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FUTURE FINANCIAL REGULATION: AN ACTUARY'S VIEW

A DISCUSSION PAPER BY A WORKING PARTY

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ABSTRACT

This discussion paper was produced by a Working Party in April 1997 to put forward some possible ways of improving the United Kingdom financial regulatory process. It was written to contribute to the expected post General Election debate on this topic. Although the new Government announced plans in May 1997 for a new Securities and Investment Board (SIB) with statutory powers, this has not reduced the value of this discussion paper which raises some wider issues on methods of regulation.

The paper excludes the supervision and regulation of banks, building societies, insurance companies and exchanges and concentrates on areas that directly affect the public on an ongoing basis. It looks at the expectations of the main parties involved in regulation, the theory and practice of regulation, opportunities and concerns, and concludes with a summary of key issues for discussion. The thrust of the paper is that self regulation should be replaced by statutory regulation and that the present 'prescriptive' regulatory process should be replaced by one based on 'outcomes' supported by guidance.

KEYWORDS

Financial Regulation; Supervision; Financial Advice; Self-Regulation; Financial Services

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1. INTRODUCTION

1.1 *Background*

1.1.1 The long run up to the United Kingdom General Election in 1997 acted as a catalyst for a general debate on the efficacy of the U.K. financial regulatory framework. In this debate the generic term 'regulatory' covered aspects of the prudential supervision of companies, markets and organisations as well as regulation relating to the Financial Services Act (FSA). During 1996 the major political parties encouraged this debate, with the Labour Party stating that they would conduct a full review of the regulatory framework if they came to power. The Conservative Government stated that it favoured evolutionary change.

Several other bodies, e.g. the Securities and Investment Board, have made formal public statements as their contribution to the debate.

1.1.2 In addition to the U.K. domestic position, the European Commission has produced a Green Paper 'Financial Services: Meeting Consumers' Expectations'. This paper encourages debate on protection for private consumers in the single market.

1.1.3 The actuarial profession has a particular role in the management of financial risk, with the accompanying skills of explaining that process to others. This expertise is reflected in the profession's involvement in various areas of financial regulation. Appointed Actuaries in life offices cover a variety of topics, from the financial well being of the company through to aspects of disclosure at the point of sale. Pension Scheme Actuaries have similar statutory responsibilities on minimum funding and other requirements. Actuaries are, therefore, well used to the expert role of representing the consumers' interest, whistle-blowing to regulators in the last resort, and producing competitive products for the benefit of offices and consumers.

1.1.4 In anticipation of the expected debate after the election, it seemed appropriate, therefore, for the profession to be ready to contribute. In September 1996 a working party, chaired by A. S. Fishman, was formed to set out some thoughts for discussion within the profession. The composition of the working party and its Terms of Reference are in Appendix A.

1.1.5 The working party had completed the majority of its work by April 1997, but its proposals could not be discussed at a Sessional Meeting (for scheduling reasons) until late 1997. In May 1997, three weeks after the General Election, the new Labour administration announced that it intended to restructure the regulatory organisation with a new Securities and Investment Board with statutory powers. The statement did not propose any detailed changes to the method and style of regulation, which were areas where the working party had some clear proposals. Therefore, it was decided to continue with the paper as originally planned. As the new SIB prepared its regulatory environment the ideas could be put forward if appropriate.

1.2 *Aim*

The aim of this paper is to put forward some ways of improving the U.K. financial regulatory system, for discussion within the profession.

2. APPROACH

2.1 In order to promote a focused discussion, the working party decided to set out some draft conclusions, and hence ideas for improving aspects of the U.K. financial services regulation. If, after discussion, there was a general acceptance of these, they could be put forward as the views of the profession to government and others.

2.2 Initially the working party considered the full range of regulatory

functions, from the FSA through to the supervision of insurance companies, banks, building societies and similar organisations. However, after reading the many papers and contributions from other sources, it was agreed that such a broad review would probably be beyond its ability and possibly less than productive. It was decided to focus on areas that directly affected the public and, in particular, where it was felt that changes should be made and where actuaries had a distinct input.

2.3 This approach centred on two aspects that were felt to be the most important:

(1) the prudential supervision of providers and advisers (or will the company be able to return my money to meet the perceived promise?); and
(2) the regulation of marketing and selling (or is there redress for me if I am misled or missold?).

Using the accepted shorthand, providers can be 'wholesale' or 'retail'. Both were considered in this paper, but marketing and selling between wholesalers was excluded, on the basis that both parties were expected to be equally knowledgeable.

2.4 This discussion paper assumes a fairly detailed understanding of the U.K. regulatory system before the changes announced in 1997. For those without this background information some explanatory notes are in Appendix B.

2.5 *Framework of the Paper*

The paper is set out in five main sections, with conclusions drawn at the end of each section:

(1) *Expectations.* This section considers the expectations of the main parties involved in the financial sector, so gaining an understanding of the relativities.
(2) *Theory and Practice of Regulation.* This section details the ideas and practicalities of regulation, deducing what is likely to be accepted and be sufficiently effective.
(3) *An Outcome-Based Regime.* This section outlines an alternative approach to the current prescriptive regime.
(4) *Other Challenges.*
(5) *Summary of the Key Issues for Discussion.*

3. Expectations of Main Parties

3.1 *The Public*

3.1.1 It is possible, but perhaps unproductive, to write an essay on the definition of 'the public'. For the purposes of this discussion paper, it was assumed that the public was an individual who was interested in a financial product or service and who clearly knew considerably less about either than the provider or seller.

3.1.2 The public expects to be able to study, invest and purchase in a truly competitive market with the confidence that there is a regulatory system that will provide an environment of trust. Three particular risks are identifiable:
— the insolvency of the provider;
— a failure to understand the product — hence purchasing that which is inappropriate; and
— a failure of the product to meet its forecast or perceived performance.

3.1.3 It can be argued that, as the public has no particular protection over the first two risks in most consumer products, there should be no special help or protection for financial services or financial products. However, rightly or wrongly, (rightly in the authors' view), the public has a greater expectation in the financial sector for several reasons. These include:
— The amounts of money involved sometimes represent a significant proportion of an individual's assets/income over time.
— The product may not be used, or the purchase completed, for some considerable time, and, in most cases, the purchaser will not discover its true and relative worth until it is too late to change it, probably having paid for it well in advance.
— For each individual purchases are rare, and therefore there is little personal accumulation of experience and understanding.

3.1.4 General education on financial matters is a critical component in the management of public expectations. Teaching financial awareness in centres of secondary and tertiary education is generally poor, compounded by public suspicion that imported specialist teachers may, themselves, be thinly disguised salesmen; but, without a better general education, improved expectations and trust will not follow. Such education will not reduce the need for regulation, as there is an overriding public demand for proven effective regulations.

3.2 *The Financial Sector*

3.2.1 Providers and advisers in the financial sector have relatively straightforward expectations. In simple terms these are:
— freedom to produce competitive products; and
— a transparent fairness in the regulatory system.

3.2.2 In selling financial products (savings accounts or loans), providers and advisers generally accept that the information that they supply may be used by other parties for comparisons, so engendering a healthy market.

3.2.3 An extreme example of regulatory fairness might be the suggestion that house repossessions by particular mortgage providers should be recorded. It could be argued that this is equivalent to insurance policy persistency, and that such borrowers might have redress against overlending by particular lenders.

3.3 *Government*

3.3.1 In an ideal world, government need have no role in regulation. However, in a democratic country government must support and endeavour to realise the expectations of its electorate. The electorate will include that part of the public with expectations of individual protection, as well as those who run the financial sector and who expect to have their business interests promoted in world markets.

3.3.2 Government, therefore, has a difficult balance to achieve. It must construct a regulatory framework that is minimalist, yet sufficiently flexible, so that it can meet changes in demand without constant major adjustment. Potential investor dissatisfaction should be anticipated and prevented, and the ability to prevent a systemic loss of confidence in any sector of the market is highly desirable.

3.3.3 Historically, government may appear simply to react to certain well publicised events, with the inherent danger that rushed legislation or regulation is rarely good legislation. However, this would be a harsh judgement. Certainly loopholes must be closed, but the laws of supply and demand can apply to regulation — as is discussed in a later section.

3.3.4 These expectations must be met at lowest possible cost.

3.4 *Conclusions on Expectations*

3.4.1 It is important, in the debate on regulation, that the expectations of each party involved are recognised and managed. Some expectations may seem unreasonable, but ultimately the essential climate of confidence and trust will not be achieved without such recognition.

3.4.2 Education and dialogue are key components in the management of expectations.

3.4.3 Government is expected, and expects, to meet the demand for regulation; but, as it cannot accurately anticipate the result, it must tread carefully if it is not either to fail to meet that demand or, on the other hand, to suppress fair competition.

3.4.4 Overall, the management of the expectations of the three key players is possible, if not always easy.

4. REGULATION — THEORY AND PRACTICE

4.1 *Demand and Supply*

4.1.1 The political and economic influences on regulation have formed a major field of study within the actuarial profession for many years. Adams & Tower (1994) and Booth (1997) both provide a significant background.

4.1.2 In a free market economy, regulation, itself, can be considered as an economic good, subject to the laws of supply and demand. For example, if a major crisis occurs in the financial services sector, say the insolvency of a

prominent insurance company, then there is likely to be a demand from the customers of the surviving companies for reassurance that a similar catastrophe will not happen to them.

4.1.3 This demand might be satisfied by actions taken by the industry itself, in order to restore public confidence; for example by the introduction of minimum reserving standards, possibly with the support of a publicly respected actuarial profession.

4.1.4 Alternatively, the government might decide to legislate to meet the public need, again, possibly, with the involvement of the actuarial profession.

4.1.5 Those who hold to the efficient market hypothesis would argue, however, that government intervention is never necessary, and that the market will reflect the balance of demand between the need/greed for cheap insurance products and the comfort of regulation. This may be true in the long run; however, many individuals may well suffer financial loss whilst the market mechanism operates. Excessive focus by the financial sector on short-term sales and profit targets may elongate this process.

4.1.6 Industry or government may then seek to overcome by regulation those inefficiencies in the market mechanism which lead to individual financial loss.

4.1.7 The question as to whether regulation can ever truly restore perfect efficiency to the market has been raised from time to time:

— Booth (1997) refers to Hayek (1982), who argues that, as the equilibrium position of any market is only known after the market has traded, it is impossible for a regulator to predict this position, and hence implement the appropriate level of regulation to achieve it. Thus regulation often either fails to correct the inefficiency or is excessive to the detriment of all market participants.
— Booth also develops a theory of Hayek (1988) to imply that the beneficial regulation of an established market has often become something far different from that which was originally envisaged, as a result of a series of reactions to market signals. This suggests that any regulatory structure should be established in a flexible form to enable such a development.

4.2 *Market Inefficiencies and Attempts to Correct Them*

4.2.1 A transaction in any market can be seen as consisting of a number of phases; for example, gathering of information by both parties, negotiation of terms and the after-sale period. Inefficiencies manifest themselves in deficiencies between the two parties in one or more of these areas.

4.2.2 These deficits between the two parties can be narrowed from either side, either by weakening the service provider's position or strengthening that of the customer.

4.2.3 Information about third parties possessed by the service provider can be limited to that which is public knowledge, by techniques such as 'Chinese Walls' or insider-trading bans.

4.2.4 The provider can also be required to disclose information about its

products (e.g. the volatility of equity-linked investments) or about itself (e.g. its solvency), either periodically or at the point of sale. The need for information can be dispensed with to the extent that firms or product designs have to meet minimum regulated standards.

4.2.5 Imbalance in negotiation can be constrained most obviously by price control. More subtle means include regulating selling practices. A simple example would be the prevention of cold calling at unsociable hours. Other examples include a code of conduct and a system of remuneration of representatives which focused on customer satisfaction, e.g. as measured by persistency, more than sales volume. The customer's position can also be strengthened, providing the right to terminate the sales process at any time or by making available comparisons with rival products.

4.2.6 Information must be provided in a way that enables the recipient to comprehend its meaning properly. Provision without assisting comprehension is not provision at all. Competitors and the Press can assist with comprehension.

4.2.7 The after-sales period can provide for cooling off, for the provision of support by the provider to the customer and/or for access to redress if the product is unsatisfactory.

4.2.8 Regulation cannot, however, even out imbalance without some input from the customer. The customer is reasonably expected to understand all the information provided, make rational decisions and exercise rights at the appropriate time. An element of *caveat emptor* will always remain, although education and access to impartial advice should assist in its exercise.

4.2.9 If possible, the pitfalls foreseen in ¶4.1.7 must be avoided. Appropriate monitoring and sanctions need to be in place to make it financially worthwhile for providers to comply with regulations. Also, the burden of compliance should not be out of proportion to the customer benefit produced.

4.3 *Self Regulation — Success or Failure?*

4.3.1 Self regulation can be said to occur when a group of market participants agree to follow common practices for the benefit of customers. The City Takeover Panel works as a self-regulatory body, and has been quite successful. A good example from outside financial services might be the Association of British Travel Agents (ABTA) bonding scheme, which protects the money paid in advance to travel agents by their customers.

4.3.2 The ABTA scheme is an example of an arrangement which has worked well for a number of years. The public is aware of its existence, and so generally only transacts business with ABTA bonded firms. Also, travel agent failures are sufficiently frequent and well publicised for the public to be aware of the risk.

4.3.3 However, in many cases self regulation fails. There is, inevitably, a conflict of interest between adherence, with its attendant short-term cost, and profitability. This is true of all types of regulation, but self regulation is often weakly enforced externally, not compelling production-oriented management to establish proper lines of internal control over staff. Breaches may then go

undetected. This phenomenon was common amongst Life Assurance and Unit Trust Regulatory Organisation (LAUTRO) members when that self regulator was founded by U.K. life insurers and unit trust providers to substitute for direct regulation by SIB (Jebens, 1997). It could be said to be the main reason why so much poor financial advice was given, undetected, in the late 1980s to U.K. occupational pension scheme members about the attraction of the personal pension alternative. Whether any other system of regulation would have fared any better is, of course, a moot point; but the principal issue is that, if there is little common acceptance of regulation, then there must be a means of early identification of breaches and the ability to take action.

4.3.4 If self regulation is to be successful, it must be adequately externally enforced from the outset, including meaningful sanctions for breaches, unless there is sufficient consumer pressure for such regulation to make adherence a commercial necessity. The well-publicised fining by LAUTRO of a number of major companies in the early 1990s and the requirement, or threat, to some to suspend new business was felt by many to be the start of serious self regulation.

4.3.5 It should be added that LAUTRO was not an entirely self-regulatory body. The Financial Services Act permitted SIB to set minimum standards which LAUTRO, and other self-regulatory bodies, had to meet to gain approval. In turn, SIB could be directed by government.

4.3.6 The present structure of a diverse group of regulatory bodies — SIB, the Personal Investment Authority (PIA), (a successor to, *inter alia*, LAUTRO) other Self-Regulatory Organisations (SROs) and Recognised Professional Bodies (RPBs) — which are not operating within a coherent, tight, consistent framework and which do not appear to be responsible to the public, devalues the self-regulation concept. This fragmentation of regulatory power is expensive and leads to overlap and inconsistency in application, with the odd result of firms choosing their own regulator.

4.3.7 Whilst it can be argued that the present regulatory system (self regulatory in name) is workable and is slowly improving, it may be too late to challenge the emerging consensus that it should be changed. The public does not understand it, and there is no doubt that the public and most Members of Parliament have lost faith in the concept of self regulation.

4.3.8 This deduction, which links directly to the earlier section on the importance of meeting the expectations of the main parties involved, would have particular effect on those professions (including the Institute of Actuaries) who are RPBs. However, the loss of that role would be balanced by the improved system of regulation of companies and individuals. Many commentators and the two main political parties have suggested alternative organisational structures to replace SIB, the Bank of England and others. The Labour Party has made it clear that it favours statutory regulation, with fewer organisations involved in detailed regulation. The Working Party saw little value in joining this organisational debate, as it believed that changes to the detailed processes of regulation at operational level were of more importance now that the need for statutory

regulation appeared to be generally accepted. (See ¶1.1.5. Since this paper was completed there have been several announcements from the Government on its programme to amend the FSA and remove self regulation.)

4.4 *Regulatory Process — Prescription or Outcome?*

4.4.1 Regulation can be 'prescriptive'; "thou shalt/shalt not do .....", or it can be 'outcome-based'. The former approach regulates the means, arguing that, if these are sufficiently constrained, the end will be constrained too. Monitoring focuses on the adherence to the word of the rules.

4.4.2 Under 'outcome-based' regulation, the correct end is the objective. The means to achieve it are not constrained unnecessarily. Monitoring focuses on the end objectives and on the controls which are in place to ensure that they are achieved.

4.4.3 Here are some characteristics of the two processes:

Prescriptive	Outcome
Clear rules — easy to see breaches and hence easy audit	Must be clear what is a good or a bad outcome
Many rules needed — bureaucratic/complicated costly	Fewer rules, but clear guidance
	Encourages adoption of spirit of law
Encourages adherence to the letter and not to the spirit — hunt for loopholes	Audit process — based on assessment of objectives and controls rather than completion of forms; a process that should benefit firms
Implementation simple and unchallenging, other than in the clerical complexities	
	Can be applied to a wide variety of firms and internal processes
More likely to encourage compliance through ritual than through acceptance of good principle	Requires high level of knowledge of practitioners, but should be less expensive in running costs

4.4.4 Outcome-based regulation could be a better option for U.K. financial services. Certainly the focus on ends, rather than on means, removes a possible source of regulatory failure, namely an inadequacy of detailed rules. However, enforcement may be more of a problem in practice, particularly proof of failure. This is because failure to deliver a proper outcome is often more difficult to prove than a clear procedural rule breach. LAUTRO was successful in disciplining some of its members on the general grounds of failure to adhere to SIB principles (these set out general requirements about maintaining adequate controls and providing appropriate advice, etc.).

4.4.5 Outcome-based regulation would require a reasonably clear outcome framework that is backed up with codes of practice (or guidance). The former can be difficult to write without ambiguity, and the latter, whilst ensuring that the

minimum standards are being applied by all, must not become overly detailed. Both would be enforced by a regulator. An example of guidance would be the illustration of possible levels of future policy benefits. Without guidance, providers would be tempted to test the limits of the regulator's tolerance until a successful 'prosecution' finally defined the limits, thus providing that guidance.

4.4.6 It can be argued that outcome regulation may be too difficult to achieve, and can only be adopted in a mature market. However, it is a concept that has more to commend it than the present procedure-driven system. Essential elements in such an outcome based process would be:

— consistency in the interpretation of the outcome regulations that were drafted by regulators and practitioners;
— trust by the public that occasional failures did not prove its inability to cope;
— professional regulators respected by providers, in that they would be assessing objectives and controls, rather than checking details; the concept of *caveat emptor* would be understood; and
— a greater acceptance by providers that adherence to regulation was an integral part of the internal management process; this might include the acceptance of the role of certain professions.

4.5 *Freedom with Publicity — some Limitations*

4.5.1 It is often said that the prudential regulation of U.K. companies is based on freedom with publicity. The Companies Act requires the publication of audited accounts; the Insurance Companies Act requires the submission of publicly available returns to the Department of Trade and Industry (DTI). In theory, potential customers can access these documents to see if the company with whom they intend to do business is financially sound.

4.5.2 However, as Kay (1988) identifies, the reality of freedom with disclosure may be little more than an illusion at the margins. When there is anything of potential importance to disclose, disclosure dries up rapidly. For example, regulators almost invariably agree to a suspension of disclosure when a company is in difficulty, to retain confidence long enough to arrange an as-orderly-as-possible solution to the crisis.

4.5.3 Appointed Actuaries of U.K. life offices are also often considered to operate within a framework of freedom (to choose a solvency valuation basis) with disclosure. Some may challenge the reality of this freedom. Regulations specify the maximum discount rates that may be used, as well as effectively constraining the choice of bases and of other parameters. The foreknowledge of examination by the Government Actuary's Department on behalf of the DTI further constrains the Actuary to operate within guidelines set down by those departments. For some this feels like a considerable restriction.

4.6 *The Role of the Actuarial Profession*

4.6.1 The actuarial profession has traditionally ensured that the life insurance companies and pension funds maintain the necessary solvency margins, despite

the natural desire of, respectively, their management or their sponsors to minimise funds invested. Success in this endeavour is reflected in the continuation of the unique two-hatted role of the employed Appointed Actuary and the Pension Scheme Actuary.

4.6.2 The actuarial profession already has a minor role in FSA regulation, in the disclosure of with-profits expenses and of representatives' total remuneration. A professional guidance note (GN22) substitutes for detailed regulation, and the proper exercise of the Appointed Actuary's even-handedness between public and competitive interests plays an important part.

4.6.3 Although not formally requiring actuarial involvement, life offices' With-Profits Guides are also usually drawn up by actuaries, and a similar professionalism is required.

4.6.4 One possibility would be that further responsibilities under a reformed FSA, using an outcome-based regime, could be delegated to the actuarial profession, which would issue guidance and exercise its usual impartiality of application. (Examples might include: with-profits guide details, objective disclosure of investment risk). The extension of this responsibility to firms (e.g. unit-trusts, investment trusts) which do not traditionally use actuaries must be addressed, however. Equally, the profession would have to be able to demonstrate its proper independent outlook and concern for the public interest.

4.6.5 There are those who say that the public do not understand the roles of the professions. For example, it would be difficult to argue that, if all Independent Financial Advisers (IFAs) or sales staff were full members of a new professional institute, their status in the eyes of the public would be enhanced. The actuarial profession has, however, a significantly good reputation within the financial services sector and with regulators that would enable it to play a key role in designing and monitoring any outcome-based system.

4.7 *Conclusions on Regulation — Theory and Practice*

4.7.1 The application of regulation is not an exact science, and cannot, in itself, prevent error, fraud or obviate *caveat emptor*. Regulations are necessary.

4.7.2 Self regulation has not been a proven success in the financial services sector, and has little credibility in the eyes of Parliament or the public. Whilst it is being reformed and is improving, it is no longer an acceptable option.

4.7.3 Outcome-based regulation, as a concept, has greater appeal for practitioners and regulators than prescriptive procedures. The public will need to be convinced of its efficacy and effectiveness. Overall, the concept should be tried and assessed.

4.7.4 Such outcome-based regulation will require greater consistency and professionalism amongst regulators. Thus, the present range of regulators — SIB, SROs, RPBs — should be considerably reduced. This would improve the speed of reaction to new products and events and allow greater public accountability. The exact shape and structure of the new organisation is not the subject of this paper.

4.7.5 The actuarial profession has a potentially important role to play in both setting acceptable targets for outcomes and in providing guidance. This would be in addition to its more traditional role of the management of financial risk and its explanation to providers and consumers alike.

5. AN OUTCOME-BASED REGIME

5.1 This section expands the proposals for an outcome-based regime, including the setting of suitable outcomes and the audit process.

5.2 *Outcomes*

5.2.1 It is unlikely that there would be much disagreement if the outcome of every piece of investment advice was "the investor was satisfied with the investment". However, an outcome of this nature suffers from two major defects, which render it completely impractical for regulatory purposes:

— no investment exists which will satisfy every investor all of the time; and
— the outcome could only be proved to have occurred when the investment ceased.

5.2.2 A workable regime must, therefore, cater for:

— investments which may disappoint investors in certain circumstances; and
— the achievement of a satisfactory outcome that must be measurable shortly after the investment has been made.

5.2.3 A workable basic desirable outcome could be "the investor understands why the proceeds of the investment are likely to meet his or her financial needs and how those proceeds are likely to vary with changes in both external influences and the investor's own behaviour". The achievement of this outcome:

— permits unsatisfactory, but not unexpected, results from investments; and
— is capable of verification immediately following the making of the investment.

5.2.4 An example of how this approach might apply in a particular case is provided in Appendix C.

5.2.5 It will be impractical for either the investment firm or its regulator to verify directly that a satisfactory basic outcome has been achieved every time. In practice, both the firm and the regulator are likely to want to have in place a system of controls which gives confidence that desirable basic outcomes are, indeed, the norm. Intermediate outcomes may well be defined for this purpose. For example, "investment advisers are properly trained", "adequate controls are in place". "company management strategy genuinely focuses on investor satisfaction", etc.

5.2.6 The regulatory regime may well have subsidiary objectives, such as the

promotion of competition. Additional outcomes may well be defined to assist in achieving this. For example, "the expenses associated with a product are understood by the investor".

5.2.7 An approach of the type described above is capable of applicability to a wider range of financial services than those currently covered by the Financial Services Act, whether under a statutory regime of some description or under an industry's code of conduct.

5.3 *Achieving Satisfactory Basic Outcomes*

5.3.1 A satisfactory basic outcome may be achieved in a variety of ways, depending upon the complexity of the investment, the knowledge of the investor, the medium employed (e.g. face-to-face, over the telephone) and the degree of advice provided or required. However, in every case, it is of secondary importance how the outcome is to be achieved. An outcome is not rendered satisfactory by the delivery of information, no matter how comprehensive, in a particular manner; it can only ever be satisfactory if the investor *understands* the information.

5.3.2 Neither can a satisfactory basic outcome necessarily be assumed just because the investor has signed a form confirming his understanding. The investor may simply be mistaken. Nevertheless, seeking the investor's acknowledgement to the objectives and features of an investment being recommended to him may well be a useful and educational tool on the way to a satisfactory outcome.

5.3.3 It is likely that the regulator would want to provide some guidance on methods likely to achieve a satisfactory basic outcome in various situations. However, the temptation to provide too much or too prescriptive guidance must be avoided if the regime is not to be outcome-based in name alone.

5.3.4 Appendix C provides an example of the investor understanding required for a satisfactory basic outcome.

5.4 *Compliance with the Regime*

5.4.1 It is one of the disadvantages of the present regulatory system that 'compliance' and the work of the 'compliance officer' is often regarded as a costly regulatory 'add-on' to the management organisation. As such, it is not at the heart of business, contributing with constructive innovation. There are few incentives for management to comply with regulation.

5.4.2 In an outcome-based system, a good outcome is a clear success for both regulator and management (whilst also a success for the consumer). Both parties have an incentive to measure the outcomes, with any failures highlighting problems or human weaknesses. The costs of such an audit should, therefore, be acceptable to the company, particularly if it also causes the focus to be raised from new business alone to new business and good outcomes.

5.4.3 There is a danger that any guidance associated with outcome-based regulation could expand excessively, and ultimately over restrict advisers. This would need to be monitored carefully to ensure that the existing prescriptive

regulations are not reinstated. There are opportunities for the actuarial profession to help in setting suitable outcomes and in providing well-balanced guidance to support the new system.

5.4.4 An outcome-based regime will not necessarily change the attitude described in ¶5.4.1. Where this attitude is present, what is needed is a change of management culture throughout the organisation.

5.4.5 Requiring an intermediate outcome of a customer-centred culture can bring this about. Its achievement will be evidenced by practices such as the design of advertisements which present a balanced view of a product (no small print), sales training which stresses the risks as much as the advantages, products which are not designed to mislead and a reward structure for investment advisers which is based on objective measures of customer satisfaction.

5.4.6 To maintain such a culture, the firm will naturally be motivated to implement adequate controls and to audit the achievement of satisfactory outcomes to the advice process. Firm and regulator will then be in harmony.

5.5 *Outcome Audit*

5.5.1 Both firm and regulator will want to audit the achievement of satisfactory outcomes, both basic and intermediate.

5.5.2 Intermediate outcomes (e.g. advisers' competence, systems of control, etc.) can be audited in a conventional manner by internal audit or compliance departments, and either by the regulator directly or by external auditors reporting (in public?) to the regulator.

5.5.3 Basic outcomes (i.e. investor understanding) could be audited by means of surveys of customer understanding/satisfaction, both post sale and at subsequent times, including post encashment. Again, these could be internal to the firm or independent.

5.5.4 Audit results should feedback into improvements to product design, adviser and management training, advertising materials, control systems, etc.

5.5.5 The regulator should limit its own audits as much as possible, relying instead on the regime to encourage firms to audit internally to a satisfactory standard. Also, whilst guidance may be given on the types of audit most likely to work well in various circumstances, the regulator once again needs to avoid too much rigidity.

5.5.6 Low persistency may also be an indication of poor outcomes in some circumstances; but not necessarily in the case of products which do not penalise early termination.

5.6 *International*

5.6.1 There are both concerns and opportunities in the international field of regulation. In reality, E.U. FSA-type regulation is not well harmonised, and each nation follows its national legislation.

5.6.2 It would clearly be advantageous if solvency requirements, marketing

and advising practices were pulled together, so reducing the number of procedures that multi-national firms had to follow, but this is not an issue that is foremost in the public's mind.

5.6.3 Fairness between providers across frontiers is clearly a problem, and this must be addressed where it arises.

6. OTHER CHALLENGES

6.1 *Competition*

6.1.1 The need for fair competition within the financial services sector was reviewed in Section 3, as one of the expectations in an environment of trust. Statutory regulation, whether prescriptive or outcome-based, has a formal legal basis that, over time with piecemeal amendments, can become all embracing. It is important, therefore, that an independent third party has the power to review both statute and regulation, to ensure that there are no detriments to competition.

6.1.2 It would be for government to incorporate such review powers in its legislation. In broad terms, this would equate to the present duties of the Office of Fair Trading.

6.1.3 However, it is vital that regulators have a duty to promote competition as well as to protect the customer. The conflict between the criteria used by regulators and the OFT led to considerable wasted effort, time and expense in relation to the disclosure regime between 1990 and 1994.

6.1.4 As mentioned in ¶5.2.6, an outcome-based regime can also promote competition.

6.2 *Relative Risk*

6.2.1 In most satisfactory 'outcomes' there will have to be some acknowledgement or acceptance of the level of risk involved. This will require careful explanation, as it is more usual for purchasers to fail to understand the risks associated with one product, or the collective risk in a portfolio of products, than for a financial product to fail to perform as forecast.

6.2.2 The actuarial profession is well placed to assist investment providers and their future regulators to devise ways of explaining the relative risk of different types of investment to investors with various levels of financial awareness.

6.2.3 The actuarial profession also might wish to consider whether the present 'key features' system adequately fulfils these requirements.

6.3 *Solvency Standards*

6.3.1 During the course of its work the working party looked at the varying solvency levels or standards laid down by statute or regulation. There are arguments which, if fully deployed, can lead to a general simplification and unification of these standards to reflect the changes in ownership of insurance companies/banks/building societies, etc.

6.3.2 However, whilst the present standards, which are different for various organisations, may seem strange, they are of little consequence to the public, provided that the regulator is satisfied that they meet their purpose. Such standards need regular review to allow suitable reaction to change, e.g. derivatives, or new types of companies seeking to circumvent current regulations. The profession is well placed to assist in the monitoring and regular review of such solvency standards.

7. Summary of Key Issues for Discussion

7.1 The points below are those that the authors felt could usefully be raised by the actuarial profession in any discussion on financial regulation. The paper suggests a possible line to take, but the aim is to seek the views of others on these proposals.

7.2 Any regulatory system must play a part in engendering an environment of trust. This environment must meet the expectations of the public, the financial sector and government. It is suggested that this trust is not presently apparent, as the expectations of all three are not being met. Perfect regulation is impossible, as it follows to some degree the laws of supply and demand.

7.3 Self regulation where commercial gain is involved has not been a proven success in the financial services sector, and has little credibility in the eyes of the public. Whilst it can be improved, there are insufficient advantages in trying to preserve it. Does the actuarial profession see any reason to retain self-regulation? [Note that this has been overtaken by events; see ¶1.1.5].

7.4 The present prescriptive regulation based on fixed procedures and checks has some benefits, particularly where both regulators and practitioners are uncertain of their powers and abilities. Outcome-based regulation should provide an overall process relying on clear agreed objectives supplemented by guidance notes. This is a new approach that will require considerable effort and skill to put into effect. Should the actuarial profession promote this concept, or are there alternatives which members would prefer to see advocated?

7.5 Is the approach to an outcome-based regime, set out in Section 5, with a clear focus on investor understanding and management culture, at all workable? Should the actuarial profession advocate and expand further upon this approach, or is there a better one?

7.6 If so, how do we meet the challenges of:

(1) educating investors that this seemingly looser regime will provide them with a better service and engender an environment of trust;
(2) encouraging guidance which is effective without being prescriptive; indeed can this be achieved in some areas (e.g. illustrations); and
(3) devising measures of relative risk?

7.7 A move to statutory regulation may bring with it the end of the status of Recognised Professional Body. The Institute of Actuaries, amongst others, is able

to regulate the investment advice given by its own members. Whilst the workload of the statutory regulator may not be significantly increased by the addition of a few firms of actuaries, the same cannot be said of accountants or solicitors. Is there still a role for RPBs under statutory regulation? Is this more or less likely under an outcome-based regime? Should the Institute continue to have RPB status if allowed?

7.8 This discussion paper has concentrated on fairly specific areas where the actuarial profession has experience and training that can help others. It has deliberately not looked at:

— the organisational debate of how many regulators and to whom they should report (e.g. DTI or Treasury);
— the supervision of banks and building societies and the regulation of markets; and
— a wholesale revision of the FSA.

Are there some points in these sectors where the actuarial profession can usefully contribute to the debate?

7.9 The paper refers to the poor quality of financial education (including a reference to 'specialists' who are salesmen by another name) resulting in a generally low level of knowledge on the part of the public. One problem is not so much the complexities, but the continual change triggered by legislation changes. Some organisations, e.g. the ABI, do provide material for schools, but they may be seen as biased. Should the profession:

— promote the idea of 'managing your money' being part of core education; and
— put forward the possibility of teaching material, which would need regular updating, being prepared by an independent organisation funded by the financial services industry rather than by a particular part?

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APPENDIX A

COMPOSITION OF WORKING PARTY AND TERMS OF REFERENCE

A.1. COMPOSITION OF WORKING PARTY

The members of the working party were:

A. S. Fishman, F.I.A. (Chairman); J. J. Daldorph, F.I.A.; A. K. Gupta, F.F.A.; T. W. Hewitson, F.F.A.; M. R. Kipling, F.I.A.; D. R. Linnell, F.I.A. and S. R. Nuttall, F.I.A.

A.2. TERMS OF REFERENCE
(written in September 1996)

A.2.1 *Background*

A.2.1.1 The present Government and the Labour Party have stated that they will review the present regulatory regime for financial services in the widest sense. However, they have both implied that work would not start until after the next general election and that changes would only follow a period of full consultation.

A.2.1.2 The Faculty and the Institute would like to be in a position to contribute to the debate. The actuarial profession has considerable experience in various forms of financial services regulation; but it also has a wider public interest role, with many years experience in advising companies, supervisors and regulators on long-term risks and financial viability. A working party composed of members of all Boards has been formed to prepare the profession's contribution. It will report to FIMC, with other Boards' input at the appropriate time.

A.2.2 *Tasks*

The working party should consider:

(1) the objective of regulation (and prudential supervision) in the financial services sector;
(2) the scope of such regulation; and
(3) the best form of delivery, such that it is cost effective. It should not restrict itself to the 'narrow' actuarial aspects.

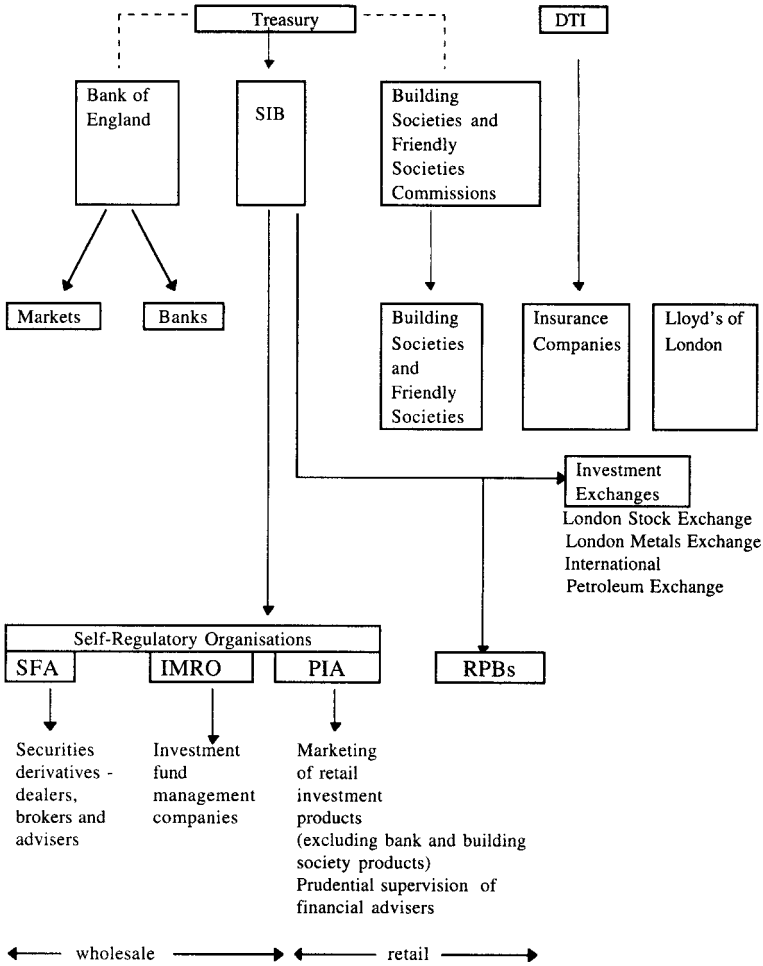
A.2.3 In their deliberations they may care to consider:

(1) the desirability or otherwise of treating any particular form of financial services products differently from another;
(2) to what extent, if at all, consumers need protection against their own shortcomings (i.e. is execution only a desirable development?); and
(3) the desirability of a multitude of regulators and supervisors, involving, in turn, a number of 'masters'.

A.2.4 The working party should aim to produce a discussion paper that could be the basis of a sessional meeting in 1997, preferably in the spring. Thus, taking account of other views, those required to respond in any consultation process will have the necessary information.

APPENDIX B

UNITED KINGDOM REGULATORY SYSTEM FOR MOST FINANCIAL SERVICES
(Structure as at May 1997)



ABBREVIATIONS

DTI — Department of Trade and Industry
IMRO — Investment Management Regulatory Organisation
PIA — Personal Investment Authority
RPB — Recognised Professional Body
SIB — Securities and Investment Board
SFA — Securities and Futures Authority

B.1 The above diagram sets out the essence of the U.K. regulatory structure. In broad terms it is supported by the Financial Services Act (FSA), Bank and Building Society legislation and the Companies and Insurance Companies Acts.

B.2 *Companies*

All companies have to produce audited accounts. In addition, certain regulations require special levels of solvency and reserves (e.g. for banks) and the publication of detailed past performances (e.g. life insurance companies).

B.3 *Individuals*

Directors of companies have to be 'fit and proper' in order to hold certain appointments.

B.4 *Products and Prices*

In general there is meant to be a light hand on product design — there is little control in life insurance, but some in unit trusts. There are no price constraints. Most regulators avoid control on products and prices to allow the free market and competitive innovation to flourish. The constraints on solvency, quality and ability of individuals and selling practices are designed to protect investors.

B.5 *Sales Process*

Regulators stipulate codes of conduct in selling processes and set minimum competency and training standards for sales staff. There is no formal prescription on the remuneration of sales staff (e.g. commission levels), but the disclosure of the level of commission is required at the time of sale. It is in this area that the public are most involved, and the paper focuses on ideas to improve these processes.

B.6 *General Comment*

The diagram and the few paragraphs above grossly simplify a complex system. Through law, regulation, practice and structure, the whole has developed with many good points and many bad ones, as set out in the body of this paper. To understand how a firm and its products are regulated, it is necessary to determine the nature of the firm's primary business, in order to see by whom and how it is regulated for solvency purposes, and then discover whether its product is an 'FSA regulated product', and hence which regulator controls the marketing and selling processes. There are many anomalies.

APPENDIX C

SATISFACTORY BASIC OUTCOMES: AN EXAMPLE

C.1 This appendix sets out an example of a satisfactory basic outcome for an investor in accordance with the principles suggested in Section 5.

C.2 The example is based on a customer seeking advice on the repayment of a domestic mortgage and being advised to use a unit-linked endowment for the purpose.

C.3 Firstly, the way in which the product operates is explained. Comparisons with alternative solutions will probably be appropriate. It would be explained that each month some of the money which would otherwise have been used to repay part of the loan is, instead, in effect, invested in a portfolio of assets chosen by the life office. The objective of doing this is to earn enough from those investments, after tax and the life office's charges, to more than offset the additional interest incurred (after tax relief, if any), and so not only repay the mortgage but also provide an additional sum.

C.4 Then the main risk associated with this approach should be explained; that the investment return may not be sufficient to build up enough capital to repay the mortgage and more would end up having been paid than under a repayment mortgage. The customer would be invited to list, with the adviser's help, all the circumstances or constraints which they considered relevant to the mortgage commitment (e.g. likely to be ending a contract of employment or some other anticipated change of circumstances).

C.5 Then an explanation is given by the adviser of how these circumstances have been taken into account, and the main reason for recommending the product on offer. At this point, assistance to the investor in assessing the risk of failure of the product, to enable him or her competently to accept or reject it, is important, particularly in ensuring that the risk is expressed in terms with which the investor is familiar. If the investor appears unable to understand the risk, it is likely to be a signal that the recommendation is inappropriate.

C.6 To do this properly, advisers first need to understand the risk themselves in a quantitative sense. This is one area where the profession may be able to assist (e.g. with risk levels derived from stochastic modelling).

C.7 Secondary benefits are then explained; for example, that the mortgage will be repaid on death (although the fact that a repayment mortgage can be covered for this contingency, too, would be pointed out) or that tax relief may be obtained for longer or that the tax relief might be reduced or withdrawn.

C.8 Secondary risks are also pointed out; for example, if it is the case, that early surrender of the policy (for example as a result of unemployment, sickness, divorce, or simple change of mind) will result in a loss and so in a worse position than under a repayment alternative; also, that a sudden stock market fall shortly prior to maturity might expose the investor to a substantial and unforeseen capital

shortfall. This might be the opportunity for the adviser to recommend planning ahead for an investment switch to lock in value as maturity approaches.

C.9 If not already mentioned, alternative approaches to meeting the investor's need should be raised, and reasons for their dismissal advanced (e.g. a pension mortgage — not appropriate if the individual is in a company scheme). An independent adviser will also want to refer to alternative product providers and why the one being recommended is preferred.

C.10 To conclude the process, the adviser is likely to want to verify that all has been understood, possibly by inviting the investor to describe in his or her own words why and in what they are investing and the risks which they will face to achieve the possible benefits.

C.11 Some documentation could then usefully be left with most investors to assist them to review periodically their understanding of their investment. This would be supplemented, where appropriate, by some regular reviews by both adviser and customer together.

SUPPLEMENTARY NOTES ON 'FUTURE FINANCIAL REGULATION: AN ACTUARY'S VIEW'

1. INTRODUCTION

1.1 A discussion paper on this topic is to be presented to the Institute on 22 September 1997. In order to assist the discussion, a sub-group of the Personal Financial Planning Committee of the Faculty and the Institute, chaired by N. H. Taylor, has prepared these notes on some of the topics suggested in the discussion paper. Questions posed by the sub-group are shown in bold type.

2. OUTCOME-BASED REGULATION

2.1 One of the key issues listed in the discussion paper is whether the profession should promote the concept of outcome-based regulation. The sub-group considered some particular areas where outcome-based regulation might be applied.

2.2. *Measuring Outcomes for Investors*

2.2.1 In their latest document on the Evolution Project, the PIA asked how they could measure 'outputs' or, as they would prefer to put it, the quality of the transaction for the consumer. Currently firms and regulators monitor the processes involved in training staff and the paper records made of sales, together with other indicators, such as complaints and persistency levels. These checks are obviously essential, but they are all, to some extent, indirect, in that they do not involve testing the consumers' understanding or satisfaction with the sales.

2.2.2 The overall objective of the monitoring process is to establish whether sales are appropriate — in other words, do the products sold match the investors' needs, are they affordable and sustainable, and does the investor understand the key features of what has been bought? Is the sale genuinely in the interest of the investor? The 'outcome' is the sale itself, not the eventual out-turn of the contract purchased. Any checks need to be made very soon after the point of sale, so that any inadequacies can be dealt with at the time and any wider problems identified and acted upon to the benefit of other prospective investors.

2.2.3 Hitherto, it has been difficult to see how consumers, themselves, could be involved in the monitoring process. Towards the end of its existence, LAUTRO considered the idea of 'mystery shopping', but this, on its own, is too limited and expensive a technique for firms or regulators to rely on. A better solution might be to build a level of consumer checking into firms' own processes, with the regulators monitoring this to ensure that it is effective and that its results are followed up when necessary.

2.2.4 In the past, although large quantities of explanatory material have been supplied to investors before and after a sale, there has been little confidence that they have found it useful (or have even tried to read it). Each investor should have had an explanation from the salesperson of what has been bought, and why, and its risks and cost. In addition, we now have 'key features' and 'reason why' letters across much of the Financial Services Act (FSA) product range, and their coverage is likely to be extended; the investor will have received written summaries of the key information, in an understandable form. 'Reason why' letters and factfinds can be audited by firms and by regulators, to check that sales are compliant.

2.2.5 As firms develop their processes for producing 'reason why' letters, and gain experience in using them effectively, the way will open up for checking the outcome of a sale directly with the investor, in a focused way. The techniques for making such checks need to be developed and tested in practice.

2.2.6 If this approach is adopted, it could cover all sales made by the firm. Alternatively, sampling techniques could be used. There are well-tried methods in other fields for testing whether an initial sample gives rise to cause for concern and, if so, for taking further samples as a precursor to other appropriate action. Where relevant, the sampling could be 'targeted' at areas of potential concern, such as products or geographic areas with higher-than-acceptable discontinuance rates, or contracts with unusually large premiums, or sales by particular salespeople or sales teams.

2.2.7 The checks could be carried out by telephone, by direct visit, or by letter. Again, the nature of the client base and the situation may determine that a particular technique or mixture of techniques would be appropriate. To ensure proper standards are maintained, it is likely that those carrying out the checks within firms would not form part of the sales management team. In carrying out their reviews, they would not be working blind, but would have the record of the sale (the fact find, the relevant 'key features', the 'reason why' letter, etc.) in front of them, either on paper or in electronic form. Particularly in telephone interviews, this would enable them to tailor their questions to the particular sale. The checks could cover all relevant aspects of a sale, or could focus on those aspects most likely to cause concern.

2.2.8 As an example, based upon the background information available, a telephone interviewer should be able to establish whether or not an investor of a personal pension is clear about its costs, its affordability, the absence of a company scheme and the possible effects of a change of job.

2.2.9 *Questions*

(a) Would compliance audits of 'reason why' letters and factfinds be the most effective approach?

(b) Alternatively, should compliance checks be carried out by contacting investors, in conjunction with an analysis of the written records of the sale?

(c) Should such checks with investors be detailed, or should the checker merely attempt to establish whether or not there are sufficient doubts about a particular sale to need follow-up action, either on the particular sale or in relation to any wider issues raised?

(d) If this approach is adopted, should all sales be checked with investors, or should sampling be used?

2.3 *Advertising Rules*

2.3.1 The basic criteria for advertisements are that they should be fair, clear and not misleading. There are three sets of PIA rules, covering 'image'-type advertisements, general product advertisements and 'direct offer' advertisements, all of them inter-related and interwoven. They were drafted at a time when there were no 'key features' or 'reason why' letters (and indeed no requirement to provide anything in writing before a sale took place).

2.3.2 In their latest document on the Evolution Project, the PIA asked whether the detailed advertising rules could be replaced by a general rule supported by a code. Under an outcome-based approach, whether an advertisement meets or fails to meet the basic criteria should be judged by considering its likely impact on investors. Image advertisements and general product advertisements could not directly harm investors, as the advertisements would have to be followed up by some further form of sales process, the outcome of which would be measured under the approach outlined in Section 2.2.

Would a general rule on advertisements, supported by a code, be a satisfactory way to proceed?

2.3.3 A desirable subsidiary outcome could be that advertisements meet the fair, clear and not misleading criteria, to avoid possible misunderstandings by investors (which would need to be corrected during the sales process). The PIA points out that advertisements are subject to public scrutiny. This, of course, extends beyond scrutiny by members of the public to scrutiny by the regulators and by the advertisers' competitors.

(a) Should financial services regulators adopt procedures equivalent to those used by the Advertising Standards Authority, whereby complaints from the public and competitors would be looked at by a panel of industry experts and consumers (and regulators?)?

(b) Should advertisements which fail this test be withdrawn immediately, and the offending firms given immediate publicity in a monthly or quarterly report (along the lines of the reports produced by the Insurance Ombudsman, but with the offending firms named)?

2.3.4 For direct offer advertisements, investors are placing total reliance on the contents of the advertisement in making their purchases.

(a) Would it be preferable to retain detailed guidance, or even detailed rules, for such advertisements?

(b) Alternatively, should there be outcome-based testing by firms and regulators for products bought as a result of such advertisements, along the lines suggested in Section 2.2?

2.4 *Pensions Mis-selling*

2.4.1 It is, of course, impossible to turn the clock back. However, it is possibly of interest to speculate what might have happened under an outcome-based approach involving investor contact in respect of the problems which have emerged in relation to sales of pension contracts to occupational pension scheme 'opt-outs' and 'non-joiners', and in relation to transfers of pension benefits from pension schemes to personal pension arrangements. This may suggest whether or not the outcome-based approach would be helpful if practical problems emerge in other areas in future.

2.4.2 On opt-outs, it would be generally agreed that, in the vast majority of cases, members of occupational pension schemes should be advised to stay in their schemes rather than take a personal pension. For non-joiners, the normal advice will be to join the employer's scheme — does the consumer know whether he or she is eligible (and when), and what benefits are provided? For transfers, there are considerable differences between the structure of the contracts involved and the risks involved, and these have implications both financial and non-financial. There are some cases where the sale of a personal pension arrangement will be correct. In each case, it is very important to establish whether a sale meets the investor's needs. For contracts with continuing premiums, are they affordable and sustainable? In all cases, does the consumer understand the key features of the occupational scheme and the personal pension arrangement? Is the sale genuinely in the interest of the investor?

2.4.3 Pensions mis-selling cases would seem to fail these criteria, which are those set out in ¶2.2.2. In many cases, there will have been only a limited record of the sale, and rarely any form of 'reason why' letter. Focusing on outcomes, and contact with investors, might well have enabled firms and regulators to identify cases where investors lacked knowledge or understanding of the benefits of their employers' schemes, and the relative merits of the options open to them.

2.4.4 *Questions*

(a) Would the proposals set out in Section 2.2 have enabled conscientious firms to identify these problems much more quickly?

(b) Would they have assisted regulators to formulate guidance more swiftly, both to assist conscientious firms and to steer others in the right direction?

(c) If so, does this give encouragement for the adoption of the outcome-based approach in future?

2.5 *Effect on Small Firms*

2.5.1 As far as investors are concerned, it is essential that the same standards

of regulation should apply whatever the size of the firm involved. However, the cost of regulation can place a very large burden on a small firm, particularly where FSA business forms only a very small part of the firm's work. This will apply particularly to some professionals who are regulated by their professions, such as actuaries, lawyers and accountants.

2.5.2 As well as the direct costs of regulation, such as regulators' fees, there are considerable indirect costs. The time spent on regulatory issues can be large. There will probably not be a full-time compliance officer; instead, a senior manager, a partner or the sole proprietor will carry out the role. Maintaining knowledge of the rulebooks and understanding the impact of rule changes, filling in reports to the regulators, and dealing with inspection visits, can occupy a significant part of this person's time and energy.

2.5.3 For such firms there may be few FSA-regulated events in a particular period — or even none at all. Under outcome-based regulation, those with no relevant business in a particular period could simply be required to provide a nil business return to the regulator, and could be absolved from detailed record keeping and reporting. Inspections by the regulators would still be needed, to check that this was the case. Similarly, for firms with few FSA-regulated events in a given period, there could be a lighter reporting regime (but not a lighter standard of outcomes), and the regulators' inspections could focus on the relevant investors' experience of the advice given.

(a) Would outcome-based regulation be a help to such firms?
(b) Should the relevant professional bodies maintain their disciplinary role in relation to such business under whatever new regulatory structure emerges?
(c) Should separate compensation arrangements be maintained?

2.5.4 Consideration of regulatory visits to investors highlights a potential problem of confidentiality. At present, investors' affairs are examined by regulators as part of their inspection visits, but investors are probably unaware of this. Moving to an outcome-based approach would entail letting investors know that they would be approached by firms and/or regulators.

(a) Would investors be happy to know that regulators were examining their affairs under the current approach?
(b) Would they be prepared to co-operate with firms' checks and regulators' checks under an outcome-based approach?
(c) Is there any conflict with the duties of confidentiality placed upon professionals such as lawyers and actuaries?
(d) Would the reactions of high-net-worth individuals or business customers differ from others?

2.5.5 There are likely to be small IFA firms which are in a similar position to small professional firms in relation to the burden of regulation and their volumes of FSA-related business. Possible examples are IFAs with only a few

employees, and IFAs where the main focus of the business is on motor and household insurances. However, there is usually no professional body able to take disciplinary action in respect of such firms.

Would a similar approach to regulation be appropriate for such firms, under the auspices of the new regulatory body?

2.6 *The Need for Continuing Advice*

2.6.1 In Section 2.2, it was suggested that the 'outcome' audited should be the sale itself, not the eventual out-turn of the contract purchased. However, there are some purchases where there may be an implied commitment to continuing advice. One possible example is the sale of Appropriate Personal Pensions, where a decision to contract out of SERPS may need to be reviewed some years later, as the investor ages or when the Government changes the explicit or implicit terms of the arrangement (as for example the regular reviews of contracting out rebates or the recent change to ACT). Another possible example might be the sale of a term life insurance contract with an option to convert to an endowment within a specified period. A further example could be the sale of a with-profits or unit-linked endowment policy, or a PEP, in connection with the repayment of a mortgage.

(a) Is it reasonable to merely inform the investor at the point of sale of the need for future action and to leave matters in their hands, or should there be some back-up mechanisms in place to issue reminders, either by the initial adviser or (where the product provider was not the initial adviser) by the product provider?

(b) Should such arrangements be monitored along the lines suggested in Section 2.2?

2.6.2 Similarly, at the point of retirement, an investor who has previously taken out personal pension arrangements should be aware of any open market option (and how to exercise it) and of the different forms of annuity and income drawdown arrangements available.

(a) Who should be responsible for ensuring that this actually occurs (the initial adviser, any current adviser or, where different, the product provider)?

(b) Should investors' understanding of these issues be monitored along the lines suggested in Section 2.2?

(c) Is the same level of information, understanding and monitoring appropriate, irrespective of the size of the purchase money available, in view of the potential cost impact on small purchase amounts?

3. CONTROLS OVER INDIVIDUALS

3.1 Irrespective of whether an outcome-based approach is adopted, the regulators need adequate controls over the firms they regulate. There is currently a debate developing over whether regulators should also have greater controls over particular individuals employed by regulated firms, and whether there should be potential sanctions against individuals where there are breaches of the rules (instead of, or as well as, sanctions against firms).

3.2 There are already sanctions against individuals available to SIB under the FSA; however, although they have been used more frequently in recent years, they are not seen by the regulators as flexible enough to act as a real deterrent. Recent high-profile breaches of regulations have led to calls for more effective sanctions against individuals.

3.3 In a recent consultative paper on this topic, SIB proposed laying down guidelines on how a firm should provide (and document) a clear management structure. SIB sees this as essential, both to the effective running of the firm, and also to being able to establish clearly where responsibility lies if things go wrong. SIB comments that a balance needs to be struck on the degree of detail involved in the descriptions of responsibilities and controls that firms create. SIB's aim is to ensure that senior managers recognise their responsibilities, and would not accept undue delegation of these; it wishes to ensure that there are adequate internal controls which reflect the scale and nature of the risks in each financial services business. Some smaller firms may be exempted from the requirements.

3.4 The SFA and IMRO already require individuals to be 'registered', in a way which creates a responsibility on the individual to abide by the SRO's rules, and enables the SRO, itself, to take action against an individual. The PIA is considering similar steps. If disciplinary action is taken, the burden of proof required is expressed differently by the SROs, but appears, in general, to place the burden of proving the facts (and that those facts amount to a breach) upon the SRO. The SROs apply a civil standard of proof, with the degree of proof needed varying according to the nature and gravity of the charges. (Briefly, the civil standard of proof allows judgements on the balance of probabilities, whereas the criminal standard requires proof beyond reasonable doubt.)

3.5 The procedures to be adopted by disciplinary tribunals set up by SROs are flexible, and less formal than civil or criminal court proceedings. One significant difference between SRO and court proceedings is that the regulated person (and firm) has to co-operate with the regulator in providing information. Also, the regulator has virtually unlimited access to the firm's documents, but the firm (or the manager) has no equivalent right of access to material held by the regulator, unless the regulator puts it formally into evidence before a tribunal.

3.6 *Questions*

(a) Are SIB's proposals for guidance on the delineation of responsibilities and controls within firms the right way forward?

(b) When these are in place, should senior managers be subject to disciplinary action by regulators?

(c) If so, should the civil standard of proof apply to both firms and individuals, or should actions against individuals be conducted to criminal standards of proof?

(d) Is it relevant that, without the support of their employer or partners, few individuals would have the resources to mount a defence against charges brought by a regulator?

(e) Are there more effective alternatives (such as restricting or banning sales of new business by firms)?

(f) Are SIB's proposals more or less relevant under an outcome-based approach?

ABSTRACT OF THE DISCUSSION

HELD BY THE INSTITUTE OF ACTUARIES

Mr A. S. Fishman, F.I.A. (introducing the paper): On being invited to chair this Working Party, the first question that I asked was simply: "What added value could the actuarial profession bring to the debate on future financial regulation?"

At the outset the Working Party focused on public interest, a core concern of the profession, from the perspective of the public. We came to the conclusion that actuaries have much to offer in this area, an area in which our expertise in designing financial products, managing risk, and in explaining the process to others gives us a unique role to play.

The Working Party has put forward for discussion the proposition that regulation should focus on outcomes rather than have the present prescriptive processes. From a starting point of: "Are we suggesting something that is impossible?" the Working Party moved gradually to a position of "Perhaps it can work". The momentum has been maintained in a positive fashion by a sub-group of the Personal Financial Planning Committee chaired by N. H. Taylor.

Mr M. R. Kipling, F.I.A. (introducing the paper): In Section 4 the Working Party reports its brief investigation and deliberations on the theory of regulation. We were not enamoured of the hypothesis that the market mechanism will operate best when unconstrained, but neither were we convinced that regulation is always beneficial.

Regulation is necessary to correct major inefficiencies in the market, particularly information imbalances. It should not be so excessive as to remove all risk from an investor, nor, as in those wise words of Professor L. C. B. Gower, should it do more than "protect reasonable people from being made fools of". We agreed with the Austrian economist, F. A. Hayek, that regulation is an inexact science, and that it will often develop in a way unimagined by its originators; the Financial Services Act is probably a good example of this. As a result, the framework for regulation should be broad and flexible — it should aim to obtain compliance with its spirit, not with its letter.

Our proposal for such a system of regulation is the 'outcome-based' approach. This judges the compliance of a regulated activity, not by whether the activity follows a prescribed process, but by whether it satisfies the customer.

The outcome of any financial services activity can only be determined to be satisfactory or not when the investment is finally cashed in. However, as noted in ¶5.2.1, "no investment exists which will satisfy every investor all of the time". Also, by the time a preponderance of bad outcomes has come to the regulator's attention, it may be some while since the investments were sold, with many more similar sales since.

Our suggested solution is to define a satisfactory outcome of a financial services product sale, in such a way that, as stated in ¶5.2.3, "the investor understands why the proceeds of the investment are likely to meet his or her financial needs and how those proceeds are likely to vary with changes in both external influences and the investor's own behaviour". This definition permits investments which can disappoint, but only in circumstances of which the investor is aware. It can also be measured almost straight away.

The most direct way to verify a satisfactory outcome is an outcome audit; that is to ask the customers themselves. This could be through random sampling by the regulated firms, possibly independently audited, or, indeed, sampling directly by the regulator, for example.

Alternatively, there could be more focus on adequate systems of control being in place at financial services firms, with those systems ensuring that an advice process, such as that described in Appendix C, had been gone through every time. This is an indirect audit process, and may work well in conjunction with more limited direct auditing.

However, we suggest that a 'box ticking' approach, against a background of prescriptive regulation, be avoided. Sometimes with this the wood cannot be seen for the trees.

There are some areas where, to promote fair competition, reasonably specific guidance may be

needed as to what the regulator would consider appropriate; for example, standard or maximum investment return assumptions for benefit projections or the reduction in yield format for comparing expenses. However, these should be the exception rather than the rule.

Mr A. K. Gupta, F.F.A. (introducing the paper): I am here, not as an expert in financial regulations, but as a practitioner working in the sector. There are two issues which I would like to cover. First, is there a political will towards outcome-based regulation? Secondly, would outcome-based regulation be good for the industry and consumers?

Since we wrote the paper, the Securities and Investments Board (SIB) has published its paper on the reform of the financial regulatory system. Its plans include rationalisation of the regulatory structure and removal of self-regulation. This pre-empts the Working Party's recommendations.

A quick perusal of the aims of the proposed structure indicates close agreement with our own views, with perhaps a slightly differing emphasis on competition. Whilst open competition is not stated as a primary aim in SIB's paper, the benefits of competition and innovation to the consumer are recognised.

When we turn to the method of regulation, no major changes are proposed currently. It is too early to conclude that a political will exists today towards outcome-based regulation, but, on the other hand, it does not, as yet, appear to have been precluded.

Secondly, would outcome-based regulation be good for the industry? My view is yes, but not for reasons to do with regulation *per se*. Success is achieved by building on strengths. Eliminating deficiencies is necessary, but not sufficient. Our industry has many strengths, but for the last five to ten years it has been blighted by its poor standing, the low esteem in which it is held and continual media focus upon its deficiencies.

If we are to upgrade the image and the quality of the industry, we must reinforce and encourage positive behaviour rather than merely eliminating inadequate and unacceptable behaviour. We must create competition around excellence of delivery and around satisfying consumer needs; and we must focus on, and allow ourselves to be led by, the best. By doing so, we may help to focus consumers and the media on the positive things that the industry is doing, and not just on its failings.

The biggest potential benefit to outcome-based regulation could be the ability to encourage and reinforce positive behaviour and to create competition around excellence of compliance standards and around meeting consumer needs. It might be one of the measures which helps shift media attention away from the industry's failings towards the positive things that the industry is doing. In this way outcome-based regulation could play an important part in the industry's rehabilitation process, and could help to produce a stronger industry for the benefit of consumers and the country.

Mr N. C. Dexter, F.I.A. (in a contribution that was read to the meeting): The regulation of financial services has, over the past few years, been a very interesting area to work in, and it will continue to be so for at least the next three years as NewRO is born. Actuaries should play an important role in the development of regulation in the United Kingdom, with our breadth of knowledge of both the insurance and pensions industries.

In ¶3.1.2 three risks are identified for the public, but there is an important fourth risk — that the agent or adviser misappropriates the client's money. As is pointed out in ¶3.1.3, the client may not 'use' the product for some time after purchase, and may only discover any problems at the time that he or she is least in a position to cope with the situation, for example at the onset of a critical illness or on the insured's death. Thus, it is important that there is sufficient regulation to give confidence to members of the public to trust the salesperson with their money.

The paper understates the position, in ¶4.2.8, when it says that "the client is reasonably expected to understand all the information provided, make rational decisions and exercise rights at the appropriate time". Is this realistic? The actuarial profession must take some of the blame for this not happening in the past by designing too complex products. The unfortunate result of this is that it is actually very difficult for less-well-educated clients to understand what they are being sold. Members of the public do rely on the IFA or the salesperson to give them appropriate advice.

Regarding outcome testing, the notes produced by the Personal Financial Committee refer to the

'outcome' being the sale itself. The implication of this is that 'outcome' tests are not very different to what many companies do routinely today with their customer satisfaction surveys. The acknowledged weaknesses of these are that:

(1) it is not always easy to arrange to see a client to go over again the detailed fact finding process;
(2) even if you can, once the client has made a decision he or she will often defend it, at least in the short term; and
(3) companies are already looking at ways of reducing the costs of sales, whereas the costs of surveying a large proportion of sales would tend to increase the burden.

We have had enough change in getting to where we are with the Financial Services Act without suddenly moving to a completely new system. It would be better to continue rolling the ball started by the PIA's evolution project — looking at ways of improving the current approach and removing some of the more onerous, inefficient parts — particularly when we are now moving to a situation where salesforces are better trained, there are fewer rogue advisers, and controls are becoming embedded in the culture.

It should be feasible to devise controls which rely more on good quality management information systems than on time-consuming form filling. It should be possible to move to risk-based monitoring, where firms with good compliance records are rewarded with a lighter regulatory regime. This is where there is an incentive for management to comply with the regulations — which is currently lacking, as mentioned in ¶5.4.1.

So, what role should actuaries play in all this? Life actuaries could devise products which are simple enough for clients to understand, and pensions actuaries will have a key role in the coming months in shaping the future for pensions in this country. Last, but not least, those of us who work in the wider field of management consultancy and compliance can assist in establishing compliance regimes which are less onerous, yet are more effective and efficient in controlling the risks for clients in purchasing financial services products.

Dr L. W. G. Tutt, F.F.A.: Whilst the recommendation of the paper that self-regulation of the financial services industry be replaced by statutory regulation has, apparently, already been decided upon officially, it would seem that the Working Party's phrase 'supported by guidance' is, at least to some extent, still an open issue.

In the supplementary notes to the paper mention is made of such matters as advertising rules, controls over individuals, inspections by regulators, and so on. In such areas the views of actuaries can well be worthy of consideration, but necessarily alongside the views of others who may be more specialist in such issues. The supplementary notes also refer to the important aspect of measuring outcomes for investors, making mention of checking the outcomes of a sale, perhaps only on a sampling basis, directly with the investor. The notes make much play of carrying out the checks by telephone calls; in my experience a most unreliable method of checking technical details. Indeed, this section highlights the substantial practical difficulties associated with the outcomes approach. Posing so many questions without answers suggests that the outcomes approach has not been properly thought through.

The supplementary notes also refer to the mis-selling of pensions. Many financial products emanate from companies in which actuaries play an influential part, and whose sales and marketing have caused such genuine concern.

Naturally, the Working Party refers to the attributes of actuaries, especially in the management of financial risk and associated issues, matters closely involved in the subject area of the paper.

There are a number of references throughout the paper to life assurance and the role of the Appointed Actuary. The management of financial risk in a number of proprietary life offices has resulted in the quite unnecessary building up, over recent decades, of vast amounts of so-called orphan assets. Not only this, but it would appear from actuarial discussion that, at least in some cases, the Appointed Actuary, in his attempted management of financial risk, has not been able, reliably, to assess the differing extents by which such unnecessary excess assets have arisen from various possible causes. Without such knowledge, it is difficult to see how steps can be taken, within the actuarial

framework of the management of financial risk, to prevent such recurrence, and how the Appointed Actuary can recommend equitable distribution on a professional basis.

In fact, there is stridency regarding the proportion, if any, which should be distributed to policyholders and/or shareholders. In any event, it is apparent that, during the period of the building up of the so-called orphan assets, the concept of generational fairness has been devalued. Also, it might be asked whether, without any exception, all solutions proposed responsibly within the profession to the orphan assets problem comply fully with the implication of the statement, in ¶1.1.3, that actuaries are well used to the expert role of representing the consumers' interest.

The Working Party states, in ¶1.1.3, that the actuarial profession has the accompanying skill of explaining to others the process of the management of financial risk. Might it be asked to whom has it exercised such skill of explanation? The proprietary life offices are subject, by statutory regulation, to government departmental monitoring. Those life offices regularly submit appropriate returns and accounts to the DTI, who also have powers to call for further relevant information. Yet, throughout the decades during which proprietary life offices have been building up unnecessarily so-called orphan assets, perhaps, in a single case, amounting to some thousands of millions of pounds, the DTI did not even perceive their existence.

The statement, in ¶7.2, that perfect regulation is impossible is understandable. Thus, the continuation, albeit in a different form, of imperfect regulation, with all its implications, is a factor which consumers should keep very much in the forefront of their minds.

Mr N. B. Masters, F.I.A.: The compliance industry does not stand still. In many ways the prescriptive approach which has been described, and which came out of the original regulations, is now beginning to be overlaid by exactly the outcome-based procedures which have been put forward in the paper.

For the large organisations which recognise the reputational risks involved, FSA health checks, file reviews, pre-PIV reviews, and so on, are all becoming very commonplace. However, smaller organisations, in my experience, have not got such a healthy culture at the moment. For these, I believe that a prescriptive regime still has to be in place. Outcome-based compliance is where we should evolve to, but I do not think that it is appropriate yet.

For good compliance practice, a successful outcome-based regime is, first, having a senior director on the board who is responsible directly for compliance. This rests, in part, on the power of that position, and, perhaps more importantly, indicates the quality of person taking responsibility for compliance. Secondly, that there is almost always a very clear initiative which has been taken to remake the culture, to change the sales culture that we had in the 1970s and 1980s towards the consumer-aware culture that we must have and live with now. There are skilled staff underpinning that. Finally, there is a robust framework of controls, perhaps not prescriptive, but certainly risk-based monitoring, looking at where the problems might arise, and actually pro-actively searching out and improving those, rather than simply waiting for something to go wrong.

Concerning the practice of outcome-based regimes, Dr Tutt said that telephoning policyholders was not effective. I completely endorse that. It is expensive, and, frankly, policyholder memories are not always as reliable as we might expect. It is much better to have the reviews of fact finds and 'reason why' letters. They do get to the heart of the problems. Outcome-based monitoring is the best method if you have the right culture to back it up. The way to do this is to have a management information system which generates information such as persistency rates, issues about the number of fact finds that fail, and so on; in other words information that points out areas to go after and risks to look at.

There are places where monitoring by tick boxes is appropriate; perhaps in telephone sales and other volume sales, but there the tick boxes have to be tailored, and an outcome-based regime can help you to have the flexibility to tailor it to the product properly.

We need to recognise that there is always an opportunity, under an outcome-based regime, for compliance failure. It may be very successful in the right atmosphere, but in the wrong atmosphere it is very dangerous.

Considering the profession's role in the compliance field, my concern relates to our profession

acting as a recognised professional body (RPB). We cannot avoid some compliance scandals, and there is a mood afoot, particularly in the media, to alight on those scandals and to make great capital of them. Such a scandal could be regarded as a failure of actuaries to police themselves, and one compliance failure could taint the whole image of the profession. I question whether we should continue to act as an RPB.

There is an air of complacency in this paper. I am not sure how well we have served the public in some of the things that have gone on over the last decade and before that. We could, and probably should, have done more.

This paper highlights, more than anything else, how essential it is to follow through a growing role for the profession in looking out for the public good, and not just to pay lip service to it.

Mr C. D. Pullan, F.I.A.: As an actuary employed by a financial services regulator, I have a keen interest in the future of regulation. Any opinions that I express are my own views, and my own views alone.

Regulation exists to protect investors, but, as the PIA's Mission Statement puts it, this should be done in an open, competitive and innovative market place. This means that regulation is not easy, and no regulation system will make it easy. What makes it work is the skill of the regulators and the culture of the regulated. Unfortunately, the late 1980s and early 1990s were very difficult times in which to regulate. The regulators were inexperienced, and the regulated paid insufficient regard to the interests of the investors. What mattered to them was the level of new business. What has happened since is that the regulators have gained experience and that the regulated have recognised that bad business is very expensive. Not only will it suffer a high lapse rate, but the firm may have to pay substantial amounts of redress to investors, something they did not have to do before the Financial Services Act. There is now greater acceptance that good regulation means good business.

It is a pity that Section 3.1 is written in terms of the public without specific reference to the expectations of individual investors, since everyone is different. The investor will expect to be sold the right amount of the right product at the right cost, and this must be done at the right time and in the right circumstances. Further, he or she will wish to be satisfied that it is right.

Outcome-based regulation can be used to assess four of the rights, namely: amount; product; time; and circumstances. However, it cannot deal with costs or investor satisfaction. So, it seems that some elements of prescriptive disclosure are inevitable. For example, it is necessary to deal with the solvency of the provider, and I suggest that prescriptive regulation also reduces the likelihood that consumers will be exposed to advisers who, through inclination, lack of knowledge, or whatever, fail to give good advice.

Over the last nine years I have argued strongly that regulators should provide an environment in which advice can be given, but not to specify exactly what that advice should be. To make this point clear, we have a very interesting situation at the moment. In the light of the abolition of the recovery of advance corporation tax (ACT) on pension funds, should investors contract out of SERPS? That is a typical issue for outcome-based regulation.

In the ultimate form, outcome-based regulation would suggest that regulators do not take an active role in determining the answers to such questions, but to allow the market to develop, and then to determine whether the outcome was correct. I believe that investors have a right to expect more from their regulator, and that it should be pro-active in providing an environment in which the advice can be given.

An outcome-based regulation would have a role in finding whether the standards had been met in individual cases. The pro-active approach should also have the effect of reducing the costs to the industry. Mr Masters referred to the position of small firms. The publication of a standard of useful guidance means that it must be cheaper for 3,000 firms to read one framework document than for each to work out its own ideas.

The example of the difficulties likely to be faced can be seen from ¶2.3.2 of the supplementary notes. It asks: "Would a general rule on advertisements, supported by a code, be a satisfactory way to proceed?" There are a number of words that make me nervous as a regulator. One is 'reasonable', and another is 'satisfactory'. Unless the other party responding to 'satisfactory' is 'reasonable', it is

probable that such an approach will give rise to long and expensive processes to determine whose interpretation was right. Would it not help things if there was a rule that actually says which way to point in particular situations?

It is at this point in the argument that I am reminded of the basic management principle: tell me what is expected of me and tell me how I should be judged. My experience of management shows that staff are nervous if management can come along after the event and say what the staff should have done, and do not explain in advance what the staff were expected to do.

I have always believed that what is needed are sufficient rules, codes and guidance to make clear how firms will be judged. Should the Institute and the Faculty continue to develop this initiative, could I ask that this is not overlooked, since the public will wish for there to be clear statements of what they can expect, both for the prescriptive product disclosure information and for the quality of the advice.

Mr J. M. MacLeod, F.I.A.: I am in favour of the outcome approach, not for pragmatic reasons, but because the prescriptive approach violates Gödel's Law. Kurt Gödel was an Austrian mathematician who, in 1931, shook the world of pure mathematics literally to its foundations when he announced and proved the proposition that now bears his name. This states that if you have a system that comprises a set of axioms, and a series of rules or procedures, then it is always possible to construct a situation in which the rules either break down or else give a contradictory answer. Thus, in the field of logic, is the statement, "this statement is false" true or false? If it is true, then it is false; and if it is false, then it must be true. Either way you get a contradiction.

You cannot draw up a complete formal specification of the fundamentals of mathematics. Gödel showed that this was impossible, and that mathematics was, to use a technical term, 'incomplete'.

Such incompleteness is recognised in other professions. *Queen's Regulations* consist of a thick book of military do's and do nots. Embedded in them are two do nots in particular: one says that a soldier can be charged for "acting in a manner contrary to the maintenance of good order and military discipline"; and the other states that an officer can be cashiered for "behaving in a manner unbecoming an officer and a gentleman". At a stroke these two regulations make all the other 999 mere illustrations of wrong-doing. It is not necessary to transgress any of them to commit an offence; it is merely sufficient. It is always possible to commit an offence that cannot be foreseen or predicted or defined in advance. The catch-all regulation that they do have to abide by may, indeed, be circular, or self-defining, if you like, but Gödel insists that that is something that has to be accepted.

The Inland Revenue has recently and belatedly bowed the knee to Gödel with the Ramsey judgment, which states that it is not merely the mechanics of a transaction that matter, but the underlying intention. This means that however many loopholes the Finance Acts may have, it does not matter. A tax avoiding individual can still pass through them, but there is a net underneath into which he will still fall and be trapped.

What of actuaries? We are currently being inundated with a whole plethora of Guidance Notes and updates to Guidance Notes. Gödel says that they could be drastically reduced if some, possibly self-defining catch-all regulation, were introduced instead. I do not know what might that be, but Redington's dictum: "an actuary is not an actuary if he is only an actuary" could be a starting point.

I said that Gödel could make a nonsense of any set of prescriptive rules. Here is an example from the selling of financial services. In 1990 a financial adviser told a client to opt out of the NHS pension scheme and take out a personal pension instead, with consequences to himself that we all know too well. That same day another adviser advised a client to opt out of the Daily Mirror pension scheme. What would have been the consequences for him: praise or blame? Would he have been considered shrewd; or greedy and commission hungry; or would he have been told that he had merely been doing his job?

Within what outcome-based framework should financial advisers operate? Contrary to what is expressed in ¶4.4.5, such a framework cannot be written totally without ambiguity. I trust, though, that any form of words chosen will not include the phrase 'best advice'. That is a wholly technical term, and one that has surely given the wrong signals to the general public, leading them to believe that advisers are, in effect, underwriters of the risks on which they advise; a belief which nobody has

seemed inclined to dispel. This has greatly contributed to the sad events that have befallen the financial services industry over the last few years.

Mr J. M. Webber, F.I.A.: Investing in a life policy or a pension policy or taking out some protection cover should be a simple process. There should be no need for a plethora of unrequested, and probably largely misunderstood, communications from the life office or from the distributor. Yet we introduce much of this complexity through the design of our products and partly through the way in which we remunerate our advisers.

While the paper suggests 'road testing' the outcome-based process, little practical 'road testing' appears to have been carried out. For example, I 'road tested' the outcome-based process on my wife, who recently purchased two personal pension contracts, having had four quotations from leading mutual offices. She probably gained several inches of paper in the process, and she is relatively comfortable with her purchases. However, if anyone chose to phone her and ask her about the process, other than getting some generalities that she felt broadly comfortable, she would find it difficult to explain what she had received; what would happen to her policies on certain contingencies, such as a move from self-employed to employed status; and she would find it very difficult to give any comments on whether the advice she was given was good or bad.

I suspect that this is the norm on most occasions where individuals are given advice. Any outcome-based regime, while potentially adding to the sum of human knowledge, may do little to prove the quality of the advice. After purchasing any product, customers normally feel pretty comfortable with the decision that they have reached. That is true whether one is buying a suit, a car, a record player, a personal pension transfer plan, a home income plan or an endowment mortgage five or six years ago.

Because of the complexity that we have introduced into our products and our selling processes, one possible avenue for simplification of the process is to consider the product itself. Product-based regulation is the norm in many industries. It seems to me that, in the past, the unit trust industry has tried to resist regulation — possibly not unreasonably, because the product charges are relatively low, and these days we are increasingly moving to level-loaded contracts.

There has been much talk of kite-marked products. There are encouraging noises towards fee-based advice. I think that we should be considering regulatory or compliance simplifications for products which meet certain criteria, and possibly for advisers who choose to extract a fee rather than extract a commission. This could all encourage policyholders to take out policies which are most appropriate and provide better value, and could also encourage people to seek fee-based advice. I hope that the Working Party considered this option.

This discussion on whether the current prescriptive approach or an outcome-based regime is superior seems fundamentally flawed. In essence, we already have an outcome-based regime, as the current review of pension transfer liabilities suggests. In practice, both approaches rely very much on the quality of the adviser, the quality of the management of the distribution company and the product providers, and the quality of the regulatory agency in identifying where poor advice may be being given. Typically, where poor advice is given, it is given on a systematic and widespread basis, and, despite all our best intentions, there have been too many examples in the past where we have not identified mis-selling rapidly enough. Further examples are likely to arise in the future. Possibilities are the selling of certain guaranteed bond products and the marketing of draw down pensions close to retirement, and one wonders how often the sale there is motivated more by commission than by best advice. It is not clear to me that an outcome-based regime will address these issues any better than the current regime.

Mr A. C. Boulding, F.I.A.: Two aspects concern me. The first is the reference to *caveat emptor*. After several years' service in a customer services department, it is my personal experience that many of our customers in retail financial services have a very low level of understanding of what it is that they have bought, and, against that backcloth, *caveat emptor* offers very little consumer protection.

My second concern is on reliance on guidance notes for regulation. Whilst these may be of considerable help to us in conducting ourselves in a professional manner, I doubt that they are stable

enough for the cut and thrust of retail regulation. Indeed, our own Guidance Note GN11, on pension transfer values, enabled many pension schemes to pay very low transfer values to leavers, contributing to the pensions mis-selling.

I endorse the comments of Mr Webber on product-based regulation. I feel that if the new Labour Government put their kite-mark stamp of approval on stakeholder pension products, then the public will buy those products with confidence. The consequences of product regulation should be less point-of-sale regulation, but with some tough minimum pricing standards, which we must expect with kite-mark regulation; and then we will see the poor value products being driven out of the market.

Ms P. J. Herz, F.I.A.: My experience from the pensions review and from compliance work is that a proper understanding of financial products is not something that the man in the street can easily grasp. Indeed, those who do have an understanding at point of sale may not retain this several years down the line. The principle of achieving understanding is a desirable aim, but it cannot be fundamental.

In its place, we must identify to customers which products meet a basic range of criteria, and thereby take away some of the risks from the individual. Effectively, such products would be kite marked as being safe products. For protection products this would mean reasonable charges and no unexpected and unwelcome policy conditions. For investment products a modest level of risk would also be required.

I recognise that such kite-marked products would not be for everyone. There should be choice, so that sophisticated investors can take risks to gain rewards, but this should be seen as a minority sport.

I would call on the Consumers' Association to link up with the actuarial profession to develop the criteria for awarding kite marks. Here there is a clear and essential role for the actuarial profession in measuring and assessing levels of risk and in promoting plans in which the general public can trust.

Mr P. W. Wright, F.I.A.: Section 2.4 of the supplementary notes asks whether an outcome-based approach would have averted all the problems associated with pensions mis-selling. In the run up to July 1988 I was LAUTRO's and, for a short time, SIB's actuary, and would presumably have been involved in setting the relevant questions, so, to that extent, I can speak with some authority.

Certainly questions eliciting whether or not investors were opting out or concurrently not joining an occupational scheme would have been included. However, I was then under the impression that occupational schemes had, up to July 1988, generally enforced the rule that membership of a scheme was compulsory.

In the circumstances, I would not have advised asking any questions about whether or not the investor had previously had an opportunity to join a scheme and had declined to do so. Clearly, subsequent analysis shows that I was wrong in my assumption that employers had been enforcing the compulsory joining rule, and prior opt outs form a very significant part of the total compensation payments for many offices.

I have kept quiet about this subject for many years, partly because it does not show me in a particularly good light, but I think that it is unfair to have expected company representatives, and even IFAs, to have asked questions regarding prior opt outs when the actuary of LAUTRO would not have thought it necessary to include such questions in any official outcome-based assessment.

LAUTRO is blamed, in ¶4.3.3, for the poor financial advice given to occupational scheme members in the late 1980s, on the grounds that the self-regulation aspect of its constitution had somehow undermined the system. I do not believe that this is an entirely fair comment. Those bancassurers who opted for direct regulation by SIB are not noticeably absent from the lists of companies involved in the various mis-selling episodes.

I was surprised at the reference to investment providers in ¶6.2.2, at least as far as long-term insurance companies are concerned. The Appointed Actuary is already required to ensure, as far as is practicable, that incoming policyholders are not misled as to their reasonable expectations. This duty is, of course, backed up by the mandatory production of an annual report to the board on policyholders' reasonable expectations.

On the general approach to the outcome-based method, I have doubts about the practicalities of subjecting an investor to an examination on the financial characteristics of his or her product. I do not

know how welcome this would be to the general public, but I suspect that the pass rate might be very low. If the outcome shown in Appendix C, of a unit-linked endowment assurance to repay a mortgage, passes the test, then there is something wrong, and I think that any policyholder who felt that he or she had understood his product should be named and shamed for that one!

The first sentence of ¶3.3.1 starts with the words "In an ideal world", and the next with "However, in a democratic country". I could not help speculating about the political views of the various authors. I would also dispute the statement: "in a democratic country, government must support and endeavour to realise the expectations of its electorate." This is the way that we seem to be going, but I still believe that leadership has a role to play. Winston Churchill did not establish focus groups in July 1940 to determine whether or not we should continue to prosecute the Second World War!

Mr M. J. Boléat (a visitor): I want to put the debate in a wider perspective, because the paper and some of the debate is rather narrowly focused on actuaries. However, we do have NewRO. The decision to create NewRO was probably taken on 19 May 1997, and it was announced on 20 May. This is not normally the way in which government acts; there is normally a somewhat longer gestation period between a thought and an announcement.

The initial period of consultation with the industry was just weeks. So, if anybody wants to have an input into what is going on, one has to be fairly quick with one's views, otherwise it will be too late. I do not think that many have fully appreciated what NewRO is all about. It will be a single regulator for the entire financial services sector. For anybody in the sector at present, it means, to some extent, a significant reduction in the special nature of their sector, and, perhaps, even an ending of it.

The moment that NewRO was announced, I realised that, longer term, there are some implications for my own association (the Association of British Insurers). There are going to be implications for all of the professions that are involved in the financial services field. Many are seeking a special preserved status for their own profession, their own organisation, their own sector.

IFAs have been polled, and have resolved that a majority of the board of NewRO should consist of IFAs. This is one of the least likely recommendations to be adopted, and, indeed, I despair of people whose mentality produces such an outcome. The agenda has been set very clearly by the Government, and one of the great merits of establishing NewRO in this way is that we will not go through the very painful process that accompanied the birth of the PIA. It will be a quicker and a cleaner operation, because decisions are going to be taken by a small number of people whose job it will be to take into account various representations and special interests.

However, I would be surprised if foremost in their minds is the need to give a role to the actuary. I do not think that that will even enter the agenda. If actuaries want to contribute to the debate, it will be on the same basis as the ABI or anybody else — that is, by putting in good quality papers that address the issues that have been raised, and to do so in a way that meets the Government's agenda, rather than by protecting a particular interest group.

I now take up a few of the points that have been made in the discussion so far. I am not from the insurance industry, being an economist. I used to represent the building societies, an industry that consistently scores much higher than life insurance in terms of public esteem. We never heard of conduct of business regulation; we did not have any examinations for staff; there was no requirement anywhere in banking or building society legislation for staff to have any qualifications of any form. Knowing this, you should bear in mind that those who are going to be making the key decisions on the supervision of insurance companies in future will come, to some extent, from a Bank of England background.

That is the starting point, but it is not the point where every aspect of business is regulated. We cannot get the ideal; we do not live in a perfect world. To produce the sort of result that Mr Pullan was talking about is impossible. To do so would require such massive cost that you would put the consumer off.

We go into great depths and treat financial services products as being different, and to some extent they are. We talk about protection, security and peace of mind; and the fact that companies do not always deliver that, but can succeed in delivering the opposite, is inevitably going to call for regulatory response.

For the ordinary member of the public, what is vastly different between putting £1,000 in a unit trust and putting £1,000 in a new set of golf clubs or a dishwasher? It is an investment. It is something that is going to yield a return over several years. Indeed, what about buying a holiday? It can cost £2,000. There is no regulation of holidays — there is of holiday insurance. There is almost no regulation of the sale of hi-fi equipment, but there is of insurance policies that accompany it. There is no regulation for selling shares, but if you want to put £50 into a unit trust, that is very different!

If we go down the road of input regulation, we go on a slippery slope. To begin with, you specify the requirements that a salesforce must have; then you specify the training regime; then you have a register of them as well. At the end of the day, when something goes wrong, one can sue the regulator, because there appears to be a contract between the salesman and the regulator.

It also takes responsibility away from management. Somebody said, "How will small firms cope?" The answer is that if they cannot, then they should not be in business. It is not the job of the regulator to manage small firms or, indeed, big firms. If firms cannot cope with the regulatory regime, the solution is simple, and I think that we are going to move in that direction.

We have had a vicious circle with complexity. Products have been made complex, partly for tax reasons, and also because the marketing man wants to make them complex; he wants to make them different — this is a new, improved life policy, so let us add a tweak here and a tweak there. Because they are complex, the selling of them becomes more difficult and the scope for abuse becomes greater. Therefore regulation is needed, and to match the regulation a compliance industry develops. If we ask the compliance managers for their views on regulation, they want more of it. They are not into deregulation at all — the bigger the rule book, the better. So, we have this vicious circle of complexity. People tell me that pensions are complex, but I cannot understand why. They have been made complex, but there is no reason why they should be, and the industry should aim to simplify pensions — and that requires working with the Government, because the Government also causes them to be complex.

Mr R. E. Brimblecombe, C.B.E., F.I.A.: I support much of what Mr Boléat said. Having been Chairman of the Life Insurance Committee in the formative days of regulation, I know that the industry wanted more and more prescription, because — and I quote — "It is the only way we can control our salesforce".

If we are not careful in relation to the question of outcome-based regulation (which I fully support), there is a danger of throwing the baby out with the bath water. Many speakers here have concentrated on the details of what the paper sets out about asking investors. I agree with most of the speakers, that this is not necessarily the best way forward.

Reference has been made to the LAUTRO mystery shopping exercise, with which I was involved. That was fine, but it needed a lot of work. There were focus groups, briefing and debriefing. It is not the same as simply ringing people up, as the paper suggests.

I now concentrate on what is in ¶2.2.9 of the supplementary notes, which is the outcome-based approach to the audit of compliance. Over the past few years we have had far too much emphasis on the audit of process rather than of outcomes. This has had an adverse effect, for two particular reasons. Certainly, from the early days of the FSA this has produced monitoring by staff from the regulators, by way of checking files to ensure that certain documents are there and completed, rather than concentrating on the quality of advice.

For this reason, compliance departments of regulated businesses have had to adopt the same mindset, whereby, in terms of compliance, audit by internal compliance staff of regulated businesses has been satisfied by the completion of the appropriate tick boxes. Worse still, salesmen authorised by regulated businesses, whether they be direct sales forces or IFAs, may well concentrate on passing that type of audit with flying colours rather than concentrating on the advice given to the client.

We have talked a lot about pension transfer business. It is probably fair to say that the issue has been exacerbated because, in many cases, although the advice was sound, unfortunately the right boxes were not ticked. I am sure that we have all found that in looking at our own pension transfer business.

I do not believe that regulation should be specific. We have an opportunity for change. Although

we know the basic outline of NewRO, we have yet to see the detail, but in the new regulatory regime most of the prescription could be swept away. Outcome-based regulation should supersede it, and not just overlay it, as Mr Masters said.

The industry should concentrate on two — and probably only two — aspects of a sale. These are fact finds and the letter of recommendation, or 'reason why' letter. If those two documents were the sole documents to be audited, then I think that that would almost always be totally satisfactory.

The letter of recommendation has to be very comprehensive, identifying the needs of the investor and the risk profile of the investor, and explaining suggested solutions in detail. If the regulators would allow audit based on these two documents, this would relieve and reduce substantially the regulatory burdens, enhance the quality of advice for the consumer, and, importantly, get away from the tick box mentality, which, I am afraid, is still present.

Where does the actuarial profession come in? 'Reason why' letters or letters of recommendation must vary between types of policy, and the profession has a role to play in establishing, not actuarial standards for our members, but standards for the regulators for which they can judge whether or not 'reason why' letters are satisfactory, given the specifics of a particular type of product.

In addition to kite-marked products and marketing methods, we could also kite mark levels and standards of advice. Against that, I believe that there is over-regulation in some areas at the moment — for example, in contracting out via APPs and the purchase of annuities at retirement — where the concept of outcome-based regulation is also useful, but could be based on a simplified form of advice, compared with products such as pension transfers.

NewRO should not go back, in the detail of the new regime, to regulation by prescription, but, with the help of the actuarial profession, move to truly outcome-based regulation, which will serve the public far better.

Mr P. G. Meins, F.I.A.: I support the outcome-based approach. However, as Mr Brimblecombe said, you require the information on which to assess the outcome, and I am not sure, given that, how much regulation could be reduced.

The background to regulation is a recent history of widespread problems; the conflicts which we still have with the commission-based remuneration system, and the complexity and long-term nature of some of the issues. Against that, any one particular approach to regulation should not be used in isolation. It needs to include various factors, such as training and competence. The multi-dimensional approach has had an impact. The regulators have been learning over the years, and there are improvements in standards. The kite mark is a good idea. It can work only with particular types of fairly simple products. For the complex products advice is needed. No system of regulation will work if it is not properly implemented. The pensions mis-selling scandal is a good example of that.

The complexity of the issues can be illustrated by one small point. In ¶2.4.2 of the supplementary notes it is claimed that, for the vast majority of cases, members of occupational pension schemes should have been advised to stay in their schemes rather than take a personal pension. I disagree with that. For example, a young mobile employee, offered membership of a contributory contracted-out final salary scheme, may have been well advised to take out a personal pension instead.

I agree with Mr Pullan that the regulators have a very important role in helping the industry to address technical matters, a pro-active role. One of the difficulties when the FSA first came out was the problem of trying to get some guidance as to what it all meant.

Our role as a profession should not be restricted to technical matters. We have operated pension schemes and we have designed contracts, but, as other speakers have observed, many provided very poor value for money to those people who left or terminated their policies. We cannot claim much credit for the legislation and the changes in regulation which have occurred over the years, when it came to be realised that, perhaps, the majority of people were early-leavers. As a profession we stood by. We were not selling these policies, but we stood by whilst many customers were sold inappropriate policies which ceased shortly thereafter.

Matters have improved. Persistency has improved quite significantly in recent years. However, if we want to develop our leadership role in the industry — and I think that we could do more — we need to be prepared to take responsibility for change. A key part of that is being sensitive to the

concerns and the needs of consumers. One example is the initiative which the Institute took recently in relation to traded endowment policies. As individuals, we may be constrained by our commercial role, but, as a profession, we should not be.

Mr R. C. Tulloch, F.I.A.: In ¶3.1.2 the authors identify three risks to which the customer purchasing an insurance policy is exposed: the insolvency of the provider; failure to understand the risk; and failure to meet forecast or expected performance. All are perfectly reasonable and justifiable.

However, the second and third risks may also apply to the industry itself. Over the past years there have been many products marketed by the industry which have been unwise. The products have indicated that, not only are some customers financially naïve, but so too are some parts of the industry, for example: offering such products as single premium bonds with retrospective switching facilities; single premium with-profits bonds; guaranteed bonds; high guarantee minimum cost policies; unit-linked mortgage policies; SERPS for everybody. Some of these products have given great joy to the financially astute, whilst others have generated unreasonable expectations in the financially naïve. I am sure that there are some actuaries who probably spotted the faults in these products, but in this sales-driven industry the cynical or cautious actuary often has no voice or speaks too quietly.

Regulation and its many rules are the result of past bad products. The actuary must lead, raise his voice, and become pro-active in protecting and simplifying things for the customer, so that regulation becomes unnecessary.

Mr H. D. Sutherland, F.I.A.: The paper and the discussion highlight the dilemma of trying to satisfy many competing needs and demands: the desire for consumers to have freedom of choice as against being told the products that they should purchase; the desire for product innovation as against constraints on their design and the assumptions underlying them; the fact that consumers typically lack detailed knowledge and skill, and therefore *caveat emptor* cannot apply; and, indeed, the competence of salesforces.

An alternative approach that we could consider is to base the outcome on sensitivity testing, and raising the question: "What would happen if certain external events or economic environmental conditions changed?" The actuary has a particular skill in this area. We employ sensitivity testing in our approach to product design, the GAD requires sensitivity testing when looking at solvency, and, therefore, actuaries could have a wider and more pro-active view of the issues against which products should be tested. For example, producers could explain, in their sales literature, what would happen if somebody had to surrender the policy early, or if there was an early death. The clients could then decide whether they wished to purchase a policy that responded in that way to those anticipated events. The producers could also decide whether they wanted to market this product against those circumstances, and the salesperson could decide whether he or she is competent to advise the client about this product in those circumstances.

This approach is pro-active; it calls upon our skills and our abilities, but it does not require extensive regulation or the sort of outcome testing that has been proposed in the paper.

Mr D. T. Addison, F.F.A. (in a written contribution that was read to the meeting)**:** The paper raises many interesting points, and my comments concentrate on the quality of the financial education of the general public.

The paper contains words to the effect that the customer is reasonably expected to understand the information given to him or to her. This was a bit optimistic; but the authors appear to have a high opinion of their customers' abilities, because, in Appendix C, they expect them, not only to understand the product, but to write out, in their own words, what risks they face in purchasing it. This conjured up visions in my mind of some poor customer being locked in an office for hours on end trying to find the right words to describe capital units!

It is not entirely realistic to expect the public to understand some of the products that insurance companies offer. Part of the blame for this must lie with the companies themselves and with the actuaries who design the products, rather than with the poor quality of the financial education of the

general public. If we designed simpler products which did not contain nasty surprises — like capital units — then the customer would be better placed to understand them, and we could all enjoy the benefits of a lighter regulatory regime. I support the idea in the PIA's evolution paper of there being a trade-off between the weight of regulation and the complexity of the product being sold.

Notwithstanding these comments, the financial education of the public could, and should, be improved for the benefit of all concerned. In particular, one area where I think that the profession should make a contribution to educating the public is in explaining investment risk and reward, for three main reasons:

(1) as a nation of gamblers, the general public is capable of understanding the concepts, provided that they are explained in suitable language;
(2) as far as long-term investments are concerned, the public currently has the wrong perception of what is low risk and what is high risk — a building society deposit, for example, is invariably seen as low risk; and
(3) the current projection rules, which do not differentiate between investment vehicles in terms of the rates of return used, tend to add to the confusion in this area.

Mr J. A. Geddes, F.I.A.: The paper proposes a shift from 'prescription' to 'outcome' regulation, but appears to retain the assumption that the consumer wants to understand the technical content of the product and such other matters as the effect of expenses on yields, and is willing to be tested on this knowledge and understanding.

Such technical matters may be useful to the IFA in making an assessment of the relative merits of different offices, but I do not think that the average consumer is at all interested. Like Mr Boléat, I have always thought that an individual 'personal' pension is (or should be) a very simple product, and a much simpler one than most of the other things that people buy in their daily lives. The consumer knows that he or she is going to put some money away, and what is wanted at an older age is some sort of income and lump sum. The consumer does not know how much; does not know what his life or his income requirements are going to be then. He will be as uncertain as we are as to the level of benefits that will, in practice, emerge from the particular policy. He does, however, need and want to have confidence in the product provider, and to be able to feel that he is dealing with honest and competent people. I believe that he needs to be in a position, consciously or subconsciously, to draw comfort from the fact that the provider has been advised, *inter alia*, by actuaries whom he can recognise as people of integrity and members of a respected profession — which is where we come in.

I suggest that, if there is some truth in the analogy that, if we have got into a hole then we should not go on digging, then our contribution as actuaries should now be to direct the regulators away from consumer questionnaires, 'fact finds' and 'outcome reviews' — all difficult and expensive for most people — towards addressing the one principle weakness in most of our products, and that is the low return on early transfer or surrender.

The principle that so many of us were brought up on was that the early leaver should, so far as possible, pay for the recovery of his initial expenses. If this were now reversed (as is beginning to happen), either by regulation or by good practice, and product providers were to bear the loss of initial expenses if there is not good persistency, then this might have a far better effect, generally, on office practices and the conduct of business, rather than tomes of prescriptive regulations.

If there was a requirement, in connection with long-term financial products, on transfer or surrender at any time, to provide, for example, a guaranteed return of a predefined percentage of premiums together with an appropriate investment return, a great deal of the need for additional regulation would be obviated. This would be subject to a requirement that the investor receives a regular report on the progress of his or her investment.

Mr M. R. Kipling, F.I.A.: If personal pensions had been kite marked in 1987 to 1990, more people would have opted out of occupational pensions and into personal pensions rather than fewer. It is not the product; it is the circumstances in which it is sold.

Whilst it may be difficult to get the customer to respond to telephone checking, I am concerned

that some speakers were suggesting that it might be acceptable for policyholders not to understand the major risks associated with what they have been sold. If investors cannot explain, in their own words, what would happen to their pensions if the Stock Market crashed a couple of months before they wanted to retire, or what would happen to their lump sums invested in building societies if inflation ran at 25% p.a., then, perhaps, they do not have the right products.

The Working Party was not being unusually harsh in suggesting that there should be an element of *caveat emptor*. We did not mean that insurance companies should be allowed to bamboozle clients with complicated products, but we meant that clients should be free to take risks which they understand, the difference, for instance, between investing in some form of index-linked security and some form of equity.

The President (Mr D. G. R. Ferguson, F.I.A.): Thank you all for contributing to a lively discussion, which has been less formal than is usual at sessional meetings — and I think all the better for that.

I shall not try to summarise the discussion, but I do regret the mistakes which have been made in the past on the build up of orphan assets and on the pensions mis-selling. I share the view that GN11 certainly contributed to the inadequate transfer values which were a significant part of the pensions mis-selling problem.

We have had a good debate between proponents of product-based regulation, whether kite-marked products or otherwise, and proponents of outcome-based regulation. I was particularly taken with Mr Brimblecombe's suggestion for a simplification based on fact finds and 'reason why' letters, especially if we can rely on a large proportion of the population following Mr Boléat's advice and not going for the fact finds, and perhaps not even for the 'reason why' letters either.

We shall need a good deal of Mr Geddes' commonsense if we are going to heed Mr Boléat's advice that actuaries will not have a role, will not have a voice, will not have influence, in the regulation which will be in place for the future, unless we can put forward good quality, well thought out, reasoned, practical advice as to the way forward. We have had some very useful contributions on that in this discussion.

Mr N. H. Taylor, F.I.A. (replying)**:** The Personal Financial Planning Committee, of which I am Chairman, is relatively new. One of our main aims is to help the profession serve the public interest in a better way. Thus, I was particularly interested in Mr Boléat's wide ranging comments. I will now form a new group to reconsider the issues in the light of the views that have been expressed by all who spoke.

The Faculty are holding a Sessional Meeting on the subject on 16 February 1998, and by then our thinking should be more advanced. Indeed, we will almost certainly have needed to make a submission to NewRO before the meeting.

Mr A. S. Fishman, F.I.A. (replying)**:** On the negative side, you have heard criticism that the discussion paper did not go far enough; that actuaries have not, in fact, performed an expert role in the past in representing consumers' interests; and that there are too many practical difficulties associated with an outcome-based approach.

On the positive side, the introduction of a new actuarial concept, Gödel's Law, is going to save us all — not to mention our apparently new-found ability to charge a member for not behaving as an officer and a gentleman.

I have one overriding comment to make, in that I do not accept that the actuarial profession should fall in line with the herd in determining the structure and role of NewRO. Past events give little confidence that falling into line will necessarily result in better regulation in the future.

The radical approach established by the new Government demands imagination and, if necessary, a radical, and not a tired, response, simply rehashing and reshaping what has proved unsatisfactory in the past.

The President (Mr D. G. R. Ferguson, F.I.A.): It remains for me to add a vote of thanks on behalf of all present to the whole of the Working Party and to Mr Fishman as Chairman of the Working

Party, for the work that they have done. The new Working Party, whether it is the same group or another one, will now carry matters forward, so that we have a worthwhile contribution for those that are going to drive NewRO.

I ask you to join me in thanking the authors of the paper for stimulating a good discussion on an important topic on which the actuarial profession needs to be heard.