
Case Study L9 – With Profit Guarantees

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Agenda

- ▶ The story so far
- ▶ Scope
- ▶ The three questions
 - ▶ Taking on the project
 - ▶ Main points to raise
 - ▶ Likely journalist questions and response
- ▶ Future vulnerability with PRE



The story so far

- ▶ 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.
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The story so far

- ▶ 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.



The story so far

- ▶ 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.
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Scope

- ▶ Not a discussion of the technical aspects of the case, but the professional implications and any lessons for the IAI
- ▶ Very much a forward looking analysis
- ▶ **So what are our questions?**
 - ▶ What factors would you consider before accepting the appointment?
 - ▶ What opening remarks should the working party members make at the press conference?
 - ▶ What questions might the journalists raise?



Taking on the project

What factors would you consider before accepting the appointment?



Taking on the project

▶ **Actuaries Act 2006:**

- ▶ To promote, uphold and **develop the standards of professional education**, training, knowledge, practice and conduct amongst Actuaries;
- ▶ **To promote the status of the Actuarial profession;**
- ▶ To regulate the practice by the Members of the profession of Actuary;
- ▶ **To promote, in the public interest, knowledge and research in all the matters relevant to Actuarial Science and its application; and**
- ▶ To do all such things as may be incidental or conducive to the above objects or any of them. Charitable Trust Act, 1950. In 1989, the ASI started examinations up to Associate level, and in 1991.



Taking on the project

▶ Vision

- ▶ IAI to be a **globally well recognised** professional organisation, developing thought leadership to manage uncertainty of future financial outcomes

▶ Mission

- ▶ To educate/train risk professionals
- ▶ To enhance and maintain high professional standards
- ▶ To shape Public Policy and Awareness
- ▶ To engage with other professional/regulatory/government bodies
- ▶ **To promote/build IAI as a respectable Brand of risk management globally**
- ▶ To promote research, to advance actuarial science/application

▶ Value

- ▶ Integrity
 - ▶ Respect for others' views
 - ▶ **Accountability**
 - ▶ Continuing learning/Research oriented learning
 - ▶ **Transparency**
 - ▶ Be responsive/sensitive
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Taking on the project

▶ **Professionalism and Ethics Committee**

- ▶ Set up of Actuarial Standards and monitoring compliance
- ▶ Set up of Criterion for and Issuance of Certificate of Practice (CoP)
- ▶ Set up of criterion for Continuing Professional Development (CPD) and monitoring compliance
- ▶ Conduct of CPD/ Professionalism/ Ethics courses/seminars
- ▶ Other functions that may be assigned to this Committee from time to time by the Council

▶ **Advisory Group on Professionalism, Ethics & Conduct**

- ▶ Inculcate high level of Professionalism amongst members through delivery mechanism that is effective,
- ▶ Develop robust code of conduct, Actuarial Practice Standards and its compliance mechanism,
- ▶ Encourage, motivate and incentivise compliance with code of conduct and Actuarial Practice Standards,
- ▶ Advise on implementation of Disciplinary provisions within the framework of Actuaries Act 2006, that is just, fair and meets the ends of justice within the requirements of principles of public interest,
- ▶ Run Professionalism courses that meet the requirements of the profession on its members to be ethically compliant at all times.



Taking on the project

- ▶ Can I criticise my profession?



Professional Conduct Standards

- ▶ 2.2. A member has a duty to the profession and must not act in a manner, which denigrates its reputation or impugns its integrity. Responsibility to any client must be consistent with that duty. The requirements of this paragraph do not, however, preclude **criticism of the profession** which forms part of a **justifiable debate conducted in the public interest**.



Professional Conduct Standards

- ▶ 8.1 Members must avoid any action that would unfairly injure the professional reputation of any other member. Criticism of one member's work by another member is acceptable, provided that the **criticism is properly reasoned and believed to be justified.**



Taking on the project

- ▶ Can I criticise my profession?
 - ▶ Must be constructive and justifiable
 - ▶ Need to have sensitivity to colleagues
- ▶ Am I personally qualified to participate?



Professional Conduct Standard - Conflict of Interest

- ▶ 5.1 Clients are entitled to assume that advice given by an actuary is unaffected by interests other than those of the client, taking account of any identifiable professional or legal duty of care of the client in respect of a third party.
- ▶ 5.2 If there is or might appear to be a conflict of interest between two or more clients of an actuary or of the actuary's firm, or a conflict between a client and the member or the actuary's firm, the actuary **must consider the nature and extent of the conflict** and whether it is such as to make it improper for the actuary to give advice to one or more of the clients involved in the conflict.



Taking on the project

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 - ▶ Must be constructive and justifiable
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- ▶ Am I personally qualified to participate?
 - ▶ Conflict of interest
 - ▶ Need to disclose my past service
 - ▶ Uniquely qualified to comment



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 - ▶ Uniquely qualified to comment
- ▶ Am I legally allowed to participate?



Professional Conduct Standards

- ▶ 2.5.1. As a matter of law, information acquired by an actuary in the course of professional work is frequently confidential to the actuary's client or the actuary's firm. As such, it should not normally be disclosed unless consent has been obtained from the actuary's client or the actuary's firm, as the case may be.



Professional Conduct Standards

- ▶ 2.5.2 There are, however, circumstances in which, despite the normal duty of confidentiality, an actuary might in law be:
 - ▶ obliged to disclose confidential information, either by virtue of statutory or judicial authority or by virtue of other guidance by which the client is bound, or
 - ▶ free to disclose confidential information if it is in the public interest to do so, or
 - ▶ in some circumstances, if it is for the actuary's own protection.
- ▶ An actuary may wish to seek legal advice before invoking this provision



Taking on the project

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- ▶ Am I legally allowed to participate?
 - ▶ Should seek legal advice
 - ▶ Be sensitive to information that is in the public interest vs. proprietary



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Main points to raise

What opening remarks should the working party members make at the press conference?



Opening Remarks

- ▶ Actuarial Profession has prided itself on setting and keeping high standards in serving the public, its clients and employers
- ▶ As a Professional body we learn from our mistakes
- ▶ As a Professional body we regularly monitor our standards for the better
- ▶ We undertake continuous steps for improvement
- ▶ The Institute of Actuaries has formed a Working Party



Objectives of Working Party

▶ Objectives of the WWP

- ▶ To suggest a roadmap for better with profit fund management
- ▶ To explore whether discretion in with profit business can be better managed keeping in mind PRE
- ▶ To explore the requirements of Treating Customers Fairly for WWP business
- ▶ How to bring transparency to the principles and practices of WWP fund management
- ▶ Detailed reporting requirements & disclosures
- ▶ To consider the non-regulatory, internal users / clients / 'customers' of the Actuarial Function and their requirements and expectations.
- ▶ To discuss issues of independence, conflicts of interest and the appropriate segregation of responsibilities in the context of the Actuarial Function
- ▶ To monitor developments in this area



Indian Context

APS I – Appointed Actuary & Life Insurance Business

- ▶ The Appointed Actuary must have regard to policyholders' reasonable expectations when determining the value of the liabilities.
- ▶ The Appointed Actuary must advise the company keeping in view the provisions contained under **Section 49 of the Insurance Act, 1938** as to how much of any surplus be distributed to policyholders or transferred to shareholders and recommend the allocation thereof.
- ▶ AA should be satisfied that groups of with-profit contracts are appropriately and equitably treated having regard among other things to the terms of the policies, their duration and their relevant pooled experience



Indian Context

Insurance Regulatory and Development Authority (Appointed Actuary) Regulations, 2000

- ▶ A life insurer shall not carry on business of insurance without an appointed actuary.
- ▶ Complying with the provisions of the section 64V of the Insurance Act, 1938 in regard to certification of the assets and liabilities that have been valued in the manner required under the said section.
- ▶ Certify that the mathematical reserves have been determined taking into account the guidance notes issued by the Actuarial Society of India and any directions given by the Authority
- ▶ Ensure that the policyholders' reasonable expectations have been considered in the matter of valuation of liabilities and distribution of surplus to the participating policyholders who are entitled for a share of surplus



UK context

GN 40 – Role of Actuarial Function Holder

- ▶ To advise management on the risks being run by the firm that may affect the long-term liabilities relating to policyholders, and on the capital required to support the business on an ongoing basis.
- ▶ To monitor these risks and inform the management of any concerns that the firm may fail to meet its liabilities, including with regard to the terms on which new business is written.
- ▶ To advise the firm's governing body on the methods and assumptions for actuarial investigations, to perform the investigations and to report the results to the firm's governing body. The actuarial investigations include those relating to solvency.
- ▶ Liaison with the With-Profits Actuary in key aspects of discretion, and the need to ensure that the management is aware of the Actuarial Function Holder's interpretation of policyholders' reasonable expectations and obligations to treat customers fairly.



UK context

GN 41 – Role of With Profit Actuary

- ▶ To advise management on key aspects of the discretion exercised affecting with-profits business and to produce a report to the firm's governing body covering this advice at least once each year.
- ▶ To advise management whether the assumptions used to calculate the With-Profits Insurance Capital Component (WPICC) are consistent with the Principles and Practices of Financial Management (PPFM).
- ▶ To produce a publicly available annual report for policyholders. This report must confirm whether or not, in the opinion of the With-Profits Actuary, the firm has properly taken policyholders' interests into account in exercising its discretion and whether it has treated its customers fairly.



Likely journalist questions

What questions might the journalists raise?



Likely journalist questions

- ▶ **The general public:**
 - ▶ Are you a part of the company? Are you independent?
 - ▶ How can actuaries truly review other actuaries?
 - ▶ Who is regulating you? Whether they are tough enough?
 - ▶ How long has it been going on for? How long was this left unchecked?
 - ▶ Will this episode effect other companies/mutuals?
 - ▶ Was this a member error or a professional error? What are the punishments?
 - ▶ Are we supposed to believe the AA was acting in the public interest?
 - ▶ Is the pool of talent deep enough? Only 250 Fellows?
 - ▶ How can we be sure while buying participating product that we are not cheated?
 - ▶ What is the role of regulator in these scenario?



Likely journalist questions

- ▶ **The technical questioner:**
 - ▶ PRE is central to all guidance (APSI,2,3 etc.) is this just talk?
 - ▶ How does your professional guidance compare to other territories? What about the industry regulations?
 - ▶ Reviewing actuary (newly added) and With Profits Actuary are missing?
 - ▶ Who signs off on the valuation?
 - ▶ The bonus philosophy was the problem, are you checking these philosophies or making them publicly available
 - ▶ The bonus philosophies are really inconsistent across companies, as are asset share approaches, is this not asking for further trouble?
 - ▶ Is the Appointed Actuary too revered and not challenged?
 - ▶ Is there any additional reporting requirement for With Profit business?
 - ▶ How the surplus are shared with Policyholders?
 - ▶ Is there any practise or procedure to check that loss making New Business are not written in participating Fund?



An aside: The Equitable Life Story

Source: Wikipedia

- ▶ Large with-profit fund giving substantial terminal bonus
- ▶ At inception, policyholders could choose a Guaranteed Annuity Rate (GAR) to be used at retirement or the market rate
- ▶ Equitable worked under the assumption that they could reduce terminal bonuses on GAR policies to offset the cost of the guarantee
- ▶ In July 2000 the UK House of Lords Judgement stated that this conflicted with the reasonable expectations of the policyholders



An aside: The Equitable Life Story

- ▶ As a result of the Equitable Life case the UK Actuarial Profession was heavily criticised for its role.
 - ▶ Penrose report
 - ▶ Morris Review of the Actuarial Profession
- ▶ The Appointed Actuary was abolished and replaced with the Actuarial Function Holder (AFH)
- ▶ While the AFH has many of the roles of the AA, the statutory valuation was now to be signed off by the board and hence open to audit
- ▶ Requirement for a Reviewing Actuary



Future Vulnerability - PRE ?

- ▶ “The future reversionary bonuses are set so as to exhaust the **asset share**. Thus the reserve includes a provision for future bonuses at a rate consistent with the valuation rate of interest”
- ▶ For par policies, the reserves are calculated by taking into account the future reversionary bonuses... as per the policy **terms and conditions**. This is in line with our **illustrations** demonstrated to the policyholders”
- ▶ “Bonuses are declared after evaluating **bonus earning capacity** of each product... so that bonuses are equitable for groups of policyholders. Bonuses are smoothed and are based on pooled experience.”
- ▶ “Terminal bonuses are set ... as the **excess** of projected asset share **over guaranteed maturity benefits**”
- ▶ “Bonuses are valued at **current declared rates**”



Conclusion

Thank you

