

Comments on Morris Review

January 2005

These comments come from the life assurance companies in the Abbey National Group. The Interim Assessment covers a wide range of topics and we offer a number of comments, more or less in the order in which the topics appear in the report.

Executive Summary

Paragraph 7 refers to the fabled actuarial "black box". We fear that the new emphasis on stochastic modelling (which we support) is likely to make matters more, rather than less, opaque.

Conflicts of interest are mentioned in Paragraph 30. Our experience is that the Directors of a Life Company are very well aware of the conflicts of interest between shareholder interests and policyholder interests (and the conflicts between the interests of different classes of policyholders). From conversations with Pensions colleagues we believe Trustee Boards (which will often include company appointees, elected scheme members and, sometimes, trade union representatives) are also well versed in recognising and handling conflicts of interest.

Introduction

Paragraph 1.3 says that life company liabilities have historically not been subject to scrutiny. Our experience over many years is that most Annual Returns have given rise to questions from whoever was the current statutory regulator.

There is discussion starting at paragraph 1.28 of the role actuaries are alleged to have played in the collapse of confidence in long-term savings. We don't believe this analysis stacks up. Consumers have lost confidence in PEPs and ISAs as well, and actuaries have no role in the management of these products.

The paper criticises actuaries for not adopting disciplines such as financial economics. Paragraph 1.42 suggests that if all actuaries had been armed with this knowledge, we might have been better

prepared for the recent stock-market crash. However, our understanding of financial economics is that the use of such models indicated that the possibility of the stock-market fall in three consecutive years was an extremely unlikely event.

The market for actuarial services

We offer four observations:

- Our experience is that insurance company boards and, more recently, our With Profit Committees, have not had undue difficulty in understanding the key issues and have not been slow to offer challenge.
- Any reports produced by one of our actuaries (whether in a reserved role or not) will normally be seen by a number of actuarial colleagues. Even though no formal peer review is invited, we would expect comments and challenge if there were any questionable content.
- As purchasers over the years of a wide range of actuarial consultancy we have rarely felt there was any shortage of potential providers.
- While there are obviously roles for non-actuarial investment advisers we would be very concerned if assets and liabilities were not considered as a package at some stage as there are important links. For example if bonds “do well”, this is because long-term interest rates have fallen and this may well lead to the liabilities increasing by a greater amount than the increase in the asset value. It is quite possible for bonds “doing well” to be detrimental to a life or pension fund.

The profession and regulation

We note the comment in section 3.8 asking whether we continue to need a separate Faculty. We would suggest we do and offer as evidence:

- It gives a focus for activity in an area geographically distant from London with the result that there are more actuaries involved in voluntary work for the profession than would be the case if there were no Scottish base.

- Scotland does have distinctive features to its educational, legal and social institutions and the profession needs to have some mechanism to ensure it reflects these when necessary.
- The establishment of a Scottish Parliament means that there are pressures for more Scottish Institutions, rather than fewer. To the extent that legislation on devolved matters or other public interest concerns with a distinct Scottish dimension would benefit from an Actuarial input, this is much more likely to be provided, and much more likely to be listened to, if it can be provided from a Scottish Faculty rather than from a London-based Institute.

Actuarial roles.

There are significant issues associated with the option of having the With Profit Actuary (WPA) external to the Life Company. The volume and intensity of interaction that the WPA will need to have with the business makes it difficult to see how operating with an external WPA would be feasible. This is especially the case when the WPA also has substantial detailed responsibilities under a scheme of demutualisation.

We do not think the situation would be altered from present arrangements, in any genuine sense, if the WPA were external to the company, but performing that role was his only, or principal, source of remuneration.

Paragraph 4.19 mentions the possibility that the WPA need not be an actuary. Our experience is that the WPA's role is as actuarially intense as the Actuarial Function Holder's role. There is a need to understand the multiplicity of assumptions underlying the realistic balance sheet, and the calculation of the With Profits Insurance Capital Component. The actuarial load is increased if the WPA also has responsibilities under a scheme of demutualisation. We agree, however, that the WPA should not be the whole mechanism for assessing fairness. The existence of the WPA does not preclude having other sources of advice upon fairness issues. Indeed we note that our With Profits Committee has access to advice from an external lawyer, from our internal auditors and our investment professionals in addition to advice from the WPA.

Public Interest and Accountability.

Paragraph 30 of the Executive Summary mentions that actuaries face multiple, and often conflicting, responsibilities. We note the paper has not analysed whether actuaries are unusual in this situation. If actuaries are not unusual in this regard, it may be possible to identify helpful lessons to be learned from other professions on how to manage this issue. Reference is made in the paper to other professions, but these references are not focused on the multiple stakeholder issue.

One option proposed in Paragraph 5.85 is for the WPA to be appointed by the With Profits Committee. It is difficult to see how this would work, if the WPA's contract of employment remains with the life company. In addition, there seems to be the complication that there is no obligation upon the company to have a With Profits Committee. However, this option does at least recognise that a WPA's major line of reporting can be to the With Profits Committee.

Option 4 in Paragraph 5.85 says the WPA could make a full report to the regulator. Presumably this possibility could be combined with any of Options 1, 2 or 3.

Providing the WPA's full report to customers may expose the Actuary to excessive risk of class action and may reduce the number of actuaries willing to perform this role.

Education and CPD.

We are wholly in favour of encouraging those not in reserved roles to keep up their CPD, but are less convinced about the need for compulsion or about the division between formal and informal CPD.

However our main point on CPD is to note that the report makes very little reference to the profession's role as a learned society which encourages and publishes research. The *British Actuarial Journal (BAJ)* is not always the first choice of publisher for UK academics, but we still

have in *BAJ* a journal publishing every year a fair number of fully refereed academic papers and making the fruits of research available to the membership.

In addition to *BAJ* we have the long-running and well-regarded research and reports of the Continuous Mortality Investigation Bureau and the Profession's Research Committee encourages, and makes grants to, relevant research projects.

We comment that 6.125 is not quite right - the Appointed Actuary role is of considerably older vintage than 1992.

Standard Setting

There is a criticism that the principal life guidance notes did not go far enough in pinning down proper and best practice for Appointed Actuaries. There is a difficulty here in that there was a statutory regulator in the person of the Secretary of State. It is hard to believe that any shortcomings in the Regulations that were known within the profession were not also well known to the Secretary of State, or to his appointed advisers. If we suppose that the Secretary of State and his advisers knew about any problems and chose not to bring in amending regulations or to issue guidance, then it is arguable that it would have been inappropriate for the profession to bring in quasi-regulation by means of professional guidance.

We note the comment that professional guidance has not always been kept up to date. This has not been our experience in the life area, where there must have been large amounts of work put in by the drafting committees, particularly during 2004, to achieve the publication of new guidance alongside the successive revisions to FSA Rules.

On the topic of policyholders' reasonable expectations (PRE) we note that the profession did extensive work on what was meant by PRE, most notably the reports from the working party chaired by Bernard Brindley in the early 1990s. The statement that the profession did not follow this work through to conclusions is not entirely fair.

There are scattered references to PRE in earlier material but it was only with the use of the term in the 1973 Insurance Companies Amendment Act that the term came into widespread usage. It came in as part of a clause giving the Secretary of State power to intervene in a company's affairs if he had reason to think that policyholders' reasonable expectations might not be fulfilled. We might ask whether it was really the profession's role to define a legal term.

By today's standards, one would expect a reasonable regulator taking such powers to have attempted to explain what the term meant, and indeed by today's standards it seems somewhat strange that it was left up to those being regulated to decide for themselves what the legal provision meant.

Scrutiny and discipline

In our situation of a firm employing several dozen actuaries, with the two reserved roles held by separate individuals and with other actuaries filling distinct roles in capital management, as finance director and in pricing and allowing for the new requirement for the auditor to take advice from a Reviewing Actuary in certifying the liabilities and with an active With Profits Committee, we are unconvinced of the need for a new further layer of external scrutiny.

Paragraph 8.42 sets out options for scrutiny of actuaries in life assurance. Expanding the Reviewing Actuary's role does seem likely to lead to increased market concentration in the provision of actuarial services.

We comment that whether external scrutiny of the work of the With Profits Actuary would be needed would seem to depend on decisions taken on the future role of the WPA. For example, external scrutiny might be unnecessary if the WPA were external to the company, or had a direct reporting line to the FSA.

GAD

We have no recent experience of dealing with either the GA himself or with GAD, but we suggest that it seems odd to publish a review of GAD which does not include some comparison with how Government interacts with its principal advisers in the legal, accountancy & audit and banking professions and with advisers in medicine and other scientific disciplines.

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