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MONITORING COMPLIANCE WITH PROFESSIONAL GUIDANCE

A Discussion Paper
prepared by the Compliance/Peer Review Working Party
of the Professional Affairs Board

[Presented to the Faculty of Actuaries, 21 February 2000]

ABSTRACT

This is a discussion paper prepared by the Compliance/Peer Review Working Party of the Professional Affairs Board. It considers the monitoring of compliance with the professional conduct standard and guidance notes, how this is being done, and whether changes need to be made to the monitoring in the light of on-going changes to the regulation of financial services.

KEYWORDS

Compliance; Professional Conduct Standard; Guidance; Monitoring

1. Introduction

The Working Party was set up by the Professional Affairs Board to examine systems for the monitoring of compliance in professional matters. Following consideration of a report of the Working Party submitted to the Professional Affairs Board and the Faculty and Institute Management Committee, it was agreed that a discussion paper be prepared to enable a discussion in the wider profession to take place on these matters. This paper considers the monitoring of compliance with the professional conduct standard, guidance notes that are practice standards and certain recommended practice guidance notes. It covers compliance generally, but in particular by the holders of practising certificates. It does not consider wider quality issues concerning actuarial advice. However, application of many of the procedures outlined to non-monitored activities would enhance the standing of all actuarial work. In the same way, some of the work covered by the forms in the Appendix goes beyond that required to demonstrate compliance with practice standards, but should result in an overall improvement in the quality of actuarial work.

1.1 *Objective and Terms of Reference (as determined by the Professional Affairs Board and approved by the Faculty and Institute Management Committee)*

Objective: To consider how the profession can be satisfied that its mandatory Guidance Notes are being adhered to by members.

Terms of reference:

(1) to review the present working arrangements and identify any problems;
(2) to consider alternative compliance/peer review processes; and
(3) to liaise with the Guidance Committees of the Practice Boards (to include the Regulation and Supervision Committees of the Life Board) who will be represented on the Working Party.

1.2 *Membership of the Working Party*

David Martin (Chairman), John Bannon, Wendy Beaver (Pensions Board), Roy Brimblecombe, Paul Grace, Michael Green (Life Board) and William Hewitson (General Insurance Board).

2. What are the Benefits of Doing This?

Benefits were identified for employers, clients of actuaries, policyholders, pension scheme members — in fact all 'stakeholders' in products or services with whom actuaries are associated. Benefits also flow to the actuaries themselves and the profession as a whole.

The following benefits were identified.

2.1 It will strengthen the position of the profession and individual members, and will build upon procedures and good practices already adopted by many firms and life offices. For the avoidance of doubt the term 'firms', wherever it appears in this paper, shall be deemed to include limited liability companies and groups of companies. The definition is intended to be flexible.

2.2 If properly done and appropriately publicised, it will maintain and strengthen confidence in actuaries among the public and users of their services. These would include policyholders and pension scheme members. Clients would be reassured. These effects would lead employers of actuaries to find that the increasing requirement by the public for demonstration of standards to be met, and the cachet of professionalism among actuaries, will be seen to give a business advantage. An example might be among firms whose reputations may have been affected during the publicity regarding pensions mis-selling.

2.3 The advent of the new Financial Services and Markets Bill presents an opportune moment to introduce these measures voluntarily. The Government and the Financial Services Authority (FSA) may force regulation on the profession if they are not seen to be proactively monitoring compliance.

2.4 There is ongoing debate with the FSA towards extending the remit of actuaries (e.g. the role of the actuary in general insurance). If we are seen to have an effective compliance review process in place, then we can argue more persuasively for the FSA to implement change.

2.5 Increasingly, guidance notes are evolving as an extension to legislation, and there is, therefore, an increasing need for compliance to be policed.

2.6 With the increasing impact of 'public interest' awareness, there is pressure from consumer associations and the public for all professions to be more accountable.

2.6.1 Recent developments in the medical profession include the proposal for compulsory assessment of doctors on a regular basis. That profession is currently committed to this process, and is examining ways to implement it. The public interest awareness issues mentioned above are underlined.

2.6.2 Recent developments in the accountancy profession, on the regulation required of accountants, emphasise the continued development and formalisation of standards in professions. They may be required now to have a predominance of non-accountants on the relevant ethics committee.

2.7 The Working Party believe that monitoring of compliance will, in due course, have an effect on the nature of guidance itself, and lead to more regular reviews of the guidance.

3. What Should We Monitor?

The terms of reference suggested that adherence to mandatory Guidance Notes should be monitored. The Working Party discussed this, and suggested that monitoring should be of adherence to:

— the Professional Conduct Standards (PCS);
— mandatory Guidance Notes (i.e. practice standards); and
— certain selected advisory (recommended practice) Guidance Notes, as advised to members of the profession from time to time.

It was felt that, if the scope of the monitoring was limited to the above, this would allow the introduction of these arrangements to be introduced in a controlled, limited and manageable fashion.

The Working Party believe that the purpose of their proposals is only to monitor adherence to guidance, and not to go substantially beyond this in commenting on the quality of advice.

4. What do Others do?

The Working Party found relevant experience in the profession only in North America. Experience of other United Kingdom professions was also sought.

4.1 *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 in an article by Robert J. McKay, in the January 1999 edition of *The Actuary* (the newsletter of the Society of Actuaries). This is reproduced as Appendix A1.

As a consequence of the strength of opposition voiced by the membership, the task force has now been given a revised mandate to explore alternatives to practice review that would give a greater emphasis to education. The task force is no longer under any obligation to implement the practice review recommendations.

While the task force has reached no conclusions, it is now studying peer review, mandatory for public opinions (after a suitable transition period) and voluntary for all other work, with the CIA issuing guidelines for peer review.

In a recent article by Paul F. Della Penna in the May 1999 issue of the *CIA Bulletin* (see Appendix A2), he 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 supports 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 situation in Canada is still subject to change, and the latest proposals on peer review are now being shared with the membership.

4.2 *The Experience of the United States of America*

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 U.S.A. the Actuarial Board for Counselling and Discipline (ABCD) investigates complaints regarding members of the U.S. based actuarial organisations, and provides counselling or recommends disciplinary action by the appropriate organisations. A key element related to professional practice requirements in the U.S.A. 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.

4.3 *U.K. Accountancy Profession*

While the U.K. accountancy profession and legal profession regulate firms and not individuals, it was considered useful to find out what they were doing on compliance review.

Information about how the accountancy profession monitors compliance with professional standards was obtained from meetings with representatives of UK200, the Institute of Chartered Accountants in Scotland (ICAS) and the Joint Monitoring Unit (JMU).

4.3.1 *UK200*

This is a group of 170 out of 10,000 to 12,000 small accountancy firms. They have a small organisation which reviews professional standards of their members. When the various accountancy institutes combined to set up a Joint Monitoring Unit (JMU) for all accountancy firms, they took advice from UK200.

Information obtained at the meeting about monitoring the accountancy profession by UK200 is set out in Appendix B.

It is clear that there are marked differences in the tasks of monitoring the accountancy and actuarial professions (e.g. monitoring firms — many of them very small, as opposed to individuals in firms, as well as different costs for monitoring). However, the similarities to the solutions are worth study — e.g. annual questionnaires, monitoring internal to the firms, and external monitors. The copies of accountancy monitoring checklists obtained may also prove helpful.

4.3.2 *JMU and ICAS*

A meeting was held with the JMU on 5 May 1999. The JMU is a limited company, owned 80% by the Institute of Chartered Accountants of England

& Wales (ICAEW) and 10% each by the Institute of Chartered Accountants of Scotland (ICAS) and the Institute of Chartered Accountants in Ireland (ICAI).

It was set up in 1987 to monitor the compliance of firms authorised to conduct investment business under the Financial Services Act 1986. In 1991 this role was extended to include monitoring the work of registered auditors, under the Companies Act 1989.

The JMU also carries out investment business monitoring visits under the Financial Services Act on behalf of the Institute of Actuaries. Information obtained at the meeting about monitoring the accountancy profession by the JMU is set out in Appendix C.

4.4 *U.K. Legal Profession*

4.4.1 *The Law Society of Scotland*

The Society pro-actively monitors compliance with the Solicitors Accounts Rules, and has also issued a booklet for members on risk management.

4.4.2 *The Law Society of England and Wales*

The Law Society introduced, in Spring 1998, Lexcel. Lexcel is a new quality mark which will be awarded by the Law Society to practices and legal departments that are independently assessed as having achieved the Law Society's Practice Management Standard. No compulsion is involved, and it is a matter for the individual practice whether to undergo assessment. Details are in Appendix D.

5. How do we Currently do it?

5.1 *Monitoring of Complaints*

Complaints received about members are monitored by the Compliance Committee of the Professional Affairs Board. These would include complaints from clients, members of the public, reports from other actuaries and referrals from other regulatory bodies. The complaints can be passed to the disciplinary process, but where this is not appropriate, there is no subsequent monitoring of the individual thereafter. Details of the complaint may, however, be passed to the Secretary of the Practising Certificates Committee, and is then taken into account by the Committee when determining whether or not to issue a Certificate. There are some complaints of such a serious nature that they are referred directly to a disciplinary tribunal without being seen by the Compliance Committee. However, there are also some complaints dealt with in a conciliatory way by the Compliance Committee, to the satisfaction of the complainer, which never reach the length of a disciplinary tribunal.

5.2 *Career Progression Following Disciplinary Action*

Where individuals are subject to discipline, there are no formal procedures in place, although a watchful eye is kept over their subsequent careers. It is suggested, however, that a more formal procedure be put in place.

5.3 *Self Disclosure*

Written actuarial advice to a client must state clearly any methodologies adopted and material assumptions made by the actuary. Therefore, if an actuary does not adhere to a guidance note, he is under an obligation to report to his client why he has not complied, and to justify it. In essence this is a form of self-monitoring, and the Working Party considered whether this could be extended to a requirement that such non-compliance could be reported to the profession at the same time as reported to the client. However, reporting to the senior actuary of the relevant firm might be appropriate, as considered later in the paper.

5.4 *Monitoring of Appointed Actuaries*

5.4.1 *Role of the Government Actuary's Department (GAD)*

The GAD examines each year, on behalf of the FSA, the financial returns for all life insurers authorised in the U.K. This examination includes consideration of whether the valuation methodology and assumptions are consistent with regulations and professional guidance. It is also able to monitor, in broad terms, other internal reports that may be received from an Appointed Actuary or presented to it during a visit to a life office. In the event of any possible non-compliance being found, then action taken would range from a written warning from the GAD to a formal complaint being made to the profession's Investigation Committee.

5.4.2 *Audit firms*

The role of the actuaries working for the external auditors of life offices does not extend to monitoring the work of the Appointed Actuary in his role in the production of the supervisory returns. As stated in ¶4.1 of GN7:

> "The accountancy bodies recognise that the valuation and certification of the liabilities under long-term business for the purposes of the Insurance Act 1982 is solely the professional responsibility of the Appointed Actuary. Hence the Appointed Actuary's certificate and schedule 4 of the Supervisory returns are not subject to audit."

Indeed, GN7 goes on to state that, although the auditors (and actuaries working for them) may need to 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 (GN7, ¶4.4).

However, with regard to the production of the long-term business provision for the Companies Act accounts, the reporting actuary (as separately defined in GN7) is open to challenge from the auditors (GN7, ¶5.5). As stated in GN7, ¶3.3 the reporting actuary may be the same person as the Appointed Actuary, but this may not necessarily be the case.

The scope of the work of actuaries employed or retained by the auditor is a matter to be agreed between them and the auditor. They would normally be required to consider:

(1) the integrity of the data used;
(2) the appropriateness of the investigations underpinning the assumptions adopted;
(3) the controls over the calculations, including the documentation and testing of any relevant computer programs;
(4) the controls over the consolidation of the results; and
(5) the completeness of any analysis of change as it relates to business activities.

The actuaries' assistance to the auditor would normally extend to seeking 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.

5.5 The remit of the Working Party was to examine existing systems of monitoring, not to discover specific existing professional problems. Thus, the proposals in the paper do not attempt to cope, retrospectively, with any particular past problems for the profession. They take into account, however, the reactive nature of the existing systems, and attempt to suggest the adoption of more proactive systems.

6. How could we do it?

The Working Party considered all the following suggested proposals for monitoring. It was recognised that firms and life offices vary in nature and size, and so no universal series of measures or solutions would be practicable.

6.1 *Internal Compliance Review*

This process is defined, for the purposes of this paper, as being an ongoing review of work done by a member of the profession by a fellow member working within the same firm or life office. Checking would take the form of ensuring compliance with professional guidelines, not checking that the figurework was correct. Only documents setting out advice to clients

would be reviewed. It would be carried out, on a day-to-day basis, on every document produced which contained actuarial advice.

There would be a requirement on the firm or life office to have in place a standard procedure for reviewing and checking work. If this proposal was adopted, the Practice Boards would be asked to draw up core compliance review standards.

6.2 *Internal Actuarial Audit*

This process is defined, for the purposes of this report, 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 practising certificate. It would be carried out on an annual basis. The 'auditor' would be given a list of the clients and 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 check list, to check for compliance with professional standards.

6.3 *Compliance Questionnaire*

The definition of this questionnaire would be similar to that used by the Canadian task force. It would have three 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.

6.4 *Annual Report from the Senior Actuary of a Firm*

This paper, on professional matters in his firm or life office, would be made by a senior actuary in a firm. This would be the senior actuary as defined in the PCS, if such a post exists. The format of the paper would also need to be designed, but it should, naturally, include reporting on adherence to professional guidance. This might be the means by which non-compliance with guidance notes, as reported to clients (see ¶5.3), could be reported to the profession.

6.5 *Client Questionnaire*

Following a suggestion from the General Insurance Board, this suggestion was considered by the Working Party. Feedback from clients is an important part of quality control, and may be relevant to the public perception of the profession. The Working Party considered that, in the rather narrower field of compliance with professional standards, most clients would not be able to differentiate between that subject against general service issues. A good deal of thought would be required in preparing any questionnaire in this area, and it was considered that the Practice Boards should determine if it was appropriate for their areas of work.

6.6 *Compliance Certificate*

The concept of a compliance certificate has emerged from the Life Board actuaries considering 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 the fields as well as to the life area. If this was based purely on a practice review it could be issued by the authorised reviewer, but it might be more appropriate for it to be issued by the profession, based on the appropriate mixture of compliance monitoring procedures. The issuing of these certificates would be the responsibility of a committee of the profession.

6.7 *Practice Review*

The definition of this type of review is the same as used by the Canadian task force. It would involve a sample monitoring of a limited number of actuaries. It would be undertaken by members of the profession. The way that it would be carried out, however, would be similar to the internal actuarial audit referred to above. While it would not be an exhaustive practice review, a review cycle would be agreed for firms and life offices. All members would know that there was a possibility of one or more of their cases being subject to review, and this in itself would concentrate their minds. This approach could be controversial due to confidentiality of reports. Two possible approaches to providing the practice review are set out below.

6.7.1 *Team appointed by the profession*

One model considered involved the appointment by the profession of a team of reviewers. These would need to be qualified actuaries with experience in the particular field being reviewed. It was considered that actuaries very recently retired from mainstream work, but who keep up to date by attendance at CPD events, would be possible candidates for this role. The reviewer would not necessarily hold a practising certificate for the relevant area, but would be someone for whom the provision of such a certificate would be unquestioned.

6.7.2 *External firms*

Actuaries appointed by other firms could provide this service. The firms that employed these actuaries, or of which the actuaries were partners, could be firms of consulting actuaries or have a substantial actuarial department (e.g. an auditing firm). This approach and the one mentioned above, operating together, would allow a market to develop between the actuarial consultancies, audit firms and the profession's team, allowing the cost of peer review to find its market level.

6.8 *Practice Review of Appointed Actuaries, and their supporting Actuaries in Life Offices*

This area proved the most controversial subject considered by the Working Party. Many views were expressed publicly and in private to members of the Working Party. While some of the methods given above might be appropriate in many circumstances, there may be situations where external audit is the only route. The Life Board of the profession is working with the FSA to determine whether the current form of Appointed Actuary system can be integrated within the new environment. The need for an effective robust compliance review process forms part of that discussion.

The work of Appointed Actuaries is already more subject to informed external scrutiny than is that of most other actuaries subject to mandatory guidance. Paragraph 5.4.1 explains the work done by the GAD. This work does not normally extend to monitoring those parts of GN1 and GN8 which are not reflected in Schedule 4. Most firms of auditors now use an actuary to scrutinise the accounts prepared under the Companies Acts regime, and, as part of this, they normally discuss the statutory valuation basis with the Appointed Actuary. In addition, many companies also use external firms of consulting actuaries to advise on the value of the business in force, and again they will normally discuss the basis with the Appointed Actuary. In forming our proposals we were well aware of this fairly heavy burden, and are anxious to avoid it being exacerbated. Hence, our proposals suggest that the practice review could become an extension of work already carried out by one or other of those external parties, where appropriate. This does not, of course, preclude the work being carried out by other parties if felt to be more appropriate.

In considering the role of the Appointed Actuary under the new supervisory regime, the Life Board produced a paper ('The Role of the Appointed Actuary under the New Supervisory Regime'). This was produced in connection with discussions with the FSA in June 1998. The following paragraph — Section 6.2 of that report is:

> "It has also been suggested that FSA may wish to carry out quality control of the Appointed Actuary's work. We support, in principle, the idea that the profession should be able and willing to carry out an effective audit when necessary. We believe that this would help to resolve a perceived conflict in the current position (since it could confirm the

employed Appointed Actuary's freedom from inappropriate influence from the business). We believe that it is important that this monitoring task is outsourced from FSA either to the profession or to the Civil Service (presumably the Government Actuary's Department). We also believe that it is important that such a review of the Appointed Actuary's work should be about matters of financial significance to the company or to its customers (as individuals) rather than concerned with the detail of regulation."

In line with the thoughts expressed above, there were four approaches to external monitoring considered by the Working Party. These are set out below.

6.8.1 *Extension of the role of the Government Actuary's Department*

At present the GAD has responsibility to the Government to supervise clearly defined aspects of the running of life offices. The proposal being made here is for an extension of that role, but in a different direction. The proposed role would involve the GAD reporting to the profession as well as to the Government. This role would be different and distinct from the one it carries out for the Government. However, the two roles could be carried out in conjunction, leading to economies of scale.

Complementing 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 its existing role. We endorse the principle in the paper of the Life Board, referred to above, that there should be effective monitoring of the work of the Appointed Actuary. This should include verification that all professional standards have been adhered to. It would, therefore, be proper to invite the GAD to extend its review of the actuary's work on behalf of the FSA to include a specific review for the profession of whether professional standards had been properly observed in all areas. There would need, however, to be further consideration of the scope of the review, and whether any potential infringements would be referred to the profession or to the FSA for possible further action (given that the Appointed Actuary is required to certify to the FSA that certain mandatory Guidance Notes, i.e. GN1 and GN8 have been complied with). It will be necessary formally to ask the GAD to take on this role, if the profession decides that this is the proper course.

6.8.2 *Extension of the audit firm's role*

An alternative suggestion relates to the role currently carried out 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. Such a review could take place at a different point in the year from the main audit work. In the view of some actuaries this would have serious consequences for the role of the Appointed

Actuary. An external audit review of all actuarial work, including confidential reports to the board of the life office could involve fundamental changes to the role of the Appointed Actuary and the structure of our profession, and this would not necessarily be desirable, as it might diminish the role of the Appointed Actuary.

6.8.3 *Use of external consulting actuaries*

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. Nevertheless, as for the GAD and the audit firm above, this particular role would be carried out on behalf of the profession.

6.8.4 *Use of the team appointed by the profession*

This last alternative could 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.

7. Horses for Courses: Appropriateness of the Various Methods

The Working Party then considered the appropriateness of the various methods.

7.1 *Internal Compliance Review*

This method of monitoring is expected to be easy to introduce for consultancies. The method lends itself to firms with a number of actuaries advising in the same area. It was also felt appropriate for life offices with relatively large valuation departments, where several actuaries with considerable experience were assisting in the preparation of the returns for the regulatory authorities and for reporting under the Companies Act. This method was less appropriate for small firms, where there might be only one experienced actuary.

7.2 *Internal Actuarial Audit*

The application of this method would be similar to that for internal compliance review, mentioned in ¶7.1. For both of these methods, special situations arise for sole practitioners or firms with a very small number of actuaries. Reciprocal arrangements could be set up, as already exist in some circumstances, between small firms. These firms would, naturally, need to trust each other not to poach business from each other. It would also be necessary to alter the terms of contract between clients and actuarial firms, to acknowledge that the work might be reviewed by employees or partners of another organisation.

This approach would have more limited application in life office situations, but both a peer review and actuarial audit should be applicable to pension scheme actuary work done in a life office.

7.3 *Questionnaire*

Consideration was given to compliance questionnaires forming part of the practising certificates application form. However, after some discussion it was felt best to keep the matter of practising certificates separate from the return of questionnaires for timing and resource reasons. It was agreed that members should be required to have submitted the questionnaire within 12 months of renewal, thus giving the Practising Certificates Committee the opportunity to consider any areas of possible concern in advance of the next application. Initially, these questionnaires are likely to be appropriate only for Appointed Actuaries, Scheme Actuaries and holders of the new Lloyds' certificates.

A broad outline of a compliance questionnaire would be prepared, but it would be for the Practice Boards to prepare the detailed questions relevant to their own areas. The role of the Professional Affairs Board would be to ensure consistency across all Boards.

The questionnaire would have to be designed in such a manner that the profession's secretariat could, in the first instance, filter out the straightforward ones. There would have to be a committee, similar to the existing Practising Certificates Committee, to review problem questionnaires and flush out the problems.

7.4 *Annual General Report from the Senior Actuary*

It would be necessary to identify the senior actuary within firms and life offices.

The paper would include items relevant to the firm or life office in question. Clearly the response from a sole practitioner would be substantially different from that from a life office.

7.5 *Compliance Certificate*

The Committee referred to in Section 7.3 is likely to be the appropriate body to issue the compliance certificates.

7.6 *Practice Review*

It was felt that the existence of this review would concentrate minds on tightening up standards. The frequency of practice review might be determined by the existence, or otherwise, of the internal compliance review and internal actuarial audits, and reports by the senior actuary. Practice reviews would be limited by cost and availability of suitable reviewers. These would have to be on a very selective and sample basis, at least at the start.

7.7 *Life Office Actuary Monitoring*

The monitoring of an Appointed Actuary, in addition to the method outlined in ¶¶6.1 to 6.4 where appropriate, would be supplemented by a practice review, as set out in Section 6.7, using one of the approaches of Section 6.8, at the choice of the life office. Practice review of other actuaries, such as the reporting actuary, might not be appropriate at this stage, as his/her work may not be subject to mandatory guidance. Attention might be given to GN22 on disclosure, and, at some stage in the future, the whole question of product design and marketing, particularly as far as it relates to PRE. Examples might be the role of the reporting actuary and those involved in product design and marketing.

7.8 *General Insurance Actuary*

The methods described in ¶¶7.1 to 7.6 would be appropriate for actuaries working for external firms who are asked to provide a report or certificate for a general insurance company or Lloyds' syndicate. For actuaries directly employed by an insurance company or managing agent, then the approach described in ¶¶6.8.1 to 6.8.4 could also be relevant in respect of any formal reports or certificates produced by the actuary. For other assignments undertaken by employed actuaries for their own firms, then ¶¶7.1 and 7.2 could be relevant for monitoring compliance with PCS and any relevant guidance notes.

7.9 *Pensions Actuary Monitoring*

There are a considerable number of guidance notes which need to be monitored, the most important of which are GN9 and GN11 and all those arising under the Pensions Act. All the methods described in ¶¶7.1 to 7.6 would be appropriate. However, there may be practical problems for small consultancies and the pensions departments of life offices, where lack of resources may dictate the need for external audit in order to satisfy the profession's requirements. However, it is important that all firms, whatever their size, fall within the ambit of the proposals.

8. Pilot Testing

The Working Party believes that pilot testing of the practice review process is both appropriate and necessary. A formal pilot testing exercise will enable regular two-way feedback between the membership and the responsible Standing Committee (see ¶12.2) of the Professional Affairs Board, which, we envisage, will be in charge of the project. It will therefore help to build confidence on the part of members that their views will be constructive in developing the processes that will ultimately emerge. It will also ensure that the final processes which emerge are truly workable.

Pilot testing could be carried out initially on a voluntary basis. Any non-compliance discovered during this process should be dealt with on a sensitive and supportive basis. The Professional Affairs Board will need to give guidance as to how to handle the unlikely event that a serious problem of non-compliance could be discovered, and may consider an exemption under Section 2.9 of the Professional Conduct Standard for this purpose. This would avoid an automatic formal complaint against a member who had volunteered for the pilot, and where monitoring indicated a problem. It is likely that these exemptions would apply only to the pilot cases, and not to subsequent monitoring.

It will be helpful if the firms, life offices and individuals who volunteer for pilot testing comprise a good range of size and type of firm and life office, so as to represent, as far as possible, the full range of firms/life and general insurance offices/individuals who will ultimately be subject to the finalised procedures. Further thought will need to be given as to how to encourage such a spread of volunteers.

9. Costs

9.1 *Internal Compliance Review and Internal Actuarial Audit*

The additional costs within a firm or life or general insurance office would relate to the number of hours another actuary would spend reviewing work and the extent to which similar reviews already take place. In respect of the internal actuarial audit, this would be between half a day and a day for each qualified actuary being reviewed, and, in respect of the internal compliance review, would be between a quarter of an hour and, at most, two hours, depending on the size of the document being reviewed. These times could be multiplied in the case of consulting firms by typical charge out rates (between £160 and £250 an hour for consultancies) to arrive at the cost.

9.2 *Fees for the Services of Reviewing Actuaries*

These actuaries might be retired actuaries, or possibly, in some instances, staff actuaries of the Secretariat. The fees are likely to be of the order of £500 a day.

9.3 *Outside Audit Firm for Life Office Review Work*

The cost of such a review is difficult to estimate without specific terms of reference, and will vary according to the complexity of the office.

We estimate that the time spent conducting such a review for a medium-sized office might be of the order of one man week, assuming that the audit firm is already responsible for the external audit of the life office involved.

9.4 *Secretariat Fees for Reviewing Questionnaires*

It is envisaged that this function will fall under the ambit of the Professional Affairs Board, and would initially either be subsumed into the existing Practising Certificates Committee (albeit that, perhaps, a smaller sub-group will be formed to deal with problem questionnaires) or subsumed into the existing Compliance Committee. Initially, only those actuaries requiring Practising Certificates will be asked to complete a questionnaire, and the information would primarily be sourced by the Practising Certificates Committee when reviewing applications for certificates.

There are presently *circa* 800 Scheme Actuaries and 160 Appointed Actuaries, and it is assumed that there will be *circa* 100 actuaries requiring Practising Certificates for issuing Lloyd's opinions. In total, therefore, there are likely to be an initial 1,000 questionnaires to examine each year. Until the length and content of the questionnaire is determined, it is not possible to scope accurately the additional work involved, but, assuming an average of 15 minutes to review and action a questionnaire (based on an assumption that the majority will be straightforward and only a minority will require additional investigation), this equates to about five hours per week.

This would require to be found from within existing resources. If this was subsumed into an existing committee, then there would be minimal additional outlays. If the questionnaire was extended to all members of the profession, however, it will have a major impact on resources, which would have to be reviewed in light of the experience and feedback from dealing with Practising Certificate holders only.

10. Recommendations for Discussion

The Working Party recommends the following procedures for monitoring compliance. They fall into 3 stages.

10.1 *Stage 1*

It is anticipated that Stage 1 would last for one to two years after implementation. Internal compliance review and internal actuarial audit, along guidelines provided by the profession, should be put in place as soon as practicable by firms and life offices on a voluntary basis, and this will be actively promoted by the profession. A compliance questionnaire prepared by the profession should be compulsory for members applying for, or reapplying for, practising certificates. An annual report from the senior actuary should also be compulsory for firms and life offices where such a post exists, and this will be firmly recommended in all cases.

Pilot testing of practice review should take place during Stage 1. Firms and life offices should be asked to volunteer to participate in the pilot testing.

Unless very severe problems were found with such firms and life offices, they could expect to be put at the end of the list for future practice reviews.

10.2 *Stage 2*

This should commence after the pilot testing carried out in Stage 1 has been reviewed. Internal compliance review and internal actuarial audit should continue on a voluntary basis, and practice reviews should 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 three years would be appropriate for life offices, carried out by the profession's team, the GAD 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. The details of implementing Stage 2 might alter as a result of feedback from the pilot testing.

10.3 *Stage 3*

A review of procedures should be conducted by the Professional Affairs Board after an appropriate time, to see how they are working (no longer than four years after the implementation of Stage 1).

11. Need for Publicity

11.1 *Taking the Profession with us*

For the proposals to succeed, the goodwill and co-operation of the membership as a whole will be essential. The suggestions made in this paper for monitoring compliance represent a significant change from the existing methods used. The existing methods (see Section 5) represent largely a reactive approach, whereby, generally, the Compliance Committee of the Professional Affairs Board merely responds to complaints or referrals put to it.

The recommendations made by the Working Party, on the other hand (see Section 10), will, if adopted in the way suggested in this paper, change the monitoring process to a much more proactive approach. Individual actuaries and their actuarial colleagues will become formally accountable for the internal compliance review and internal actuarial audit processes envisaged in Stage 1 (see ¶10.1). Although these internal processes will apply on a voluntary basis, it is expected that many members will adopt them as part of good business practice. It is envisaged that the senior actuary report will be compulsory under Stage 1, and the practice review process will apply on a compulsory basis under Stage 2. The latter will bring in external actuaries to review the professional practices of the firm and its individual

actuaries. Moreover, this paper recommends that the completion of compliance questionnaires will be compulsory for actuaries applying or reapplying for Practising Certificates from Stage 1.

The Working Party believes that these recommendations are necessary to achieve the objectives set out in Section 2. It is believed that they should not be too onerous to operate. For a number of firms they will do little more than formalise existing good practices. Nevertheless, these recommendations will involve significant changes to current procedures operated by the profession. The fact of change, the additional compliance workload which will result (although the Working Party hopes that this will not be significant), and a natural resistance to having one's own work inspected by others under practice review (in particular by actuaries external to the actuary's own firm) might be unwelcome to some. In addition, the Working Party appreciates that firms and life offices may be concerned about confidentiality being maintained and the costs of practice review.

While our proposals are considered to be in the best interests of the profession, the Working Party accepts that a negative reaction is possible, at least initially. It hopes, however, that the steps set out below will help to reduce this reaction and, instead, encourage the approval and co-operation of the membership as a whole to the processes recommended. Clearly it is crucial for the success of these compliance monitoring procedures, and thus the achievement of the underlying objectives, that the membership agrees and works with them.

The Professional Affairs Board and FIMC have agreed the Working Party's recommendation, that the following steps should be implemented:

— There should be (and be seen to be) transparency and openness with the membership from those in charge of the project each step of the way.
— The issue needs widespread consultation amongst the membership of the profession, and should be the subject of a discussion paper presented at a Sessional Meeting (Faculty and Institute).
— Such open communications should be continued by the responsible Standing Committee of the Professional Affairs Board throughout all the key stages of the initiative. As noted above, the co-operation of the membership is crucial to its success — the purpose of this communications exercise will, therefore, be to give and receive regular feedback on how the project is implemented. This contact with the membership will 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 will help to build confidence on the part of the membership in the processes that will 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.

— Communications with the membership will be reinforced by separate formal pilot testing of the practice review for compliance monitoring. Firms and life offices will be asked to volunteer to participate in the pilot testing exercise (see Section 8).

11.2 *Explaining to the Public*

A key objective of the initiative is that the profession should be, and be seen to be, more accountable to the public (see ¶2.6). 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 under way, it will 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. This part of the project should be referred to the Public Relations Committee to develop further.

The Working Party feels, however, that the public relations aspects of this initiative will 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.

Again, this is an aspect which should be referred to the Public Relations Committee to consider further.

12. Work Required

12.1 Practice Boards should be asked to produce standard compliance review and actuarial audit forms based on the draft generic audit form and draft generic compliance review form attached as Form 1 and Form 2 respectively, and a relevant compliance questionnaire based on the generic questionnaire attached as Form 3.

A draft standard senior actuary report, based on the draft attached as Form 4 will also be needed, to be drafted by the Professional Affairs Board and reviewed by each Board before implementation, as well as a list of points to be covered in a practice review and a standard practice review report.

These items should be based on the suggestions in this paper, and could draw further upon the experience of the Canadian actuarial profession's documents and those used by UK200.

The Professional Affairs Board should oversee the above documents produced by the Practice Boards to ensure consistency among them.

12.2 The Professional Affairs Board should also set up a Standing Committee, to oversee procedures, and a Compliance Questionnaire Committee (separate if necessary).

The Secretariat needs to budget resources to run the committees and other aspects of the regime outlined, including production of the standard materials referred to above.

The Charter Rules and Byelaws Committee should consider what changes would be required by the new arrangements.

12.3 The Professional Affairs Board needs to consider how to manage and monitor the progression of the recommendations.

12.4 The Practice Boards may wish to consider areas for future monitoring (e.g. the Pensions Board may wish to consider Section 67 Certificates and the Life Board may wish to consider product development and growth rates in premium calculations).

12.5 *Who Pays?*

We have not, at this stage, considered the issue of who would pay for the costs discussed above, but would draw attention to the fact that substantial costs to the Institute and the Faculty could arise.

In particular, it will be necessary to address the question of who pays for external reviews. This might be the profession, who might seek payment from members, and, in turn, recompense any members or team carrying out external reviews.

13. Conclusion

The ideas and proposals set out in this paper are submitted to the profession for consideration as a package of measures, to achieve the objective set out in the terms of reference.

The Working Party has already taken steps to obtain the views of employers of actuaries in this area. The purpose of this paper is to stimulate discussion among the whole of the actuarial profession in the U.K. on this subject. Views on all aspects are very welcome, but, as an aid to debate, the following points might be discussed:

(1) Whether the review should monitor the quality of advice given as well as adherence to specific guidance.
(2) Whether practice reviews should be introduced on a compulsory basis, or on a voluntary basis, as proposed by the Institute of Chartered Accountants in England & Wales.
(3) Whether monitoring of life office actuaries should be an extension of activities already carried out, either by the GAD or others, or whether a completely separate review is desirable.

(4) Whether the completion of a compliance questionnaire would form an appropriate conduit of information and problems relating to actuaries in the relevant field.
(5) The way in which issues of confidentiality between an actuary and his client or employer can be dealt with, where a third party has sight of the advice provided.
(6) The best way to deal with the issues arising when an actuary, carrying out a practice review for the profession, comes across a major problem which, according to the Professional Conduct Standard, should be reported as an example of professional misconduct. Whether to deal in different ways with problems under this heading, arising under the pilot testing, and those arising after full implementation.
(7) Who should pay the costs of the monitoring of compliance, and how much would a practice review cost for the different kinds of projects in which actuaries advise.

APPENDIX A1

ARE STANDARDS UNDERSTOOD?

Canadian Institute considers practice review process

An article by Robert J. McKay published in the January 1999 edition of *The Actuary* — the Newsletter of the Society of Actuaries

During the second half of 1998, members of the Canadian Institute of Actuaries (CIA) debated implementing an 'inspection system' for the profession in Canada. The proposed system was described in the report of the CIA Task Force on Compliance Review. Because of significant opposition to the details of the proposal, the CIA is now reviewing other alternatives for practice review, including implementing parts, but not all, of the inspection system model.

The task force's report was issued in July 1998 and has been discussed and debated in town hall meetings. Although the task force proposal for practice review is likely to be modified based on comments from these meetings, the current proposals may be instructive for SOA members.

The term 'practice review' refers to the actuary's total practice. This differs from peer review, in which a specific piece of work is examined. Alternatives to practice review include compulsory peer review and detailed annual questionnaires on compliance, ideas the CIA might consider in the coming months. The CIA implemented a questionnaire several years ago; one option might be to expand this instead of implementing a full practice review.

During the town hall meetings, many actuaries asked what problems would be solved by practice review. The concerns raised by the task force are unique neither to Canada nor to North America. Peter Morse, CIA president, responded at a November meeting of the CIA membership:

> "In order to be in a position to respond to increasing concerns expressed regarding the range of practice of actuaries in some practice areas, the profession needs to be aware of whether the standards are being understood and followed and to discover where the standards are deficient. In addition, education of our members concerning the range of practice is also perceived to be a responsibility of the profession."

He went on to say, "To suggest that no action is necessary because 'we are actuaries, and each of us as individuals knows best' [as one member put it at a town hall meeting, 'Let the regulators send any case they don't like to Discipline' (the CIA Committee on Professional Conduct)] will get us nowhere and could lead to regulators and legislators taking control of areas which we consider as our domain."

Why did the task force feel that the CIA should take this major step? It identified several potential benefits of a practice review policy. Such a policy would:

— Ensure that members understand proper actuarial standards and the application of those standards to their work.
— Identify areas where standards are deficient or unworkable.
— Bring about changes in practice by persuasion where wide variations of practice in similar circumstances are discovered.
— Call the situation to the attention of the CIA Committee on Professional Conduct, where matters are discovered that question the competence or integrity of the practitioner.

The task force concluded that practice review should only apply to work in Canada by a member in support of the member's public actuarial opinions. This would include actuarial opinions in published documents, plus all opinions of an actuarial nature that are required to be provided by a Fellow of the CIA, that must be filed with a Canadian regulator, or that may be included as evidence by parties to a lawsuit.

The task force developed a proposed review system that includes two levels of review. Tier one would be an annual questionnaire for all practice areas. Tier two, the more controversial recommendation, would be an in-office review of practices and procedures for the practice unit on a random cycle. The task force expects that a review would involve up to 50 hours of time. Tier two reviews would be initiated either as a result of information discovered in a tier one review or by random selection. All practice units would be visited at least once every five years.

A major concern among practitioners is who would conduct reviews. With only about 2,000 actuaries in Canada, conflicts of interest and professional competitive practices are real concerns. To address this, the report stated that the CIA should hire a staff actuary to support the development of detailed procedures and to provide day-to-day management of the process.

The task force also recommended that persons engaged by the CIA should conduct all practice reviews. It also stated that reviewers must not be active practitioners or at least have no conflicts of interest with the practice unit, its members, or the cases being reviewed. It also recommended that the CIA Committee on Practice Review should have no knowledge of the identity of the practitioners or client files associated with a given review.

The task force stated that the in-office practice reviewer should be able to request any detailed information necessary to support a review of a practitioner's work. In some cases, this could require additional calculations or other tasks. Members should be required by rules of professional conduct to co-operate with the practice review process.

In a recent note to CIA members, Morse summarised the major criticism of the proposals. These included the seemingly intrusive nature of the proposed processes; the estimated cost of the program compared to perceived added value to the membership; the perceived lack of sufficient numbers of competent yet independent reviewers; the burden such reviews would place on the practice unit, particularly for small operations and sole practitioners; and the lack of a demonstrated need for the process in those practice areas where robust peer review practices are already in place. According to Morse, member reaction tended to be more negative among pension actuaries than those working in insurance, and reaction was strongly negative among actuaries working in small practices.

While the final form of practice review in Canada may differ from the current recommendations, it is likely that the CIA will eventually implement some form of review. And the concerns raised by the task force are unique neither to Canada nor to North America. In his presidential address, Paul Thornton, 1998-2000 President of the Institute of Actuaries, observed:

> "Professional judgement used to mean that, with skill and experience, the professional knew best — and at one time professional judgement would have been accepted without question. We now live in an era where professional judgement is under challenge in a way in which it was not in the past, and we will retain respect as a profession only to the extent to which we earn it and keep re-earning it."

Robert J. McKay, consultant, Hewitt Associates, Toronto, is an associate editor of *The Actuary*.

APPENDIX A2

WHITHER PRACTICE REVIEW?

An article by Paul F. Della Penna, published in the May 1999 edition of the *Canadian Institute of Actuaries Bulletin*.

The topic of practice review has received a lot of attention in the past few months in general meetings, regional 'town hall' meetings and on the general list. The Task Force on Professional Conduct (TFPC) was handed the task of digesting member input to the recommendations (for the Institute's adoption of a program of practice review) released last August by the Task Force on Compliance Review. In all, ten regional meetings were held. Member response to the proposed initiative ranged from lukewarm to hostile. Also, a total of 56 individuals returned the questionnaires that we distributed. In response to the single question whether the recommended program should be adopted ASAP or within three years or five years or never, of 33 pension practitioners, 23 said 'never,' while of the 17 life respondents, seven said 'ASAP' and seven gave no answer.

Given this response, Council revised the mandate of the TFPC to make it clear that we were under no obligation to implement the practice review recommendations. They also asked us to explore alternatives that would give a greater emphasis to education. While the task force has reached no conclusions as yet, we are anxious to put some of these thoughts before you in advance of the annual meeting in June, and this Bulletin article seemed to be the most practical way of doing so.

What We Shouldn't Do

One idea that appeals to a number of actuaries is that, since the life actuaries were generally supportive of practice review, and, since OSFI is pressing us in this practice area, we should adopt practice review only for life actuaries. By practice review, I mean a process that involves a review of a practitioner's work by a representative of the professional body responsible.

I believe that it is a fundamental error to consider having a form of practice inspection by whatever name for some actuaries but not for others. It is okay to define a certain type of work (e.g. public opinions), but it makes no sense to single out life actuaries, in-house actuaries, male actuaries, actuaries over 60, sole practitioners, or any other subset. For the CIA to adopt practice review for life actuaries and not for others immediately raises the question, why them? Is it because we have doubts about the quality of their work? Is it because their work is more important than that of others? Of course, there are other ways of interpreting such an initiative that reflect equally unfavourably on the Institute (e.g. we impose requirements like practice review only on members who don't object to it, or only to those

areas of practice where regulators are especially demanding). On the other hand, CIA initiatives of this nature that apply to all actuaries are quite easily explained as being motivated by the desire to make continual improvements to a product that is already of high quality.

Please remember that OSFI is encouraging the CIA to introduce a peer/practice review system for all practice areas, starting with life actuaries. Rather than introduce practice review for life actuaries only, it is better to tell them now that we cannot proceed without the substantial support of our members, but that we can do 'something else.'

What We Should Do

The 'something else' that the task force is now studying is peer review, mandatory for public opinions (after a suitable transition period) and voluntary for other work, with CIA guidelines (standards?) for peer review. This is a giant step forward. The CIA today does not encourage or require peer review, nor does it have any guidelines. Yet the majority of our members already utilize peer review, as many of you pointed out in the regional meetings. It makes sense to build on that in order to promote quality work and to be perceived as doing so.

How does peer review differ from practice review? It is easy to become confused, particularly since some professional bodies use one term to mean the other. To me, 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-release and addresses a specific report or opinion. There are a number of variations of both practice review and peer review.

The task force is currently discussing how such a peer review system might operate among members of the Institute. In addition to consulting our members, the TFPC will be consulting a number of published reference works to help us as we go, but so far, we have identified some elements of a peer review process that could suit our needs:

(1) Peer review, especially in connection with public opinions, is something that applies to the member who takes responsibility for specific work. While a number of different actuaries may have participated in that work, a separate peer review would not be required of each participating actuary's work. Only one peer review(er) would apply to all the work supporting the opinion.
(2) Peer review is not about checking calculations and verifying data. It is good practice for the practitioner to do those things or have them done. One task of the peer reviewer should be to review the evidence of that (e.g. by confirming that someone has signed off as checker).
(3) The peer reviewer should meet the same test of competence for the work as the practitioner and should be capable of performing a review

objectively without being unduly influenced by the practitioner. Expressed that way, it is evident that internal peer reviews are okay, provided that a qualified reviewer can he found internally.

(4) While pre-release reviews are desirable because it is easier at that stage to deal with issues arising, on review, mandatory reviews for public opinions may he conducted on a post-release basis, provided that the review takes place within a reasonably short time.

Other specific issues that the task force is discussing include (1) the acceptability as a substitute for peer review of two or more actuaries taking responsibility for the work, and (2) how to deal in a practical way with the work of actuaries who produce a large volume of very similar, brief reports.

Where external reviews are necessary, there is a concern that it could be too costly, and the profession needs to be sensitive to that. Of course, costs can be expected to decrease over time if the same reviewer is used for several years. A number of sole practitioners have told us that they now have mutually satisfactory peer review arrangements with other sole practitioners. However, if CIA peer review guidelines are perceived as being too onerous, this is an area where problems might arise. In-house insurance actuaries will also be concerned about the cost of external reviews, and the profession must be sensitive to that too.

In accordance with the CIA's Statement of Purpose, which states that our actuarial services and advice provided to the public will be of the highest quality, our profession should seek to have good peer review practices become habitual across the profession, and then work over the years to gradually improve upon them. I believe that this is a goal all actuaries can share. The experience of those who practice it demonstrates that peer review improves the quality of our work, not only that of the practitioner, but also that of the peer reviewer. We all learn in the process.

Apart from peer review, our task force supports the recommendation that the existing compliance questionnaires be enhanced and changed to diminish the emphasis on compliance. They 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 'out there.' The compliance questionnaires can also be used to help the practice committees gather information on the application of standards as input to the process of standards development.

Paul F. Della Penna, FCIA, is chairperson of the Task Force on Professional Conduct.

APPENDIX B

U.K. ACCOUNTANCY PROFESSION — COMPLIANCE MONITORING

In Section 4.3.1 reference is made to the role of UK200 and the JMU in monitoring compliance of members of the accounting profession. Information obtained from a meeting with representatives of UK200 is set out in this appendix.

UK200 requires an annual return from its member firms. The reviewer arrives armed with the completed return/questionnaire, and also last year's report. There is also a comprehensive checklist and manual. These items are in both paper and electronic format, as required. The lists are both of the tickbox and short commentary variety. Internal monitoring (of audit regulations set by ICAEW) of two or three cases per partner per year is carried out. Small firms have mutual agreements with other small firms to review each other's work. UK200 reviewers look at the in-house reviews. They review the same files and reassess them, as well as conducting further reviews. The selection of cases is done by the reviewer, with highest risk cases first. Selection is from a list supplied by the firm. The process is carried out by interviewing as well as by looking at files.

UK200 awards grades for the quality of work done. For individual partners, these range from 1-5 (1 is best, 5 is worst). Most audits are 2s and 3s. Action is taken on the very few 4s. There are virtually no 1s. In addition an award is given for the firm overall. These range from A down to E. Most firms get B (but gradings of B+ and B− are possible). If a D is given, there is an investigation into further cases. There is then a quarterly summary of performance. If a firm fails the grade, it is removed from membership. This only occurs, however, after a warning review, following which a firm is entitled to receive help.

All audit work is monitored, and the reviewers are all experienced in this area. Other work is reviewed, but it is accepted that the reviewers may not have as much expertise in a speciality area as the professional under review. Examples might be pension scheme audits and share valuation work. There are specialist checklists for these.

Costs were initially covered entirely by commission from PI insurance. Most recently, however, two thirds come from this source, and the balance is paid for by the firm. The total fees are £215 per day for the reviewer and £190 per case by the administrator. The number of days depends on the size of firm. For small firms a day per partner would be appropriate, but this reduces with size of firm. For a two-man firm the cost would be about £500 in total, so a firm would contribute less than £200.

JMU

Turning to the procedures for the JMU, typically, for a small firm, the JMU visit occurs about every four to five years. There is also an annual return for JMU of 30-40 pages. The results are analysed by computer — so called 'desk top monitoring' — to identify high risk areas. JMU reviewers are full time employees — not necessarily older people.

The JMU was, reportedly, 'heavy-handed' initially, but changed its style to make it less so. There is concern about the make up of the profession's Ethics Committee (and the proposal to switch to having a majority of non-accountants on it). It is accepted, however, that professionals have to keep up to date or 'fall out'. There is some concern about the recent proposal for the JMU to make unannounced 'knock on the door' visits. This requires files to be kept continuously in good order, rather than tidying them up after the end of a major exercise such as the audit of a substantial company.

UK200 firms (and all firms for JMU purposes) have confidentiality clauses in their engagement letters/service contracts agreeing to external review. This is in small print. The clause says that a file may be selected and reviewed on a confidential basis.

Various examples of UK200 checklists were obtained.

APPENDIX C

INFORMATION FROM MEETING WITH THE JMU HELD ON 5 MAY 1999

In Section 4.3.2 reference is made to a meeting with the JMU. Information from that meeting is set out in this appendix.

The JMU explained that all three Institutes of Chartered Accountants had, or were 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 JMU are involved. A report is submitted to the Irish Institute, but this does not name the individual firms subject to review.

ICAS. At its Special General Meeting on 16 April 1999, ICAS 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 is being introduced with effect from 1 January 2000. Any firm which is subject to audit or investment business review within 12 months of that date will automatically be subject to a practice review at the same time as the audit and/or investment business 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, but not necessarily within the first 12 months.

Reports from the inspectors will be submitted to an ICAS committee, which 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 will be recharged to the firms being reviewed.

ICAEW. 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.

As stated, it will concentrate on quality of service, unlike investment business visits where the quality of advice is also looked at, although the JMU admitted that this was something of a grey area.

The intention is to make it profitable to firms, marketable and educational, and lead to a reduction in PI premiums.

Although plans are still being developed, it is likely that successful firms will be kite-marked by the ICAEW, and something tangible will appear on the notepaper. Again, if the firm fails it would be open to it to reapply. The JMU did voice concern of a possible first and second class status emerging between those with the seal of approval and those without, but, on balance, it considered that this should stimulate volunteers.

The JMU agreed that firms must know what they have to do to get accreditation, and it is looking at producing official guidance to be adopted by Institute Council, setting out practice management standards. It is not likely to be exposed to all members. However, as ICAEW is introducing this on a voluntary basis, this is probably not essential. There would, however, be a pilot study using external quality consultants before the scheme is introduced. It was noted that in Scotland and Ireland no full exposure of relevant guidance to members was undertaken.

The following key areas were discussed against the above general background:

(1) *Kite-marking*

As mentioned, ICAS, under its compulsory scheme, intend to remove the CA quality mark from those firms failing to meet the required standard. ICAEW intend to reward successful firms with some tangible stamp of approval which would appear on its notepaper.

(2) *Annual returns*

Annual returns are currently required by the JMU in carrying out investment business and audit reviews. It would be intended to apply this to practice review. The purpose is to ensure that firms are carrying out annual internal quality control reviews, and detailed help sheets are made available to firms as an *aide mémoire* for matters to be considered when conducting a whole firm review. This annual return is signed off by the compliance officer and is then run through the JMU's internal risk assessment programme to determine whether or not it might be appropriate to conduct a review outwith the normal three year review cycle. It should be noted that the major firms are inspected annually, as it is regarded as being in the public interest to do so.

When inspectors visit firms to check internal processes, they re-perform some of the work to check the same conclusions are reached. In audit review, every audit partner is subject to quality assurance review by one of his peers annually, and the designated audit compliance partner in each firm will sign off that this has been completed.

Small and sole practitioner firms have arrangements with other firms to carry out the annual review.

(3) *Timescale and fees*

The JMU confirmed that for a review of a four/five partner firm they allow two days to conduct an audit review, and estimated that a further one and half days would be required for practice review.

The cost of completing an audit for a four/five partner firm was £750 per inspector per day, although, to undertake practice review where all charges including overheads would be recovered, this was likely to be £900 per day per inspector.

It was noted that the JMU employs inspectors on a full time basis spread throughout the country, including two in Scotland.

The actual fees charged by the ICAEW for audit registration was based on a grading system. For a sole practitioner with one office it would be £260 p.a., rising to £60,000 for large firms with a number of offices. This includes the fees for inspectors, as mentioned above, but does not include any subsequent follow up that might be required if a transgression is uncovered. Such follow up visits would be fully charged on the basis of the inspectors daily charge out rate.

(4) *Confidentiality*

Inspectors working with the JMU are required to sign annual 'fit and proper' certificates, which require them to disclose any information, such as previous employment, which might lead to conflict.

As far as engagement letters between firms and their clients, this was slightly academic for audit review and investment business review, as the JMU has statutory powers of intervention. It was agreed that this would be more problematic in practice review, and firms would need to consider their terms of engagement.

(5) *Risk of litigation*

The JMU recognised that the introduction of a quality stamp following practice review might lead to the risk of challenge. For example, if the JMU issues a quality stamp, then a third party may seek to sue the Institute if things go badly wrong in respect of service given to that third party by the accredited firm.

(6) *Reporting breaches and disclosure to professional body*

Accountants only report breaches to the professional body if it is in the public interest to do so, e.g. money laundering. Any minor breach of ethical guidance, for example, would not be disclosed.

It was noted that accountants working for Chartac Advisory Service were exempt from the Professional Ethics Code in respect of reporting breaches. Chartac is the body through which advisory services, on behalf of the ICAEW, is delivered to members, and it sends accountants into firms and, in exchange for a fee, advice is given to that firm.

(7) *Publicity*

The meeting agreed that this was vital. The JMU has on its Audit Regulation Committee and Investment Business Committee at least three non-accountants. The non-accountants are required to report to the DTI on public interest matters. In addition, the Committee is obliged to report to the DTI on the audit side, and meets with the FSA regarding investment business.

(8) *Soft report*

The JMU highlighted a practice adopted by the Canadians in Alberta, whereby a 'silent letter' or 'soft report' is made available to the firm without further reporting. This was seen as an informal and effective way of improving standards.

APPENDIX D

U.K. LEGAL PROFESSION — COMPLIANCE MONITORING

In ¶4.4.2 reference is made to the Law Society of England & Wales having introduced Lexcel in spring 1998. Information obtained from the presidential meeting is set out in this appendix.

The core Practice Management Standards are the basis for the 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; and
— case management.

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.

By having the assessments carried out by third parties on behalf of the Law Society, it will ensure that the process is seen as objective and rigorously quality controlled. The standard itself will remain under the control of the Law Society.

Only assessors who have achieved certain qualifications, have experience of the legal sector and have undergone special training, will be approved by the Law Society to take part in this scheme.

Appropriate checks will be made on the practices' SIF and disciplinary records before a certificate is awarded. After three years a full re-assessment is required.

The full costs are recharged to the practices involved.

(DRAFT)

GENERIC INTERNAL ACTUARIAL AUDIT FORM

(FORM 1)

Faculty and Institute of Actuaries

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(DRAFT) GENERIC INTERNAL ACTUARIAL AUDIT FORM

In preparing the standard form for a particular task, a Board should appropriately replace the wording in italics, particularly the reference to specific Guidance Notes (GNs)

The wording in heavy type are reminders as to the points to be taken into consideration in carrying out the review

1. Nature of file being reviewed, e.g. *GN22 assumptions: XYZ C Ltd Pension Scheme.*

2. Client's name, address and reference

3. Name and capacity of actuary responsible for file

4. Name of actuary leading team (if any) carrying out audit

5. File record

   - general appearance. **Is filing up to date? Is it chronological? How are faxes and e-mails recorded? Were deadlines met — if not, was explanation given to client?**
   - summary of contents
   - summary of earlier work
   - cross reference to other relevant files
   - reports in last twelve months. **Were ToR agreed? Was a plan of action drawn up? Is there evidence that work was checked? Were peer review procedures followed? Was any advice given over the telephone? If so, was it confirmed?**

6. Pre-report contact

   What contact was made with the client prior to the Report. **Was this by correspondence, telephone or attendance at meeting? If at meeting, did actuary attend? Was actuary accompanied by any other actuaries or member of staff? If so, what were their involvement with client?**

   Were any meetings documented and client sent copy of meeting minutes?

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7. Content of Report in last twelve months

- Objectives **(clearly stated?)**
- Data **(summarised?)**
- Assumptions **(stated and explained?)**. *Detailed questions will be required for each practice area and the various tasks within each area, e.g. in the life office area — solvency valuations, embedded value assessment, pricing etc. These will need to be developed by the relevant Practice Board.*
- Checks on calculations. **Were date of calculations recorded? Were any cross-checks carried out at the time of report?**
- Presentation of rationale of method and approach used **(clearly tested?)**
- Conclusions **(clearly stated?)**
- Was Report prepared in accordance with any timetable?
- Did Report refer to profession's guidance? Was the work in accordance with *GN* . . . and PCS?

8. Follow up to Reports

- What contact was made following issue of report?
- If meeting took place, did actuary signing off the Report attend the meeting? If not, why not? Who else attended? What was their previous involvement with the client?
- Was further work carried out as result of any meeting? Did this conform to standards?

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(DRAFT)

GENERIC COMPLIANCE REVIEW FORM

(FORM 2)

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FACULTY OF ACTUARIES INSTITUTE OF ACTUARIES

(DRAFT) GENERIC COMPLIANCE REVIEW FORM

In preparing the standard form for a particular task, a Board should appropriately replace the working in italics, particularly the reference to specific GNs

The wording in heavy type are reminders to the points to be taken into consideration in carrying out the review

1. Nature of document being reviewed *e.g. report on GN22 expense factors; report on transfer value basis.*

2. Client's name and reference

3. (a) Name of Report's author
   (b) Name of actuary who will sign report

4. Name of reviewer

5. Comments on draft report

   - Objective (**clearly stated?**)
   - Data (**summarised?**)
   - Assumptions (**stated and explained?**)
   - Presentation of rationale (**clearly stated?**)
   - Conclusions (**stated? are they reasonable?**)

6. Professional guidance

   Have you any reason to believe that the work is not in accordance with GN . . . and the Professional Conduct Standards (PCS) issued by the actuarial profession?

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OUTLINE FOR
GENERIC COMPLIANCE QUESTIONNAIRE
(FORM 3)

Faculty and Institute of Actuaries

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COMPLIANCE QUESTIONNAIRE FOR ACTUARIES

Note: Before completing the questions in this schedule, it is recommended that you review the appropriate paragraphs of the PCS issued in July 1999 and all relevant professional guidance notes.

{This schedule has been drawn up at present solely by reference to the PCS. It would need to be extended or supplemented to include the relevant points from the mandatory (or other) guidance notes in each practice area.}

1. **Identification of Parties**

   Does each report prepared during the year include all the relevant information needed to identify the parties to the report? . . . . . YES/NO

2. **Purpose and Scope of Report**

   Are the purpose and scope fully described in each report prepared during the year?. . . . . YES/NO

   Have any relevant restrictions on the application of the advice been [considered and] set out in each report? . . . . . YES/NO

3. **Level of Disclosure in Report**

   For **each** report prepared during the year:

   Was the methodology fully described to an appropriate level of detail? . . . . . YES/NO/N/A

   Were all the relevant assumptions listed? . . . . . YES/NO

   Were any changes to the methodology and assumptions set out and discussed in the report? . . . . . YES/NO/N/A

   Was each relevant factor discussed in the report?. . . . . YES/NO

   Were the results of all investigations adequately described and discussed? . . . . . YES/NO/N/A

   Was there sufficient information and discussion to enable the client to judge both the appropriateness of the recommendations and the implications of accepting them? . . . . . YES/NO

4. **Data**

For each report prepared during the year, were appropriate investigations undertaken to assess the accuracy and reasonableness of any data that was utilised for the purpose of preparing the report?
. . . . . YES/NO/N/A

Were any reservations about the reliability of the data set out in each report?. . . . . YES/NO/N/A

5. **Professional Standards**

For **each** report prepared during the year:

Were the implications of any actuarial advice set out in the report?
. . . . . YES/NO

Were there any perceived conflicts of interest in providing the advice set out in the report?. . . . . YES/NO

If so, please describe how these were reconciled . . . . . .
. . . . . .
. . . . . .

Were the implications for third parties of the advice considered?
. . . . . YES/NO

Were comments on the implications for third parties, or an appropriate disclaimer included in the report? . . . . . YES/NO

Were all relevant financial interests of the actuary or actuary's firm disclosed to the client?. . . . . YES/NO

Were any comments made about the work of other actuaries consistent with the requirements of Sections 10 and 11 of PCS? . . . . . YES/NO

Are you satisfied that each report was prepared in compliance with the appropriate professional guidance notes and the PCS?. . . . . YES/NO

If not, have you maintained records which include appropriate justification for any non-compliance ? YES/NO

Did you consult a Professional Guidance Committee to discuss the reasons for the non-compliance and/or get approval for your actions?
. . . . . YES/NO

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6. **Transmission of Advice**

Was each report forwarded direct to the client? . . . . . YES/NO

If not, please set out what alternative steps were taken to comply with paragraphs 7.2 of PCS. . . . . .
. . . . . .
. . . . . .

7. **Documentation**

Was there a properly ordered file of correspondence and relevant calculations maintained for each report produced?. . . . . YES/NO

Were the figures shown in each report on file cross-referenced to the relevant calculations held on file? . . . . . YES/NO

Were all calculations on file checked by individuals at an appropriate level? . . . . . YES/NO

8. **Feedback**

Were there any areas where compliance with the PCS and GNs caused significant problem? . . . . . YES/NO

If yes, please give brief details. Suggestions for improvements to the guidance are welcome.. . . . . .
. . . . . .
. . . . . .

Are there any other areas where you would seek an improvement?
. . . . . YES/NO

If yes, please give details. . . . . .
. . . . . .
. . . . . .

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9. **Self-Certification**

I certify that I have the appropriate knowledge and experience to have completed all the assignments undertaken by me during the year, and that each report, and the underlying [investigations and other] work undertaken, fully complies with all relevant [legislation] professional standards and guidance.

I hereby affirm that, to the best of my knowledge and belief, the answers given above and in my accompanying letter are complete and accurate.

Signature . . . . . .

Date . . . . . .

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(DRAFT)

SENIOR ACTUARY REPORT

(FORM 4)

Faculty and Institute of Actuaries

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FACULTY OF ACTUARIES INSTITUTE OF ACTUARIES

(DRAFT) STANDARD SENIOR ACTUARY REPORT

The Report, to be signed by the Senior Actuary of the Company or Firm, shall state, if such be the case:

1. that in his opinion the Professional Conduct Standards, mandatory professional Guidance Notes and certain advisory notes relevant or the actuarial disciplines operating within the Company or Firm have been complied with;

   A list of the actuarial disciplines within the Company or Firm is to be appended showing, for each discipline, the relevant guidance notes which have been complied with.

   Note: Members of the profession will be advised as to which advisory guidance notes (if any) are to be included.

2. that procedures are in place to monitor compliance with the professional Guidance Notes applicable, as detailed in the attached documents;

   Copies of the Company's or Firm's monitoring procedures to be appended.

3. that in his opinion satisfactory peer review, checking and monitoring procedures are in place in respect of all actuarial work carried out by the Company or Firm; and

4. that he has drawn the CPD requirements of the profession to the attention of all actuarial staff within the Company or Firm.

If the Senior Actuary is unable to make any of the above statements, he should explain the circumstances and, if appropriate, append a plan by which procedures will be put in place to resolve deficiencies.

In addition, the Senior Actuary is invited to comment further on the above issues or other professional issues if he so wishes.

ABSTRACT OF THE DISCUSSION

The President (Mr C. W. F. Low, F.F.A.): It is my pleasure to welcome some official guests to this very important meeting. They are Mr Wason, President of the Canadian Institute of Actuaries; and from fellow professions in Scotland we welcome Mr Tombs, the Secretary to the Royal Incorporation of Architects; Mr Murnin, Past President of the Royal Institution of Chartered Surveyors; Mr Scanlan, President of the Law Society of Scotland; and Mr Monaghan, President of the Institute of Chartered Accountants. I also welcome one of our Honorary Fellows, Mr Paul McCrossan, who has come over for this meeting from Canada.

The subject of the meeting is the discussion paper 'Monitoring Compliance with Professional Guidance'. This has been prepared by the Compliance Peer Review Working Party of the Professional Affairs Board, chaired by Mr David Martin.

Some of the genesis for this paper derived from my own Presidential Address, where I mentioned that I wondered how long it would be before the profession would have to have a meeting such as this. I was not intending to stimulate a debate. Nevertheless, that is what has occurred.

Mr D. B. Martin, F.F.A. (introducing the paper)**:** The paper has developed from a report to the Professional Affairs Board (PAB) and the Faculty and Institute Management Committee (FIMC). The development has taken place over many months, and latterly the Working Party was asked to convert the report to a paper, as it was firmly believed that this subject is something which the profession, as a whole, needs to discuss before decisions are made about how — and, indeed, whether — to proceed.

Many ideas emerged, and these have been set out in the paper, with commentary. Most of these ideas have been incorporated into a possible plan, in what was intended to be a practical and pragmatic way. Comments, both on the individual ideas and the overall plan, would be very welcome.

Our proposals are aimed at all our activities to which the Professional Conduct Standard and the Guidance Notes apply. Although a considerable part of our discussion has centred around Appointed Actuaries, as their position has raised many issues, we are certainly concerned equally with all fields of actuarial work.

The subject is not wholly uncontroversial, touching, as it does, on the public interest issues discussed in the profession in recent years. So, it is appropriate to put these ideas to a meeting of actuaries, along with a few guests from the accounting, legal and other professions, including those who have helped with the review. Our profession differs from that of the accountants, in that we are individual members of our Institute and Faculty, but these two organisations of ours have no direct influence over the firms for which we work. As a result of this, it was felt appropriate at FIMC that, prior to this meeting and the seminar held in London on 2 February, discussions should be held with a selection of employers. It was felt that no alteration to our monitoring arrangements can be achieved successfully without the support of these employers. Letters were sent out to employers inviting a meeting. Some written responses were received, and some meetings were held. Regrettably, but naturally, it was not possible to contact all employers of actuaries.

Employers were asked about their existing procedures. It is apparent that most firms have procedures in place, although these are not always formalised. If we take the case of life insurance, for example, 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 paper could be incorporated without difficulty.

Secondly, employers were asked if the suggested measures would enhance the standing of actuaries within their organisation. The majority view seemed to be 'no', although there was a small proportion who believed that there would be some enhancement. Most of the 'noes' felt

that the effect would be neutral, with only a few commenting that it would have a negative effect. Certainly 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.

Views were sought on which areas of actuaries' work should be monitored. Many, particularly those working with auditors, considered that only those areas of work covered by practising certificates should be monitored. This might tie in with the idea of the costs of the exercise being met through practising certificate fees. Some felt that picking out certain advisory notes for monitoring and not others was inappropriate, and no doubt the existence of a monitoring scheme would affect the drafting of future guidance notes. There was a number of responses suggesting that all areas of work should be monitored.

The question of costs and how they should be borne was raised. There was some support for a certain proportion of the costs being met by subscriptions and practising certificate fees. The balance would be paid by the firm in question if a more detailed review was required. However, there was no consensus on costs, as some felt that the profession should meet the cost entirely (presumably from subscriptions), and some felt that firms should meet all the costs.

The preferred body for undertaking the external review was discussed. Taking the position of life assurance first, there was a fairly even split among life offices between those who would prefer the GAD and those who preferred actuaries working for their auditors. It is fair to say that many would regard their choice as the 'least worst option'. The idea of other competitor consultants undertaking the review was most definitely not welcomed.

Accountancy firms and some consultancy firms were supportive of the Joint Monitoring Unit (JMU) carrying out such a review. This body was set up to carry out reviews for the accountancy profession, and assists our Institute with Financial Standards Authority (FSA) compliance matters. There did not seem to be a huge enthusiasm for a team appointed by the profession.

Other comments made suggested that there was a substantial amount of support for improved internal reviews. 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.

Some felt that external practice reviews should be compulsory; others felt that they should be voluntary. Some were distinctly not keen on the idea at all. Some felt that only very small firms with one or two actuaries needed external review, but this view was not necessarily shared by these one-man bands.

There was certainly some support for the idea of a questionnaire, not necessarily to provide monitoring information, but as a means of reminding actuaries of their duties, and for them to express their views on areas where there were difficulties or where there was scope for improvement in compliance matters.

Some felt that arrangements like this were necessary, because otherwise the FSA or other organisations would regulate actuaries. Others felt that an FSA regulatory regime would be more acceptable than the profession's own regime, and that they would not want to have both.

While considering whether or not the FSA or other authorities might wish to regulate actuaries, it is worth considering some comments that we have received from Mr Paul McCrossan, the Past President of the Canadian Institute of Actuaries and Honorary Fellow of the Faculty. He has been deeply involved with compliance monitoring issues in that country. He tells us that a Canadian regulator is requiring external peer review of a limited number of targeted and randomly drawn actuaries' reports each year, and he also notes that, on an international front in on-going discussions between the International Actuarial Association (IAA) and the International Accounting Standards Committee (IASC), statements have been made by the accountants that they will only be prepared to allow the actuary to have professional discretion in the preparation of insurance liabilities under the new proposed insurance accounting standards (IAS) if actuaries are subject to 'comprehensive and enforceable standards'. The IAA has given its professionalism committee the mandate to report in Jerusalem in May 2000 on how these international actuarial standards might be adopted. Enforcement will be up to the local accreditation organisation, so, perhaps, the compliance review might be a way of preparing the Faculty and the Institute for the

new IAS, which is expected to come into force in 2003. Further on the Canadian position, a task force report was produced in January 2000 along the lines mentioned in Section 4.1 and also in Appendix A2.

There was some querying of the motivation for this paper, and this is covered in Section 2, but some people to whom we spoke felt that there was no evidence that there was a lack of compliance at present. The Working Party discussed this matter, and felt that it was not our remit to seek out cases of non-compliance, but rather to consider how compliance might be better monitored. It is certainly true that a small number of employers that we talked to felt that not all breaches would come to light under the present arrangements, but it would be true to say that most actuaries and others felt that the profession had, at present, a clean bill of health, with very few disciplinary cases. Some felt that introducing any kind of monitoring meant that an external review would become inevitable, and that, once in place, such an apparatus would need to be seen to work. We would need to catch some fish in the nets to show that they were effective.

The Councils, the FIMC, the PAB, and the Working Party all felt that there was a fundamental need that any change to monitoring should have the backing of the profession as a whole. As well as taking the profession with us, there was a need to take the public with us. We are all very aware of the potential public relations disaster if it is considered by the public that the profession is taking this kind of action because of previously unknown wrongdoing found among its members. However, if this is portrayed as keeping our house in order voluntarily, it will be most advantageous to us.

At a recent Institute Sessional Meeting, Mr John Hayes of the Occupational Pensions Regulatory Authority (Opra) said that the low profile of actuaries is a unique selling point for the profession. The idea of a low profile and a selling point in the same sentence does seem a bit of a contradiction, but I think that I understand what he means. Given that we have a profile, I would hope that we can design a compliance monitoring arrangement with a very handsome one, however low that profile might still be.

Mr W. J. Robertson, F.F.A. (opening the discussion)**:** I think that this is an important issue for the profession. A look back in history helps here. I still consider myself relatively young as an actuary, but when I became an actuary we did not have a *Manual of Actuarial Practice*, we did not have 33 guidance notes, and we did not have a Professional Affairs Board. However, we did have standards of professional conduct. A quote from these is illuminating:

> "The Council of the Faculty does not lay down rigid rules governing professional conduct and practice. It relies on the judgement of its members in upholding the dignity and integrity of the profession. It believes that the importance of maintaining the highest standards is generally recognised by its members."

As a young actuary I found this standard extremely demanding. I just did not have a line against which to measure myself. I had a responsibility and choice about where to place that line, and I had to be able to justify it to my peers. Late in 1999 the profession issued a vision for actuaries. Under values it said: "We aspire to the highest standards of expertise in our fields". It also said: "We aspire to the highest ethical standards which we uphold".

I am very comfortable with these values, and they sit well with the profession which I entered many years ago. They require members of the profession to be fully focused on providing quality advice and on continually developing themselves to maintain that quality. Unfortunately, the proposals from the Working Party seem to me to focus on form filling, to focus on ticking boxes and to focus on performing up to the line, rather than aspiring to push the line forward; but do the arguments and the analysis within the paper contradict this immediate reaction?

In considering this, my starting point is to ask why we are doing this. Section 1.1 contains the terms of reference of the Working Party, of which (1) states: "to review the present working arrangements and identify any problems". It seems to me that this is critical to the issue. You

solve a problem by identifying exactly what it is. This leads to the development of solutions. In the paper we begin, in Section 2, with the benefits of the proposed approach without any identification of the problem that we are seeking to address. I wonder if this failure to identify the problem was behind the very negative reaction to similar proposals in Canada, which the Working Party noted in Section 4.1.

Having said this, do I think that the proposals will lead to improved standards? Sadly I have to answer 'no'. Ticking the appropriate boxes in the general compliance questionnaire would not lead to improved standards. If the boxes could not be ticked, we would have real problems as a profession. What does improve standards is the constant search for improvement; it is the use of techniques such as internal peer reviews and project reviews; it is the encouragement for staff to attend internal and external CPD events. All of these improve the quality of our actuaries and, as a result, the quality of their advice.

On a point of detail, it is suggested in Section 8 that the PAB: "may consider an exemption under Section 2.9 of the Professional Conduct Standard" for any non-compliance discovered during pilot testing. I find this astonishing. It is almost condoning poor quality, and I doubt whether it would ever have met with the approval of the individuals who drafted the original professional conduct requirements.

The next goal for any proposals must be to reduce the problems that we have encountered in recent years. Would these proposals have avoided personal pensions mis-selling? In the public's minds, would endowment mis-selling be less of an issue? I am afraid that my answer to both these questions is 'no'. I do not believe that anything within these proposals would have had a serious impact on pensions mis-selling. As far as the public is concerned, their impact would be equally small. The public, guided by the press, are more interested in a story than in any facts. It was interesting to read the Court of Appeal's decision in the Equitable Life case, a company that has been criticised in the press over recent months. The Master of the Rolls, with all the facts at his disposal, commented: "It appears to me that both parties are to be commended and not criticised for trying to resolve the issues between them in this way". The man that had the facts at his disposal recognised an even argument. We should not delude ourselves into believing that these proposals will protect us from criticism if the press finds an appropriate issue in the future. Therefore, I am not convinced by the arguments in ¶2.2 about the public relations benefits of the proposals, as I have some concerns with these proposals.

I now consider ¶¶2.3 and 2.4. The Working Party is to be commended for attempting to address the potential for the FSA to impose compliance upon us. My concern is that we are opening the door by introducing the limited compliance that is identified in this paper. I wonder whether a more appropriate stance to take would be to encourage the FSA to embrace the top-down approach that it has recently been promoting. The message from Mr Howard Davies of the FSA is that it wants to move towards this, and I have already seen some signs in discussions and visits that the message is being followed through at ground level. Regular visits from the FSA could, and probably should, include its actuaries being involved in more detailed discussions with Appointed Actuaries — covering matters such as bonus reports and financial condition reports. It feels to me that this would have the benefit of educating the FSA on the key issues for a company, and the dialogue with the FSA's actuaries would give Appointed Actuaries the benefit of greater insight into the concerns of the FSA and, perhaps, how other companies have addressed them. This type of approach avoids the cost issues associated with alternatives such as external consultants or a team appointed by the profession; and it allows existing knowledge within the GAD and actuaries within the FSA to be built on rather than starting from scratch with new people. Most importantly, it brings the FSA into the process, rather than leaving it outside, commenting on our ability to monitor standards and achieve these standards in practice. While I may differ in how we go about addressing this issue, I am generally happy with the arguments in ¶¶2.3 and 2.4. Although I have concerns as to whether the right conclusion has been reached, the need to be proactive in dealings with all bodies, and in particular the FSA, is undoubtedly right.

Mr C. G. Thomson, F.F.A. (in a written contribution that was read to the meeting)**:** The profession's decision on this subject could be a watershed for the health of the profession and its members. Well-intentioned (but, I believe, foolish) changes are likely to lead to a fundamental and destructive change in the power base of different parts of the profession. Some of the options in the paper would lead to a serious reduction in the status of the profession.

My comments are made in a personal capacity, and not as Chairman of the Life Board. In that role I will always try to represent the mainstream body of actuarial opinion. For compliance review there is, as yet, no mainstream view, and I earnestly hope that the proposals here do not find favour with the profession.

I fear that this paper represents 'modern thinking'. We live in a world that has a fundamental naïve belief in rules. If something is thought to be a little suspect (or if it is not widely understood), then modern thinking says that more rules will solve the problem. This naïvety is curious, since it is so at odds with our experience. Indeed, if we have a fundamental belief in rules, why do we not believe that our professional conduct standards (PCS) are sufficient? I quote from Section 2.9 of the PCS: "An actuary must take appropriate action immediately on becoming aware of any event which appears to be a breach by another actuary of any aspect of either the spirit or the letter of the PCS, or of the requirements of any professional or other guidance." Given this requirement, I find it completely unacceptable that some actuaries are prepared to cast general criticism without specific examples and without following up with a report to the PAB. Correspondingly, if there are well-founded reports to the PAB, they should act convincingly. The statistics, over the years, for actuaries who have been censured, suggest that either the general standard of professional behaviour is so high that a compliance review is a 99.99% waste of time, and therefore a complete waste of money, or, alternatively, that our disciplinary procedure is failing badly. I incline to the first view, but, even if the latter were the truth, inventing a whole new process of rules would be treating the symptoms, not the cause. It seems to me that we ought to consider extremely carefully what is wrong with our existing processes before we invent new ones.

My remaining comments are concerned with the position of Appointed Actuary. We already have external review of parts of the Appointed Actuary's work by the GAD on behalf of the Insurance Directorate. If they have grounds for concern, they have the right to investigate. I have not yet seen any argument to justify a further process and further cost.

I have acted as an employed Appointed Actuary in a large company with a significant team of experienced professionals to assist me. In these circumstances, either formally or informally, all work is checked before going to the board. I would be greatly disappointed in my colleagues if they did not report me if they believed that my actions were unprofessional. I have also acted as Appointed Actuary in a variety of other circumstances, including as external actuary, both in circumstances where the company had its own in-house actuaries and where it did not. I have always believed that the Appointed Actuary must have access (at least) to all of the board papers, but I have learned that this may not be enough. If the board does not meet very often, then there are no board papers to review. The management may be unhelpful, and may have moved a considerable distance between board meetings. I have had experience of such a company. For effective monitoring, therefore, I believe that the Appointed Actuary should be an employee of the company, and that the alternative of an external Appointed Actuary is, necessarily, a weaker protection of the public interest.

I appreciate that the position of an Appointed Actuary working on his or her own in a company is very different, and, in those circumstances, it would be reasonable for that individual to seek some form of external review in order to have confidence that the work was adequately checked. There may be analogies with sole practitioners in other parts of the profession. We should not allow the need for review in those circumstances to change the position of the majority.

In our paper to the FSA we said that the profession should be able to carry out an effective audit when necessary. To me 'when necessary' does not mean all the time. It means when there is evidence or a well-founded suspicion that a review is needed.

The fundamental question in all of this is about trust. The modern world trusts nobody. As a result, it suffers even more because of its distrust (the FSA costs more than Robert Maxwell). Even the Romans were more advanced than this. *Quis custodiet ipsos custodes?*

That is why I think that this is such a major issue for the profession. As professionals, whom in our profession do we trust? Do we trust the great majority, and believe that they intend to do their work well? In that case, we should be content with professional review only for sole practitioners or very small practices. We should believe that most actuaries will self-report if they have made a mistake, and that other actuaries will follow the PCS if they have reason to do so, and report another actuary. If we believe that all actuaries are lying cheats, then we need the heaviest form of peer review; but then what reason do we have to trust those who are doing the checking? While life has encouraged me to a cynical view of the world, I have not yet reached the stage where I am that cynical about the profession. I believe that the great majority of my fellow professionals are trying their best to do a good job. In these circumstances I can see no need for more than the lightest form of peer review. In the particular case of the Appointed Actuary working with a team of actuaries in a significant sized office, then formal internal peer review may be required, but no further action is necessary.

I am very uncomfortable with the recommendations in the paper. If the system is not broken, why are we being asked to fix it? If it is broken, where is the evidence? If there is evidence, why has action not been taken? Is it the disciplinary process that we need to review? We have a process already. If it does not work, why is a new one better?

Mr J. P. Batting, F.F.A.: If this meeting had been held a month ago my comments would have been very different. When I first read the paper my reaction could, at best, be described as negative. I found the tone of the paper presumptuous, and almost offensive. I was comforted to find that others who had read it had had similar reactions, both within and outside my firm. However, I was equally disturbed to find that many other actuaries had not even bothered to read it.

Since then, there has been a seminar on this paper at the Institute and a presentation at the Association of Consulting Actuaries (ACA) conference at the beginning of this month. The seminar has given me comfort that many other members of the profession have serious misgivings about the contents of the paper. The presentation gave me the opportunity to hear from, and question, one member of the Working Party in more detail. The most important point that came out of the ACA presentation was that this is only the start of a consultation process. I was heartened to hear that, because it certainly does not read like one. In fact, it reads as though the whole issue has already been decided. That may be the reason why some people have only briefly skimmed the report, believing that the proposals are: "inevitable . . . coming anyway . . . nothing we can do about it".

So what is wrong with the paper? It is the implicit suggestion that the processes outlined are a prerequisite to high quality actuarial work, and that, therefore, anyone not employing such methods cannot be giving good professional advice. It is the way that the paper drifts from an initial concept of monitoring compliance with selected guidance notes to an intrusive system of monitoring how all actuarial work is carried out. It is the checklist and tickbox mentality on which it seems to rely so heavily.

The great strength of our profession has always been its emphasis on professional and personal responsibility. Right from the start of my actuarial training a number of important points were instilled and stressed: the importance of not advising on unfamiliar matters; the value of second opinions in areas of uncertainty; and the responsibility that comes with signing as an actuary. For many of us, the first time that we did sign as an actuary was an important occasion, and I suspect that some of us can recall exactly the circumstances in which that happened. I believe that it is the continuing emphasis on that responsibility, and full awareness of the interests of those who rely on our advice, which hold the key to continuing the high standards of our profession.

I do not believe that the procedures outlined in the paper will actually add anything to the

standard of advice that experienced and competent actuaries are already providing, and it is unhelpful to say that they will. It is also a mistake to believe that checking and checklists are a panacea for all problems. Such systems can very often encourage a more casual attitude, because people think that someone else will spot their mistake. While it is only sensible that an actuary who relies on others to carry out his or her work will want to see that their work is checked, it is troubling that some actuaries seem to believe that they cannot provide any advice to anyone without first having it checked. It would be a sad day for this, or any other profession, if its members really held that view.

We should also remember that monitoring systems do not, of themselves, guarantee protection. It has been no comfort to those who were mis-sold pensions to know that their advisers were subject to regular compliance monitoring at the time.

If this really is the start of a consultation exercise, then we need to think more carefully what we are trying to achieve. We also need to consider whether these aims can be achieved in the same way in different strands of the profession. For example, in my own area of pensions, I can see that an argument could be made that cash equivalents and minimum funding requirement (MFR) calculations are of such importance to members that we need to be able to demonstrate objectivity and consistency in their calculation. However, I do not believe that our direct clients, such as trustees and employers, who will ultimately bear the costs, will thank us for setting up elaborate compliance structures to demonstrate that we really *are* doing correctly what they always believed that we *were* doing correctly.

Equally, if it is ultimately agreed that monitoring compliance with guidance notes is necessary, then it should be considered in conjunction with a review of the current structure of guidance notes. In my view, many of our current pension guidance notes are simply 'legislation on the cheap'; regulations would be preferable, and in many cases clearer. While I would welcome the notion of a genuine guidance note, by which I mean a note that would provide useful and helpful advice in an area of practical complexity, many of our current guidance notes are more like 'enforcement' or 'instruction' notes. I understand that there are some who believe that the proliferation of guidance notes automatically increases the standing of our profession. I am afraid that I do not agree, particularly when some are ambiguously drafted and add little to the quality of our professional advice.

Because of limited time, I now briefly mention a number of other points:

— We should make sure that we learn from others' experiences, particularly the Canadian Institute's. The summary referred to in the penultimate paragraph of Appendix A1 would seem to encapsulate many of the criticisms that could be made of these proposals.
— We should strenuously avoid, wherever possible, the type of forms and checklists that make up the draft forms attached to this paper. If reviews are required, we should concentrate on peer review, rather than practice review. It is a pre-release system, and at least, therefore, has the potential to enhance the quality of actuarial advice before it is given. We should, however, recognise that there may be more than one way of performing such reviews, and that some existing systems may be more a product of commercial needs than of professional standards. I believe that an open discussion, perhaps by way of a seminar or a conference, of the different ways in which firms operate formal or informal peer review systems would be a helpful contribution to the debate.
— External reviews by other firms in a highly competitive market, such as pensions advice, is inappropriate. There seem to be very limited benefits of external reviews, and little that could not be better provided through educational means, such as the professional seminars that are already organised by the Faculty and the Institute.
— Whatever methods are proposed should be practical. I believe that too much of the guidance that is produced seems to be produced by those in management or research. While it is inevitable that actuaries whose time is devoted mainly to advising clients find it difficult to spend time commenting on draft guidance, it is vitally important that their input is obtained if guidance of any form is to be practical and worthwhile. I would like to see the Faculty and the Institute look at ways in which this could be achieved.

— The proposals in this paper, or rather consultation paper, are potentially the most significant proposals made in the professional lifetime of many of us. I would like to think that all parts of our profession will pay full attention to these proposals, and be properly consulted at all future stages of this process. In particular, I would like to see all actuarial employers, whether large or small, being kept fully involved in, and informed about, these discussions.

Mr W. P. McCrossan, F.C.I.A., Hon. F.F.A.: My comments come from someone with the following public policy background:

— As a legislator, I initiated legislation to create the Appointed Actuary for both life and general insurers in Canada, which broadened the role of the actuary.
— As an advisor to the all-party House of Commons Standing Committee on Finance, I reviewed legislation which curtailed the role of the pension scheme actuary in Canada because of perceived abuses of public trust related to small pension schemes.
— As a former President of the Canadian Institute of Actuaries (CIA), it was my misfortune to be in office when the first two major life insurers failed in Canada, which caused questions to be raised about the role of the actuary in protecting the public interest.
— As a member of my own firm's peer review committee, I have extensive practical experience with internal peer reviews as well as with voluntary external peer reviews, involuntary (regulator demanded) external peer reviews and the quasi peer reviews which an actuary whose principal practice is mergers and acquisitions is obliged to conduct.
— As the IAA's representative to the IASC Insurance Accounting Steering Committee, I have had to respond to accountants' queries about the objectivity and credibility of actuarial opinions.

Actuaries in Canada and in the United Kingdom both have more freedom to exercise their professional judgement and have accepted more public responsibilities than have actuaries in other countries. These rights and responsibilities are not God-given; but need to be earned continuously.

How can they be earned? By having the actuarial profession be seen to act in the public interest by the stakeholders who rely upon their work. Section 2 identifies our stakeholders as: employers, clients, policyholders and pension scheme members. This list is much too short, and should be expanded to include shareholders and auditors, as well as governments and their various regulators. The stakeholders listed in the paper include those who rely on our work, but cannot hit back, such as policyholders and pension scheme members. It includes those who rely on our work and who have limited powers to hit back, such as by terminating our professional engagements; but the missing stakeholders all have very big teeth. Failure to satisfy them that actuaries are acting in the public interest can quickly lead to loss of the rights and responsibilities mentioned previously.

Currently I am the international actuarial profession's representative on the IASC's Steering Committee engaged in developing new international accounting standards for insurance, and I am involved on the periphery of the International Association of Insurance Supervisors' efforts to develop new international regulatory standards for insurers. These projects may result in reinforcing, or even expanding, the role of the actuary currently performed in Canada and the U.K., or they may result in dramatically curtailing it.

I believe that the actuarial profession has much to offer the widely defined public in the areas under discussion. However, there is significant opposition, from outside the profession as well as from inside small segments of the international profession, to such an internationally expanded role.

Let me observe the *sine qua non* of the current discussions. The major players are only willing to even consider a significant role internationally for the actuary if the relevant standards of practice will be comprehensible, enforceable and enforced. I suggest that no smaller hurdle needs to be met in Canada or in the U.K. to preserve our rights and responsibilities.

I will leave aside the issue of comprehensive standards, and focus entirely on the issues of enforceability and enforcement, which must be addressed by professional bodies such as the Faculty. It is my very strong view that, in order to be seen to discharge their obligations to their publics, professional actuarial bodies must institute regimes of pre-release and post-release peer review of work of the professional actuary. For the moment, I will restrict myself to work performed by an insurer's Appointed Actuary, a pension Scheme Actuary and a social security actuary.

In 1992 the CIA first instituted a post-release self assessment compliance review of the work of the insurer's Appointed Actuary. Each Appointed Actuary is required to complete extensive documentation of his or her work, as is each actuary to whom the Appointed Actuary delegates major functions. A summary return is filed by the Appointed Actuary with the CIA, which has established a committee to review the returns. The questions are simple and straightforward — and I can tell you that completing the return makes the actuary 'sweat blood'. Each Appointed Actuary knows that each completed questionnaire is a potential career terminator, should the work later be found to have been unprofessional.

How well has the compliance questionnaire worked in the insurance field? I think that it has helped improve professional practice substantially. It is well accepted by insurance Appointed Actuaries; but the external hurdle to demonstrate that the profession is acting in the public interest has now been raised, and self assessing compliance questionnaires are no longer regarded as adequate by organisations and others with 'teeth'.

The CIA also extended compliance questionnaires to pensions and employee benefits. Here professional acceptance has been much less. There has been a commoditisation of the work of the benefits actuary, and many clients are small with limited budgets. Professionals in these fields complain of a costly bureaucratic process, which they see as having very limited merit. However, those wider constituencies for actuarial work, the ones with 'teeth', such as government regulators and securities commissions, have, at the same time, expressed their views on the inadequacy of self policing of certain 'dubious' or non-objective practices.

The CIA investigated the concept of comprehensive periodic practice review of the actuary's work by the profession itself. This was received as 'neutral to positive' by insurer Appointed Actuaries, and as 'negative to neutral' by pension and benefit actuaries. Negatives cited were competitive concerns, bureaucratic approach and potentially high expense.

In January 2000 the CIA published a new document which proposes mandatory peer review of all statutory actuarial reports. This concept appeared to be widely supported in 'town hall' meetings held across Canada.

Why does there appear to be support for peer review, but not practice review? Much of the work of the actuary is now subject to voluntary pre-release peer review (at the firm level or at the level of a network of practitioners with small practices). Some work is already subject to post-release peer review — often regulatory induced mandatory external peer review, but also voluntary external peer review. In this regard, I note that the Appointed Actuaries of many of Canada's largest life insurers have recently commissioned my firm to do peer reviews of their work as Appointed Actuaries, and produce reports on industry wide 'best practices' and company specific deviations.

The CIA Task Force recommends, and I endorse, the development of CIA standards for the pre-release peer review of actuaries' work on statutorially required opinions.

Here are my practical comments on the peer review process:

(1) The peer reviewer should be competent in the practice area, and should be prepared to be 'aggressive' in a collegial way.
(2) The peer reviewer needs to go beyond confirmation of assertions of compliance with regulatory or professional requirements, and actively question what was done (or not done), and why.
(3) No peer reviewer should be replaced without conducting an interview with the replacement peer reviewer (similar to what occurs with replacement of Appointed Actuaries).
(4) No peer reviewer should hold the position for more than three years, to avoid the development of a relationship that is too 'cosy', without the necessary professional probing.

Before 2003, I expect the role and responsibilities of the insurance actuary to be settled at the international level. Actuaries will either have substantial delegated responsibilities confirmed or the role of the actuary will have been reduced from that currently practised in Canada and in the U.K. The actuarial professions in Canada and in the U.K., therefore, need to recognise that they must lead the way — or be swept away.

I note that at this time in 1999 the Faculty and the Institute were focused on the vision and values of the U.K. actuarial profession. My theme today has been that the need of the profession to demonstrate its commitment to service to the public has increased greatly in the last twelve months. Continued concrete demonstration of this commitment to our key stakeholders is urgently needed if the profession is to be deemed worthy of continued public trust. I wish the Faculty and the Institute well in their deliberations at this pivotal time for the actuarial profession worldwide.

Mr R. K. Sloan, F.F.A.: Paragraph 4.2 sets out the current practice in the United States of America, which has much to commend it, and broadly reflects the current stance that we adopt in the U.K. They have no formal process for monitoring adherence to professional requirements, but rely on: self regulation; publicising the Guidance Notes and Code of Professional Conduct; and a disciplinary process, which, as we have heard emphasised earlier, must be enforceable and enforced. Although self-regulation has become somewhat of a tainted term in the financial services area in the U.K. of late, I believe that our profession still carries enough gravitas and respect to enable this approach to continue to have a sporting chance of success.

Paragraph 6.5 suggests a possible client questionnaire, on which I can do no more than reiterate the fact that, as is stated: "most clients would not be able to differentiate between that subject [compliance with professional standards] against general service issues".

While it goes without saying that we need to take our profession with us, I believe that a key element is the public perception, as discussed in Section 11.2. I subscribe to the view there stated that there is a risk that we might achieve the opposite of what we intend. Such adverse comments as currently arise in the press tend to be of a relatively light-hearted nature, generally giving actuaries the benefit of the doubt. My concern is that any such attempt to strengthen the monitoring process might be viewed as 'no smoke without fire'.

As my firm's compliance officer for investment business under the Financial Services Act, I already have some experience of the workings of the JMU and the cost of the whole process. My general impression, as supported by companies regulated by the PIA (now the FSA), is that greater emphasis tends to be placed on complying with the *letter* of the rules than with their spirit. I was reminded of this where, in ¶13.4, completion of a compliance questionnaire is suggested, but I am thankful that our profession has not yet reached the stage where our examinations are undertaken by a series of multiple choice questions!

To the extent that our professional standards could do with some strengthening, I believe that the best course is to place greater emphasis on peer review, as is well described in Paul F. Della Penna's article in Appendix A2. While this practice is already adopted in many firms, it could prove a sensible move to make this mandatory. While some one-man practices might find this onerous, I would suggest that any resultant amalgamations might, perhaps, prove advantageous.

We should continue to place emphasis on the same three principles as at present, and as adopted in the U.S.A., namely: self-regulation, guidance notes and our disciplinary process, but, perhaps, now to be supported by mandatory peer review.

Mr S. Tombs (a visitor, Secretary and Treasurer, The Royal Incorporation of Architects in Scotland)**:** I am an architect, and it has been the position of architecture in the U.K. in this century to be subject to Registration Acts under Statute since 1931. These were subject to a major review in the early 1990s by John Warne, when the then Conservative Government considered that these Statutory Acts were out of date. His recommendation was that they should be swept away, and that self-regulation was a more likely basis for achieving quality in

architectural discipline, and was sufficient to satisfy public concern on matters of quality, code of conduct, and complaints handling.

A reaction from the membership generally, however, was that the protection of title was of sufficient worth to fight hard for, and the members put up a strong campaign and eventually succeeded in persuading the then Prime Minister, with support from the National Consumer Council. I think that it is important to recognise that in architecture the only thing that is protected is the title and use of the term 'architect'. There is no licence to practise. There is no practice control, so there is, indeed, freedom for anyone to design buildings if you can persuade the building control officer that they will stand up and you can persuade the planning committee that they fit planning requirements. Thus we are in a slightly in-between state between those professions which are not regulated at all and those which are under statutory control, such as lawyers and the medical professions.

The Royal Incorporation of Architects in Scotland (RIAS) has been a chartered institute since 1922, and, since my arrival in Scotland in the mid 1980s, the role of the RIAS in self-regulation has been quite rigorous, because by that stage the old registration board had become rather slow and sluggish in dealing with matters of complaint. In general terms, dealing with complaints from the public in a vigorous and active way has given the public, generally, a positive view about the role of the professional institution. At the same time, the Incorporation has been providing practice notes and guidance in a supportive way to practitioners since the early 1980s. Although these do not have a binding quality, they are looked at when matters of complaint arise. However, under the code, the Incorporation was somewhat ahead of the game in looking at client accounts in 1987, professional indemnity (PI) insurance, as a mandatory requirement for everybody providing service from 1993, and continuing professional development from the same date.

There has been a continuing debate since that time as to the degree to which a professional body should make positive inquiry as to the compliance of its members. Up until now we have resisted actually contacting members with regard to PI insurance, for example, although the registration board is now showing signs that it wishes to enforce that. I think that that is one indicator of the public perception of confidence which is required from professionals — some evidence is required that they do comply. I suspect that what will happen in future is that a similar level of inquiry will take place with regard to continuing professional development. We have been undertaking a pilot study, over the last year, of compliance with basic requirements on the minimum amount of attention to continuing competence, and I know that the surveyors have similar arrangements. The evidence to date from the returns, and these have been on the basis of a questionnaire format, is that over 90% are indeed complying way beyond the minimum requirements. There are, however, some areas where guidance is being issued to individuals where they are felt to be falling below the standard. Whether that turns into something of a more mandatory kind has yet to be determined.

My assessment would be that the RIAS would still prefer to see self-regulation rather than statutory regulation. It is much more flexible, even with the Scottish Parliament. Getting statutory controls adjusted is a very difficult, long and exhausting process, statutory arrangements being far more democratic. I would tend to favour self-regulation, and spot checking may be a wiser course than blanket approaches. At the moment our compliance questionnaire on CPD is held as an institution overhead, and there is no specific payment required in addition for that.

There is a fundamental question that underlies all of this; the relationship between individuals and their institutions, and between those who deliver services to consuming clients (which tends to be through some form of partnership or business) and the institution. That is a difficulty for all of us as institutions. This is a matter which this discussion throws up once again.

Mr R. P. Walther, F.I.A. (in a written contribution that was read to the meeting)**:** I am delighted that the Faculty have awarded this subject a full sessional meeting. Indeed, in my company we felt it of sufficient importance that we tabled a neutral paper for discussion at our

board, setting out the remit of the Working Party. Our board was unanimous, and agreed that the following minute be recorded, and they have asked me to relay this minute to the Working Party, the Institute and the Faculty:

> "The Board of Clerical Medical is comfortable that it receives appropriate reporting and advice from its Appointed Actuary that assists it to make proper commercial and strategic decisions.
>
> The Board does not believe that professional peer reviews will improve the current position. Indeed, such reviews may make the position worse by causing the Appointed Actuary to divert attention towards demonstrating compliance rather than analysis and communication. They will also inevitably lead to a further increase in regulatory costs.
>
> The Board does not believe that the Appointed Actuary's status will be enhanced by these proposals. Status should not be 'conferred by statute', but earned through the contribution to the strategic management of the business."

It might be helpful to give some of the discussion and views that our board expressed at the meeting. It did not agree that the role of the Appointed Actuary has declined. Its Appointed Actuary is not a director, but does attend all board meetings and presents all actuarial papers directly to the board. He has complete and open access to the chief executive. The board values the Appointed Actuary's independence and clarity of role, and believes, for instance, that it would be a very retrograde step to go back 20 years when, very often, life offices' chief executives had the title of General Manager and Actuary.

The board is concerned at the cost and the possible bureaucracy of the proposals. In the course of the last five years the company has gone through the process of demutualisation and has required external actuarial advice on a number of occasions. Some of this advice has been very helpful and constructive and of considerable value. However, equally the board has felt that some of the actuarial advice (particularly that which was prescribed) was of relatively little help and was very expensive.

Most importantly, the board relies upon the Appointed Actuary to help directors to form judgements as regards the long-term financial condition of the company. Directors see it as their prime responsibility to understand the issues and to maintain the company in a healthy position for all its stakeholders. Directors value the advice and the judgement that they receive from their Appointed Actuary, and do not believe that any of the possible proposals of the Working Party would be likely to improve the quality of that advice; indeed directors feel quite strongly that the opposite would be the case.

Having given the official view from the company, I now give a personal response to the Working Party. I passionately believe that the direction suggested by the Working Party is wrong for our profession. Over the last 15 years we have seen a steadily growing number of frauds in financial services, and we must also be concerned by the failure of financial institutions, on occasion, to provide customers with good advice and good value. Turning first to fraud, it seems to me that both as a director in the provision of accounts and as an institutional investor using such accounts, then Messrs Cadbury, Hampel and Turnbull have done little to improve the overall background, although I do agree that the improvement in corporate governance and the greater prominence and clarity of role with regard to non-executive directors have been significant. However, generally we have found more and more work to be done and more cost to be borne. Do we really believe that the quality of accounts has improved as a result, and do we really believe that the professional accountability of individuals or corporations acting as auditors has been increased? I, for one, do not.

Turning to the value that financial service institutions provide for customers and the quality of advice that we give them, I still remain concerned that the emphasis throughout the 1990s has been on whether the provider or the adviser can deal with the detail, rather than whether the customer has been properly advised or obtained appropriate value. Overall, I still see the last decade as being one where ticking the appropriate box has become more and more important

compared to the real issue, which is to persuade boards and management to manage these key risks in a responsible fashion. To travel down the road of 'internal compliance reviews' and 'internal actuarial audit' is the same knee-jerk reaction. We must not go down this path, since it will lead to more attention to detail and less concentration on the real issues.

In this context, I welcome very strongly the FSA's announced intention of operating its new regime on a top-down basis, concentrating on the key risks and major decisions facing boards and management, and placing much less emphasis on the detailed monitoring of individual actions on a compliance basis. I would hope that the Institute and the Faculty could endorse very strongly this powerful message from our new and equally powerful regulator.

Now to be more constructive, I believe that the Institute and the Faculty can provide greater assistance to Appointed Actuaries. As an example, surely the key variable which is important in the judgement given by Appointed Actuaries is the long-term rate of interest. At the beginning of this year long-dated gilt-edged yields in the U.K. were 4.5%, some 2% lower than those in the U.S.A., and about 1.5% lower than rates in Germany. I have yet to meet any actuary or institutional investment manager who seriously believes that the long-term rate of inflation in the U.K. is likely to be significantly less than that in Germany or the U.S.A. The level of long-dated gilt yields is quite clearly a major anomaly caused by the excessive demand created by regulation and a total absence of supply. Surely the Institute and the Faculty have a real responsibility to look at this issue (which has significant impact on actuarial valuations and on future projections), and to influence the authorities, if appropriate. Serious discussions on issues like this would be a real help to the Appointed Actuary, informing the judgement that he has to give to his board, and, in my view, would be of far greater assistance than any of the remedies proposed by the Working Party.

Mr R. E. Brimblecombe, C.B.E., F.I.A.: As a member of the Working Party, I had intended to be here in listening mode, as part of the consultation. However, I feel moved to make one or two comments, based on my past experience, firstly, as Appointed Actuary, then as a member of various Institute and Faculty committees, and, in the past ten or so years, as a member of the board of LAUTRO and recently committees of the PIA.

In my capacity as a member of the Working Party, I get increasingly inclined to say: "do not shoot the messenger". Mr Thomson said that no problems have been identified, so why act? I would think that this is a very good time for the profession to act, otherwise such thoughts, as 'stable doors' and 'horses' come to mind. We only have to see the recent publicity in the medical profession resulting from the case of Dr Harold Shipman to realise that, when something like that happens, the wrath of the public comes down very heavily on a profession as a result of the actions of one individual. I believe that now is the time to take action for various reasons. Although there have been no major problems, there have been one or two cases which have been brought to the attention of the profession from time to time, which have not been referred to discipline or have been resolved outside the disciplinary system. However, there are cases where the standards which have been applied have been less than one would expect.

I think that it would surprise members of the public — and I am talking about our individual stakeholders here; pension scheme members, life assurance policyholders, and so on — if they realised that there was no peer review system by the profession of actuaries' work in what is a very important area for them — their future savings, and, indeed, their provision for retirement. I believe that it behoves the profession for things to be seen to be done. It is not a question of whether things need to be done, but I believe that peer review needs to be seen to be done.

The following story may be apocryphal. The original start of the discussion within the profession on this issue goes back some four or five years now, when the profession was having initial discussions with the Department of Social Security (DSS) on what became the Pensions Act 1995. One of the comments that was allegedly made was when the DSS mentioned to the profession that it was very keen to see the profession continuing to provide much secondary or tertiary legislation by way of guidance notes. Perhaps somewhat injudiciously, it is alleged that a member of the profession said: "That is all very fine, but we do not have any procedures in

place in the profession for monitoring compliance". We had to backtrack very heavily on that before the Pensions Act finally came to be, with all the guidance notes resulting from it.

Comments have been made about ticking boxes. It is certainly the case under the financial services legislation, where most of the compliance over the past 13 years or so has been done that way. I agree that the FSA is looking for a top-down approach. The idea of the tick boxes is to act as an *aide mémoir*. However, if you move away from the tick box mentality, as I believe is right, you move almost inexorably away from what I call a compliance review of professional standards and mandatory guidance notes, to perhaps almost a peer review of the quality of the advice being given. Again, that fits in with what the public believes that the profession should do and possibly does already — that it should be reviewing the quality of advice and what that does for individuals.

Professionals have a high level of responsibility, particularly in those professions which pride themselves on self-regulation, like the actuarial profession. If we are to maintain that eminent position, we need to ensure that we maintain the confidence of the public and the regulators alike. Whatever system finally comes out of peer review, some actions need to be seen to be done for us to progress as an eminent profession.

Mr A. E. Miller, F.F.A.: As a practical person, it is the day-to-day application of some of these things that concerns me. I am a life office pension Scheme Actuary working with a team of seven. I have no experience of the role of an Appointed Actuary. As several speakers have already mentioned, these proposals seem to be trying to answer questions which have not yet been asked, and which, in a pension scheme context, quite probably never will be. In the pensions environment, as Mr Brimblecombe has mentioned, I see the proposals as falling, probably, into two camps. There is the 'tick box' approach to ensure that guidance notes are followed, and there is verifying that the advice given is sound and proper.

What about a tick box process? How many pension Scheme Actuaries these days do a valuation report starting with a blank sheet of paper? I would suggest none. We must surely all start with a word processor master document. This will cover all the aspects of a report that the guidance notes require, only the numbers will require to be added. In our case this has been put together as a team task, so it has been checked by all of us to ensure that all the points required by the guidance notes are covered. Thus, in order to fail a tick box test, we would positively have to delete things, which I would be very surprised if it were to happen. Even the one-man actuary firm doing pensions work is more than likely to operate in this fashion.

If a tick box is the approach, yes, you have assumptions; yes, you have the data; yes, you have the assets; and yes, you have done this or done that. However, are your assumptions reasonable? What if they were 20% interest, 2% salary growth? These do not sound very sensible to me, but you can still tick the box because the assumptions are there.

Thinking about vetting the quality of the advice, it is one thing to be tested by examination of your written output, but the time when an actuary really needs to be tested is when he is sitting face-to-face with a client and talking off the cuff. The only way that I can see of being vetted in these circumstances is by having somebody else from somewhere else sitting beside me, taking notes and reporting back afterwards. This is the only way that this could be done properly, but the prospect disturbs me (and no doubt would disturb my client too).

In the final salary pensions field, particularly, very rarely — and I suppose that this is more true of life offices' actuaries than of consulting actuaries — do I attend a meeting with a client, and only the client, and even if it does happen, I can never be certain in advance that it is to be the case. For virtually all the meetings that I attend, I must assume that they will be attended by other pensions professionals. Usually they will not be actuaries, but sometimes they are. However, the point is that there are others there who are independent of us. We are being peer reviewed very frequently. It may not be by other actuaries; but if we are putting our foot in it, saying the wrong things, or whatever, these other professions also will pull us up on the spot. In other words, much peer review goes on, both within organisations such as ours (between the members of our team) and again out in the field. To impose yet further peer review is, to my mind, gross overkill.

Mr G. M. Murray, F.F.A.: I add my voice to those in favour of moving forward the monitoring of professional guidance in some way. There is probably no one more proud of the actuarial profession, and its standing in society relative to others, than myself. I agree with those who have said that the vast majority of our members do an excellent job and are working very properly. However, I also feel quite strongly that the actuarial profession is not immune to the normal distribution curve which applies through society at large to the standards in our own profession, and how valuation reports, etc. are done. Therefore, although we have high standards, a statement with which everyone will agree, we cannot become complacent, and we must ensure that we continue to move these standards forward and edge them up.

I would draw attention to a report prepared three years ago by one of our members, Peter Milburn-Pyle, on the back of South African experience, which was initially presented at an international conference of consulting actuaries, and subsequently then produced at the South African annual convention. He discovered a disappointingly low standard of reporting in some of the pensions areas. It appeared that it was necessary to have some sort of monitoring, and this was taken on board. The reason I think that it is important to us is because, even today, most South African actuaries are Fellows of the Institute or the Faculty. There is no reason to believe that they are different in type and character from ourselves. Therefore, if that sub-standard approach applies in South Africa, then it is difficult to believe that there is nothing like it happening here.

With regard to the questions raised in Section 13, I do not think that we should monitor quality of advice. I think that is going far too far at this stage. It is adherence to specific guidance where we should be looking towards edging forward. In terms of whether it is compulsory or voluntary, that is a very difficult question. I have doubts about it being totally voluntary. On the other hand, there is no question that being compulsory gets it into the realms of becoming very costly. So, somewhere in between must be what we are searching for. I have some sympathy for the compulsory peer review type of approach.

In terms of the monitoring of life office actuaries, we have quite an element of peer review and regulatory review which takes place at the moment, and so anything that happens there should be an extension of present practice, rather than any completely separate review.

The completion of a compliance questionnaire could be helpful. I hesitate to introduce more administrative items, but I think that, given that the bulk of us are very honest and hard-working and have a proper approach to things, introducing a reasonable questionnaire, incorporating items that must be taken seriously, can help in a small way. I do feel that certain box ticking can be helpful on the margin. As I do not believe that there is a fundamental problem, I do not have any fear about the public reaction to this. I think that it should be seen that we are being positive in keeping our standards up and moving them forward.

I see the confidentiality issue in some ways as a red herring. Although you could apply a normal curve to how a large cross-section of actuaries would treat 'confidential', nevertheless, on balance, I believe that our approach to professional standards is such that we could rely on adherence to confidentiality.

In terms of the best way to deal with the issues arising when an actuary, carrying out a practice review, comes across a major problem, then I believe that we would manage to deal with it when or if it arises. It may be awkward, but, if we do discover a problem, we just cannot sweep it under the table. Therefore, while it may be a difficult problem to decide how to deal with it, our PAB and committees should have no difficulty in agreeing on how we should carry that forward. Who should pay the costs of the monitoring? That all depends on what is introduced. The lower the costs can be kept at this stage, the better. Some sort of peer review monitoring may be the way of managing to keep them down. We have to bear the costs, and I think that the way society is moving, then we too have to be seen to be the moving this way.

Mr I. M. Aitken, F.F.A.: For many years I was a partner in a major firm of consulting actuaries. Whilst I was there, and I am sure that the procedures have not changed, it was the policy that no figures or calculations of any kind left the office without being checked. The

checking was always carried out by a senior person who had more experience and to whom the originator reported either directly or indirectly. In addition we had a system of peer review to ensure that standards were maintained.

I have no reason to think that the policy of that firm is any different from the other firms of consulting actuaries. These procedures are put in place to safeguard the good name of the firm and the profession.

Whenever an actuarial report on a statutory valuation is sent to the PSO, it has the right, if it wishes, to have the valuation details checked. Some reports are sent to the Government Actuary's Department for checking on a random basis — from experience I know that a very thorough check is made. This is an independent check that ensures that standards are maintained.

All the foregoing are forms of peer review. If we, as a profession, move forward as proposed, we are creating more paperwork and, if I may say, unnecessary paperwork, which is all going to cost money. If anything, perhaps our disciplinary procedure ought to be strengthened, but not a formal peer review introduced by the profession.

Mr S. Wason, F.C.I.A.: I am here as the President of the Canadian Institute of Actuaries. It is interesting, as I listened to the discussion, to find marked similarities between points raised and those which we have gone through in the Canadian Institute. Many of the thought processes are quite similar.

One question that stands out in my mind that I have heard from a number of speakers is: "Why should we do this?" I must admit, even in our own process, perhaps we were not wise enough to enunciate that clearly early in the process, but we have got round to it eventually. I believe that we have a proposal with which most members agree and which strengthens the profession. Why should we consider greater degrees of compliance and peer review? We are a profession that is dedicated to the public interest, and we must continue to earn that public trust day by day in all of our actions. As Mr McCrossan was indicating, if we are to seek a greater role on the international stage and be recognised by the IASC, we must continue to earn their trust with comprehensive, enforceable standards.

In its deliberations, the Canadian Institute of Actuaries did not hit on the 'magic bullet' of what was right for us immediately. We bounced through three different iterations before we hit on a product which we think is right for us, and that is peer review. Peer review is right for the Canadian Institute of Actuaries, because it is the epitome of what is best for the public, in that it requires the member to make sure that his or her work is checked before it goes out the door in the first place, whereas practice review can be a process of checking the work after the fact, after the horse has gone out through the barn door.

Mr A. M. Eastwood, F.F.A.: I believe that it is right that the profession should decide actively how it regulates its members' compliance of professional standards and guidance. In Sections 7 and 10 a number of recommended actions are set out and have been discussed already. I struggled a bit on reading the paper to understand exactly what the Working Party saw as our objective in going forward. Certain 'benefits' are set out in Section 2, but we need to be absolutely clear what our key objective is. We should be ensuring public confidence in our integrity and professionalism at a cost which encourages actuarial advice to be sought and taken. We need to tread very carefully indeed if we are going to contain costs. Unless the reviews suggested are to be relatively superficial, the estimates of cost included in Section 9 seem very light to me. It is vital that, by accidentally increasing costs or client concerns over confidentiality, we do not raise barriers to obtaining frank and objective actuarial advice.

On the subject of confidentiality, while wholeheartedly endorsing the motivation of efficiency, I have some concerns about extending the role of the GAD, while expecting the GAD to continue to act on behalf of the regulator. A report designed by the Appointed Actuary to spur his board into action might well be less forthright, and might be respun, if it is to be available to the regulator as a matter of course. Like it or not, subjecting the Appointed

Actuary's reports to automatic external scrutiny will, in some instances, further marginalise the position of the Appointed Actuary.

I would not suggest that we continue with the status quo. The world moves on, and we will need to be able to point to something more than: "We have not noticed any problems", to gain public confidence. In many instances, it should be relatively straightforward to formalise existing internal best practices. We could, in the spirit of signing a certificate concentrating the mind, request all Fellows to certify positively that they followed relevant guidance and professional conduct standards (including ¶2.9 of the PCS) as they renewed their Fellowships and paid their annual subscriptions. Where there is a requirement of demonstration of active enforcement of standards, we could introduce compulsory peer review for certain identified reports, which should be positively acknowledged as having been peer reviewed on the certificates provided by Appointed Actuaries or Scheme Actuaries.

I believe that there is a place for practice review. The possibility of it can concentrate minds. We should, however, recognise that it is likely to be very expensive, and accordingly the incidence should be very low — perhaps on a random audit-type basis. The piloting of measures such as this is absolutely critical.

I was not entirely clear to whom the reports suggested in the paper are to be addressed, particularly those of the senior actuary in his or her annual report and the internal actuarial audit report. In summary, we need to be clear in our objective and to tread very carefully to avoid excessive costs. We should not be thanked for demonstrating compliance with guidance while altering the price or the scope of actuarial advice to the extent that only minimal advice is sought and provided.

Mr J. F. Hylands, F.F.A.: There is one possible important consequence of the proposals in this paper which has not attracted comment. The future of our profession depends very much on our ability to continue to recruit new entrants of the highest ability and the highest integrity. If we examine the proposals in the paper, and ask ourselves whether they are likely, on the whole, to encourage such people to join our profession or to discourage them, I would suggest that they are likely to discourage them. The professions in general, and ours in particular, are likely to find it increasingly difficult to attract high-quality graduates prepared to embark on an arduous course of study and rigorous professional examinations. We will be able to do so if we hold out to them the prospect of their being able to operate as professionals, however we see that. Some of the proposals in the paper, particularly at the more mechanistic end of those suggested, are quite likely to make recruitment more difficult for our profession in the future.

Mr J. Hastings, F.F.A.: I work as an investment consultant, and all the work that I do is subject to peer review. I get the impression that we have a particularly jaundiced view of regulations because of our experience of the Financial Services Act, the regulation which has been introduced in that area and, particularly, the poor value in economic terms of the regulations which have been introduced. However, there are, perhaps, other regulatory regimes that have worked better in the U.K., for example the water industry. It was an economist rather than a lawyer who put in place the regulatory structure for the water industry, and he actually looked at economic value added and the benefits of commercial competitiveness in terms of setting the regulatory tone.

There has been some discussion about mere box ticking. As an investment consultant, I rely quite heavily on a profession which, I hope, acts in the best interests of the public, and is subjected to quite a lot of checklist activity and also peer review. I refer to airline pilots. Fortunately, they have not been subject to much post-period practical review of the work that they have undertaken. There are certain benefits in checklists, but they need to accommodate the fact that there is often more than one correct answer. I think that it would be helpful to include within checklists some open questions, such as: "What other alternatives might you have considered at the time, but considered that your own choice was more appropriate?" I think that that approach is more helpful than mere box ticking — "Did you do this?" or "Did you do that?" Also, we have to bear in mind that hindsight clarifies quite a lot of situations, for example

pensions mis-selling. It is clear that there were more options and choices available at the time when the advice was given than are apparent now, ten years or more after the event, and with the benefit of knowing what has happened to interest rates in the interim.

Mr M. Scanlan (a visitor, President, The Law Society of Scotland)**:** It might be of interest were I to give you a thumbnail sketch of what the Law Society of Scotland is all about. Suffice to say, if we were running this discussion as a seminar it would be called 'Monitoring compliance with professional direction as a requirement'. The Law Society of Scotland is a creature of statute. Everything that we do, we stand for, is dictated by the Solicitor (Scotland) Act 1980, which followed upon the Solicitors and Legal Aid (Scotland) Act 1949. We are the 'new kids on the block'. We came into existence 50 years ago, and our *raison d'être* was not the self-regulation of solicitors, but to act as a vehicle for the regulation of legal aid in Scotland.

The 1949 Act was a very short Act, with 26 sections in total. Numbers 1 to 18 had to do with the administration of legal aid, and numbers 19 to 26 with the regulation of solicitors in Scotland. Fifty years down the line we now have the regulation of solicitors in Scotland comprehensively set out in a compendium which is in excess of 1,000 pages. Every single word in this is about the regulation of solicitors. We are a statutory organisation, and we self-regulate. We self-regulate, not because we want to, although we do want to, but because it is imposed upon us by legislation. Our statutory objectives are to act in the interests of our members and to act in the interests of the public in relation to those members. We monitor rigorously through our accounts rules, compulsory continuing professional development and statutory sanctions in relation to conduct, where we have an independent solicitors tribunal, which is where we send solicitors whom we wish to see struck off. We also have the concept of inadequate professional service, which again is statutory and regulatory. We also have a client care manual, which is very heavy. The manual sets out best practice for solicitors in very many areas. Not to comply with the client care manual and to breach best practice is not necessarily *per se* a matter for discipline, but it is rapidly becoming so. Not only does the Law Society of Scotland scrutinise, rigorously, its members — and we have 10,000 of them — but we are subject to additional scrutiny from the Legal Aid Board, with which we have close connections, for obvious reasons now that it regulates the practice of criminal legal aid in Scotland.

Financial services was touched upon. We have the rather bizarre situation that the Law Society of Scotland has tendered to monitor for financial services solicitors in Scotland, but nowhere else, whereas the Law Society of England and Wales — and we nearly nipped them in the bud — was intent on submitting a tender to regulate the whole world.

We are soon to be regulated by the mortgage code, and that will be imposed upon us if we sign up to it. We will not be able to deliver mortgage advice business if we do not sign up to it. There is a mandatory arbitration scheme capable of making awards of up to £100,000. We have regulatory safeguards in terms of our master policy, which is our protection, not the client's protection, and risk management, which is tied in to the master policy. All of these are designed to protect our core values, and our core values are, of course, independence, confidentiality, privilege and conflict of interest.

The strange thing about it is that these were our core values before the 1949 Act came into place, and solicitors were not regulated. So, as I say, I have no advice to give you, but I am trying to give a picture of what is like to be a member of the most regulated profession in the world.

Mr T. W. Hewitson, F.F.A. (replying)**:** The Working Party, of course, has not had time to consider carefully all the very interesting and helpful comments that have been made in this discussion. No doubt they will wish to look at these in the first instance, and then the Faculty and the Institute will wish to consider more carefully how to take this work forward.

I was certainly struck by the number of comments from those who did not see the benefits or advantages in the proposals that were set out, although it was very useful to hear comments from the Canadians and one or two others saying that the potential advantages were the greater

recognition of actuaries who earned more respect and confidence, and possibly also earned a wider role, both internationally and also in dealings with other professions. Even though a number of speakers did not seem to perceive all these advantages, I was also struck by the way that almost everybody seemed to conclude that some form of peer review might well be a suitable way forward, that it could bring some advantages to the profession and to its members and, perhaps, meet some of the concerns that have been expressed.

On the subject of the benefits and the costs of the proposals that have been put forward, the opener said that the problems have not been identified in the paper, and that public relations issues would not necessarily be solved if some problem arose. The point about public relations is something that we will need to look at very carefully. I tend to favour the view expressed by the Canadians and some others, that we cannot simply stand back and wait for some serious problem to arise.

There are also the issues of proactivity or reactivity. The opener suggested that, if we behave proactively, this might help to head off the possibility that the FSA would wish to take some action. Mr Murray, very importantly, said that we should avoid any complacency and have regard to the experience in a number of other countries. Mr Brimblecombe added that we should act while we were not under pressure, and be seen to be acting properly, taking account of the public interest.

On the question of the regulators, Mr McCrossan gave us a very useful description of the events that have taken place in Canada, and the particular circumstances there which may well have driven them in one particular direction. It is interesting to see that the form of peer reviews that they now seem to be developing are the type of approach that seems to be attracting some level of support here. The opener and Mr Walther said that they would like to encourage the top-down approach, which the FSA has been suggesting recently. By that, I assume that they are referring to the focus on principles rather than looking at specific compliance with individual rules. However, there is a second aspect to this top-down approach, which may be less appreciated in some quarters, where I understand that the FSA is intending to focus much more on the impact of regulation, and that may well mean more attention being given to the larger companies rather than to the smaller firms. That would, of course, then beg the question of what form of protection can be given for some of the smaller firms. That seems to me to be an area where the profession may be able to add some value through the application of our professional standards.

Mr Hastings also made an interesting point that there might be value in having economists rather than lawyers setting the regulatory environment. A number of members here may have been somewhat alarmed at hearing the trend in the Law Society, which seems to be towards more and more rules of conduct and greater levels of discipline. We also had a very useful summary from Mr Tombs of the RIAS, giving us a useful explanation of the trends taking place there between statutory controls and self-regulation. One point that he made was that they seem now to be giving guidance to members who are perceived as being below the required standard. It was suggested that the proportion there might be something of the order of less than 10%. It certainly gives us all food for thought, and might well give us a possible way forward as well. I know that a number of people have expressed concern about what would happen in the event of some non-compliance being identified. There is, of course, a spread of views on the possibility of giving guidance, rather than moving straight to formal discipline that could lead to throwing someone out of the profession. That seemed to me a very worthwhile idea to develop further.

Guidance notes were an issue that was addressed both here and at the Institute seminar held on 2 February. Mr Batting said that he would prefer regulations to detailed guidance. I am not quite sure whether he meant that those would be monitored by regulators rather than by the profession. He also expressed some concerns over the ambiguity that exists in some of the current guidance notes. I am sure that that is something which we, as a profession, will find worthwhile to look at more closely.

The possible means of carrying out any of these reviews did not receive much discussion, although most people seem to favour peer reviews. Questionnaires were mentioned. Mr McCrossan

explained how these might demonstrate that actuaries were acting in the public interest, and, indeed, would be sweating blood in trying to complete these. I am not sure whether that is quite what we had in mind. I certainly accept the point made by Mr Hastings that open questions could well be more helpful rather than purely having a box ticking approach. Indeed, the question of quality versus box ticking was addressed by the opener, Mr Batting and Mr Sloan. They expressed concerns about the box ticking approach. Mr Murray felt that quality might be too difficult to assess. Mr Brimblecombe seemed to prefer some sort of review of quality. This whole dilemma as to the extent to which we are looking at compliance with specific points of guidance, rather than trying to address the more qualitative issues, is something that needs to be discussed much further.

One of the key issues that was raised was on consultation. As Mr Batting rightly said, this is very much the start of the process. We shall, indeed, consider very carefully just how we can advance this in a way which will add to the status and recognition of the profession, and find some positive advantages for all of us, while minimising the potential costs and any other adverse consequences.

The President (Mr C. W. F. Low, F.F.A.): This is, indeed, relatively near the start of what will be a prolonged consultation process. The implementation of any changes would require a special general meeting to deal with rule changes or ratification of bylaws. It may be that implementation of anything like this is a little way off before we achieve a sufficient degree of consensus to allow such a meeting to be held.

It is interesting that none of the home contributors touched on the view that Mr McCrossan put to us, which was the international scene. We reflect the views of our members looking at the U.K. domestic scene, that everything has been working pretty well so far, so what is the problem? Howard Davies at the FSA believes in having the Financial Services and Markets Bill written in a sufficiently flexible form to be durable. You may have noticed that, in the week before last, Clause 20 was tabled in the House. That changed the provision of the person to advise the court on a capital reorganisation of the merger of two life funds from an independent actuary, as in current legislation, to merely a person appointed by the FSA — not necessarily independent, and certainly not necessarily an actuary. Is this in line with giving Mr Davies the necessary flexibility? So, there are already signs that our profession is under threat domestically, let alone the possibilities internationally.

It is the Council's clear duty to lead the profession, but we can only lead where we can reasonably expect the profession to follow. It is for that reason that, when this Working Party's report was presented to FIMC, it refrained from endorsing the report, but merely endorsed its publication for a full discussion by the membership. We will now have to consider how to proceed. I do believe that it is the Council's duty to encourage the profession to move at least some way in this direction.

I now ask you all to thank the contributors to the discussion and the Working Party, not only for presenting and replying to the discussion, but for all their hard work in preparing the paper.