FRIENDS PROVIDENT RESPONSE TO THE MORRIS REVIEW

The following response on behalf of Friends Provident answers questions raised in the Morris Report from the perspective of a Life Office only and therefore we have not responded to every question.

The Scope of the actuarial Role

Q1.3 Do you think there is still a need for particular roles for actuaries to be reserved by statute and, if so, which roles and for what reasons? If not, why not?

There are numerous areas in the running of a life office that require specialist skills. This is recognised in the regulatory requirement for boards of life offices to seek actuarial advice in defined areas and for a named person to be responsible for that advice, whether it is the Appointed Actuary under the current regime or the Actuarial Function Holder or the With Profits Actuary under the proposed regime (see Supervision Manual chapter 4.3 set out in FSA Policy Statement 04/16). This is currently provided by the education and training of an actuary, supported by mandatory professional guidance and, increasingly, by the assurance that comes from practice certification and peer review.

Whilst there is overlap between the skills and training of actuaries and other professionals, the actuary is uniquely qualified to provide the full range of advice in the regulated areas and the requirement to seek the required advice should be retained for reasons of public confidence.

Q1.4 What impact, if any, has the existence of reserved roles had on the effectiveness with which actuaries work with non-actuaries?

In general, we do not believe that the existence of reserved roles for actuaries has impacted materially on the effective working of the life office. A far greater impact is had by the way in which the senior management team (comprising both actuaries (in reserved and non-reserved roles) and other disciplines) work together and the nature of the personalities involved.

Nevertheless we support the changes that the FSA have made to make Boards more visibly responsible for decisions. These changes should ensure that Boards do not see decisions on technical issues as the responsibility of the Actuary alone and properly question reasons for proposals. With these safeguards in place, the role of the actuary as advisor is clarified and the existence of the reserved role is seen as one within the team rather than in some way having an unchallengeable status over the team.

Q1.5 If roles reserved exclusively to actuaries are maintained, do you think that there is a need to introduce greater peer review and scrutiny of such work?

We support in principle the actuarial profession's proposals for peer review of the work of the actuaries carrying out reserved roles. Given that the cost will eventually be met by the customers of the life office, it is important that this scrutiny is done in a cost efficient manner and is not duplicated with other elements of the governance arrangements. For example a requirement for peer review of the Actuarial Function

Holder should not add to the costs of the very similar requirement for review by an actuary appointed by the auditor (the 'reviewing actuary').

Q1.6 Could other professions work more closely with actuaries or in related functions to help maintain and improve actuarial effectiveness?

We would encourage actuaries to work more closely with other professions and believe that in many cases multi-disciplinary finance teams are already the norm. In this way the breadth of knowledge of all the professionals involved is extended, ideas can be shared and conventional wisdoms of each profession may be questioned.

Accountability of Actuaries

***Q1.7* To what extent should actuaries accept some responsibility for their role in designing financial services products that have subsequently turned out not be "fit for purpose" for consumers? Why were these issues not brought to light by the profession earlier and therefore perpetuated to the detriment of consumers? What lessons can be drawn from these experiences for the future?**

The examples relating to pension and mortgage endowment misselling highlight products, designed by actuaries, that were well designed and fit for purpose for many people, particularly taking into account tax relief and other incentives offered by the Government at one time. However, in some cases they were sold to people for whom they were clearly inappropriate, and in others (where they may have been appropriate) without sufficient consideration of the sales practices required in a relatively new regime.

Different issues possibly arise when considering some more recent products, such as bonds linked to multiple indices or some high income bonds (precipice bonds). These were products which might have been suitable for some financially-aware customers but which were complex and not easily understood by most customers, who would therefore not have understood the risks implicit in the contracts. The actuaries who designed these products should have been aware of these risks and, although not necessarily in a position to determine their company's position, should have been able to advise the company appropriately.

Companies should and do accept responsibility for the products they sell and the way in which sales are made. Actuaries and other professionals within companies have both a moral and a commercial obligation to monitor the effectiveness of the sales and marketing process as part of the product development risk and control process. When this process fails it is for all involved to accept their part of the responsibility for the failure. It is already a formal responsibility of the compliance function to monitor sales practices and therefore should not be the formal responsibility of actuaries (whether or not employed by the company), although they might be well placed to recognise deficiencies and alert employers to them.

The profession is, however, in a position to look across the market and could usefully draw worrying trends to a regulator's attention. It is not resourced however to do this on a systematic basis.

Q1.8 Are actuaries sufficiently accountable for their actions? To whom should actuaries be primarily accountable – to their clients or employers, to pension fund trustees or sponsors, or to a broader public interest, which encompasses the strength and stability of the insurance and pension sectors and the interests of those consumers involved?

Insurance company actuaries are primarily accountable to their employers for their actions. They take personal responsible for the advice they provide and breaches of professional guidance may lead to disciplinary action by the profession.

If actuaries believe that their employer is not acting in the public interest then they must raise the matter at an appropriately senior level within the company. If they feel that their concerns are not appropriately addressed and fall within the scope of 'whistle blowing' legislation they should then consider doing so. The profession does not require members act in the public interest (however desirable that might be) but 'to maintain and observe the highest standards of conduct'.

We believe this is an appropriate balance of accountabilities.

Q1.10 Are actuaries sufficiently liable for their actions? If actuaries provide poor advice, to whom should they pay compensation?

In a life company the holders of regulated actuarial roles are essentially advisers to the Board. The Board is responsible for their appointment and for the decisions taken based upon their advice. If customers suffer from a company's actions they look to the company for redress. Therefore if 'bad' advice (in the legal sense) is given it is a matter between the actuary and his employers.

Compensation is not usually appropriate in an employer/employee relationship as Boards should have sufficient expertise and strong enough governance processes to be able to spot bad advice and react accordingly. If advice fails to meet professional standards, the profession's disciplinary schemes can and do act and the actuary may forfeit both his job and his career.

Entry into the Profession

Q1.17 In particular, do you think that it should take on average 5 or 6 years for an actuary to qualify? Is there the right balance between academic and practical experience, sufficient breadth of subjects studied or not studied and the appropriate degree of specialisation at the right time?

The profession has regularly reviewed the education syllabus in order to both maintain its relevance in a changing world and to maximise its efficiency. Whilst making the qualification period shorter should not be done at the expense of a reduction in quality, the wastage in time (and talent) inflicted on those who drop by the wayside is regrettable and the profession does need to continually seek ways of improving.

There is an increasing tendency for actuaries to seek to move from one professional discipline to another during the course of their training and early career. The present

structure, which both delays specialisation until the later stages of training and has a strong emphasis on CPD, is an appropriate response to this.

Scope of actuaries' statutory or reserved roles

Q2.5 Do you think that the FSA's proposals to change the appointed actuary regime address the concerns that Lord Penrose raised in this regard? Is there a need to do anything further to address Lord Penrose's concerns?

We feel that the FSA proposals have satisfied concerns about over reliance on the Appointed Actuary by visibly placing responsibility for decision making with the Board. By splitting the role of the Appointed Actuary into two there is greater visibility where conflict arises between policyholder and shareholder interests, however there is a risk of loss of holistic oversight. The FSA's proposals permit firms to address this by vesting both roles in the same individual provided that he is not a member of the Board. This is a sensible alternative in the short term, but it runs the risk that technical actuarial roles in a life office cease to attract the strongest talents, since Board membership can no longer be aspired to.

The role of reviewing actuary largely covers the scope of the work of the Actuarial Function Holder in his remit and an appropriately constituted With Profits Committee (containing an independent appropriately experienced actuarial member) can scrutinise the work of the With Profits Actuary. The Institute of Actuaries' proposals for peer review ('two pairs of eyes, one of which is external') risk duplicating costs for little additional public interest protection.

Q2.7 Do non-executive directors in life insurers have sufficient expertise and information available to them to enable them to challenge the actuarial calculations of the value of the insurer's assets and liabilities or whether policyholders are being treated fairly?

Some non-executive directors can and do have this expertise and all can be provided with appropriate access to information. However, it is not realistic, or necessary, to expect all non-executive directors to have this ability and indeed Boards should be multi-disciplinary, judged on their abilities in the round.

Q2.8 Will the FSA's realistic reporting basis make actuarial calculations more accessible for non-actuaries?

We see realistic reporting as an important improvement. Realistic reporting (with full and appropriate disclosure against clearly defined standards) should improve comparability between the returns of different companies. However, without expert guidance, the additional complication of an extra set of results may make the results less accessible to the non-actuary. Experience to date has suggested that rating agencies and analysts have a good grasp of the issues leading to good market discipline.

Maintenance of professional competence

Q2.20 Is there the right balance between the Profession issuing practising certificates and regulators giving their approval?

The Profession has an interest in maintaining standards while the FSA have an interest in ensuring that staff in controlled functions are competent. Currently there is consensus between the profession and the FSA about the standards, which is the ideal situation.

However, the FSA should form an independent view of standards required and if this differs from the standards applied by the profession they should initially discuss the matter with the profession with a view to reaching agreement. Life Office actuaries have no interest in the profession and the FSA adopting an uncoordinated position.

Q2.21 In your view are the current CPD requirements and the provision of CPD appropriate?

The present minimum requirement for 15 hours per annum of formal CPD backed up by informal CPD is too little and most actuaries in the current climate of constant change will feel that they require rather more CPD to adequately fulfil their roles.

However quality of CPD is more important than hours and it is difficult to measure this objectively. There is a case for greater monitoring of CPD by the profession and use of computer-based learning exercises to verify acquired knowledge.

Q2.22 Do you support the Profession's proposals to extend the concept of practising certificates to cover all actuaries who give advice on actuarial matters?

We support this proposal provided it is restricted to those actuaries of sufficient seniority who provide advice of an actuarial nature to senior management in Life Offices or who work directly for an actuary giving statutory advice. Any wider extension risks giving greater status to the advice than might be appropriate.

Whistle-blowing

Q2.24 Are there appropriate legal and professional duties and safeguards for disclosures by actuaries to protect the public interest in regulated sectors?

Yes.

Q2.25 Is it sufficiently clear to actuaries and others when they should report concerns to the regulators and the Profession?

Normally the position is clear, but the regulations allow for some subjectivity, requiring, on occasion, the application of judgement.

Q2.26 Is there an appropriate level of disclosures by actuaries to protect the public interest?

The FSA currently proposes that the With Profits Actuary makes an annual report to policyholders on the discretion exercised by the Board. This is an unnecessary step, supplementing as it does a report by the firm itself and a report by the With Profits Actuary to the Board.

Standard-setting

Q2.27 Does the Profession's technical guidance, as set out in the Manual of Actuarial Practice, provide unambiguous, up-to-date and clear standards for practising actuaries and other professionals e.g. auditors, who work with them? Do you agree with Lord Penrose's view that professional guidance in the past has not protected policyholders' interests?

The guidance notes issued by the Profession should provide a clear basis within which actuarial judgment can be exercised. The guidance notes are in the process of being rewritten to accommodate both regulatory change (which itself has increased the amount of prescription) and taking into account both the views of Lord Penrose and legal advice. We believe that the guidance should not seek to interpret FSA rules and guidance but should set out generally accepted actuarial practice where this is not covered by the FSA so that Life Office actuaries can apply these principles to the circumstances of their firm.

As an example policyholders' reasonable expectations will be based on historical actions of the company and communications with policyholders. For every company this is different. If the FSA rules and guidance became even more prescriptive it could result in companies being forced to act in a way that was inconsistent with the fair treatment of their policyholders.

We therefore believe that the balance between prescription and judgement is changing appropriately.

Q2.28 Does the technical guidance need to be updated more regularly and are fast-track processes required to provide guidance on urgent issues?

We are satisfied that guidance relevant to life offices is updated sufficiently quickly. There is a 'fast track' process for the development of professional guidance, which can be used when required.

Q2.29 Who should provide the guidance: The Profession, the regulators or the government?

The present system provides rules and guidance issued by the regulator supplemented by professional guidance and codes of professional conduct and in our view this approach works well in principle. The major rewrite of both regulation and guidance that is currently nearing its conclusion should address flaws noted by Lord Penrose in the existing approach.

Guidance notes are also produced in consultation with Government to provide a more flexible and responsive alternative to primary legislation and regulation (e.g. GN27).

The profession should not have to issue guidance to make good deficiencies in a regulator's or parliament's drafting.

Q2.30 Is there a need to reduce the level of discretion permitted within the guidance to come to some generally acceptable professional practices?

As implied in our answer to Q2.27 we think that the current major redraft will have this effect to the extent necessary.

Q2.31 Will the Profession's own proposals for an actuarial standards board go far enough to improve the quality and timeliness of standard-setting to protect the public interest? Is there a need for even greater independence from the profession or a statutory underpinning to bring greater credibility to the technical standard-setting process?

We believe that there is a need to improve the existing approach and that the profession's proposals are welcome. Nevertheless there needs to be consideration of the cost-benefit case for the change to ensure that it is proportionate.

Typically actuaries employed by the regulator play a full part in the professional bodies that draw up guidance notes and there is legal scrutiny. We believe that this approach strikes the right balance.

Q2.32 Does the Profession work closely enough with other professions e.g., accountancy, to ensure that its standards are widely recognised and to influence other profession's standards where appropriate, and to ensure that there are no regulatory gaps or overlaps in standards?

It is desirable for actuaries to work closely with other professions (particularly accountants) to influence standards that affect the work of both professions. Recent examples of this cooperation are that actuaries have been working with accountants in the production of International Accounting Standards and the Accounting Standards Board has adopted this approach in the preparation of the recent draft FRED34 which is specifically applicable to the life industry.

Openness, peer review and audit of actuarial work

Q2.33 Do you agree with Lord Penrose's assessment of the lack of openness and transparency of the profession to non-actuaries, including other professionals, and their clients?

We agree that in the past there has been a lack of openness and transparency of the profession to non-actuaries. This is rapidly changing, for example as a result of the emphasis on responsibility of directors for decisions and the introduction of PPFMs and With Profits Committees.

Q2.34 What steps can be taken to improve communications between the actuarial profession and their clients or other professionals?

In respect of life offices the role of the actuary is now clarified as an advisor to the Board with the Board responsible for decisions. This has increased the emphasis on the need for actuaries to present recommendations in a way that the Board will understand and provide additional background training where appropriate. Communication will be most successful where there is a desire or a need for communication on both sides, as there is in the case of the actuary advising the Board.

Q2.35 Given the Profession's recent proposals on peer review, and the FSA's proposals for the reviewing actuary function in life assurance, will there be an appropriate level of peer review and scrutiny in the actuarial profession to protect consumers' or policyholders' interests in the future?

We believe that the two sets of proposals may not be fully joined up, resulting in the risk of costs for firms that are excessive in relation to the public interest safeguards. (See also Q1.5 and Q2.5).

Q2.36 When should actuarial opinions be directly addressed or otherwise communicated to members of the public, such as policyholders or scheme members?

It is presently proposed that the With Profits Actuary should provide a report on use of discretion addressed directly at policyholders. This proposal appears unnecessary, costly and contrary to the FSA's desired positioning of the Board as decision-maker and the actuary as adviser. In general, in the case of a Life Office, we feel it more appropriate for opinions to be addressed to the Board.