

Sir David Walker
Review of Corporate Governance of the UK Banking Industry
c/o Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Sent via email to: feedback@walkerreview.org

3 April 2009

Dear Sir David,

Independent review of corporate governance of UK banking industry

The Actuarial Profession welcomes the Walker Review. The issues and circumstances that have led to the current crisis in the banking sector are complex and wide ranging. Whilst there are a wide range of areas where the Actuarial Profession could usefully contribute we wish to focus this initial response on one specific area where we have deep knowledge and experience and where we believe the banking sector would benefit from change. We believe that significantly enhanced regulation and professionalisation of the risk function in banks would greatly strengthen the effectiveness of risk management. We believe that there is much to learn from the experience of regulated risk management roles in other sectors of the financial services industry and in this letter we set out positive aspects of two regulated roles within the insurance sector and how these could be translated into the regulation of the Chief Risk Officer (CRO) role in banks.

Our core recommendations are that:

- a new Controlled Function, the Chief Risk Officer, be established as a regulatory role
- banks must appoint a Chief Risk Officer (this may be either an internal role or if appropriate in a smaller company an external appointee)
- the Chief Risk Officer must be a member of an approved professional body and fulfil any specific or additional requirements that the professional body may specify for its Chief Risk Officer members
- approved professional bodies would need to demonstrate certain minimum standards such as professional education standards, Continuing Professional Development requirements and disciplinary arrangements

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- the CRO must have direct access to the Board and be provided with sufficient resources to fulfil the role properly
- the Board must seek the advice of the CRO in relation to changes to the organisation's business plans or in relation to any major changes in strategy or structure such as for example an acquisition
- whistleblowing regulations would be extended to encompass the CRO role
- the CRO would have defined responsibilities that would include, for example;
 - o Advising the Board on its risk exposures
 - o Maintaining appropriate risk management systems and processes in the organisation
 - o Recommending to the Board the basis for calculating regulatory capital amounts
 - o Acting as a central focus point for staff to report new and enhanced risks
 - o Giving guidance to line managers about the identification and management of risks

In Appendix 1 we detail some of the regulatory and professional requirements that apply to two reserved roles within the insurance sector. As you will see these requirements are extensive and demanding and we believe they ensure that the roles contribute significantly to the effective risk management in insurers.

We contrast these requirements with the very limited requirements that currently apply to the Chief Risk Officer. This role has become increasingly influential in all types of financial institution and in many regards is similar to the role of the Actuary. However, there are very limited regulatory and no formal professional requirements for such a role. The role of CRO is not formally recognised in regulation. There is a Controlled Function 28 which covers aspects of risk management but the rules and guidance are extremely sparse and poorly defined. Whilst there are a number of organisations operating in the risk management space, none offer a comprehensive framework to support the role of the Chief Risk Officer in banking. The nature and scope of the CRO in different organisations will vary significantly from one institution to another.

We believe that the proposals we have described above would help to ensure that the Board receives independent professional advice in relation to its risk exposures and major strategic. They would also help to embed a culture of risk management within an organisation. Whilst such



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making financial sense of the future

changes cannot guarantee that major issues would not emerge they would provide a needed and important improvement to the risk management capabilities of banks.

The Actuarial Profession would be delighted to engage with your team to provide more detail on these ideas and to work with you to develop them further.

Yours sincerely,

Caroline Instance
Chief Executive

Please reply to Staple Inn

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APPENDIX 1 – Reserved roles in the Insurance Sector

There has long existed a regulated/reserved role within the life assurance sector. We would contrast this situation with that which applies in the banking sector. Until 2004 this role was the “Appointed Actuary”. This role was effective in the vast majority of companies in ensuring that the policyholders’ interests were properly recognised. However, partly in the light of the events surrounding Equitable Life, the respective roles of the Board, the Executive and the Actuary were clarified and, to some extent, redrawn.

The newly defined regulated role was divided into two. The “With Profits Actuary” has a clear duty to the interests of the policyholders in the with profits fund. This is an important but relatively narrow brief.

The “Actuarial Function Holder” (AFH) is a much broader risk management role, the responsibilities of which are very clearly defined by the FSA. In discharging the role the AFH typically requires a sophisticated professional infrastructure. Though it is too early to make definitive claims of success there is some encouraging evidence to suggest that this role, and the culture which it creates, has been effective in helping UK insurance entities to deal with the present turmoil in financial markets.

We would contrast this situation with that which applies in the banking sector. Whilst the influence and importance of the risk function has increased in recent years there is little regulatory or professional support for this activity. In the rest of this letter we set out some of the areas where the experience of the insurance industry and the actuarial profession could be used to inform the future regulation of and risk management within the banking sector or indeed the wider financial services industry.

As noted above the role of the AFH is essentially a risk management role and could be considered in many ways similar to the role of Chief Risk Officer. To be appointed as the AFH it is necessary to be a member of a recognised professional body, and therefore to have passed extensive professional examinations, to have attended a series of professionalism courses and to have maintained an up to date CPD record. In addition, a formal application to the Professional Body is required to obtain a practising certificate, renewable on an annual basis. This is no formality – the AFH needs to demonstrate sufficient relevant experience at a sufficiently senior level to exhibit a capability to take on the regulatory role. Having obtained the Profession’s Practising Certificate an interview with the FSA’s Chief Actuary typically follows, setting out the FSA’s expectations of the role holder. Before taking on the role formal communication with the previous role holder is required to confirm whether there are any matters of which the new AFH should be aware.

The roles of Actuarial Function Holder and With Profits Actuary are regulatory Controlled Functions. A whole chapter of the FSA Supervision Manual, amounting to some 20 pages, is dedicated to the actuarial roles. The rules and guidance deal with the appointment requirements, required qualifications, consideration of conflicts of interest and then set out the core expectations of the actuary. The key requirements of the AFH are, in summary, to:

(1) advise the firm's management on the risks the firm runs in so far as they may have a material impact on the firm's ability to meet liabilities to policyholders in respect of long-term insurance contracts as they fall due and on the capital needed to support the business, including regulatory capital requirements;

(2) monitor those risks and inform the firm's management if he has any material concerns or good reason to believe that the firm:

(a) is not meeting liabilities to policyholders under long-term insurance contracts as they fall due, or may not be doing so, or might not have done so, or might, in reasonably foreseeable circumstances, not do so;

(b) is, or may be, effecting new long-term insurance contracts on terms under which the resulting income earned is insufficient, under reasonable actuarial methods and assumptions, and taking into account the other financial resources that are available for the purpose, to enable the firm to meet its liabilities to policyholders as they fall due (including reasonable bonus expectations);

(c) does not, or may not, have sufficient financial resources to meet liabilities to policyholders as they fall due (including reasonable bonus expectations) and the capital needed to support the business, including regulatory capital requirements or, if the firm currently has sufficient resources, might, in reasonably foreseeable circumstances, not continue to have them;

In the case of the With Profits Actuary the regulations have additional explicit requirements for the firm to keep the actuary informed of its plans and seek advice where there are material changes in business plans, practices or other circumstances relevant to the fair treatment of policyholders. The holders of these key regulatory posts are subject to explicit whistleblowing requirements under the Financial Services and Markets Act 2000 which require them to report to the FSA on a range of defined matters.

In addition to the formal FSA regulation there is extensive professional guidance covering a range of aspects of these roles. Perhaps the most important of the many provisions is that before accepting an appointment the individual must ensure they have direct access to the Board and adequate resources to fulfil the role. The guidance ranges from ethical codes maintained by the Profession to detailed practice standards now maintained by the Board for Actuarial Standards. The combination of regulatory and professional requirements provides an extensive and demanding framework which helps to ensure that the role holder can provide independent and valued advice to the Board.