
APPENDIX

PUNTER SOUTHALL & CO RESPONSES TO SPECIFIC QUESTIONS

(LODGED WITH A CONFIDENTIAL LETTER OF 7TH SEPTEMBER 2004)

CHAPTER 1 – THE ROLE OF ACTUARIES, THE PROFESSION AND THE ACTUARIAL SERVICES MARKET

The scope of the actuarial role

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?

In a pensions context (especially defined benefit) the actuary usually has the best understanding of the financial dynamics of the arrangements, which he or she can assess, monitor and communicate in changing circumstances and against the legal backdrop of the Trust Deed & Rules and other pensions legislation. He or she is also likely to have an understanding of generic investment issues, although investment consultancy services are often sourced separately.

On a broader interpretation of “value”, we consider that consulting actuaries have a strong professional ethos and a high level of integrity. Actuaries also have a good record (in Opra’s assessment) of timely and diligent whistle-blowing.

A weakness for actuaries can sometimes be in the communication of extremely difficult concepts to a lay audience. Because of its size the Profession itself is not well understood and much press and other comment can be over-simplistic, inaccurate and misdirected.

In relation to UK occupational pension schemes we are of the view that actuaries are extremely well-equipped for the roles they perform (and the roles themselves are usually well-documented in client terms of engagement, trust documentation and legislation).

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?

It is possible that the provisions of the Finance Act 2004 will necessitate greater actuarial involvement in individual financial planning and modelling. In our experience actuaries do not stray into areas best left to other professionals.



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?

The actuarial role in relation to pension schemes is and will remain extremely important. The reserved role for the Scheme Actuary (which has to be a personal appointment) has been helpful in clearly aligning interests and reporting lines and increasing trustee focus.

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

Non-actuaries include both other professionals and nearly all of our clients. In our view the Scheme Actuary role has enhanced our standing and reinforced the duties owed by the individual to his or her clients – the trustees. Arguably, the role has reduced the ability of scheme sponsors to exert untoward pressure, as an employer knows this is not an appointment for it to make or to cancel (at least directly).

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?

We already operate a mandatory peer review process for all our Scheme Actuaries' work and covering a range of other advice. We have supported the Profession's proposal to introduce a peer review process.

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

In our experience of occupational pension schemes, actuaries, auditors, lawyers and investment consultants interact very effectively.

Accountability of actuaries

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?

We do not accept that in our particular field (occupational pension schemes, rather than personal pensions) we have designed any products which have turned out to be not "fit for purpose".



There are aspects of schemes which have been imposed by law which we consider are not ideal and, for the lower-paid, means-testing and State benefits can result in inequitable, or relatively inequitable, outcomes. These are impossible to address where the provision is made by employers on a collective basis. Even if they could be addressed at the outset, regular changes in State benefits and contracting-out terms, as examples, would tend to undermine across-the-board fairness.

Where we are involved in the administration of pension schemes we have consistently issued financial health warnings to leavers (or the far fewer opters-out), often using communication material provided by the regulators (SIB, FSA, etc). These warnings have been issued at our suggestion but with the agreement of our clients (i.e. the trustees). There is no adviser/client relationship with the leaver or opter-out, but the need for him or her to seek independent financial advice is always stressed.

A clear lesson to be learned is that in a world of free choice (essentially incepted with personal pensions in 1988) individuals will always make mistakes whatever advice they receive. Furthermore, the compensation culture we now live in means that targets of blame are often sought (by individuals, interest groups, regulators and Government) even when “loss” only emerges as a consequence of convenient hindsight.

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?

Like all professionals and service providers, consulting actuaries are accountable to the clients with whom they have contractual relationships. As practitioners subject to professional conduct standards and guidance, we are also accountable for observance of these rules and, to some extent, these could be said to encompass a wider public interest. Speaking as non-lawyers, accountability to third parties with whom no contractual arrangement exists would seem to be wholly inappropriate, unless there has been a clear breach of any actual duty of good faith.



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?

In the pensions field we consider the UK situation sensible and balanced. We would not support changes in the terms of our accountability, especially as any such changes could put us at a competitive and financial disadvantage to other operators and professions.

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

We are sufficiently liable and we would expect to account to our clients (under the terms of our contractual relationships) in cases of proven error, professional negligence, employee default, etc. Conversely, we would naturally resist claims from unconnected or remotely connected third parties.

The Profession

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

In our view the Profession makes great efforts to interact openly, effectively and helpfully with all of the above. The success of each engagement depends on all parties and the results are not uniformly successful.

If the Profession's lobbying, warnings and counsel are ignored or misconstrued (e.g. on the grounds of political expediency) then the honest approach is for that stance to be publicly admitted. The Profession's, the ACA's and many others' opposition to the ACT windfall tax on pensions is a matter of record as is the aggregate tax take since the change which, had it not occurred, would have massively reduced, if not reversed, the large aggregate deficit in UK defined benefit schemes. Similar warnings were sounded in relation to the idea of voluntary scheme membership and the launch of commission-based personal pensions in the late 1980s.

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

Yes. Furthermore, the highly competitive market for consultancy services acts as a further stimulant.



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

Yes, but it would be greatly served by more accurate and balanced reporting in the popular press.

Entry into the Profession

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?*

In our experience there is ample opportunity for companies to contribute to education strategy and policy. Members of the Profession who serve on the relevant boards and committees are employees of the companies that recruit and train actuaries. The curriculum is, therefore, partly driven by the needs of employers, which is as it should be.

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?*

It has served its purpose well, but the syllabus must continue to evolve over time as actuarial science develops and the needs of employers and their clients change.

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?*

Speaking from the perspective of pensions, the issues and legislative background are now so complex that it takes about five years for most professionals to develop an adequately deep understanding in order to be able to advise clients. Those who complete the examinations in 3 or 4 years still require considerable development to become fully-fledged consultants. As such, if it takes 5 or 6 years to complete the examinations, whilst gaining work experience, this is not a particular concern.

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

Yes, the evolution of the syllabus has kept pace.



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

We very much welcome it, particularly the business awareness module, emphasis on recording work-based skills acquired and the practical modelling module. We expect pensions students will welcome the dropping of the requirement to study both life and general insurance, although the impact of this needs to be monitored.

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

The student body is largely self-selecting, as this remains a vocational profession requiring a high level of personal commitment to study and training. The nature of the study and the work itself tends to exclude those who are not highly numerate. It is difficult to see what could be gained by formal links with other professions' qualifications, although most actuaries will work with other professions during their careers.

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?

This is not an area of concern. If the market saw a need for further providers, there are no barriers to entry, as was seen previously when Hazell Carr set up as a rival to the Profession's own educational service. The result was a higher standard of education materials and tuition for all students. Checks and balances exist because the Profession prepares the syllabus and core reading and sets the examinations but the tuition provider prepares its own course notes and other material.

The market for actuarial services

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?

In our area of occupational pensions the main drivers have been the avalanche of pensions legislation (mostly within the UK, but with some emanating from the EU), the increased financial importance of schemes relative to the capitalisation of their sponsors, greater member awareness of pension issues and more comprehensive governance structures. New accounting standards on pension disclosure have also produced work, as has the more common separation of briefs between trustees and companies. We have not been involved in any meaningful sense in the assessment of loss in the mis-selling field.



Although the new Pensions Bill and the Finance Act 2004 are likely to lead to increased consulting actuarial activity in the short term, the market for our traditional services will stagnate or even decline on a five-year view. This is as a result of the continued erosion of defined benefit schemes and a reluctance amongst potential sponsors to voluntarily commit to any meaningful long-term pension provision if this can be avoided. It remains to be seen whether different pensions models emerge and become attractive to members and sponsors, but this is a challenge to which we will try and rise. Whether the overall background conditions are empathetic to a reversal of the trend away from collective or individual pension savings (maybe saving at all) depends to a large degree on Government thinking and policy. This could remain incoherent whilst tensions continue to exist between the DWP and the Treasury.

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?

Please refer to our (confidential) covering letter. In our view there is huge consumer choice for clients of all sizes (compared, for example, to the limited choice of auditors for the largest companies) and a highly competitive market in which new entrants have emerged and continue to emerge.

The market for individuals requiring actuarial advice is more limited; there are fewer willing buyers and fewer willing providers. This is a complex area which is outside the scope of our response.

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?

Switching between providers is generally feasible for even the very largest and most complex arrangements, although sometimes the difficulties of switching are over-estimated and act as a constraint.

The pool of available advisers might also be constrained by the limited availability of professional indemnity insurance (“PII”) for actuaries. The PII market is currently such that adequate cover is simply not available for some operators or only available at inadequate levels and/or exorbitant cost for others. It is possible that the ease of switching would be increased by a more widespread acceptance of liability caps set at sensible but commercially viable levels.



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?

The best consultants do all they can to ensure recipients of advice understand what they are being told, the options available to them and the possible consequences of the different decisions they could make.

As a firm we have absolutely no interest in making advice any more complex than it needs to be or in trying to impose any preferred outcome. That clients have differing levels of training, education, interest and technical ability is inevitable and some clients will naturally want (sometimes demand) more prescriptive advice.

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?

Please see our covering letter (and Q1.23 above). Professional rules and conventions present no barriers to entry.

Other professions

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?

There are potentially lessons to be learned in terms of standard setting but equally a “tick box” approach is in no one’s best interests. We are significantly less persuaded that an independent regulator would fulfil any purpose, especially as the Pensions Bill already provides for a new (and powerful) Pensions Regulator overseeing the area in which we operate.



The Role of the Scheme Actuary

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

The Scheme Actuary role should remain reserved exclusively for actuaries and, as importantly, actuaries with the necessary experience. Other professionals (in a wide sense) could provide some of the advice which a Scheme Actuary might give as an ancillary part of his or her activity (e.g. because he/she may comment on Rules, emerging legislation or generic investment issues) but none of them could adequately undertake the specific tasks reserved for Scheme Actuaries.

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?

On the whole we are of the view that scheme trustees have the information to challenge our advice. Furthermore, scheme sponsors may also challenge the advice and, sometimes, they seek additional professional assistance in doing so. Expertise can be a more problematic area, particularly with inexperienced member-nominated trustees. However, the Pensions Bill is set to address the standards expected of trustees.

We do not generally make decisions by default, either on the distribution of benefits between different generations or on funding strategies (not least because it is not our money to spend). The only exception might be with regard to (unusual) Trust Deed provisions which specifically allocate the responsibility for setting the sponsor's contribution rate to the actuary.

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?

We operate internal peer review on a mandatory basis. We are also of the view that the necessary external checks and balances exist and will be strengthened by the new Pensions Regulator.

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?

The Scheme Actuary can only be accountable to the Trustees as a matter of law. The MFR provided a highly prescribed "line in the sand" that sometimes proved helpful in resolving potential conflicts between trustees and scheme sponsors. It is possible that another minimum will emerge, either as part of the scheme specific funding guidance or as a result of directions from the Pensions Regulator. The pricing basis for the risk-based element of the Pensions Protection Fund levy might also have a "standardising" impact.

We expect there to be a continued increase in the trend towards separate advice for trustees and scheme sponsors, but there is no blanket need for such a separation. Insistence on separate firms advising in all cases could seriously prejudice the viability of many smaller and medium-sized schemes, which are already burdened with massive compliance costs.

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 scheme sponsors and trustees?

The way pension schemes are funded (i.e. the pattern of contributions made to provide for benefits and to adjust solvency levels over time) has been reliant upon actuarial advice, but usually with decisions taken by trustees and sponsors in tripartite discussion. The actual funding/solvency level of UK pension schemes from time to time has been a consequence of what has happened in the real world (as opposed to the actuarial world of long-term assumptions). Actual pension costs are dictated by what actually happens in terms of investment returns, salary and price inflation, mortality experience, membership turnover, etc, and not by what the actuary assumes.



The Pensions Bill is likely to increase the power of the trustees acting on actuarial advice. It is possible that the propensity of scheme sponsors to take their own advice will increase and that there will be many references to the Pensions Regulator to determine what is and what is not acceptable.

Standard-setting

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

In the context of the wider pensions legislation framework which prevails at present, we are of the view that the level of discretion accorded to actuaries is about right. In our assessment there has been a reduction in discretion in many areas over the last 20 years.

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?

The Profession works closely enough with other professions in the area in which we operate and we do not consider that there are any significant regulatory gaps or overlaps in standards.

Openness, peer review and audit of actuarial work

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?

We do not agree with this assessment in relation to occupational pensions and nor do we consider that Lord Penrose intended his remarks to be accorded this wider construction given his own terms of reference.

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

We are of the view that communications between consulting actuaries and their clients and other professionals operating in the same area work very well. Where communications are unsatisfactory a natural consequence in a highly competitive marketplace is for providers to be changed; hence competition acts to maintain standards of communication (and of many other factors).



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

The Pensions Bill proposes an Annual Funding Statement to be issued directly to members. In theory this is a sensible proposal in our view. It remains to be seen whether the proposal can be given useful practical effect. It is, perhaps, worth pausing to consider how useful the auditors' report is to readers of company or pension scheme accounts.

