

Terry Arthur submission to the Morris Review – January 2005

1. I make this short submission with the following credentials (in addition to those in the email “signature”):
 - a. Member of Council of the Institute of Actuaries for 20 years from 1975 (then resigned voluntarily). The Appointed Actuary system was installed early in this period and, as I recall, I was the only Council Member who opposed it – for reasons now only too plain.
 - b. Co-author of a paper (discussed at a full Sessional Meeting) in 1989 suggesting an actuarial valuation technique (very similar to some of those now being mooted after the horse has bolted), which would have avoided over-valuation of assets during stock market booms.
 - c. Author of an article in “The Actuary” magazine in 1994 “Cautious actuaries? Come off it” which warned of the overvaluation dangers in the proposed *statutory* methods for calculating transfer values (essentially continuing the same errors regarding equities as those used in actuarial valuations).
2. Accordingly I agree with the Review’s major conclusion re pensions, savings, etc (item 10 of Executive Summary). There is also some truth in the remarks made about actuaries’ investment consultancy skills although these skills are not deficient in asset allocation – the problem is that *asset allocation itself* is a greatly overvalued element of investment which is far *less* important than stock selection. In common with the general theme of my criticism of the Review’s current proposals, the whole professional community (not just actuaries) is in error on this point just as it was on the boom and bust episode; furthermore these views were specifically encouraged by Government and its regulators, and its chosen advisers such as Paul Myners, whose report is merely one of many harmful statutory or quasi-statutory measures that pension schemes have suffered in recent years.
3. In my personal experience, the suggestion that the profession has been too insular is baseless. Furthermore other professions were vociferously accusing actuaries of being too cautious in their investment assumptions throughout the 1990s and as late as 2000.
4. The Review is quite right in identifying the central question: how can the actuarial profession ensure efficient delivery of best-practice actuarial services to users? However its current answers are quite the opposite of what is required. The error concerns the extent to which the profession is influenced by Government, Statute, State Regulators, and so on. The current extent is wrong, the Review suggests that more is needed; the correct answer is that *less* is needed; the build up of State Regulation in the past 30 years has been immense and has moved in step with reducing quality. The profession is caught in a lethal combination of statutorily reserved functions, statutory regulations, and mandatory professional standard-setting.

5. As in several other professions such as accounting and medicine, much of this is self-inflicted in ill-considered desires to serve “the public interest” or worse.

The Review’s reference to the role of the GMC is particularly unfortunate; that body’s standards have deteriorated alarmingly over the years to those of a typical Trade Union. Prior to nationalisation of the Health Service, the GMC operated in a competitive environment; if some members behaved badly they would be thrown out by their colleagues. That was the only incentive needed. In accountancy, I urge you to read the IEA publication “Unshackling Accountants”, by David Myddelton.

6. What the Review calls “best practice” is never static. The choice is to determine such practice from on high (whether or not by laborious consensus is immaterial) or to leave it to develop in a free and plural market. If the former, “best practice” will *always* be miles behind the curve, as shown in the Actuarial Profession by such matters as Appointed Actuaries and standard valuation techniques. Under this route we may as well all join the Government Actuary’s Department – that would be much more honest.

If the latter, individuals and statisticians will always be able to find something “substandard” but even that will be far higher than the norm under the alternative top-down application.

7. State Regulation has a history of unremitting failure, the latest example in the financial sector being the role of the FSA in the Split-Capital Investment Trust Crisis. State Regulation is bound to fail. This is clear both in theory and practice.
8. Theoretically, State Regulation starts off lightly and tightens in response to scandals, reaching a point where it measures itself in “hits” irrespective of justice, thus adding another turn of the screw. Each turn is a one-off, a few years at best after the previous one, whereas free markets and competition provide a continuing process of discovery and adjustments. Scandals increase as regulations tighten because the regulations are misdirected (Law of Unintended Consequences) yet it crowds out other natural mechanisms – in which the role of trust is important. State Regulation corrupts enterprise (as predicted in Public Choice Theory). It has no cost/benefit analysis worthy of the name. It creates barriers to entry and hits small business hardest. It creates an atmosphere of fear.
9. Empirically, the strong positive connection between increasing regulation and scandals is particularly clear in the financial sector, with the added factor of booms and busts. The standard book on the Split Capital Trusts Crisis, (by no means an anti-State Regulation publication) cites US law professor Stuart Banner’s view that “most of the major instances of new securities regulation in the past three hundred years of English and American history have followed after crashes and “had ramifications that were not always positive”.

10. The Review makes few distinctions between actuarial work that is statutorily reserved for actuaries and that which is not. Such a distinction is crucial. There should be no external regulation whatsoever in the latter category, nor should there be any high-handed attempt to decide on any unbundling of services. (Here Myners is at his worst; the major feature of any economy is bundled products, which are all around us. A pencil is a bundled product. A company is a bundled product. The idea that a Czar can dictate the best and worst forms of bundling is a monstrosity.

With regard to statutorily reserved functions, the Government and the actuaries must decide what they want. By far the best solution is to have *no* reserved functions, and let the market regulate the resulting quality – which it is perfectly capable of doing. Individual actuaries, or the profession as a whole, can refuse to cooperate on statutory functions. If the profession takes the route of the last two decades and embraces the State, it will not deserve to survive.

11. I would be delighted to discuss this submission at any time, and/or to provide the documents referred to. I have a presentation on the over-reliance of an “Asset Allocation” as opposed to Stock Selection, which I will be happy to provide.