

### **Case Study G3 — Another actuary's work**

You are employed by the Acquisitive Insurance Group, negotiating the purchase of an insurance operation, a subsidiary of Divestment Re, another Insurance Group. Part of the documentation you have seen is an actuarial report prepared for the insurance subsidiary by another UK actuary.

- (a) On reading the report you see that although it complies with GN12, the assumptions are somewhat unrealistic. What should you say and do?
- (b) Suppose that on reading the report you see that it does not comply with GN12, although there is no indication that the underlying work was deficient. What should you say and do?
- (c) Suppose that the underlying work was incompetent, for example by using methodologies unsuited to the classes of business under consideration, or using inappropriate data without adjustment. What should you say and do?

*Would your answers to the above questions differ if you were a consultant?*

## Discussion points

- (a) PCS 8.1 says that you can criticise if properly reasoned and you believe it to be justified. Therefore you can voice such criticisms of the other actuary's assumptions to your employer/client. But you need to acknowledge that other members may quite properly hold different professional opinions and that special circumstances may exist in any particular case (PCS 8.2).
- (b) *First you would ask the author of the actuarial report why GN12 was not complied with. It might be that what you have seen is an interim report, a work in progress or part of a larger report.*
- (Can fail PCS by e.g. not giving enough detail to allow the client to judge whether the recommendations are appropriate and what their implications are — PCS 3.5.)
- (c) There may be grounds to report the other actuary to the professional body. The PCS suggests that you try to resolve the matter with the other actuary first, but if this fails and the matter is material, then subject to confidentiality you have a duty to refer the matter to the professional body (PCS 4.4.5). *You would probably consult another actuary before doing any of this.*

*As a consultant, your interests are no different from those of your client, except that you are limited by the scope of your assignment – an employee would be less constrained about exceeding his or her scope. So all of the above should apply. It is likely that a consultant will be more circumspect in criticising another actuary – an employee is likely to feel able to speak more freely.*

## **Case Study G5 — Data quality**

You are the consulting actuary to a medium sized insurance company that has grown rapidly in recent years. Part of your engagement is to provide an actuarial certificate confirming the adequacy of the claims reserves. This certificate is included in the published Report & Accounts.

Over the past two or three years you have become concerned about the quality of the data. You have also heard market rumours that the company is suppressing case reserves in order to improve results. Staff turnover in the claims department is abnormally high. Two months ago the company's founder resigned as CEO "to spend more time with his family". You have raised your concerns with the company who have assured you in writing that the data are accurate. You have spoken to the auditors who have also confirmed in writing that they are happy with the data.

The incurred claims projections give reserves consistent with those the company wishes to book.

The Finance Director has just phoned to remind you that he needs your certificate by the end of the week.

*What would you do?*

## Discussion points

Which Guidance Notes is an “actuarial certificate” subject to? (Probably none.) Does the certificate need to be backed up by a GN12-compliant report, as required for Statements of Actuarial Opinion under GN18/GN20/GN33?

In general, it is reasonable to rely on or utilise the work of other professionals (GN12 6.1). But to what extent can you rely on the work of other professionals (e.g. auditors) if you think they've got it wrong? Is it enough just to draw attention to the shortcomings in the actuarial report (GN12 6.3)?

GN12 6.2 says you can use imperfect data if you think the results appear reasonable. The implication is that you can't use the data if you think the results are unreasonable.

How can you tell whether the results look reasonable? Is it enough that the projections of incurred claims (which incorporate the suspect case reserves) give reserves consistent with those the company wishes to book? No. The fact that the company has come up with similar figures is not an independent check on the reasonableness of the incurred claims projections. You could conduct projections of paid claims — which are unaffected by case reserves — and see if the answer is consistent with the incurred claims projections. (This point is a bit technical but it cuts to the core of data reliance.)

Is it practicable to draw attention to the data issues in the actuarial certificate? Not without your own evidence: you cannot write derogatory information in a professional opinion based on market rumours and gut feelings (both the company and the auditors wrote that they were happy with the data). If you were concerned enough, you would have to refuse to provide the certificate and face the consequences in respect of the client relationship and your fees.

The Morris Review recommended that the FSA should require general insurance companies to get advice from an approved person, not necessarily an actuary. If the approved person was an actuary and had to prepare an annual report on the financial condition of the company as part of the company's annual supervisory return, would this have helped in this case?

If the Case Studies finish before time is up:

### **Other contentious public-interest issues**

The first case study dealt with conflicts in a commutation situation. Was it implicitly assumed that an actuary will give a different report on the same issue depending on which side he/she was acting for? If so, is this “professional”?

Extended warranty business with loss ratios of 20% — should the Actuarial Profession point out that these things are a waste of money? (Arguably, the Actuarial Profession should have said this about personal pensions — were we in the pocket of our paymasters?)

Should we be pushing for certification of the reinsurance to close of Lloyd’s syndicates (as a sessional paper recommended in 2000)?

## Case Studies

### Case Study I1 — Advising a new client

You are an experienced consultant within the investment consulting practice of a firm of pension consultants. You have just been advised that you have been successful in acquiring a new client.

The Trustee was not happy with the advice received from the previous firm of consultants and is embroiled in an ongoing dispute with them. Besides this, the Chairman of the Trustees felt they were not proactive enough. He expects the appointed consultant to be his investment “eyes and ears” and to tell him when things should be changed. To start the ball rolling the Trustee has requested that you complete a full review of the Scheme’s investment arrangements, namely strategy, structure, and managers. At present, there are three fund managers, the Director of one these firms is also a Director of your firm. Your review is to take into account a large bulk transfer payment that is due to be received in relation to an acquisition that was completed last year. The monies from this are due within the next month. The Trustees do not want to invest the monies with the current managers until the review has been completed but at the same time do not want to be out of the market. The Trustee would like some advice from you on this matter. Given the Trustees want to act quickly as well as the fact that they want to keep the costs down due to the Scheme being poorly funded, the Trustees don’t want to wait ages for a complex report. Rather you are to attend a Trustees’ meeting in a few weeks time to discuss how you think matters should be dealt with.

*What professional and regulatory issues arise?*

## Discussion points

*What professional and regulatory issues arise?*

1. The Director of one of the fund managers also happens to be a director of your firm. You need to disclose this conflict of interest. Assuming that you knew the client had appointed the fund manager concerned prior to pitching for the business, you should have disclosed the conflict of interest during your new business presentation. In any event you should not provide any advice in relation to the manager concerned without disclosing the conflict of interest.
2. It is not clear whether or not you will be conducting Investment Activities as defined by the Financial Services Authority (FSA) or the Institute of Actuaries via its Designated Professional Body Status (DPB). This needs to be checked out and if necessary ensure all required documentation/disclosures required by the FSA/DPB are issued to the client. This should be done before any Investment Activities are carried out.
3. You need to obtain details on the dispute between your client and their previous adviser. You should raise the matter with the client and consider whether it would be appropriate to consult with the previous advisor. If you decide that you should consult the previous advisor, you should obtain permission from your client. If they refuse or will not provide you with the background information you require, the appointment should normally be declined.
4. The extent of your responsibilities needs to be made clear in your contract and you must ensure you do not stray into areas that you are not competent to deal with. There is a significant difference between strategic advice, which relies on providing clients with a periodic review of their investment arrangements and short term tactical advice that requires day to day monitoring. Given the clients' "eyes and ears" comments, which imply day to day monitoring, you need to be sure this is something you are competent to deal with, in terms of knowledge as well as internal resources. The scope for a potential E&O claim if the necessary resources etc. is not in place is significant.
5. It should be pointed out to the client that whilst you can present your advice verbally at the Trustees' meeting, the Trustees are required in law (the Pensions Act 1995) to have all advice confirmed in writing. A letter should be issued to the client detailing what you will be doing for them, including the extent of any written advice required, along with an estimate of your fees as well as the time frame required to carry out the work required. If the client pressurises you to reduce costs or shorten the time frame to the extent that it is likely to bring into question the quality of your advice, then you should decline to act or only do so on the basis that your advice will be qualified.
6. The key item on the agenda at the initial meeting is likely to be how to deal with the bulk TV. This may involve discussion on the use of derivatives and out of market risk. There are a wide range of risk warnings that will need to be given. Unless you are going to have time following on from the Trustees meeting to formally confirm your advice in writing you should issue your letter to the Trustees at the meeting. There is huge scope for misunderstanding in this area that could lead to an E&O claim and question the professional integrity of the adviser and hence the Profession.

## Case Study I3 — Audit trail

You have recently secured a new investment consulting mandate to the Trustee of a UK pension scheme, the size of which is substantial relative to that of the sponsoring company. You are not appointed by the sponsoring company. The Finance Director of the sponsoring company is about to retire after 20 years with the company as Finance Director as well as a Trustee. You are invited to the retirement party at which you are introduced to the new Finance Director (FD), who due to concerns over conflicts of interest, declined the request to join the Trustee board. During your discussions with the new FD he mentions his concern over the poor state of funding of the Scheme and would like to have a chat with you at some point.

A meeting is duly arranged. The FD comments that whilst he is concerned over the poor state of the Scheme's funding it is not that per se that he wishes to talk to you about. He asks for your thoughts on something he discovered during a review of the pension scheme files. In particular, he noted on a file a draft investment strategy review report from the previous investment consultant to the Trustee dated December 1999 recommending a reduction in equity allocation from 80% to 45%. However, whilst the audit trail on file is not complete, it appears there was some resistance from the sponsoring company at the time and in particular the outgoing FD to such a significant change. The final signed off report from your predecessor includes a recommendation to reduce the equity allocation from 80% to 60% and not the 45% referred to in the draft. The FD's concern is that the advice given was swayed by the protestations of the outgoing FD. The FD questions the integrity of the previous investment consultant noting that if the Trustee had followed the advice in the draft report the Scheme would be in a much healthier state. The FD is wondering whether there is a case to make a claim against the previous advisers.

*How would you deal with the situation you find yourself in?*

*What professional issues arise?*

*If you found yourself in the position of the previous investment consultant being pressurised to change your advice, how would you deal with the situation?*

*Does it matter where the pressure is coming from i.e. company or Trustee?*

## Discussion points

*To be developed further — the following bullet points have been fed back from discussions at Professionalism Events*

- What were the terms of reference of the draft report — did they change?
- It is easy to be wise in hindsight.
- If you change your recommendations, document the change — ensure there is an audit trail
- Need much more information about the earlier situation.
- You cannot advise the FD as the Trustees are your client, not the company. It would have been better not to have met the FD but to have directed him to the Trustees.
- You could say there may have been valid reasons for the change. You could talk, for instance, about the long term vs the short term strategies without discussing this case.
- The FD should raise his concerns with the Trustees and, or the previous adviser.
- The FD may need legal advice.
- You should notify the Trustees of your conversation.
- The previous adviser should have been careful in phrasing the final report so that it reflects, explicitly, any discussions between the drafts. You could have presented the Trustees with a range of equity allocations and risks and left them to argue with the FD. You need to resist pressure, whether from the company or the Trustees.
- If pressurised, point out the risks and consequences.

## Case Study L7 — Capital injections

You are the Actuarial Function Holder of a UK life company, whose parent is based in the Far East. The company is set up as a proprietary company in the UK, and has a local Board, on which the Chief Executive of the parent company sits. As the Actuarial Function Holder, you have full rights of access to your local Board. However, after several meetings, it becomes apparent that the real power is not held in the Board, but by the Chief Executive and his Board colleagues in the Far East. The local Board is there purely as a dressing tool to satisfy UK authorities. The company's forthcoming plans indicate that a capital injection will be required, in order to retain the company's competitive free asset position. You refer the matter to your local Board, who note and agree your concern, but say that it is nothing to do with them, merely one for the parent. The Chief Executive of the holding company advises you that he will decide what capital you will get, and the report is to go no further. He points out that with all the money invested in the UK, the company will not let it go insolvent and will decide, as and when appropriate, as to what money to input to the company.

What should you do?

## **Discussion points**

How serious is the solvency position? You need to assess the risk of going insolvent and the adverse effects of any restrictions on investment freedom, etc.

Discuss with the FSA and/or ensure that management does.

Even if position is not deadly serious, the Actuarial Function Holder does not have access to the decision-making Board. He or she should have such access and if it is denied, the situation needs to be discussed with the Chief Executive and if it is not resolved satisfactorily the FSA would need to be informed.

You need to point out to the Chief Executive the possible implications for the company of not having the capital when it is needed, but there could be some doubt as to how well he or she will understand these implications.

It would be possible to get a second opinion from the Faculty/Institute.

Is the problem in the Case Study a professional or a commercial one?

The parent is not a financial company, which will probably mean that it will be harder to explain the implications of their actions to them.

It is essential to ensure that a foreign owner knows what UK practice and statutory requirements are.

## Case Study L8 — Model office projections

You are the actuary responsible for forecasting in a life company. As part of your normal annual work, and in particular as part of the Financial Condition Report work, you work out the effect of increasing charges to policyholders in a variety of different ways. The base level scenario indicates that the company does not make much profit and certainly does not achieve the targets it has set itself. If the extra charges were to be made to the policyholders, then the position would be different, and both profits and internal targets would be achieved. You know, from your own market research, that if the charges were to be increased to levels you suggest that these charges would be well in excess of the market norm.

What should you do?

Suppose that you were instead the Actuarial Function Holder and that the forecasting actuary briefs you on his work. What should you do?

## Discussion points

What is your role? It appears to be solely to produce forecasts.

There will be TCF considerations, and PRE and commercial issues. The Principles and Practices of Financial Management will set out the position in respect of with profits business. The With Profits Actuary should advise on any implications for with profits business.

You need to discuss with the Actuarial Function Holder because of the TCF and PRE issues and the possible effect on the statutory valuation assumptions as the company could experience high lapses.

You need to discuss with the company's legal advisers to see if the policy conditions allow charges to be increased.

You need to check that the market research is reasonable and check with those who formulate company policy that the proposal will not impinge adversely on that policy.

You need to check that the assumptions used are realistic.

The company can do what is suggested in the FCR, provided that they appreciate the commercial implications of it. Hence these need to be spelt out.

There may be a conflict here between TCF/PRE and maintaining the profitability of the contracts. Should you be considering TCF/PRE? In any case, will there be a conflict given that increasing charges could lead to higher lapses and hence lower profits?

The directors need to be kept aware of TCF/PRE implications.

Should you say no to increasing charges in order to maintain profits? Perhaps you should say no if the scheme to increase profit harms policyholders.

## Case Study L9 — With Profits Guarantees

A well-known mutual life office is now facing financial difficulties and adverse press coverage following a High Court ruling on issues relating to the management of its with profits business. The Court found that the bonus philosophy which the life office had operated for some years had not satisfied Policyholders' Reasonable Expectations. For certain classes of policyholder this has resulted in policy benefits being enhanced with a consequent, very substantial, increase in the office's liabilities. As a direct result the office has been forced to close to new business.

You are now a senior life actuary at another life office, having previously worked, in a much more junior capacity, at the troubled mutual. You have been invited to join a working party being established by the Institute and Faculty of Actuaries to examine implications of this affair for the profession. The working party plans to focus particularly on the future of the Actuarial Function Holder role.

1. What factors would you consider before accepting the appointment?

A press conference has been arranged to announce the establishment of the working party and to explain its objectives. Past press coverage of the mutual life office's problems has been critical not only of the management of the company but also of The Actuarial Profession with comments noting that the Appointed Actuary role has been abolished and that the Profession failed to act in the public interest. The journalists responsible for these articles are all expected to be present.

2. Prepare a five minute summary of opening remarks you think the working party members should make at the press conference.
3. Prepare a list of questions you think the journalists would raise.

### Role play (press conference):

Each group (alternately) to take the roles of:

- (a) the working party; and
- (b) the journalists

## Discussion points

The following summary reflects the points made by delegates at the Professionalism Course held on 12–13 June 2003, and which the Principal Lecturer can use in any way that may help assist in the discussion.

### Introduction

- Actuarial Profession accepts responsibility to lead the debate.
- ...not to comment on past actions...
- ...but to make recommendations for the future
- will consult interested bodies
- will publish in two months
- could use the press conference to reassure the public

Journalist's Questions	Working Party's Response
Who are the members and what is their relevance?	Chairman admitted being a junior employee of XYZ Life <b>(but needed help in coping with adverse comments!)</b>
	Will investigate past in detail but only so as to recommend for the future.
	<b>(Principal Lecturer commented need to explain why each member has been chosen.)</b>
WP looks like a self preservation exercise!	WP will consult with other bodies to avoid this.
How can a WP made up of actuaries realistically tackle the issue?	With their knowledge of the issues, actuaries can best tackle this objectively and will consult with others to ensure a wider view.
Will WP explain the detail of the issues involved?	No
How will the Actuarial Professional Conduct Standards impede you — you are not allowed to criticise another actuary?	WP interpretation is that debate/discussion is encouraged and criticism will be done constructively.
	Not looking to comment on the past, but to advise on the future.
	<b>Not</b> a disciplinary role.
Are the issues common across the industry?	Expect this to be a unique case but will identify lessons to prevent similar events occurring in the future.
From the Actuarial Guidance Notes, lots of issues look very grey — are you intending to make these more "black and white"?	May do, but with profits will always require subjective judgement though may necessitate better disclosure.

Do you expect to introduce sanctions for failing to comply with your recommendations?	Accountability will be looked at.
Will policyholders be compensated?	
Is there a conflict given that legal issues are still being considered?	

**Principal Lecturer added the following:**

What are policyholders' reasonable expectations?

Why couldn't the Actuarial Function Holder/With Profits Actuary define this correctly?

What is endowment assurance with profits/how does with profits work?

**The Principal Lecturer also needed to give a resume of the Equitable story as not all knew about the guaranteed annuity rate problem, the consequences and that this was not restricted to the Equitable.**

**From 2005, need to consider implications of treating customers fairly.**