



Institute  
and Faculty  
of Actuaries

# Compensation for Professional Shortcomings

Guide on APS X5: Compensation for  
professional shortcomings

by the Regulation Board

Not yet in force

November 2020

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## 1. Introduction

- 1.1. This Guide is issued by the Regulation Board of the IFoA. Its purpose is to aid Members' understanding of the requirements of **APS X5: Compensation for Professional Shortcomings** (APS X5) and help those Members to whom it applies to meet their professional responsibilities under it.
- 1.2. The purpose of APS X5 is to set out requirements for Members who are Principals in Organisations that provide actuarial work to external Clients, to have in place measures relating to compensation of Clients, or alternative arrangements relating to liability, for loss caused by professional shortcomings relating to that actuarial work.
- 1.3. This Guide includes background information about the rationale and aims of APS X5 and explains its scope and application.
- 1.4. Recognising that there will be a variety of different suitable approaches, this Guide also provides some examples of what appropriate arrangements for compensation might be and the types of considerations Members who are Principals might wish to have in mind when determining what measures to put in place.
- 1.5. The Guide also contains, at Appendix 2, some useful information about professional indemnity insurance (PII) and some considerations that Members might want to have regard to when procuring this type of cover, recognising that, while PII is not compulsory in terms of APS X5, it is one of a range of Appropriate Arrangements that may be adopted.
- 1.6. Members must at all times remember the obligations imposed on them by the Actuaries' Code (the Code).
- 1.7. This Guide imposes no obligation upon Members over and above those embodied in the Actuaries' Code or APS X5.
- 1.8. While the Guide may be referred to and considered in the course of disciplinary proceedings it will not necessarily provide a defence to allegations of misconduct.
- 1.9. The defined terms used in APS X5 apply to this Guide.

## **2. Preliminary consideration – minimising risk**

- 2.1. The IFoA's regulatory framework, including the Actuaries' Code and Actuarial Profession Standards (the "Framework"), imposes on Members a number of professional requirements relevant to carrying out actuarial work for external clients. For example, the Actuaries' Code requires that Members respect confidentiality, carry out work with competence and care, act impartially and communicate accurately, while APS X2: Review of Actuarial Work imposes requirements in relation to Work Review and Independent Peer Review.
- 2.2. Compliance with the Framework, as well as any other relevant professional standards, should mean that the risk of loss to users of actuarial work caused by professional shortcomings is minimised and the potential for subsequent claims for compensation for loss is reduced.
- 2.3. It can therefore be helpful to ensure wherever possible that operational policies and procedures that are applicable to actuarial work within an Organisation effectively take account of the Framework

## **3. APS X5: Key provisions and principles**

### **Background**

- 3.1. Wherever they are working in the world, Members will generally have legal duties to Clients, whether as a result of direct contractual relationships or indirectly through their employers, to make sure that when they provide a service it is carried out to a certain standard. In many jurisdictions, this is expressed as having a duty of care. The requirements of a duty of care usually include working to appropriate professional standards and considering how advice may influence the decision making or judgement of users.
- 3.2. APS X5 has three particular aims:
  - i. To ensure reasonable provisions are in place in relation to compensation of Clients of External Actuarial Work for loss caused by the professional shortcomings of Members, or to ensure alternative arrangements relating to liability are in place;
  - ii. To raise awareness and encourage Members, particularly sole practitioners and those working for firms with insufficient resources, who could find themselves personally liable for compensation, to ensure they are adequately protected; and
  - iii. To be proportionate, balancing the need for appropriate protection for users of actuarial services against the need for sufficient and appropriate flexibility to ensure Members are not subject to an unreasonably onerous burden.

## Key provisions of APS X5

- 3.3. APS X5 requires Members who are Principals in Organisations that provide actuarial services to external Clients to consider the potential for those Clients to suffer loss, in relation to the External Actuarial Work provided and ensure that Appropriate Arrangements in relation to compensation for such loss, or alternative arrangements in relation to liability, are in place.
- 3.4. APS X5 also includes the further general requirement that Members who are Principals in Organisations that provide actuarial services to external Clients must ensure that they are in a position to justify the appropriate arrangements that they have in place, if reasonably called on to do so. This may be in response to a request from the IFoA for example.
- 3.5. Members who are Principals are encouraged to document their reasoning at the time any Appropriate Arrangements are made, however such justification can also be provided at a later stage, on request.

## Scope and application of APS X5

- 3.6. APS X5 applies to Members who are Principals in Organisations that provide actuarial work to external Clients.
- 3.7. A Principal of an Organisation is defined in APS X5 as:

*A Member who is responsible for, or has material input into, determining any measures taken by that Member's Organisation to compensate Clients for loss caused by professional shortcomings or deciding alternative arrangements in relation to liability.*
- 3.8. In most cases it will be clear whether or not a Member is a Principal of an Organisation. Principals will typically hold a senior position within an Organisation, for example a Partner, Director or Senior Manager, and have responsibility for how that Organisation is run, however not all Members holding senior positions will necessarily fall within the definition of 'Principal'. Members are expected to exercise judgement in determining whether or not they fall within the definition.
- 3.9. APS X5 does not impose any obligations upon Members who do not fall within the definition of a 'Principal'. Members who are not caught within the definition are entitled to satisfy themselves about the Appropriate Arrangements in place within their organisation however they do not have any responsibilities in terms of APS X5.
- 3.10. APS X5 applies to all practice areas and is not limited in terms of geographic scope.

- 3.11. The requirements of APS X5 only apply to Principals in Organisations that provide External Actuarial Work so would not apply where the work is provided for an Organisation's own use rather than that of an external Client, for example where actuaries are working in-house for insurance companies.
- 3.12. In some Organisations, those responsible for determining measures to compensate clients for loss or other appropriate arrangements may not be a member of the IFoA and therefore not subject to the requirements of APS X5.

#### 4. Appropriate Arrangements

- 4.1. Appropriate Arrangements, in terms of paragraph 1.1 of APS X5, are not prescribed and may take one or many forms, depending upon the particular circumstances in each case and taking into account any relevant legal duties. They might include:
- i. **The scope and extent of any PII applicable to the work.** Having PII cover would generally satisfy the requirement to have Appropriate Arrangements in place, providing cover is adequate. For further information on PII please see Appendix 2 of this Guide.
  - ii. **The terms of the contract between the Client and the Organisation.** This might include, for example, agreement in the contract with the Client on the scope of the advice being provided and any limitations in relation to the potential liability for any losses. Another Appropriate Arrangement might be a ring-fencing arrangement to ensure a Client has a prior claim on assets in insolvency.
  - iii. **The terms of the contract between a Member and their employer or other organisations for which they work.** For example, there may be terms setting out matters for which responsibility is accepted by the employer and the extent of any indemnity provided to the Member. In many circumstances, a Member's employer will be vicariously liable for the actions of the employee.
  - iv. **The Organisation's own resources.** An Organisation may have its own resources, for example PII or business insurance, to cover any claims for liability.
  - v. **The personal financial resources of a Member.** Relying solely on this could be risky for both Member and Client and is not encouraged unless the Member has sufficient means to provide reasonable and proportionate compensation.
- 4.2. In many instances a combination of measures might be adopted as Appropriate Arrangements. In a large consultancy for example, appropriate PII together with contractual provisions dealing with liability might be adopted to provide adequate compensation for loss. PII is however not universally available or it may be available only at a disproportionate cost (an example might be

where a firm or individual based in the UK provides advice to US clients). In such circumstances, other Appropriate Arrangements might be adopted in combination, such as: mutually agreed contractual provisions limiting liability, together with the organisation/individual's own resources and other measures such as the ring-fencing arrangement set out in paragraph 4.1(ii) above.

- 4.3. Members who are Principals are expected to use their professional judgement when determining whether an arrangement is 'Appropriate' in all of the circumstances of the particular case.
- 4.4. A contract between an actuarial firm and a commercial client that limits or excludes liability may, for example, be a permissible form of 'Appropriate Arrangement' if the terms are lawful and the limitations are reflected in the fee agreed by the Client for those services.
- 4.5. Other arrangements, for example pro-forma contracts with a consumer client which contain very broadly drafted limitation or exclusion of liability provisions may not be considered an 'Appropriate Arrangement' depending on the nature of those arrangements. An example of this could be a Member valuing pensions on divorce for members of the public through a limited company with little assets and without PII, relying instead on generic contractual clauses to avoid liability in a situation in which their client is unlikely to understand the significance of these.
- 4.6. Some types of liability cannot be excluded. Members are advised to seek legal advice in relation to contractual arrangements which contain provisions limiting or excluding liability.

## 5. Contact us

- 5.1. The content of this guide will be kept under review and for that reason we would be pleased to receive any comments you may wish to offer on it. Any comments should be directed to:

**Regulation Team (Ref: APS X5)  
The Institute and Faculty of Actuaries  
Level 2, Exchange Crescent  
7 Conference Square  
Edinburgh  
EH3 8RA**

*or*

- 5.2. Members may also use the IFoA's Professional Support Service (PSS), which is a free guidance service that can assist with any professional or technical actuarial matters including queries about the appropriate standards to apply to a piece of work. Queries can be submitted through the IFoA's website using the PSS form<sup>1</sup>.

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<sup>1</sup> <https://www.actuaries.org.uk/upholding-standards/professional-support-service/submit-query-professional-support-service>

## Appendix 1

### APS X5: – COMPENSATION FOR PROFESSIONAL SHORTCOMINGS

**Version:** 1.0, effective from 20 November 2020

**Purpose:** The purpose of this **APS** is to set out requirements for **Members** that are **Principals** in **Organisations** that provide **Actuarial Work** to external **Clients**, to have in place measures relating to compensation of **Clients**, or alternative arrangements relating to liability, for loss caused by professional shortcomings relating to that actuarial work.

#### 1. **Appropriate Arrangements**

1.1. A **Member** who is a **Principal** in an **Organisation** that provides actuarial services to external **Clients** must consider the potential for those **Clients** to suffer reasonably foreseeable loss, whether direct or indirect, caused by negligence, breach of duty of care or equivalent legal liability in relation to the **External Actuarial Work** provided and ensure that **Appropriate Arrangements** are in place in relation to compensation for such loss.

2. A **Member** who is a **Principal** in an **Organisation** that provides actuarial services to external **Clients** must ensure that they are in a position to justify the **Appropriate Arrangements** they have in place in relation to 1.1, if reasonably called upon to do so to.

#### 3. **Interpretation and application**

3.1. A failure to comply with this **APS** may result in a finding of misconduct in terms of the **IFoA's Disciplinary Scheme**.

3.2. This **APS** uses the word "must" to mean a specific mandatory requirement.

3.3. In the event of any inconsistency between this **APS** and the **Actuaries' Code**, the **Actuaries' Code** prevails.



#### 4. Definitions

Term	Definition
<b>Actuarial Work</b>	Work undertaken by a <b>Member</b> in their capacity as a person with actuarial skills on which the intended recipient of that work is entitled to rely. This may include carrying out calculations, modelling or the rendering of advice, recommendations, findings, or opinions.
<b>Actuaries' Code</b>	The ethical professional code for <b>Members</b> issued by the Institute and Faculty of Actuaries.
<b>APS</b>	Actuarial Profession Standard issued by the Institute and Faculty of Actuaries.
<b>Appropriate Arrangements</b>	<p>These are not prescribed and may take one or many forms, depending upon the particular circumstances and taking into account any relevant legal duties. They might include, for example:</p> <ul style="list-style-type: none"><li>• the scope and extent of professional indemnity insurance (PII) applicable to the <b>Organisation's Actuarial Work</b></li><li>• the terms of the contract between the <b>Client</b> and the <b>Member</b> and/or his or her employer;</li><li>• the resources available to the <b>Member's</b> employer; and/or</li><li>• the personal financial resources of the <b>Member</b>.</li></ul>
<b>Client</b>	The person, including a corporate entity, for whom the <b>Actuarial Work</b> is produced
<b>External Actuarial Work</b>	<b>Actuarial Work</b> provided to a <b>Client</b> that is external to the <b>Organisation</b> .
<b>IFoA</b>	The Institute and Faculty of Actuaries.
<b>IFoA's Disciplinary Scheme</b>	The currently in force Disciplinary Scheme of the Institute and Faculty of Actuaries, as may be amended from time to time.

<b>Member</b>	A member of the Institute and Faculty of Actuaries.
<b>Organisation</b>	A corporate entity, including, for example, companies, partnerships and Sole Traders.
<b>Principal</b>	A Member who is responsible for, or has material input into, determining any measures taken by that Member's <b>Organisation</b> to compensate <b>Clients</b> for loss caused by professional shortcomings, or deciding alternative arrangements in relation to liability.

Not yet in force

## Appendix 2

### Professional Indemnity Insurance

1. Professional Indemnity Insurance (PII) provides an indemnity to individuals and/or firms who are insured in the event of their incurring a liability to pay damages, for example, as a result of negligence. It may also meet legal and other defence costs.
2. In certain circumstances PII may be required by law or other regulations. An example is the requirement under the IFoA's Designated Professional Bodies regime for licensed firms to have PII in place. PII may also be stipulated as a contractual requirement by a Client for specified categories of work.
3. PII is not always universally available or may only be available at disproportionate cost and/or with significant coverage limitations. If so, other arrangements may need to be considered either to provide compensation for loss or to make other arrangements in relation to liability.
4. When relying on PII, Members who are Principals are expected to consider the cover and be satisfied that it is reasonable in the circumstances. Principals procuring PII on behalf of an Organisation are encouraged to take account of the following considerations:

#### Scope of cover

5. When considering the scope of any cover, the following factors are likely to be relevant:
  - i. The risk exposure involved in the type of work undertaken, with regard to potential for individual losses and accumulation of claims over time; and
  - ii. Appropriate advice, e.g. from a broker, that reasonably balances best practice and cost.

#### Limit of Indemnity

6. There is no one-size-fits-all approach to quantifying a reasonable and proportionate limit of indemnity. Consideration of the following factors can assist:
  - i. Estimation of maximum reasonably envisaged risk exposure both in terms of the maximum individual loss and the scope for accumulations of claims within any 12-month period, by virtue of the nature of the work and the scale of activity within the organisation. Identifying those who are at risk as a result of work undertaken, either directly or through a clearly defined contractual chain should assist in determining whether any claim for compensation might be expected to be made directly or through another party in any contractual chain, or both;
  - ii. The costs of defending a claim for compensation;
  - iii. Comparison, if available, with the approach adopted by colleagues or similar organisations;

- iv. Levels and terms of indemnity available, including excesses applied; and
- v. Proportionality of cost.

### **Levels of Excess**

- 7. Members who are Principals will be expected to use their judgement, taking into account their Organisation's particular circumstances, to ensure that any level of excess for PII cover can be covered by other Appropriate Arrangements.

### **Run-off Cover**

- 8. Most PII policies are provided on a claims-made basis, rather than a claims-occurring basis.
- 9. A claims-made basis covers claims that are made and reported during the policy period only and not once the policy period is over.
- 10. A claims-occurring basis covers claims that occur during the policy period irrespective of when the claim is made.
- 11. In order to cover claims that arise from actions carried out during the policy period but made after the end of claims-made policy, for example on retirement, it is likely to be appropriate to consider, if available, purchasing run-off cover that lasts until at least the legal limitation for the type of claims that could be made within any relevant jurisdiction. For example, the limit for most types of claim in England and Wales is six years; in Scotland it is five years. It should be noted, however, that limitation periods can be longer and Members who are Principals would be expected to consider whether, taking into account the particular circumstances, it is reasonable and proportionate to have a longer period of run-off cover. It may be sensible to seek legal advice on limitation periods applicable to the work covered and the relevant jurisdiction.

### **Errors and omissions cover**

- 12. Where the conclusion is that PII is not required, for example because of the financial strength of an Organisation, or an Organisation's PII cover is limited, Members who are Principals may wish to ensure that the Organisation will provide an indemnity in respect of personal liability for any errors or omissions.
- 13. If such an indemnity is not forthcoming, PII cover can be arranged in a Member's own name against claims made by third parties, but this might not cover claims brought by an employer.