

Submission to the Morris Review of the Actuarial Profession

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Context of this submission

1. The Pensions Policy Institute (PPI) promotes the study of pensions and other provision for retirement and old age. The PPI is unique in the study of pensions, as it is independent (no political bias or vested interest); focused and expert in the field; and takes a long-term perspective across all elements of the pension system. The PPI does not make policy recommendations, but exists to contribute facts and analysis to help all commentators and decision-makers in the field of pension policy.
2. This submission is written on behalf of the PPI by Alison O'Connell, Director.
3. Alison has worked as an insurance actuary (1985 to 1991; Fellow of the Institute of Actuaries 1988). Subsequent work outside of actuarial practice has been in insurance (as a strategy consultant) and in pensions (as a policy analyst); in both cases often working alongside practising actuaries.
4. The PPI does not get involved with the running of any pension scheme in practice, nor has any of its staff ever worked as pension scheme actuaries. This submission comes from the perspective of what should make for good pension policy.
5. The submission covers comments on some selected questions raised by the Morris Review: first, some general comments on the role of Scheme Actuaries and second, some specific comment on the role of the Government Actuary's Department (GAD) of particular relevance to the work of the PPI.

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Chapter 2 – The current regulatory framework of the actuarial profession

6. **Q2.1** The objective of a regulatory framework for the actuarial profession, **as far as it applies for actuaries advising pension schemes** should take into account that:

- Any actuary or firm of consulting actuaries is but one of a number of stakeholders involved in any pension scheme. It is only to be expected that these stakeholders may have different, and possibly conflicting, interests.
- **(Ref also Q1.8)** There is a legal framework within which pension schemes have to operate, and Scheme Actuaries have ‘reserved’ roles, both statutory and regulated by the Profession. But pension schemes are a benefit of employment. Provided statutory rights of scheme members are protected (which generally apply in greater force to the contracted-out part of the scheme benefits), then employers are free to operate the scheme as they wish. **This dual nature of pension schemes sets up a potential lack of clarity about the status of the Scheme Actuary’s advice.** There may be elements on which the Scheme Actuary is giving advice in a ‘reserved’ capacity (usually to trustees), and elements on which the same actuary or firm of actuaries may be giving ‘non-reserved’ advice to the trustees or employer.
- The Profession is small, and necessarily has limited resources to apply to regulation. There are only around 900 Scheme Actuaries and this number is unlikely to increase substantially. The number of people wanting to become expert in the special nature of actuarial calculations involved in such schemes is necessarily limited and the number of open Defined Benefit schemes is declining.
- The regulation of pension schemes is increasing in scope and complexity. The profession’s Guidance Notes are extremely detailed. A move to Actuarial Standards that focus more on the basic principles underlying actuarial advice should make for a clearer definition of the regulatory role of the Profession.

7. **Q2.3** The Profession’s dual responsibility for representing its members to the outside world and regulating them is not a significant issue. But a conflict of interest may arise from the dual role of an actuary or a firm of actuaries in advising pension schemes, as outlined in point 6 above. For example, the contribution rate needed to secure the contracted-out benefits of a Defined Benefit scheme is a ‘public interest’ matter; the range of contribution rates that should secure future additional benefits is a matter for negotiation between employer, employees and trustees.

8. **Q2.9 The role of Scheme Actuary should be reserved exclusively** for those who have an unusual combination of skills to do the necessary specialist calculations (requiring expert knowledge in specific areas of law, mathematics, demography and financial economics); and who operate under a system of checks and balances. Therefore, Scheme Actuaries should have a suitable professional qualification, have sufficient relevant monitored work experience and be regulated by a professional body with a disciplinary process. There is no alternative available other than, in the UK, being an FIA or FFA.

9. The critical issues are whether:

- Individual actuaries could do their jobs better (but note that not all 'actuaries' work 100% in 'actuarial work')
- Firms of actuaries could train and manage their actuaries better
- The Profession could run its qualifications and regulation better.

It is important that these three issues are not conflated. Some of the criticism aimed at 'actuaries' in general may be due to individual or firm underperformance. **This conflation exists in the language of the Morris Review consultation document¹; the recommendations of the Morris Review should not continue it.**

10. **Q2.10 Whatever the expertise of the trustees, it should be the responsibility of the Scheme Actuary to communicate sufficient information and explanation** to ensure that:

- Trustees understand the status of the Actuary's advice ('reserved' or 'non-reserved')² and the implications of that.
- Trustees are in no doubt where decision making responsibility lies, in particular, who takes responsibility for choosing the assumptions in the actuarial calculations.
- Trustees make their decisions understanding the likely and possible range of outcomes from those decisions.
- Trustees understand, and can communicate to members, the degrees of security and risk in the accrued and future scheme benefits.

In practice, this means the Scheme Actuary should communicate at whatever level of technical expertise should reasonably be understood by the least actuarially-literate trustee in any particular case.

¹ For example, in Questions 1.1 to 1.10

² As defined in point 6

11. It is a moot point whether better communication of the Scheme Actuary's advice should be regulated by the profession in some way (e.g., by some standard form of actuarial statements) or left to market forces to make it happen (i.e., trustees choosing those actuarial services providers who are better communicators).

Chapter 3 – Roles and Responsibilities of the Government Actuary's Department

12. **Q3.1** The PPI uses published and unpublished data produced by the Government Actuary's Department (GAD) from the GAD's statutory functions and core activity work (as described in Morris para 3.4 to 3.7 and 3.11 to 3.13). Most of this work is critically important, for example, some GAD reports are the single available source for anyone outside of government trying to analyse elements of state expenditure on pensions.
13. **Q3.2** The PPI is not a client of the GAD, and we have no insight into their other advice work.
14. We have good working relationships with individuals in GAD, who are generous with their time in answering queries, providing explanations to published data and sharing with us unpublished data. For example, GAD data on longevity projections have been used in PPI publications³. This has, we believe, been important in extending the audience for the GAD knowledge and expertise on the likely lengthening of life: a huge social policy issue as well as having implications for the cost of state pensions and other benefits.
15. **Q3.3** The PPI is satisfied with the quality of the work done in reporting to Parliament on social security matters and preparing national population projections. We would always hope that this work could be published more quickly than it is; but one suspects this is an issue of government budget and resources rather than of the GAD's skill or will.

³ *Raising State Pension Age: Are we ready?* (2002); *Raising State Pension Age: An update* (2003); Briefing Note Number 13 (August 2004)

16. There has been some suggestion that the GAD were slow in spotting the trend in improving longevity, and as a result the population projections have always underestimated the size of the older age population and have had to be updated frequently. This experience is not unique to the UK – it has happened in every modern economy⁴ - and it may well keep happening as the pace and extent of longevity change cannot be predicted with certainty.
17. What is important is that the actual trends are monitored well and possible futures modelled well. The GAD's demography experts are qualified to do this, and should be able (with appropriate budget and resources) to do so.
18. Sometimes confused with this issue is the criticism that pension scheme actuaries have been slow to advise their pension scheme clients to fund for longevity improvements. This is not an issue for the GAD in terms of its work on population mortality tables⁵. Actuaries advising large pension schemes tend to work with data on the mortality of the particular pension scheme. For smaller pension schemes, standard mortality tables prepared by the CMI Bureau of the Institute and Faculty of Actuaries (CMIB) tend to be used. Therefore, this is an issue of how the CMIB develops the mortality data and how consulting actuaries use that data and develop and use scheme-specific data.
19. **Q3.3 and Q3.5** For reporting to Parliament on social security matters and preparing the national population projections, an independent, non-commercial GAD is the best approach for all the reasons in Morris para 3.20.

⁴ Oeppen J, Vaupel J. (2002) *Broken Limits to Life Expectancy* in *Science* Volume 296 10 May 2002, p. 1029

⁵ Although it may be where the GAD is a pension fund actuary, for example in the public sector. The PPI has no knowledge of the quality of the GAD's work in this area.

20. **Q3.6 For reporting to Parliament on social security matters and preparing the national population projections, there is a need for continuing and even strengthening the role of a separate actuarially-based department, working independently with costs met by Parliamentary funding.** For example:

- To improve still further the data on population projections, and analysis of their implications, by developing a multi-disciplinary centre of excellence in national demography, with actuarial and non-actuarial expertise (for example, epidemiologists and statisticians).
- To make available more quickly and more widely the data on and actuarial analysis of social security investigations and explanation of the implications.
- To make expert resource available quickly when Parliament needs actuarial analysis of pension policy issues and proposed future pension policy reforms. Actuarial analysis (that is, combining demography and economic assumptions) of the implications and cost of such significant issues should be done by a Parliament-funded government unit with actuarial and public policy expertise, independently of any Departmental interest.

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