



## **Morris Review of the Actuarial Profession**

**Response by the Government Actuary's Department**

**to Chapter 3 of the June 2004 Consultation Document**

**September 2004**

# THE MORRIS REVIEW

## CHAPTER 3: THE GOVERNMENT ACTUARY'S DEPARTMENT

### Response by the Government Actuary's Department<sup>1</sup>

#### 1. Background

- 1.1 The Government Actuary's Department (GAD) was created in 1919 to provide actuarial advice to Ministers and their departments. The original focus of GAD was on the financing of social security, but this rapidly expanded into all areas of pensions and social security. Starting from the late 1960s, GAD became involved in advising those responsible for the supervision of insurance companies. Actuarial advice in connection with the regulation and supervision of UK insurance companies was transferred in its entirety, with the staff concerned, to the Financial Services Authority (FSA) at the end of April 2001.
- 1.2 A review of GAD was carried out under the programme of Rayner scrutinies in 1982 to examine critically the nature and extent of the actuarial advice needed by Ministers and their departments, and whether their essential needs could be met more effectively or more cheaply than by GAD. The main conclusions were that it was essential for Ministers and their departments to receive actuarial advice on the scale, and broadly of the nature, then being provided and that it would not be possible to provide as effective a service in other ways.
- 1.3 In 1989 a further review of the role of GAD and its financial viability was carried out by HM Treasury officials and a consultant from Peat Marwick McLintock Management Consultants. Recruitment and retention of actuarial staff was at that time a major problem and the ability of the department to continue in operation was in some doubt. The review endorsed GAD's role and confirmed the essential nature of many of the services it provided. In order to safeguard the future of GAD as an independent department, it recommended that GAD be required to adopt a 'full repayment' régime, charging all clients for actuarial services, with the exception of GAD's activities for which there is no single identifiable client, on population projections, life tables and the regular occupational pension schemes survey, in respect of which GAD should continue to receive a net vote (a limited excess of expenditure over income which Parliament has approved for the department to incur – in 2004/05 the net cash funding available is just over 8% of approved total income). Departmental clients were encouraged to market-test actuarial services in all circumstances where they were not under a statutory obligation to use GAD.
- 1.4 In 2000 a further review was carried out by the Government Actuary, assisted by a Steering Group of officials from HM Treasury, the Department of Social Security and the Inland Revenue, to consider the likely viability of GAD, subsequent to the

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<sup>1</sup> This response has been prepared on behalf of the GAD Management Board but also has the support of the Branch Council of Prospect, the union representing GAD staff.

transfer of staff and functions to the FSA in April 2001. That review concluded that:

- GAD should continue to operate as a separate Chancellor's department on a full repayment basis;
- no changes were required to the basic operating principles or to the expenditure limits agreed by the Chief Secretary to the Treasury in the 2000 Spending Review;
- consideration should be given to ways of alleviating short-term cash flow issues caused by the prohibition on maintaining any working capital (see also paragraph 5.16 below);
- GAD should introduce greater flexibility in charging structures; and
- GAD should seek opportunities to expand its client base in the wider public sector and internationally, subject to the overriding need to have sufficient resources to continue to provide a good quality of service to Ministers and officials in key departmental clients.

1.5 In 2001 the Treasury Select Committee carried out a review of GAD. The recommendations are set out in full in Appendix A.

## **2. Role of and rationale for GAD**

2.1 The principal reasons for GAD's separate existence remain essentially unchanged from those which have been considered persuasive in previous reviews. The most significant factor in this is the very dispersed nature of GAD's clientele and the variable nature of the need of any particular client for actuarial advice. The arguments can be considered under two headings.

2.2 *Why have a separate GAD rather than employing actuaries within other departments?*

- a) GAD's role in giving actuarial advice to Ministers, and to a wide range of departments and public sector bodies, helps to ensure continuity, comprehensiveness and consistency in the provision of such advice and in the resulting decisions that are taken;
- b) GAD's status as a separate department provides a degree of assurance that its professional advice is impartial and objective, as well as robust and defensible;
- c) few departments would have the need for even one full-time actuary, and their requirements are quite variable over time, but GAD can provide them with flexible access to a specialised professional resource, in keeping with the principles of the Gershon Review;
- d) individual actuaries (or very small groups of actuaries) working in separate departments would find it difficult to maintain their professional cutting edge and give as up-to-date, strong and well-resourced an input as GAD is able to do, nor would they easily be able to develop the required technical systems efficiently, nor get their work peer-reviewed;
- e) it is unlikely that individual departments would be able to attract and retain on a permanent basis sufficient actuaries of appropriate quality to meet their needs;

- f) GAD is a sufficiently large player in the actuarial recruitment market to have critical mass in attracting trainee actuaries and in recruiting and retaining qualified actuaries; and
- g) GAD offers more attractive and interesting career development paths for actuarial trainees and for qualified actuaries, with a viable remuneration structure superior to that which would most likely be possible within a larger department, although still subject to the normal constraints of being a government department.

2.3 *Why have a GAD rather than using private sector actuarial consultants?*

- a) GAD is a not-for-profit organisation and provides a cost-effective source of actuarial advice for government departments and other public bodies compared to the alternative of using private firms of actuarial consultants;
- b) there is less likelihood of a conflict of interest arising in dealing with issues where there is an interface with bodies outside the public sector, particularly on regulatory issues, where the use of one firm of consultants may give other firms commercial and confidentiality concerns;
- c) the accepted impartiality of GAD avoids some of the wastefulness of public money which could arise if different public sector entities each were to appoint actuarial consultants to help support their case;
- d) an “in-house” source of actuarial advice is more comfortable for policy development and regulatory matters and for handling confidential or sensitive issues;
- e) dual skills from being both actuaries and public servants bring knowledge of the ways of government and how advice should best be formulated and presented;
- f) GAD provides a readily available source of actuarial advice “on tap” for government departments, Ministers and other public bodies; and
- g) GAD reduces the challenges and costs of bringing ad hoc consultants up to speed on government requirements for each separate assignment.

2.4 A special case of the first alternative, of having actuaries in other departments, would be to have a centralised actuarial unit, still headed by the Government Actuary, but located within another department. Whilst this could overcome some of the arguments against dispersion of the actuarial function into a number of different departments, and could offer some advantages in terms of reducing overheads, it would be likely to present problems in terms of the perceived objectivity and independence of the advice given to clients other than the “home” department. Furthermore:

- a) it would be more difficult to organise a consultancy service for a wide range of departments and the wider public sector out of another department, for which providing actuarial services would not be a core activity;
- b) it would be harder to maintain the necessary flexibility on remuneration, recruitment and training;
- c) it would be unlikely to be as attractive a prospect for potential recruits and indeed for existing staff; and
- d) it could give rise to conflicts in relation to availability of resources for work outside the “home” department.

2.5 GAD has direct experience of using the services of other professional units which

were embedded in “home” departments but with a remit to provide services more widely. For example, an internal audit service was provided to GAD for several years by the internal audit function at the Department for Education and Skills. However, it did not prove to be a sustainable arrangement, since the priorities of the “home” department proved decisive and eventually led to the withdrawal of external services to other departments.

### **3. The work of GAD**

- 3.1 There are more than 300 references in primary or secondary UK legislation<sup>2</sup> to tasks which are required to be undertaken by the Government Actuary, the Deputy Government Actuary or by GAD. Some examples of these are listed at Appendix B. In addition, following a “machinery of government” decision by HM Treasury in 1954, GAD has on a regular basis prepared the official national population projections for the UK and its constituent countries, in consultation with the Registrars General for England & Wales, Scotland and Northern Ireland and with user departments.
- 3.2 The majority of GAD’s work for departmental clients and public sector entities falls within the following categories:
- advice to managers or trustees of individual public sector pension schemes;
  - public sector pensions policy;
  - advice on the pensions aspects of outsourcing and retendering of public service functions;
  - social security financing;
  - demographic projections and life tables;
  - social security and national policy and legislation on state and private pensions;
  - pension scheme surveys; and
  - regulation of private pension schemes.
- 3.3 Advising government departments and other public bodies and their pension schemes on pension provision is the largest component of GAD’s activities, accounting for some two-thirds of GAD’s income. GAD provides advice to government departments, to public bodies and agencies at local as well as national level and to a variety of other public sector schemes and employers.
- 3.4 GAD specialises in advising on pension provision for public service employees. It works for pension schemes, employers or other scheme sponsors, including a significant number of clients for whom GAD actuaries act as Scheme Actuary (or equivalent). The regular work that is carried out includes:
- carrying out regular valuations of major pension funds to advise the scheme trustees;
  - advising on restructuring of schemes and on design changes;
  - advising on the expenditure cash flows likely to arise in future as a result of pension scheme commitments;

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<sup>2</sup> including legislation passed by the Scottish Parliament and the Assemblies in Wales and Northern Ireland.

- advising on pension arrangements for senior appointments;
- advising on actuarial factors for different purposes within the structure of pension schemes;
- assessing bulk transfers into and out of public sector pension schemes;
- preparation of Resource Accounts in respect of the pension liabilities of public sector organisations; and
- advising the Inland Revenue on the arrangements for tax approval of occupational pension schemes.

3.5 Advising public bodies who are letting, and to an increasing extent re-letting, contracts for outsourced activities and other Public Private Partnership (PPP) and Public Finance Initiative (PFI) projects accounts for about a quarter of GAD's public pensions consultancy. As well as working with HM Treasury on the policy for protecting pension rights in these transactions, GAD:

- advises contracting authorities on the implications of the "Fair Deal" policy on staff transfers, both within and across the boundary of the public service;
- assesses proposals from potential contractors for meeting the broad comparability standard;
- assists in negotiating pension transactions and advises on the financial implications when outsourced activity is transferred between contractors; and
- develops and provides communications material and presentations to affected employees and their representatives.

3.6 The Registrars General for England & Wales, Scotland and Northern Ireland commission GAD to undertake the preparation of the official national population projections for the UK and for its constituent countries. These are normally prepared every two years, but, as a result of a number of revisions to population estimates following the 2001 Census, interim projections have also been required in the intervening years. The next full set of projections is scheduled for publication in October 2005, with an interim set due at the end of September 2004. In addition GAD prepares variant projections and projections by marital status, and also prepares the official decennial life tables for England & Wales and for Scotland. Drawing on 50 years' experience of demographic analysis, GAD is able to support the Registrars General in a most effective way, providing them with a dedicated and independent resource for undertaking population projections and related demographic assignments. GAD works closely with the Registrars General and other government departments to ensure that demographic outputs are produced in a timely fashion to meet user needs as required. As a department with UK responsibilities, GAD is ideally placed to ensure that consistent methods are applied for each constituent country of the UK and that the most defensible projections are produced at UK level. GAD also makes a significant contribution to the demographic work of the Continuous Mortality Investigation of the UK Actuarial Profession, and is able to apply this expertise when working with the Registrars General to prepare the national population projections.

3.7 GAD provides advice on the finances of the GB National Insurance Fund, including fulfilling the Government Actuary's statutory duties to prepare quinquennial reviews of the long-term financial implications of the current

legislation and preparing annual reports to the UK Parliament to accompany the government's proposed orders up-rating benefits and amending the contributions structure (and similar work for the Northern Ireland National Insurance Fund). GAD also provides a financial memorandum for Parliament when changes to social security legislation are being proposed. In addition, GAD provides regular advice to the Department for Work and Pensions (DWP), the Inland Revenue and HM Treasury on financial projections relating to social security benefits and contributions, costing of possible changes, estimates for the purposes of the pre-Budget report, the Budget itself and other Treasury forecasts, public expenditure exercises and so on.

- 3.8 GAD provides advice on overall design and public policy issues in relation to pensions and social security in the UK, including the interaction between pension schemes and social security arising from the contracting-out arrangements. In relation to the Pensions Bill currently before Parliament, GAD has been particularly involved in advising on the design and structure of the Pension Protection Fund, policy development on the Financial Assistance Scheme and the replacement for the Minimum Funding Requirement.
- 3.9 GAD provides actuarial advice to the Occupational Pensions Regulatory Authority (Opra) on the regulation of employer-sponsored pension schemes and stakeholder pensions and undertakes regular surveys of occupational pension scheme provision in the UK. GAD undertook a full review of these surveys last year. A key issue was whether GAD should retain responsibility for such survey work or whether, for example, it should be transferred to Opra. Following an extensive public consultation, the inter-departmental steering group overseeing the review published its recommendations in October 2003. Opra, DWP and the Office for National Statistics (ONS) were amongst those represented on this group. One recommendation was that, pending further clarification of the roles and responsibilities of the new Pensions Regulator that is expected to replace Opra in 2005, GAD should continue to undertake regular pension scheme surveys.
- 3.10 Among a variety of other tasks, GAD advises (or has advised) on the following issues:
- regular certification that there is no evidence of non-randomness in the output from the ERNIE premium bond random number generator;
  - preparation of the Ogden Tables for use by the Courts in assessing damages in personal injury and fatal accident cases;
  - advice to the Lord Chancellor on setting the discount rate under Section 1 of the Damages Act 1996;
  - preparation of recommendations (with tables) for Employment Tribunals to use in assessing the value of lost pension rights in cases of unfair dismissal;
  - the practical operation of the draw-down facility that is available as an alternative to annuity purchase in respect of personal pension holders under age 75; and
  - Consumer Credit legislation and the calculations for determining the annual percentage rate of charge, and amounts due on early settlement, in consumer credit transactions.

3.11 In addition GAD carries out a certain amount of work for overseas governments on:

- social security reviews;
- reform of social security;
- regulation and supervision of insurance companies and pension plans;
- public sector pensions;
- risk evaluation of social security and health care systems; and
- actuarial training.

Work for overseas governments and public bodies, including that financed by international agencies such as the World Bank, amounted to almost 15% of GAD's fee income in 2003/04.

3.12 GAD has strong and long-standing client relationships with a number of Crown dependencies, British Overseas Territories and Commonwealth countries, including, among others, the Channel Islands and the Isle of Man, Bermuda, Cyprus, the Falkland Islands, Gibraltar, Malta and Mauritius. More recently, GAD's services have been much in demand from a wider range of countries, because of GAD's specialised skills in social security, pension reform and financial regulation.

3.13 GAD was heavily involved throughout the 1990s in contracts to organise actuarial training and support the establishment of a local actuarial profession in a number of countries, on behalf of the Know How Fund of the Department for International Development. This was part of a strategy to support and strengthen the emerging market democracies of central and eastern Europe by providing technical assistance to train actuaries and also support for new supervisory authorities and pension reform programmes.

3.14 In the light of the recommendations of earlier reviews, including the Report of the Treasury Select Committee in 2001, GAD has sought to develop its services to UK departmental clients and has also expanded its client base in the wider public sector in the UK and internationally. Since 1989, when UK departments were first encouraged to market-test actuarial services, GAD has lost relatively few jobs to private sector firms. Those which have been lost have usually contained a significant non-actuarial element, on which GAD has not been able to compete with other firms which offer a wider range of expertise. GAD's success in retaining most of its UK public sector work, and gaining additional clients in the wider public sector and internationally, reflects the good value for money which GAD continues to be able to offer through its charging structure and the focused way in which GAD is able to meet the demands of public sector clients for actuarial services. Meanwhile GAD does not seek to compete with private sector firms for private sector clients and has no ambitions to move into this market. In order to compete more actively with private firms for wider public sector work, GAD would also need to develop a range of ancillary services, such as investment consulting, administration of pension arrangements and communications consultancy. Paragraphs 5.15 to 5.18 below include further comments on this aspect, in response to Question 1.29 of the Consultation Document.

3.15 One of the key questions of the 2000 Review was whether GAD would remain viable in the aftermath of losing some 20 staff to the FSA in April 2001. The

conclusion of that review, that viability should not be a major problem, has been borne out in practice. GAD is now almost as large as it was before losing staff to the FSA and has continued to operate successfully within all the financial targets set by Parliament and by HM Treasury. GAD is required by HM Treasury to charge fees which cover all of its costs, including not only direct staff costs but office accommodation and all overheads. GAD is also required to use the same fee structure for all its clients and not to favour any one client over any other.

- 3.16 In the last financial year GAD invoiced about 160 of its clients for more than £5,000 each, about 30 of these being invoiced for more than £50,000. No single client accounted for more than 10% of fee income in either of the last two financial years and the top ten clients in 2003/04 accounted in total for less than 40% of GAD's fee income.
- 3.17 GAD is not a static organisation. It actively develops and extends its services, helps staff to expand their skills and keeps its systems under review, so as to provide clients with the actuarial service they expect, and should expect. Regular client satisfaction surveys are conducted and what clients have to say about GAD is listened to carefully. GAD staff are in the distinctive position of being public servants who are exposed to the commercial world, both through running a business and in relation to the numerous commercial transactions on which GAD advises. A change in structure or a reduction in GAD's range of activities could seriously impede GAD's ability to develop and deploy the range of skills, and the blend of public servant, actuary and commercial knowledge which so many parts of the public sector are seeking.

#### **4. Conclusions**

- 4.1 Possibly the key strength of GAD is its professional independence, with a clear appreciation of public policy and the public service. This is supported by its structural and financial independence as a separate department charging fees for its services, albeit on a not-for-profit basis. GAD believes that its clients appreciate this strength and that it is well-recognised by Parliament, knowledgeable academics and private sector individuals in the fields in which it operates, including other members of the actuarial profession, in the UK and internationally. GAD has a significant public interest role and those who work for GAD take pride in its reputation for quality and independence.
- 4.2 GAD offers very good value for money for the provision of actuarial services to departmental clients and so, ultimately, to the taxpayer. Hourly fee rates are lower than those charged by private sector actuarial consultants and there is little doubt that GAD can provide most of the actuarial services which departments might require at significantly lower cost to the public purse than if they were to go to the private sector for those services.
- 4.3 The needs for actuarial services within government are generally too dispersed to justify employing actuaries in individual departments. In any case this would usually be unlikely to be practicable because of the difficulty of recruiting and

retaining sufficient actuaries in the absence of the critical mass which GAD is able to offer for career development opportunities.

- 4.4 GAD's experience and expertise in matters relating to public sector pension issues, UK demography and social security, and familiarity with working within the context of government and political constraints, puts it in a strong position to provide a high quality of service in respect of most of the actuarial issues which are of concern to departments.
- 4.5 Although GAD's good value charges are beneficial to departmental clients in keeping down the cost of actuarial services, they do not necessarily give GAD any particular advantage in competition for work in the wider public sector. GAD suffers from significant operational constraints relative to private sector firms and would require more flexibility in charging structures, in managing its finances and in other operational ways, including remuneration structures, in order to be able to compete on more of a level playing field with private sector firms in the wider public sector.

## **5. Answers to Questions in Section 3 of the Consultation Document**

### Question 3.3

- 5.1 One of the Government Actuary's more important roles from a national interest perspective is reporting to the UK Parliament on the finances of the National Insurance Fund. The annual reports that are made in connection with the benefit upratings and contribution re-ratings impose a discipline on governments and on Parliament to make responsible short-term decisions about benefit levels and contribution rates with due regard for the financial consequences. More important still is the regular requirement for quinquennial reviews of the long-term financial prospects of the National Insurance Fund and the requirement for a report by the Government Actuary whenever a Bill proposes changes to the social security scheme with significant financial implications. However, behind these statutory roles lies a well-embedded culture and practice in the UK of properly considering the long-term financial consequences of all social security legislation and changes in operation and experience. This regular examination of long-term financial consequences has been a critical factor in helping successive governments make decisions about state pension provision and its long-term affordability, and in informing the debates in Parliament and more widely.
- 5.2 It is recognised that, under the current arrangements, the Government Actuary reports only on the long-term finances of the National Insurance Fund, and not on Pensions Credit, Housing Benefit, and the costs of health care, residential care and tax allowances, although in the most recent quinquennial review (Cm 6008) reference was made to the costs of a broader range of benefits than just those payable from the National Insurance Fund. A solution to this would be for the scope of the Government Actuary's remit to be extended. Independent actuarial review of the future financial viability of the social security arrangements is in line with international best practice. It is important for public and Parliamentary

confidence in the projections for them to have been carried out by someone who is professionally independent of the government departments responsible for the policy and also for the review to be carried in line with the guidelines recommended by the International Actuarial Association. In order to further buttress GAD's independence in this role, an external peer review of GAD's work in this area was carried in 2002 by actuaries from the Office of the Chief Actuary in Canada.

- 5.3 Closely associated with GAD's role with the National Insurance Fund is the statutory responsibility to advise Ministers on the level of the rebates for those contracted out of the State Second Pension (formerly SERPS). It should be noted that GAD's responsibility under the statute is to advise on a neutral actuarial assessment of the cost of the benefits being offered by contracted out arrangements in substitution for the State Second Pension, whilst it is the responsibility of Ministers to decide on what the level of rebate should be, in the light of the Government Actuary's advice, in order to create the desired structure of incentives for contracting out, as against the costs to the National Insurance Fund in the short term of having a greater or lesser number of people contracted out.
- 5.4 Preparing the UK national population projections is closely associated with the social security role, since GAD has to prepare long-term demographic projections for Great Britain in order to fulfil the social security role and GAD is the predominant user of the very long-term population projections. Whilst the Registrars General for England & Wales, Scotland and Northern Ireland could in practice each do the part of the projections work relating to their country, there are considerable advantages in GAD doing the work for all the countries of the UK, both for efficiency and consistency, and because GAD brings an appropriate degree of independence to the overall co-ordination of the projections.
- 5.5 Social security actuarial work is highly specialised and is not the stock-in-trade of private firms. This is not to say that other actuaries could not learn such skills, but it does require exceptionally close collaboration with the relevant government departments (in particular DWP, Inland Revenue and HM Treasury), both on the policy side and in their analytical departments, involving statisticians and economists. It also requires an intimate involvement in the process of developing policy in an area which is often highly sensitive politically, including Budget sensitivity for some aspects. Having an in-house actuarial department at DWP is a theoretical alternative, but one which is unlikely to be feasible in practice, since it could be difficult to maintain the quality of advice or attract good actuaries without broader career development prospects and within a larger department's remuneration structure. Some of the short-term forecasting can be (and to an extent already is) carried out by economists, but long-term projections would normally be regarded as an actuarial field of expertise.
- 5.6 Many of GAD's 300 or so other statutory responsibilities concern different aspects of the financial management of public sector pension schemes. Whilst none of these individually is as significant a part of the government budget as the National Insurance Fund, collectively they do represent a huge financial commitment and regular actuarial analysis would seem essential for proper financial governance.

The public service pension schemes are different in nature and in financial operation from private sector pension schemes, so there are considerable advantages in this work being done by GAD from a practical professional point of view, as well as advantages of:

- consistency of advice across similar schemes;
- ready availability of good value advice both to the individual scheme managers, to responsible government departments and to HM Treasury;
- confidentiality in respect of sensitive policy development;
- readier defensibility of advice from GAD, as compared to advice from an individual private firm, including with Ministers, Parliament, trade unions and public sector employers;
- cost-effectiveness of GAD as a supplier of services; and
- specialisation of GAD in public sector work.

5.7 None of the public service schemes has enough need for actuarial services in its own right for it to be feasible to have a self-standing actuarial department.

5.8 In the field of broad comparability and the implementation of the government's "Fair Deal" policy, GAD has a quasi-regulatory role and a responsibility for maintaining consistency of assessment across the public services. It would be difficult to envisage any other actuarial firm performing a similar function, for example in issuing "passports" to private sector bidders for public service contracts. We understand that GAD's involvement is seen as critical to the confidence of the public sector unions in the process of contracting-out of services, as well as vital for ensuring that the public sector continues to get good value for money in the pensions aspects of these transactions.

#### Question 3.4

5.9 Other areas of GAD involvement serve to emphasise the enormous practical advantages to government departments and agencies of having GAD working alongside Ministers and officials as a source of actuarial advice and expertise – including pensions policy development (the current Pensions Bill is an excellent example), advice on pension schemes, consumer credit, actuarial tables for use by the Courts and Employment Tribunals, annuity draw-down, pensions on divorce, design of index-linked gilts and so on. Having an independent GAD within the public service is undoubtedly the most efficient and effective way of meeting such needs.

#### Question 3.5

5.10 All of the ten reasons in paragraph 3.20 of the consultation document remain highly relevant and current, as they have been throughout GAD's long history. Other reasons for maintaining GAD as a separate independent entity include:

- the importance in this type of work of maintaining professional freedom to give advice in relation to each client's requirements; and
- the challenge of maintaining a viable structure, within a government employment context, for the successful recruitment and training of actuaries and the ability to offer an attractive career structure and reasonably competitive remuneration.

- 5.11 GAD's current structure achieves all these objectives in a satisfactory way. No other structure would appear likely to do so. Changing the current structure could be highly detrimental to the public interest and to the interests of Ministers and government departments and agencies.

Question 3.6

- 5.12 Yes. As already discussed in answer to Question 3.5, no other structure would be able to offer the advantages of the present structure. Other possibilities have been considered in previous reviews but have always been rated as impractical or likely to prove detrimental to the interests of government and the wider public interest.

Question 3.8

- 5.13 GAD has a very strong reputation internationally as being particularly effective in achieving the objectives of the availability to government of high quality and broad-ranging actuarial advice. Only Australia, Canada, Japan and the United States of America come anywhere close in the effectiveness of their arrangements. An analysis of the situations in these countries is provided in Appendix C. Interestingly, in Australia and Canada, and also in Japan, there has been political pressure to move towards a structure more like the UK model. GAD has been asked to advise in several countries on the practicalities of establishing such an organisation.
- 5.14 The high international reputation of GAD is clearly one of the factors why many other countries turn to GAD for actuarial services, including not only countries with limited availability of actuarial services locally, but also countries which do have local alternatives available to them, such as Greece, Guernsey, Ireland, Mexico and Singapore. It is reasonable to say that in the global field of actuarial work in social security and public sector pensions, GAD is a pre-eminent provider of services. This is also the case for advice on the regulation of financial institutions, even though GAD no longer advises those responsible for the regulation and supervision of insurance companies in the UK. In those countries where there are not enough actuaries to be able to achieve a satisfactory actuarial presence within the regulator itself, there are in practice also very few consultants available to provide actuarial services to the regulators, and most of the consultants are conflicted as advisers to the regulated entities.

Question 1.29

- 5.15 This question also touches on the role of GAD. Since GAD was required to move to a "full repayment" basis in 1989, private sector actuarial firms have in principle been in competition with GAD. GAD's clients have been encouraged to test the market for actuarial services and, apart from GAD's statutory functions, most of GAD's clients have been free to use other providers of actuarial services. The rationale for this was to ensure that GAD had the incentive to remain efficient and competitive with the private sector and not allow it to become complacent as a result of being the automatic actuarial service provider for departments. This appears to have worked well in practice, with GAD offering very good value for

money in the provision of actuarial services to departmental clients.

- 5.16 GAD does not have the same commercial freedom as its competitors. GAD is a government department, with the associated expenditure controls and obligations to implement centrally determined policies, including fee-charging policy, personnel policies and constraints on salaries resulting from government pay policy. GAD is required to meet very specific income and expenditure targets, on both a cash and an accruals basis, and is also not permitted to maintain any working capital, all surpluses having to be surrendered on a year to year basis to HM Treasury. GAD is much more in the public eye than other firms of actuaries and its advice and role comes under direct public scrutiny, including frequent reviews of its overall role and responsibilities, as explained in Section 1 above. These are strengths in delivering objective advice which our clients across government, both locally and nationally, value.
- 5.17 It is neither practical for GAD to enter effectively into competition with private sector firms of actuaries for private sector clients, nor would this accord with the *raison d'être* of the department. In order to compete more effectively with private firms for private sector clients, GAD would also need to develop a range of ancillary services, such as investment consulting, administration of pension arrangements and communications consultancy. GAD has no ambitions to move into this market.
- 5.18 GAD is able to continue to operate successfully in its niche market because of the advantages it offers to public sector clients and the limited attractiveness of these organisations as clients to private sector firms. In the public sector pension field private firms could clearly compete (and in isolated cases have done so successfully) but the reasons in paragraph 3.20 of the Consultation Document remain powerful for most of GAD's public sector pension scheme clients. GAD also competes with other providers of actuarial services globally in the social security field (including individual actuarial consultants and the actuarial department of the International Labour Organisation – in practice the large actuarial firms are not very active in this particular market).
- 5.19 GAD's experience across the piece in social security, pensions and demography, both in the UK and internationally, gives it insight and new perspectives which have proved invaluable in determining the depth and range of advice GAD is able to give the UK government and the devolved administrations. At the same time this work helps GAD to maintain a strong team of professionals with the expertise necessary to provide a high quality service to Parliament, and to DWP, HM Treasury and the Inland Revenue on work in connection with the National Insurance Fund.
- 5.20 The maintenance of a wide range of public sector pension clients, both with funded and unfunded arrangements, is essential to the ongoing integrity of GAD as an actuarial employer which can provide sound training, development and professional experience opportunities for its staff. Without a strong scheme advice side to GAD's work, it would become increasingly difficult to provide effective policy advice to government departments and regulators.

5.21 There are no constraints to GAD working in partnership with private sector consultants on particular projects, where this would result in the most efficient mix of skills and experience.

A handwritten signature in black ink, appearing to read 'Chris Daykin', with a horizontal line underneath.

**Chris Daykin**  
**Government Actuary**

**9 September 2004**

## **Appendix A**

### **Recommendations of Seventh Report of Treasury Select Committee<sup>3</sup>**

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#### **SEVENTH REPORT**

#### **The Treasury Committee has agreed to the following Report:- GOVERNMENT ACTUARY'S DEPARTMENT**

##### Summary of Conclusions and Recommendations

- (a) We appreciate the high regard in which GAD is held by those who deal with it (paragraph 7).
- (b) GAD should continue to play a role in the supervision of life insurance firms even after the end of its contractual relationship with the regulator (paragraph 13).
- (c) We consider it important that Parliament should be regularly informed about the condition of the life insurance industry, particularly in light of the recent problems affecting Equitable Life. GAD is well placed to provide such information, even after the FSA takes over responsibility for actuarial advice on life insurance firms, by developing its relationship with firms' appointed actuaries. We recommend that GAD be given statutory responsibility for publishing a regular report on the life insurance industry (paragraph 14).
- (d) We consider it vital that the independence of GAD should continue to be upheld (paragraph 15).
- (e) We have received the impression that GAD is a rather under-utilised resource of which the Government could make more use in future (paragraph 16).
- (f) We recommend that the Government review GAD's activities with a view to identifying areas where the department could usefully make regular reports to Parliament (paragraph 17).
- (g) We recommend that the Government consider giving GAD a budget for carrying out work on matters of public interest, for example when commissioned by Select Committees (paragraph 18).
- (h) We recommend that the Government review the scope for GAD to be given more commercial freedom to pursue work overseas (paragraph 21).
- (i) There may be merit in re-examining GAD's status, to ensure that the Government continues to get the best value actuarial advice (paragraph 22).
- (j) We look to the Government to ensure that GAD's expertise is fully exploited in future: this will help it continue to attract high-quality actuarial staff (paragraph 24).

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<sup>3</sup> <http://www.publications.parliament.uk/pa/cm200001/cmselect/cmtreasy/236/23606.htm>

## **Appendix B**

### **Some examples of statutory duties of the Government Actuary and the Government Actuary's Department**

#### **Section 142(1) of the Social Security Administration Act 1992**

'Where the Secretary of State lays before Parliament a draft of an order under Section 141 above, he shall lay with it a copy of a report by the Government Actuary or the Deputy Government Actuary on the effect which, in that Actuary's opinion, the making of such an order may be expected to have on the National Insurance Fund; and, where he determines not to lay a draft order, he shall with the report laid before Parliament under Section 141(6) lay a copy of a report by the Government Actuary or the Deputy Government Actuary on the consequences for the fund which may, in that Actuary's opinion, follow from that determination.'

#### **Section 150(8) of the Social Security Administration Act 1992**

'The Secretary of State shall lay with any draft order under this section a copy of a report by the Government Actuary or the Deputy Government Actuary giving that Actuary's opinion on the likely effect on the National Insurance Fund of such parts of the order as relate to sums payable out of that Fund.'

#### **Section 166 of the Social Security Administration Act 1992**

'...the Government Actuary shall review the operation [of the Act] during [that] period to determine the extent to which the level at which the National Insurance Fund stands from year to year may be expected in the longer term to bear a proper relation to demands in respect of payments of benefit. After completing his review, the Government Actuary shall report to the Secretary of State and the Treasury his opinion and the Treasury shall lay a copy of the report before Parliament.'

#### **Section 630 of the Income and Corporation Taxes Act 1988**

This section provides for the maximum amount that may be withdrawn under an 'income withdrawal' arrangement to be determined by reference to tables prepared by the Government Actuary.

#### **Section 28A of the Pension Schemes Act 1993**

Provides for the maximum amount that may be withdrawn under an 'interim arrangement' to be determined by reference to tables prepared by the Government Actuary.

#### **Section 656 of the Income and Corporation Taxes Act 1988**

This section provides for the Government Actuary or the Deputy Government Actuary to certify the expected term of an annuity or the actuarial value of any annuity payments where it is not otherwise possible to do so in accordance with the mortality tables prescribed under this section.

### **Schedule 23ZA of the Income and Corporation Taxes Act 1988**

Provides that the approach used to determine excessive funding may include methods, principles or tables published by the Government Actuary for any purposes of the personal pension provisions of the Act.

### **Section 49 of the Welfare Reform and Pensions Act 1999**

This section provides for the calculation and verification of cash equivalents for the purpose of sharing State Second Pension on divorce to be in such manner as may be approved by or on behalf of the Government Actuary.

### **Sections 42, 42B and 45A of the Pension Schemes Act 1993**

These sections require a report to Parliament by the Government Actuary or the Deputy Government Actuary when the Secretary of State proposes a change in the rates of National Insurance contributions payable by employers and employees who are contracted out of the State Second Pension respectively through a contracted-out salary related occupational pension scheme, a contracted-out money purchase occupational pension scheme and an appropriate personal pension scheme.

### **Section 64 of the Pension Schemes Act 1993**

This section requires a report to Parliament by the Government Actuary or the Deputy Government Actuary when the Secretary of State proposes revised actuarial tables for calculating the premiums payable to restore benefits in the State Second Pension [provisions repealed in 6 April 1997, but held in force on a transitional basis to cater for premiums payable in respect of events before 6 April 1997].

### **Section 10 and Schedule II Part III of the Judicial Pensions and Retirement Act 1993**

These sections provide for the Government Actuary to advise on actuarial factors and guidance in relation to transfers in to the judges' pension scheme and additional voluntary contributions.

### **Section 10 of the Civil Evidence Act 1995**

This section provides for the admissibility in court of the 'Ogden tables' prepared by the Government Actuary's Department for use in personal injury and fatal accident cases.

### **Section 1 of the Damages Act 1996**

Before making an order under this section the Lord Chancellor must consult the Government Actuary and the Treasury; and Scottish Ministers must consult the Government Actuary.

Numerous additional references to the Government Actuary or the Government Actuary's Department appear in secondary legislation, a few illustrative examples of which are given below. In many cases there are equivalent legislative provisions in Scottish and Northern Ireland legislation:

**Regulations 3 and 4 of The Sharing of State Scheme Rights (Provision of Information and Valuation) (No 2) Regulations 2000 (SI 2000/2914)**

These regulations impose requirements relating to the provision of information about the valuation and sharing of state scheme pension rights on divorce. The regulations also provide for the valuation of shareable state scheme rights and the calculation and verification of cash equivalents for the purposes of the creation of state scheme pension debits and credits to be in such a manner as may be approved by or on behalf of the Government Actuary.

**The State Scheme Premiums (Actuarial Tables) Regulations 1992 (SI 1992/796)**

Sets out the tables provided for in section 64 of the Pension Schemes Act 1993.

**The Council Tax Benefit (General) Regulations 1992 (SI 1992/1814)**

Makes reference to the tables issued by the Government Actuary under section 630 of the Income and Corporation Taxes Act 1988 and section 28A of the Pension Schemes Act 1993.

**The Damages (Personal Injury) Order 2001 (SI 2001/2301)**

Order made by the Lord Chancellor under section 1 of the Damages Act 1996, after consultation with the Government Actuary and the Treasury.

**Regulations D2, E5, E6, J1, M6, N3A, N4, Q7, T7 and U3 of The National Health Service Pension Scheme Regulations 1995 (SI 1995/300)**

These regulations refer to the role of the Government Actuary in determining actuarial factors, carrying out the actuarial valuation, and advising on employer contribution rates and on issues such as bulk transfers.

**Regulations 20, 20A, 31, 33, 49, 55, 58, 66, 80, 87, 122A, 124, 125, 142, 147, 149, 156, Schedules 4 and 8 of The Local Government Pension Scheme Regulations 1997 (SI 1997/1612)**

These regulations refer to the role of the Government Actuary in providing actuarial factors and guidance for a variety of purposes in connection with the Local Government Pension Scheme.

**Regulations G2, G4, G5, G7 and G8 of The Teachers' Superannuation (Amendment) Regulations 1997 (SI 1997/312)**

These regulations provide for the Government Actuary to carry out five-yearly actuarial valuations and to advise on the contributions to be made by participating employers.

**Regulations G1, M6, N4, P5, P6 and Schedules 6 and 10 of The Parliamentary Pensions (Consolidation and Amendment) Regulations 1993 (SI 1993/3253)**

These regulations provide for the role of the Government Actuary in relation to a variety of different aspects of the Parliamentary Contributory Pension Fund for members of the UK Parliament.

**Regulations 8, 9, 22, 23, 24 of The European Parliamentary (United Kingdom Representatives) Pensions (Consolidation and Amendment) Order 1994 (SI 1994/1662)**

These regulations provide for the Government Actuary to advise on commutation factors, transfers in and out and abatement of pensions for UK members of the European Parliament.

**Regulations 2, 4A, 17, 18A, 18B, 37, 40, 41, various clauses of the Rules and Schedule 7 of The Mineworkers' Pension Scheme (Modification) Regulations 1994 (SI 1994/2577)**

These regulations provide for the Government Actuary to advise on actuarial factors, carry out the regular actuarial valuations, and advise on employer contribution rates for the closed Mineworkers' Pension Scheme following the privatisation of the coal industry.

**Regulation 24 of The Pension Sharing (Pension Credit Benefit) Regulations 2000 (SI 2000/1054)**

This regulation requires the Government Actuary to advise on the manner of calculation of cash equivalent transfer values for public sector pension schemes in the context of pensions on divorce.

## **Appendix C**

### **Arrangements for actuarial advice to government departments and public sector organisations in Australia, Canada, Japan and the United States of America**

#### **Australia**

The Australian Government Actuary (AGA) operates as a division of the Australian Treasury. AGA is fully self-funding, with about 40 clients. The largest client generates some 25% of their fee income. AGA provides actuarial and related policy advice to clients, who are in the main Commonwealth of Australia public sector agencies, although sometimes they advise state agencies and occasionally other governments overseas and direct work for Ministers and Parliamentary committees.

AGA does not advise on the regulation of insurance or private pensions (known as “superannuation” in Australia), or on basic social security (which is means-tested in Australia and for which there is no established practice of carrying out long-term projections). Work includes superannuation for various groups of public sector workers, policy advice on superannuation, policy advice on certain government insurance-like systems and on aspects of the insurance market and the financial system, medical indemnity insurance, superannuation and divorce, higher education funding, financial reporting, workers’ compensation and disability compensation, and responsibility for producing the Australian Life Tables.

AGA has a fair amount of autonomy, although this has sometimes been questioned. There are some pressures over the perceived potential for the AGA to be subject to government pressure and over whether the AGA’s advice is sufficiently publicly available. The current Opposition (the Australian Labour Party) has included in its manifesto for forthcoming general elections a proposal to establish the AGA as a separate statutory office along the lines of the UK Government Actuary’s Department<sup>4</sup>.

#### **Canada**

In Canada the Office of the Chief Actuary (OCA) is established within the Office of the Superintendent of Financial Institutions (OSFI). The Chief Actuary is not involved in actuarial advice in relation to the regulation and supervision of insurance companies, or other financial institutions – OSFI has a number of other actuaries for that work (and the regulation of private pension plans is mostly carried at provincial level). The Chief Actuary is operationally a separate entity within OSFI and is in principle autonomous in relation to the provision of advice to the Canada Pension Plan (the Canadian equivalent of the UK’s State Second Pension) and other government departments in relation, primarily, to their pension arrangements. Statutory actuarial reports are currently sent to four different ministers. There was some discussion over the Chief Actuary’s autonomy at the time of the sacking of the previous incumbent, since he alleged that this was, in part at least, over a question of the actuary’s independence to choose assumptions. A private member’s bill was introduced into the House of Commons in 2003 which would have provided for an independent Chief Actuary who would have reported directly to the House of Commons.

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<sup>4</sup> <http://www.alp.org.au/media/0304/20007069.html>

The OCA is largely funded by fees from its clients, although 10% of its budget is met from appropriations from the budget. OCA has a number of statutory responsibilities. Details of the Reporting and Accountability of the OCA can be found on the OSFI website<sup>5</sup>.

## **Japan**

In Japan actuaries are recruited and posted to individual ministries, in particular the Ministry of Health, Labour and Welfare, working in the Ministry's Pensions Bureau, Health Insurance Bureau and its Statistical Information Department. The Pensions Bureau has more recently evolved to be a source of actuaries for other posts within government, including seconding three actuaries to the Financial Services Agency and one to the Mutual Aid Association for Government Employees.

The main actuarial work in relation to the social security system is performed within the Actuarial Affairs Division of the Pensions Bureau. During recent discussion of the pension reform bill, several opposition members of the Diet and some academics have argued that the Actuarial Affairs Division should be separated from the Pensions Bureau and made into an independent agency, in order to ensure that the actuarial projections are independent and transparent.

## **United States of America**

In the United States of America, the equivalent of the UK Government Actuary's responsibilities for reporting on the long-term financial viability of the National Insurance Fund fall to the Chief Actuary of the Social Security Administration (SSA). The Office of the Chief Actuary is about as large as the whole of GAD and reports to the Secretary of Health and Human Services. Its costs form part of the SSA's overall budget. A major public function is to carry out the long-term actuarial projections which are published as part of the annual review by the Trustees of the Old Age, Survivors and Disability Insurance Program (who are political appointees). Responsibility for the assumptions underlying the projections rests with the Trustees rather than the Chief Actuary, although the actuary provides a professional opinion within the report. The Office of the Chief Actuary also provides a service to Congress in carrying out projections, costing proposals and responding to enquiries about the financing of social security.

In the USA there are actuaries employed in the offices of most of the (State-based) Commissioners of Insurance (e.g. 38 at the New York State Insurance Department and 10 at the California Department of Insurance). At federal level there are actuaries in several government departments, including the Internal Revenue Service (11), Pension Benefit Guaranty Corporation (17), Centers for Medicare and Medicaid Services (26), US Department of the Treasury (1), Bureau of Workers' Compensation (2), US Department of Defense (7), Office of Management and Budget (1), Office of the Attorney General (1), Executive Office of the President (1). Some States or cities have a number of actuaries working for them, for example the New York City Office of the Actuary has 13 actuaries.

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<sup>5</sup> [http://www.osfi-bsif.gc.ca/eng/office/mandate/Reporting\\_Accountability\\_OCA\\_e.pdf](http://www.osfi-bsif.gc.ca/eng/office/mandate/Reporting_Accountability_OCA_e.pdf) and <http://www.osfi-bsif.gc.ca/eng/office/mandate/index.asp>