

Morris Report – Institute Meeting – Comments – February 4th, 2005

In the Meeting there was one word conspicuous by its absence – Inflation.

Let me re-cap – the Actuarial profession was started by mathematicians who were challenged by the problems of providing the increasing risk of life assurance with increasing age. From the scanty and unreliable statistics then available they sought to establish a 'fair' level premium and because The Equitable was a mutual Society when they found that because of improving mortality they had over-charged it was agreed that an appropriate part of what they regarded as the surplus should be returned to the policyholders – this was the very sensible origin of the with-profits concept.

At that time the moneyed classes were concerned with dying too soon. Later, and particularly in the twentieth century, the weight of interest changed and the now much wider 'moneyed classes' realised their problem was much more of living too long than dying too soon. Hence the switch of interest to pensions.

The whole 'ball game' changed but the profession did not take this on board. Whereas improving mortality provided a margin for life assurance it represented a hidden loss for pension provision.

Again inflation, while a problem for the holders of life policies, represented a major weakness for those offering to provide pension benefits. A major weakness of our profession is that we did not, probably could not, ensure that what our ultimate customers really needed was stable purchasing power. Various expedients were attempted the one where the major effort was made was to switch the greater part of pension fund and life assurance fund investments into equities primarily the 'blue stock' variety in the UK market.

When Margaret Thatcher's Government squeezed inflation out of the UK economy this automatically led to the dramatic fall of rates of interest and this associated with the three year bear market exposed both Life Funds and pension Funds they found it difficult to cope with. In the case of the failure of the Equitable this was compounded by the misguided House of Lords decision which, in their interpretation

of PRE striving to be fair to a particular group of policyholders completely ignored the PRE of all the other policy-holders. In addition they also over-rode earlier legal precedents on the interpretation of the protective clauses in both the Equitable's Constitution and policies regarding the Directors' responsibilities regarding the allocation of final bonuses. Their blinkered decision was certainly not 'in the public interest.

Degree of Risk – It has been argued that in handing out any Actuarial Report the actuary has a responsibility to indicate the risk margins involved in his assumptions – these are 'fair words' but the reality is that he can only guesstimate this. The Equitable actuaries could not possibly have given any reasonable estimate of the factors inflation, the Law Lords interpretation of PRE and on the limitation of the powers of the Directors, when they were assessing likely contingencies.

Bundling and Conflict of Interest – Here again there has been, in my opinion, an inadequate appreciation of reality. Many, if not most of the smaller schemes are placed with life insurance companies. This means administration, investment and actuarial services are provided for an overall fee usually a very reasonable one. The actuary giving actuarial advice is an employee of the life company which usually is selected by the employer. This means he has a commitment to his employer the life company, the employer and the trustees. In ordinary circumstances this does not matter but when special circumstances arise it must be impossible for him to provide disinterested advice. From experience I know what I am talking about because I was a pensioner trustee for a large Health insurer whose schemes were with the Equitable!

Education & University Links

I suggest that one of the main weaknesses of our selection system is in the over-emphasis on mathematical ability in the examination process. My many years of experience in the profession makes me sceptical of the mathematician (and often their lack of common-sense in real situations) in their superior ability to determine those vital factors in their crucial assumptions. These are future mortality, future interest, future inflation and future expenses. What used to be the formidable task of calculation has now been eliminated by computers.

Finally there is the question of 'value judgements' – these must arise in the interpretation of such phrases as 'the public interest', PRE, professionalism and so on. Since every individual has different 'values' the interpretation must, in the long run, be a consensus matter – who will decide on that? Each Judge? The House of Lords? All these terms are 'weasel words' leading to confusion.

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