



SUPERANNUATION PRACTICE COMMITTEE

Discussion Note: An Update on Conflicts of Interest in Superannuation

June 2012

Contents

A. Purpose and status of Discussion Note	2
B. Background regarding pensions in the United Kingdom (UK)	2
C. APRA and the draft Prudential Standards	4
D. Brief overview for superannuation in Australia	5
E. Feedback sought	6
Appendix 1: Conflicts of interest – UK principles for pensions actuaries (November 2007)	7
Appendix 2: UK Actuarial Professional Standard (APS) P1 “Duties and Responsibilities of Pension Actuaries”	9
Appendix 3: Extract from the Code of Professional Conduct for the Institute of Actuaries of Australia – November 2009	11

A. Purpose and status of Discussion Note

1. This Discussion Note was prepared by the Superannuation Practice Committee ("SPC") of the Actuaries Institute ("Institute"). The purpose of this Discussion Note is to:
 - ▶ raise awareness and stimulate discussion amongst Members on the potential for conflicts of interest in superannuation, in particular where an actuary advises both the trustee of a defined benefit fund and an employer sponsor of the fund;
 - ▶ share the SPC's preliminary views on various issues to consider when deciding the appropriate course of action in relation to an actual, potential or perceived conflict of interest; and
 - ▶ solicit feedback from Members on the issues raised in this Discussion Note, which can be emailed to the SPC's Convenor, Andrew Boal, at: andrew.boal@towerswatson.com.
2. This Discussion Note does not represent a Professional Standard or Practice Guideline of the Institute.
3. This is the first version of this Discussion Note.

B. Background regarding pensions in the United Kingdom (UK)

4. In March 2005, the Morris Review of the actuarial profession in the UK ("Profession") identified conflicts of interest as a significant issue facing the Profession, especially in relation to work on pensions. It recommended that:

"Pension fund trustees, the scheme sponsor and the Scheme Actuary should explicitly agree that they perceive no material conflicts of interest prior to the Scheme Actuary advising both the trustees and the scheme sponsors;

If any of the three parties, i.e. anyone of the trustees, the Scheme Actuary or the scheme sponsor, deem at any point that a material conflict of interest has emerged, in relation to the same actuarial advisor advising both parties, then the trustees should have the option to retain the existing advisor and the sponsor should secure separate actuarial advice;

The Profession, or another appropriate body, should develop guidance for actuaries on the issues that they should take into account when considering the materiality of potential conflicts".

5. As part of the package of reforms recommended by the Morris Review, the Professional Oversight Board ("POB") was established in the UK in April 2006 and issued its first report in December 2006 covering its role of overseeing the Profession. This report noted that there were areas in which it believed that the Profession should do more and, in particular, the POB commented that it would look to the Profession to make substantive progress in the area of ethical principles including consultation on new guidance on conflicts of interest.
6. In response, the Profession's Pensions and Professional Affairs Boards set up a Working Party to deal with conflicts of interest, which developed a number of principles for addressing conflicts in the pensions area. These principles were agreed by the Professional Affairs Board in November 2006 as the basis on which a new (ethical) Actuarial Professional Standard for Scheme Actuaries could be developed (refer to Appendix 1 for a copy of the UK principles).
7. In subsequent reports, the POB urged the Profession to progress its work on conflicts of interest as a priority, applying the principles developed to conflicts across all practice areas. In its May 2009 report on the Profession, the POB considered arguments for a separation of advisory roles for trustees and sponsoring employers in pensions and recommended:

"As part of its development of an actuarial standard on conflicts of interest in pensions, the Profession should consider prohibiting actuaries from providing advice to separate parties, such as both trustees and sponsors, on the same or a closely related issue, unless there is a robust independent review of their work".
8. On 10 October 2011, the Profession's Conflicts of Interest Working Party issued a consultation paper about the Profession's new policy proposals on conflicts of interest. At this stage, it is not proposed to amend the Actuaries Code of the Profession. However, it is proposed to introduce new provisions to the existing Actuarial Professional Standard (APS) P1 ("Duties and Responsibilities of Pension Actuaries") in a new section 5 and paragraph 6.4 (refer to Appendix 2). It should be noted that a substantial number of responses were received in respect of the consultation paper and the Conflicts of Interest Working Party is currently in the process of considering the comments that have been provided. At the time of writing, it is expected that its final report will be published in time for new provisions to take effect by the end of the second quarter of 2012.

9. The Conflicts of Interest Working Party has also prepared a draft guide¹ which contains a description of relevant regulatory provisions affecting actuaries; related legal matters; and practical advice on how to identify and manage potential conflicts of interest.

C. APRA and the draft Prudential Standards

10. The Australian Prudential Regulation Authority ("APRA") is interested in how the actuarial profession in Australia manages the potential for conflicts of interest in superannuation. Having regard to the developments in the UK where the Profession is preparing to strengthen its guidance to actuaries in relation to conflicts of interest, the SPC has formed the view that it would be timely for the Institute to consider providing additional guidance to its Members to supplement the requirements of the Code of Professional Conduct ("Code") in this regard (refer to Appendix 3).
11. On 27 April 2012, APRA released 11 draft Prudential Standards for the superannuation industry, including SPS 520 (Fit and Proper) and SPS 521 (Conflicts of Interest). If an RSE licensee appoints an actuary to perform an actuarial function under the SIS Act or Regulations, the Prudential Standards or the Financial Sector (Collection of Data) Act, then the actuary so appointed is a "responsible person" of that RSE licensee.
12. The fit and proper criteria to be a responsible person includes a requirement that the person either has no conflict of interest in performing the duties of the position or, if the person has a conflict of interest, it would be prudent for the RSE licensee to conclude that the conflict will not create a material risk that the person will fail to perform properly the duties of the position.
13. The Board of an RSE licensee must take all reasonable steps to ensure that all of the entity's responsible persons, including the actuary, clearly understand the need to identify all potential conflicts of interest and the circumstances that might give rise to a conflict. The Board must also have procedures in place to require an incoming actuary to disclose all relevant duties and relevant interests. The Board must also keep an up-to-date register of all relevant duties and relevant interests as part of its conflicts management framework to provide reasonable assurance that all conflicts are being clearly identified and either avoided or prudently managed.

¹ Available in Appendix 5 of the document at: <http://www.actuaries.org.uk/research-and-resources/documents/plenary-3-conflicts-interest-guide>

D. Brief overview for superannuation in Australia

14. By way of background, a real conflict exists in a situation where, in acting for the benefit of one client, the actuary might need to work to the detriment of another. Potential conflicts of interest which have not yet arisen but may potentially arise in the future need to be treated with the same degree of care as real conflicts. Perceived conflicts, where other parties such as clients, the media or a regulator might perceive there to be a conflict even if the actuary does not consider there to be a conflict, also need to be managed carefully as they might affect the reputation of the actuary and the profession.
15. In superannuation, the most common opportunity for a conflict of interest to arise is between the trustee and the employer sponsors in relation to the funding of the defined benefits in a superannuation fund, or in relation to a matter which has a bearing on the benefits payable to members under that fund and therefore its cost to the employer sponsors. As there will generally be cost advantages for both parties in using the same actuary, the opportunity for a conflict of interest to arise emerges.
16. In practice, there is usually a reasonable alignment of interest of both parties, in that both the trustee and the employer sponsors are generally interested in adequately funding the defined benefits over the long term in order to provide security for their members and employees.
17. Where disagreement can emerge is in relation to the pace of that funding, though in practice to date the parties have generally been able to agree on a funding basis that is acceptable to both parties and also to APRA without too much difficulty.
18. Conflicts of interest may also extend to the actuary's duty of confidentiality. Information acquired by the actuary in the course of his or her professional work is frequently confidential to the client and the actuary has a duty not to disclose this information to third parties without the consent of the client (unless required to by overriding legislation). On the other hand, the confidential information may have a material impact on the advice provided to another client, with the result that, in some situations, the actuary may not be able to provide appropriate advice to that other client without disclosing the confidential information. This conflict of duty may not be easily resolved so it is important that the parties understand in advance how this situation will be managed.
19. In the interests of all parties involved, when a conflict of interest does emerge then, consistent with the Code, it needs to be managed appropriately through appropriate disclosure and controls, or by avoiding the conflict altogether.

20. Potential conflicts of interest can be managed through informed consent and mutual understanding regarding the approach that will be adopted if a conflict emerges, including which party has priority access to the nominated actuary in the first instance. Such an approach would allow all the parties to deal appropriately with their confidential information and seek independent advice from their own independent actuary should the circumstances warrant it. Whether the independent actuary is from another firm or not is up to the relevant party.
21. For example, the trustee of a superannuation fund may notify the employer sponsors of the fund that the trustee will have priority access to the nominated actuary in the event of a conflict of interest and, if any employer sponsor has any concerns regarding a potential conflict of interest and/or the trustee's access to any confidential information of the employer sponsor, then that employer sponsor should seek advice from its own independent actuary. If the parties wish to adopt a different approach then this should be documented in writing in a formal agreement.

E. Feedback sought

22. The SPC is considering the merits of developing additional material for Members on dealing with conflicts of interest in superannuation, which may assist Members in deciding how they will apply the Code in certain relevant circumstances. The SPC does not yet consider that a more prescriptive approach, such as the proposed new provisions to the UK Actuarial Professional Standard (APS) P1, is warranted.
23. To assist the SPC in considering whether further formal guidance on dealing with conflicts of interest in superannuation is needed and, if so, what form that guidance should take, the SPC is seeking comments from Members on:
 - ▶ their experiences in dealing with conflicts of interest in superannuation;
 - ▶ their views on the need for further guidance;
 - ▶ the matters on which further guidance would be helpful; and
 - ▶ the nature of any guidance that they would consider helpful.
24. Please provide comments by 31 July 2012 to Andrew Boal at: andrew.boal@towerswatson.com.

Appendix 1: Conflicts of interest – UK principles for pensions actuaries (November 2007)

1. Appointments - general

- 1.1. If a member is to provide actuarial advice under a dual appointment, the relationship with both clients must not be such as would be likely to bring the member or the Profession into disrepute if challenged after the event.
- 1.2. Definition: A dual appointment is an appointment of a member to provide actuarial advice to the trustees of a pension scheme with a simultaneous appointment to provide advice or services to one or more employers in relation to the scheme (or companies linked with them). For this purpose, a member is deemed to hold an appointment if the member's firm holds such an appointment and the member is operating at a level where he or she has direct contact with the client.

2. Appointments - requirements

- 2.1. A member must not hold a dual appointment unless a conflict management plan has been drawn up and agreed with each client covering the extent to which the member's duties to each client are restricted or unrestricted by reference to the other client, in particular:
 - i) the extent to which the advice to each client may be restricted by the advice or services to the other client, and the extent to which this will consistently be the case;
 - ii) the extent to which information will remain confidential to each client or will be disclosed to the other client without assertion that a breach of confidentiality has occurred; and
 - iii) which client would have access to future advice or services in the event that a conflict develops or either client withdraws consent to continuation of a dual appointment.
- 2.2. A Scheme Actuary appointment must not be restricted by reference to the other client in a dual appointment. One effect of this must be that, if there is a Scheme Actuary appointment and it is necessary to modify or cease one of the appointments, it must always be the trustees who have priority in relation to maintaining the appointment.

3. Actual conflict

- 3.1. Dual appointments must not be entered into, or if entered into must be appropriately modified, suspended or ceased, if there is an actual conflict between the member's

duty to provide the actuarial advice covered by the appointment to the trustees and his or her duty to provide the services covered by the appointment to the employer.

4. Provision of services by the member's firm to employer and trustee clients

- 4.1. If a member holds or is invited to accept an appointment he or she must take all reasonable steps to establish with the member's firm whether the member's firm provides any services to another client which mean that a firm's dual appointment exists or will exist if the appointment is taken on.
- 4.2. If all reasonable steps show that there is or would be such a firm's dual appointment, the member must not accept or maintain the first appointment mentioned in 4.1 unless either:
 - 4.2.1. the appointment is treated for conflict management purposes as if that member was personally accepting a dual appointment; or
 - 4.2.2. sufficient independence exists between the two appointments that the confidentiality of all information relating to the two clients and the quality of advice provided by the member or the member's firm are not at material risk of compromise; the member's client is appropriately aware of the other appointment and its implications; and the member's client has given consent to the firm's dual appointment.
- 4.3. Amplification: A firm's dual appointment occurs where there would be a 'dual appointment' as defined under 1.2 above if the firm were regarded as an individual.

Appendix 2: UK Actuarial Professional Standard (APS) P1 “Duties and Responsibilities of Pension Actuaries”

5. Conflicts of Interest

- 5.1. A Scheme Actuary to a Relevant Scheme must not advise the Employer to that scheme in relation to the funding of that scheme or in relation to any matter which has a direct bearing on the benefits payable under that scheme, including, but not limited to, advice on actuarial factors.
- 5.2. Before and while undertaking work (other than work specifically prohibited by paragraph 5.1. above) for an Employer to a Relevant Scheme, the Scheme Actuary to that scheme must follow either the approach set out in 5.2.1 to 5.2.4 below or an alternative approach which could reasonably be expected to provide equivalent protection to the interests of the Trustees:
- 5.2.1. the Scheme Actuary, Trustees and Employer produce and maintain a written agreed plan setting out how conflicts of interest are reconciled, how it is intended they will continue to be reconciled and what will happen if they cannot continue to be reconciled;
- 5.2.2. the plan allows the Trustees the option to continue with the Scheme Actuary appointment if the Scheme Actuary becomes unable to act for both parties;
- 5.2.3. so far as necessary to safeguard the interests of the Trustees, the plan provides for the waiver of any duty of confidentiality which would otherwise be owed to the Employer; and
- 5.2.4. the Scheme Actuary reviews regularly, having regard to principle 3 of the Actuaries' Code and to this section 5, whether or not he/she is able to continue acting for both parties. In so doing the Scheme Actuary must consider all of the relevant circumstances, including whether advice proffered to the Employer may have an indirect impact on funding or benefits or whether it might otherwise give rise to a reasonable perception that the Scheme Actuary's ability to provide objective advice to the Trustees is compromised.
- 5.3. A Scheme Actuary to a Relevant Scheme who is aware that another person in his/ her Firm is undertaking work for the Employer to that scheme must ensure that the Trustees are aware of any conflicts of interest which as a result arise or might potentially arise.

Transitional provision (section 5)

- 5.4. To the extent necessary to comply with paragraphs 5.1 to 5.3 above, any changes to engagement letters or similar contractual documentation must be implemented by the date six months following the coming into effect of this version of this APS.

6. Members other than Scheme Actuaries, including students, undertaking work in relation to pension schemes

6.4. Section 5 also applies, as it does to a Scheme Actuary;-

6.4.1. to any other Member who provides, or is materially involved in providing, the Trustees of a Relevant Scheme with any significant advice in relation to the funding of that scheme, or in relation to any matter which has a direct bearing on the benefits payable under that scheme, to the extent that they also provide significant advice to the Employer of that scheme;

6.4.2. to any other Member acting for the Trustees of a pension scheme, other than a Relevant Scheme, where;-

6.4.2.1. the Trustees exercise a fiduciary responsibility in relation to the delivery of benefits under that scheme;

6.4.2.2. the Trustees have powers and/or rights over funding and/or the size of benefits;

6.4.2.3. there is an Employer in relation to that scheme; and

6.4.2.4. the behaviour of the Employer could affect the security or size of benefits under the scheme.

Section 5 should be read accordingly, subject to such changes as may be necessary to give effect to this provision.

Appendix 3: Extract from the Code of Professional Conduct for the Institute of Actuaries of Australia – November 2009**4 GENERAL****4.1 Responsibility of Members in serving the public interest**

4.1.1 The Institute is a professional body that seeks to enhance the actuarial profession and to serve the public interest. In order to achieve this, it is essential that Members maintain proper standards of professional conduct and performance. The Institute therefore establishes and maintains Professional Standards and this Code to govern the provision of Professional Services by its Members.

4.1.2 When taken together the law, the Constitution, this Code and the Professional Standards, both in general and as they relate to specific roles and responsibilities, define a Member's professional responsibility. In particular, provided that a Member meets the requirements of the law, the Constitution, this Code and the Professional Standards, then he or she will have met the expectations of the profession with respect to the public interest.

4.1.3 The Institute relies on the conscience of each Member, and the collective conscience of all Members, to ensure that this Code and any Professional Standards are applied effectively and that perceived breaches are dealt with in accordance with clause 4.1.4.

4.1.4 A Member who reasonably believes that another Member may have committed a breach of this Code or of a Professional Standard must first consider discussing the matter with the other Member with a view to resolving it. If the matter cannot be resolved, or if either Member does not consider such a discussion to be appropriate or constructive, the concerned Member must seek the guidance described in clause 4.2.4. Following such steps the concerned Member, if warranted, must consider his or her duty to make a complaint in accordance with the rules of the Disciplinary Scheme.

4.2 Professional conduct

4.2.1 A Member must act with integrity, honesty and due care, and in a manner that seeks to uphold the reputation of the profession.

4.2.2 The obligation in clause 4.2.1 extends to requiring that a Member, in engaging in conduct, or providing advice, a report, communication or other information, does so in a way which is not knowingly false, misleading or deceptive.

4.2.3 There is room for honest differences of opinion between Members on many professional matters. Where such differences of opinion are held, a Member may express a view on such differences, provided that the Member does so in a measured and reasonable manner which avoids improper criticism or malicious injury to the reputation of another Member.

4.2.4 A Member who is in doubt as to what constitutes appropriate professional conduct in a particular situation must seek guidance on the interpretation and application of this Code and, where appropriate, the Professional Standards from a Fellow or Accredited Member whose opinion he or she values and must, if necessary, obtain legal or other relevant professional advice, and take the appropriate action required in the circumstances.

4.3 Professional experience

4.3.1 In accordance with the Professional Standard set by the Institute on continuing professional development, all Members have a continuing duty to maintain professional knowledge and skill at a level required to ensure that a Principal receives the advantage of competent Professional Services, based on current legislation and generally accepted practices and techniques.

4.3.2 In providing a Professional Service, a Member must take reasonable steps, taking into account the nature of the Professional Services to be provided, to ensure that they have appropriate knowledge and skills in the relevant area and at the level required in order to provide competent Professional Services.

4.4 Impartiality

4.4.1 A Member who provides Prescribed Actuarial Advice must exercise his or her independent professional judgment and give impartial advice.

4.4.2 Except as set out in clause 4.4.3 of this Code, a Member who provides a Professional Service (other than Prescribed Actuarial Advice) must exercise his or her independent professional judgment and give impartial advice.

4.4.3 Subject to clause 4.4.4, a Member who provides a Professional Service (other than Prescribed Actuarial Advice) which involves acting other than impartially (including, but not limited to, fulfilling an advocacy role for a Principal) must:

- (a) comply with the requirements laid down in clause 4.2; and

- (b) take such steps as are generally considered reasonable in the particular circumstances to ensure all parties who will receive the product of such Professional Service or be Materially affected by it are aware of the capacity in which the Member is acting and of any constraints imposed on the Member's independent professional judgment.

4.4.4 In any case, a Member must not act or give advice if there are constraints imposed on his or her professional judgment which the Member considers would result in engaging in conduct that would breach the standards of conduct set out in clause 4.2.

4.5 Conflicts of interest

4.5.1 A conflict of interest arises if a Member's duty to a Principal conflicts with:

- (a) the Member's own interests;
- (b) an interest of the Member's firm; or
- (c) a duty to another Principal.

4.5.2 A potential conflict of interest may arise in a number of circumstances, including accepting remuneration that is contingent upon a particular outcome related to the provision of a Professional Service.

4.5.3 A Member must manage actual or potential conflicts of interest so as to avoid a breach of the requirements set out in clause 4.4 of this Code. This may lead to different courses of action in different circumstances, including (but not limited to) making full disclosure or declining to act.

4.5.4 A Member must disqualify himself or herself from providing a Professional Service where there is a conflict of interest that cannot be managed in accordance with clause 4.5.3.

4.5.5 A Member must document the steps taken to manage any conflict of interest and agree such steps with all Principals whenever such agreement is necessary for the proposed resolution of a conflict of interest to be effective.

4.5.6 A Member must, as soon as practicable, disclose to his or her Principal the nature of Material compensation or income to the Member or a related party from a source other than the Principal that is related to the Professional Service provided to the Principal.

4.6 Confidentiality

4.6.1 A Member must have proper regard for the trust that is implicit in the relationship between the Member and his or her Principal. The Member must take reasonable steps to ensure that the information used and the result of any Professional Services provided remain confidential to the extent expected by the Principal and that the Principal is made aware if there is a breach of confidentiality.

4.6.2 Notwithstanding clause 4.6.1, obligations may be imposed on a Member by law that require the Member to breach confidentiality in certain circumstances.

4.7 Potential misuse of Professional Services

4.7.1 A Member must not provide, or continue to provide, Professional Services to a Principal when the Member reasonably believes the result of any Professional Services provided will be used to evade the law or in a manner that is likely to mislead third parties.

4.7.2 If a Member reasonably believes that the result of any Professional Services provided is or has been subject to such misuse, the Member must, in the first instance, immediately alert the Principal that he or she believes there has been misuse, and clarify in writing the purpose for which the result was to be used. The Member must also consider whether it is appropriate to offer to provide assistance to the Principal to rectify any misuse.

4.7.3 In circumstances where the Principal does not address and, if necessary, rectify any misuse within a reasonable time, and maintenance of confidentiality is or is likely to be Materially damaging to third parties, the Member must obtain legal or other relevant professional advice, and take the appropriate action required. Also, in such circumstances the Member must consider whether, in the context of his or her legal obligations, there is a greater obligation to such third parties than the maintenance of confidentiality.

4.7.4 If a Member has reasonable doubt about whether the actions of a Principal are legal and honest, the Member must consider his or her ongoing relationship with that Principal.

4.8 Co-operation with others

4.8.1 A Member must, in a manner consistent with the Member's obligations under this Code, co-operate with third parties providing services to the Member's Principal.

4.8.2 In circumstances where a Principal is replacing an appointee to any role which is required by Legislation to be performed by either an actuary or a person with actuarial qualifications:

- (a) the new appointee (if a Member) must, where practicable, speak with the incumbent or previous appointee. Before doing so, the Member must notify the Principal unless the Member is otherwise constrained by a legal or professional requirement from doing so. The incumbent or previous appointee (if a Member) must take reasonable steps to cooperate with the new appointee; and
- (b) if the new appointee Member is aware that his or her advice differs Materially from that of the incumbent or previous appointee, then the new appointee Member must endeavour to explain the reasons for the differences to the Principal.

4.8.3 In other circumstances where a Member is replacing another person, the Member must consider whether it is appropriate to consult with the other person to ensure that there are no professional reasons to decline taking on the new role.

END OF DISCUSSION NOTE