review only for life actuaries as they were generally supportive. However, again quoting from the article by Paul F Della Penna “it is okay to define a certain type of work (eg public opinions), but it makes no sense to single out life actuaries, in-house actuaries, male actuaries, or any other subset.”

The task force supported the recommendation that the existing compliance questionnaires be enhanced and changed to diminish the emphasis on compliance and should focus instead on the handling of specific issues of importance so that all members can have a better perception of the range of practice. The compliance questionnaires are also seen as helpful to the practice committees gathering information on the application of standards as input to the process of standards’ development.

The proposals on peer review were shared with the membership, and an exposure draft is under consideration of the membership. (Bibliography 3.7).

Appendix 2

Members of the Working Party

David Martin (Chairman)

John Bannon

Wendy Beaver (Pensions Board)

Roy Brimblecombe

Paul Grace

Michael Green (Life Board)

William Hewitson (General Insurance Board)

Appendix 3

Bibliography

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