

Risk and investment conference 2010, Edinburgh, Monday 14 June  
Speaker: Tony Hewitt, Imperial College Business School



# Real-life case studies of professionalism issues

23 May 2010

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# Tony Hewitt:

## Brief autobiographical details

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- Tony teaches at Imperial College Business School.
- He helps run the Imperial Actuarial Finance MSc, launched in 2006 for full-time actuarial trainees
  - combining on-the-job training with
  - day-release education from world class university lecturers, introducing latest developments and breaking news into the training of new actuaries.
- He has practised as a consulting actuary for over 35 years, particularly in the pensions, health and social security areas.
- His interests include professionalism, enterprise risk management, healthcare quality, DC pension reform and attracting high quality graduates into the Actuarial Profession.

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# Professionalism

## Protocol for discussing case studies + Disclaimer

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

### Disclaimer

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

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# Professionalism issues

## Key learning objectives

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- Appreciating the need to understand concepts such as
  - ethics, morals, moral principles, moral philosophies
  - integrity, trust, honesty
- Using these moral frameworks to solve ethical dilemmas
- Understanding how to use the Actuaries' Code:
  - its purpose – serving the public interest, building confidence
  - observe and be guided by the Code's spirit [not a helpful ghost!]
  - how it fits in with the definition of misconduct
- Applying the Actuaries' Code, using hypothetical case studies based on Milan Vukelic, Alliance & Leicester/HBOS and Lehman Brothers
- Managing the risk of (frivolous) misconduct complaints

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# Professionalism issues

## Recommended pre-reading and further reading

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### Pre-reading

- Six-page version of the Actuaries' Code + an introduction from Sir Philip Mawer  
[http://www.actuaries.org.uk/\\_data/assets/pdf\\_file/0004/156766/ActuariesCode-A4final.pdf](http://www.actuaries.org.uk/_data/assets/pdf_file/0004/156766/ActuariesCode-A4final.pdf)
- The “*Integrity*” article in the April e-edition of The Actuary  
<http://www.the-actuary.org.uk/873808>

### Further reading

- Public trust in the professions, Ethics, trust and integrity  
– speech by Sir Philip Mawer, Staple Inn, 25 February 2010  
[http://www.actuaries.org.uk/\\_data/assets/pdf\\_file/0009/167607/Mawer\\_Public\\_trust\\_20100225.pdf](http://www.actuaries.org.uk/_data/assets/pdf_file/0009/167607/Mawer_Public_trust_20100225.pdf)
- “Ethicability” – a very readable book by Roger Steare
- FRC – Actuarial Quality Framework [January 2009]  
<http://www.frc.org.uk/images/uploaded/documents/Actuarial%20Quality%20Framework4.pdf>
- FRC – Regulatory Strategy: Strategic Outcomes 4 and 5 on pages 16 and 17 [April 2009]  
<http://www.frc.org.uk/images/uploaded/documents/Regulatory%20Strategy%20our%20role%20and%20approach%20v43.pdf>

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# Professionalism issues

## Ethics, morals, moral principles, moral philosophies

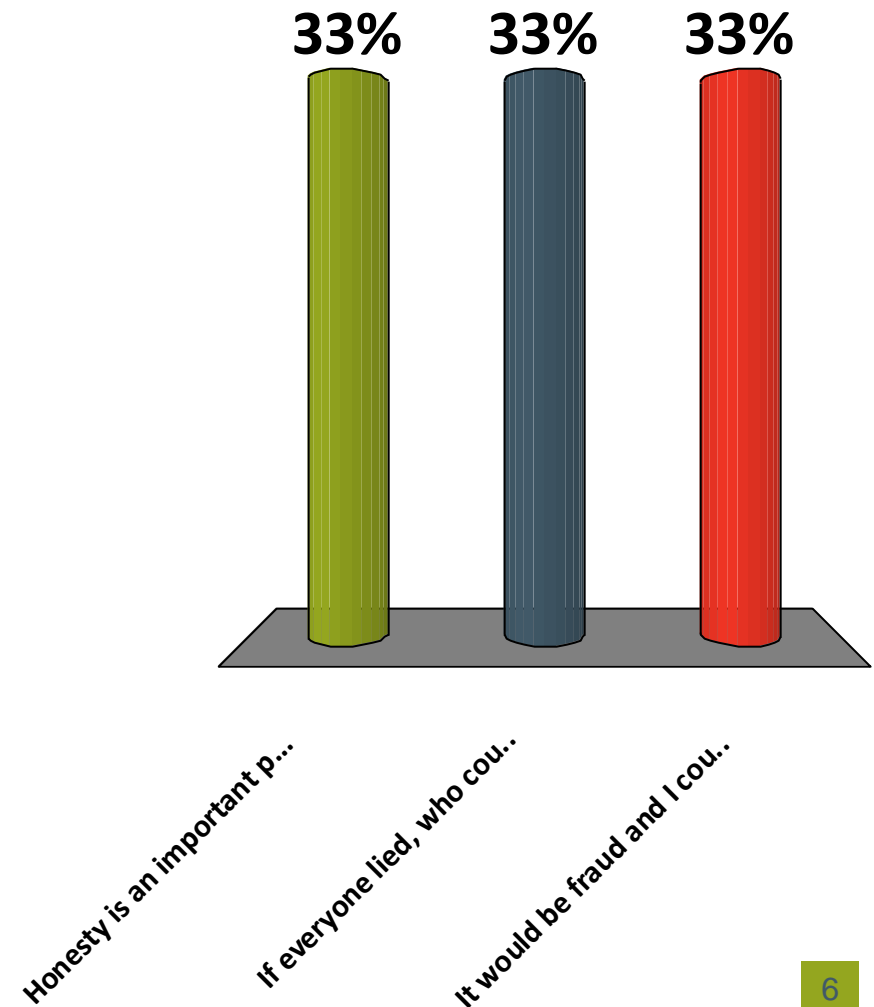
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- Ethics is defined as moral principles that guide our behaviour
- Morals is defined as principles of right and wrong behaviour
- Moral behaviour also means to be concerned with, based on, or adhering to the code of behaviour that is considered right or acceptable in a particular society rather than legal rights and duties
- Three dominant moral philosophies
  - Principled conscience
  - Social conscience
  - Rule compliance

[Source: Oxford English Dictionary and Ethicability by Roger Steare]

# You are pitching for a new client but your experience is lacking in one area. You are truthful because...

1. Honesty is an important principle for me
2. If everyone lied, who could we trust?
3. It would be fraud and I could be fired if found out later



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# Professionalism issues

## What do we mean by integrity?

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- Integrity is the sum of all those principles that guide the way we live and behave with others:
  - Prudence            - wisdom, caution, good sense, mindfulness
  - Justice             - fairness, impartiality, rights-and-duties
  - Fortitude          - courage, guts, determination [fear/stubbornness]
  - Temperance       - self-discipline, self-control, patience
  - Faith               - trust, loyalty, commitment [betrayal/naivety]
  - Hope               - cheerfulness, confidence, optimism
  - Love                - honesty, openness, kindness
  - Excellence       - doing our best, quality [mediocrity/perfectionism]
  - Respect            - courtesy, respect, manners

[Source: Ethicability by Roger Steare]



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# Professionalism issues

## How do different ethical standards fit together?

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- As a member of the Actuarial Profession, you need to consider which ethical framework is over-riding:
  - Professional ethics – the Actuaries' Code
  - Business ethics
  - Cultural ethics
  - Personal ethics
- If they conflict, the Actuaries' Code should be paramount (if you decide otherwise, you will need to justify that decision and be satisfied it will stand up before a Disciplinary Panel)

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# Professionalism issues

## How do you solve dilemmas and do the right thing?

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- Analyse the dilemma carefully – who's involved, what are the facts, what are the options, can you find a **cunning plan**?
- You need to ask the RIGHT questions
  - Rules – What are the rules?
  - Integrity – How do your principles guide you?
  - Good – Who would benefit and how?
  - Harm – Who could be harmed and how?
  - Truth – Are we being honest and accountable?
- Test your decision – does it build trust, will it stand the test of time, have you shown courage?

[Source: Ethicability by Roger Steare]

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# Professionalism issues

## What is meant by serving the public interest?

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- As members of a chartered profession, actuaries have a core obligation to serve the public interest
- Purpose of the Actuaries' Code:
  - To serve the public interest
  - To build and promote confidence [trust] in the work of actuaries and in the Actuarial Profession

## My view: TWO SIDES OF THE SAME COIN

- See the UK Actuarial Profession public interest role explained on the Profession's website [The Profession > Public Interest]

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# Professionalism issues

## “Observe the Code’s spirit”. What does this mean?

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

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# Professionalism issues

## What is meant by misconduct?

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

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# Professionalism issues

## What is meant by misconduct?

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

Disciplinary Scheme Rule 1.10: An employer/partnership, its employees, its directors/partners are all “connected” (my layman’s non-lawyer summary)

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# Professionalism issues

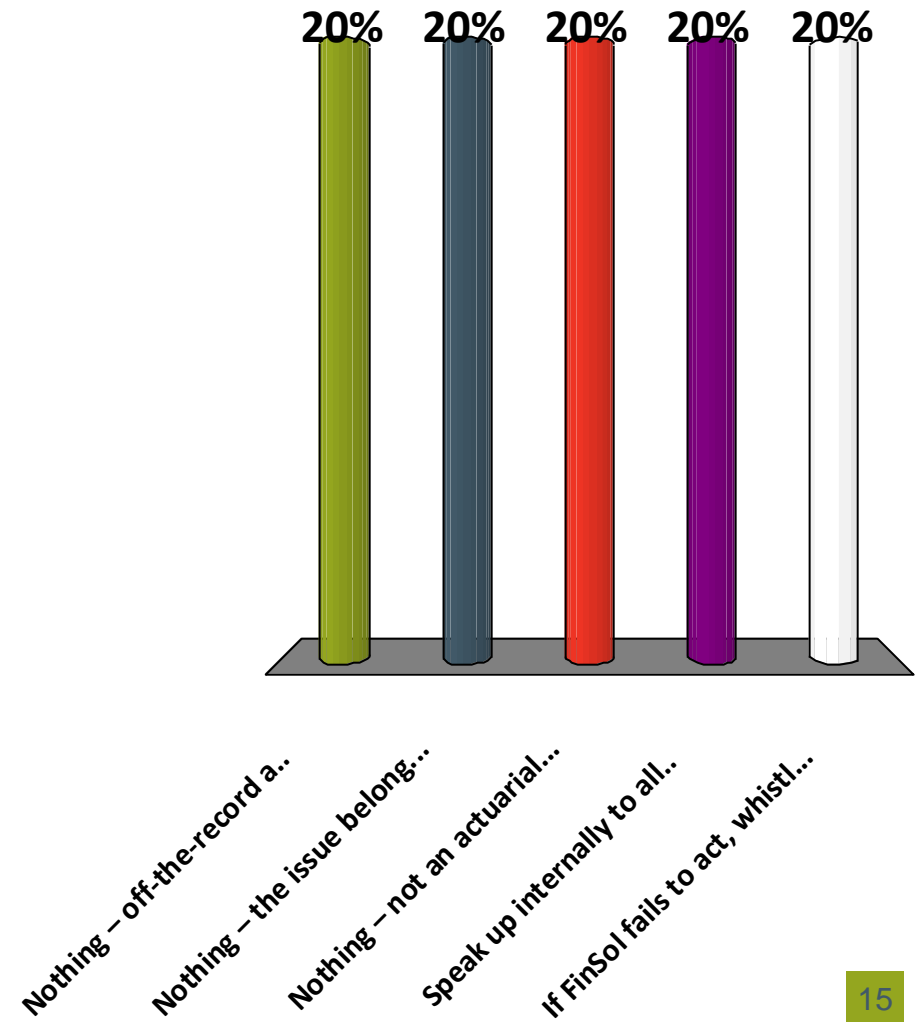
## FinSol – 1<sup>st</sup> hypothetical case study

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- Muscat is a senior actuary in FinSol (UK), the UK subsidiary of a global firm called FinSol Group
- FinSol sells financial reinsurance products to insurance clients
- Muscat is shocked to learn – off the record – from a big-4 auditor that
  - FinSol's clients are being investigated for producing misleading financial statements
  - The root cause of these misrepresentations appears to be FinSol's products
- Muscat takes this very seriously and considers what to do.

# What would you do in Muscat's position?

1. Nothing – off-the-record and so no need to get involved
2. Nothing – the issue belongs to clients and their auditors
3. Nothing – not an actuarial issue
4. Speak up internally to allow FinSol to address the issue
5. If FinSol fails to act, whistle-blow to the FSA and the Profession





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# Professionalism issues

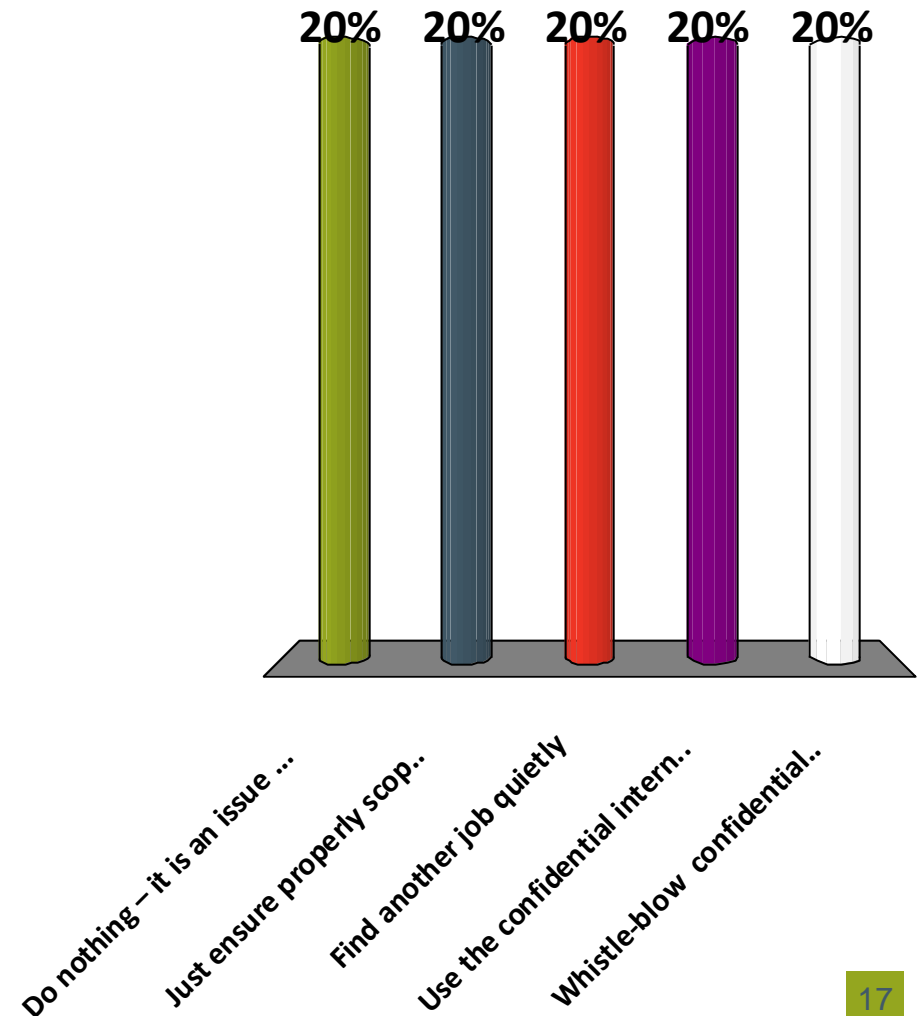
## FinSol – Muscat decides to speak up internally

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- Muscat learns that FinSol's products involve two legs
  - each leg involves a genuine transfer of insurance risk
  - each product is legally highly complex, but careful analysis of both legs shows it is obvious the net risk transfer is immaterial.
- Muscat is told bluntly by FinSol's internal lawyer
  - FinSol's products are highly attractive to clients, and highly profitable to FinSol Group
  - the products meet all legal and regulatory requirements
  - any failure to explain the products to auditors and any misleading financial statements are issues solely for clients and their auditors
  - Muscat should stick to his actuarial terms of reference and not meddle in business issues beyond Muscat's competence – or else....
- Muscat is left deeply depressed by this threatening behaviour

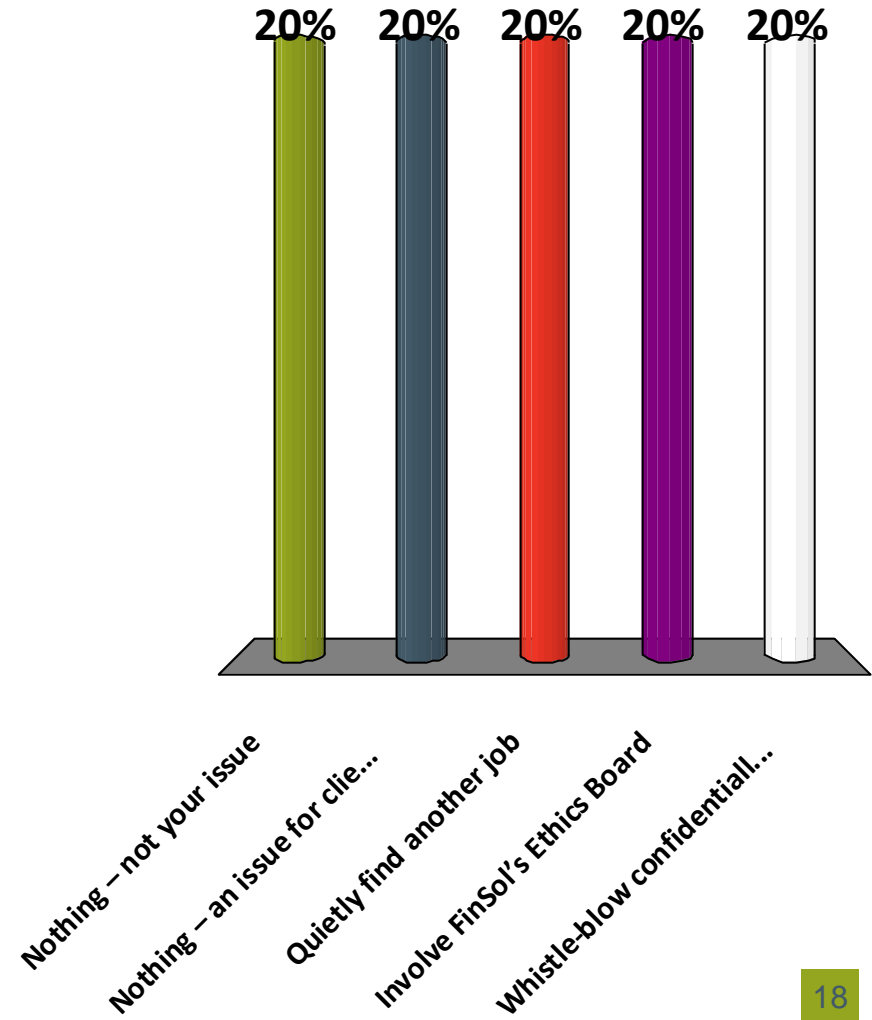
# You are an actuary also employed by FinSol (UK). Muscat consults you. What should you advise him?

1. Do nothing – it is an issue for clients and their auditors
2. Just ensure properly scoped terms of reference are agreed for all FinSol actuaries
3. Find another job quietly
4. Use the confidential internal whistle-blowing facility to involve FinSol's Ethics Board
5. Whistle-blow confidentially to the FSA and the Profession if action 4 fails



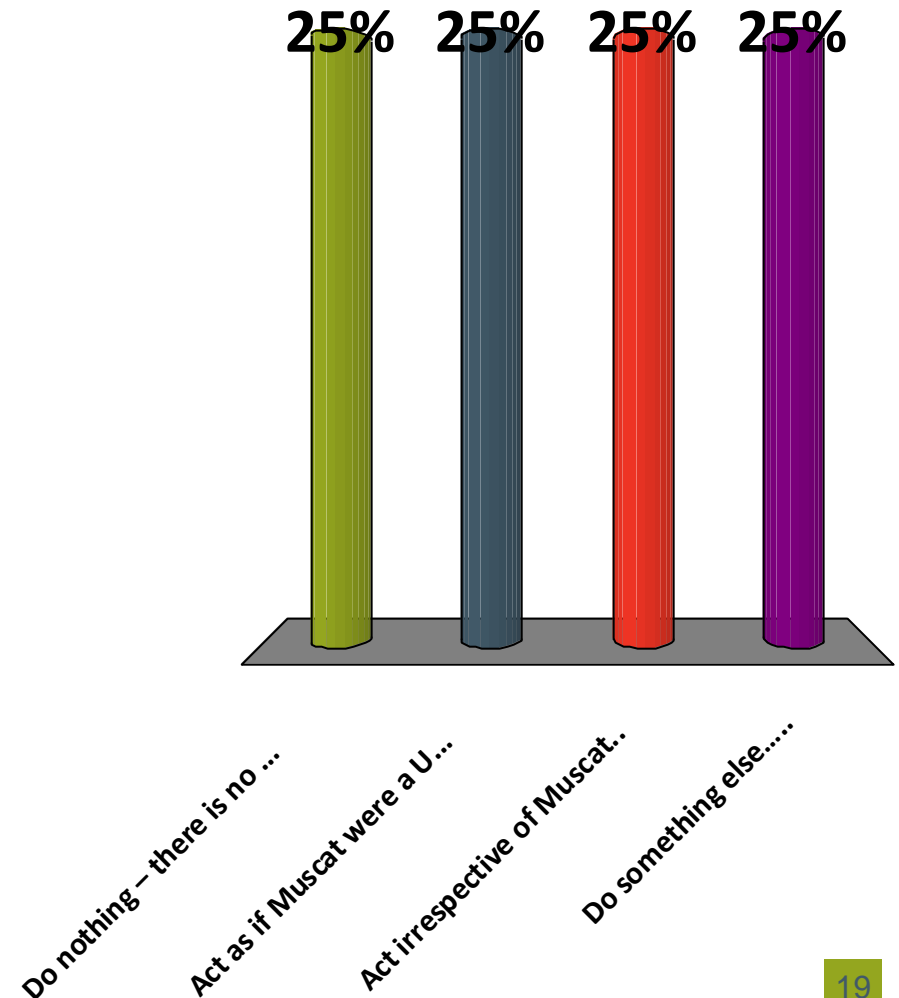
# Muscat does nothing. What should you do?

1. Nothing – not your issue
2. Nothing – an issue for clients and their auditors
3. Quietly find another job
4. Involve FinSol's Ethics Board
5. Whistle-blow confidentially to the FSA and the Profession if action 4 fails with the Ethics Board taking no action itself



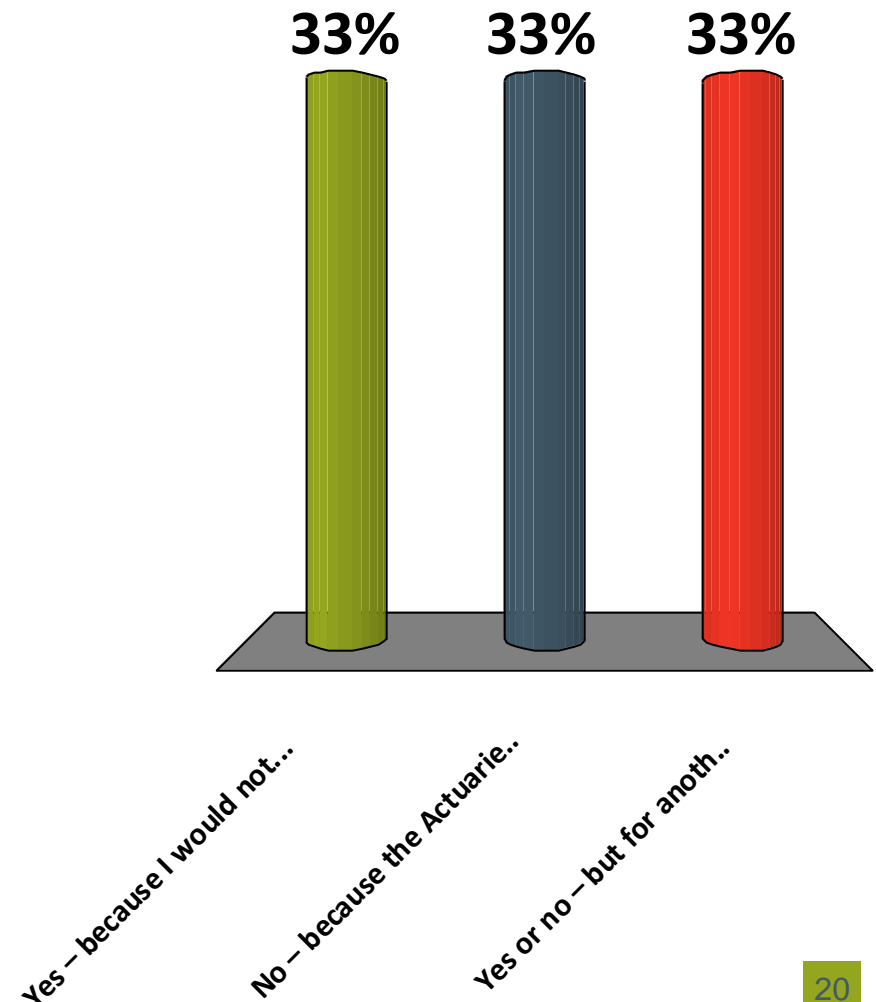
# Muscat consults you but does nothing. How would you act if you learnt Muscat was not a UK actuary?

1. Do nothing – there is no need to whistle-blow on Muscat under Compliance Principle 4.4 if he is not a UK actuary
2. Act as if Muscat were a UK actuary, because it does not matter whether or not Muscat is a UK actuary
3. Act irrespective of Muscat's UK actuary status in order to observe the Code's spirit
4. Do something else.....



# Muscat consults you and does nothing. Would you act differently if you were employed by FinSol Inc?

1. Yes – because I would not be liable for misconduct under Disciplinary Scheme Rule 1.9(a) [assume you have obtained legal advice to this effect]
2. No – because the Actuaries' Code expects me to observe the Code's spirit and being employed by FinSol Inc is a technicality. Relying on such a technicality would risk damaging the reputation of the Profession
3. Yes or no – but for another reason which I will be happy to explain.....



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# Professionalism issues

## FinSol – based on Milan Vukelic/FSA case study

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- Details of a real case study can be found in the Final Notice issued by the FSA to Milan Vukelic on 15 April 2009
- Full details are also available of the arguments made by lawyers representing Milan Vulelic and the FSA, and the conclusions of the Financial Services and Markets (FSAM) Tribunal, which sat in public on 1-9 December 2008 and 13-2 March 2009
- Relevant guidance is set out in the Enforcement Manual component of the FSA Handbook and the Fit and Proper test for Approved Persons

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# Professionalism issues

## Questions arising from the Milan Vukelic/FSA case

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- What is the burden of proof for our Disciplinary Tribunal?
  - For the FSAM Tribunal, it is to a civil standard – a flexible standard where the more serious the allegation.....the stronger must be the evidence before the Tribunal will find it proved on the balance of probabilities
- How is honesty defined?
  - For the FSAM Tribunal, it is defined by the ordinary standards of reasonable and honest people
- What are the responsibilities of regulatory compliance?
  - See paragraph 123 of the FSAM Tribunal's judgement.

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# Professionalism issues

## Bancassurer – 2<sup>nd</sup> hypothetical case study

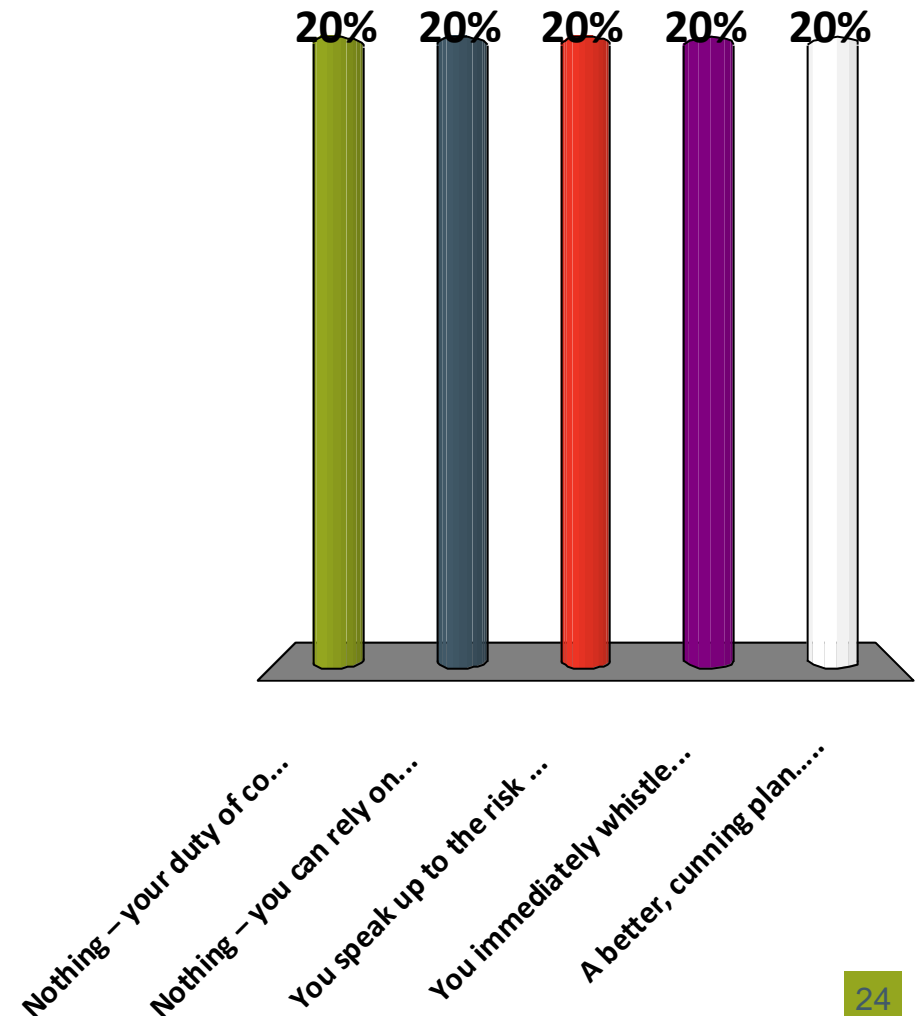
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- You are an actuary employed by Bancassurer Insurance Ltd
- You are a close friend of the Chief Risk Officer (CRO) employed by Bancassurer Group Plc, who tells you
  - He has discovered unethical selling of Payment Protection Insurance (PPI) by the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



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

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



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# Professionalism issues

## Bancassurer – based on whistle-blower allegations

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

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# Professionalism issues

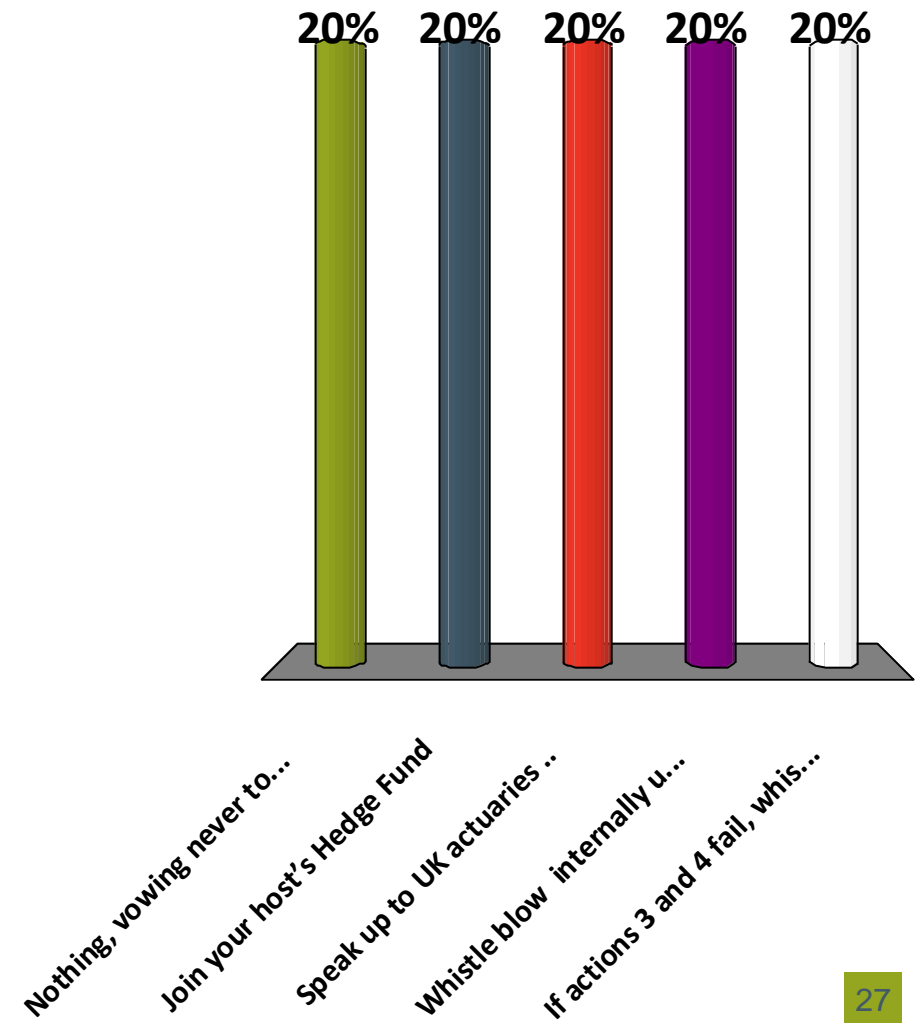
## GlobalFinance – 3<sup>rd</sup> hypothetical case study

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

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

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



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# Professionalism issues

## GlobalFinance – based on recent books and reports

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

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# Professionalism issues

## Managing the risk of (frivolous) misconduct complaints

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- Misconduct complaints can be linked to negligence litigation, taking years between the formal complaint and the Tribunal
  - So always take notes of your decisions and the reasoning behind those decisions on how you have applied the principles of the Actuaries' Code
  - This is necessary because professional standards will inevitably evolve over time, and your decisions will be judged with the benefit of hindsight
  - The process is important – consider everything that should be considered, ignore everything that should be ignored
  - You are dead in the water if you did not even think of the principles of the Actuaries' Code when you should have

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# Professionalism issues

## Managing the risk of (frivolous) misconduct complaints

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- Become a savvy actuary – learn about wider governance issues such as the FRC’s Combined Code, its new Stewardship Code and the FSA’s Principles for Businesses
- Know the Actuarial Profession’s governance
  - The role, strategy and objectives of the FRC/BAS/POB
  - Specifically, the “Working environment for actuaries” part of the FRC’s Actuarial Quality Framework
- Google the Audit Transparency Report of an Auditing Firm, where the FRC has had time to develop high governance standards, and check whether your employer meets those standards (peer review, conflict checks, whistle blowing etc)
- Develop **cunning plans** to avoid “misconduct complaint” traps

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# Questions or comments?

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

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

