To : Members of IAA Council

This paper has been prepared by the Faculty and Institute of Actuaries in the UK (the "UK actuarial profession"), to help IAA Council members understand the background to the recommendations on peer review in the Morris Review.

The Morris Review - Independent Scrutiny of Actuarial Work

One of the main themes in the final report of the Morris review into the UK actuarial profession is the "understanding gap" which exists between actuaries and the users of actuarial advice, such as trustees of pension funds and non-executive directors of insurance companies. He suggests various ways in which this gap may be reduced, such as better communication by actuaries and better training for the users of actuarial advice. But he concludes that the "understanding gap" will never be fully closed, because of the nature of actuarial work, and therefore there will always be a need for independent scrutiny of actuarial work.

Standards

The report by Lord Penrose into Equitable Life (which gave rise to the Morris Review) was critical of the wide scope for discretion allowed in the standards of the UK actuarial profession. Lord Penrose stated that effective peer review required proper standards against which to review. This meant that, as well as pressing ahead with plans for introducing peer review, the UK actuarial profession had to undertake an urgent revision of its existing standards, in order to narrow their application so as to enable peer review to be effective.

Life Assurance

The UK insurance regulator, the Financial Services Authority ("FSA"), had carried out a major reform of the regulation of insurance companies, with new rules coming into force on 31 December 2004. These included the removal of the position of Appointed Actuary and its replacement with three actuarial roles, Head of Actuarial Function, With Profits Actuary and Reviewing Actuary. This last role, Reviewing Actuary, is necessary because the long term liabilities have been brought within the scope of the audit. The role is described by the FSA as:

- reporting directly and privately to the auditor
- giving a view on the reasonableness of the valuation of the liabilities
- enabling the audit report to state that the auditor has been advised by a suitably qualified and experienced actuary and that all relevant professional guidelines have been complied with.

Throughout his review, Sir Derek Morris was at pains to point out that this new FSA regime was untried and should be given time to see how it worked in practice.

In parallel with the review, the UK actuarial profession had been consulting on proposals to introduce external peer review to all statutory actuarial work in life insurance (what Morris calls

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"reserved work"). The profession received strong objections from the insurance companies' trade association (the Association of British Insurers, or "ABI"), backed by the FSA, on the grounds that these peer review proposals would largely duplicate the new Reviewing Actuary role. The profession consequently agreed to defer the introduction of external peer review, while we carried out an urgent investigation to identify those aspects of actuarial work which we considered should be subject to scrutiny but which would not be covered by the Reviewing Actuary. Sir Derek supported this approach in his final recommendations and our investigation started as soon as his report was published.

Pensions

The profession drew up proposals for peer review in pensions, consulted widely and refined its proposals during 2003 and 2004, introducing its requirements with effect from 1 January 2005. Mindful of the difficulties which had been experienced in other countries, we decided to bring in our proposals gradually. The first stage is limited to "reserved work", is initially voluntary but with an early date for becoming mandatory, and permits internal as well as external review. Moreover, it allows a choice between pre release peer review and post release "audit" of a sample of work. It was always recognised that this was a weaker form of peer review but it was considered important to get the principle accepted first, with a view to strengthening the regime gradually over time.

In his interim report, Sir Derek Morris offered a number of options, one of which was to continue with the profession's proposals and another was to move to a system similar to the life insurance regime brought in by the FSA, with a Reviewing Actuary reporting to the auditor. His final report recommends that the Pensions Regulator should ensure that "reserved work" is subject to formal scrutiny by independent experts, through either risk-based supervision, audit or external peer review. He adds that, in the meantime, the review supports the Profession's introduction of peer review.

As in all regulation of UK pension plans, there is an issue of costs for the long "tail" of very small plans. Regulatory solutions that are appropriate for larger plans are criticised for being too great a burden for smaller plans.

General Insurance

The profession's plans to bring in peer review for "reserved work" in relation to the Lloyds market have been strongly opposed by Lloyds. Plans for peer review of GI work for other entities, eg insurance companies, where there is currently no "reserved work" for actuaries, have been deferred until this issue of "reserved work" for actuaries has been settled.

Conclusion

For all three practice areas, Morris recommends that the Financial Reporting Council ("FRC")(the body that will independently oversee the UK actuarial profession in future), in conjunction with the appropriate regulator and the profession, should – within 2 to 3 years – satisfy itself that appropriate monitoring of actuaries' compliance with professional standards and independent scrutiny of actuarial advice is occurring through either direct supervision by the regulator, audit or external peer review.

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The Actuarial Profession
making financial sense of the future

The UK actuarial profession is fully supportive of the recommendations in the Morris review. They will lead to a proper scrutiny of actuarial work, which is what we have favoured all along, and the FRC will be able to overcome any opposition from users of actuarial advice or from our own members.

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