

FINAL DRAFT

Morris Review

Friends Provident Response

Introduction

Sir Derek Morris is conducting a wide ranging review of the UK actuarial profession in response to criticisms raised by the Lord Penrose enquiry into the Equitable Life. An interim assessment report has been published following an initial consultation phase, to which FP contributed, outlining key issues, possible policy options and seeking the views of interested parties by 4 February 2005. The report was highly critical of the actuarial profession and, as such, is likely to have far reaching consequences.

We welcome the review. We believe it to be a thorough and independent review of the actuarial profession.

Our comments are restricted to key issues and policy options as they affect Insurance companies and Friends Provident in particular.

We note that a number of the issues raised in the interim assessment report are in the process of being addressed by the FSA through the changes to the regulatory framework for insurance companies.

Issues

Actuaries have a unique ability to understand the financial dynamics of insurance companies and pension funds through their knowledge of the relationship between assets and liabilities. Given this understanding, it is not surprising that actuaries have moved into related wider fields of provision of actuarial advice, most notably, provision of investment advice. Moreover, this was encouraged by the profession. However, it runs contrary, to a certain extent, to the notion that actuaries have been slow to adopt new techniques. Prudential regulation at the time enshrined traditional methods and this may have contributed to the reasons why actuaries have been slow to adopt financial economics.

The modern financial services environment is complex and it is our view that solutions to complex financial and risk mitigation issues are best delivered by multi-skilled teams consisting of members from a variety of professional disciplines such as accountants, actuaries, lawyers, tax specialists, financial economists and statisticians to name a few.

We accept that, on the whole, there has been insufficient transparency in actuarial advice. Typically, actuaries are not good at documenting models and processes and this has undoubtedly led to the 'black box' view of aspects of actuarial work. In addition, actuaries have not always been successful at communicating complex issues tending to enjoy getting involved in the detail rather than providing a more simplistic overall understanding of an issue or solution. This may have contributed to the view

that users have been too ready to accept the advice of the actuary or become too reliant upon him. Furthermore, this may have been exacerbated by strong personalities who have been over authoritative in providing their advice or key in decision making.

Our view is that it is incumbent upon the governing body of an insurance company to understand the advice provided to it at a level which allows it to make informed decisions. Equally, it is incumbent upon the actuary as the provider of the advice to present his or her advice clearly, bringing to the attention of the governing body all material aspects. This may require a process of developing a 'storyboard' over a period of time for significant and complex issues. In addition, the advice should be presented in such away that allows the user to understand the range of possible outcomes and the likelihood of those outcomes.

Although beyond the remit of the review there may be any opportunity for the profession to provide simple actuarial training courses to other insurance professionals.

Given the complexity of the advice provided by actuaries we are fully supportive of the requirement for robust and concise actuarial standards.

Education and training of actuaries is of paramount importance. Qualified actuaries with appropriate knowledge and experience are required for reserved roles and there will be a requirement for qualified actuaries in support of these roles. However, arguably, many of the aspects of the actuarial function can be undertaken by actuarial technicians who do not complete the actuarial exams.

We partially accept the view that actuaries have, in the past, been persuaded too frequently by commercial arguments. However, we note that more often it was the appointed actuary who was derided as being overly conservative. With hindsight, it is easy to argue that the actuary should have been more robust in the defence of his position while the rest of the market was arguing against him. Notwithstanding the above, we believe that the FSA has made its' position clear that the responsibility for the determination of the liabilities rests firmly with the governing body (after having considered the advice of the actuary) and, as such, we believe that this issue is, to some extent, being dealt with under the revised regulatory environment.

Policy Options

Actuarial Standard Setting

We believe that the actuarial profession must modernise its governance structure, objectives and mode of operation and must develop robust standards and techniques in order for the profession to re-establish itself.

We believe that given the issues raised in the interim assessment report, self regulation of standard setting, monitoring and disciplinary procedures is unlikely to be an acceptable way forward for the actuarial profession, not least because many other professions are moving away from self regulation. However, we believe regulation by

a government body to be overly burdensome and we would not advocate following this route. We believe self regulation with independent oversight from a body such as the Financial Reporting Council (“FRC”) to be appropriate as long as it is appropriately governed and has adequate representation from the actuarial community. It should be noted that accountants and actuaries for the most part perform different roles and, as such, the FRC’s oversight process of the Institute of Chartered Accountants of England and Wales (“ICAEW”) may not be appropriate for the actuarial profession. Clearly, we would not want the FRC oversight mechanism to mark the end of the actuarial profession. We note though that there are synergies between the actuarial and accounting professions and, as such, the FRC, on face value, appears to be the most appropriate oversight body.

Public interest and accountability

Our view is that the changed roles of the actuarial function holder (“AFH”), the With Profits Actuary (“WPA”), the Reviewing Actuary (“RA”) and the governing body need time to evolve and bed down before further changes are made to their responsibilities. Currently we believe the structure is working and that there is appropriate statutory protection for the AFH – the key requirement is that the AFH has appropriate access to and relationship with the governing body.

Similarly, we can understand the view that there may be conflicts of interest which could arise if the with profits actuary is an employee of the company. However, if there is appropriate independent governance with respect to the duties performed by the with profits actuary our view is that the current mechanism is workable. Further, if the WPA were required to be external it is likely that the he or she would be drawn from one of the leading firms of actuarial consultants which, arguably, would not be independent if they are pursuing follow on work (in much the same way as the independence issues that arose with accounting firms with large consulting practices).

The RA currently has indirect whistle blowing powers through his relationship with the auditor (and in practice the RA is likely to be drawn from the same firm as the auditor). As such, we do not foresee problems with the current structure and would therefore advocate that the structure be given time to bed down and evolve before significant changes are made to it.

Education and CPD

An independent body with oversight of the Profession’s syllabus development would be costly and would only be workable if there was adequate actuarial representation with a good understanding of the training requirements. Further, full time and dedicated professional examiners, while ideal, would be costly.

Our view is that the profession needs to do more to make CPD requirements robust, at least for reserved roles. Given the complex nature of the work which actuaries undertake and the rapidly changing environment in which they operate we believe the CPD requirements should be significantly improved and strengthened. We believe that CPD requirements should not be just for reserved roles. Reserved role holders are generally supported by a large number of highly skilled qualified actuaries who should also meet CPD requirements. However, it is noted that many actuaries have

non-actuarial roles e.g. trustees on pension schemes. It would be inappropriate to require these members to meet CPD requirements simply because they are actuaries. If this were the case, non-practising actuary members may be forced to resign from such positions if meeting the CPD requirements were onerous (which should be expected for practicing actuaries). Actuaries should make it clear when they are not acting as a practising actuary so as to ensure that the advice they are giving or the statements they make are not perceived as being made from a practising actuary.

Market for actuarial services

Our view here is that there is an appropriate level of competition for actuarial consulting services to the life insurance industry. Further, Friends Provident value the depth and breadth of knowledge and experience obtainable from the major actuarial consultancies.

Friends Provident are also users of contractors where the overall management of a particular project is maintained internally and we are not seeking high value expert advice normally sought from the major actuarial consultancies.

Greater scrutiny of performance

Friends Provident argued against peer review on cost/benefit grounds. We believe there is now an appropriate element of peer review as part of the RA role and independent representation on the with profits committee.

Improving user understanding

We believe that user understanding is a two way process. It is incumbent on both the providers and receivers of actuarial advice to ensure that the advice is clearly communicated and understood respectively. The responsibility of the governing body has been strengthened under the FSA Integrated Prudential Source Book and this should serve as a driver for governing body's to better understand the advice they are given and, as a result, demand additional clarity from the providers of that advice. Early indications are that this mechanism is working.

Brian Harrison
Director of Actuarial Services
Friends Provident
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