

MORRIS REPORT

Notes for Institute meeting 24th January 2005

We are indebted to Sir Derek and his team for giving us this opportunity for a thorough look at ourselves. I am sure we are all most grateful for all the effort they have put in.

There is much in this review which looks as if it could result in increasing regulation and restrictions on our modus operandi and which if we are not careful might succeed only in killing off whatever creative flair our insular souls might still have. So I am glad that Sir Derek will look on the positive side in reviewing the role of Actuaries, and concentrate on how our qualities can best be harnessed as a force for public good.

He has referred to the potential for conflict where the scheme actuary also advises the Scheme sponsor. Although I am now mainly retired I act as an Independent Trustee of schemes where once I was the Appointed Actuary. One of these comprises a large majority of Pensioners and deferreds, made redundant when their original Company was recently taken over. The scheme actuary has for many years also advised the Company and has acquiesced in a minimum MFR funding basis. His fees are met ultimately by the Company so he is unlikely to take a stance which is significantly against the company's interests. There is clear potential for conflict. The large group of retired and deferred members are effectively 'orphaned' with no-one to speak directly on their behalf and it is in this type of situation that separate advisers to the Trustees and the Company become very necessary. Handled in the right way, I think Sir Derek's misgivings that this adds significantly to the overall administration expense need not necessarily be borne out. For example the data need not be processed by *each* side. In our Scheme we encourage Member Nominated Trustees but, despite the hopes pinned on them by Paul Myners and the Government, these people are not, and – overnight at least - cannot become, pensions experts, yet they assume massive responsibilities. Also, they owe their livelihood to their employer and must naturally think carefully before taking a stance against him. Another conflict. It is in this increasingly common type of situation that an Independent Trustee who is a professional with many years experience in pensions and is not beholden to the Company can exercise real influence. He can keep the Scheme actuary on his toes and he can also imbue Member Trustees with more confidence to speak up on behalf of their Members. Actuaries are particularly well qualified for such a role and in his review I would hope Sir Derek will investigate ways in which our ability to contribute in this way can perhaps be enhanced.

The review lays stress on competition, and that tasks we currently carry out could perhaps be equally well performed by others. Competition is healthy and we should welcome this, with the proviso that whoever carries out a particular task has the necessary experience and technical expertise. So, **who should value the assets?** Well, for the purposes of carrying out an actuarial valuation the value attaching to the assets must relate to the value the actuary has placed on the liabilities, and any other method of valuing them risks undermining the validity of the valuation. For other purposes the field is open to competition. **Who should determine asset allocation?** Again, the technical profile of the liabilities is the prime determinant of asset

allocation. This is squarely in the Actuary's domain, and is indeed integrated with the valuation process, so the opinions of others must be viewed in that light. Our examinations were amongst the first to incorporate Finance and Investment in the syllabus, so we can lay claim to specific expertise in these areas.

It seems to me counter productive to hint that people other than actuaries should be permitted to carry out certain tasks without specifying who are able and qualified to perform such duties. So it is to be hoped that the final Report will spell out precisely who it envisages are these alternatives to Actuaries and in what circumstances; otherwise the competence and confidence of the Profession may be undermined to no avail.

The Actuary's specific skill is that he (alone perhaps) is qualified to calculate and base his judgement on long- term projections. As recently as 15 years ago **asset** values were determined by discounting the income streams they produced using assumptions consistent with those used in establishing the present value of the liabilities. This was called their 'actuarial value' (which was sometimes in excess of market value and sometimes below it). It needed to be backed by an asset allocation designed to deliver what this 'actuarial' value of the assets promised but which, because it could be averaged over 50 years or so, was much more likely to bear out the Actuary's assumptions in the long term. However, over the last decade or so the increasing maturity of Schemes coupled with the advent of FRS 17 and the spread of legislatively prescribed Transfer Values made it increasingly more difficult for the Actuary to ignore market value in this way. This placed him in the parlous position of having to reflect (in time honoured fashion) the long term on the one hand whilst at the same time having to take into account short term considerations on the other. No man can serve two Masters, it is said. The only way is to reserve on the more strict of the two sets of calculations, which makes the Scheme less and less economic for the employer, and drives yet another nail into the coffin of Final salary Schemes. Once the actuary feels obliged to subscribe to Market Value (or something close) as a measure of the assets a Scheme becomes unsoundly valued if an asset fall occurs unless he can adjust his liability valuation, but the need to recognise increasingly onerous Transfer Values and current Company Balance sheet reporting militates against him being able to do this.

Finally, on the question of regulation it can only be to the Profession's benefit to be answerable to an independent overseeing body, but this should comprise not merely high profile and competent lay members but consist also of at least two senior actuaries so that there is interplay at this highest regulatory level. I do not think it is appropriate for such a body to be the same as that which regulates the Accountancy profession as this would open the door for us to be judged by standards appropriate to another profession and to become a small subset of the Accountants. In reality we are totally independent and in most respects perform quite different functions.

