THE SOCIETY OF ACTUARIES IN IRELAND
PRESIDENT'S ADDRESS
Kevin Murphy FSAI
Tuesday 15 September 2009

1. Introduction and Welcome

I have the honour of being the 19th President of the Society and pleased that a number of my predecessors are here to see it. In particular I would like to welcome my personal guests.

In structuring my speech tonight I have focussed around three areas:

Firstly I would like to talk about the current crisis and how we need to react to it.

Secondly I would like to give you a quick update on progress on various issues in the Society at the moment. As you know we have completed a strategic plan that shapes the agenda for the Society.

Thirdly I would like to set out the main additional priorities for the Society in my two year tenure.

2. Response to current crisis

Clearly we in Ireland and globally have gone through a very difficult environment and the outlook is that this will take some while to unwind particularly in Ireland. One consequence of what has happened is that society is beginning to ask pretty fundamental questions about the real added value of people involved in financial services and also questioning the forecasting ability of various professions including ourselves given what has occurred.

As you know the vision we have for our actuarial profession in Ireland is that we are recognised by our clients and policy makers as the leading profession in the use of financial modelling and risk management skills to enhance the long term financial position of individuals and institutions.

Frequently we as in many professions tend to confuse inputs and outputs. That means we do spend lots of time discussing our financial monitoring and risk management skills. Far less time is or spent discussing the extent to which we are or are not enhancing the long term financial position of individuals and institutions.

So for example, one of the big success stories of the actuarial profession was the development of the mortality tables. Whilst we should congratulate ourselves on the mortality table, the real added value to society we have created through these tables is that we have used them to enhance the lives of our customers. If our customer buys a protection policy and dies then they have the added value of having the family financially looked after. If they buy an annuity they get the considerable protection of knowing that they will be paid an agreed level of income for life irrespective of how long that is. So both of those are huge added value to society and we should be proud of them.

It is important in every activity we do that we review both the input and the output. And the ultimate test of the quality of the reputation of the actuarial profession will not be the quality of its financial models or the quality of its risk management skills but ultimately do we or do we not enhance the long term financial position of the individuals and the institutions we are responsible for.

This crisis has been a very difficult crisis for the nation and the world. It's important we review our performance with the object of learning lessons and ensuring we are a healthier profession because of what we have learnt from what has happened. No profession is perfect but every profession has the capability within it to revisit a very difficult environment and put together a plan for the future to enhance the profession based on frequently difficult lessons learnt in a difficult environment.

The first business to mention that we are involved in is the pension fund business. It has been severely affected both financially and also in terms of its image by what has recently occurred. The underlying aim of having a defined benefit scheme is to preserve the standard of living of the employees in this scheme and this aim is essentially achieved by linking the benefits to the salaries of the people involved in this scheme. Typically the broad long term aim is that to provide long term employees with two-thirds of their salary. When the employer first began this process we would have indicated to him that say 15% of salary would be sufficient to provide this benefit. Today's reality has made the cost significantly in excess of this. We do have lots of good rational reasons why the costs have gone up but ultimately it has been difficult to predict the long term costs here.

So the challenge for us from here is how to manage this situation as best we can. The reality is that many defined benefit schemes will be forced to close. In addition there will be reductions in future accruals or benefits to existing members given that the costs at this stage have gone way beyond what would be regarded as a reasonable cost for an employer to pay in respect of his employees' long term pensions.

This is a challenge for us and we as a profession have to work hard both for the employers and the trustees to manage quite difficult complex HR and financial issues here. There are no easy solutions here. However we do have to ensure we produce the best solution we can of a complex and difficult situation.

One particular issue we need to deal with is the whole question of investment risk. Many pension funds are taking too much investment risk and this is a challenging environment to deal with. As everybody here knows if we reduce the amount of investment risk we should see a reduction in investment return and this compounds the already difficult situation of having an unaffordable set of benefits. Employers may not like volatility in pension costs but they like even less increases in the absolute costs of providing pensions

It will be a challenge for the Society is to deal with this issue. This will involve firstly figuring out some way of putting a measure on the risk currently being taken by the pension funds. Secondly agreeing some standard for a reasonable level of risk to be taken and then agreeing with the Regulator to set some time by which the pension fund has to come within that standard. Essentially defined benefit funds are mini financial companies and no company is allowed to take uncontrolled investment risk in its pursuit of its provision and promise of benefits.

There are similar issues in defined contribution but less so as most of the people in defined contribution are quite young. However there is the longer term issue as people approach retirement and once again investment risk has to be measured and standards have to be set and ultimately people have to be persuaded to come within those standards. So once again there is a role for the Society here in working with the Regulator in figuring out a process which will manage defined contribution investment risk in future.

The next business area is the life business. Fortunately the solvency of the life company hasn't been particularly affected by the crisis and by and large most life companies in Ireland have by their low risk nature survived well. However the same thing cannot be said of their customers. Many of their customers have had poor experiences in their investment with life companies. So once again there is an issue here of investment risk. This is an issue we have discussed frequently.

The reality is that people have very poor understanding of investment risk and the checks and balances here in terms of people making an investment decision are very biased towards taking disproportionate risk.

Some of this is caused by how we look at the situation. We tend to regard the problem of educating people on investment risk as a solvable problem. We therefore pour lots of information into them and get them to sign lots of forms and conclude that we have done our job well. Now a job well done means that if there is any hassle we have lots of signatures and forms to justify how hard we tried in explaining what we are trying to do. But there is a world of a difference between explanation and understanding.

My view is that we need to move the industry closer to the pharmaceutical industry whereby we fundamentally accept that people will never fully understand what exactly is going on and that the onus of responsibility in that environment is for the manufacturers and the advisors and not the consumer.

If you go into a chemist today you will be offered an over the counter tablet which you can buy yourself. However, this will have already been checked in detail by the federal drug agency or somebody else so that it is a low risk offering. If you want a high risk tablet you have to go to the doctor who will individually examine you and give you a prescription which will be carefully administered to you.

If the pharmaceutical industry acted like the financial services industry when you went into the shop you will be offered a range of tablets:

- a high risk tablet that had 100% chance of curing you but 20% chance of killing you;
- a low risk tablet that had 70% chance of curing you but 0% chance of killing you;
- and the consensus pill would offer you say about 85% chance of curing you but a 10% chance of killing you.

And you would typically be advised to take the consensus pill since that was the normal tablet accepted by most people.

To move to that different environment means we have to pre-agree some standards of investment risk for over the counter funds and to put considerable controls in place for people who want to invest outside the over the counter funds. This will be a big challenge for us as a profession to work on this agenda and clearly we need careful co-operation with the Regulator in order to ensure that this is done.

Finally our general insurance business. Fortunately this business is the least affected by the current crisis. The solvency of general companies has been well protected as most historic excess positions in equities in the reserves were unwound post previous equity downturns. It is quite a soft market but that is due to the cyclical nature of pricing in that market. Current recession is also putting some pressure on the financials of the business.

In summary then, the current environment has had a significantly negative affect on the customers and institutions which we advise. With those outputs we need to review our inputs and learn from what has happened.

The main lessons we should consider are as follows:

Firstly we need to look at our forecasting ability. Clearly we can forecast some variables well in the short term, for example mortality, but longer term forecasting ability is particularly difficult due to the systematic improvement that is going on. On the other hand we are also forecasting variables such as investments that are hard to forecast short term and less so long term. Even the phrase long term is ill defined – sometimes for investments long term would be 40 years +.

As forecasters we should not over estimate our abilities. The long term consequences of optimism can be significantly negative for people we are advising. Life unfortunately is more unpredictable than can be captured in many of our models. Humility should be the number one attribute for forecasters of the future at any time.

However our customers need advice and we do have insight - however we have to be careful not to be excessively confident in the advice we give.

Secondly there is the investment agenda. This is an agenda which has been a controversial agenda in the actuarial profession in recent years. On the one hand we had the traditional views on long term equity risk premiums and on the other hand financial engineers' view of a mark to market perspective. Fundamentally I am arguing that we need to focus on the output here namely the customer agenda. The reality is from either perspective customers are typically taking too much investment risk relative to their abilities to withstand it. As a result of which we do need to put in some counterforce in this system typically regulatory standards or controls to ensure that people take the level of investment risk that ultimately they have the capacity to deal with. We have insight on this issue and we should use it far more than we have done to date.

Next I would like to turn to progress on the various issues in the Society at the moment.

3. Update on Strategic Plan

As you know we completed a three year strategic plan in 2008 and last year was the first year of that. We made significant progress in 2008/09 and the main highlights of these are as follows:

- Solvency II. A new committee was set up to develop this major agenda. This will involve significant liaison with the Financial Regulator on the future regulatory structure in Ireland post the introduction of Solvency II. In addition the committee will ensure that the Society supports members in preparing for the potential changes in their role post Solvency II.

- We were also conscious that there are many new areas for actuaries and we set up a committee to ensure that this area develops strongly as the possibilities emerge.

- We established a CPD committee to ensure that we professionally educate our members into the future.

- We set up a demography committee to build the process of building Irish mortality tables.

- Finally we worked on the standards agenda – a complex area. As you know we have been considering three areas:

  - Setting up some counterforce to ensure that our standards are not subject to any commercial capture;
  - Ensuring compliance standards are met
  - Review of the disciplinary process.

In terms of the first item the progress has been difficult. We initially sought the support of a statutory oversight body which the Government had not considered necessary. We then moved on to a discussion on the voluntary oversight body with some regulatory input and whilst there was initial agreement to this subsequently, the advent of Solvency II has caused the Regulators to withdraw from such a body. The Financial Regulator pulled out because a shift from a principles-based approach to a rules-based approach to regulation is envisaged and it is not clear what the approach to actuarial standard setting will be.

On the compliance agenda as you know we have made significant progress on the pension side but we continue to struggle on how best to develop compliance in our other areas of statutory work. Once again Solvency II has put a question mark over this as with any reasonable likelihood Solvency II will have many of its standards set at EU level and compliance of those standards will be monitored by the Regulator or some external party. Of course if the standards, professional and/or technical, are to be developed in the international actuarial arena the Society will play its part in this through the Groupe Consultatif and the IAA.

Finally on Disciplinary Scheme this is being progressed by the Professional Affairs Committee and the Committee on Professional Conduct, with assistance from Alfie Shaw, Executive Secretary to the Investigating Committees. It is expected that proposals on changes to the scheme will be ready for Council's consideration before the end of the year.

4. Main new priorities for the next two years

Next I would like to set out the main new priorities for the next two years:

Firstly we will need to get each of our main business committees to look at the implications for each of our business lines of the economic crisis and to look at the issues I have raised in my opening statement to deal with the complex range of issues that are emerging in each of our businesses today.

In addition I would like to focus the Society on the following additional areas:

- **Keeping our skills up to date**

Keeping our skills up to date is one of the big challenges for us. Indeed all professions are battling to keep the skills of their members relevant and up to date. This is a demanding objective as the world is becoming infinitely more complicated and everybody here made a huge effort to pass the actuarial exams but with the passage of time and increased personal/work responsibilities the appetite and indeed the time to invest in future development is limited.

From the Society's point of view in order to keep the profession in good stead and well regarded the onus is for the Society to help actuaries to keep their skills up to date. The advent of compulsory CPD has helped this because it no doubt provided the pressure on people to keep their skills up to date.

So in terms of the next couple of years we are looking at two issues. Firstly the format of CPD events. Currently most of our CPD events are evening meetings involving a presentation and Q&A. We are going to look at other formats, including more interactive workshops on specialist topics and CPD events tailored to suit actuaries at different levels of experience. Secondly it is critical we have a professional approach to CPD in order to make sure that we are hitting all the spots in terms of the quality of programme we are providing. We are considering hiring a full time resource from an educational background to ensure our programmes have the width and the depth to ensure the profession is completely up to date.

- **Updating our Ethical Standards**

A rethink of the current system should start with our primary ethical standard – the PCS. This certainly needs some updating but more fundamentally the key question is whether we should retain the current rules-based approach or move to a more principles-based approach as other professions have done or are doing. The principles in this instance would be statement of the ethical values to which we collectively commit (including, for example, integrity, impartiality and openness). These could be supported by more detailed guidance on expectations of conduct.

Council advised by the Professional Affairs Committee will be considering these issues and will first endeavour to put flesh on the bones of what a new actuarial code might look like. This will then be brought to our wider membership for debate and consultation. The recent introduction of the Actuaries' Code in the UK gives this added impetus.

- **Becoming Risk Managers**

So far I have talked a lot about the whole question of investment risk and I now want to talk about risk in general. To date we have quite successfully managed risks in a few specialist areas. In the earlier days of the profession all our calculation routines were based on the average experience and it took quite a while for the profession to evolve into the stochastic view of the world which deals with the variation in future experience. That was quite a challenging step for the profession ultimately as it made the whole calculation, investigation and thinking about what was going to occur inherently a lot more complex.

However, there is a huge opportunity now for us to significantly step up our risk ability. And this is going to be given to us by the Solvency II agenda. Under the proposed Solvency II each institution, life office, general insurance company, reinsurance company not alone will have an actuarial function but will also have a risk manager who will look at all the risks of that operation and be responsible for both the identification of the major risks and working with the business in managing them successfully.

So my view is that this is a change point for the profession and we should step up to the plate in reskilling our actuaries to run the risk functions of all these institutions over the next few years. I think this is a fantastic opportunity because risk is a huge issue for the world and there is in practice very little understanding and knowledge of how to successfully discuss how best to manage risks. The reality is there are many people in the world who can understand an average but hardly anybody who can understand the whole concept of variation. If we can become the profession that successfully manage variation then we will have a successful future in all organisations who are going to hire us.

So we have a unique opportunity at the moment. The financial services risk area is going to be significantly developed because of what's happened over the last few years. Mathematics is at the heart of risk management. We are the most mathematical of the professions and our combination of a mathematical training and a professional framework gives us a unique opportunity in the first instance to step up to the plate to manage and lead the risk function of all financial institutions. Once we have established a strong position in the insurance/pensions risk sector we should be able to transfer our talents into banking and other financial institutions based on the techniques and the insights and the skills we build up in this Solvency II development.

5. Summary

Finally to finish up.

Ireland and the world are in a difficult position at the moment. But we in the actuarial profession have a strong history of looking after our clients and we have demonstrated an inherent commitment to doing this with integrity, professionalism and objectivity. Tomorrow is going to be very demanding as we continue to apply these qualities and I am confident we will rise to the challenge of a much more demanding world.

Thank you very much for listening to me tonight. It has been a very proud moment in my professional life to be President of the Society of Actuaries. I look forward to the challenge of leading the profession for the next two years and I do thank you for the honour of asking me to do it.

K Murphy
15 September 2009