

**10 September
2004**

Prepared for
Sir Derek Morris

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1. Introduction and Summary

Our response

We are pleased to set out our response to the Consultation Document issued by the Morris Review in June 2004.

This response reflects the views of Hewitt Bacon & Woodrow. Our employees may have differing or additional points of view and are at liberty to express these directly to the Review. Some employees are involved in drafting the responses from the Actuarial Profession and the Association of Consulting Actuaries.

Hewitt Bacon & Woodrow

Hewitt Bacon & Woodrow is the UK arm of Hewitt Associates Inc, a publicly quoted company whose shares are traded on the New York Stock Exchange.

In the UK, we are structured into three lines of business:

- Pensions & Benefits Consulting (including investment);
- HR & Benefits Administration; and
- HR Consultancy.

The first of the above lines of business employs around 200 qualified actuaries, making it one of the three largest actuarial employers.

Our approach

In view of the volume of responses you are likely to receive, and the fact that many of our views will be reflected in the responses from the Actuarial Profession and the ACA, we have tried to be concise in this document.

Also, the vast majority of actuaries we employ are only involved in UK occupational pension scheme work. We do not advise on life assurance, and the only general insurance advice we provide is in connection with risk benefits provided by our pension fund clients.

The approach we have adopted is therefore as follows:

- In Section 2 we set out the four main themes which we would like to emphasise. These have been written in the context of advising UK pension scheme clients.
- In Appendices A and B we have provided brief comments on the specific questions you raised in chapters 1 and 2 respectively of the Consultation Document.
- We have not responded to all of the questions in chapters 1 and 2, and we have not responded to any of the questions raised in chapter 3, though some comments on the Government Actuary's Department

are included in Appendix C.

- Appendices D and E set out diagrammatically, with some additional comment, our views on the main drivers on the role of a pensions actuary.

Summary

The main points that wish to highlight from our response are:

- Actuaries need clarity on the extent to which they can work in partnership with the employer and trustees, or whether they can only advise one party.
 - We think that it would be better for actuaries to have more of a “broker” role, and that the current move towards making actuaries into “advocates” (or even “calculators”) will ultimately be detrimental to the long terms interests of pension provision in the UK.
 - The market for pensions actuarial services in extremely competitive.
 - The spiralling costs of PI cover and the more litigious culture mean that the profits being made could be seen as small in comparison with the risks to which actuaries are exposed.
 - Public confidence in actuaries is probably at an all time low. We support changes to the profession, such as the new disciplinary scheme and the proposed Actuarial Standards Board that will bolster public confidence.
 - There continues to be a need for reserved roles for actuaries. The risks of opening up existing reserved rolls to those who work in a less regulated environment are substantial.,
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2. Main Themes

Theme 1 – The actuary’s role

Three roles

There are a number of roles which a UK pensions actuary can have. These can be classed into three broad areas:

- Calculating, i.e. carrying out computational work in accordance with methods and assumptions which are decided by others (e.g. the Government or regulators).

Currently there are relatively few situations where an actuary is just acting as a calculator. With the abolition of the Minimum Funding Requirement, this role could almost disappear, except that the Government or the new Pensions Regulator may establish quasi-funding standards under the new scheme specific funding legislation.

- Advising, i.e. using judgement and communication skills to advise clients (whether trustees or employers) as to the methods and assumptions to be used to calculate liabilities, set contributions, set investment strategy, award discretionary benefits, etc.

Much actuarial work falls within this area, and scheme rules commonly require the trustees or the employer to take decisions only after they have received advice from an actuary.

- Deciding, i.e. using judgement to take decisions on the calculation of liabilities, setting of contributions, setting of investment strategy, awarding of discretionary benefits, etc.

This is comparatively rare, though some schemes require the employer’s contribution rate to be determined by the actuary. But historically, when in theory an actuary was “advising” trustees on funding assumptions, in practice the actuary often decided the assumptions and simply explained them to the trustees.

Implications of these roles

The actuary’s role will affect the training he/she needs as well as professional guidance, quality control procedures, disciplinary schemes, the type of regulation required, etc. Hence before the Review tries to answer all these questions it needs to consider what role(s) actuaries should carry out.

- It could be decided that actuaries should mainly be calculators with a very limited role in advising and certainly no role in deciding.

Decisions would not be made on the basis of actuarial judgement but on the basis of prescription which would ultimately have to be by the Government. However, the Government has not shown any

enthusiasm for taking responsibility for such decisions, because it recognises that it would be held responsible if things did not turn out in accordance with the assumptions it had laid down.

- It could be decided to give actuaries a significant role in advising (and even deciding) on the basis that they should be best equipped to weigh up the various risks and can add most value by being fully involved. If actuaries are to advise rather than just calculate, there is then the question as to whether they should:
 - act as a “broker” between the employer and trustees, advising both sides with a view to helping them reach a decision which balances the competing interests;
 - act as an “advocate” for one side in a more confrontational environment between employers and trustees.

Actuaries have traditionally felt able to deal with the challenge implicit in the “broker” role. However, more recently some actuaries perceive the risks involved in being seen close to the decision-making process as too great. This issue is considered further in Theme 2 below.

Our clients

It would be easy to say that the actuary’s clients (i.e. employers and trustees) should be taking the key decisions. However there are a number of issues here, particularly:

- Neither trustees nor employers are normally best equipped to take decisions about the funding of a pension scheme. This is particularly the case in small schemes. They will inevitably rely heavily on their appointed actuary such that, in practice, it would be difficult to divorce the actuary from the decision.
- Many trustees and employers have severe conflicts of interest. There is currently a debate about conflicts of interest for actuaries, but, if necessary, these can be dealt with by appointing separate advisers in “advocate” roles. The conflicts faced by the actuary’s client are normally both more severe and more difficult to address.

Our view

- Actuaries can add most value when they are fully involved in making decisions on the major issues surrounding the funding of pension schemes. They should not just be calculators, but there needs to be an informed debate as to whether they should be “advocates” or “brokers”.
- But it is not clear what the Government’s thinking is on this. One possibility is that the new Regulator will effectively make the main decisions and actuaries will become calculators. This issue needs to be settled by the Government before any decisions about the operation of the Actuarial Profession can be made.

Theme 2 – Accountability and conflicts

Discretion and flexibility

The UK occupational pension system was founded on the basis of employers and employees sharing risks. The employer made a basic pension promise, but this contained little in the way of guaranteed inflation-proofing, and only if the scheme assets performed well would members' living standard be maintained. In extremis, the employer could walk away from the scheme with no further liability. This gave a lot of flexibility in the funding, investment and granting of benefits in pension schemes.

Almost all this flexibility has now gone. The pensions promise has been elevated to a contractual commitment, and has been expanded to include near guaranteed inflation-proofing. This makes it hard for trustees to justify risky investment or funding strategies because there is little upside for members. But employers cannot afford very low-risk strategies.

This, coupled with the pressures exerted by low interest rates, fallen equity markets and extending life expectancies, means that the old partnership between trustees and employers has been replaced by an adversarial situation in which either side may feel they need to get all they can for their stakeholders.

Conflicts of interest

This can place the actuary in a very awkward position:

- Should he/she continue to try to stand between the two sides as a “broker”, balancing everyone's interests when making a recommendation (or decision) which can be relied upon by each party?

This approach is reflected in the trust deeds of many pension schemes where the actuary is supposed to provide advice to both the employer and the trustees. This is an increasingly uncomfortable position for the actuary to occupy, and may be risky from a legal perspective (as highlighted by recent legal advice to the Profession).

- Or should there be an actuary on each side, occupying an “advocate” role?

This will probably make the situation more confrontational and will certainly increase the total actuarial fees charged (not to mention legal fees and client time). This is the “safe” position for the actuary (as well as being the most profitable overall), but we instinctively feel that this approach will not be in the long term interests of either employers or scheme members.

It would be helpful for actuaries to have clarity on the approach they should adopt. It should be open to any party to obtain separate actuarial advice, but where a client wants to go the way of partnership, actuaries need to know if they can agree to continue in their traditional role.

Accountability

The above analysis raises questions as to whom the actuary is accountable. Many actuaries believe that they have a public interest role when advising any party to a pension scheme. This view may sound quaint in today's world, but may be important in situations where (for example) the trust deed gives the employer unilateral control over contributions, subject only to the need for the employer to obtain actuarial advice.

The "public interest" responsibility is ingrained in many actuaries to the extent that, even if they were only advising the employer and the trustees were separately advised, they may be reluctant to condone a course of action which could seriously prejudice the benefits of scheme members.

If it is right that in future actuaries should only advise either the trustees or the employer, we think that it follows that the actuary no longer has any duty to the public interest but only to his/her client.

More protection is less?

We think that the UK pensions landscape needs to recapture some of the advantages of discretionary benefits, with the actuary having a greater role in balancing the interests of all parties in funding and bonus decision.

An example would be the removal of guaranteed pension increases in defined benefit schemes (as is soon to be the case in DC schemes), to be replaced by a "best endeavours" provision to match the current level of guarantees for benefits already accrued, and total discretion as to inflation-proofing on future benefits.

Our view

- Actuaries need clarity on the extent to which they can work in partnership with the employer and trustees, or whether they can only advise one party.
 - We think that it would be better for actuaries to have more of a "broker" role, and that the current move towards making actuaries into "advocates" (or even "calculators") will ultimately be detrimental to the long terms interests of pension provision in the UK.
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Theme 3 – Regulation and guidance

Reality

We live in an age where trust is a scarce commodity and there must always be someone to blame.

Actuaries have not helped themselves in this regard by allowing events, such as those at Equitable Life, that have directly resulted in this Review.

So we have to face up to the fact that we will be subject to greater scrutiny and accountability in future. Whatever the pros and cons of the current system, it must change and we need to embrace the new and take the opportunity to demonstrate to Government and the public that actuaries can be trusted.

But it is important not to lurch towards an over-prescriptive system for the reasons set out in Theme 2.

Role of employers

Actuarial employers have a major role. They finance the Profession and they who provide the work experience and training on which actuaries rely. The actuarial employers also have a “brand” which is based on quality, trust and a duty to the public interest. So arguably it is they who have most to lose if confidence in actuaries is further eroded.

As an actuarial employer, we already have very stringent quality control procedures and training programmes and we do not think that greater regulation would make any real difference to the quality of our advice.

But we recognise that we need to play our part in enhancing the image of actuaries, and so we would be happy to embrace new rules and procedures so long as they can be justified by reference to the goal of increasing confidence in our profession.

Role of the Profession

We do not have strong views on who should regulate us and whether the dual roles of the Actuarial Profession should continue. We do think that the Profession has become more effective in recent years, and should be encouraged to continue along this path.

However, the Review may wish to consider whether it would be appropriate to split the regulation of actuaries engaged in different fields, e.g. different bodies for pensions and life insurance actuaries.

Our view

- More regulation is needed to enhance the stature of actuaries. We won't like it and we doubt it will have much impact on the quality of advice which is already high in the vast majority of situations. But we accept that it is necessary to improve confidence.
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Theme 4 – The market in which we operate

Concentration

The tone of page 12 of the Consultation Document is that the actuarial market is concentrated and hence uncompetitive.

While we accept that there is some concentration in the market, we don't think this is remarkable taking into account the size of the profession, comparisons with other professions and the significant investment in technology and research needed to operate effectively.

Certainly, if there is a "Big Four" in the actuarial profession, their dominance is much less significant than in the accounting profession. There are also a large number of new and smaller firms.

While each of the Big Four accountants and a number of other firms have attempted to enter the actuarial market, only those who have been able and willing to invest significant resources have been successful.

Competition

Anyone who works in the actuarial pensions market will know that it is extremely competitive. This is for a number of reasons:

- Many of our clients act in a fiduciary capacity and have to be able to demonstrate that they are getting value for money. In the case of (for example) local authority clients, this involves mandatory retendering at regular intervals.
 - The pensions community is very close-knit. Clients are in frequent contact with each other and read the same periodicals, etc. Stories of good or poor service circulate quickly.
 - Hourly charge-rates and fees for carrying out defined tasks such as actuarial valuations can easily be compared.
 - It is very easy to change actuarial advisers. There are no bid-offer spreads (as when changing investment manager) or implementation fees (as when changing scheme administrator). As a firm we have been very successful in winning new business and our experience is that taking over as actuary is very straightforward and need involve minimal cost and disruption to the client.
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The economics

It is sometimes assumed that the larger actuarial firms make enormous profits. While it is no doubt true that the larger firms are profitable, there are some very large costs involved with operating in this market which mean that profit margins are by no means excessive. These costs include:

- The salaries that have to be paid to attract and retain top quality actuaries.
- The investment in actuarial trainees who are paid full-time salaries but only spend part of their time in the office.
- The costs of having exceptionally rigorous quality control procedures (which are necessary given the sums involved).
- The spiralling costs of professional indemnity insurance.
- The investments required in new technology and services.

Our view

- The market for pensions actuarial services is extremely competitive.
 - The spiralling costs of PI cover and the more litigious culture mean that the profits being made could be seen as small in comparison with the risks to which actuaries are exposed.
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Appendix A – Brief comments on questions 1.1 to 1.37

Q1.1 What do you see as the main value provided by actuaries and, conversely, what are their weaknesses? In general, are actuaries properly equipped for the roles that they perform?

Actuaries bring the benefit of a rigorous training which equips them to analyse financial problems in a systematic way. However, they are probably influenced and equipped more by their work experience than by their formal training, and this experience is highly variable. For example, some employment situations do not equip actuaries to think creatively or to communicate clearly.

Q1.2 Are there areas of business that you think actuaries should become more involved in or conversely are there areas of work you think actuaries should leave to other professionals?

Subject to the situations covered in Q1.3, market forces should result in actuaries being used in areas where they can add most value. With a few notable exceptions, there is little evidence that actuarial skills are valued outside traditional fields, but this is likely to change in future. Traditional actuarial employers are increasingly questioning whether some jobs previously carried out by actuaries could be carried out more economically by others.

Q1.3 Do you think that there is still a need for particular roles for actuaries to be reserved by statute and, if so, which roles and for what reasons? If not, why not?

Yes, there are some jobs where actuarial skills are required in order for the job to be done effectively. If organisations were given the choice to employ others with less highly developed or regulated skills, there is a risk that things could go badly wrong and that those who suffer will be third parties. Hence we think that there is a place for professional reserved actuarial roles in the pensions and life assurance market.

Q1.4 What impact, if any, has the existence of reserved roles had on the effectiveness with which actuaries work with non-actuaries?

In the area of pensions, which is our expertise, scheme actuaries invariably work cooperatively with legal advisers to scheme trustees and employers. There have, on occasions, been some areas of boundary dispute with scheme auditors but these have almost always been settled amicably.

Q1.5 If roles reserved exclusively to actuaries are maintained, do you think that there is a need to introduce greater peer review and scrutiny of such work?

Yes, for the reasons given in Q1.3, there needs to be confidence in the quality of actuarial advice. Whereas this may not be such an issue for larger firms where this is the core business and there is a reputation to maintain, we recognise that all will have to play by the same rules.

Q1.6 Could other professions work more closely with actuaries or in related functions to help maintain and improve actuarial effectiveness?

We already work closely with other professionals appointed by our clients and cannot see much scope for even closer working.

Q1.7 To what extent should actuaries accept some responsibility for their role in designing financial services products that have subsequently turned out not to be “fit for purpose” for consumers? Why were these issues not brought to light by the profession earlier and therefore perpetuated to the detriment of consumers? What lessons can be drawn from these experiences for the future?

No comments since this question is primarily directed towards designers of financial services products and we do not carry out this type of work.

Q1.8 Are actuaries sufficiently accountable for their actions? To whom should actuaries be primarily accountable – to their clients or employers, to pension fund trustees or sponsors, or to a broader public interest, which encompasses the strength and stability of the insurance and pension sectors and the interests of those consumers involved?

Actuaries giving reserved advice are already fully accountable. In our experience they are normally well aware of the significant personal responsibility they carry as a result of their role.

It flows from our response to Q1.3 that actuaries giving reserved advice are accountable to the broader public interest. In practice, for most pensions actuaries this means being accountable to pension fund trustees and sponsors.

They clearly also have to be accountable to their employers, and this makes it important for actuarial employers to have a “brand” that is consistent with public interest.

Q1.9 How would you characterise the current situation in the UK in this respect? Are there changes you would like to see introduced in terms of the accountability of actuaries to their employer or to the public interest?

Actuarial employers need to give the lead and make it clear to clients that they support the actuary’s duty to the public interest.

Q1.10 Are actuaries sufficiently liable for their actions? If actuaries provide poor advice, to whom should they pay compensation?

Yes, in today's compensation culture, actuaries like anybody else are liable for their actions. The fees which actuaries charge for their services are probably too low when these liabilities are taken into account and will have to be increased. In our view actuaries, and firms of actuaries, should only be liable to their clients with whom they have a contractual relationship. We would not expect actuaries to be liable to third parties.

Q1.11 How effectively does the Profession engage with government, business, regulators and other professions?

In the field of occupational pensions (our area of expertise), we have close relationships with government in the drafting of legislation and of professional guidance that is tied to legislation. Our clients include businesses of all kinds and we are of the view that we engage well with them. We work closely with Opra and the FSA to ensure that we remain compliant. We comment on draft regulation issued by Opra and the FSA. We meet frequently with other professional bodies, frequently attending events held by them and inviting them to ours on a reciprocal basis.

Q1.12 Has the Profession successfully expanded the horizons of actuarial knowledge and promoted innovation?

We believe that it is for actuarial employers to provide the lead in these areas. However, it is important for the Profession to support change.

Q1.13 Has the Profession done enough to promote the work of the actuarial profession?

Yes, we think so, given the finite resources available.

Q1.14 Are there any aspects of the Profession's governance structure that you would like to draw to the attention of the review? Do the Profession's various decision-making bodies represent a diverse range of interests? Should there be greater lay input into the Profession's key decision-making bodies?

We have no particular dissatisfaction with the governance structure. But we feel that a full merger of the Institute and Faculty should take place quickly. Consideration might also be given to having clearer separation of regulation for the different parts of the Profession, since it must be questionable whether a single body can effectively regulate such diverse occupations as actuaries advising insurance companies and those advising in relation to pension schemes.

Q1.15 How important an influence on the Profession are the companies that recruit and train student actuaries? To what extent is the curriculum shaped by the needs of employers? Is this good or bad?

As stated above, we think that actuarial employers are a key influence and that this is proper.

Q1.16 What is your view of the appropriateness of the current actuarial qualification syllabus (set in 1999) in preparing actuaries for their actuarial and broader business and management roles?

The syllabus has very limited use in preparing actuaries for broader business and management roles. However it is effective in preparing for mainstream actuarial roles. In all cases it is crucial for it to be accompanied by suitable work experience.

Q1.17 In particular, do you think that it should take on average 5 or 6 years for an actuary to qualify? Is there the right balance between academic and practical experience, sufficient breadth of subjects studied or not studied and the appropriate degree of specialisation at the right time?

We would like to see a reduction in the 5-6 year average for passing exams, coupled with a greater emphasis on practical experience.

Q1.18 Has actuarial education and training kept up with developments, particularly in the financial markets and in financial economics?

It seems to have caught up in recent years and is now more open to new thinking.

Q1.19 Do you have any comments about the proposed new qualification syllabus that will come into effect in April 2005?

Generally we welcome the changes. In particular, we welcome the introduction of the Business Awareness Module and the move towards more specialism. However, the new syllabus will be more expensive for employers.

Q1.20 Is there sufficient diversity in the composition of the student body and are there enough links with other professions' qualifications?

Financial mathematics is at the core of our work and so we would expect that the subjects studied at university by students would be largely mathematical, which is reflected in the table at paragraph 1.24. We aim to recruit the best in the market and the list of universities at paragraph 1.25 would tend to cover the majority of such recruits.

Q1.21 Is it of concern that, apart from a few universities that offer degrees in actuarial science, there is only a single provider of actuarial education in the UK?

Not particularly at present, but it has been an issue in the past and could be in future.

Q1.22 What have been the main drivers of demand for actuarial services over the last ten years? How do you see the demand for actuarial services evolving in the future?

Legislative change, particularly in pensions, with an increasing focus on compliance. Plus pension schemes becoming larger and more significant relative to employers, accompanied by poor funding levels and greater disclosure. Demand has peaked and will decline as DB schemes are phased out.

Q1.23 Do the consumers of actuarial services have access to a wide range of providers or is choice in this market in any way constrained? If so, in what way and why is consumer choice limited?

There is plenty of choice. They can go for a big firm where actuarial work is a core business, or a small firm, or an accounting or broking firm where actuarial is a side-line.

Q1.24 Is it easy for consumers to switch between actuarial service provider? If not, what do you think could be done to encourage switching?

Yes, it is easier to change actuarial adviser than (say) third party administrator (where there will be set-up costs) or investment manager (where there will be dealing costs). We often take over actuarial appointments and find the process very simple.

Q1.25 Do you think that those receiving actuarial advice sufficiently understand what they are being told and how the advice was produced? If not, what generates this informational shortfall, how important an influence on the market is it and what, if anything, do you think might be done about it?

Some actuaries are not good communicators and some do not think communication is important. This is a differentiator in the market and will ultimately be dealt with by commercial pressures, but a more rigorous experience requirement might help to stamp out poor communication.

Q1.26 Which factors have influenced the supply of actuarial advice over the last ten years? What are likely to be the most significant influences on the industry structure in the future?

See 1.22 above.

Q1.27 What determines whether actuarial advice is provided by in-house employees or external advisers or consultants? Does it reflect a clear difference in the actuarial role and function? Do firms employing in-house actuaries ever experience recruitment difficulties?

No comment as we suspect that this question is directed towards actuaries who advise insurance companies.

Q1.28 What is your overall assessment of the degree of competition in the market for actuarial services? Is competition in any way constrained by existing professional rules or conventions? If so, which ones and to what extent could they be modified?

Our experience is that competition is extremely intense and that the actuarial market is more cut-throat than (say) the legal market. We don't think that professional rules get in the way.

Q1.29 Do you think that the Government Actuary's Department competes with private sector suppliers of actuarial services in the market? What impact do you think GAD has on competition in the market?

Yes, it does compete in certain areas. See Appendix C for comments on this.

Q1.30 How are the skills and professionalism of UK actuaries and the UK actuarial profession regarded internationally?

We believe that the skills and professionalism of UK actuaries and the UK profession have been highly regarded internationally. The wide variety of work we do and the quality and depth of the UK training compared with other parts of the world is recognised, and the contributions to developments in our fields of activity both by the UK profession and individual UK actuaries have always been at the forefront. However, recent events (e.g. Equitable and the current funding level of many UK pension funds and the volatility resulting from the investment strategy adopted by many UK funds) has fairly or unfairly caused others to question some of the methods used in the UK.

Q1.31 How easy is it for actuaries to work across international boundaries?

As a global firm we clearly operate across borders for the benefit of our multinational clients. However we interpret this question to mean how easy is it for an individual actuary trained in country A to work in country B. Actuarial techniques and methodologies are easily transferable, so the main difficulties relate to language, different laws and regulations, and the certification requirements in some territories.

Q1.32 Do you agree that there are lessons to be drawn from a consideration of the work of actuaries in Canada, Australia and the US? If so, on which aspects of the work of actuaries in these countries do you think the review should focus?

It is always instructive to consider how the actuarial profession operates in other countries and Canada, Australia and the US would be good examples to analyse. Particular areas to focus on would be what aspects of actuarial work are specified by regulation, what aspects are left to the discretion of the actuary, explicit or implicit fiduciary responsibilities, whistleblowing requirements, and what potential there is for conflicts of interest and how these are managed.

Q1.33 Are there any EU or other countries that the review should be considering in seeking to identify best practice?

Generally speaking, the UK actuarial profession is more developed than in other parts of Europe. However an examination of practices in Germany and Netherlands in particular could highlight some interesting differences.

Q1.34 Do you agree that the review can learn lessons from recent developments in the UK accountancy profession, for example, in areas such as standard-setting or in the establishment of a single unified and independent regulator – the Financial Reporting Council?

It is difficult to comment on how better (if any better) an independent regulator would regulate the actuarial profession than the Institute and Faculty. A comparison with accountancy bodies is difficult to make as there are many professional accountancy bodies whereas there are only two actuarial bodies, which do already work in unison in regulating the profession via standard setting and more recently as a joint disciplinary body.

Q1.35 Are there any forthcoming EU directives or international accounting standards that are likely to impact on the actuarial role?

The Pensions Directive is being implemented into UK legislation in the Pensions Bill currently going through Parliament. We do not as yet know the details of how the technical reserving provisions of the Directive will be implemented under secondary legislation to follow the Pensions Act. This could impose a higher workload on UK actuaries in the short term. However, the details of the implementation of the Directive is in the hands of the UK government and, from past history, greater danger to UK pensions lies with the government taking perverse decisions rather than in the actuarial profession implementing them.

Q1.36 Are there lessons for the actuarial profession from comparison with the professional and regulatory framework of the legal profession?

Not that we can see.

Q1.37 Which other professions' regulatory models, and what aspects of them in particular, do you think the review should consider?

We are not aware of any.

Appendix B – Brief comments on questions 2.1 to 2.43

Q2.1 What should the objective of a regulatory framework for the actuarial profession be?

Ensuring that there is public confidence in actuaries.

Q2.2 What is your overall view of the strengths and weaknesses of the current self regulatory approach as applied to actuaries by the professional bodies? Does it adequately protect the interests of consumers? If not, are there key aspects of the regulatory framework that you think should be changed? Is there too much emphasis on reserved roles for individual actuaries?

The pros and cons of the current approach are fairly clear, and in our view it has generally worked well (i.e. probably as well as any other system would have done). However in today's world it looks too "cosy" and therefore we need to move away from self-regulation in order to inspire confidence. But it is important to move gradually and not to lose some of the benefits of the current approach. The new Disciplinary Scheme and proposed new Actuarial Standards Board are thus a good start which should be allowed a chance before further changes are made.

Q2.3 Does the Profession's dual responsibility for representing its members to the outside world and regulating them in the public interest create a conflict of interest? Is this conflict acceptable?

It works, but see Q2.2.

Q2.4 Are there areas where you believe the burden of regulation is disproportionate and should be reduced? Are there areas that you believe should continue to be self-regulated by the professional bodies?

Yes, there is too much regulation, but that is the way society is going. See Q2.2.

Q2.5 Do you think that the FSA's proposals to change the appointed actuary regime address the concerns that Lord Penrose raised in this regard? Is there a need to do anything further to address Lord Penrose's concerns?

We are not involved in life assurance work and thus are loath to comment, although of course failings by life insurance actuaries will reflect poorly on the whole Profession (and vice versa).

Q2.6 Do you have any other concerns about the role of actuaries working in life assurance?

No comment as we are not involved in life assurance work.

Q2.7 Do non-executive directors in life insurers have sufficient expertise and information available to them to enable them to challenge the actuarial calculations of the value of the insurer's assets and liabilities or whether policyholders are being treated fairly?

No comment as we are not involved in life assurance work.

Q2.8 Will the FSA's realistic reporting basis make actuarial calculations more accessible for non-actuaries?

No comment as we are not involved in life assurance work.

Q2.9 Should the Scheme Actuary's role be reserved exclusively for actuaries? Could other professionals provide similar advice?

Yes, this role should be reserved for actuaries for the reasons give in Q1.3.

Q2.10 Do pension scheme trustees have the expertise and information to question and challenge the advice of Scheme Actuaries? In the absence of effective challenge from trustees are Scheme Actuaries effectively making policy decisions by default on the distribution of benefits between different generations of pensioners and on funding strategies?

Some trustees do not have the necessary expertise and information to perform their role adequately. However, the trend is positive in this regard. Although some actuaries may in the past have strayed from advising into decision making, most actuaries are now well aware that this is not their role (except in limited circumstances).

Q2.11 Is there sufficient audit or peer review of the Scheme Actuary's advice to provide checks and balances on the influence that could potentially be exerted by the Scheme Actuary?

This is variable – see the response to Q1.5. Note however that the current developments on audit within the Profession are focused on compliance with guidance notes and do not necessarily deal with the issue of the influence being exerted by the actuary.

Q2.12 To whom should the Scheme Actuary be accountable? What will be the effect of the intended removal of the minimum funding requirement on the potential for conflicts of interests if the same Scheme Actuary is advising both the trustees and the pension scheme sponsor? Is there a need for a separation of these roles?

See our response to Q1.8. We think that the new legislation on funding may make it more difficult for the scheme actuary to advise the employer on funding issues.

- Q2.13 To what extent has actuarial advice contributed to the way occupational pension schemes are funded in the UK? How will the Pensions Bill's proposals affect the role and power of actuaries advising pension schemes sponsors and trustees?

The present state of pension scheme funding is due to a variety of issues, most of which are outside the control of the actuary. These include the historic commitment of most trustees and employers to equity investment, the ratchetting up of guaranteed benefits by successive governments, the taxation of "excessive" surpluses, the severity of recent equity market falls and increased longevity. But with the benefit of hindsight, some actuaries could have been more persistent or proactive in spelling out the risks.

We hope that the Pensions Bill will result in trustees, employers and actuaries focusing more clearly on their respective roles, though until we see the details we are unclear as to how the new legislation is going to operate in practice.

- Q2.14 Are there any other issues relating to actuaries' statutory or non-statutory roles in advising pension fund trustees and pension fund sponsors that you would like to bring to the attention of the review?

No, except that the current requirement (stemming from legislation) that actuaries should certify shortfalls on a scheme winding up on a buy-out basis when no quotations are available is problematic.

- Q2.15 What are the implications for actuaries of the FSA's moves to a realistic reporting regime in general insurance?

No comment as we are not involved in general insurance work.

- Q2.16 Do you agree that a reserved role for actuaries in general insurance is unnecessary?

No comment as we are not involved in general insurance work.

- Q2.17 Are there any other issues specifically relating to the role, responsibilities or regulation of actuaries working in general insurance that you would like to draw to the attention of the review?

No comment as we are not involved in general insurance work.

- Q2.18 Are there any specific issues faced by actuaries working in institutional investment that you would like to draw to the attention of the review team?

Actuaries working in these areas, while often using actuarial skills, are working with (and competing against) non-actuaries. Hence it is not clear that they should be regulated by the Actuarial Profession.

Q2.19 Do you have any observations about the Institute's role in regulating investment business by actuarial firms as a designated professional body under FSMA?

Where investment advice is given as complementary and incidental to the main professional advice being given to clients, by people who are expert in their fields, a 'lighter touch' regime by a professional body is proportionate to the task. Too much regulation can be self-defeating if it results in costs of running pensions schemes deterring employers from offering such schemes to employees. The Institute, both as a RPB and DPB, has we believe achieved the right balance.

Q2.20 Is there the right balance between the Profession issuing practising certificates and regulators giving their approval?

No comment as we are not involved in life assurance work.

Q2.21 In your view are the current CPD requirements and the provision of CPD appropriate?

Full formal CPD credit is not currently given for attendance at internal technical training sessions held by the major firms for their own staff. As these tend to be more pertinent to the job requirements than attendance at external sessions, the limit on internal CPD should be relaxed.

Q2.22 Do you support the Profession's proposals to extend the concept of practising certificates to cover all actuaries who give advice on actuarial matters?

Yes, if this has the effect of making experience a recognised part of the qualification – see response to earlier questions.

Q2.23 Are there any other changes to the CPD programme that you would like to see?

See 2.21 above.

Q2.24 Are there appropriate legal and professional duties and safeguards for disclosures by actuaries to protect the public interest in regulated sectors?

Yes, the right and duty to report to Opra is an important safeguard. We are pleased that Opra have at last got this onto a more sensible footing.

Q2.25 Is it sufficiently clear to actuaries and others when they should report concerns to the regulators and the Profession?

Yes.

Q.2.26 Is there an appropriate level of disclosures by actuaries to protect the public interest?

No, the current statutory disclosures to pension scheme members on the security of their benefits (as appended to trustees' reports to members) are weak to the point of being meaningless.

Q2.27 Does the Profession's technical guidance, as set out in the Manual of Actuarial Practice, provide unambiguous, up-to-date and clear standards for practising actuaries and other professionals e.g. auditors, who work with them? Do you agree with Lord Penrose's view that professional guidance in the past has not protected policyholders' interests?

Professional guidance will never be able to cover every situation satisfactorily. However, on the whole we think that the guidance is too weak. Also, on occasions it has been hard to get timely clarification from the Profession on specific questions which arise in practice. We are not involved in life assurance work and have not commented on the part of the question about policyholders' interests.

Q.2.28 Does the technical guidance need to be updated more regularly and are fast track processes required to provide guidance on urgent issues?

See previous response. We think that there needs to be a better process for providing informal guidance on specific issues.

Also, various Guidance Notes are subject to approval by the Secretary of State (for instance GN27 on the MFR). We have found the Government to be both very tardy, and at times obstructive, in agreeing amendments that the profession considers to be required.

Q2.29 Who should provide the guidance: the Profession, the regulators or the government?

It does not appear to us that the Government has sufficiently recognised the effective role which the Profession can and should have in helping to design primary and secondary legislation. An example is the MFR where the Government cherry-picked changes suggested by the Profession, which has resulted in the MFR weakened so far as to have fallen into total disrepute.

On the other hand the Government appears to have been happy to try to leave difficult issues (which should be matters for Government) to be dealt with in actuarial guidance notes which, in effect, form tertiary legislation.

Q2.30 Is there a need to reduce the level of discretion permitted within the guidance to come to some generally acceptable professional practices?

Yes, in crucial areas such as the assumptions which can be used for funding pension schemes or setting transfer values, it would be helpful to have a clearer guidance on acceptable ranges.

- Q2.31 Will the Profession's own proposals for an actuarial standards board go far enough to improve the quality and timeliness of standard-setting to protect the public interest? Is there a need for even greater independence from the profession or a statutory underpinning to bring greater credibility to the technical standard-setting process?

See Q2.2.

- Q2.32 Does the Profession work closely enough with other professions e.g., accountancy, to ensure that its standards are widely recognised and to influence other profession's standards where appropriate, and to ensure that there are no regulatory gaps or overlaps in standards?

We are not sufficiently aware of the current processes, which go on behind closed doors, to be able to answer this question.

- Q2.33 Do you agree with Lord Penrose's assessment of the lack of openness and transparency of the profession to non-actuaries, including other professionals, and their clients?

Lord Penrose's comment, to which this question relates, was made of that part of the actuarial profession involved in advising life offices. This does not square with our experience in the pensions area. But it is not really for us to comment.

- Q2.34 What steps can be taken to improve communications between the actuarial profession and their clients or other professionals?

Lord Penrose's comment, to which this question relates, was made of that part of the actuarial profession involved in advising life offices. We do not think that it is relevant to actuaries advising sponsors and trustees of pension schemes.

- Q2.35 Given the Profession's recent proposals on peer review, and the FSA's proposals for the reviewing actuary function in life assurance, will there be an appropriate level of peer review and scrutiny in the actuarial profession to protect consumers' or policyholders' interests in the future?

See Q1.5.

- Q2.36 When should actuarial opinions be directly addressed or otherwise communicated to members of the public, such as policyholders or scheme members?

In the case of occupational pension schemes set up under trust, we think it is acceptable for opinions to be addressed to the trustees who are the guardians of members' interests.

Q2.37 Is there a need to further widen the scope of actuarial activities that are subject to peer review or other forms of scrutiny – for example into Lloyd's syndicates and general insurance?

No comment as we are not involved in general insurance work.

Q2.38 Do the new disciplinary processes implemented by the Profession from 1 January 2004 address the issues that Lord Penrose raised?

Se Q2.2.

Q2.39 Is the Profession's past record of 17 complaints over 15 years a sign of a successful profession or an indication that monitoring and disciplinary procedures were not effective?

In the area of pensions, and considering recent years, we think that the monitoring and disciplinary process has been adequate and very effective.

Q2.40 Should the review consider whether a fully independent disciplinary process is needed?

The Review should consider this, but our view is that the recently introduced process should be given a chance before further changes are made.

Q2.41 In the accountancy profession the joint monitoring unit verifies whether firms are complying with audit standards. Given Lord Penrose's criticisms and the long-term nature of actuarial advice, is there a need to move away from reactive complaint-driven disciplinary procedures to a more proactive regime of monitoring of compliance with professional actuarial standards? If so, who should have responsibility for overseeing the monitoring and disciplinary proceedings and who should bear the associated costs?

Yes, it is not totally clear whether the responsibility for monitoring should lie with the professional bodies or with the new standards setting body. However, as any penalties would be enforceable by the professional bodies, the disciplinary proceedings should lie with them. Costs should fall on actuaries via either membership fees or fees for certification. However, these would put up costs and would be passed on to clients.

Q2.42 Should discipline be undertaken by the Profession or by regulators?

See answer to 2.41.

The Review may also wish to consider whether regulation and discipline should apply to actuarial firms rather than individual actuaries. We have no strong view on this point.

Q2.43 Do regulators make appropriate use of actuarial expertise to supervise the work of actuaries?

The Board and staff of Opra includes actuaries, and the FSA also employs actuaries. However there is always a risk that actuaries working for regulators will become detached from latest practices, and it is important for regulatory actuaries to remain in contact with practicing actuaries, and for there to be cross-fertilisation of ideas.

Appendix C – Comments on GAD

Introduction

We have decided not to answer the specific questions on GAD but just to make the following comments:

Purpose

- We think it would be helpful to clarify what the purpose of the GAD is.
- For example, is it intended to provide impartial advice to Parliament, or is it an arm of Government?

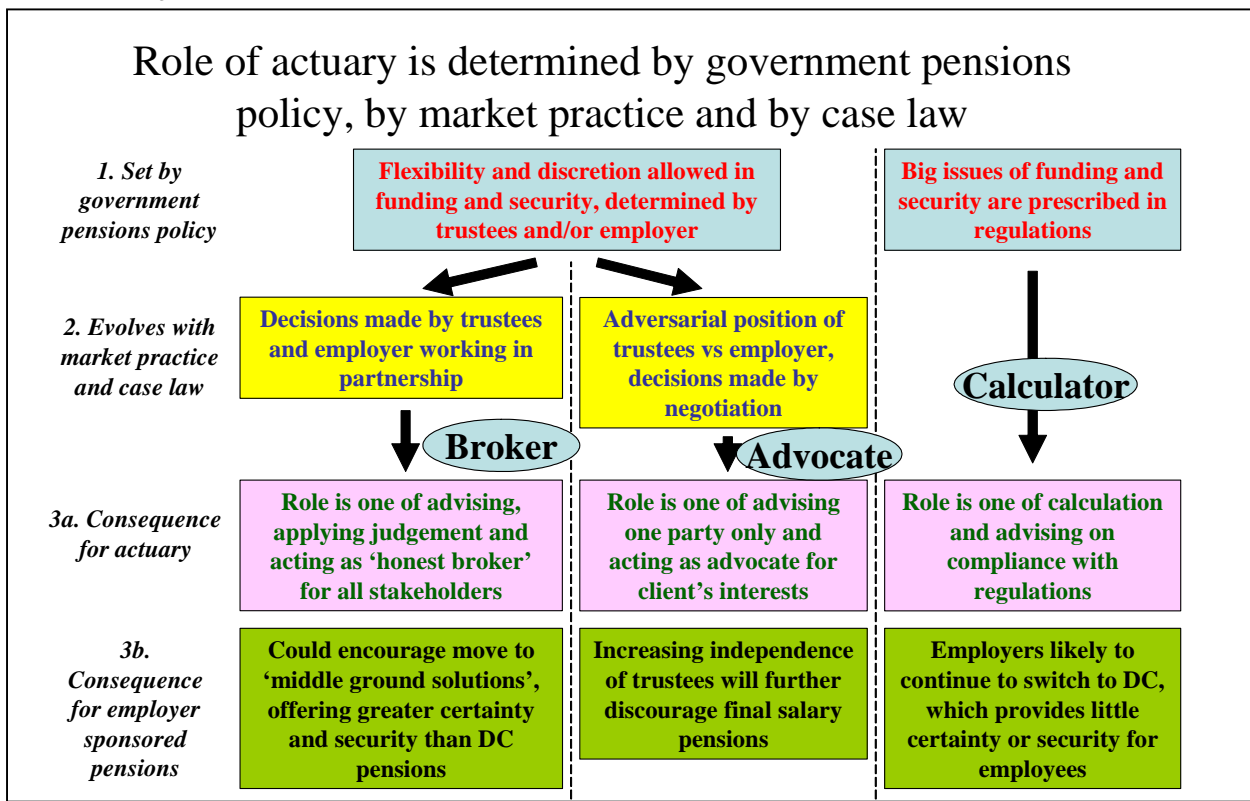
Commercial issues

- We think it is up to the Government to decide whether it wishes to maintain its own actuarial services agency as opposed to outsourcing work on a commercial basis.
- However, the recent win by us of the actuarial role in relation to the Principal Civil Service Pension Scheme demonstrates that it is not necessary for the GAD to have a monopoly of the other major public sector schemes.
- Where the GAD does compete openly, i.e. for local government scheme actuarial work, we are not aware of them having achieved much success, despite undercutting commercial rates.

Overseas schemes

- It is not clear to us why the GAD operates in foreign markets (e.g. when advising on national insurance arrangements) where it undercuts commercial rates. This does not appear to be in the UK national interest.

Appendix D – Main determinants on the role of a pensions actuary



The traditional role of the actuary

The UK occupational pension system was founded on the basis of employers and employees sharing risks. The employer made a basic pension promise, but this contained little in the way of guarantees, and only if the scheme assets performed well would members' living standard be maintained. In extremis, the employer could walk away from the scheme with no further liability. This gave a lot of flexibility in the funding and investment of pension schemes.

This is the current situation (indicated in the first column on the above chart) where the traditional role of the actuary has been to advise and apply judgement on an 'appropriate' level of funding and security - not too little, nor so much as to be too costly.

Increasing independence being asserted by trustees

Almost all this flexibility has now gone. The pensions promise has been elevated by successive Pensions Acts to a contractual commitment, and has been expanded to include near guaranteed inflation-proofing. This makes it hard for trustees to justify risky investment or funding strategies because there is little upside for members. But employers cannot afford very low-risk strategies.

This, coupled with the pressures exerted by low interest rates, fallen equity markets and extending life expectancies, means that the old partnership which existed between trustees and employers is being replaced by an adversarial situation where either side may feel they

need to get all they can for their stakeholders. The WH Smith case is a pointer to the future.

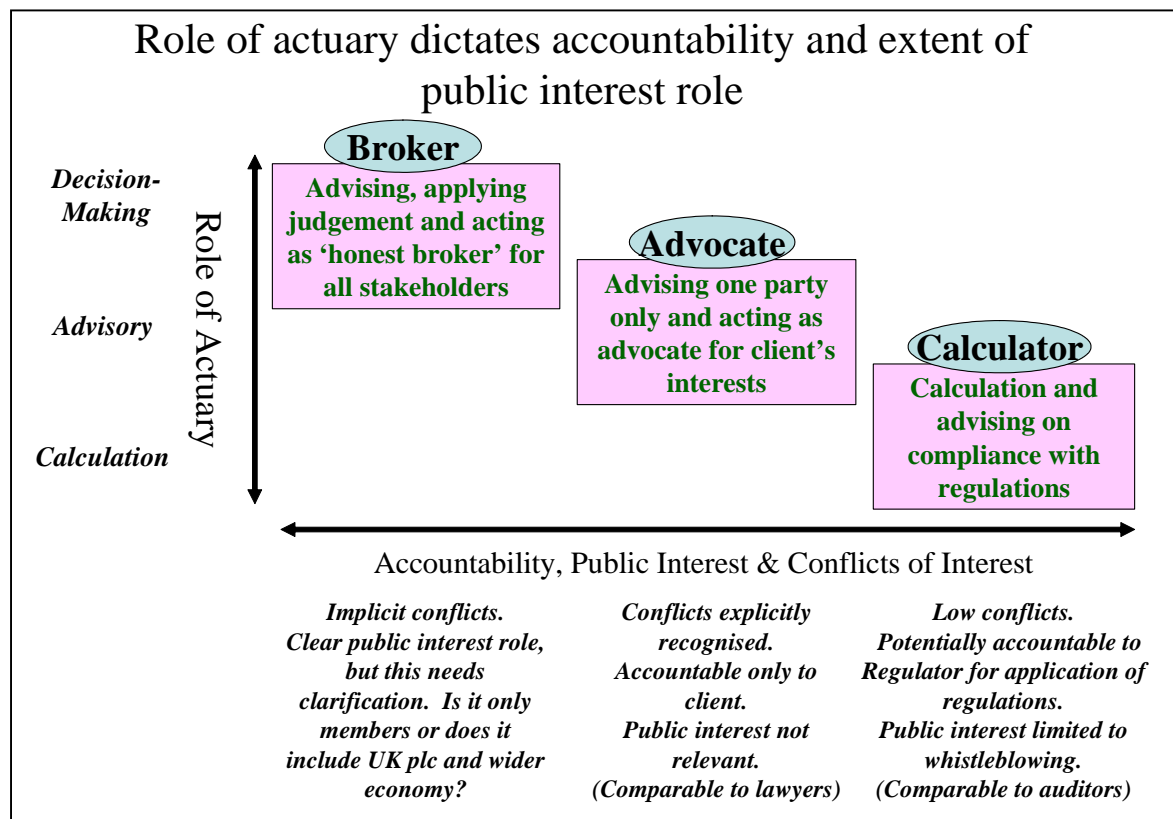
We are moving towards the middle column on the chart, with trustees and employers starting to hire their “own” actuaries and to take separate advice. While this is beneficial for us commercially, we believe the increasing assertive independence of trustees will only further discourage employers from providing final salary pensions.

Big Brother has the answer?

The government could come up with the ‘answer’ to how to balance security for members with affordability for employers, and attempt to prescribe in regulations the level of funding required. This is the final column in the chart, and it would reduce the role of the actuary to one of calculation and application of the regulations.

However, it is also unlikely to stem the continuing switch to Defined Contribution provision, which provide little in the way of certainty or security for employees. This would require a rolling back of the tide of well-intended pensions legislation which has continually turned expectations into entitlements. Employer-sponsored provision has to be preferable to relying entirely on private individual savings. There are significant advantages in lower costs, pooling of risks and the provision of education that can engender consumer confidence. It should be encouraged, not discouraged.

Appendix E – Role of a pensions actuary dictates accountability



The role of the actuary dictates to whom he/she is primarily accountable and the extent of any public interest role.

The Broker

In the left column there is a partnership of interests between trustees and the employer and the actuary acts as an honest broker between them. In this traditional model, the actuary attempts to find a balance between the competing interests, advising both parties and applying judgement when recommending a 'middle path' between possible extremes.

The Advocator

In the middle column the actuary acts for one party only in an adversarial situation between trustees and the employer. He/she acts as an advocate for his/her client's interests. We believe market practice has already started to move towards this model, with trustees increasingly asserting their independence from the sponsoring employer and hiring separate actuarial advisers. In this scenario a public interest role is not relevant. The closest analogy is perhaps the legal profession.

Calculator

In the last column the actuary simply performs calculations set out in regulations and advises clients on the application of regulations. In this scenario the actuary's public interest role is possibly to be

responsible to the Regulator for the enforcement of regulations, and this could include a whistleblowing duty. The closest analogy is perhaps the auditing profession.
