Hymans Robertson

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Response to the Morris Review

of the Actuarial Profession

Hymans Robertson fully supports the Morris Review and welcomes this independent perspective on the profession's governance and standards. We also hope that the external impetus created by the Review will cause much needed changes to happen more quickly than would otherwise be the case.

We agree with a great deal of what is said in the Interim Assessment report as regards our profession. However, we do not agree that the state of the actuarial profession is as bleak as is portrayed in the Executive Summary of the Interim Assessment. There are, in particular, a small number of specific issues with which we disagree and these are discussed in this response.

Our Firm provides advice primarily to pension fund clients. The comments in this response therefore relate either to matters in the Review which concern the actuarial profession as a whole, or those which relate to the provision of pension consultancy services.

Contents

We are pleased to respond to the Interim Assessment of the Morris Review of the Actuarial Profession which was published by the Review team in December 2004.

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Hymans Robertson was formed in 1921 and is one of the longest established independent firms of consultants and actuaries in the UK. Our core business is the provision of advisory and management services to the Trustees of occupational pension schemes and to the sponsors of those schemes.

We employ 302 staff in the UK in offices in Glasgow, London and Birmingham. As shown in the Interim Assessment of the Review we are, by one measure, the UK's fourth largest provider of actuarial consultancy services. We are also, by the same measure, the UK's fourth largest provider of investment consulting services.

Our response

A number of the Firm's Partners serve on the Boards, Committees and Councils of the Profession's various bodies (such as the Council of the Faculty of Actuaries, the profession's Pensions Board and the Association of Consulting Actuaries) and the Firm consequently has input into the responses submitted by these bodies.

This response is therefore intentionally brief, concentrating on our general view of the Interim Assessment and, in particular, the key points with which we disagree.

Where we agree with the Review

We agree with a number of the issues raised in the Interim Assessment. In particular, we would agree that:

- The profession has a tendency to insularity.

- The Education system is slow to adapt and the supervision of further development through an actuary's career almost non existent.

- The Profession is confused about what its public interest duty actually means in practice.

- Formal actuarial standards published by the Profession form only a minimum set of standards which often fall well short of best practice.

- Though acting in good faith it is unsatisfactory for practising actuaries to set standards and then apply them without any independent review.

- Given the events which led up to the instigation of the Review and changes happening in other professions the current Governance structure of the Actuarial Profession is unlikely to be a sound platform for restoring public confidence.

We are, therefore, particularly supportive of:

- All measures and proposals that will broaden the education of trainee and qualified actuaries.

- A move towards an Actuarial Standards Board with a greater lay representation and independent oversight.

- Improved Actuarial Standards (towards which the recently established Scrutiny Committee of the Profession is a useful step).

- Clarification (in legislation if necessary) of what is the actuary's public interest duty, including his/her responsibility to whistle blow.

- The introduction of compulsory peer review and much tighter monitoring of post-qualification development.

We hope that the Review will put real impetus into all of these measures.

Where we disagree

There are, however, a number of comments raised and options proposed in the Interim Assessment with which we have particular concerns.

Expectation of Actuaries

We entirely support the Review's neat description of what we do:

"actuarial work …seeks to characterise, measure and analyse an uncertain future. This assists consumers to take better, and ideally optimal, decisions in preparing to meet that uncertain future".

However we dispute the Review's sweeping assertion that we go beyond this and hold ourselves out as fortune tellers.

"Explicitly or otherwise, too much has been promised by [actuaries]" … "most of those involved have tended to avoid or resist clear presentation of the unavoidable risks inherent in assessment of an uncertain future." [1]

In our experience, many actuaries do present the risks inherent in their assessments (indeed, the professional guidance for actuaries providing pension scheme actuarial valuation reports has required them to comment on investment-related risks and sensitivity issues; more recently, the guidance has been extended and strengthened in this respect).

We accept that practice in this area is not uniform and we also accept that many of the current ways of explaining risks have been embraced relatively recently. Nonetheless we ask that, in framing its final recommendations, the Review team takes account of current best practice.

Communication does remain an issue: the risks are not always necessarily communicated in a way that is readily understood by the client. Furthermore, in some cases clients have allowed self-interest to colour their judgement of the potential risks of a particular course of action. In most pension schemes the actuary can only advise and influence. He cannot make decisions.

In our view, the challenge for actuaries is to communicate the risks associated with an uncertain future both in plain English and in the context of stakeholders' circumstances.

We agree that the challenge for the clients of actuaries is to equip themselves to respond to that advice.

[1] Paragraph 1.17
[2] Paragraph 2.120, Option 2
[3] Paragraph 2.132, Option 2
[4] Only four firms advise all the LGPS funds

The market for actuarial services

Like Myners, the Review team bemoans the concentration of market share in the hands of four Firms of advisers. However like Myners the Review team finds that there are few barriers to entry and that each year around 10% of schemes review their advisers. Our sense is that a) the market is becoming ever more competitive; b) that prices for "commodity" services are falling in real terms; c) that more schemes are reviewing their advisers (and many more companies and trustees are considering separate advisers) and d) clients are becoming more aware of "quality" when they market test.

We believe the market is taking care of the competition element itself.

We have concerns, in particular, with two of the possible options proposed by the Review in the Interim Assessment.

(i) 'Bundling'

The first of the proposed options which gives us cause for concern is as follows:

"In the pensions area, unbundling the provision of advice related to statutory roles from other types of advice (particularly investment consulting services) would help open up the market to greater competition." [2]

Separate contracts for investment consulting and actuarial appointments are now the norm. That is right and proper. Trustees should choose the most appropriate actuarial adviser and separately the most appropriate investment adviser. Indeed they may even wish to divide the latter appointment into specialist blocks: there is no particular reason why, for example, a good strategy adviser should be an expert on Socially Responsible Investment.

But we strongly disagree that it is somehow wrong to appoint the same Firm for the actuarial and investment contracts if that Firm can demonstrate that it is the most appropriate in both areas. It has been one of our Firm's great successes that we have been able to recruit investment specialists who have then helped to develop the broader thinking of their actuarial colleagues. The implication in the Review that appointments should be split could lead to the development of narrower and narrower focussed firms and an increase in the very insularity which it criticises.

(ii) Market testing

The second possible option with which we have concerns is this:

"Regular formal reviews of advisers could be recommended or required every 3-5 years." [3]

The Interim Assessment does not acknowledge the extent of the costs associated with market-testing of advisers. To prepare a tender for a potential new client (or for an existing one re-tendering) costs upwards of £20,000 in man hours which would otherwise be spent doing productive work for clients. Those costs have to be recovered somehow and inevitably through charges to clients. We welcome competition but, unavoidably, it comes with a cost. Smaller pension funds already find the cost burden to be very onerous.

Hymans Robertson is no stranger to regular market testing of our services. We advise a large proportion of Local Government clients in the UK — these clients are required to carry out regular market testing of actuarial services under the Local Authority Best Value regime. Our experience of these exercises has led us to draw the following conclusions regarding the benefits of regular market testing:

- Regular testing of the market tends to lead to price being a significant element of the decision process (because it is one of the few measurables).

- Advisers need a large client base in order to achieve economies of scale—leading to greater concentration in the market [4] and high barriers to entry.

- Despite the Best Value edicts, relatively few funds have actually changed adviser except where the previous adviser has declined to retender.

- High bidding costs for advisers are inevitably incurred—which need to be recouped from the system somehow and, when combined with the lower margins, lead to a further increase in the barrier to entering the market.

- A business considering entering the market needs deep pockets to meet the costs associated with tendering and a long time horizon to consider a return on the investment.

Market testing has been a significant positive for our Firm (over 25 years our market share in the Local Authority sector has doubled). However the number of Firms in the sector is still four, just as it was in 1980.

Simply requiring more market testing seems a rather crude and potentially short-termist approach to what is a long-term problem. Although market testing may be successful in driving down costs to clients in the short-term, there is a risk of having fewer players to sustain long-term competition in a rapidly maturing market for advice on defined benefit pension schemes, thus having the opposite effect to that intended in terms of increasing competition.

Conflicts of interest

There is no question that there is a potential for conflicts of interest arising for actuaries advising trustees and employers. However, this potential conflict is no greater (and possibly less) than for those senior employees of the employer who also act as trustees. The position of the actuary is part of a wider governance issue about UK pension schemes.

Nonetheless, actuaries should not be complacent about potential conflicts of interest. The profession has recently placed a legal opinion on its website to help actuaries understand the issues.

The Interim Assessment proposes[5] four possible options relating to potential conflicts of interest for Scheme Actuaries:

1: Scheme Actuary advises both the scheme sponsor and trustees, unless the actuary deems there to be a conflict, in which case the Scheme Actuary only advises the trustees;

2: Scheme Actuary advises both the scheme sponsor and trustees, unless the trustees deem there to be a conflict, in which case the Scheme Actuary only advises the trustees;

3: role of advising the scheme sponsor and the scheme trustees is separated in some clearly defined circumstances; or

4: role of advising the scheme sponsor and the scheme trustees is separated at all times.

Many activities which actuaries carry out do not involve conflict so we do not favour option 4 with its attendant increase in costs. We also think it difficult in practice to define in advance all the circumstances in which conflict may arise: we have attempted to do so for our Firm.

Thus we favour a combination of options 1 and 2 but with some disciplinary bite to ensure the highest possible standards.

Overall view

Whilst there are certain aspects of the Interim Assessment with which we disagree, we do welcome the Review that is being carried out by Sir Derek and his team.

In our view, the Actuarial Profession requires an external force for change to avoid becoming enveloped in self-indulgent procrastination. We look forward with interest to the Review's final report and recommendations, due to be published in spring 2005.

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5 Paragraph 5.96