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making financial sense of the future

# Professionalism: a matter of principle…….?



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## Agenda

- Introduction
- The current position- background to the Profession's move towards principles-based regulation
- Defining the concepts and placing them in context:-
  - Principles-based?
  - Outputs-focused?
  - Risks-based?
- Analogy with other sectors

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## Agenda (contd)

- What the new approach means in practice for actuaries (and lawyers, accountants….)
- Enforcement
- Benefits and challenges
- Questions

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## Introduction

- *"Principles-based regulation means, where possible, moving away from dictating through detailed, prescriptive rules and supervisory actions how firms should operate their business."*
  (The FSA, *"Principles-based regulation- Focusing on the outcomes that matter"*, April 2007)

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## Introduction (contd)

- Principles-based regulation not a new concept – has featured in UK professional regulation since at least 1990.
- Similar early 1990s forays in Australia and Switzerland
- Contextual relevance of the Better Regulation Agenda

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## Introduction (contd)

- Now widely adopted by UK regulatory bodies including;-
  - The Financial Services Authority
  - The Solicitors Regulation Authority
  - The Institute of Chartered Accountants of England and Wales
  - The Health Professions Council
  - Royal College of Veterinary Surgeons
  - The Institute and Faculty of Actuaries

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## The Current Position

- The Actuaries' Code- launched 1 October 2009
- *"A modern statement of principles for a growing profession"*
- Replaces the Professional Conduct Standards with "5 core principles"
- *"Principles-based…….it provides a short statement in relatively simple terms of the standards actuaries can be expected to observe when serving the public and their clients….."*

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## The Current Position (contd)

- 'Ethical' rather than technical; Integrity, Competence and care, Impartiality, Compliance, Open communication.
- Standards of conduct
- Brevity (5 principles, 2 pages)
- High level- general/ inspecific?
- "The Code is not a set of rules"
- Principles v rules?

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## The Current Position (contd)

- November 2009- BAS launches the first of its Technical Actuarial Standards
  - TAS D (Data)- Nov 2009
  - TAS R (Reporting Actuarial Information)- Nov 2009
  - TAS M (Modelling)- April 2010
  - Pensions TAS- Oct 2010
- "*At the highest level, all standards must contribute to the FRC's strategic goal that users can place a high degree of reliance on actuarial information.*"

  (BAS- Conceptual Framework- July 2008)

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## The Current Position (contd)

- *"TASs are intended for the benefit of the public, rather than for the protection of actuaries……"*
- *"The BAS wishes to avoid a "tick-box" approach to standard-setting…..TASs will be written in a manner which favours principles over prescriptive rules."*
- *"The more generic the scope of a standard the more likely it is that the standard can be completely (or predominantly) defined by principles without spelling out detailed rules."*

  (BAS- Conceptual Framework, July 2008)

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## The Current Position (contd)

- Principles and 'detailed', or 'specific' rules, but with emphasis on the former
- Avoiding 'tick box' approach
- Emphasis on professional judgement
- Public protection
- Principle: *"A rule or belief governing one's personal behaviour"*

  (Concise Oxford English Dictionary, 2006)

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## The Current Position (contd)

- What then is the distinction between 'principles' and 'rules'?
- What is meant by 'principles-based regulation'?
- What actually has changed- in theory, and in practice?

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## Defining the concepts

- Dispelling some myths;-
  - 'Principles' are not the converse of rules- the distinction is not helpful
  - Principles may (arguably should) be just as binding as rules (no necessary distinction in the level of compulsion which they confer)
  - Rules also require judgement
  - Principles and rules not mutually exclusive
  - 'Principles-based' does not (necessarily) equate to 'light touch' regulation (but it does depend how it is done….)

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## Defining the concepts (contd)

- The important point about principles is the level (or lack) of detail that they prescribe.
- Principles tend to be higher level- less specific.
- They are as such better suited to prescribe defined results (outputs), rather than the particular method/ route by which the result is achieved.
- Principles allow regulatory focus on core objectives, with the over-riding focus on public protection.

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## Defining the concepts (contd)

- Firms/practitioners better placed to determine the actions required to achieve compliance
- May provide cost efficiencies for regulated entities
- Largely behavioural standards
- Qualitative rather than quantitive
- Purposive

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## Defining the concepts (contd)

- To understand principles-based regulation, you need to understand at least one, possibly 2, related concepts;-
  - Outputs-focused regulation
  - Risks-based regulation

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## Outputs-focused approach

- Focus on the end point, the desired goal, rather than specific processes

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## Outputs-focused approach (contd)

- TASs explicitly outputs-focused;-
  - Directed at 'actuarial work'
  - Reliability principle
  - Specific 'purposes' defined within each TAS
- Actuaries' Code- clearly output-driven:
  - *"Open communication: members will communicate effectively and meet all applicable reporting standards"*
  - Focus on the goal rather than the means

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## Risks-based approach

- Prioritisation of work and resources
- Co-ordination of approach with other regulators
- Tacit acknowledgement that ‘zero-tolerance’ not desirable/ possible
- Risk cycle

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## Risks-based approach (contd)

- Risks-based:
  - Structured prioritisation- compliance
    - enforcement
  - Wider ethos/ regulatory philosophy
- To the extent that process-focused detailed requirements tend to encourage ‘tick box’ compliance and enforcement regimes, so outputs-focused regulation fits better with a risks-based approach

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## Analogy with other sectors

- **Origins: Financial Services Authority (FSA)**
- PRINCIPLES
  - e.g. Principles for Businesses (PRIN); Statements of Principle for approved persons; TCF Consumer Outcomes; Listing Principles
- FSA STATUTORY RULES
  - e.g. client money rules
- INDUSTRY GUIDANCE
  - e.g. Unfair Contract Terms Regulation Guide

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## Analogy with other sectors (contd)

- A hybrid of high-level principles and detailed rules and guidance
- *"First Principles – set of axiomatic statements that articulate what action and behaviours we expect from firms and which provide the backbone of [the FSA's] regulatory regime*", per John Tiner (former CEO, the FSA)
- Enforcement action may be taken on the basis of breach of principles alone

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## Analogy with other sectors (contd)

- **Solicitors Regulation Authority**
  - **Consulting on new Handbook**
  - *"We intend that the new Handbook and our outcomes-focused approach to authorisation, supervision and enforcement, will bring about a culture change in the provision of legal services."*

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## Analogy with other sectors (contd)

- Principles (mandatory)
- Code of Conduct- Outcomes (mandatory) + Indicative behaviours (non-mandatory)
- Retention of detailed rules in 'high risk' areas (eg solicitors' accounts rules)

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## Analogy with other sectors (contd)

**Health Professions Council**

- Standards of Conduct, Performance and Ethics
  - High level principles
  - *"Every registrant...must make sure they keep to them"*
- Rule 9 CCC(P) Rules 2003: "*Where the Committee has found that the health professional has failed to comply with the standards …the Committee may take that failure into account but such failure shall not be taken of itself to establish that the fitness to practise of the health professional is impaired"*

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## Analogy with other sectors (contd)

- Standards of Proficiency
  - Detailed
  - "*Registrants are expected to meet"* these standards
  - Not an exhaustive list
- Standards issued by professional bodies
  - Guidance only

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## Practical implications

- Principles may require greater exercise of judgement (but even detailed rules rarely absolutely prescriptive)
- Best suited to 'ethical standards'. Technical requirements may require more detail, in the form of guidance or more detailed rules.

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## Practical implications (contd)

- Actuaries' Code- very little actually new, or, in principle, ojectionable.
- Consider:
  - Principle 1- Integrity:
    Members will act honestly and with the highest standards of integrity.
  - Principle 2- Competence and care:
    Members will perform their professional duties competently and with care.

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## Practical implications (contd)

- Principle 3- Impartiality:
  Members will not allow bias, conflict of interest, or the undue influence of others to override their professional judgement.
- Principle 4- Compliance:
  Members will comply with all relevant legal, regulatory and professional requirements, take reasonable steps to ensure they are not placed in a position where they are unable to comply, and will challenge non-compliance by others.

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## Practical implications (contd)

- Principle 5- Open Communication:
  Members will communicate effectively and meet all applicable reporting standards.
- More detailed guidance may be appropriate in relation to the application of Principles 2 & 3 in particular.
- Comparison with PCS
  - PCS already ‘principles-based’
  - Some more detailed provisions eg conflicts, disclosure of financial interests, whistle-blowing.
  - Status and enforcement provisions

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## Practical implications (contd)

- DPB Handbook
  - Principles + detailed rules
  - Eg Conduct of Business Code-
  - *"When carrying on any regulated activities, a DPB firm must communicate clearly, completely and effectively with its clients"*
  - *"A DPB firm must conduct its business (i) with honesty and integrity (ii) with appropriate knowledge, skill and care and (iii) show appropriate respect for others when carrying on any exempt regulated activities"*

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## Practical implications (contd)

- *The DPB Handbook (contd)*
  - *"A DPB firm shall carry on any regulated activities in the best interests of each of its clients"*
  - *"A DPB firm must ensure that its ability to provide objective advice to its clients is not, and cannot reasonably be seen to be, compromised"*
- Other guidance, materials, including material produced by other regulators

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## Enforcement

- Interaction with the Disciplinary Scheme
- The definition of Misconduct:
  - *"For the purposes of this Scheme, Misconduct means any conduct by a Member, whether committed in the United Kingdom or elsewhere, in the course of carrying out professional duties or otherwise, constituting failure by that Member to comply with the standards of behaviour, integrity, competence or professional judgement which other Members or the public might reasonably expect of a Member.....*

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## Enforcement (contd)

*".....having regard to the Bye-laws of the Institute and Faculty of Actuaries and/or to any code, standards, advice, guidance, memorandum or statement on professional conduct, practice or duties which may be given and published by the Institute and Faculty of Actuaries and/or, for so long as there is a relevant Memorandum of Understanding in force, by the Board for Actuarial Standards and to all other relevant circumstances"*

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## Enforcement (contd)

- ..... *"might reasonably expect of a member"*
- The importance of clarity.....
- ....and fairness (including fair notice)

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## Benefits and Challenges

- Benefits
  - Flexibility
  - Greater clarity/ accessibility/ comprehensibility
  - Better targeted
  - Focus on outputs (not 'tick-box')
  - Emphasis on professional judgement and autonomy

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## Benefits and Challenges

- Challenges
  - Danger of ‘the regulatory fudge’
  - Unfair/ unrealistic burden on smaller firms?
  - Culture shift- for regulators and regulated
  - Risk of confusion/ ambiguity if (1) principles not adequately drafted; (2) status not clearly defined; (3) relationship with other material unclear.
  - Risk of ‘regulatory creep’

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## Benefits and Challenges (contd)

- Risk of ‘rules by the back door’;-
  - Elevation of advice/ guidance to detailed rules
  - Informal ‘precedent’ system
- Principles- based = ‘light touch’ regulation?

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## Benefits and Challenges (contd)

- Risk of 'enforcement failure'- the elephant in the room?
  - Can principles be effectively (and fairly) enforced?
  - Little experience to date
  - The FSA experience- eg Goldman Sachs, Sept 2010
  - Importance of precision and clarity, as to substance, status and relationship with other material
  - Sufficient detail, where appropriate
  - From an enforcement perspective, secondary to the definition of misconduct

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## Benefits and Challenges (contd)

- Requirement for 'culture change'-
  - Judgement required of regulator as well as regulated
  - Regulators need to be fair, consistent, outputs-focused
  - Active engagement by professionals in the regulatory process

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## Final word

Principles v (detailed) rules:

- *"It's something like the difference between football and soccer….."*
- "*A principles-based regulator without any teeth is the worst of all possible worlds."*

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