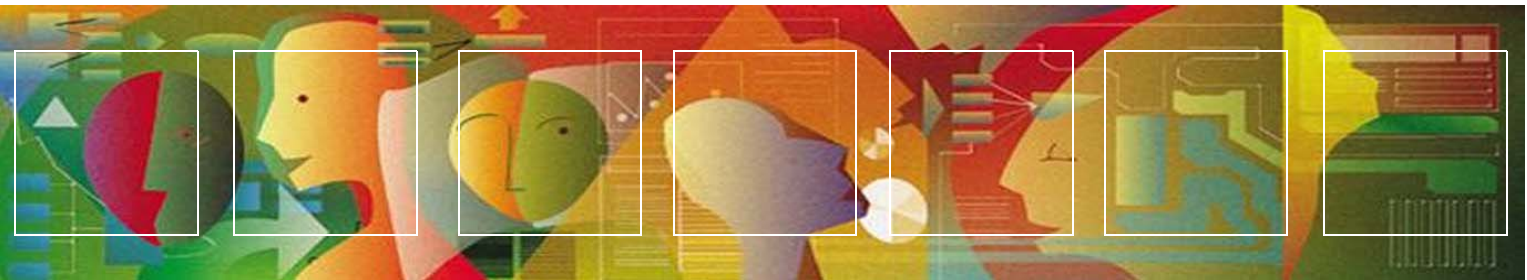


MERCER

Human Resource Consulting



The Mercer response to “The Morris Review of the Actuarial Profession – Interim Assessment”

February 2005

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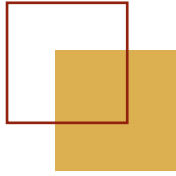
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1. Introduction and Summary

- 1.1 “The Morris Review of the Actuarial Profession - Interim Assessment” (the “Morris Interim Assessment”) was issued on 17 December 2004. In this response we comment from the perspective of being the world’s largest consulting organisation of our type and a leading provider of actuarial services to pension scheme trustees and scheme sponsors in the UK.
- 1.2 Although it was prompted by the Penrose enquiry into the Equitable Life, we believe that the Morris Review comes at a timely point for the actuarial profession, particularly in relation to pension schemes.
- 1.3 The widespread closure of final salary pension schemes to new members and an increasing business focus on corporate governance and managing risks, including accountability for, and the management of, pension schemes are acting to change the pension landscape in the UK.
- 1.4 The needs of pension scheme trustees and scheme sponsors are changing rapidly and it is therefore vital that the actuarial profession keeps up with the pace of change if it is to continue to play an important role in advising on pension provision in the future.
- 1.5 Equally we hope that the Morris Review can acknowledge that, in response to client demands, firms such as Mercer have for some time been addressing many of the areas in which he has expressed some concern. This includes, for example, requirements for peer review and the setting of actuarial standards. These changes have happened without the need for detailed regulation and represent a recognition that client needs and expectations change and providers need to change to meet them.
- 1.6 Our response therefore has the following key themes running through it:

The market for actuarial services

- 1.7 We question the need for any regulation in this area. Client demand and free competition should continue to be the prime determinants of the ways in which services are organised to meet the diverse needs of trustees and pension scheme sponsors.

- 1.8 We do not accept that the market for actuarial services is uncompetitive and see plenty of evidence that clients regularly review service providers. In response to measures to improve pension scheme governance, such reviews are already happening more frequently than in the past.
- 1.9 We also believe that scheme sponsors and trustees would resent the additional costs and time they would need to incur by being forced to carry out reviews at specific time intervals.
- 1.10 The bundling of services, including actuarial and investment consulting services has come about in response to client demands and not through any actions aimed at tying clients into particular service solutions. In our experience most, if not all, actuarial consultancies are perfectly willing to provide standalone consulting advice, whether this be actuarial, investment manager selection or strategic investment advice.
- 1.11 Also, the fact that pension scheme trustees choose to purchase services in particular combinations is a function of their preferred buying behaviour rather than it being due to any actions from the actuarial profession and/or firms within it.

The actuarial profession

- 1.12 We recognise that in the 21st century no profession can operate completely under self regulation and we would therefore support a move towards independent oversight. We would however want to be sure that the cost of any new regulatory regime is not excessive, since this will act as a further deterrent to employers sponsoring pension scheme provision.
- 1.13 We also support Morris's view of the continuation of the Scheme Actuary role.

The public interest and accountability

- 1.14 We support the conclusion of the Morris Interim Assessment that there must be clarity over whether and to what extent individual actuaries and the Profession should serve the public interest.
- 1.15 We are however concerned that the term "the public interest" is capable of different interpretations at different times and we therefore fully support the suggestion made in the Morris Interim Assessment that, to the extent there needs to be an explicit public interest obligation, there also needs to be clear guidance on its meaning and application.
- 1.16 In relation to conflicts of interest we do not believe there is any need to mandate which appointment an actuary should resign from in the event of a conflict between trustees and sponsor. This needs to be dictated by the specific client circumstances, with both trustees

and the scheme sponsor having a say in whether there is indeed a conflict and if so whether separate advice is needed.

- 1.17 Our detailed comments on the Morris Interim Assessment are set out in the remaining sections of this response and follow the chapter headings used in the Morris Interim Assessment.
- 1.18 We would welcome the opportunity to meet with members of the Morris Review team to expand on any of the comments made in this report.

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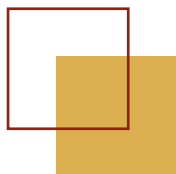
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2. The Market for Actuarial Services

Market Shares and Bundling of Services

- 2.1. We believe the market for actuarial services is more stratified and complex than the Morris Interim Assessment suggests and we do not accept that the market for actuarial services is uncompetitive (see also 2.12 to 2.14 below).
- 2.2. In our experience, client needs range from those who demand a one-stop shop for all retirement services, to those who prefer to pick and mix services from different providers, to large multinationals that may prefer to use the same provider globally.
- 2.3. These needs are influenced by many factors specific to each client and we do not believe it is possible to impose a “one size fits all” regulatory solution on them. Equally we do not believe it is possible to legislate for the variety of ways in which services can be provided if needed.
- 2.4. We therefore consider that the organisation of services to meet client needs is best left to market forces rather than prescribing which combinations of particular services a provider is allowed to supply.
- 2.5. We also believe that any regulatory restrictions on how trustees and sponsors select retirement services will lead to further reductions in occupational pension provision as sponsors react to what they will perceive as severe constraints on their freedom and the imposition of additional regulatory costs.
- 2.6. Morris also suggests that the availability of professional indemnity insurance cover may act to constrain new providers entering the market for actuarial services. Whilst we would accept that clients can, and do, ask questions about professional indemnity insurance cover, there are many other factors which influence their choice of service provider and these need to be recognised.
- 2.7. Also, the introduction of liability caps, as put forward by Morris as a possible solution to this issue is, in fact, already happening as a result of the current free market pressures on advisers, and it is as relevant to large firms as it is to smaller ones.

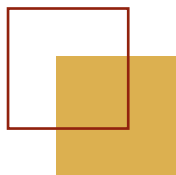


Improving user understanding and clarity of advice

- 2.8. We support the encouragement of user understanding through improved knowledge and expertise and welcome the recognition that several initiatives are already in train to do this.
- 2.9. As a major provider of trustee training services in the UK we continually look for ways of helping trustees to become more effective and we actively encourage clients to set time aside for bespoke training sessions.
- 2.10 We do not see any specific need to impose the greater use of professional trustees since clients who perceive the need for such support are likely to act on it in any event.
- 2.11 We would also emphasise the importance of user understanding from the point of view of scheme sponsors. It is just as important for sponsors to understand the risks associated with pension provision and to be able to challenge actuarial advice as it is for trustees. Many scheme sponsors are already addressing this need because of changes in the funding positions of schemes and the closure of final salary schemes to new members, without the need for additional regulation.

Increasing Competition

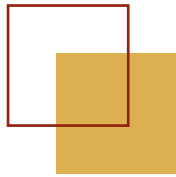
- 2.12 Our own experience suggests that scheme sponsors and trustees are not slow to review advisers when the need arises.
- 2.13 Many of the options put forward in the Morris Interim Assessment for increasing market testing, such as more professional trustees and greater frequency of review of advisers, are happening in any event largely due to an increased focus on the governance of pension schemes, which is itself being driven in part by pressures for further improvements in corporate governance.
- 2.14 We do not therefore see any need for regulation in this area and would reiterate our concerns about increases in the costs of running an occupational pension scheme.



3. The Profession and Regulation and Actuarial Roles

- 3.1. We recognise that in the 21st century no profession can operate completely under self regulation and all professions have to be able to defend and explain their actions and standards.
- 3.2. We would however suggest that in practice, self-regulation of the actuarial profession is already a thing of the past. Increasingly, actuarial professional guidance notes are either subject to ministerial approval or subject to agreement with the Financial Services Authority or the Occupational Pensions Regulatory Authority.
- 3.3. However, we recognise that the work of the Profession has a large number of stakeholders beyond the statutory regulators. We therefore believe the hybrid approach of model B suggested by Morris is the right way forward for the future regulation of the Profession.
- 3.4. We would support independent oversight of the actuarial profession by the Financial Reporting Council (FRC) and would also support the establishment of an Actuarial Standards Board and independent disciplinary board both of which would report to the FRC.
- 3.5. We suggest that the membership of an Actuarial Standards Board should consist primarily of people with actuarial qualifications and that it be chaired by an actuary to give it the right authority for its role. The Board would be supplemented with some lay presence.
- 3.6. We would suggest an independent disciplinary board should have substantially lay representation appointed by the FRC to do its assigned oversight tasks.
- 3.7. Overall, we believe, given the size of the Profession, that the above structure would provide the right balance between cost and effectiveness. We welcome Morris's recognition that due to the relatively small size of the Profession, cost is an issue and that it is important to get the balance right.
- 3.8. We also support the Morris Interim Assessment conclusion for the continuation of the Scheme Actuary role.





4. The Public Interest and Accountability

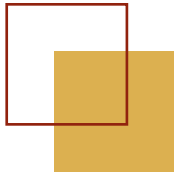
The Public Interest

- 4.1. We support the conclusion of the Morris Interim Assessment that there must be clarity over whether and to what extent individual actuaries and the Profession should serve the public interest.
- 4.2. We are however concerned that the term “the public interest” is capable of different interpretations at different times. For example, when the Minimum Funding Requirement (MFR) was introduced in 1997 it was seen as being in the “public interest”. The subsequent demise of the credibility of the MFR and its replacement by the Statutory Funding Objective, shows how the “public interest” in 1997 was deemed to be met by a funding standard which is not considered appropriate to protect the “public interest” in 2005.
- 4.3. The issue we outline in 4.2 above is compounded by the introduction of the term “the wider public interest”.
- 4.4. We therefore fully support the suggestion made in the Morris Interim Assessment that, to the extent there needs to be an explicit public interest obligation, there also needs to be clear guidance on its meaning and application.
- 4.5. The Morris Interim Assessment considers, in particular, the options for reporting and whistle-blowing. We believe that bringing whistle-blowing requirements for actuaries and auditors more into line would be worthwhile, as previous experience has shown that where such protection is in place, for example, whistle-blowing to Opra, the process has worked. Where such statutory protection is not in place, for example, when whistle-blowing to the Profession under its disciplinary scheme, we believe the scheme is less effective.

Accountability

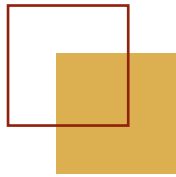
- 4.6. In relation to conflicts of interest we believe the legal situation is at present a modified version of option 2 as described in Section 5 of the Morris Interim Assessment i.e. that both the trustees and employer can decide there is a conflict and decide advice needs to be separate.

- 4.7. In practice we would suggest the employer is more likely to know of an emerging event which could lead to that situation so, giving the power to deem a conflict only to the trustees could actually serve to weaken the protection of members.
- 4.8. Also in practice we find the way in which an event emerges, and is communicated, substantially affects whether the protection of members is best served by the Actuary resigning from the employer or the trustee appointment. In some situations, because of, for example, confidentiality or legal constraints, the Actuary may have to resign from both appointments.
- 4.9. Our experience is that, in the instances when the situation becomes adversarial, there are already timely moves made to separate appointments and that Option 3 suggested by the Morris Interim Assessment already happens in practice (i.e. steps are taken to ensure separation of advice in clearly defined circumstances).
- 4.10 Overall we do not see any need to mandate which appointment the Actuary should resign from in the event of a conflict. This needs to be dictated by the specific client circumstances, with both trustees and the scheme sponsor having a say in whether there is indeed a conflict and if so whether separate advice is needed.
- 4.11 We would however support a move which required actuaries to have clear conflicts of interest protocols in place within their employing firms. This is, in fact, the approach we have adopted within Mercer for some time in order to meet the concerns now identified by the Morris Review.



5. Education and Continuing Professional Development

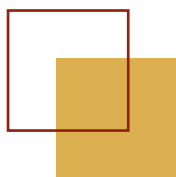
- 5.1. We believe that commercial pressures on actuarial consultancies are already leading to more emphasis being placed by them on consulting and communication skills and management and business awareness. Continuously improving professionalism is a key element in the business strategy of many major firms, including Mercer.
- 5.2. We support the Morris Interim Assessment that the 2005 Education Strategy for the Profession is a well formulated attempt to deal with the issues which Morris identifies (e.g. management and business awareness) and we lend our support to the need for the reforms to be given time to bed-in.
- 5.3. Of the options outlined by Morris, we do not consider either the residual issues or the size of the Profession warrant a fully independent oversight committee devoted full time to this particular area, but we recognise that some independent oversight may be considered necessary.
- 5.4. Overall we would favour minor reform of the existing governance structure to promote greater academic and non-actuarial input to the education of actuaries.



6. Standard Setting

- 6.1. Within Mercer, we have, for many years, had our own Professional Standards Committee which has been responsible for providing guidelines to our actuaries on the setting of actuarial assumptions.
- 6.2. We recognise the need for more independent oversight of the actuarial profession and of the options put forward by the Morris Interim Assessment for standard setting, we would prefer the establishment of an Actuarial Standards Board subject to oversight by the FRC. This recognises that a quasi-independent body appointed by the Profession's appointment system may not provide sufficient independence.
- 6.3. We reject the idea that standards should be set by the FSA and/or DWP/Opra on the grounds there are some topics which can fall between or across interests and there is also a strong case for common or consistent standards in different areas of interests where the issues are similar. Also we consider that one Actuarial Standards Board for the UK would be the best way of coping with emerging international issues e.g. International Actuarial Standards.





7. Scrutiny and Discipline

Scrutiny

- 7.1. Section 8 of the Morris Interim Assessment suggests 4 options for the scrutiny of actuaries in pensions:
- Option 1 maintains the status quo of no formal scrutiny;
 - Option 2 would lead to the inclusion of long term liabilities within pension scheme financial statements which would then be audited;
 - Option 3 would introduce peer review of the Scheme Actuary as envisaged by the Profession;
 - Option 4 would require audit of the Scheme Actuary's triennial valuation.
- 7.2. We do not believe Option 1 is sustainable.
- 7.3. In relation to Option 2 we are aware that PRAG, the accounting standard setter on pension scheme accounts for the Accounting Standards Board wishes to talk to the Profession and the DWP to design the Statement of Funding Principles so that it contains a liability figure. This could become a disclosure note in scheme accounts that would satisfy international accounting standards in this area without the need for audit (other than verification that it contains the requisite information). In practice we fail to see how this proposal improves scrutiny given that formal actuarial valuation reports are already subject to disclosure requirements.
- 7.4. We would favour a strengthening of the Profession's proposed approach to peer review under Option 3 suggested by Morris. Mercer's own standards of peer review have a greater degree of internal independence than the proposals of the Profession.
- 7.5. As regards Option 4, which proposes that the Scheme Actuary's triennial valuation should be audited, we believe this adds a layer of additional cost that scheme trustees and sponsors would not be prepared to meet. In our view it would further hasten the decline in the provision of occupational pensions in the UK.



Discipline

- 7.6. We recognise the Profession's new disciplinary system could be open to the criticism that the Disciplinary Board is still ultimately appointed by a structure under the Profession's Councils. We therefore accept it would be better if appointment was by an independent oversight body.

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