



Institute
and Faculty
of Actuaries

Professionalism Resource Material

Professionalism: should you speak up or report? How do you decide?

Presentation by Tony Hewitt, Imperial College Business School and Cathy James, Public Concern at Work – Whistleblowing Event in November 2011

The Actuarial Profession
making financial sense of the future

Whistle blowing Event, Staple Inn, Friday 18 November 2011
Speakers: Cathy James, Chief Executive, Public Concern at Work
Tony Hewitt, Imperial College Business School



Professionalism: Should you speak up or report? How do you decide?

9 February 2011

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Cathy James and Tony Hewitt: Brief autobiographical details

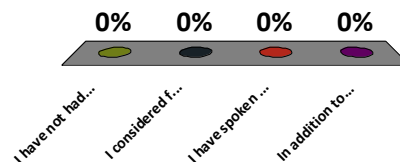
- Cathy James is Chief Executive of Public Concern at Work
- Cathy was previously a Partner at a City law firm
- PCaW is an independent charity set up in 1993:
 - giving free, confidential advice to individuals who are concerned about malpractice or wrong doing in the work place
 - providing help and advice to organisations on addressing risk responsibly.
- Tony Hewitt chairs a group set up by the Actuarial Profession to raise the professional skills and awareness of actuaries and student members
- In his “day job”, Tony helps run the Actuarial Finance MSc at Imperial College Business School
 - a route for full-time actuarial trainees to qualify as actuaries
 - combining work-based skills with an Imperial Masters education.

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Over the last 12 months, to what extent have you considered speaking up or reporting?

1. I have not had to consider either speaking up under Principle 4.1 or reporting under Principle 4.4
2. I considered formally either speaking up or reporting but chose to do nothing
3. I have spoken up, or I made a record of my reasons for not speaking up
4. In addition to any actions in 3, I have reported, or I made a record of my reasons for not reporting



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Agenda and objectives

- 16.00 – 17.00 Speaker: Cathy James
 - Role of Public Concern at Work [PCaW]
 - PCAW's confidential advice line for the Actuarial Profession
 - Speaking up and blowing the whistle – understanding the legal issues
 - How to build the right culture and use effective processes
- 17.00 – 18.00 Speaker: Tony Hewitt
 - Recapping important concepts and definitions
 - Case Studies based on modeling errors
 - Behavioral Ethics – a tool to make better decisions
 - Other real-life case studies
 - Learning lessons: preventing the next mis-selling or insolvency scandal
- 18.00 – 19.00 Discussion over drinks
 - Sharing issues and concerns informally in small groups
 - Opportunity to put further questions to the Speakers

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Protocol for discussing case studies + Disclaimer

- The case studies for discussion are deliberately hypothetical.
- In particular, the characters are designed to be entirely fictitious.
- The separate information on real-life case studies is provided not for discussion, but to help give the hypothetical case studies more credibility.
- Readers can also learn further lessons from these real-life situations.
- The presenter recommends that discussion of professionalism issues is based on the hypothetical case studies:
 - to avoid the risk of misrepresenting any aspect of the real-life case studies
 - to help focus discussion on professionalism issues, avoiding the detailed technical issues contained in the real-life case studies.

Disclaimer

- The real-life case studies are sourced from the public domain.
- The presenter has not verified any of the information in the real-life case studies and accepts no responsibility for any reliance placed by readers on that information.

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What is meant by whistle blowing?

- Two guides published in April 2011:
 - A guide for actuaries
 - A guide for employers of actuaries
- These guides use “whistle blowing” to describe any act of speaking up or reporting to employers, clients, regulators or relevant authorities
- The terms “speaking up” and “reporting” are used in Compliance Principle 4 of the Actuaries’ Code

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Speaking up – defined in the Actuaries' Code

- **Principle 4.1: members will speak up**
 - to their client [internal or external] or employer
 - if a course of action is [or ought to be] believed to be
 - unlawful, unethical or improper.
- The FRC expects actuaries to “speak up whenever they have reasonable concerns arising from actuarial work or the way it is used, and follow the issues through”
- The FRC’s UK Corporate Governance Code requires public companies to have whistle blowing policies in place

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Reporting – defined in the Actuaries' Code

- **Principle 4.2: members will report information**
 - to the relevant regulatory authority when obligation to do so
- **Principle 4.3: members will report behaviour**
 - To the regulator or relevant authority [if **legal protection available**]
 - if there is reasonable cause to believe the behaviour is
 - unlawful, unethical or improper
- **Principle 4.4: members will report** any matter which **appears** to constitute **(a) misconduct or (b) a material breach of any relevant legal, regulatory or professional requirements**
 - for consideration under the Profession's Disciplinary Scheme
 - subject to taking all reasonable steps to obtain third party consent to disclosing information

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Interaction of Confidentiality Principle 1.2 with speaking up and reporting under Principle 4

- Confidentiality Principle 1.2:
 - “Members will respect confidentiality unless disclosure is
 1. permitted by law and
 2. justified in the public interest”
- Speaking up to clients or employers under Principle 4.1 – no confidentiality issue unless disclosure is contractually restricted to named individuals?
- Reporting under Principles 4.2, 4.3 or 4.4 – potential confidentiality issues which require the two conditions in Principle 1.2 to be met?
- Given conflicts, agreement required under Principle 3.5?

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What is meant by misconduct? Main definition

- Disciplinary Scheme Rule 1.6
 - Failure to comply with the standards of **behaviour, integrity, competence or professional judgement**
 - which other members or the public might reasonably expect of a member
 - having regard to the bye-laws... and/or to any code, standards, advice, guidance, memorandum or statement on professional conduct, practice or duties
 -
 - and to all other relevant circumstances

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What is meant by misconduct? Whistle blowing definition

- Disciplinary Scheme Rule 1.9(a)
 - A member may be **liable for misconduct**
 - Where a **person (with whom he is connected) is guilty of conduct** which if committed by the member would have amounted to misconduct and either
 - any act, omission or behaviour by the member has **caused or contributed to such conduct**; or
 - following his becoming aware of any such conduct, the member **does not take such action** as other members might reasonably expect him to take in the circumstances
- Principle 4 of Code: Members....will challenge non-compliance by others

Disciplinary Scheme Rule 1.10: An employer/partnership, its employees, its directors/partners are all "connected".

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What does "observe the Code's spirit" mean?

- The status section of the Actuaries' Code explains
 - It is not a set of rules, and conduct that falls short of the Code will not inevitably constitute misconduct.
 - Equally, members will be expected to **observe the Code's spirit** in their professional conduct.
- The Architect's Code [published in September 2009] says
 - You are expected to be guided.....by the spirit of the Code as well as by its express terms
 - The fact that a course of conduct is not specifically referred to in the Code does not mean that it cannot form the basis of disciplinary proceedings
 - Each case is judged on its facts, and there may be circumstances in which unacceptable professional conduct.....is found even where there has been no clear breach of the express terms of the Code.

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What is meant by the public interest?

- As members of a chartered profession, actuaries have a core obligation to serve the public interest
- Principle 1.2 says “Members will respect confidentiality unless disclosure is justified in the public interest”
- Twin purpose of the Actuaries’ Code:
 - **to serve the public interest**
 - **to build and promote confidence [trust] in the work of actuaries and in the Actuarial Profession**

My view: TWO SIDES OF THE SAME COIN

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Peer review of Ethical’s modelling

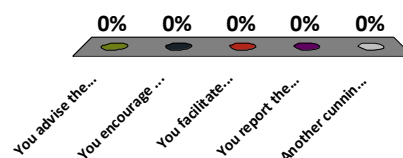
- Your client is the Chief Risk Officer of Ethical Group, responsible for risk management, reserving and reporting
- You are a senior actuary in a consulting firm, undertaking an independent peer review of Ethical’s reserving models
- You discover modelling errors repeated over many years which have been known to your client’s reserving team
- Initially the errors were not material; they have not been disclosed to the CRO, even though they have since grown
- Ethical Group’s reserving team are working flat out to solve the problem but have not yet told the CRO
- You inform the CRO who promptly wants full disclosure to all stakeholders and alleged misconduct addressed

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What do you do? Assume the client's modelling has been outsourced to a leading competitor TopAdvice

1. You advise the CRO objectively about making a misconduct complaint against TopAdvice actuaries but otherwise do nothing
2. You encourage the TopAdvice actuary leading the reserving team to report himself under Principle 4.4
3. You facilitate discussions between the CRO and the TopAdvice actuary, with a view to learning lessons and getting things right going forward, nothing more
4. You report the TopAdvice actuary and focus on building your relationship with the CRO
5. Another cunning plan.....



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Dynamic's modelling errors

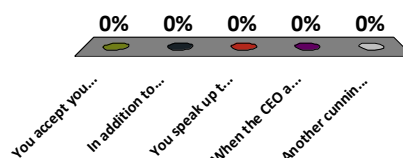
- You are a senior actuary leading Dynamic's modeling team
- Your team discovers a potentially material error within days of publishing Dynamic's quarterly reserves to stakeholders
- You immediately brief your CRO [a non-actuary] confirming that the size of the error has not yet been pinned down
- The CRO tells you to finalise the reserves as best you can, and takes the decision not to inform Dynamic's Board
- You challenge the CRO and are told to stick to actuarial matters, not to question his "management" decision
- The CRO makes it clear that your career will be over if you do not co-operate
- You have big personal financial commitments

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What do you do? You are a rising star in a successful company. The error arose years ago.

1. You accept your CRO's decision, convincing the rest of your team to get it sorted before next quarter's reserves
2. In addition to 1, you make a careful note of your reasons for not challenging the CRO further
3. You speak up to the CEO, setting out a clear summary of the issues, but do nothing when the CEO agrees with the CRO
4. When the CEO agrees with the CRO, you report to the FSA and the Actuarial Profession
5. Another cunning plan.....



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Dynamco sells a business immediately after the incorrect reserves are published

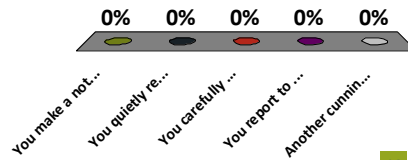
- Having co-operated with your CEO and CRO, you realise the business sale has been based on the incorrect published reserves
- It becomes clear that the purchaser has overpaid for the business, when the size of the modeling error is known
- Dynamco's top management still do not want to disclose the modeling error
- You are instructed to accept this "management" decision.
- Again threats are made that your career will suffer.....
- Your judgement is that the purchaser's actuaries can pin point the error as part of post-acquisition due diligence.

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What do you do? The CEO tells you to stick to actuarial matters – M&A matters are not for you

1. You make a note about having spoken up, with reasons why you have done nothing further
2. You quietly resign as well as 1, after obtaining a good job with another company with a strong ethical culture, and do nothing further
3. You carefully prepare an action plan as well as 1, in the event that the purchaser challenges the reserves, but nothing more
4. You report to the FSA and the Actuarial Profession
5. Another cunning plan.....



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Behavioural ethics – greater self-awareness helps you avoid ethical fading



Bazerman & Tenbrunsel – "Blind Spots: Why we fail to do what's right and what to do about it"
– Princeton University Press, 2011

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FinSol – hypothetical case study

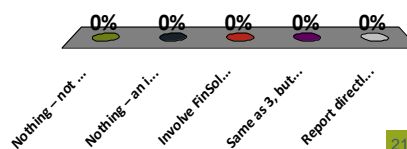
- Muscat is a senior actuary in FinSol, a company which sells financial reinsurance products to insurance clients
- Muscat is shocked to learn – off the record – from a big-4 auditor that
 - FinSol's clients are being investigated for producing misleading financial statements
 - The root cause of these misrepresentations appears to be FinSol's products which Muscat's team have helped design
- Muscat speaks to Finsol's Legal Director and is warned to stick to actuarial matters
- Muscat consults you and you advise him to think carefully about reporting to the FSA and the Actuarial Profession.

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Muscat does nothing. What should you do?

1. Nothing – not your issue
2. Nothing – an issue for clients and their auditors
3. Involve FinSol's Ethics Board – but take no further action
4. Same as 3, but report confidentially to the FSA and the Profession if action 3 fails to produce timely results
5. Report directly to the FSA and the Profession



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FinSol – based on Milan Vukelic/FSA case study

- Details of a real case study can be found in the Final Notice issued by the FSA to Milan Vukelic on 15 April 2009
- Full details are available in the report of the Financial Services and Markets (FSAM) Tribunal, which sat in public on 1-9 December 2008 and 13 March 2009
 - **What is the standard of proof for our Disciplinary Tribunal?**
 - It is to a civil standard, the same as the FSAM Tribunal – the Tribunal will find an allegation proved if the Actuarial Profession demonstrates, on the balance of probabilities [i.e. more likely than not], that the Respondent is guilty of misconduct
 - **How is honesty defined?**
 - For the FSAM Tribunal, it is defined by the ordinary standards of reasonable and honest people

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Bancassurer – hypothetical case study

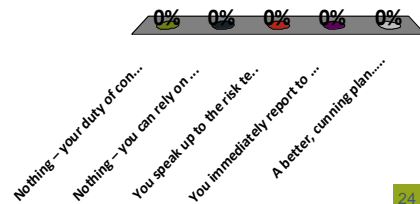
- You are an actuary employed by Bancassurer Ins Ltd
- You are a close friend of the Chief Risk Officer (CRO) employed by Bancassurer Group Plc, who tells you
 - He has just agreed to leave Bancassurer with a gagging clause, adding forcefully he would deny telling you all this
 - He has discovered unethical selling of Payment Protection Insurance (PPI) by the Bancassurer Sales Ltd salesforce
 - Profits from PPI sales are a growing share of Group profits
 - Crucial papers prepared by his risk team (which includes actuaries) failed to reach the Main Board or its Risk Committee, and discussion of these issues were not minuted

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You leave your friend, thinking about the Actuaries' Code – What should you do?

1. Nothing – your duty of confidentiality to your friend is paramount
2. Nothing – you can rely on the actuaries in the risk team
3. You speak up to the risk team actuaries, ready to escalate internally if they fail to act
4. You immediately report to the Actuarial Profession and the FSA
5. A better, cunning plan.....



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Bancassurer – based on whistle-blower allegations

- Full details of a real case study can be found in the Final Notice issued by the FSA to Alliance & Leicester on 6 October 2008
- The FSA found that A&L had breached four principles of the FSA's Principles for Businesses
 - Principle 3 (management and control)
 - Principle 6 (treat customers fairly)
 - Principle 7 (communication with clients)
 - Principle 9 (suitability of advice and discretionary decisions)
- Full details of the HBOS whistle-blower allegations can be found in the evidence given by Paul Moore to the Treasury Select Committee on 6 February 2009, 25 February 2009 and 3 April 2009
- Further information on “lessons learnt” is contained in a paper by Paul Moore and Peter Hamilton, dated 1 October 2009, prepared in response to consultation issued by the Sir David Walker review of corporate governance in UK banks and other financial entities

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GlobalFinance – hypothetical case study

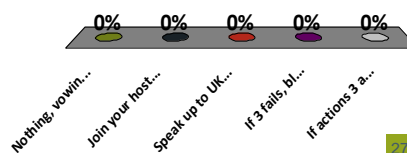
- You are an actuary employed by GlobalFinance UK Structured Products Ltd – you are seconded to Head Office in New York
- The year is 2006 – You learn at the “Greed is Good” dining club
 - widespread rumours predict the CDO manufacturing and selling pipeline is expected to end soon
 - your host is joining a Hedge Fund to participate in leveraged shorting of subprime CDOs
 - Both UK and non-UK actuaries are helping to create these CDOs for the major global banks, including GlobalFinance
 - Credit rating agencies are pressured to give AAA ratings
 - Conflicts of interest are not disclosed to buyers of CDOs

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This is a parallel universe where the Actuaries’ Code has already been published – What do you do?

1. Nothing, vowing never to get involved with Greed is Good people
2. Join your host’s Hedge Fund
3. Speak up to UK actuaries in GlobalFinance’s Head Office – but nothing more
4. If 3 fails, blow the whistle internally using GlobalFinance’s anonymous process – but nothing more
5. If actions 3 and 4 fail, report to the UK Actuarial Profession



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GlobalFinance – based on books and reports published in 2010

- One of many books, the “inside story” of the collapse of Lehman Brothers is told in Larry McDonald’s book – A Colossal Failure of Common Sense
- Further details on why Lehman Brothers failed can be found in the 11 March 2010 report by Anton Valukas, Examiner, appointed by the US Bankruptcy Court Southern District of New York (a good appendix on risk appetite if you are studying ERM)
- Transcripts of the Financial Crisis Enquiry Commission – set up to examine the causes...of the financial and economic crisis...
- News in April/May 2010 of the SEC pressing civil fraud charges against Goldman Sachs, eventually settled for \$550 million.

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Further reading

- Actuaries’ Code [2009]
- Whistle blowing: A guide for actuaries [April 2011]
- Conflicts of interest: A guide for actuaries [Consultation paper published October 2011 – see Appendix 5 for draft]
- FRC – Actuarial Quality Framework [2010]
- Ethicability – a very readable book by Roger Steare, covering moral principles, the meaning of integrity, how to solve ethical dilemmas
- Blind Spots – by Bazerman and Tenbrunsel, covering behavioural ethics, making better choices through greater self-awareness, creating a better culture within organisations.
- Wilful Blindness – by Margaret Hefernan, another excellent read, short listed for the FT 2011 book of the year.

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A call for volunteers

- Would you or a colleague be interested in joining a Panel to support the Profession in
 - designing professional skills CPD events?
 - developing anonymous case studies [based on “near-misses” as in the airline industry]?
- Would you or a colleague be interested in helping to develop country-specific guidance on how to operate under the Actuaries’ Code for actuaries working outside the UK?
 - reflecting local law, culture, professional practice
 - where law may not permit disclosure under Principle 1.2

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Questions or comments?

Expressions of individual views by members of The Actuarial Profession and its staff are encouraged.

The views expressed in this presentation are those of the presenter.



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