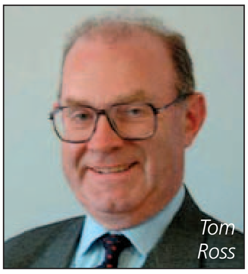
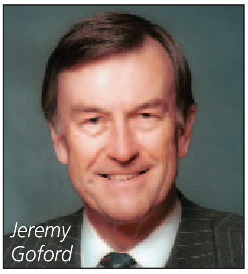
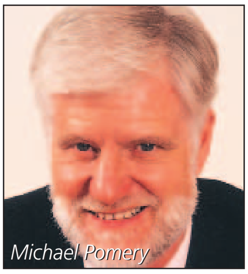
Managing Morris

Simon Carne reveals the thinking behind the profession's response.

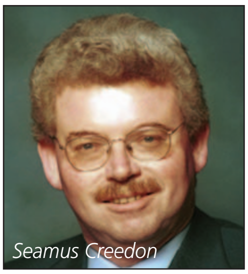

Tom Ross


Jeremy Goford


Harvie Brown


Michael Pomery


Caroline Instance


Seamus Creedon

It's Monday 8 March 2004, just coming up to 4pm. The government is moments away from releasing the Penrose report into Equitable Life.

In the House of Commons, a little-known Treasury minister, Ruth Kelly, is about to rise to her feet. It is her job to make the announcement. Around the country, a million-plus policyholders are about to find out that they will not receive any compensation. Kelly is not going to be popular. In the days and weeks ahead, her ability to defend the government's position will be tested many times over. By the end of the year, she will have changed jobs twice and been catapulted into the cabinet. By the end of the day, actuaries will be facing a threat to jobs once thought secure, and the Faculty and Institute will have been forced into a fight for their continuing relevance.

At Staple Inn, the profession's communications team is watching Kelly closely. Actuaries are at the heart of this story. Some elements of the press have been sharpening their knives in recent weeks: they seem to smell actuarial blood. Iain Taylor, the profession's head of communications, has prepared answers to 101 questions, any or all of which might be thrown at him or his colleagues.

Tom Ross and Jeremy Goford, presidents of the Faculty and the Institute, are nowhere in sight. They haven't been answering their mobiles all day. They are at the Treasury reading an advance copy of the Penrose report, having agreed in advance to remain inside the Treasury until the report has been published. They also have a copy of Ruth Kelly's announcement that she is commissioning a wide-ranging review of the actuarial profession. Their eyes fix on the words 'wide-ranging'.

Then they turn to the name: Sir Derek Morris. It is not familiar to them. For now, the announcement they are holding tells them what they need to know. Sir Derek is a former Oxford economist and the outgoing chairman of the Competition Commission. Clearly, he is very experienced at market investigations. He is also no stranger to complex finance. This could be a disaster… or could it be just what the profession needs?

When their Treasury host returns, he is accompanied by Niki Cleal, a high-flyer in the Government Economic Service. She will be the project team leader on the Morris Review, reporting directly to Sir Derek. Today, she is being introduced to the heads of the profession. By now, Tom and Jeremy have already made their first critical decision of the Morris Review: they must ensure that it is the best thing that has happened to the profession since the invention of compound interest.

Back at Staple Inn, colleagues have now heard Kelly's announcement. Iain Taylor looks at his list of 101 answers. The press will be on the phone any minute now. But there's only going to be one question: 'What's your reaction to the Morris Review?'

Work in progress

Two months previously, Michael Pomery had been elected as the Institute's next president and Harvie Brown was hotly tipped for the Faculty position. With six months to prepare for their accession, they were acutely conscious that, for several years, the profession had been identifying an extensive programme of change. They wouldn't need Lord Penrose to tell them that all was not well. There wasn't a single area of actuarial regulation, from the day a new student joined to the day he or she retired, that was left untouched by the reforms already under way.

A new education syllabus for students was scheduled to kick in just as Michael took office. A programme of 'competence revalidation' was also being devised. Regulating actuaries' day-to-day practice would be in new hands following the announcement that a new actuarial standards board was to be created. Plans were also afoot to introduce peer review into many areas of actuarial work. A new disciplinary scheme had come into effect that month.

Michael and Harvie could see it would be their job to make all this happen. The two of them had more than enough work for the next two years and were unlikely to be called upon for more change…

First contact

The Morris Review would not start until 1 May, almost two months after Kelly's announcement. This gave the profession time to prepare.

That week, the presidents wrote to Sir Derek. Determined to make a good first impression, they decided the central message must be that we had confidence in our own plans for change, but were keeping an open mind to new proposals: short and simple, but with important subtexts. First, it was important to get across that the content of the Penrose report hadn't come as a shock to the profession. We had already recognised the need for change and were doing something about it – a lot of somethings, ranging rather more widely than the criticisms identified by Lord Penrose.

Second, we needed to convey that we weren't going to dig our heels in on our existing plans. We already knew that our desire for an independent actuarial standards board was limited by the powers and the resources at our disposal. A board with external backing and external funding would be far more effective than one that owed its existence to our say-so. The Morris Review could help us with that – and more besides.

Were there risks in expressing confidence in our plans? It was almost inconceivable that the review would reject out of hand the notion of a standards board, and Lord Penrose had praised the new disciplinary scheme. That was two out of five, straight away. If Sir Derek surprised everyone by rejecting those ideas, we could address that problem when it arose in nine months' time. There was little point, now, in having less than full confidence in proposals that the *Financial Times* had already written about. The cat wasn't going back in the bag.

The letter to Sir Derek also suggested that the profession's chief executive, Caroline Instance, should meet Niki Cleal as soon as possible. The presidents had met her at the Treasury. Now it was important to maintain close relations with her.

In the shadow of Morris

Sir Derek had his team: we needed ours.

Over the course of the ensuing 12 months, an uncountable number of individuals would make a substantial contribution to the profession's input to the review. In the early days, senior members of the staff provided extensive briefings to the Morris team. Later, members of the profession's Councils, boards, and more staff colleagues would provide input to the formal submissions. Spearheading the effort was a team of seven, comprising the presidents, the incoming presidents, the chief executive, and two Council members: Seamus Creedon and me. In government-speak, we were 'the shadow Morris team'.

One of the first decisions of the shadow team was to commission an introductory paper for the review, describing the actuarial profession and putting it in a proper context. The Penrose report had given a lot of attention – understandably – to the work of the appointed actuary at Equitable Life. But it needed to be understood by the review that there were fewer than 120 appointed actuaries out of 4,500 UK practising fellows. The review would need to know what the other 4,400 did.

It was important at this stage to stick to the facts. As a profession of highly trained problem-solvers, it was tempting to pre-empt the work of the review ourselves. But there was little point in trying to tell Sir Derek the answer(s) before he had even decided upon the questions – that would be irritating, and counterproductive. As confident as we were in our ideas, we had also committed ourselves to maintaining an open mind.

Building our case

The shadow team asked the Faculty and Institute Councils to give us a broader perspective. Looking at the review from Sir Derek's perspective, what did they expect he might make of the profession? From their own perspectives, what would they most like the review to achieve – and what would they least like? Finally, what would the public expect the review to recommend?

When the review published its consultation document during the summer, Councils gave more crucial input. Drawing heavily on our introductory paper, the document set out 88 questions. Over 100 people or organisations responded.

The most difficult questions were those that called for an appraisal of the profession's strengths and weaknesses. Plainly, it would be a mistake to be overly modest and self-effacing. As a profession, we have substantial responsibilities. If we showed little confidence in our own abilities, why should anyone else? But it would be foolish not to acknowledge any weaknesses. So, while submissions by

Summary of recommendations

Regulatory framework

An actuarial standards board (ActSB) should be created within the Financial Reporting Council (FRC) to set actuarial standards.

The existing oversight board for accountancy (POBA, an operating board within the FRC) should have its role extended to include oversight of the profession's remaining functions, including education, CPD, compliance monitoring, and discipline.

The FRC's Accounting Investigation & Discipline Board (AIDB) should be empowered to investigate and discipline in actuarial public interest cases.

Education

Greater academic and non-actuarial input into the ongoing development of the syllabus and associated teaching material and improved quality control in relation to exam-setting and marking.

The profession, universities, and employers should explore alternatives to the traditional education model of on-the-job part-time study, for example, a one-year postgraduate actuarial conversion course.

The profession should proceed with its proposals for compulsory CPD and should ensure the scheme is targeted and relevant, taking account of syllabus changes.

Compliance monitoring

The FRC should ensure that there is monitoring of compliance against actuarial standards, with the FRC having whistleblowing powers.

Pensions

The Pensions Regulator should ensure that scheme actuaries' advice to pension schemes is subject to formal scrutiny by independent experts, either through its risk-based supervision, audit, or external peer review. The review supports the profession's introduction of peer review for pensions.

Life assurance

Companies should consider whether further review would be appropriate to cover actuarial advice that are not reviewed by the reviewing actuary.

General insurance

The Financial Services Authority (FSA) should consider introducing a requirement for actuarial advice as part of audit, in both the company market and Lloyd's market.

Whistleblowing

Clearer guidance from FSA, Department for Work and Pensions, and, in due course, ActSB on the circumstances in which whistleblowing is permitted and when it is required. In the longer term, the government should consider additional protection for whistleblowers.

Scheme actuary conflicts

If any of the three parties – trustees, scheme actuary, or scheme sponsor – deem that a potential conflict of interest has emerged the trustees should have the option to retain the existing adviser and the sponsor should secure separate actuarial advice.

Reserved roles

Statutory roles should continue to be reserved for actuaries in life insurance and pensions, but the position kept under review. The FSA should consider introducing a requirement for general insurers to take advice from an approved person, but not necessarily an actuary.

Market-testing of actuarial advice

As a matter of good practice, users of actuarial services should undertake a formal re-tendering by advisers every six years, with informal reviews periodically in between.

User knowledge and understanding

The Pensions Regulator/National Association of Pension Funds/Association of British Insurers should provide guidance to trustees and non-executive directors on the effective management of actuarial advisers including material to assist trustees and non-executives to challenge and question their actuarial advice.

Communication

There should be a technical standard on communication.

Separation of advisers

In line with the government's proposed revision to the Myners principles, it is good practice for trustees to invite tenders separately for actuarial advice, investment advice and fund manager selection advice.

Liability caps

The review believes that there is not currently a case for a statutory liability cap; the level and cost of professional indemnity insurance cover should be left to market forces.

Taken from www.actuaries.org.uk

Simon Carne was the final member of the shadow team; during the preceding ten years, he had advised several economic regulators and written submissions and expert evidence for clients involved in regulatory investigations before the Competition Commission; he is the author of Being Actuarial with the Truth (www.sias.org.uk/papers /truth.pdf)

some actuaries listed the ability to communicate among the strengths, the profession took the view that this lacked self-awareness. We said 'the need to communicate actuarial concepts to non-actuarial audiences… calls for a skill which is not a natural fit with being mathematically orientated problem-solvers'. By linking a strength to its attendant weakness, we felt we could steer a course which avoided arrogance, self-effacement, and complacency.

Sir Derek was not persuaded by those who claimed that actuaries, in general, were capable communicators. His view was that users find actuarial information too technical and too complex. More disturbingly, their proxies (non-executive directors and pension fund trustees) do not comprehend the advice sufficiently either. In his interim assessment, Sir Derek went so far as to suggest that regulatory intervention by way of an overarching public interest obligation might be needed to remedy 'the understanding gap'.

His final report repeated the criticism of communication skills. But, having consulted further, and analysed the proposition in more detail, Sir Derek concluded that there was no effective mechanism that would deliver an overarching public interest obligation without damaging other rights that users of actuarial services were entitled to. This conclusion drew heavily on submissions made by the profession. We can only speculate whether the profession's arguments in the closing stages would have carried as much weight if earlier submissions had included overly optimistic assessments of the profession.

In planning our approach to the review, the shadow team decided from a very early stage that, as important as it was to know where we wanted to end up, there were very few issues on which we needed to commit ourselves to a position before we were called upon to do so. Instead, we revealed our hand progressively. Starting with purely factual information in our introductory submission, we added objective opinion in our response to the summer consultation and, only after seeing the interim assessment, did we volunteer our preferred way forward.

In this way, we honoured our commitment to keep an open mind; we gave ourselves the opportunity to change our preferences in the light of new information without having to backtrack on any positions previously adopted. We also gave ourselves the credibility to press the review hard on those issues we felt strongest about.

For a copy of the reports and submissions referred to in this article, see the Morris page of the profession's website, accessible via the News and What's New button at www.actuaries.org.uk

The verdict

In his interim assessment, last December, Sir Derek proposed an independent actuarial standards board, most likely within the framework of the Financial Reporting Council (FRC), coupled with oversight of the profession's other activities by a body similar to the FRC's oversight board for accountancy. The profession considered this central proposal to be one we could and should support.

The review also identified options on a range of other topics, including education, compliance monitoring, conflicts, and market-testing. It was now time for us to reveal the options we preferred. It was important to focus on the outcomes we were for or against and not get drawn into a battle over the underlying analysis just for the sake of it.

But first we had to endure an uncomfortable few days while the press selectively reported passages from the interim assessment which identified actuarial weaknesses, and steadfastly refused to report any of the strengths highlighted in the report. The *Financial Times*, predictably, wrote up Sir Derek's assessment as a 'demolition job' and his proposals as a 'rebuke to actuaries'. Sir Derek's proposals to build on the profession's reforms and to maintain (and possibly extend) the roles reserved to actuaries did not support the press's story, so they ignored that part.

But with widespread support for the thrust of the review's proposals, Sir Derek was able to proceed to a final report ahead of schedule. At the time of going to press, the review has been accepted by government and, it seems, by most other observers.

Having gone into the review with confidence in the changes we had initiated, but receptive to new proposals, it was gratifying to see Sir Derek acknowledge that 'the review has built on changes already contemplated or initiated by the profession'. He was also complimentary about the profession's attitude to the review:

> '[The profession] does not accept all [my] analysis; but has nonetheless adopted a forward-looking stance, recognising that significant change is desirable, seeking to work with the grain of the options for reform and providing constructive input…' ❑

| MORRIS REVIEW | PRESS COMMENT

Press comment on Morris: journalist, heal thyself

As MIGHT HAVE BEEN EXPECTED from the fact that the Morris Review was released on budget day, the UK press devoted almost all financial space to consideration of the budget, and comments about the Morris Review were lacking in quantity and quality. 'Eating ourselves to an early grave?' was the most interesting press comment published on day 'M+1' that involved references to actuaries. No, it wasn't referring to Gordon Brown's appetite for taxation, but to rising obesity in America (the article appeared in the *Atlanta Journal*).

The *Daily Telegraph* referred to Morris as 'a radical shake-up of the actuarial profession', so one wonders how they'd have described the FSA's recent reforms of the insurance sector. The *Guardian* referred to 'proposals to sweep away self-regulation' and gave some interesting historical background involving 'actuaries who value pension fund liabilities for insurance companies', a dotcom crash, and a 200-page report by Sir Derek (we were only able to count 160 pages, but this may reflect our outdated deterministic enumeration algorithm).

The Morris Report and the profession

Faculty and Institute presidents Harvie Brown and Michael Pomery respond to the recent report.

Almost a year to the day since it was announced in the aftermath of the Penrose Report, Sir Derek Morris's review was published by the Treasury on budget day. It held few surprises for us, as we had been working closely with the review team during that time and its central recommendations had already been mapped out in the interim assessment, which came out shortly before Christmas. The very fact there had been a review into a profession of only 4,500 fellows in the UK underlines the important role we have in society.

The profession did not agree with all the analysis in the interim assessment. To blame actuaries, as journalists do, for underfunded pension schemes when the government had deliberately legislated for a weak funding standard is simplistic nonsense. However, the profession itself had identified weaknesses in how we did things and had already instigated a major programme of reforms. It was not surprising therefore that the review covered these nor that journalists dwelt on them. We are, however, very supportive of the review's outcomes because as Sir Derek says: '[It] built on changes already contemplated or initiated by the profession.' We wanted an independent standards board. Sir Derek has paved the way for something better than we could achieve ourselves: true independence, statutory backing, and support for the proposal from government, FSA, and the pensions regulator. Lots of practical details have still to be worked out, including the need to ensure that representation and funding are right, but we will be working for as swift an implementation as possible.

Independent oversight of professional regulation seemed an inevitable trend in today's society and it came to accountants and lawyers before us. Our response has to be to build on the positives it will bring. It still leaves the profession in the driving seat but should give us a sounding board when there are difficult issues to face and independent endorsement of the ways things are done. A large number of the Morris recommendations will be up to the profession to consider and implement. We welcome his analysis and will 'work with the grain' of those recommendations.

Sir Derek talked about the profession being at a crossroads. But we believe we were already on a journey with a clear direction. In 2000 our vision was outlined: we do see ourselves (as Sir Derek does) 'fulfilling a wider remit in the field of financial risk analysis, bringing expertise, robust technical standards and the benefits of professional conduct standards to traditional and new sectors'. As the current leaders of the profession, we have to ensure that the pace of change is accelerated. As outlined in the 2005/6 corporate plan (on the website), we will be defining the future role of the profession in the post-Morris era and the evolution of its structures to deliver that role most effectively. We will be judged by what we do, not by what we say.

Sir Derek has looked closely at the profession and, although critical of us in a number of respects, he considered us: 'dedicated, skilled professionals providing important and useful advice, with commitment, integrity, and a strong sense of duty.' Gratifyingly, this endorsement was featured in the *Financial Times* editorial about the review and the profession.

We belong to a profession we can be proud of and we have a great future. We look forward to the hard work ahead to turn the Morris recommendations and our own changes into a reality. ❏

Most disappointing of all – if only because of our 'actual vs expected' way of looking at life – was the comment of the *Financial Times*. This started with the witty and original 'they find accountancy too exciting' gem and followed a 'physician, heal thyself' slant. After a sound summary of the report's main points, and a pat on the back to us for having introduced 'significant updates of the… educational syllabus' (presumably the *FT*'s journalists haven't attended the 'business awareness module'), the comment finishes with the following interesting points:

> 'A satisfactory solution here requires more than reformed actuaries. Pension funds need well-informed and robust trustees who are prepared to demand separate actuarial advice on behalf of fund members if necessary. One message of the Morris Report is: actuary, heal thyself. But this will only be possible under pressure from well-informed and gritty customers, who will also need to raise their game.'

If you're an actuary, a customer, or (most of all) a journalist, then heal thyself. Physicians can presumably have a rest.

Matthew Edwards