



4 February 2005

Sir Derek Morris
Morris Review of the Actuarial Profession
Room G/37
1 Horse Guards Road
LONDON
SW1A 2HQ

Dear Sir Derek

Morris Review of the Actuarial Profession: Interim Assessment

Please find attached the IMA's response to the Interim Assessment from the Morris Review of the Actuarial Profession.

Yours sincerely

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IMA Response to the Interim Assessment from the Morris Review of the Actuarial Profession

The IMA represents the UK-based investment management industry. Our Members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of about £2 trillion of funds (based in the UK, Europe and elsewhere), including authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In particular, our Members represent 99% of funds under management in UK-authorised investment funds (i.e. unit trusts and open-ended investment companies).

Our members, as managers of pension funds' assets, have a keen interest in the way in which the actuarial profession services their pension fund clients. The IMA believes that there are three key areas which should be addressed and which to a considerable extent are interlinked:

- Competition;
- Market Testing; and
- Scrutiny.

The IMA believes that it is desirable to promote **competition** and would support the unbundling of the provision of advice related to statutory roles from other types of advice i.e. investment consulting. We would further support the proposals put forward in HMT's Progress Report on Compliance with the Myners' Principles that, in Principle 4, "pension funds should contract separately for actuarial, strategic asset allocation and fund manager selection and that these contracts be open to separate competition".

With respect to strategic asset allocation, IMA members believe that this is the single most important investment decision for a pension fund's board of trustees. In common with the HMT Report on the Myners' Principles, our members are of the view that not enough attention or resources are devoted to this subject. While this should improve as trustees enhance their skills and expertise, opening up the market to greater competition will result in a higher level of scrutiny of past advice and of underlying assumptions with respect to future returns. Better contractual structures for the engagement of investment consultants, or other advisers, will also contribute by providing a better framework for clarifying and contracting for the appropriate advisory requirements. The IMA considers that trustees should be encouraged to engage both investment consultants and investment managers in discussions leading up to strategic asset allocation decisions.

Increased **market testing** should go hand in hand with a higher level of trustee skill and expertise which will allow for an improved dialogue between trustees and their advisers. As fund managers our members are already subject to intense scrutiny by investment consultants and by clients. It would therefore seem appropriate that other pension fund advisers are subject to similar scrutiny. The IMA believes that regular re-tendering for advisers on a formal basis should be best practice for pension funds. This could be done every 3 or 5 years and would encourage trustee boards to assess the performance of their advisers in a more formal way and would provide an added level of scrutiny.

Improved **scrutiny** of investment consultants has a number of potential aspects. The IMA would endorse the profession's introduction of peer review, but believes that there is scope for greater external scrutiny. In particular, there is at present little or no measurement of the performance of consultants, in contrast with the asset management industry where performance measurement is a key discipline on managers. There are two areas which would seem in principle capable of measurement:

- **Manager selection.** Consultants control the appointment of investment managers by boards of trustees to the extent that they recommend particular investment management firms. The IMA believes that a form of performance measurement of actual recommendations would be appropriate in order to provide assurance to trustees that consultants are adding value. This would be done by comparing actual performance against benchmark after the asset allocation decisions are taken
- **Strategic asset allocation.** In principle it should be possible to devise metrics for measuring the outcomes of strategic asset allocation decisions against alternative scenarios. This is however much more difficult than measuring manager selection, where a comparison against benchmark would provide meaningful information. We would be happy to discuss this with you further.

Finally, the interim assessment raises the possibility of the Financial Reporting Council taking on certain regulatory functions in respect of the actuarial profession. The IMA does not wish to offer a view on the question whether regulation by a statutory body is appropriate. If, however, the Review concluded that regulation were appropriate, we would agree that the FRC would seem to be the right body to take it on.

The IMA's responses to those policy options within its remit are in the attached appendix.

APPENDIX 1 IMA's Comments on the Policy Options within its Remit

2.120 Options for Increasing Competition

- 1. To the extent that the availability of professional indemnity insurance cover is acting or may in the future act to constrain entry and limit choice, ways could be explored of introducing liability caps; and/or*
- 2. 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.*

In the pensions area, IMA members believe that unbundling of advice related to statutory roles from other types of advice should be a minimum objective, and that asset allocation advice and fund manager selection should also be contracted for separately, in line with the recommendation in HMT's Progress Report on Compliance with the Myners' Principles.

Regarding strategic asset allocation, where IMA members are well placed to give advice, encouraging a tripartite discussion involving trustees, actuaries and investment managers could be one way forward. The IMA points out, however, that smaller pension funds may find it more economic both in terms of costs and resources to buy a bundled service. Therefore, this option should not be prohibited.

2.132 Options for Increasing Market Testing

- 1. Increased education/expertise of users; and/or*
- 2. Regular formal reviews of advisers could be recommended or required every 3-5 years; and/or*
- 3. Performance measurement of actuaries could be encouraged; and/or*
- 4. Effective peer review of actuarial advice could provide actuaries with a set of incentives that encourages them to improve the clarity of advice they provide, both technical and in relation to underlying assumptions.*

All these options have merit. Increased education/expertise of users will lead to increased market testing as well as increased scrutiny and challenging of advisers, while regular formal reviews of advisers will encourage users to assess the performance of their advisers in a more formal way to ensure that the services provided are adding value.

The performance measurement of actuaries is to be encouraged and will evolve as the market is opened up for competition, resulting in a higher level of scrutiny of past advice. Fund managers are already subject to intense scrutiny by investment consultants and by clients. It is appropriate that the performance of all pension fund advisers is subject to similar analysis, both with respect to fund manager selection and to their track record in strategic asset allocation. IMA members believe that the latter is the single most important investment decision for a pension fund's board of trustees. In common with the HMT Report on the Myners' Principles, our members are of the view that not enough attention or resources are devoted to this subject. While this should improve as trustees enhance their skills and expertise, opening up the market to greater competition will result in a higher level of scrutiny of past advice and of underlying assumptions with respect to future returns. Better contractual structures for the engagement of investment consultants, or other

advisers, will also contribute by providing a better framework for clarifying and contracting for the appropriate advisory requirements. The IMA considers that trustees should be encouraged to engage both investment consultants and investment managers in discussions leading up to strategic asset allocation decisions. Investment consultants should also provide a record of their actual fund manager selection history.

2.134 Options for Improving User Understanding

- 1. User knowledge and understanding should be encouraged by measures to raise the required standards of knowledge and expertise, of which several are already in train; and/or*
- 2. In relation to pensions, trustees could be given information on the Profession's own guidance notes, to better understand what actuaries are supposed to do. This could be used as a basis for encouraging more systematic challenge; and/or*
- 3. Greater use of professional trustees or trustees who are members of several trustee boards.*

Again, all options have merit. A required standard of trustee knowledge and understanding should be aimed for. While professional trustees have an important contribution to make here, it may be that smaller schemes will not be able to afford their services. Actuaries should certainly explain in lay terms to trustees what their role is in respect of the pension fund and what limitations surround the carrying out of their functions. It is the experience of IMA members, many of whom have large numbers of overseas clients that certain models in other European countries demonstrate that high standards of trustee expertise can make a significant contribution to good fund governance and effective investment decisions. It is often common to have CFA (Chartered Financial Analyst) qualified people on client trustee boards.

2.135 Options for Improving Clarity of Choice

- 1. Leave it to the market, on the basis that if users can be encouraged to challenge more effectively, actuaries will stand or fall by their ability to respond positively; or*
- 2. Improve actuarial training and CPD requirements to equip actuaries with improved communication skills; or*
- 3. Require clearer disclosure of actuarial advice, assumptions and key sensitivities. For example by requiring the disclosure of forward-looking financial condition reports; and/or*
- 4. Explore means by which regulatory requirements might be simplified.*

The IMA believes that a more pro-active approach than option 1 is needed and is pleased that the profession is taking CPD and improvements in communication skills seriously. Clearer disclosure is to be desired, in non-technical language, as well as actuaries providing a range of outcomes around their forward-looking assumptions. Simplification of regulatory requirements is to be welcomed.

5.96 Options for Increasing Accountability in Pensions

- 1. Status quo – 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; and/or*

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; or*
3. *Role of advising the scheme sponsor and the scheme trustees is separated in some clearly defined circumstances e.g. during scheme wind-up; or*
4. *Role of advising the scheme sponsor and the scheme trustees is separated at all times.*

Ideally option 4 is to be preferred, but it is likely to be unworkable and expensive, particularly for smaller schemes. Option 1 combined with Option 3 will be a more practicable solution in certain circumstances.

8.63 Options for Scrutiny of Actuaries in Pensions

1. *Maintain the status quo of no formal scrutiny; or*
2. *Include long-term liabilities within pension scheme financial statements, which are then audited; and/or*
3. *Introduce peer review of the Scheme Actuary as envisaged by the Profession; and/or*
4. *Audit the Scheme Actuary's triennial valuation.*

The IMA concurs that the current level of scrutiny is in need of review. As a first step peer review of the Scheme Actuary is the more practicable course of action from a cost benefit point of view. It is clear that a significant degree of independence should exist between the reviewer and the Scheme Actuary and that they should be employed by different firms. The reviewer should consider assumptions made by the actuary and highlight where there is a significant divergence of view and the possible reasons for that. High-level scrutiny should be sufficient but should be the same for all sizes of schemes. In addition, however, the IMA believes the development of generally accepted and widely available performance measures for consultants would make a significant contribution to improved scrutiny.