

Sir Derek Morris,
The Morris Review
Room G/37
1 Horse Guards Road
London
SW1A 2HQ

3 February 2005

Dear Sir Derek,

MORRIS REVIEW

Please find attached the response from the Lloyd's Market Association (LMA) to the interim report from the Morris Review, published in January.

The LMA represents the interests of the Lloyd's underwriting market, and all the Lloyd's managing agents are members. I am writing this response in my capacity as Chairman of the LMA Committee of Actuaries in the Lloyd's Market.

We welcome the publication of the Interim Report, and congratulate the review group on the work they have done to date. The LMA's detailed responses to the various options are set out in the attachment; there are, however, three key themes we would like to emphasise.

1. We wish to stress the need to avoid any temptation towards "one size fits all" solutions. General insurance is different. Actuarial work is generally carried out for a far more expert customer than is the case in the pensions discipline and, we suggest, the life discipline too. Whether it be a reserve review for the board of a managing agency, or a rate review for an individual underwriter, that customer will generally use actuarial input to inform their decision making, rather than rely on it unconditionally.
2. We believe it is the job of the board of a managing agency to run that business properly and responsibly and, hence, are against any measures that transfer responsibility (and accountability) from that board to any external or in-house professional. We therefore have concerns about the current reserved role for actuaries in Lloyd's and would not support any extension to this reserved role in the Lloyd's context, nor even the introduction of an equivalent reserved role in the company market.

3. Lloyd's managing agencies are informed users of actuarial services, and we believe most decisions they make to use such services will be cost-benefit driven. In this regard, we believe that any steps to add materially to the professional bureaucracy underpinning actuarial services, for example, by introducing compulsory peer review, will merely add to the costs of those actuarial services, without materially changing the benefit to the customers. There is a real risk that some of the options set out in your interim report would, if implemented, make the profession uncompetitive. Users of non-reserved actuarial services would be encouraged to "profession shop" and, perhaps, replace actuaries in those roles with non-actuaries with actuarial skill sets. Thus, setting the standards bar too high for the actuarial profession could lead to an overall lowering of standards in the general insurance industry, to the benefit of no-one.

Thank you for the opportunity to feed our views in at this stage of the review process. We look forward to the publication of the final report in the spring.

Yours sincerely,

MARK GRAHAM
Chairman, LMA Committee of Actuaries in the Lloyd's Market

LLOYD'S MARKET ASSOCIATION RESPONSE TO THE INTERIM REPORT OF THE MORRIS REVIEW OF THE ACTUARIAL PROFESSION

CHAPTER 2: THE MARKET FOR ACTUARIAL SERVICES

Increasing Competition

We believe that the lack of professional indemnity insurance cover does act to constrain entry and limit choice. In particular, with regard to Lloyd's SAOs, we believe that the current situation creates a bias towards external, rather than in-house, sign-off, for the following reasons.

- External signatories fulfil their role as an employee of a consulting firm, and benefit from the professional indemnity insurance that firm will have in place as a matter of course. In-house actuaries sign as individuals, rather than as employees, and are not covered by any professional indemnity cover their employer will have in place. They either have to sign without professional indemnity cover or arrange specific cover for the purpose of fulfilling this statutory role.
- When the in-house actuary, or his employer, wishes to arrange specific professional indemnity cover for signing Lloyd's opinions, such cover may prove to be unavailable in practice or, otherwise, prohibitively expensive. There are certainly instances where this has been the case in recent years.

Thus, as well as supporting the introduction of liability caps, as set out under Option 1, we would also propose that the guidance be changed to allow in-house actuaries to sign in their capacity as an employee of the managing agent, rather than as an "independent" professional. This is consistent, for example, with the treatment in the accounting profession of a finance director signing off company accounts.

Increasing market testing: (a) greater scrutiny of performance

We are strongly of the belief that it is for the board of the managing agency to determine the appropriate level of scrutiny of performance of actuaries carrying out work for that managing agency. That will vary according to circumstances and it is not appropriate for either the profession or your review to attempt to mandate the level or frequency of scrutiny of performance.

That said, we would support the profession in the following:

- making available courses to assist users in interpreting actuarial work (Option 1); and
- encouraging performance measurement of actuaries, for example, by way of publishing guidance on how this could be carried out in practice (Option 3).

We believe that decisions as to the frequency of formal reviews of actuarial advisors and any encouragement for them to improve the clarity of the advice they give should be left to market forces.

Increasing market testing: (b) improving user understanding

We do not believe that lack of user understanding is a major issue in general insurance and, more particularly, the Lloyd's market.

We do recognise, however, that it can be an issue for non-executive directors who do not come from an insurance background, or executive directors from operational disciplines. Hence, we reiterate our support the profession making specialist training available to such individuals.

Improving clarity of actuarial advice

We are strongly in favour of Option 1 – leave it to the market – although we do believe the profession could and should improve its guidance notes to encourage clearer disclosure of actuarial advice, assumptions and key sensitivities. We must stress, however, that the example given in Option 3 – “requiring the disclosure of forward-looking financial condition reports” – is not, in our view, an appropriate route to achieving this.

CHAPTER 4: ACTUARIAL ROLES

Reserved role in general insurance

We support Option 1: continue with the status quo – no reserved role. It is our view that the actuarial reserve estimate is one of many items of information that a board should consider in setting reserves for a general insurance business, albeit it is often the most important item. Many of the assumptions made by the actuary in arriving at his reserve estimates are not truly actuarial in nature but, rather, rely on the expertise of other specialists. Examples include: underwriter estimates of ultimate claims from recent catastrophe losses; Reinsurance Security Committee estimates of default probability grades on unrated reinsurers; legal opinions in respect of disputed claims; legal opinions in respect of contract wordings; etc. We would argue that the managing board of the business is best placed to pull all these different items of information together to determine the appropriate level of reserves. We would also extend this argument to the determination of best estimate reserves for a Lloyd's managing agency.

CHAPTER 5: PUBLIC INTEREST AND ACCOUNTABILITY

Reporting and whistle-blowing

We do not believe that the whistle-blowing responsibility of an employed actuary is any different from any other senior manager in a general insurance business. For consultant actuaries, the position is less clear, and there may be an argument for bringing their requirements closer to those of auditors. In all cases, actuaries would benefit from clearer guidance from the FSA on the circumstances in which whistle-blowing is required, although we do not underestimate the challenge of producing this.

Actuarial Function Holder

We do not have a view on this item.

With-Profits Actuary

We do not have a view on this item.

Reviewing Actuary

We do not have a view on this item.

Pensions

We do not have a view on this item.

CHAPTER 6: EDUCATION AND CPD

The syllabus and governance

We support Option 1: minor reform of the existing governance structure to promote greater academic and non-actuarial input.

We believe that Option 2 is out of proportion with the size of the actuarial profession.

Examinations issues

We favour Option 2: involvement of full-time and dedicated professional examiners, provided it can be introduced on a cost-effective basis.

Broadening actuarial education provision

We support Option 1: wider provision and accreditation of degrees that grant exemption from the Profession's exams. We view the practical nature of the actuarial profession as one of its great strengths, and our concern with Option 2 is that it will weaken the Profession by producing qualified actuaries with little or no practical experience.

Continuing professional development (CPD)

We support Options 1, 2 and 3. We must stress, however, the need for the Profession to provide more CPD specifically tailored for reserved role holders.

We are strongly against Option 4. It is our view that giving a greater role to research-orientated actuaries and overseas actuaries would lead to an over-emphasis on theory, as opposed to practice, in actuarial CPD.

CPD monitoring

We believe that CPD is a key responsibility throughout the profession, not just for reserved role holders. Hence, we favour Option 2.

CHAPTER 7: STANDARD-SETTING

Actuarial standard-setting

Given the highly technical nature of most actuarial guidance we believe that the Actuarial Standards Board comprised largely of lay people, as currently envisaged by the profession, would more than likely lead to worse standards, not better ones.

We favour Option 2: an Actuarial Standards Board subject to oversight by a suitably independent body, with the proviso that the Actuarial Standards Board should comprise mainly of actuaries.

CHAPTER 8: SCRUTINY AND DISCIPLINE

Scrutiny of actuaries in life assurance

We have no view on this item.

Scrutiny of actuaries in pensions

We have no view on this item.

Scrutiny of actuaries in general insurance

Actuaries providing advice to general insurance companies are already dealing with expert customers. Work of external actuaries will normally be scrutinised by internal actuaries, underwriting experts and/or finance experts. Work of in-house actuaries will also be scrutinised by underwriting and finance, and key uncertainties will generally have been discussed by experts on the in-house team. The reserved role in providing a statutory opinion is, in practice, an annual staging post in a rolling quarterly process that progresses perfectly well without formal actuarial involvement at the first, second and third quarter-ends.

It is our view that, whether a Lloyd's managing agency or a non-Lloyd's insurance company, it is for the board of that business to set reserves and make other business decisions on which it may have sought actuarial advice. It is also for that board to ensure that it has a process in place to ensure that such actuarial advice gets reviewed, when necessary, and to determine the form of any such review. We, therefore, cannot support either of Options 1 and 2 for the company market, and any of Options 1, 2 or 3 for Lloyd's. In particular, we would argue that the introduction of onerous scrutiny requirements, in particular peer review, is likely to harm actuaries' employability in general insurance, and may lead directly to "profession shopping" by employers. Where the replacement non-actuaries are subject to either lower or no professional standards (e.g. statisticians, mathematicians, economists), then overall standards are likely to drop, to the benefit of no-one.

Discipline

We have no view on this item.