

EXPLANATORY MEMORANDUM TO CODE OF PROFESSIONAL CONDUCT

November 2009

A. About this Explanatory Memorandum

1. In 2007, the Professionalism Review Taskforce (“Taskforce”) was formed to consider whether the Code of Professional Conduct (“Code”) should be amended in light of experience with its operation since its original introduction in March 2006, as well as possible amendments arising out of designations changes then proposed (and subsequently adopted).
2. In July 2008, an Issues Brief was released by the Taskforce inviting comments from Members on various issues with respect to the Code. Five submissions were received.
3. In July 2009, the Taskforce released an Exposure Draft of proposed changes to the Code. It also held Horizons sessions in both Sydney and Melbourne to provide an opportunity for Members to discuss the proposed changes. The Taskforce received thirteen written submissions in response to the Exposure Draft and thanks Members for their comments.
4. This Explanatory Memorandum has been prepared to assist Members in understanding the key changes to the final Code (as compared with the Code released in February 2007) – refer Sections B to D inclusive.
5. The Appendix to this Explanatory Memorandum sets out the key changes that were made in the final Code as compared with the July 2009 Exposure Draft.

B. Framework of new Code

6. The following framework was used in preparing the new Code:
 - (a) the Code should be principles-based as much as possible and not prescriptive. This approach provides Members with appropriate levels of discretion as to how to act in the myriad commercial situations in which they work;
 - (b) the Code should: not impose undue constraints as compared with other professionals; meet, rather than exceed, established community standards; and be consistent with standards applying to equivalent professions; and

- (c) the Code should be consistent with a growing profession and encourage continuing diversity into new areas (for example, through the designations-related changes and lighter touch reporting and other requirements that avoid undue restrictions on Members).

C. Commencement date

- 7. The new Code will come into effect on 1 January 2010, being the commencement date for the designations changes (as previously announced).

D. Key changes from the previous Code

- 8. The following sets out the key changes in the new Code as compared with the Code released in February 2007.

D.1 Prescribed Actuarial Advice and Professional Services

- 9. The previous Code was prescriptive around actuarial advice which was itself broadly defined. As a result, much work performed by actuaries that was not necessarily actuarial in nature was bound by the stricter provisions of that Code, including onerous reporting compared to others who competed with actuaries for the same work. Examples are an actuary working in mergers and acquisitions, or as a share analyst. In these circumstances an actuary must have met the requirements of the previous Code unless there was an explicit agreement that the report did not constitute Actuarial Advice. This process was seen by users as unnecessary, unwarranted and risked diminishing the profession in the eyes of users. In addition, the profession had to be realistic over what the Institute can and should control.
- 10. Consequently, the broad and subjective term 'Actuarial Advice' has been replaced with a clearly defined term 'Prescribed Actuarial Advice'. Prescribed Actuarial Advice is:
 - (a) any conclusion, result, opinion or recommendation required to be performed under Legislation by either an actuary or a person with actuarial qualifications and experience; or
 - (b) anything deemed to be prescribed actuarial advice by being specified as such in a Professional Standard or declared to be such by the Council of the Institute.
- 11. Prescribed Actuarial Advice can only be provided by an 'Eligible Actuary' (that is, essentially, a Fellow or Accredited Member). Paragraph (b) of the definition of 'Eligible Actuary' has been included because, in certain practice areas, it is possible for a regulator to approve the appointment to a statutory role of a person who is not a Fellow or Accredited Member of the Institute. An example of this can be found in the Insurance Act 1973 (Cth). Under s39 of that Act, a company must appoint an "actuary" but must not appoint a person unless it is reasonably satisfied that the person meets the eligibility criteria for such an

appointment set out in APRA's prudential standards. APRA's General Prudential Standard GPS 520 sets out the eligibility criteria as including that the person is either a Fellow or Accredited Member of the Institute (paragraph 25(e)). However, paragraph 29 of GPS 520 essentially provides that, in exceptional circumstances, APRA may allow the appointment of a person who does not meet one or more of the eligibility criteria (including that of being either a Fellow or Accredited Member of the Institute). Paragraph (b) of the definition of 'Eligible Actuary' provides for such a possibility.¹

12. Prescribed Actuarial Advice is an objective term that, because of its nature, is under the professional control of the Institute. All other advice comes under 'Professional Services'. This distinction provides for stricter requirements to apply to advice that can only be provided by Fellows/Accredited Members and allows other advice to be provided on terms more consistent with other professions, but subject to requirements of professional behaviour set out in clause 4.
13. These changes are also important to allow for the new designations. In addition to the introduction of a concept of 'Prescribed Actuarial Advice', restrictions on the use of the designation 'actuary' have been imposed as set out in clause 6.1 (discussed in Section D.8 below).
14. Applying the framework discussed above, the Code:
 - (a) adopts a uniform approach in terms of behavioural requirements that meets community standards across all Professional Services (including Prescribed Actuarial Advice); and
 - (b) imposes focused additional obligations on Members providing Prescribed Actuarial Advice that reflect back community expectations in view of the trust placed by the public in Members providing such services.

D.2 Overseas Members (clause 1.1)

15. A significant proportion of Members are not resident in Australia (approx 25%). Often, such Members are also members of the actuarial association in the country in which they are practising and, potentially, under the previous Code, could have been subject to inconsistent professionalism requirements. The continuing globalisation of the profession made that aspect of the previous Code anachronistic.
16. Actuarial associations that are Full Members of the International Actuarial Association are required to have certain minimum levels of standards relating to professionalism. The new Code appropriately recognises this and that, as such, there is broad consistency in professionalism requirements around the world.

¹ For examples in other practice areas, see: paragraph 20 of APRA's Life Prudential Standard 520; and s160.1(5) of the Private Health Insurance (Insurer Obligations) Rules.

17. The wording in the new Code is intended to enable Members working overseas to more easily meet requirements of local standards, while maintaining standards broadly consistent with those of the Institute.
18. For the avoidance of doubt, a Member who, by the application of clause 1.1.2, is required to comply with the Local Association's equivalent of the Code, may still be subject to disciplinary proceedings under the Institute's Disciplinary Scheme where they have breached the Local Association's code. This is because, as the Code requires such a Member to comply with that Local Association's code, non-compliance with such would also constitute non-compliance with clause 1.1.2 of the Code and therefore be actionable.

D.3 General professionalism (clause 4)

19. Clause 4 has been refined to focus on and reinforce important principles of professional behaviour that all Members must observe. The onus is on personal responsibility for one's professional behaviour and advice which may include, for example, taking positive action where a Member becomes aware of the misuse of their advice. At the same time, the Code takes heed of the realistic ability of Members to influence the actions of others.
20. The role of Senior Actuary has been removed from the Code as it is an administrative function which can be achieved in other ways.

D.4 Professional experience (clause 4.3)

21. The new Code reflects the position that it was not appropriate to expand the previous Code wording to be more prescriptive in terms of experience (particularly for Prescribed Actuarial Advice) as this would be too prescriptive for a profession that is continually expanding its scope of work and contrary to the principles-based approach taken to the Code.
22. The new Code also recognises that the previous Code wording implied that a Member could be limited in providing advice without obtaining "adequate" guidance in areas that could be considered new fields (where there may be no guidance available).
23. Also, there are a number of areas within the new Code that implicitly require a Member to ensure they are providing advice to an acceptable level for more traditional areas of actuarial work, in addition to the requirements of Professional Standard 1 (Continuing Professional Development).
24. As a result, under the new Code, Members are required to have "appropriate knowledge and skills" instead of "taking reasonable steps to obtain adequate guidance", the emphasis being on "appropriate" rather than "adequate". The intention is to place the onus upon Members to determine what is appropriate in each case.

D.5 Impartiality and conflicts of interest (clauses 4.4 and 4.5)

25. The new Code proceeds from the position that, while Members should generally be required to exercise their professional judgment and give impartial advice (clause 4.4.1), there are categories of work where Members might appropriately provide advice that is not impartial and where the level of disclosure required by the previous Code was not in keeping with community expectations.
26. Therefore a Member providing Professional Services other than Prescribed Actuarial Advice, including a Member acting in a role where they are not giving impartial advice based on their professional judgment, must take such steps as are generally considered reasonable in the particular circumstances to ensure all parties who will receive the advice 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 (clauses 4.4.2 and 4.4.3).
27. An overriding requirement is also now in place that 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 advice that could bring the reputation of the profession into disrepute (clause 4.4.4).
28. Conflicts of interest, and potential conflicts of interest, are now identified (clauses 4.5.1 and 4.5.2) and a Member must manage any conflicts so as to avoid breaching the impartiality requirements (clause 4.5.3). Commercial conflicts arise constantly and in many cases can be managed appropriately rather than avoided.
29. A Member must disqualify himself or herself if there is a conflict that cannot be managed appropriately (clause 4.5.4). The steps taken to manage the conflict must be documented (clause 4.5.5).
30. A Member is also required to disclose to his or her Principal the nature of any Material compensation or income he or she (or a related party) receives from a source other than the Principal but which is related to the Professional Services being provided (clause 4.5.6).

D.6 Co-operation with others (clause 4.8)

31. The new Code expands on the previous Code by:
 - (a) requiring, in relation to statutory role appointments, co-operation with both Members and non-Members who are either replacing a Member in such a role or being replaced by a Member in such a role (clause 4.8.2); and
 - (b) requiring Members who are replacing someone in a non-statutory role context, to consider whether it is appropriate to consult with that other person to determine if there are professional reasons why the Member should not take on the role (clause 4.8.3).

D.7 Professional indemnity (PI) insurance (clause 5)

32. In summary, the previous Code required an Actuary to maintain a level of PI insurance cover which was adequate, with an exemption provided for an Actuary who was an employee of the Principal.
33. The new Code recognises that, in many instances, the primary PI insurance obligation is likely to fall on a legal entity, for example the Member's employer. In this context, the Code reflects what is reasonable for the profession to expect of a Member who may have only limited insight into or control over the actions of his or her employer with regard to PI insurance.
34. The more prescriptive approaches to PI insurance for the legal profession, and elements of the accountancy profession, are not considered appropriate for the actuarial profession at this time. Much of actuarial work is in the wholesale arena, with a limited intended audience and where the parties are capable of negotiating commercial arrangements relevant to warranties and indemnities. To the extent that work in the retail sector falls under the Australian Financial Services Licence requirements, there are already statutory PI obligations in place. This leaves a potential gap in the area of non-financial advice given to retail clients, which has been addressed in the new Code by adopting a principles-based approach in keeping with the rest of the Code.
35. Under the new Code:
 - (a) for "wholesale" Principals (that is, those who are not "retail"), there are no PI insurance requirements beyond those which may already be prescribed by law in certain circumstances. It is open to a "wholesale" Principal to seek specific PI insurance coverage as part of contractual negotiations for the provision of a Professional Service; and
 - (b) "retail" Principals are a special case that warrant special consideration, so that:
 - (i) where a Professional Service provided by a Member constitutes financial product advice to a "retail" Principal (falling under an Australian Financial Services Licence), the Code does not prescribe anything additional to the existing legal requirements for PI insurance coverage in such instances;
 - (ii) however, in relation to a "retail" Principal where the Professional Service provided by a Member to that Principal does not constitute financial product advice falling under an Australian Financial Services Licence, the new Code provides that:
 - ▶ the Member is required to hold PI insurance (either personally or through another party) which is adequate; and
 - ▶ for the good of the profession's reputation, this requirement extends to all Members and all forms of Professional Services falling within this category.

36. In light of the above, it is no longer necessary or appropriate to have a blanket exemption for an Actuary who is an employee of the Principal and this has been removed from the new Code.

D.8 Use of the designation 'actuary' (clause 6.1)

37. Part of the designations-related changes approved by Council included broadening the categories of Members who may use the designation 'actuary', whilst also imposing restrictions which would ensure that the public was not misled as to the qualification level of the Member concerned.
38. The new Code introduces specific limitations on the use of the designation 'actuary'. It also introduces disclosure requirements in appropriate circumstances to act as a safeguard against the public being misled or deceived.

D.9 Reporting (clause 7)

39. The new Code introduces light-touch reporting provisions which apply to a wider range of Professional Services work. In doing so, the new Code proceeds from the basis that the Code should focus on 'conduct' rather than prescriptive approaches to reporting.
40. The new Code places the onus on Members to ensure that their reporting in respect of Professional Services complies with any relevant Professional Standards and is appropriate, having regard to:
- (a) the intended audience;
 - (b) its fitness for the purposes for which such reporting may be required or relevant;
 - (c) the likely significance of the reporting to its intended audience;
 - (d) the capacity in which the Member is acting; and
 - (e) any inherent uncertainty and risks in relation to the subject of the report.
41. For Prescribed Actuarial Advice, there are some additional reporting requirements (as set out in clauses 8.1.2 and 8.1.3).
42. The provisions in the previous Code relating to reporting requirements in respect of Actuarial Advice have largely been moved to a Practice Guideline which applies to Prescribed Actuarial Advice and which will also take effect on 1 January 2010. As Members are aware, whilst compliance with a Practice Guideline is not mandatory, Members are required to consider explaining any significant departure to the Principal, and to document such explanation.

43. Where more detailed approaches to reporting are required than are provided for under the new Code, these will be introduced into the relevant professional standards relating to the type of work.

END OF EXPLANATORY MEMORANDUM

Annexure: Key changes in final Code compared to July 2009 Exposure Draft

1. Clause 1.1 – the application of the Code to all Members has been further clarified for the avoidance of doubt. The application of the Code (or an equivalent of the Code etc) for overseas Members has now been restricted to cases where the Member is practising outside Australia (rather than being employed or practising outside Australia).
2. The definitions of “Eligible Actuary” and “Prescribed Actuarial Advice” have been varied slightly to overcome a technical error. The term “Statutory Role” has been removed as being unnecessary in light of the other changes made (with consequential changes made to clause 4.8.2).
3. Clause 4.5 – specific reference has now been made to potential conflicts of interest and these are now required to be managed as for actual conflicts of interest. A new clause 4.5.6 has been added dealing with disclosure 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. The new clause addresses stipulated requirements of the International Actuarial Association (“IAA”) as to the content of codes of professional conduct.
4. Clause 4.8 re co-operation with others – this has been expanded to cover consultation with non-Members as well as Members, in accordance with the IAA’s requirements.
5. Clause 7 re reporting – the requirement in the Exposure Draft to provide clear and effective reporting and indicate how any further explanation can be obtained has been removed. It was considered that the phrase “clear and effective”, in particular, was too subjective and would lead to enforcement difficulties.
6. A new clause 8.1.3 has been inserted dealing with additional requirements for communicating Prescribed Actuarial Advice, in satisfaction of the IAA’s requirements.