



Joint Colloquium of the IACA, PBSS and IAAHS Sections of the International Actuarial Association

Westin Copley Place Hotel, Boston, U.S.A. – 4-7 May 2008

Recognising and Addressing Conflicts

Adrian Waddingham

Ian Duncan



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Speakers

- **Adrian Waddingham**
 - UK consulting actuary
 - Pension plan background
- **Ian Duncan**
 - US consulting actuary
 - Health plan background



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UK legislative environment

- Can the actuary retained by the plan sponsor also serve the trustees?
- *UK very different to the US!*
- Trustees have power/obligations
 - embedded in UK trust law
 - “delivering employer’s intentions”
 - **but UK pensions have changed**
 - Better benefits
 - More costly
 - Sponsor now liable in law


Advising both Trustees & Sponsor

- **UK actuaries have seen their role as:**
 - *honest broker*
 - *facilitator*
 - *expert valuer*
- **What's wrong with that?**
 - nothing ...
 - ... as long as the parties have common interests

Some UK statistics

Table 11

Proportion of schemes where the same individual serving the scheme is also engaged to advise the employer

	% using at all A	% of those using same advisory firm as sponsoring employer B	% of those using same individual adviser as employer C	% of all schemes using same individual adviser as employer A × B × C
Auditor	94	50	50	23
Legal adviser	84	36	55	17
Actuary	83	53	68	30
IFA	34	43	80	12
Benefit consultant	31	54	74	12
Adviser in corporate finance	11	41	68	3

Base: Interviews with trustees representing 500 schemes (unweighted), 9,020 schemes (weighted)

Source: The UK Pension Regulator



So what's changed?

- **Bad PR for actuaries lately (in the UK)**
 - Penrose report into the Equitable debacle
 - The “Morris Review”
- **Regulations**
 - Pensions Act 2004 which introduced ...
 - ... The Pensions Regulator
- **Increased focus on governance & risk management for corporates and trustees**
- ***Legal advice***



“Morris” Recommendations

Trustees, sponsor and scheme actuary should explicitly agree that they perceive no material conflict of interest

If any of the parties deem at any point that a material conflict of interest has emerged then the sponsor should secure separate actuarial advice

The Profession should develop guidance for actuaries on the issues that they should take into account when considering the materiality of potential conflicts



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UK Actuaries' Code

Conduct Actuaries act with honesty and integrity undertaking their duties in the best interests of their clients (who may be their employer).

Common Good Actuaries conduct themselves in a manner that has due regard to the wider public interest, shows appropriate consideration for others and supports confidence in the Profession

Competence Actuaries undertake all their professional duties with up-to-date knowledge, skill and care.

Compliance Actuaries conform to all relevant standards and regulations as required and seek to uphold those by speaking up where appropriate.



UK Actuaries' Code

Conflicts Actuaries take reasonable steps to avoid conflicts of interest. Where conflicts do arise they manage these in a professional manner including the disclosure of those conflicts to all affected clients, or, if appropriate, their employer.

Confidentiality Actuaries respect the legitimate confidentiality requirements of their clients or employer.

Commencing appointments

Actuaries take reasonable steps to verify that it is appropriate for them to act before accepting any appointment.

Communication Actuaries communicate information and advice, whether written or oral, in a clear, complete and effective fashion so that the recipient of that advice can be expected to understand it.



UK Professional Standards

- ❖ **‘Clients are entitled to assume that advice given is unaffected by interests other than those of the client’**
- ❖ **‘If there is or might appear to be a conflict of interest between two or more clients ...**
 - ... the member must consider the nature and extent of the conflict and whether it makes it improper for the member to give advice to one or more of the clients involved**
 - ...the client or clients involved must be notified at the earliest opportunity and if any advice given to a client is, or will be, influenced by interests other than those of that client or by any constraint other than that imposed by professional guidance, this must be disclosed’**

UK Pensions Act 2004

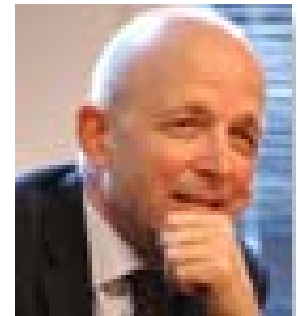
- **Trustees have control**
- **Trustees normally required to obtain sponsor's agreement on:**
 - **valuation methods and assumptions**
 - **statement of funding principles**
 - **deficit recovery plan**
 - **schedule of contributions**
 - **future accrual of benefits**
- **Have to negotiate**



The UK Pension Regulator

The Pensions Regulator is changing the relationship between Trustees and Sponsor

- **Trustees more like unsecured creditors if plan is in deficit and so they should:**
 - work to improve their position
 - assess strength of employer covenant
 - negotiate employer’s contributions and “recovery plan” for the deficit
 - demand relevant (sensitive?) information
- **Sponsor’s corporate activities may prompt Regulator demands**
 - contribution notice on debt avoidance
 - financial support directives
 - Clearance on “deals”



David Norgrove

The UK Pensions Regulator's “conflicts of Interest” consultation

- **Issued February 2008**
- **Key principles:**
 - 1. Understanding the importance of conflicts***
 - 2. Conflicts of interest policy***
 - 3. Identifying conflicts***
 - 4. Evaluation, management or avoidance of conflicts***
 - 5. Managing adviser conflicts***

www.thepensionsregulator.gov.uk



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TPR Funding Code of Practice

- **If the same actuary acts for both parties:**
 - should discuss implications with trustees
 - agree how conflicts will be recognised and steps which would be taken
 - actuary expected to resign the employer appointment if necessary
 - is this enough?
 - commercial issues!
 - should not act as ‘mediator’ between employer and trustees



Sources of potential conflict

- **Bulk transfers**
 - normally sponsor will agree something with purchaser
 - and (later) the trustees will be asked to agree
- **Benefit reviews**
 - employer will want advice on range of options
 - the full range?
 - trustees may also want actuarial advice
- **Augmentations**
 - employer required to pay up front?

What the lawyers say



Thou shalt not

Remember , though ...

Lawyers have their own agendas



Some legal background

- **Fiduciary duty**
 - a court is likely to say we have a fiduciary duty to clients
 - undivided loyalty to the client
 - may apply to the firm as well as to individuals
 - breach of fiduciary duty may be easier to prove than negligence
- **Duty to:**
 - advise each client to their best advantage
 - keep all information about client confidential
 - share relevant information about other parties
 - ignore adverse effects on other parties



Types of conflict

- **Indirect conflicts**
 - e.g. two clients who compete with each other but no conflict in relation to the current matter
- **Direct conflicts**
 - **Potential**
 - advice to two parties on same matter but interests are substantially aligned
 - **Actual**
 - advice to two parties on same matter and interests conflict

***these terms are not well-defined
and can creep up on you!***



A note on confidentiality

- **Knowledge flows within a firm**
 - Assumed information obtained by one member of a firm is known by all the firm unless proved otherwise
- **Former clients**
 - duty of confidentiality continues after the relationship ends
 - need consent of a former client before passing information to a current client
- **Exceptions to the rule**
 - overruled by statutory provision
 - contrary to the public interest
 - client has given express consent



The rules on conflicts (probably!)

Double employment rule

You cannot act for two principals with potentially conflicting interests without the informed consent of both

No inhibition rule

You cannot allow your obligations to one principal to be influenced by your relationship with another

No actual conflict rule

You must not get into a position where you cannot fulfil your obligations to one principal without failing your obligation to another



Options and risks

Informed Consent

Advise both parties of the potential for conflict, and the ramification of such conflicts. Obtain written consent to our continuing to act for both.

- **Risks**

- “no inhibition” rule may still apply
- may not protect us if actual conflict arises
- how ‘informed’ does the consent have to be?
 - do the implications need to be ‘rammed home’?
 - is ‘blanket’ consent sufficient?
 - if blanket consent is relied on, how often does it need to be confirmed?

Options and risks

Restricted retainer

Exclude specific areas of advice for one or both parties.

State conditions under which information may be withheld from or disclosed to the other party.

- **Risks**

- impossible to foresee all future circumstances
- **Some approaches are riskier than others:**
 - sponsor agreeing that we can pass information to trustees is likely to be easier to defend ...
 - than trustees agreeing that we can withhold information from them
- **Mission creep**



Options and risks

Chinese walls

Avoid leakage of confidential information by using separate client teams. Must be used in conjunction with informed consent.

- **Risks**

- ideally needs to be in place at the start of the relationship – may be too late for current clients
- the efficacy of such an information barrier has not been fully tested in the courts
- much case law may not be relevant to actuaries
- arguably deals with confidentiality rather than actual conflict of interest which the firm as a whole may face



- **Risks too big?**



Options and risks

Purist approach

Minimise legal risk.

Refuse to act for one of the parties.

- **Commercial risks**

- increases total fees for clients, so pressure on margins
- Vested interests - established firms lose more than they gain – *but good for new firms & accounting firms*
- difficult choices to be made
- if clients don't want to split advisors, it would damage relationship with them



New UK funding regime

- **Lawyers say that this makes things harder**
 - irrespective of what the Regulator says
- **Trustees have to set an approach to funding**
 - and must take advice from scheme actuary in doing so
 - they must then ‘agree’ the approach with the employer (or, in some cases, consult the employer)
- **So it is problematic for the scheme actuary to provide any advice to the employer**
 - high risk of getting in an actual conflict situation



So what are the risks?

- **Get sued**
 - now or in the future
 - by the client
 - or by the PPF (our PBGC)?
- **Get disciplined**
- **Lose confidence of your client**
 - retender
 - or loss of part of role



Commercial or professional?

- **Why is the profession interested?**
- **Internal is professional**
 - Confidence in actuaries
 - Reputation of actuaries
- **External is commercial (?)**
 - Can I take the legal risks?
 - Minimise risks & buy insurance
- **Example of checking SPA**



Client interest or public good?

- A current issue in the UK
- The obligation is to *“treat the client fairly”*

But does this mean;

- The fee payer
- The public?

(Most) clients are not stupid!

- **It may suit them to have a conflicted actuary**
 - particularly for the sponsor
 - but they won't protect us when things go wrong
- **they may be prepared to pay higher fees**
 - to get best advice
 - to be able to tick 'good governance' boxes
 - to compensate for their own conflicts of interest
- **They know what is happening in the market**
 - other professions
 - Morris, Myners, etc
 - they talk to each other



Changing relationships with clients

- **Clients recognising internal conflicts**
 - pensions manager – company employee – filters advice to trustees
 - company directors – likely to be particularly concerned about conflicts
- **Practices will change**
 - separation of pensions manager role from secretary to trustees
 - company directors stepping down from trustee boards
 - chairman – pivotal role
 - 50% Member appointed trustees on horizon in the UK
- **Increasing independence of trustee board from sponsor**
 - so Scheme Actuary no longer a route to influence sponsor?

Each client is unique

- **Attitudes will normally be formed through a combination of wanting:**
 - to have ‘best’ advice without taint of conflict
 - to be ‘whiter than white’ (in terms of governance)
 - to maintain harmonious relationship between sponsor and trustees
 - to minimise consultancy costs
 - to ‘play the conflicts game’
 - to avoid having to make difficult decisions / be told what to do / follow the herd
- **And will as ever be influenced by personalities and internal politics**



Conclusion

- **Lawyers seem clear**
 - don't do it
 - but own the agenda if you do
- **Very difficult to manage conflicts**
- **Why are we still doing it?**
 - theoretical risk
 - commercial considerations
 - still adds value
 - no guarantee of better solution





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Conflict of Interest – USA perspective

Ian Duncan, FSA FIA FCIA MAAA



Agenda

- 1. Definitions**
- 2. Academy of Actuaries guidance**
- 3. A case study**
- 4. Discussion?**

Great moments in Conflict of Interest history

Hillary Clinton replaced the longtime chief strategist of her struggling presidential campaign after the disclosure that he was working with Colombia's government to help win congressional approval of a trade pact that she opposes.

In a statement, campaign manager Maggie Williams said that "after the events of the last few days, Mark Penn asked to give up his role as chief strategist." Clinton campaign advisers made clear that he was all but forced out for what Mr. Penn on Friday conceded was "an error in judgment" in helping a client of his private, public-relations firm at the same time he held a top role in the campaign.

Wall Street Journal, April 7, 2008



Conflict of Interest – hard to define

***Conflict of interest, like
pornography – is difficult to define.
We hope we know it when we are in
the middle of it, though.***

What does the Academy have to say?

Code of Professional Conduct: Conflict of Interest

PRECEPT 7. An Actuary shall not knowingly perform Actuarial Services involving an actual or potential conflict of interest unless:

- A The Actuary's ability to act fairly is unimpaired;**
- B There has been disclosure of the conflict to all present and known prospective Principals whose interests would be affected by the conflict; and**
- C All such Principals have expressly agreed to the performance of the Actuarial Services.**

Great moments in (perceived) Conflict of Interest history

Senate Finance Committee hearings, April 3, 2008

[Rep. Marcy Kaptur, D-Ohio] asked (Fed Chairman Ben) Bernanke about the conflict of interest from his days as CEO of Goldman. "Uh, actually, I was the CEO of the Princeton economics department."

What does Wikipedia have to say?

Conflict of Interest generally (unrelated to the practice of law)

More generally, conflict of interest can be defined as any situation in which an individual or corporation (either private or governmental) is in a position to exploit a professional or official capacity in some way for their personal or corporate benefit.

- **The existence of a conflict of interest may not, in and of itself, be evidence of wrongdoing;**
- **In fact, for many professionals, it is virtually impossible to avoid having conflicts of interest from time.**

There often is confusion over these two situations. Someone accused of a conflict of interest may deny that a conflict exists because he/she did not act improperly. In fact, a conflict of interest does exist even if there are no improper acts as a result of it.

Wikipedia (contd.)

Types of conflicts of interests

- **Self-dealing**, in which public and private interests collide, for example issues involving privately held business interests.
- **Outside employment**, in which the interests of one job contradict another.
- **Family interests**, in which a spouse, child, or other close relative is employed (or applies for employment) or where goods or services are purchased from such a relative or a firm controlled by a relative.
- **Gifts from friends** who also do business with the person receiving the gifts.

Other improper acts that are sometimes classified as conflicts of interest are probably better classified elsewhere. Accepting [bribes](#) can be classified as corruption; almost everyone in a position of authority, particularly public authority, has the potential for such wrongdoing. Similarly, use of government or corporate property or assets for personal use is [fraud](#), and classifying this as a conflict of interest does not improve the analysis of this problem. Nor should unauthorized distribution of confidential information, in itself, be considered conflict of interest. For these improper acts, there is no inherent conflict of roles (see above), unless being a (fallible) [human being](#) rather than (say) a [robot](#) in a position of power or authority is considered to be a conflict.

Just to be clear:

Bad things that are not conflict of interests

- Accepting bribes can be classified as corruption;
- Similarly, use of government or corporate property or assets for personal use is fraud,
- Unauthorized distribution of confidential information;

Ways to mitigate conflict of interest

The best way to handle conflicts of interest is to avoid them entirely.

Short of avoiding conflicts of interest, the best way to deal with them are one or more of the following (mitigation) measures:

- **Disclosure**
- **Recusal**
- **Third-party evaluations**
- **Codes of Ethics**

The Academy's own conflict of interest policy

American Academy of Actuaries - Conflict of Interest Policy

The Academy has adopted the following policy to guide its activities on behalf of the actuarial profession and the public:

The fundamental purposes of the Academy require it to maintain a high level of professional objectivity and independence from any specific interests of the employers of its members. Therefore, members who work on the Academy's behalf must carefully consider and address any situation that may arise with respect to the members' activity, or the activity of any member working with them, which may call into question their professional objectivity. Members should comply with the Code of Professional Conduct whenever they provide services to the Academy. Members should familiarize themselves with Precept 7 of the Code, which provides specific guidance on dealing with conflicts of interest. Any actual or potential conflict, real or apparent, with this objective must be dealt with using the guidance provided in Precept 7, treating Academy work like "Actuarial Services" as defined in the Code of Professional Conduct. Disclosures required under Precept 7 should be made to the member supervising the activity in question.



Great moments in Conflict of Interest History

The interesting example of Sir John Bourn...

Sir John is the chief investigator into Whitehall waste and extravagance. But his travel and entertainment records revealed he spent £365,000 on foreign visits in three years, in some cases flying first class with his wife.

He also accepted hospitality from companies including computer giant EDS, a government contractor, and BAE Systems. Sir John has refused to release an NAO document on BAE's biggest and most controversial defence order, the al-Yamamah defence deal with Saudi Arabia.

Source: The Guardian, October 26, 2007

Great moments in Conflict of Interest History

Why is the case of Sir John Bourn interesting to Actuaries?

The central recommendation of the Morris Review of the Actuarial Profession (published in March 2005) was that self-regulation by the actuarial profession should be subject to independent oversight and standard setting by the Financial Reporting Council. The FRC assumed this responsibility in April 2006 and agreed a Memorandum of Understanding with the Actuarial Profession in May 2006. This is achieved through the Professional Oversight Board.

Responsibilities of the Professional Oversight Board (modeled on a similar board for Accountants) includes education, training, continuing professional development, standards, ethical matters, professional conduct and discipline.

Great moments in Conflict of Interest History

Why is the case of Sir John Bourn interesting to Actuaries?

Question:

Who chairs the Professional Oversight Board for Accountants?

Answer:

Sir John Bourn!!

Do we need more Regulation (a la U.K.)?

U.S. has traditionally relied on other solutions than regulation:

- **Competition**
- **Informed client**
- **Legal system**

Actuaries are professionals who can handle these situations.

What are your clients in your country saying?

