

Penrose report

Most readers will have already read summaries in the press of Lord Penrose's report of his Equitable Life inquiry (available from www.hm-treasury.gov.uk), and will be aware that the financial secretary to the Treasury, Ruth Kelly, has announced (inter alia) a 'wide-ranging review of the actuarial profession' by Sir Derek Morris (see p4).



Lord Penrose

Interestingly, the review also featured in the chancellor's Budget report, according to which it will 'build on the work of the Myners review of institutional investment... and has a wide-ranging remit to examine the profession and the Government Actuary's Department, to consider how to modernise the profession, and to promote an open and competitive market in actuarial advice in the UK'.

This is neither the time or place to offer a summary of the Penrose report as a whole, or to offer a view of Lord Penrose's findings, but it may be useful for those actuaries who have not read the report to read some of Lord Penrose's many comments on actuaries.

Actuaries and other disciplines

In his conclusion to the first chapter, on GARs and the outcome of the *Hyman* case, Lord Penrose says: 'Actuaries, whether the Society's actuaries or the actuarial profession as a whole, were not competent to adjudicate on the issues that emerged.' The context of this sentence suggests purely legal issues were meant (although of course there is little financial management work that is not fundamentally directed by legal precepts).

The idea that actuaries are not only not sufficiently 'holistic' but behave as if they were is presented later in the report: 'One has the impression that actuaries have at times acted as if there were fully qualified in accountancy, law and other disciplines so as to need no outside support. Whether that is tolerable in a particular company is a matter for that body. It cannot be acceptable in regulation.'

In particular, Lord Penrose calls on regulatory actuaries to work more with other professions: 'I would encourage further development of the multi-disciplinary approach. Consideration of the accounting and legal issues that inevitable arise in

the regulatory process should be fully integrated...'

Actuarial board members

Lord Penrose bewails many times in the report problems of corporate governance, one of which he attributes to actuarial professional guidance: 'There were executive directors with relevant actuarial qualifications, but... they were in any event inhibited by the terms of professional guidance (which prohibited qualified actuaries who were directors from doing anything to undermine the authority of the appointed actuary).'

Policyholders' reasonable expectations (PRE)

There is much criticism of the actuarial profession's thinking on PRE. In particular, he is critical of the way actuaries have, in his view, attempted to take over responsibility for the meaning of the phrase: 'It is not uncommon for professional jargon to appropriate ordinary words and to seek to imbue them with a technical mystery that is impenetrable to the ordinary member of society.... [Actuaries] have been the authors of their own misfortune by seeking to substitute for the straightforward language of the statute tests that are more elusive, such as the "asset share" test...'

Penrose also criticises the profession for 'having failed to develop any coherent principles or rules of practice by which to test objectively the approach of an actuary, and in particular an appointed actuary, to the ascertainment of and provision to secure the satisfaction of policyholders' reasonable expectations'.

Recommendations for the profession

Making his recommendations for future action in Chapter 20, Lord Penrose writes:

'Should the existing appointed actuary system continue, it is clear that on no account should it be permitted that the appointed actuary should also be the chief executive. That combination should simply be banned under the approved persons regime. It undermines fundamentally the "whistle-blowing" obligations of the appointed actuary, and would similarly affect any substitute. And it is also clear that if any external reliance is to be placed on the professional opinion of an actuary, in whatever capacity within a life office, the actuarial profession must be

encouraged to impose appropriate discipline. Moves to encourage the profession to take that direction in the past have been abandoned by regulators as "difficult". But if the profession does not wish to be judged by the lowest common denominator: (a) it must have a well-developed set of prescribed standards; and (b) it must have a properly developed disciplinary procedural system to confront deviant conduct.

'So far as the disciplinary structure is concerned, the professional bodies in Scotland and in England have radically overhauled their disciplinary structures and, uniquely, have taken steps to ensure the independence of those engaged in disciplinary work by providing for the selection and nomination of candidates by an independent committee chaired by a lawyer with considerable experience in professional disciplinary matters. But there is one area in which I consider there are further steps that could be taken with advantage.

'The people best placed to identify the need for disciplinary intervention are co-professionals. It would improve the public image of the profession if it were seen to accept responsibility for direct intervention where it was thought that the administration of life funds was likely to threaten the legitimate interests of policyholders. I would invite ministers to offer encouragement and support for initiatives that the profession might take in this direction.

'Whether the existing appointed actuary system should continue, or whether FSA's current proposals for a "with-profits actuary" offer any greater prospect of effective discipline on the internal actuarial management of life offices, are matters open to argument. In my view, the precise arrangements are less important than the solution to the problem of independent and effective actuarial "audit". Audit procedures that ensured independent verification of the validity of the actuarial assumptions on which the valuation is based, squarely focused on the public interest comprising the interests of shareholders and policyholders, and the duty to treat policyholders fairly, including with regard to PRE (a phrase that, however clumsy, appears to have a place in the new order), and the provision of a realistic balance sheet would go far to reduce the importance of the internal organisation of the actuarial management of the office.'

Morris review

In her statement on Penrose, financial secretary Ruth Kelly said: 'I can announce that Sir Derek Morris will lead a review of



Sir Derek Morris

the actuarial profession with a particular focus on considering how best to modernise the profession and to ensure that high standards are delivered in a more open, challenging and accountable professional culture.'

The terms of reference for the review are at www.hm-treasury.gov.uk/newsroom_and_speeches/press/2004/press_24_04.cfm (see also p4 of this issue).

Press and political comment on the profession

In any event, it seems clear that both for actuaries individually and for the profession as a whole, the future is going to be very different from the past. We have attracted more criticism than praise in the Penrose context.

In Parliament

Mr McFall: ... The financial secretary will be aware that the Treasury Committee has invited Lord Penrose to give his views



Ruth Kelly

on his report next week. Surely it sounds the death knell for the post of appointed actuary.

Ms Kelly: My hon friend draws attention to the appointed actuary system that was in place for a prolonged period during the 1980s and 1990s. The Financial Services Authority has decided to abolish that system, to remove from the appointed actuary responsibility for making key decisions about asset allocation and distribution in respect of with-profits funds, and to place that responsibility firmly on the board.

Mr Frank Field: I thank the minister for the announcement about the Paul Myners inquiry and the inquiry into the actuarial profession. Given the strategic importance of actuaries to the long-term delivery of our pension schemes, will the House have some

The group which emerges worst, blinking in unaccustomed daylight, is the actuaries, whose arcane projections have long been accepted as holy writ. They are now exposed as exponents of mumbo-jumbo, whose ability to read the future is no better than that of the average economist. Alongside the unfortunate policyholders, they are the real losers from the Penrose report.

Daily Telegraph, 9 March 2004

say in the terms of reference of that inquiry?

Ms Kelly: I thank my right hon friend for his insightful comments on the actuarial profession. Although we have published terms of reference for that review today, I assure him that they are extremely broad.

Mr Mark Field: Will the government find a way to enable the ombudsman to investigate the serious regulatory failure of the Government Actuary's Department, which was identified in Lord Penrose's report?

Ms Kelly: I pointed out that Lord Penrose himself made serious criticisms of the actuarial profession—not least the fact that one appointed actuary was reluctant ever to criticise the opinion of another appointed actuary. Lord Penrose also said that the profession was set up in such a way that there were no standards of discipline of the type that are normally accepted as applying to any professional body. That is why the government have set up an independent review to examine the actuarial profession, and it will include the Government Actuary's Department.

Mr Barry Gardiner: Lord Penrose has accused the management of the company of manipulation, concealment, and serious omission. Is not that just another way of describing the current state of the actuarial profession? I am sure the whole House will welcome my hon friend's announcement of the report by Derek Morris on the actuarial profession. Can she tell us when she expects to receive that long overdue and much to be welcomed report?

Ms Kelly: I cannot agree with my hon friend's detailed point, although Lord Penrose suggests that the actuarial profession is in need of review. However, I can tell him that the review process should be completed by spring next year.

Life's about to get interesting – Along came Sir Derek

Along Came Polly, the top grossing film in Britain last week, stars Ben Stiller as an actuary. The movie's tagline is: 'For the most cautious man on Earth, life is about to get interesting.'

Life is certainly going to get interesting for Britain's actuaries. But unlike Hollywood – where Ben Stiller eventually gets Jennifer Aniston – the prospects for Britain's actuaries are somewhat less appealing.

They're getting Ruth Kelly instead.

And quite right, too. In the aftermath of the Equitable débâcle, the financial secretary to the Treasury has ordered a wide-ranging review of the actuarial profession, to be led by Sir Derek Morris, at present chairman of the Competition Commission.

It is in the nature of actuarial practice to make reliable and informed guesstimates about the future, and in that spirit, perhaps it's worth making a few guesses about what Sir Derek might conclude from his review.

He's likely to start out considering the basic role and function of an actuary, perhaps examining their four main duties within a life company.

First, actuaries calculate premium rates.

Well, as everyone with an endowment mort-

gage now knows, they failed on that score.

Second, actuaries conduct periodic valuations of assets and liabilities. Again, failure is widespread: just look at Equitable's £4.4bn black hole, Standard Life's enforced recalculation of its financial strength, and the once mighty Pearl's disastrous decline and squandering of its orphan estate.

Third, actuaries calculate and distribute bonuses to with-profits policyholders. Bonuses, what bonuses?

Fourth, actuaries set funding rates for pension schemes and payment rates for annuities. Here, longevity is the key. Yet amid all the evidence of an ageing society – improved diet, better medicines – actuaries have managed to mess up on this one, too.

The likelihood of actuaries getting it wrong in all four areas was probably near zero – as no doubt a stochastic Zillmer model (to use the jargon) would tell us. But it happened.

And now, what is the likelihood that actuaries – average pay after four years' experience: £100,000 – will get away with it again? Probably quite high, unless Sir Derek has the courage to take on Britain's cosiest clubby profession.

Guardian, 10 March 2004