



Institute  
and Faculty  
of Actuaries

# Professionalism Resource Material

Shamelessly unprofessional: what would you  
do in this situation?

Presentation by Tony Hewitt, Imperial College Business  
School at Momentum Conference in December 2011

**The Actuarial Profession**  
making financial sense of the future

**Momentum Conference, Friday 2 December 2011, Plenary 3**  
**Speaker: Tony Hewitt, Imperial College Business School**



**Shamelessly unprofessional:  
What would you do  
in this situation?**

2 December 2011

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## **Tony Hewitt: Brief details**

- Tony Hewitt chairs a group set up by the Actuarial Profession to raise the **professional skills and awareness** of members – both actuaries and students
- In his “day job”, he helps run the Actuarial Finance MSc at Imperial College Business School
  - for full-time actuarial trainees
  - combining work-based skills with a Masters education
- He campaigns to integrate **professional awareness** into all actuarial training – CPD, CT-SA exams, university degrees

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1

## What lies ahead? For actuaries of today and tomorrow

- Do not turn a blind eye to scandals! Past or potential!
  - mis-selling scandals
    - Pension members enticed out of Final Pay Plans into Personal Pensions
    - Payment protection insurance
    - Retail structured products
  - insolvency scandals
    - Equitable Life
    - Independent Insurance
    - Maxwell Pensions scandal
    - AIG, Lehman Brothers etc.
- How can we learn lessons collectively as a Profession?
- Will you build our reputation as a trusted Profession?
- Or will you risk potential misconduct complaints, litigation, fines, compensation costs and reputational damage?

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2

## Protocol for discussing case studies + Disclaimer

- The case studies address the hardest part of the Actuaries' Code – speaking up and reporting
- They are deliberately hypothetical.
- The presenter recommends that discussion is based on the hypothetical case studies:
  - to avoid misrepresenting any aspect of the real-life case studies
  - to help focus discussion on professional issues, avoiding the detailed technical issues contained in the real-life case studies.
- The separate information on real-life case studies is provided to help give the hypothetical case studies more credibility.
- Readers can also learn further lessons from these real-life situations.

### 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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3

## 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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4

## 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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5

## Reporting – defined in the Actuaries' Code

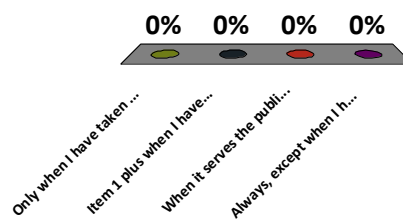
- **Principle 4.2: members will report information**
  - to the relevant regulatory authority when obligation to do so
- **Principle 4.3: members will report behaviour**
  - To the regulator or relevant authority [if legal protection available]
  - if there is reasonable cause to believe the behaviour 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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6

## Shamelessly unprofessional! When are you associated with a communication? [Principle 5]

1. Only when I have taken responsibility by signing it
2. Item 1 plus when I have advised or decided on its contents
3. When it serves the public interest [interested parties perceiving that I should take responsibility for what it contains]
4. Always, except when I have decided that I am not associated with it, and have [good] reasons to justify that decision to the sharp QC when I am in the dock



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7

## 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, but what if client information is contractually restricted to named individuals?
- Reporting under **Principles 4.2, 4.3 or 4.4** – this conflicts with the duty of confidentiality, which may be overridden only if the two conditions in Principle 1.2 are met?
- Given conflicts, agreement required under **Principle 3.5**?

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8

## 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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9

## What is meant by misconduct? Whistle blowing definition

Principle 4 of Code: Members....will challenge non-compliance by others

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 **[so the person does not have to be an actuary]**
- 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

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

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10

## 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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11

## What is meant by the public interest?

- As members of a chartered profession, actuaries have a core obligation to serve the public interest  
[What's all this crusty "holier than thou" Royal Charter stuff?]
- Principle 1.2 says "Members will respect confidentiality unless disclosure is ..... justified in the public interest"  
[OK – maybe we need to know what it means]
- Use stakeholder analyses to identify the public interest
- Also look at the twin purpose of the Actuaries' Code:
  - to serve the public interest
  - to build and promote confidence in .... the Actuarial Profession
  - These are TWO SIDES OF THE SAME COIN
- **Agree "public interest" practicalities in all your TOR**

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12

## Peer review of Ethical's modelling

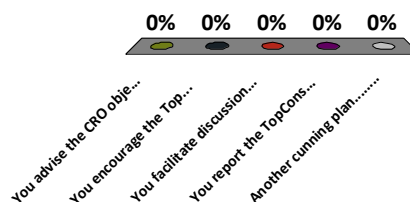
- Your client is the Chief Risk Officer [CRO] of Ethical, responsible for risk management, reserving and reporting
- You are a senior actuary in a consulting firm, undertaking an independent peer review of Ethical's reserving models
- You discover modelling errors repeated over many years which have 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 are now material
- Ethical's reserving team are working flat out to solve the problem but have still not told the CRO
- You inform the CRO who promptly wants full disclosure to all stakeholders and alleged misconduct addressed

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13

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

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



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14

## Dynamic's modelling errors

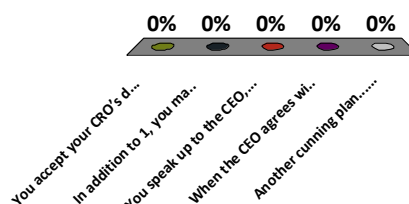
- You are a senior actuary leading Dynamic's modeling team
- Your team discovers a **potentially material error** within days of publishing Dynamic's quarterly reserves to stakeholders
- You immediately brief your CRO [a non-actuary] confirming that the size of the error has not yet been pinned down
- 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 commitments – mortgage, school fees etc.

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15

## 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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16

## Part 2: Dynamco sells businesses immediately after the incorrect reserves are published

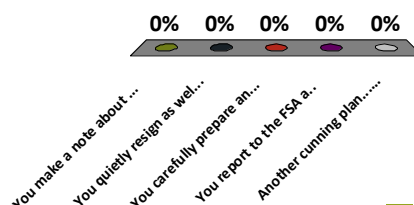
- In part 1, you chose to co-operate with your CEO and CRO
- With a sinking heart, you realise the business sale has been based on the incorrect published reserves
- It becomes clear that the purchaser has overpaid for the business, when the size of the modeling error is known
- Dynamco's top management still do not want to disclose the modeling error, now known to be big
- 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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17

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

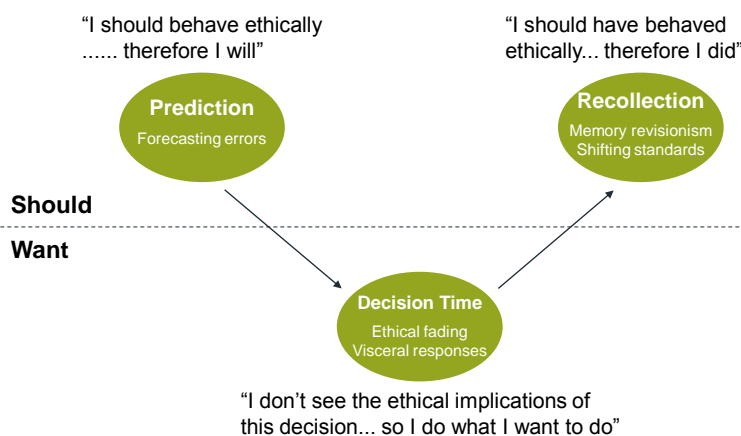
1. You make a note about having spoken up, with reasons why you have done nothing further
2. You quietly resign as well as 1, after obtaining a good job with another company with a strong ethical culture, and do nothing further
3. You carefully prepare an action plan as well as 1, in the event that the 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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18

## Knowing how to create self-awareness – when it matters – will help 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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19

## The next potential mis-selling scandal? Enhanced TVs – a strong “bullying” CEO

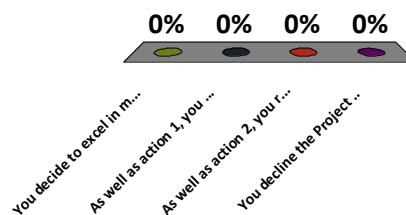
- You lead Enhanced TV projects in ConsultingCo
- Your client BigCo generates £5 million fees every year
- BigCo’s CEO wants a Enhanced TV project with tight TOR:
  - Your team will focus solely on BigCo’s interests
  - The Scheme Actuary/IFA will serve the public interest
  - You will ensure all regulatory/legal issues are ticked off
  - The key objective is to reduce BigCo’s risks and costs
- The CEO reminds you that:
  - You are soon to be promoted to a career-boosting role
  - BigCo have another firm keen to take on the project
  - BigCo pays premium fees for value-creating projects

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20

## What do you do?

1. You decide to excel in meeting BigCo’s key objective, relying on others to serve the public interest; nothing more
2. As well as action 1, you seek but fail to extend the TOR to manage BigCo’s risks of regulatory fines, compensation claims and reputational damage
3. As well as action 2, you raise concerns within your own firm, making a record of doing this but not taking any other action
4. You decline the Project on conflict grounds, advising that BigCo instructs another advisor to cover the risks listed in action 2



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21

## Events after you finish the Enhanced TV project [assume you have followed BigCo's TOR]

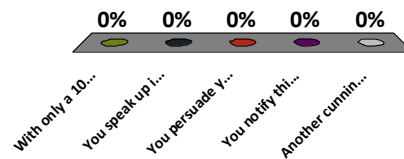
- BigCo immediately finances a full buy-out of the remaining liabilities, after a high take-up of Enhanced TVs
- You learn that the Trustees and Scheme Actuary have decided to treat the Enhanced TV project as entirely employer-led, doing nothing but checking members have access to an IFA
- You learn the IFA has followed all the normal rules correctly, but nothing more
- BigCo gives you a post-Project analysis showing the full buy-out cost was reduced by £50 million, with a significant take-up of the Enhanced TV even by members given Amber and Red advice by the IFA

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22

## Your firm estimates 1-in-10 odds of materially lower pensions for those taking Enhanced TVs. What do you do?

1. With only a 10% chance of misconduct complaints, compensation litigation and reputational damage, your firm decides to do nothing. So do you.
2. You speak up internally within your own firm, strive to learn lessons and set up training for your colleagues, but nothing more
3. You persuade your Ethics Group to support you in reporting yourself to the Actuarial Profession so that the whole Profession can learn lessons
4. You notify this as a "near miss" to the Profession anonymously
5. Another cunning plan.....



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23

## FinSol – hypothetical case study

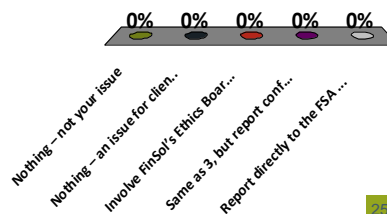
- Muscat is a senior actuary in FinSol, a company which sells financial reinsurance products to insurance clients
- Muscat is shocked to learn – off the record – from a big-4 auditor that
  - FinSol's clients are being investigated for producing misleading financial statements
  - The root cause of these 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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24

## 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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25

## 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 [who tells the best story – so keep notes!] 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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26

## Bancassurer – hypothetical case study

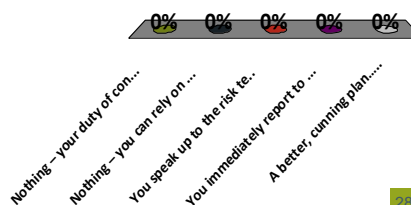
- You are an actuary employed by Bancassurer Ins Ltd
- You are a close friend of the Chief Risk Officer (CRO) employed by Bancassurer Group Plc, who tells you
  - He has just agreed to leave Bancassurer with a gagging clause, adding forcefully he would deny telling you all this
  - He has discovered 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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27

## 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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28

## 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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29

## GlobalFinance – hypothetical case study

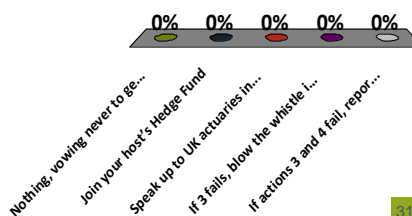
- You are an actuary employed by GlobalFinance UK Structured Products Ltd – you are seconded to Head Office in New York
- The year is 2006 – you learn at the Greed-is-Good dining club
  - widespread rumours predict the CDO manufacturing and selling pipeline is expected to end soon
  - your host is joining 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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30

## 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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31

## 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 charges against Goldman Sachs, eventually settled for \$550 million.

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32

## Further reading

- Actuaries’ Code [2009]
- Whistle blowing: A guide for actuaries [April 2011]
- Conflicts of interest: A guide for actuaries [Consultation paper – see Appendix 5 published October 2011]
- FRC – Actuarial Quality Framework [2010]  
– Corporate Governance and Stewardship Codes [2010]
- FSA – 11 business principles, 6 TCF principles, .....
- **Ethicability** – a very readable book by Roger Steare, covering moral principles, the meaning of integrity, how to solve ethical dilemmas
- **Blind Spots: Why we fail to do what’s right and what to do about it** – 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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33

## **A call for volunteers**

Please email [\*\*a.hewitt@imperial.ac.uk\*\*](mailto:a.hewitt@imperial.ac.uk)

- 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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34

## **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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35