

THE SOCIETY OF ACTUARIES IN IRELAND



**Presidential Address
Colm Fagan, FSAI
27 September 2005**

Introduction

This is a special evening, not only for me as I embark on my two years as President of the Society of Actuaries in Ireland, but also for the 21 new Fellows who receive their Fellowship scrolls this evening, and not forgetting another 3 new qualifiers who can't be with us tonight. Please join me in congratulating all of them on their achievement and in welcoming them as new Fellows of the Society of Actuaries in Ireland.

I am very pleased to see quite a few former colleagues (and current colleagues, of course) and mentors from previous actuarial lives. Thank you all for your help, wise counsel and advice over the years, even up to earlier today for some of you!

We also have a number of guests here this evening. I am particularly pleased to welcome our golfing colleagues from the Faculty of Actuaries, who are here to play a match against a team from the Society of Actuaries in Ireland tomorrow.

Most of all, I am delighted to welcome my wife Mary to this evening's meeting. She has been the most important person in my life ever since my days as a student actuary, and she shared with me the joys and disappointments of exam success and failure. She has also been a great source of support and encouragement throughout my professional career. Thank you Mary. It means a lot to me that you have been able to join us this evening.

Like Mary, the actuarial profession has been part of my persona for virtually my entire adult life. I remember the great sense of achievement on learning that I had been accepted into the profession. I still feel very lucky to be part of a profession that plays such an important part in the economic life of our country. My hope is that, in some small way, my work as president over the next two years or so will help ensure that it remains a great profession throughout the working lives of today's new qualifiers, and for long afterwards.

Our profession faces some immediate and serious threats however, and if we don't take urgent action to address them, then a combination of adverse events could do irreparable damage to the reputation of the actuarial profession in Ireland.

I propose to concentrate this evening on identifying those threats, examining how they could derail us, and stating what I think we need to do to avert them.

Enormous Responsibilities, Few Safety Nets

As I take up the mantle of the Presidency, I am acutely conscious of the responsibilities that government, regulators and society at large have placed on the profession's shoulders. They have put their trust in us to certify the amounts that insurance companies and pension funds need to set aside now and in the future to meet the benefit expectations of policyholders or pension scheme members.

In monetary terms, the extent of that trust is enormous. Just 160 or so Fellows of the Society of Actuaries in Ireland, or approximately one-third of our Fellow members, are responsible for certifying total liabilities of more than €120 billion to policyholders of insurance companies and members of defined benefit pension schemes. Putting it another way, this small group of people is responsible for certifying the security of liabilities equivalent to more than €30,000 for every man, woman and child in the country.

The quality of their work and the integrity with which they are seen to discharge their responsibilities have a clear and direct impact on the reputations of all actuaries, including those who do not occupy, and have no intention of ever occupying, statutory roles.

The extent of the trust that the state and regulators place in the actuarial profession is even greater when one considers that there is very little oversight or scrutiny, either by the profession itself, or by the regulators, Boards of Directors, pension trustees, or auditors, to confirm that that the actuary's calculations are accurate representations of the liabilities.

This lack of independent external scrutiny leaves the profession, and individual actuaries, extremely exposed should anything go wrong. We're on a high wire with no safety net.

The risks are increased by the fact that, in many areas of our work, there are no clear black and white answers, only varying shades of grey. Our guidance notes give considerable scope for different actuaries to give different answers to the same or very similar questions. This is where professional judgement comes into play. Professional judgement is vitally important, and it is often what justifies the high salaries we receive or the high fees we charge clients for our services, but "professional judgement" can sometimes be an excuse for woolly thinking, or even at the extreme for deriving answers that suit clients' interests rather than those that are objectively correct.

We must take all necessary steps to reduce or eliminate the risk that the siren call of misguided "professional judgement" might cause us to suspend our powers of rational analysis in favour of an approach that suits our clients' vested interests, in favour of an approach that makes for an easier life in the short-term, but which does not stand up to close challenge and scrutiny from our fellow professionals or from other experts, and thus can lead to disaster in the longer term.

Taking the Right Approach, Institutionally and not Intuitively

To borrow a phrase from the UK Financial Services Authority, we must institutionally and not intuitively take the right approach to solving the difficult technical, business and ethical problems that confront our members on a regular basis. Too often, under the cloak of "professional judgement", we take an intuitive approach to solving problems when a more structured, institutional approach would be more appropriate and would yield more consistent results.

In our work, we should strive to be consistently rigorous in our thinking and true to our rational and mathematical roots. As a profession, one of our goals should be to try to ensure (as far as is reasonably possible) that two actuaries faced with doing the same piece of work will produce roughly the same answers – or at least can provide good and clear reasons for their differences. As my predecessor Bill Hannan stated in his presidential address, there are circumstances where we must replace the judgement of the individual actuary with the collective judgement of the profession. This is where clear, precise professional guidance come into play.

We must go further, however. Commercial interests have the potential to cloud not only the judgement of the individual actuary but also the collective judgement of the profession as a whole. This is an inevitable consequence of self-regulation, where member support is needed for the introduction of new standards or to make changes to existing standards, and where there is no external counterforce to challenge the internal consensus. Against this governance background, it is difficult if not impossible to set actuarial standards at a level that meets the public interest rather than the interests of the providers of advice.

The actuarial profession in Ireland can claim with some justification that it has taken the long view and has done its best not to pursue short-term self-interest when developing its system of Guidance Notes. Nevertheless, it would be foolhardy of us to presume that an independent and unbiased reviewer of the actuarial profession in Ireland would come to a conclusion very different from that reached by Sir Derek Morris in his recent review of the UK profession. His verdict on the profession was that its professional standards were weak, ambiguous, or too limited in range, and that they could be perceived as being influenced by commercial interests. I fear that we could suffer a similar fate if our standards were put under a similar spotlight.

Thus, it seems to me that, in order to minimise the risk exposure of the profession itself and of its individual members, the rules and guidance for how we discharge our statutory responsibilities should be documented clearly, precisely and with minimal scope for ambiguity. There must also be a counterforce to the natural bias that exists in any self-regulating organisation against doing anything that could prove unacceptable or controversial to members.

In fact, one of the new Council's very first acts following its election earlier this summer was to commit itself to working towards the establishment of such a counterforce, i.e. a body independent of the Society of Actuaries with responsibility for setting actuarial standards. We will look to government and regulators for support and input to the establishment of such a body.

There are a number of models for the counterforce. Looking to our nearest neighbours in the UK, a new Board of Actuarial Standards is being established under the auspices of the Financial Reporting Council (FRC). The Morris report recommended that the UK government should legislate to provide the FRC with statutory powers to set actuarial standards and to oversee the regulatory activities of the actuarial profession. Presumably, a similar solution for the actuarial profession in Ireland would require the Irish government to pass similar legislation to empower the FRC – or an equivalent Irish statutory body - to set actuarial standards and to oversee the regulatory activities of the actuarial profession in Ireland.

An Irish Solution to an Irish Problem

However, while I understand that the FRC's remit extends to Ireland for some aspects of accounting standards, a similar approach is unlikely to be feasible for actuarial standards. Unlike accounting standards, actuarial standards can be quite country specific. For example, there is no equivalent in the UK of the PRSA actuary or of our signing actuary role for non-life insurers. There are also significant differences between our two countries in the approaches taken to calculating transfer values in defined benefit pension schemes and in relation to the actuary's responsibilities for prudential supervision and consumer protection in life assurance. Thus, an extension of the FRC's remit to include Irish actuarial standards would involve a host of new issues that would be difficult for it to justify in economic terms. As in other areas of Irish social and economic life, we need to find an Irish solution to an Irish problem.

Other countries where the actuarial profession discharges similar statutory roles in a similar supervisory environment have devised different solutions to the problem from that now being proposed in the UK. We intend to look to their experience for possible solutions, as well as exploring in greater detail the option of linking to the UK in regulatory terms.

Whatever the differences in the various models adopted in different countries, they all involve the establishment of a standard setting body independent of the profession. We are committed to following the same path.

Advantages of Detailed Regulations

There are a number of ways of achieving the objectives of clarity of documentation and absence of bias in the standards and guidance for actuaries discharging statutory duties. Each has its advantages and disadvantages.

The UK has taken one approach to overcoming the twin evils of weak or ambiguous standards and bias in their construction.

Over the last year or so, I have had the dubious pleasure of working under the FSA's very detailed regulations and guidance for how a UK life insurer's liabilities should be calculated and how the actuary and the insurer's governing body should exercise their powers of discretion, for with-profits business and otherwise.

This has been an interesting and enlightening experience.

Working in a highly regulated environment has a number of major advantages. One of the biggest is knowing that the results you derive and place before the Board of Directors or Trustees for their consideration are very similar to those that another actuary would derive in the same circumstances. Another advantage is that it is relatively straightforward to explain to the Board and management the context and considerations governing the choice of valuation assumptions, because the FSA has produced copious documentation on how those assumptions should be derived. The route is clearly marked.

So, for instance, we are told what assumptions it is reasonable to make when estimating the proportions of future retirees who will opt for tax-free cash in preference to the much more valuable (and much more costly) guaranteed annuity option. Rationally, in current financial conditions, almost no one, except those with impaired life expectancies, should opt for the tax-free cash, but in practice almost everyone behaves irrationally and takes the maximum cash allowable. Without clear guidance, each individual actuary could make his or her own assumptions on future take-up rates for guaranteed annuity options, and each would be able to justify their assumptions with varying degrees of confidence, and with consequent variations in the calculated liabilities.

Here and elsewhere, the clarity and objectivity of the FSA's published rules and guidance reduce significantly the scope for variations in individual actuaries' assessments of liabilities, while its independence from the profession eliminates the risk of bias identified earlier. In this highly regulated environment, the need for professional guidance is reduced, or possibly even eliminated. Nevertheless, it is still extremely challenging from a technical and professional perspective: I can assure you that there is no risk of the actuary being relegated to the role of automaton.

Implications of “Light Touch” Regulatory Regime

The situation in Ireland is far removed from that applying in the UK. Where the FSA has published reams of regulations and guidance, and has incurred enormous costs in doing so (which it in turn has charged back to the industry) the Irish Financial Regulator has taken a very different approach. It has sketched out a high-level outline of what is required and has relied on the actuarial profession to fill in the detail. The same is true in pensions, where the Pensions Board and the Department of Social and Family Affairs have published high-level regulations, with the Society of Actuaries in Ireland producing guidance notes to help individual actuaries interpret the regulations.

This partnership, where the regulator or the state provides the high level input and the Society of Actuaries - or individual actuaries exercising their professional discretion - fill in the detail, has resulted in considerable savings for the Financial Regulator and the Pensions Board. Arguably, it is also good for the status of the actuarial profession in Ireland in that it effectively devolves to the Society and to individual signing actuaries much of the responsibility for the interpretation and practical implementation of legislation in the insurance and pensions arenas.

The problem is that our guidance notes have not filled in sufficient detail to meet the demands of modern society. They need to be made more precise in order to satisfy the objective of making sure that different actuaries charged with doing the same piece of work will come up with broadly the same answers, and of minimising the scope for ambiguity.

We have achieved precision in some of our Guidance Notes, especially the more recent ones, but in my opinion we need to go further. Achieving that higher level of precision in the wording and content of all our guidance notes requires a significant amount of high quality input from members. To date, this input has been almost exclusively on a voluntary basis. We appreciate members' generosity in giving so much to the profession for so little reward. The Society is also lucky to have a dedicated professional resource in Aisling Kennedy, our Director of Professional Affairs. Aisling, with her wide experience in pensions, health and life insurance, does sterling work across all practice areas to improve the quality and comprehensiveness of our guidance to members. Nevertheless, it is impossible for one person, no matter how good, and with the voluntary support of members, to do all that is required to achieve the level of precision needed to ensure that our guidance notes meet today's more demanding requirements.

The profession simply doesn't have the resources on its own to do what is largely done by government or state-appointed regulators in other countries, where the cost is borne by the industry being regulated rather than by the actuarial profession, as is largely the case in Ireland. Our resources are already quite stretched in continuing to provide the current level of regulatory support. We need a new framework if we are to make significant progress from here.

My vision is for the Society of Actuaries in Ireland to continue to work closely with the regulators and relevant government departments towards achieving the highest standards of prudential oversight and consumer protection for policyholders and pension scheme members. I believe that we can achieve far more by working together than by each of us pursuing our own separate agendas. I would go further and say that, in a small country like Ireland, we simply cannot afford to dissipate our combined resources, given that, as a nation, we don't have the economies of scale in regulatory terms that are possible in larger countries. Without us all working together, the costs of regulation and oversight would be too onerous for a small country. In order to preserve the security and good reputation of Ireland's insurance companies and defined benefit pension schemes, we have no real alternative but to pool our efforts for the greater common good.

Ensuring Compliance with Regulations and Guidance

The steps outlined above should help significantly to reduce the risks to the profession, as identified earlier.

However, we still have to cater for the possibility that there are rogue actuaries out there, actuaries who might choose deliberately to flout even the clearest and most independent guidelines in the world. I hasten to add that we have no evidence of such rogue actuaries in our midst, but as experts in risk it would be foolish of us not to plan on the basis that at least one of our members could be a bad apple.

From a risk management perspective, the profession is completely and utterly exposed. In life assurance, the actuarial valuation of liabilities for solvency purposes and the actuary's annual certificate to the Financial Regulator are subject to neither peer nor audit review. There is even a question mark over the extent of the Board's responsibility for approving the amounts shown in regulatory returns for actuarial liabilities to policyholders. It is hard for outsiders to believe that there is so little oversight of the solvency certification of more than €70 billion of Irish life insurers' liabilities to policyholders. It is a tribute to the professionalism of our members that there hasn't been a single scandal to date in relation to the solvency supervision of life insurers. It would be absolute madness on all our parts – actuaries, regulators and legislators - to continue blithely on our way, assuming that just because there have been no major problems in the past and that everything has gone OK up to now, neither will there be any problems in future.

Arguably, the problem is even worse for defined benefit pensions. In life assurance, there is at least the safety net of board and audit review of the actuarial liabilities shown in Companies' Act accounts. These amounts are normally calculated on bases very similar to those appropriate for solvency returns. The same safety net does not exist in pensions, where the actuary's valuation and funding certificates are not subject to verification or confirmation by trustees, auditors or peer reviewer.

The limited actuarial resources available to both the Pensions Board and the Financial Regulator mean that any wrongdoing could potentially escape notice from those quarters. The regulators are also hamstrung by the problem outlined earlier of a lack of precision in actuarial standards. This lack of precision leaves open the possibility that two equally competent, honest and professional actuaries could arrive at different results, not to mind what an actuary with more dubious intent could achieve.

The profession is slightly less exposed in general insurance, where the actuary is required to provide a certificate in relation to the directors' assessment of the liabilities, rather than make his or her own independent assessment of their amount.

The Society is already working closely with the Pensions Board on how to address this risk. There have been a number of consultation meetings with actuaries working in pensions and we hope to finalise proposals in the near future.

We have also opened discussions with the auditing bodies and the Financial Regulator on addressing the same risk in life assurance.

Complaints and Disciplinary Procedures

Another very important tool in identifying and weeding out wrongdoing is through complaints from users on the competence, professionalism or honesty of actuaries.

On the face of it, things are looking good on this front. In the last twelve months, there has been only one formal complaint to the Society, and this was for what might be described as an inadvertent technical infringement of the rules. So is everything in the garden rosy?

The position is not quite so good as the sparse figures on numbers of formal complaints would seem to indicate. In reality, there have been a number of low-level and general complaints on the quality of some actuarial reports and advice. These have been very frustrating for Council to deal with, because the complainants haven't made any specific charges against individual actuaries or the profession itself. That means that it is extremely difficult to address the complaints in a meaningful way.

I want to do everything possible to make the complaints and disciplinary process less intimidating, both for the complainant and for the person who is the subject of the complaint. I would like us to address whatever is preventing complainants from coming to us with specific grievances, be it fear of legal action if the complaint is not upheld or other reasons. I believe that we have already gone a long way towards addressing some of those fears. For example, there will be no publicity whatsoever if a complaint of wrongdoing is not upheld. This should eliminate the fear of legal action against the complainant if the concerns are not sufficient, or are not supported by sufficient evidence, to justify disciplinary action against the member concerned. We also want to ensure that our complaints and disciplinary process is not only fair to everyone concerned to but is also seen to be fair by external observers.

We are now close to finalising Council's proposals for a new disciplinary scheme. I believe that we have achieved most of the above objectives. The new process will be independent of Council. It will also have strong input from people outside the profession in both the initial disciplinary and subsequent appeal processes.

It is also essential to achieve a culture change among our own members so that they are more prepared to take action on foot of any doubts or concerns they may have about the quality or professionalism of a fellow actuary's work. Much of our work as actuaries is inaccessible to people outside the profession. As a consequence, an actuary is much more likely than a layperson to recognise unprofessional conduct in one of his or her colleagues. Our Professional Conduct Standards already place an obligation on members to "take appropriate action" whenever they become aware of a matter which appears to be a material breach by another member of professional or other guidance to actuaries. We need to publicise that obligation more widely. The requirements of confidentiality mean however that members are sometimes constrained from taking action on foot of such concerns. We are considering action to address this problem. Such action might for example include a recommendation for the addition of a clause to terms of conditions of appointment for consulting firms, granting partial waiver of confidentiality where the actuary has reason to suspect another member of unprofessional conduct.

As another step in the process of making members more aware of their wider responsibilities to the profession, Council has initiated a program of meetings with actuaries in their places of work, so that we can keep in touch with the bulk of our members who do not attend regular meetings of the Society. I hope to use those meetings to remind colleagues of their responsibilities under this heading. Like a chain that is only as strong as its weakest link, the reputation of the entire profession could be damaged irreparably by the actions of a few. We all have an obligation to take whatever steps we can to ensure the highest standards of professional competence and conduct among our fellow members. It is also worth bearing in mind that prompt corrective action is also in the best interests of the affected members, since, if there is an incipient problem, it is far better to nip it in the bud and address it quickly than to wait until it becomes a major issue for the member concerned, for the profession, the regulator, or for society at large. We believe that we have the structures in place to deal sensitively and sensibly with minor breaches of professional standards as well as with major breaches. I encourage members to use those structures.

In concluding, I must stress, as I did at the start of this section of my talk, that we have no direct evidence of unprofessional conduct by any actuary practicing in Ireland. My admonitions are intended at warding off the evil day when we have to deal with a major problem, hopefully forever.

Relationship with UK Profession

The last topic I want to touch on this evening is our relationship with the UK Profession. Almost every member of the Society of Actuaries in Ireland qualified through the Institute or Faculty of Actuaries. We are proud of our qualifications as FIA's or FFA's. In fact, the initials FSAI, or Fellow of the Society of Actuaries in Ireland, only gained prominence in recent years. Many of our members also contribute on a voluntary basis to the UK Profession's examination and tuition programs.

The main problem we have with the UK Profession is that it treats us as Home members for subscription purposes. This means that actuaries based in Ireland have to subsidise the costs of the UK Profession's regulatory activities as well as contributing our full share to its activities as a Learned Society for actuaries. This is in addition to having to pay for our own Society's increasingly onerous regulatory responsibilities.

In fairness, the UK Profession has recognised the problem and agreed a few years ago to pay a subvention to the Society of Actuaries in Ireland as a contribution to our regulatory overheads. The subvention can alternatively be viewed as a rebate for the regulatory content of our fees to the UK Profession. The subvention at present is £100 per annum for Irish-based Fellows of the Institute or Faculty. The problem is that the amount of the subvention goes nowhere near covering the cost of the Society's regulatory activities. It also represents only a portion of the regulatory content of our subscriptions to the UK Profession. In a joint letter to members of both UK Professional bodies earlier this year, the two presidents, Michael Pomery of the Institute and Harvie Brown of the Faculty wrote that the combination of standard-setting, discipline, compliance monitoring and other activities mainly of a statutory nature represented more than 40% of subscription income. Some figures included in the UK Profession's recent strategy review seemed to indicate that the proportion of total subscriptions taken up by activities other than those of a Learned Society nature could be even higher than that implied by the above figure. In contrast, the subvention from the UK Profession to the Society of Actuaries in Ireland represents only 16% of members' subscriptions to the UK Profession.

The result is that the cost of being an actuary in Ireland is far higher than in the UK. Given that the UK is already one of the most expensive countries in the world to practice as an actuary, the cost of remaining in both bodies is becoming quite onerous for some members. The problem will only get worse, since the cost of regulation shows no signs of reducing in either of our countries.

Some of our members, or their employers, who often pay members' subs on their behalf, have told us that they are considering dropping one of the two subscriptions. In that situation it is the Society of Actuaries in Ireland that suffers, since the Society's rules require that members keep their membership of the Institute or Faculty fully up to date if they want to remain as members of the Society of Actuaries in Ireland. We have already lost a small number of our members on that account. We must take action, and quickly, to avoid that trickle turning into a flood.

As I said, the UK Profession is aware of the problem. I have already met with Michael Pomery, my counterpart in the Institute of Actuaries, and have signalled to him that we would like to discuss the matter with him and his colleagues as a matter of urgency. Michael is sympathetic to our plight and we hope to commence detailed discussions in the near future on how best to resolve this particular problem to our mutual satisfaction.

Conclusions

There are many more items that I could have touched on this evening. The topics on which I chose to speak are ones that demand urgent action, for different reasons.

To recap briefly on the main issues covered in my speech:

Council has already committed itself to the establishment of a counterforce, the aim of which is to ensure that actuarial standards will be set at a level that meets the public interest rather than the interest of the providers of advice. The form that the counterforce will take has yet to be decided.

The profession should engage constructively with regulators and government on the establishment of the counterforce, and on the related issues of making actuarial standards more precise and monitoring compliance with them. The costs of putting the improved regulatory environment in place should be shared equitably between the beneficiaries of that improved environment, including insurers and pension funds.

We need to improve our ability to identify and deal with allegations or suspicions of misconduct. This will be achieved partly through improvements to disciplinary structures and procedures, but much depends on winning hearts and minds, both of our own members and of people outside the profession who interact with actuaries on a regular basis.

Finally, I spoke about our relationship with the UK Profession and the need to address as a matter of urgency the substantial extra cost of being an actuary in Ireland compared to the UK.

I hope that there will be many opportunities during the course of my presidency for us to discuss the variety of other issues, both domestic and international, that impinge on the profession. I am particularly anxious to develop the two-way dialogue between Council and members that has already commenced. Our first meeting with members went very well and the second such meeting is scheduled for next month. Through these meetings my colleagues on Council and I want to understand better your hopes and fears, what you want from the profession and what you're prepared to give back to it.

Pat Healy handed on the reins of presidency to me with the profession in good shape. I want it to be even healthier when I hand over to my successor. It will be hard work and we face a number of serious threats that could derail our plans, if we do not address them vigorously and as a matter of urgency, but I believe that we can do it. We have an excellent team on Council and two wonderful executives in our offices in Pembroke Road. Aisling Kennedy as Director of Professional Affairs and Mary Butler as Director of Member Services bring fantastic ability, energy, enthusiasm and professionalism to their jobs. I am sure you will join me in thanking both of them for their great work on our behalf.

Finally, I want to say that, in recalling the Baconian motto that graced the front cover of the old JIA, I do recognise the debt I owe to the profession and I will do my very best to repay it. I rely on you, my colleagues and friends, to help me.