



Actuaries & Consultants

**Morris Review of the Actuarial Profession  
Consultation Document June 2004**

**Response from  
Lane Clark & Peacock LLP**

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## **Lane Clark & Peacock LLP**

Lane Clark & Peacock LLP (“LCP”) is a consulting firm providing actuarial advice to its clients. Out of a total of 310 employees and partners, 70 are qualified actuaries (45 being partners, a number having been practicing for over 20 years) and 80 are trainee actuaries.

The majority of our clients are in the pensions area - including trustees and employers - where we advise on benefit, contribution and investment issues. The balance of our clients are in the general insurance area; we do not advise on life insurance. The majority of our client advice relates to the UK. This response reflects where the majority of our advice is addressed, which is UK occupational pensions.

LCP actuaries are members of the Association of Consulting Actuaries and several participate in the committee structures of the ACA. Several actuaries also participate in the committee structures of the Institute of Actuaries. This participation gives us an opportunity to contribute towards professional developments affecting actuaries.

We generally support the expected response to the Morris Review from the ACA. However, we wish to make some additional general observations, give some examples of how we deal with a number of issues, and then address some of the numbered questions.

### **The pensions scene**

Within occupational pensions, as opposed to say life insurance, clients require actuarial advice on issues which are not part of their main business activity.

Pension arrangements are not provided in order to generate a direct source of profit.

There are two key drivers to occupational pension provision

- Employers have a choice as to the elements of employee remuneration. Providing pensions is only one such choice. If pensions become an inefficient way of remunerating employees, then employers are likely to look at other routes. The issue over defined benefit versus defined contribution pension provision is a case in point; many employers have already decided that the risks and compliance costs of providing defined benefit pensions have become unacceptable and are switching to defined contribution arrangements instead.
- Pension schemes have to operate within the terms of both their governing documents and legislation. Actuarial advice has to be given within this context.

## **LCP's philosophy**

As a large advising firm, we have a clear commercial, as well as professional, interest in ensuring that our advice to clients is appropriate and correct. Our clients are those to whom we are providing the advice.

To manage this, we identify areas of risk, and then set up procedures to control our exposure. Particular risks include:

- Competitive risk - as one of a number of providers of actuarial advice, we are aware of the need to provide high quality advice on a timely basis and for an appropriate fee. Our clients will also expect our advice to be directed at their needs and circumstances.
- Commercial risk - if our advice is incorrect and causes our clients loss, we may have to cover that loss.
- Professional risk - the actuaries in the firm are dependent on their professional qualification to earn a living, so compliance with professional requirements is essential.
- Reputation risk - minor mistakes, or misjudgements, which do not necessarily pose a serious commercial or professional risk, can still tarnish our reputation and hinder our business development.

Our overriding control of these risks is to instil the importance of providing quality, and compliant, advice into all our actuaries. Also, as a partnership, many of the actuaries are partial owners of the business, so have a natural motivation for the business to be successful. Our philosophy is to keep experienced actuaries at the forefront of client advice, not swamped by management responsibilities.

In an increasingly complex legislative and professional environment, we have recognised the need to provide assistance to our actuaries. This is done through regular training programmes and by various levels of internal guidelines.

- Although all actuaries are required to meet the profession's minimum level of Continuing Professional Development, we encourage our actuaries to do more. We run regular internal training and development sessions.
- Our office guidelines range from subjects such as conflicts of interest to detailed actuarial requirements concerning the approach to actuarial valuations of pension schemes. A key requirement is that every material piece of advice must be reviewed by an appropriate second professional before it is issued. For actuarial advice, this would mean a second actuary. Consequently most of our client teams will include two active professionals, with the second professional actively encouraged to challenge the advice proposed by the other.
- To support this structure, we also have a process of post-release audit review. This is intended to identify how well our general guidelines are being applied and whether there is any need for updating, or extension, of them.

We recognise that actuarial advice needs to evolve. Improvements in technology now allow us to consider approaches that were simply uneconomic in the past. We now see our role as providing answers to a series of “what if” questions and advising clients as to how particular strategies will respond to a range of possible outcomes. We are constantly developing new, and, we believe, better, approaches to actuarial issues - driven, not least, by the need to help clients understand the risk and uncertainty in long term financial vehicles.

Competition risk is one of the risks that we manage. We do not see any constraints on competition within the pensions consulting market. We receive many opportunities to present to potential new clients and are aware that our own clients will review our services from time to time. The development of innovative ideas is an important part of our marketing initiative; it both attracts new clients and demonstrates our continued commitment to existing clients.

## **CHAPTER 1 - THE ROLE OF ACTUARIES, THE PROFESSION AND THE ACTUARIAL SERVICES MARKET**

### **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?

- There is no legal precedent for every actuary to have a duty of care to the ultimate consumer of products or services incorporating actuarial advice. In the commercial world, the regulators have recognised that consumers will need their own advice and thus regulate the sales process. In occupational pensions, trustees will stand between the actuarial advice and the member, and it is part of their role to look after the interests of members.
- However, in an increasingly complex and competitive financial world, it is becoming very difficult to get appropriate advice into the hands of the individual consumer at a reasonable cost.

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?

- In the commercial environment, actuaries are primarily accountable to their clients.
- Within pensions, the actuary may well have two clients in relation to the same pension scheme: the trustees and the employer. This issue is picked up later in response to question 2.12.
- Any requirement to reflect the public interest should be put on the provider of the product, not the provider of the advice. If only some advisers were required to reflect the public interest, there would be the risk that the advice might be sought from other advisers not subject to the same requirement. Also, there may be no universal view of what represents the public interest.
- There is a role for actuarial input to debate on public interest issues and in practice much of this already happens on a voluntary basis through the professional bodies and the ACA. It is not clear who would pay for a specific public interest appointment; if additional cost were forced on employers in relation to pensions issues, it may simply accelerate the decline of voluntary employer provision.

## **The Profession**

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

- We, like many firms, have a strong commercial incentive to promote innovative ideas to current and prospective clients and see this as an important driver for developing our business.
- Both the Profession and the ACA act as “clearing houses” for innovative techniques and ideas developed by actuaries within their working environment. Although commercial sensitivity may sometimes slow down the spread of ideas, once they appear in the market place, they will soon be picked up by others.

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?

- As with any profession, individuals can find themselves conflicted between the commercial pressures of their business and the profession’s need for actuarial resource. Time is generally given to the profession “free”.
- The challenge, for a relatively small profession, of how to meet the costs of introducing lay input, or of a more formal, remunerated structure, has to be recognised.

## **Entry into the Profession**

Actuarial training is extensive, due to the range of specialist skills required.

We see commercial value in arranging our own training programmes for actuarial trainees to supplement those otherwise available. This both helps our trainees to qualify more quickly and ensures that they have the necessary commercial understanding and skills to be more effective within the business.

## **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?

- Within pensions, legislative changes have been, and continue to be, a major driver on demand.
- Within pensions, it is clear that the traditional demand for actuarial services in relation to defined benefit occupational pension schemes will ultimately reduce as defined benefit schemes are closed and replaced with defined contribution arrangements. However, closing a defined benefit scheme to new employees does not immediately remove the need for actuarial advice - indeed in the short to medium term, it may increase it.
- Further the move to defined contribution does not eliminate risk from pension provision, it simply shifts the risks borne by the employer on to the employee. Just

as employers need to understand the nature of the risks, so do employees. However, providing actuarial advice to employees is expensive and, currently, may be limited to higher paid individuals. Finding ways to deliver effective advice more generally to employees remains a challenge.

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?

- For consulting services, we see no artificial barriers preventing switches of actuarial adviser.
- However, the short term / long term issues should not be ignored. A long term relationship offers a number of advantages:
  - the adviser's knowledge of the client;
  - the client's trust in the adviser;
  - continuity of advice - many actuarial appointments are open ended, rather than project specific;
  - greater accountability - it is difficult to assess the benefits of advice about long term issues over a short term.
- Frequent full reviews of advisers generate inefficiencies; there are costs for both the advisers and the client in conducting a review and the actuary's costs will, in the long term, be borne by the clients.
- However, this should not allow either the adviser, or the client, to become complacent about the relationship.

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?

- This clearly depends on the skills of the particular actuary and the general experience of those receiving the advice.
- In the commercial world, effective communication of complex issues will always be a competitive advantage. Clients are not prepared to put up with poorly presented advice and will seek alternative suppliers.
- Communication is thus a significant part of our internal training.

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?

- Within the consulting area, we are not aware of any significant lack of competition.

## CHAPTER 2 - THE CURRENT REGULATORY FRAMEWORK OF THE ACTUARIAL PROFESSION

### 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 duties of the Scheme Actuary need specialist skills and experience. Requiring an individual taking on those duties to be a member of a professional body provides a structure to ensure that he/she has the necessary skills and experience, and exercises them appropriately (ie is subject to a disciplinary code). Currently, the only profession in a position to do this is the actuarial profession.

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?

- As with any specialist adviser, the client (in this case the trustees) cannot be expected to have the same expertise as the adviser.
- Clients are naturally less likely to challenge advice when it represents good news.
- However, in today's environment, when the advice has not been so welcome, the actuary expects to be challenged and to have to explain the basis for the advice being given. Advice is now including more "what if" calculations so that the consequences of alternative scenarios can be considered, and decisions be made, with a greater understanding of the risks. Advice can, and indeed in our view should, include "stochastic" projections with "probabilities" being applied to different outcomes.
- The powers of the trustees, the employer and the actuary over the setting of contributions varies significantly between schemes. There are schemes where just one of the group has unilateral power; others where there is a requirement for some form of agreement and/or consultation. However, even where the Rules state that the actuary sets the contributions, we would expect our actuaries to discuss the options available and the consequence of adopting them, rather than take policy decisions by default.

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?

- From LCP's perspective yes, although it is currently done at our own initiative. We would not anticipate any material change in our procedures to accommodate the new Compliance Review requirements of the profession.

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 is primarily accountable to the trustees, although this may be overridden by whistle blowing responsibilities.
- Within our own firm, we make our actuaries aware of the potential for conflicts of interest - in particular that trustees and employers should be treated as separate clients - and have guidelines for managing real conflicts and monitoring potential conflicts. We will be reviewing, and updating, our internal guidance and training in the light of the expected new requirements under the Pensions Bill. In some cases, in the light of the particular circumstances and after discussion with both the trustee and employer clients, we may conclude that it is appropriate to move to separate appointments.

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?

- As indicated in our response to 2.10 above, there may be many parties involved in setting contribution levels. It would be very unusual for actuarial advice not to have been available. However, other issues would also be relevant, for example the employer's ability to pay.
- Also, it is easy to look back with the benefit of hindsight and state that contributions should have been maintained when schemes were in surplus. First, Inland Revenue restrictions may have prevented this and, secondly, there was a genuine expectation, shared by clients and advisers, that such contributions were not necessary.
- Clearly, had investment strategy been changed to protect the gains from historic equity investments, schemes may not now be so underfunded. However, whilst this was possible on a small scale, limited capacity in the bond markets would have made a general switch from equities more difficult.
- Some of the factors that have increased the liabilities could not have been reasonably anticipated - the speed with which expectations about the rate of improvement in pensioner longevity have increased is one such example, and new statutory requirements are another.

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?

- Although it may be naive to think that the "simple" days of actuarial advice being based solely on the professional judgment of the actuary could return, there is a real danger of over-legislation suppressing all judgment. The consequence could be that actuaries over concentrate on compliance requirements to the detriment of professional advice on the real long term issues.

## **Investment**

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?

- Within pensions, money to pay benefits can only come from the proceeds from investments or contributions. A major influence on the former will be the high level investment strategy. In our view, therefore, advice on high level investment strategy and contributions strategy should be joined up.

## **Maintenance of professional competence**

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

- We agree with the concept of CPD and this is reflected in the level of internal training that we provide.
- However, a formalised CPD requirement has to be supported by an appropriate supply of CPD opportunities. In particular, CPD opportunities for experienced actuaries and those operating in non mainstream areas need to be thought through carefully.

## **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 practices?

- This is a difficult issue. Where there is guidance it needs to be up to date and unambiguous. However, if it is too detailed, it will not always deal with the whole variety of real world issues. Over-regulation will stifle individual judgment and prejudice innovation to the detriment of clients' future needs.

## **Openness, peer review and audit of actuarial work**

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

- As already stated, we see effective communications as an essential element of our competitive position.

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

- In pensions, members are able to see certain actuarial advice provided to the trustees. In practice, the number of members who ask for this is very small.

## **Monitoring, complaints and disciplinary schemes**

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

- Given that the new disciplinary process, which includes significant independent input, is still untested, it would seem premature to consider further wholesale review.