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"What does the public expect of actuaries and the profession?"

by Walter Merricks
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First the apologies and the excuses. It is obviously rather presumptuous of me to be telling you what the public thinks with so little a qualification. I have done no empirical research, no historical or literature study of the actuarial profession. Nor do many of the complaints we handle at the Financial Ombudsman Service involve complaints directly levelled at the competence or professional standards of actuaries.

Nor can I entirely blame your president for having given me this title. I can blame him for having lured me into being here in this slot, but the title of this address is one for which I bear responsibility. I thought it would give me a reasonably free hand to talk about the problems you face. And I did deliberately try to ensure that there should be some reflection both on the role that actuaries are expected to play and also the expectations of a professional body in regulating and representing them.

So what entitles me to be here at all? First, the function of heading a body concerned with public complaints about financial services inevitably requires me to observe and scrutinise this field closely. And I am a relative newcomer, on whom time has not yet done its weary work. Finally, for eleven years from the mid 80's to the mid 90's I worked in a senior position in the Law Society. This was also period during which a profession body, previously regarded as comfortably reclusive was subjected to wholly unexpected withering and sustained public attack; it and its members suffered an unprecedented crisis of identity and purpose. What was the profession for? Or was it just a trade dressed up? What about the Law Society? Was it a primarily a self-regulatory body serving the public interest, or a professional association serving the interests of its members, or a learned society dedicated to the improvement of knowledge? This agonised soul-searching was played out while Government action loomed, consumer organisations launched informed and well founded offensives, and the media turned the focus on a new and interesting sight – an exposed and divided professional body squirming in the spotlight. In the meanwhile professional earnings (at least in some sectors) soared.

I do not know how you now feel as actuaries, as members of a professional body, after this year – a year which must surely be counted as something of an *annus horribilis* in the annals of your profession. The words Equitable Life, with profits, Independent Insurance, endowment mortgage, MFR - I need say no more. These words have appeared not simply in trade or professional journals, but in front page headlines in popular papers or on TV news, day after day. The great British public have now been told repeatedly that there has been a massive scandal of incompetence or worse in which whole generations of people have been robbed of their savings and the money put by for their pensions. The hunting pack searching for scapegoats has been in full cry. Actuaries, it has been spotted, have been the key advisers in all these affairs. Mathematical mystery men, crafty calculators who cooked up clever schemes to rip people off, or at least who stood idly by while the marketing boys waved smoke and mirrors to stitch consumers into disastrous long term contracts or to cream off money destined for investment into the company's bottom drawer. The Consumers' Association's director Dame Sheila McKechnie said recently "'Trust me, I'm an actuary' has no more resonance with me than Dr Harold Shipman saying 'Trust me, I'm a doctor'". I guess that's about as offensive to any professional person as you can get.

So while these perceptions may be exaggerated and misplaced, I would be surprised if you can simply shrug all this criticism off and expect it to go away. On the one hand of course the public rarely has direct contact with actuaries, and this will shield you from too much attack, and the ignorance of most journalists of what you do may be an asset. On the other hand the fact that by and large you do not provide a consumer service insulates you from public and customer pressure. Some heart-searching is in order.

So where might well intentioned and well informed members of the public suggest that this search might be directed? How far can actuaries reasonably be blamed for any of the so-called scandals that have erupted or come to prominence in the last few years? What might reasonably be expected of actuaries in the new century?

I have looked carefully at your paper on vision and values for the profession, and as with all such worthy documents they sound fine, but it is absurdly easy to pick holes.

Actuaries in 2020 will work in a much wider range of businesses than at present. [*We will finally get a few people out of insurance and pensions.]*

The actuarial training will be highly attractive as the basis for a career in finance with its distinctive emphasis on questions of financial and other uncertainty. *[Attractive to egg heads willing to spend 7 years qualifying; real world people run a mile.]*

The profession will be known for its objective and responsible views on current issues. *[Objective and responsible= guarded and impenetrable, with plenty of hindsight to back the views]*

And there is much about serving the public interest.

How the profession serves the public interest
It provides skilled, trustworthy, workers to meet both business and society's needs. *[The Guild of Electricians does too, but they don't have pretensions to professional status]*

It meets requirements for current or future statutory prudential roles in the financial management of all major financial institutions such as Life Insurance, General Insurance, Pension Funds and Banks. *[So there's a nice monopoly carve-up in these jobs?]*

Its members are willing to accept roles which ensure financial protection for consumers. [*But most get paid by institutions to serve their interests]*

It provides authoritative and objective input to public debate. *[The Daily Mail would say the same]*

Looking at your professional conduct standards, and your statement of Vision and Values, these give the impression that here are the independent professionals who fearlessly stand between employers and pensioners, between management and policy-holders, using their knowledge and influence to ensure that rights of the latter groups are not overridden. No doubt some actuaries see themselves this way. But how far does this accord with reality? And with most actuaries either employed directly or indirectly by financial institutions, it is inevitable that you are seen as pipers playing the tunes that those who pay you want. Of course this can seem an unfair accusation. Look around any financial institution, say an insurance company. It isn't exactly a cultured institution. It is primarily a business driven environment. There are the smart marketing people, the chancy underwriters, the hard-bitten claims managers, and at the top perhaps some flamboyant, entrepreneurial, demanding, and charismatic leader driving the operation. And there's an actuary or two – perhaps the only people (apart from an accountant in finance and a lawyer in legal) who are members of a serious professional body. Perhaps the only ones who have a professional obligation not merely to consider the interests of policyholders as opposed to shareholders, but to report to regulators if those interests are compromised. So why should actuaries take all the blame?

Well, let me take one area that is affecting me – endowment mortgages. Two years ago complaints about these – around 1,700 formed about 15% of all the investment complaint made to the Ombudsman in the year. This year we are expecting 13,000 complaints forming 70% of the investment work. None of the complaints are about actuaries, but plenty of people are asking who if anyone was to blame for a situation in which so many thousands of people feel dissatisfied. In ordinary customer protection language these products have been discovered to be unfit for purpose.

Some we have discovered were never fit for purpose because the combination of premium levels and charges meant that the policies could never on any reasonable projections as to investment returns repay the mortgage. If actuaries were not to blame for this who was?

If interest rates increase (for example, as a consequence of increasing inflation), then, on the whole, the investment growth of the endowment will increase, the customer pays the increased interest, and it is likely that there will be a tidy surplus by the end of the term. Or, looked at another way, the customer has overpaid more than was necessary to repay the loan, though the customer will, perhaps, usually be too happy having a surplus for that to be a problem.

But if interest rates decrease the customer pays less interest, which is fine for the customer. What is less fine is that also, on the whole, the investment growth of the endowment will decrease, so that there may be a shortfall at the end of the term, unless the product contains a way of switching some of that saving on interest into increasing the payments intended to repay the mortgage. Without such a mechanism, the product is inherently unstable. Many, perhaps most unit-linked endowments had a review mechanism, perhaps because it was recognised that there might be problems in the future, but this was rare for with profit endowments.

These products were designed for a purpose, and the purpose, I might cynically say, was not so much as to pay off mortgages as to be sold in large numbers to generate profits for insurance companies and intermediaries. And would I be cynical in suggesting that for some designers the key element was that the product should be priced so that the cost, combined with the interest only payments, would at the point of sale be a little below the cost of a repayment mortgage?

In product design actuaries are inevitably involved. They must have given actuarial advice. Maybe the advice was taken, maybe it wasn’t. Of course actuaries should ensure that the product will not bankrupt the company, that it doesn’t promise what cannot be delivered. But what if it under-promises what ought to be delivered? Having searched your professional conduct standards, I am still left wondering what duties a member of the institute has when advising or assisting in the design of a product that he or she can see that may make the company a lot of money but is not going to be fit for the customers’ purpose. And how does this fit in with your proclaimed public interest role? Eventually of course regulators may step in and consumers may complain, if necessary to the ombudsman. So there may well be a cost to a company that is concerned with its bottom line as well as with its reputation.

I recognise of course that in 1999 the Faculty and Institute’s working party produced an influential and customer focussed report on endowment mortgages. This finally destroyed the credibility of the endowment as a means to repay mortgages for the vast majority of people. Well, better late than never. But the time when the sale of endowments was at their peak was eight to ten years before this. A similar report from the professional bodies in 1989 might have prevented the problems that have occurred.

And what about pensions misselling? Were actuaries for schemes out of which people were being persuaded to transfer or for companies selling personal pensions unable to see what the PIA finally saw?

Which brings me to regulators. And the question I ask myself is how far regulation in the field of pensions and long term insurance is saving actuaries and their employers from having to face difficult questions. Growth rates for example are now prescribed for use in the pensions review and for the sale of endowments. If growth rates were not prescribed, I imagine that it would be part of an actuary's duty to ensure that assumptions about growth rates used would be reasonable. And bringing me back to the recent mortgage endowment re-projection exercise, let us suppose that FSA had not prescribed growth rates. Would competitive industry pressures lead to a variety of escalating growth rates? Would actuaries find themselves under pressure to justify higher and higher return rates to minimise current exposures? I ask these questions merely to probe how deep is the alleged conflict between the departments in charge of short term profit, and the actuary in charge of the long term view, and to speculate whether the increasing intervention of regulators is reducing this conflict or simply suppressing it.

Well you may say, this is all about actuaries employed in institutions. What about the large number who practise independently in consulting practices? They will have no such conflicts. I have no doubt that the various enquiries into the collapse of Independent Insurance will trace the role of its consulting actuaries, and whether they were to blame for failing to spot the troubles or should be praised for finally blowing the whistle, or indeed both or neither. But there is one potential conflict of interest that they held and that has been the subject of comment and criticism, and that is the revelation that as a firm they were insured by Independent Insurance. On the one hand it can be said that they had an interest in ensuring that Independent was sound, on the other that their interest was that Independent should carry on trading. Whichever it is seen to be, it is not a matter directly addressed in your professional conduct standards. One of the insurance trade papers has called for a ban on actuaries and auditors taking out insurance from insurers for whom they act. That issue ought at least to be addressed.

I have heard many people bemoan the reduction of actuarial influence at senior levels in insurance companies. Time was when the general managers of every insurance company, and many of the senior executives would have been actuaries. Actuaries, it is said, have become marginalised as a serious force within financial institutions. Of course actuaries do still head of some of the large British institutions, but far fewer than thirty years ago. These are similar to the moans I used to hear about the demise in the number of solicitors in the boardrooms of public companies, or as chief executives of local authorities (previously a virtual monopoly). Come to think of it I cannot think of an insurance company or bank of which the chief executive has a legal background.

And my answer is much the same. If lawyers or actuaries have skills that are wanted they will find themselves in senior positions. But there is a serious risk that the professional training we offer breeds precisely the wrong qualities needed in managerial or leadership roles, and there is a danger for both professions. Businesses and organisations need advisers who can also be implementers. I was surprised therefore that your Vision for 2020 does not include seeing actuaries holding a greater proportion of senior management positions than now. Actuaries (or lawyers) need to be equipped with the communications and management skills to play leading roles in the organisations of the future. There is no quicker or surer route to becoming marginalised than by retreating to the ivory tower to dispense unwanted advice without getting one's hands dirty.

So how should a professional body under attack from without, and I imagine beset with uncertainties from within, respond? My first answer is that that is what it must do – respond. It is easy to be seduced by the comfort of the organisation's history, and imagine that this will all pass. The Law Society made the opposite mistake in responding of launching an institutional advertising campaign designed to tell the public of the virtues of solicitors. All that did was to spend thousands of pounds of the profession's money with virtually nil benefit. Perhaps it cheered up a few solicitors, but that is all.

In today's fast moving consumer climate, the only safe ground for a profession is one which is fully open, transparent, accountable. Openness also means open to external comment, keeping lines open to key players, and open to change. How far are your affairs open? The Law Society has recently decided to include on its governing council a number of lay people. I know that I am not the first to suggest that this is a course worth pursuing. Your internal discussion about monitoring has been going on for some while – is it drawing to a conclusion yet?

The problems to which I have referred seem to me to lie in a lack of transparency in the position of actuaries, particularly those employed within institutions. The advice of an actuary to his employer client is said to be confidential professional advice. But I have pointed to potentially conflicting duties. And if actuaries wherever they practice are exposed to conflicts, one aspect of accountability will be the possibility of being brought to book through professional discipline. Yet a small profession with limited funds may face an unattractive prospect in trying to discipline a member who is backed by the full resources of the institution or firm for which the member works. Could a sceptical observer speculate whether this might give most actuaries virtual immunity from any charge unless they have actually been sacked or caught with their fingers in the till?

The Government through its various arms will always be suspicious of monopolistic professions, and if you have no solutions to offer to key problems, eventually they will be imposed on you. So you need to avoid being seen as defensive or unhelpful; you must be seen as the key partners for any Government in coming up with the policy ideas it needs. To take one example, could you have pre-empted the need for Myners with your own report? And would it only be a mean-minded observer who might characterise your response to Myners as distant or unconstructive? Where is your answer to MFR?

Finally open to change. Part of your Vision is to see more actuaries working in wider fields. But is it impertinent to ask whether these wider fields want more actuaries in them? Perhaps there is a good reason why these fields are not already more populated with actuaries. Look at the issue the other way round. Who are the people now doing the jobs you think actuaries might do in the future? Is it blasphemous to suggest that those who now work in these or allied fields might be admitted into a wider if not quite such an exclusive family? Could the solution to your problem of being such a small profession come in welcoming those who work in allied fields, such as the financial derivatives market, the professional business economists, statisticians and the risk managers? Could a home be found for them within a broader institute?

I have thrown out enough provocative and probably ill-founded ideas and comments for one evening. But as a candid friend I hope these observations have been helpful. Let me briefly end by reminding you of your strengths. Introspective you may be, but there is for a small profession, an impressive degree of activity devoted to considering the future and attempting to plan for it. The concentration of intellectual capital within the profession will always stand you in good stead. And the fact that you are facing more challenges and conflicts that may need more radical solutions, is a reflection not of a decline in standards, but of a changing world. And beyond these shores no doubt other professions who hold British actuaries in high regard would be amazed at the treatment that has recently been meted out to you.

So to sum up, the public may reasonably expect of actuaries not just high standards of skill and competence, not just honesty and trustworthiness, but openness in the application of your skills, transparency in all your dealings and accountability for all your actions. If you can test yourselves against these criteria I am sure you will prosper and the public will benefit.