

# MORRIS REVIEW OF THE ACTUARIAL PROFESSION

## Interim Assessment

### Response from HSBC Actuaries and Consultants Limited

HSBC Actuaries and Consultants Limited (HACL) is an integral part of one of the world's largest financial services organisations and is a leading UK actuarial and employee benefit consultancy.

HACL employs over 400 people in 9 offices throughout the UK and through its participation with both the HSBC Group and a major international employee benefits network, is extending its international presence.

We have chosen to respond to the Interim Assessment primarily by discussing the series of options which have been set out in the Assessment under each of the chapter headings. This response has been led by our Chief Actuary, Alistair Meikle (e-mail: [alistair.meikle@hsbc.com](mailto:alistair.meikle@hsbc.com))

As a firm of consulting pensions actuaries we are of course not expert in all areas of actuarial activity and so have left others who are better informed to respond to certain sections of the Assessment.

We have found the Assessment very thorough and thought provoking. It is unfortunate that the press have focussed on extracting sound bites from the Executive Summary which is perhaps less balanced than the Assessment as a whole.

We would of course be very happy to expand on any of the ideas set out in our response if that would be of assistance to the Review.

## CHAPTER 2: THE MARKET FOR ACTUARIAL SERVICES

We are pleased with the conclusions reached regarding the extent of competition and choice within the pension scheme market and the level of user satisfaction.

### Increasing competition

#### Options

- Option 1: to the extent that the availability of professional indemnity insurance cover is acting or may in the future act to constrain entry and limit choice, ways could be explored of introducing liability caps; and/or
- Option 2: in the pensions area, unbundling the provision of advice related to statutory roles from other types of advice (particularly investment consulting services) would help open up the market to greater competition.

We note and agree with the view that there is undue concentration of actuarial advice amongst the larger pension schemes.

There is a real risk that PII cover is having a negative effect on competition. Ongoing funding and solvency debates have recognised that certainty has a cost and it would seem a reasonable quid pro quo for the efficiency of the market to improve in the normal course of events at the price of capped cover when things go wrong. It would be logical for peer review and other initiatives to drive down the cost of PII but other factors may prevent any net benefits emerging.

The interim assessment has recognised the strong link between long term liabilities and investment strategy. Historically the investment management industry has placed too little emphasis on scheme liabilities in formulating strategic advice and it is natural for a significant element of such advice to come from the actuarial incumbent. Having said that, there does appear to be an excessive degree of inertia amongst the larger pension schemes and if this is a way of opening up this market and exposing users to smaller firms then it might be worth pursuing further. Where investment consulting is provided outwith an actuarial environment there ought to be an equivalent level of interest and scrutiny to ensure that such advice is not provided in the absence of a proper appreciation of long term liabilities.

## **Increasing market testing**

### **a) greater scrutiny of performance**

#### **Options**

- Option 1: increased education/expertise of users; and/or
- Option 2: regular formal reviews of advisers could be recommended or required every 3-5 years; and/or
- Option 3: performance measurement of actuaries could be encouraged; and/or
- Option 4: effective peer review of actuarial advice could provide actuaries with a set of incentives that encourages them to improve the clarity of advice they provide, both technical and in relation to underlying assumptions.

Increased education of users is essential particularly at the smaller end of the market and hopefully the measures introduced by Pensions Act 2004 will improve matters. Unfortunately, the costs of training will be more of a burden for the smaller schemes.

A requirement for regular reviews would have no parallel in other professions/industries and would introduce more negative than positive consequences. The incentive for actuaries to provide sound long term advice would be reduced and there would be an incentive for users to switch away from good advisers simply in order to avoid a charge that a relationship has become too cosy.

Performance measurement would be a good thing but as has been noted it is difficult to measure some aspects of actuarial advice particularly over the short term. Some criteria could however be developed and such a system might also help to establish a culture of scrutiny.

Peer review will improve the way in which advice is presented and therefore improve opportunities for the end user to challenge that advice. However, it is very true that compliance pressures have increased the complexity of advice and made it more difficult for the actuary to determine what is an accessible and effective style of communication for a particular client

## **b) improving user understanding**

### **Options**

- Option 1: user knowledge and understanding should be encouraged by measures to raise the required standards of knowledge and expertise, of which several initiatives are already in train; and/or
- Option 2: in relation to pensions, trustees could be given information on the Profession's own guidance notes, to better understand what actuaries are supposed to do. This could be used as a basis for encouraging more systematic challenge; and/or
- Option 3: greater use of professional trustees or trustees who are members of several trustee boards.

Option 1 is long overdue – see comments under a).

The guidance notes do assume a considerable amount of technical knowledge and would only really be accessible and useful in this respect to users that already have a very high level of understanding. Perhaps the Profession could produce a layman's guide to each of the Guidance Notes.

Professional trustees may improve the position in the short term albeit at further cost to schemes themselves.

## Improving clarity of advice

### Options

- Option 1: leave it to the market, on the basis that if users can be encouraged to challenge more effectively, actuaries will stand or fall by their ability to respond positively; or
- Option 2: improve actuarial training and CPD requirements to equip actuaries with improved communication skills; and/or
- Option 3: require clearer disclosure of actuarial advice, assumptions and key sensitivities. For example by requiring the disclosure of forward-looking financial condition reports; and/or
- Option 4: explore means by which regulatory requirements might be simplified.

Option 1 is too complacent. There will be a market effect as described but it should also be supplemented by a strengthening of the CPD requirements. Guidance notes have been moving in the direction of Option 3 and this is generally a good thing. On the other hand it is very difficult for such requirements not to increase costs. The removal of all actuarial judgement as to when such detailed disclosure would be appropriate would also be a negative consequence and further encourage complex, compliance driven advice.

Option 4 has the potential to significantly increase the scope for providing clear advice but recent legislation has largely missed this opportunity. The communication of the regulatory framework within which advice is given and/or which precipitates the advice can be a serious challenge even before it is overlaid by the actuarial complexities.

## CHAPTER 4: ACTUARIAL ROLES

### Reserved role in general insurance

#### Options

- Option 1: continue with the status quo – no reserved role; or
- Option 2: no reserved role, but require certification of the reserves by an approved person with appropriate skills, who may or may not be an actuary; or
- Option 3: a full role reserved to actuaries, with associated public interest duties and whistle-blowing requirements; and/or
- Option 4: a requirement that the auditor take appropriate actuarial advice when auditing general insurers (a role akin to the Reviewing Actuary role for life insurers).

## CHAPTER 5: PUBLIC INTEREST AND ACCOUNTABILITY

## Reporting and whistle-blowing

### Options

- Option 1: more comprehensive guidance from the Profession or from regulators on the circumstances in which whistle-blowing is permitted and when it is required, covering all relevant statutory, regulatory and professional provisions, matters which regulators are likely to regard as significant, and the safeguards and sanctions available; and/or
- Option 2: ensuring that, on the one hand, legal protections for whistle-blowers are wide and give appropriate room for individual judgement, based on good faith and what an actuary “reasonably believes”; while nonetheless ensuring that, on the other hand, duties to whistle-blow are clear, objective and enforceable, for example based on what an actuary has “reasonable cause to believe”; and/or
- Option 3: bringing whistle-blowing requirements for auditors and all actuaries more closely into line, and extending protections for whistle-blowers, e.g. supplementing the existing relief from duties of confidentiality with statutory provisions conferring qualified privilege (i.e. when acting in good faith) from actions in defamation.

We agree that guidance generally has not been sufficiently clear. However, the new stance being taken by OPRA to reporting and the associated guidance is a considerable improvement on the previous approach and is a good example of how to communicate to practitioners.

As regards the Profession itself, it has erred towards procedural and vague guidance that has left too much scope for interpretation. Whilst to some extent this may be an appropriate style in formal guidance notes there are other ways in which the underlying intentions could be brought to life.

If more emphasis is to be placed on a “reasonable cause to believe” then the framework should enable actuaries to determine whether there is reasonable cause with a greater degree of confidence. It is still currently the case that one actuary’s view of what regulators are interested in can be very different from another’s.

The effectiveness of protection is a serious issue for actuaries when reporting and an extension to cover actions in defamation would free the system up in a material way.

As has been noted in the interim assessment, actuaries are exposed to very real practical deterrents to reporting arising from their wish to retain relationships with clients and in turn their own employers. The greatest risk of non-disclosure lies in this area as clients can take sanctions against actuaries and their employers with apparent impunity. Any measures that could be introduced to address this problem would be very welcome.

The roles of actuaries and auditors are very different and so we don’t see that convergence of their respective reporting requirements should be an objective in itself.

## Actuarial Function Holder

### **Options**

- Option 1: status quo – Actuarial Function Holder role as currently specified by the FSA; or
- Option 2: greater protections for whistle-blowers.

## **With-Profits Actuary**

### **Options**

- Option 1: status quo – With-Profits Actuary role as currently specified by the FSA; or
- Option 2: the With-Profits Actuary should be external to the insurer; or
- Option 3: the With-Profits Actuary should be appointed by the With-Profits Committee, if one exists, or otherwise the Audit Committee; and/or
- Option 4: the With-Profits Actuary makes a full report to the regulator. Policyholders receive a copy of the With-Profits Actuary's opinion and have access to the full report.

## **Reviewing Actuary**

### **Options**

- Option 1: status quo – Reviewing Actuary role as currently specified by FSA, with the Reviewing Actuary reporting privately to the auditor; or
- Option 2: Reviewing Actuary role as currently specified by FSA, with additional duty to provide a private management letter to the Board on the Actuarial Function Holder's compliance with professional guidance; and/or
- Option 3: Reviewing Actuary to have direct whistle-blowing duties.

## Pensions

### Options

- Option 1: status quo – Scheme Actuary advises both the scheme sponsor and trustees, unless the actuary deems there to be a conflict, in which case the Scheme Actuary only advises the trustees; or
- Option 2: Scheme Actuary advises both the scheme sponsor and trustees, unless the trustees deem there to be a conflict, in which case the Scheme Actuary only advises the trustees; or
- Option 3: role of advising the scheme sponsor and the scheme trustees is separated in some clearly defined circumstances e.g. during scheme wind-up; or
- Option 4: role of advising the scheme sponsor and the scheme trustees is separated at all times.

Option 1 has generally served stakeholders very well but it is a system that is unlikely to continue to perform as well in an increasingly regulated and litigious culture and particularly with the low funding levels that currently exist. However, we believe it would be premature to abandon it altogether because the “honest broker” argument is very valid and is particularly valued by Trustees and sponsors with limited understanding of the issues and within the smaller pension scheme market. A separation of the role in some circumstances, wind up being the obvious one, is a sensible idea.

Trustees should also have a responsibility to react if they believe that they are receiving advice which is conflicted. We think that the suggestion that Trustees should have the power to direct the sponsor to seek separate advice is a good one. This responsibility should be in addition to the actuary’s duty to consider the nature and extent of the conflicts to which he is exposed.

It should be noted that the more significant source of conflict arises from the fact that many Trustees are also directors of the sponsoring employer. In considering the appropriateness of radical changes designed to improve the independence of advice, it should be borne in mind that decisions based on independent advice may not differ as much as would be the case in the absence of other sources of conflict.

## CHAPTER 6: EDUCATION AND CPD

### The syllabus and governance

#### Options

- Option 1: minor reform of the existing governance structure to promote greater academic and non-actuarial input; or
- Option 2: establish an independent body with oversight of the Profession’s syllabus development along the lines of the accountancy profession’s Professional Oversight Board for Accountancy (POBA).

The interim assessment acknowledges that the 2005 Education Strategy is well formulated and addresses previous failures. This suggests that sufficient changes have already been made for the current system to work effectively. There is no reason to believe that subsequent reviews of the Education Strategy will not be equally well thought out. For these reasons we believe that Option 2 is not appropriate at least at the present time and that minor reform is the way to buttress and consolidate more recent success.

## **Examinations issues**

### **Options**

- Option 1: reform of the existing governance structure to improve quality control; and/or
- Option 2: involvement of full-time and dedicated professional examiners; and/or
- Option 3: involvement of an independent oversight body in exam setting and marking.

We agree that some reform of the examination process is necessary. Option 2 might lead to the loss of some of the experience and talent of the paid volunteers. Greater transparency and accountability is necessary – the mystery that has surrounded the process historically is no longer appropriate.

The independent oversight body in Option 3 would have to be comprised of a high proportion of actuaries in order for students to have confidence that their knowledge was being properly assessed. Such a high proportion may compromise the degree of independence or at least the perception of it. The examination process should be independent of the demand for actuaries and an independent body may reassure stakeholders in this respect.

We are surprised at the emphasis on reducing qualification time. It may be possible to reduce qualification times without lowering standards. However, the years spent as a student present a wider learning and development opportunity which is inevitably more intense than any CPD programme that will commence after qualification.

## **Broadening actuarial education provision**

### **Options**

- Option 1: wider provision and accreditation of degrees that grant exemptions from the Profession's exams; and/or
- Option 2: promotion of post-graduate fast-track law-style conversion courses for those with university degrees.

Greater diversity would be beneficial. There is no reason why both of Options 1 and 2 should not be more widely available. We accept that the internal salary arrangements of the main employers are not particularly relevant. It would be very important to ensure consistent and appropriate standards of education. This, of course, becomes more of a challenge as diversity increases.

The description of the Australian system is interesting and relevant. However, the legislative framework in the UK and Australia is different and the roles and responsibilities of actuaries reflect these differences. The diversity of employment in Australia is therefore not wholly attributable to their University based approach.

The assessment has noted and we would like to reiterate the importance of post qualification experience particularly in the context of reserved roles. This would have to be formally recognised if the time to qualify becomes shorter, particularly if it becomes shorter because of a growth in non-work based study.

## Continuing professional development (CPD)

### Options

- Option 1: the Profession should set out clear objectives for the CPD Scheme and clarify what constitutes formal CPD. The Profession should ensure that CPD that qualifies as formal CPD is meeting an objective of the CPD Scheme, and is not simply a tick-box exercise based on attendance at meetings or conferences; and/or
- Option 2: the Profession should consider increasing the amount and quality of formal CPD required for reserved role holders, in recognition of the importance of these roles. For example, the Profession, with regulator input, could develop tailored CPD opportunities ahead of key changes in the regulatory environment for actuaries in reserved roles; and/or
- Option 3: closer links could be fostered between those within the Profession with responsibility for syllabus development, the actuarial research community and those focused on CPD to ensure that the CPD Scheme is kept-up-to-date and reflects recent developments in other disciplines and actuarial research; and/or
- Option 4: greater input to the CPD Scheme could be given to research-oriented actuaries, overseas actuaries and non-actuaries, for example through involvement in an oversight body, constitutionally independent of the Profession containing a mix of actuaries and non-actuaries. This could monitor the Profession's performance in relation to CPD Scheme development to ensure that the scheme is kept up-to-date, that links to other disciplines and actuarial research are made and that CPD is available to all actuaries, not just to those working in traditional areas.

The Profession's definition of CPD seems very clear and it is reasonable to infer that the objectives of the CPD scheme are to enable or require actuaries to develop their professional skills in accordance with the definition. A particular type of formal CPD will meet the objectives of the scheme for one actuary but not another. For the profession to ensure that CPD that qualifies as formal CPD does consistently meet the objectives of the scheme would require much closer scrutiny of the CPD needs of individual actuaries and how they go about meeting those needs. This would be quite onerous for the Profession and individual actuaries and therefore expensive. We accept though that CPD can be a tick box exercise at times but there must be a balance whereby some trust is placed in actuaries to maximise the effectiveness of the time that they devote to CPD. There is after all no incentive for them to do otherwise.

Option 2 would be most welcome although it is recognised that the Profession has increased the number of courses it runs recently. The largest firms have the resources and contacts to provide such training internally. Smaller firms have to wait longer for the Profession and Regulators to impart an equivalent level of insight into these new regulatory developments.

Options 3 and 4 both have their good points. Some independence may be necessary if commercial pressures within the Profession are distorting priorities.

The CPD scheme does need to be broadened and inviting contributions from the parties mentioned should help to achieve this. However, there is also a serious need for training in the core areas given the complicated and ever changing professional and legislative framework and the priority should be to provide this support to the reserved role holders as per Option 2.

## **CPD monitoring**

### **Options**

- Option 1: the Profession implements its three-tiered professional revalidation proposal as currently envisaged, which introduces technical CPD requirements and annual monitoring for reserved role holders, technical CPD requirements and three-yearly monitoring for holders of the new voluntary non-statutory practising certificates, and basic CPD requirements and 10-yearly monitoring for the remainder of working actuaries; or
- Option 2: as Option 1 but non-statutory practising certificate regime is expanded to cover all actuaries (except those performing statutory roles) so the technical CPD requirements and three-yearly monitoring apply to all working actuaries; and/or
- Option 3: the task of monitoring CPD requirements and monitoring of compliance with the CPD scheme should be made part of the remit of the independent professional oversight body referred to above.

Option 2 doesn't seem to address the more important disadvantages of Option 1 even though there are more progressive options available. We think that the reserved role CPD requirements should be strengthened by an increase in the number of hours of formal CPD and a requirement for individual actuaries to keep a peer reviewed record of their CPD needs and priorities. In addition more detailed records of the content of CPD events attended should be maintained on an ongoing basis. The voluntary nature of non-reserved CPD is too weak and as the assessment points out will not convince the public.

The risk presented by actuaries who may not be up to date because of historical shortcomings in the education system is overstated. Each generation of actuaries will inevitably acquire different skills against a different background. Such actuaries can't be expected to possess or acquire all the knowledge of, say, financial economics that today's newly qualified actuary will possess. Today's practising actuaries have been through a system that deservedly has a formidable reputation and against which other qualifications were regarded as a soft option.

## **CHAPTER 7: STANDARD-SETTING**

### **Actuarial standard-setting**

#### **Options**

- Option 1: Actuarial Standards Board (ActSB) which is quasi-independent of the Profession (as per the Profession's proposal); or
- Option 2: Actuarial Standards Board (ActSB) subject to oversight by a suitably independent body, for example the Financial Reporting Council; or
- Option 3: the FSA sets standards in life and general insurance, and DWP/Opra sets standards for pensions.

Option 2 appears the most appropriate so long as a suitable body can be established to oversee the ActSB. We have doubts that the FRC is the right body because the Profession is likely to be under-represented. In terms of costs there is much reference in the assessment to the small size of the profession when perhaps the influence/importance of the profession should be the yardstick by which costs are measured.

The Profession's development of an ActSB has been on hold whilst the Review is underway. It would be interesting to allow the Profession to flesh out its proposals before deciding on a way forward.

It is an appealing concept at one level to have standards set by Regulators. As noted this would avoid second guessing policy intentions but we also agree that there could be practical difficulties in such an arrangement.

## **CHAPTER 8: SCRUTINY AND DISCIPLINE**

### **Scrutiny of actuaries in life insurance**

#### **Options**

- Option 1: Reviewing Actuary as currently specified by the FSA, with no mandatory peer review as proposed by the Profession; or
- Option 2: Reviewing Actuary as currently specified by the FSA, and peer review as proposed by the Profession; or
- Option 3: Reviewing Actuary's remit is expanded to include an explicit duty to report on compliance with actuarial standards; or
- Option 4: Reviewing Actuary as currently specified by the FSA, with additional duty to provide a peer review letter to the Actuarial Function Holder and/or the Board.

### **Scrutiny of actuaries in pensions**

#### **Options**

- Option 1: maintain the status quo of no formal scrutiny; or
- Option 2: include long-term liabilities within pension scheme financial statements, which are then audited; and/or
- Option 3: introduce peer review of the Scheme Actuary as envisaged by the Profession; and/or
- Option 4: audit the Scheme Actuary's triennial valuation.

The lack of any formal scrutiny does seem inappropriate and inconsistent with the level of scrutiny applied in other related disciplines. Option 1 is clearly no longer acceptable and this has, of course, already been recognised by the Profession.

Option 2 is interesting but the costs would indeed be prohibitive especially for the smaller schemes. Also there would be even less chance that users, in particular scheme members, would request a copy of the actuarial valuation report itself. This would be unfortunate as only the valuation would contain the information necessary in order to gain a proper understanding of a scheme's financial position.

Current professional guidance might make it difficult for the accounts to show long term liabilities without the accounts themselves become part of an actuarial valuation report rather than the other way round.

Scheme accounts should make it far clearer than they do at present that long-term liabilities have been excluded. Readers of accounts should also be directed to the actuarial valuation in order to appreciate the funding/solvency position of the scheme.

Peer review should be the main way in which scrutiny is carried out. Further guidance is required on the degree of independence of the actuary and the reviewer. At present there is a risk that the reviewer will not be sufficiently independent of the scheme actuary. However, appropriate weight should be given to the cost considerations faced by small schemes and also the smaller actuarial firms.

Audits should be carried out of the Scheme Actuary's triennial valuation but it should be sufficient and would certainly be more practical for this to be done on a sampling basis. It should be noted that a triennial valuation will already have been subjected to a considerable amount of checking and scrutiny by actuarial students and/or non-scheme actuaries before it is checked/reviewed by the Scheme Actuary.

## Scrutiny of actuaries in general insurance

### Options (for the company market)

- Option 1: introduction of requirement for actuarial advice as part of audit; and/or
- Option 2: introduction of peer review.

### Options (for Lloyd's)

- Option 1: if the Statement of Actuarial Opinion is produced internally then it must be externally peer reviewed; or

- Option 2: introduction of external peer review of the work of all Syndicate Actuaries; and/or
- Option 3: introduction of a requirement for actuarial advice as part of audit.

## **Discipline**

### **Options**

- Option 1: the disciplinary scheme remains accountable to the Faculty and Institute's Councils; or
- Option 2: the disciplinary scheme is accountable to a suitable independent oversight body; and/or
- Option 3: encouragement of closer links between whistle-blowing to regulators and the disciplinary scheme.

Option 1 would not in our view weaken the process but we accept that it may be presented by others as prima facie evidence that the process is weak.

We are comfortable with Option 2 in principle but are not comfortable with the further issues raised in the assessment particularly the idea of a single actuarial/accountancy body to oversee the disciplinary schemes.

The assessment has noted that there are conflicting messages within the PCS regarding the threshold for making a complaint against another actuary. Clarification of the requirements is important if the new scheme is to work properly.