The Actuarial Profession

making financial sense of the future

Submission by The Actuarial Profession

Response to the Morris Review's Initial Consultation Document of June 2004

Highlights

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The Actuarial Profession's Response to the Morris Review's June 2004 Consultation Document

Introduction

At the request of the Government, Sir Derek Morris is carrying out a Review of the actuarial profession. The Review began on 1 May 2004 and is expected to conclude in Spring 2005.

The Institute of Actuaries and the Faculty of Actuaries in Scotland, working together as The Actuarial Profession in the UK, have responded to Sir Derek's initial Consultation Document, including answers to all of the (88) wide-ranging questions posed by Sir Derek. The Profession's complete response is available at the Profession's web site, **www.actuaries.org.uk**, as is an earlier submission, *An Introduction to the Actuarial Profession*, made in April of this year.

This document summarises the Profession's response.

The Context in which Actuaries Work

Most people see risks and try to avoid them. The Actuarial Profession was created by people who wanted to manage the financial consequences of death – a risk that could not be avoided.

The profession has moved on from its origins, over 150 years ago. Actuaries now work in areas where the management of assets and liabilities, especially over the long term, is assisted by a combination of mathematics, economics and finance.

Despite the popular myth, actuaries cannot predict the future or make unshakable forecasts. We have never been able to. Actuaries build financial models – some as familiar as a spreadsheet projection, others based on stochastic (random simulation) processes – all founded upon assumptions about uncertain future events and all designed to throw light on alternative future circumstances so that people can plan for a range of outcomes.

A Changing Ethos in Society

In the modern ethos of transparency of products, the traditional savings vehicles are a dying breed. This is quite a change for the actuarial profession which thrived in a world before transparency. Actuaries were needed, because no one else knew how to manage the inter-generational transfers built into many savings products. It is probably true to say that even though some mathematicians, economists and perhaps MBAs would probably have been able to build the underlying models, no one outside the actuarial profession came close to offering to do so or offering to manage those transfers and quite probably did not know how to.

The mechanisms originally devised by actuaries existed because of a well-ingrained paternal ethos in society. Mutual insurers and employer-sponsored pension schemes (with compulsory membership) are classic examples of such an ethos. Demutualisation and the freedom of individual workers to select their own pension providers have been relatively recent phenomena.

That paternal ethos created an environment in which cross-generational "smoothing" was the predominant financial management device: pensions and life assurance relied on a process in which either the money going into savings (eg the employers' pension contributions) or the benefits coming out (eg bonus declarations for with-profits policies) was to be smoothed over many years.

The paternal ethos has been replaced by one of transparency in which individual consumers – as savers or prospective pensioners – must be given sufficient information to be able to fend for themselves.

This change is a societal choice, which actuaries must work within. It is noticeable, however, that the drive for transparency, and its implementation, has preceded the education of (most) consumers to handle the new information.

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Learning from Recent Events

The events at Equitable Life, and the Penrose report which followed, were a shock to many actuaries. But those leading the profession during this period had already commenced a series of initiatives designed to identify what role the profession – actuaries in general and the professional body in particular – had to play and what changes were necessary.

The initiatives we began even before the Penrose report was published reflect a determined desire of the profession to reappraise itself. Five major initiatives were under way prior to the announcement of the Morris Review:

- *Actuarial Standards Board:* A taskforce presented a proposal to the Profession to introduce an Actuarial Standards Board, containing a majority of independent members, to oversee the process of setting professional and technical guidance to actuaries. The main thrust of this proposal, on which further work has been commissioned, is to introduce the concept of independence into the profession's standard-setting procedures.
- *Revalidation of Professional Competence:* Currently, practising certificates are needed by Appointed Actuaries (life offices), Scheme Actuaries (pension schemes), and Syndicate Actuaries (Lloyd's). The profession is considering a proposal to extend the concept of practising certificates to cover all actuaries who give advice on actuarial matters. The proposal envisages that revalidation of the new practising certificates for non-statutory roles should take place every five years, with revalidation for statutory roles continuing to be required every year.
- *Peer Review:* The profession has decided to introduce peer review for some actuarial work.
  - The initial plans for peer review in life assurance are being modified in the light of the FSA's forthcoming changes to the Appointed Actuary system for life assurance.
  - An Exposure Draft on peer review in pensions work (EXD 52) was issued in February, setting out the initial phase of the introduction of peer review. The consultation period closed in April and plans are under way to implement the proposals by the end of the year.
  - The development of a peer review regime in general insurance is a matter for agreement with Lloyd's. Proposals for introducing peer review are under discussion.
- *Disciplinary Scheme:* The profession instituted a revised, more independent disciplinary scheme with effect from 1 January 2004.
- *Education:* A new education syllabus has been introduced this year. The core syllabus has been extended to cover techniques across a range of different business areas in order to ensure a broad conceptual knowledge base; the detail of day-to-day work is addressed in the specialist options. The new syllabus is coupled with a shift in emphasis from examinations of the type that actuarial students currently take, to introduce alternative assessment techniques, for example an exercise in practical data modelling.

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The Value of Actuaries

Many professions can be characterised at two levels: a technical skill and the use of that skill in a broader context. So, for example, the technical skill of a lawyer is knowledge of the law. The real value lies, however, in a variety of ways in which that knowledge is combined with another skill to great effect, for example in trial advocacy.

So, whilst the technical skill of an actuary lies in the construction of financial models, the talent lies in the ability to combine the technical skill with an in-depth training in problem-solving to manage long-term financial vehicles.

Actuaries and accountants have "finance" in common, but the similarities end there: the actuarial field is typically narrower than the range of businesses in which accountants operate, but very few accountants are comfortable operating models over the time-frames that actuaries work with. The skills that actuaries use as *inputs* to a problem include experience in distilling a problem down to manageable proportions, for example, using large quantities of data, while appreciating the limitations of that data.

The *outputs* from an actuary's work include a strategy for accepting (certain) risks, and managing them, rather than avoiding them.

The Current Regulatory Role of the Profession

The FSA and Opra regulate providers of *financial* services (or vehicles for the provision of such services), ie insurers, pension schemes and the like.

The Actuarial Profession regulates its members – the providers of *actuarial* services to (amongst others) the organisations that the FSA and Opra regulate.

Statutory Monopoly over Certain Areas of Work

The Actuarial Profession takes the view that, if others have (or can acquire) the appropriate skills and expertise to take on the work now required of actuaries, there is no reason, in principle, why actuaries should continue to have any statutory monopoly. As a professional body, we think our members should be able to compete with others and that they deserve to retain the work only if they are able to survive the competition.

But competitive markets cannot be allowed to run unchecked if there is a potentially damaging imbalance of knowledge between providers and consumers. In the professional arena, regulators and the legislature want the security of knowing that someone suitable is carrying out certain types of work. Where that happens, there needs to be some recognised body (or bodies) which determine whether an individual has attained the relevant qualification and which lays down any standards for carrying out the work.

The Future?

The Actuarial Profession has confidence in its view of the future provision and regulation of actuarial services. The Morris Review represents an opportunity to test that view against the assessment of others.

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