



CheckleyFisher LLP
CONSULTING ACTUARIES

Response by CheckleyFisher to the Morris Review

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MEMBERS

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Regulated by the Institute of Actuaries in respect of a range of investment business activities

1 Background

CheckleyFisher is a small firm of consulting actuaries operating in the pensions area. The partners are all certified Scheme Actuaries under the Pensions Act 1995 and each has at least 15 years experience of providing high quality advice to our clients, including many years working for one of the UK's largest actuarial practices. Our partners have worked with a variety of clients, from some of the top 100 schemes within the UK to individuals. Around 50% of our work is project work such as:

- advising on the pensions aspects of mergers and acquisitions
- providing second opinions
- expert witness services, including litigation against professional advisers
- advice to the company where independent advice is required from someone who is not advising the trustees

We have an associated software company, CheckleyFisher Computing Limited, which provides actuarial software to other actuaries, including a statutory authority and one of the top 4 accounting and consultancy firms.

The large consulting firms heavily influence the Profession and main industry organisations. This has resulted in the position where it is customary for actuaries to accept appointments where there is a potential conflict of interest. We believe that this has led to a number of problems that need to be resolved. CheckleyFisher has therefore decided to make its own submission rather than via one of the industry bodies.

We only respond to those questions where we have relevant experience or strong views. We make no comment on the remaining areas.

Any questions should be addressed to Richard Nobbs at the address on the covering page or via e-mail at richard@checkleyfisher.com.

2 Executive Summary

We believe the Profession should make the following changes:

- a. Tighter guidance should be given to remove potential conflicts of interest. The role of Scheme Actuary to the trustees of a pension scheme and actuary to the scheme sponsor should be split between different firms to protect client interests and improve standards. Provided the actuary to the scheme sponsor concentrated on matters of principle, the additional costs of this would be minimal.

Peer review is a poor second best to improved handling of conflicts of interest, particularly if actuaries from the same actuarial firm carry out the review, as there is a lack of independence. Those actuarial firms with appropriate risk controls already carry out peer review.

- b. There is too much focus on detailed compliance, with a proliferation of guidance notes, rules and regulations. More effort should be spent on getting advice correct, as would undoubtedly happen if point (a) above were implemented.
- c. Regulation should be carried out independently of promotion of the actuarial profession to avoid conflicts of interest.
- d. Consideration should be given to providing easier access to low levels of compensation for poor actuarial advice, with a lower burden of proof than required by the courts.
- e. Continuing Professional Development requirements should be reduced, simplified and monitored more rigorously so that Professional Development is demonstrable. Self-certification is inappropriate.
- f. The actuarial profession has much to offer industries other than the traditional areas of life insurance and pensions. Efforts should be further encouraged to help the profession develop in these “wider fields”.

3 Responses to the Questions:

Chapter 1

- 1.1 Actuaries are risk and financial evaluators who develop, maintain and decommission financial products. The use of actuaries has led to the wide range of financial products available, generally with a robust financial framework and lower capital requirements than would otherwise be required or a lower risk of default.

With regard to weaknesses, actuaries now have to deal with considerable compliance overheads. Many actuaries have become so immersed with compliance that it is detracting from providing sound commercial advice. In addition, the actuarial profession has generally been quite insular and not effectively liaising with other professionals. This has led to some blinkered stances being taken, for example the use of “discounted cash flow” models where an actuary may place an arbitrary value on a portfolio of assets depending on their “professional view”. We believe that the profession is becoming less insular and that some established customs are being challenged, but there is still some room for improvement.

- 1.2 We advocate a greater role for actuaries in corporate finance, capital projects and risk control. The Risk Assessment in Management of Projects (RAMP) handbook jointly developed with the Institute of Civil Engineering illustrates that the profession has much to offer in these fields and could lead to improved risk management handling and lower costs. However, the insular nature of the profession and the difficulty of making commercial inroads has resulted in few actuaries being successful in this area.
- 1.3 We believe that it is beneficial to society for certified professionals to have roles reserved by statute, particularly around the areas of assessing capital adequacy. If non-certified professionals assessed reserves then there is likely to be increased risk or greater capital requirements, or both. We would welcome the prospect of non-actuaries being allowed to perform certification provided that they have appropriate technical knowledge.
- 1.4 No comment.
- 1.5 Peer review is helpful if it is addressing broad principles and strategic issues, but a better solution is to tighten guidance on removing conflicts of interest. Any review must be carried out by an actuary who is completely independent in order to provide a more open and stronger profession, with improved security for beneficiaries. If peer review were to provide a complete review, including detailed checking of calculations and modelling, then the costs would often be prohibitive.
- 1.6 Working more closely with other professionals would improve actuarial effectiveness. However, relationships are likely to be dictated by commercial considerations which may limit the number of opportunities at a grass roots level.

- 1.7 Actuaries must accept some responsibility for products they have developed which are not “fit for purpose”. It is important to bear in mind what the “purpose” is. For example, personal pension plans are investment vehicles for retirement but have issues that need to be considered before knowing their suitability. It is the selling of products in unsuitable circumstances that has caused immense problems. The actuarial profession should have been more outspoken about this issue. With regard to the recent problems with occupational pension schemes, it appears that some actuaries have been tempted to “disguise” poor solvency levels by changing their assumptions in order to maintain their relationship with the scheme sponsor. This has exacerbated the deterioration in solvency positions as sponsoring employers have taken action only when the position has become severe. Splitting the role of Scheme Actuary to the trustees and actuary to the scheme sponsor would have identified the issues earlier. In addition, greater access to government by the profession is vital to enable speedier resolution of problems.
- 1.8 As partners who remain liable for the advice we give, we feel particularly accountable for our advice. We feel that an actuary should be primarily accountable to their client. Accountability to any other body would lead to confusion as to who the actuary is advising and result in conflicts of interest with potentially disastrous consequences. For example, it would be difficult for an actuary to advise a company about pension scheme benefit reductions unless he is accountable to the company. If primary accountability was to the trustees or public, the actuary may have to refuse to act. In addition, where an actuary has primary accountability to a scheme sponsor whilst acting as scheme actuary to the trustees, there is likely to be a reduction in security levels for members and, consequently, lower benefits when the scheme winds up which we believe is unacceptable.
- 1.9 We would like to see greater openness and separation of roles as this would lead to each party having a better understanding of their situation. In particular, there should be tighter regulation on conflicts of interest and, where there is potential for a material conflict, an independent actuary from a separate firm should be required to advise. Trustees are broadly reflective of the public interest and so a separate “public interest” adviser should not be required, particularly if actuaries are required to have regard to the public interest after having satisfied their primary accountability.
- 1.10 We have witnessed a number of cases where the advice given has been of poor quality, has not been timely and has resulted in costs that are significant to the client. However, in many cases, legal action has not been possible because the adviser has had substantial legal resources at their disposal. In addition, poor quality and untimely advice is not necessarily negligent. We would like to see easier access to low levels of compensation, for example via a body like the Pensions Ombudsman or the Financial Services Ombudsman whereby companies, trustees and individuals can make claims against their advisers with lower levels of proof required. We believe that this would lead to a raising of quality within the profession. Compensation should only be payable to the client.

- 1.11 The profession has recently improved its engagement with the government, business, regulators and other professions. In particular, we are aware of initiatives with the DWP, liaison with the FSA and the civil engineering, legal and accounting professions. Whether sufficient resource is committed to these engagements we are unsure.
- 1.12 The profession is restricted by the interests of the large employers of actuaries who have not generally been prepared to make the investment necessary to expand the horizons of actuarial knowledge and innovation. Many actuaries are involved in compliance roles and, as such, do not challenge established customs. It is left to the individual in most cases to take the initiative and drive the profession forward.
- 1.13 The profession should commit greater resources to promote the skills and work of actuaries.
- 1.14 Greater representation of small firms and wider fields would help advance the profession into a broader church and one that is more dynamic. We would support greater lay input from those other professionals with the necessary skills and vision to help the actuarial profession develop.
- 1.15 - 1.21 No particular comment. We note that an actuary has to pass exams in fields that they will not necessarily operate in, such as those operating in the pensions field needing to pass general insurance. If qualification were restricted to the actuary's area of practice then those exams not required could be replaced by other elements such as broader skills of business and management. Actuaries wanting to change areas of practice would need to sit the necessary exam beforehand.
- 1.22 The main drivers for actuarial services have been driven by the economy, legislation and regulation. In particular:
- the Pensions Act 1995 created significant compliance requirements and increased costs. This, along with adverse financial conditions, has created a flight to defined contribution schemes. The public at large has still to understand the implications of this, being significantly lower contributions and benefits, but increased risk. There is a good chance that the industry will be embroiled in another scandal.
 - The compensation work carried out in connection with the mis-selling of personal pensions, which involved several hundred actuaries up until 2002.
 - Future demand will be dictated by the new Pensions Bill and Finance Act and the speed at which defined benefit schemes wind up. In 10 years time, actuarial work in the traditional pensions field will be limited. Unless there is a change in the current approach, there is likely to be an increase in regulatory work, rectifying compliance failures and litigation.

- 1.23 Whilst there is a wide range of actuarial firms, the market is dominated by the large consultancies. Consumers are generally not aware of differences in the strengths and weaknesses of different firms and hence clients change advisers infrequently.
- 1.24 Switching advisers is time consuming for the consumer and results in switching costs which are either absorbed by the provider or the consumer. If there were improved handling of conflicts of interest, with separation of roles between different actuarial firms, there would be more established relationships between consumers and actuaries. This would result in:
- Higher quality work from incumbents, whose work would be subject to independent review when it is material
 - Greater awareness by consumers of the strengths and weaknesses of different actuaries and actuarial firms, resulting in less reluctance to switch.
 - Lower switching costs and, ultimately, long term savings.
- 1.25 Clients generally understand what they are being told and it is the actuary's role to ensure that they have sufficient understanding to make sensible commercial decisions from the advice given.
- 1.26 There have been several mergers of larger actuarial providers over the last ten years resulting in the domination of the market by a handful of firms. There have been a limited number of new entrants, including accountancy firms who have broadened their services, that have had a limited degree of success. Future demand for services will be limited in the pensions industry due to the lack of defined benefit pension schemes being established. We expect there to be continued demand for niche services, such as expert witness and second opinions, with mainstream pensions actuarial advice reducing. Pensions Actuaries will have to find other areas of work which the large consultancies are attempting to broaden into HR consultancies.
- 1.27 In the pensions field, in-house employees provide little actuarial advice.
- 1.28 The market is reasonably competitive when clients decide to change advisers.
- 1.29 GAD has made little or no impact in the pensions field.
- 1.30 - 1.37 No comment

Chapter 2

- 2.1 The objective of the regulatory framework should be to protect the client. The actuarial profession in a wider sense can have other objectives, but the regulator's purpose is to monitor adherence to standards. The regulator should not have a wider primary objective of protecting the public interest as this will lead to conflicts between an actuary's personal objective of serving their client and that of the regulator. However, a secondary objective of protecting the public interest would be sensible.
- 2.2 There are few cases where formal complaints are made against actuaries, either through the Profession or through the courts. Given the degree of underfunding of many pension schemes that have wound up, it is likely clients would have taken action had there been reasonable grounds to do so. However, the burden of proof required is high and if complaints could be determined with a lower level of proof, albeit with lower penalties there would be a rise in standards and stronger consumer protection.
- 2.3 The Profession's dual role of member representation to the outside world and regulation represents a conflict that should be removed by separating the functions.
- 2.4 Pensions regulation is very complex with the Actuarial Profession, OPRA, OPAS (albeit without any legal powers), the Pensions Ombudsman and in some areas, the FSA all being involved.
- 2.5 -2.8 No comment
- 2.9 Other professionals could carry out the Scheme Actuary's role provided they have met a certain standard of knowledge of the technical issues involved.
- 2.10 We suspect that in the majority of schemes, whist trustees have a general understanding, they do not have sufficient expertise and information to challenge actuarial advice and that in most cases the actuary is effectively making policy decisions by default. Where the roles of adviser to the scheme sponsor and adviser to the trustee are split, there is a greater degree of questioning and debate.
- 2.11 Within each organisation supplying actuarial services, there is generally sufficient audit and peer review. However, many large organisations have "house" views and policies and hence in many cases there is not always an independent perspective. For example, we recently encountered a case where the actuarial firm refused to sign a statutory certificate because they deemed no certificate was required by law, even though the scheme's legal advisers insisted a certificate was required. No actuary was given permission to deviate from the "house" view.
- 2.12 Scheme Actuaries should be accountable to the trustees, who are the client. There will be an increase in the degree of conflicts of interest when the Minimum Funding

Requirement is removed and in our view the roles of adviser to the sponsor and the trustees should already be split. Such a split would result in improved recognition of roles and responsibilities, higher standards of debate on policy issues with only a negligible increase in costs. For example, we were recently asked to advise on a corporate transaction where the target company's pension scheme had reduced from a large surplus (such that the sponsor could take an almost indefinite contribution holiday) to a large deficit. The Scheme had invested in equities which had, like most schemes, performed badly over the inter-valuation period. From the information we had been provided with, it appeared the risks of equity investment and the fact that the plan sponsor had almost nothing to gain from an equity based investment strategy had not been appropriately raised, although technical compliance with professional guidance had been satisfied. As we were independent from the Scheme Actuary we were able to recommend that legal action against the Scheme Actuary be considered. However, had we been working within the same firm of actuaries, it is unlikely that this advice would have been possible. This demonstrates that even Chinese Walls are insufficient to overcome conflicts of interest.

- 2.13 Actuarial advice has significantly contributed to the way occupational schemes are funded. Some actuaries were reluctant to advise a sufficient increase in contributions in the late 1990's and appropriate matching of assets to liabilities for fear of upsetting the scheme sponsor that has exacerbated the current solvency problems.
- 2.14 - 2.19 No comment
- 2.20 We are not aware of any balance between the Profession issuing certificates and regulators giving their approval as the Profession generally issues certificates without question.
- 2.21 The CPD regime combined with self-certification does not ensure that actuaries develop. The existing requirements for formal CPD where internal and external events need to be attended is unnecessary for actuaries dealing with new issues or technically challenging work in their day to day activities. We would prefer to see more rigorous monitoring of a system where genuine development and improvement is required. We believe that this would result in less formal CPD but an increase in the quality. Informal CPD, such as technical work and research would increase.
- 2.22 Practicing certificates lead to a two tiered level of actuary and we do not think that there is a role for actuaries who are not able to give actuarial advice. Practicing certificates should not be introduced. If it is felt that there is a body of actuaries who should not be able to give actuarial advice, then those actuaries should not have been allowed to qualify and the exam structure should be modified accordingly.

2.23 No

2.24 Disclosures do not necessarily protect the public interest as has been evident from the number of pensions schemes that have wound up without sufficient assets to secure members' benefits in full. Greater disclosures can confuse the public due to the complexity of the issues involved. Removing conflict of interests will help protect the public interest as a party's interests will be looked after by an actuary who has the ability to fully focus on the issues involved. We believe that the whistleblowing duties for pensions actuaries are appropriate to prevent most cases of abuse of public interests.

2.25 It is clear when actuaries should report.

2.26 See 2.24

2.27 The Manual of Actuarial Practice is generally clear and unambiguous. However, in some cases, such as disclosure of discontinuance funding levels for pension schemes, the guidance has not protected members' interests. This particular point has been rectified, but there will be cases where the guidance attempts to balance the interests of various parties and, as a result, leave one or more of the parties exposed to a loss.

2.28 We would prefer to see the Manual of Actuarial Practice based on fewer core values and principles rather than detailed guidance which requires regular updating.

2.29 The Manual of Actuarial Practice should be about core principles and values. As such, the Profession should be responsible for providing the guidance, although the Regulator (who will have to judge complaints against the guidance) will need to be satisfied that the guidance is comprehensive and deals with the issues the Regulator faces. The Government does not have the capability to provide guidance as the delays in every recent review of pensions provision has shown.

2.30 See 2.28 and 2.29

2.31 An actuarial standards board may help improve the quality and timeliness of standard setting. However, a reduction in the amount of guidance so that core values and principles were addressed rather than detailed guidance could remove the need for an actuarial standards board.

2.32 Generally, there is sufficient liaison with other professions to ensure standards are recognised and that there are no gaps in standards. Where there are overlaps, they appear to be of a consistent standard.

2.33 Pensions actuaries have increased the amount of openness and transparency over the past few years, with greater disclosure. However, by its nature, actuarial work can be detailed and complex, which may give the impression that work is not

carried out in an open manner.

- 2.34 We believe that it is an actuary's duty to ensure that their client has a good grasp of the issues involved. How an actuary achieves this will differ from case to case and client to client. In some areas, it may be through educating the client on basic actuarial principles. For more experienced clients, reporting and highlighting the salient issues will suffice.

In our experience of providing second opinions on other actuaries work, many problems stem from conflicts of interest where the separation of the role of Scheme Actuary to the trustees and adviser to the scheme sponsor would improve awareness of the issues involved by all parties.

- 2.35 Peer review is already a feature of most actuarial practices and formal introduction of this function is unlikely to improve consumer protection. In many cases, peer review is used from a compliance perspective to ensure the actuary does not give advice that could result in legal action being taken against them. In our experience it can result in greater qualification of the advice given rather than ensuring that the advice is fundamentally sound. For example, we were asked to provide a second opinion on a pension scheme where the trustees were presented with two options, one costing around 10% of the assets, the other with a negligible cost. The client was advised the cost of the first option and, by way of qualification, informed that there was second option, but no estimate of the cost was provided. The client assumed the second option was more expensive and therefore selected and implemented the first option before our involvement. When the pension scheme wound up shortly afterwards, benefits had to be reduced as there were insufficient assets to insure full benefits. Unfortunately, whilst the actuarial calculations to value the first option were technically correct, the advice was poor because the second option was not presented clearly. Had the roles of Scheme Actuary and sponsor's actuary been split, then fuller discussion of the options would have been possible and the second option selected.

- 2.36 With substantial sums of money invested in pensions and insurance, actuarial opinions should regularly be communicated to those affected. In the pensions industry, the trustees provide an annual report and accounts, which include an actuarial statement. We would support the provision of a more "user friendly" summary report which included an actuarial statement, which could be distributed along with annual benefit statements. Some of our clients already provide this type of member report.

- 2.37 No comment

- 2.38 Penrose acknowledged the changes implemented by the Profession in his report. He also raised the issue of being pro-active rather than awaiting complaints and we believe that this supports our view in the pensions industry that the role of Scheme Actuary to the trustees and adviser to the scheme sponsor should be split, preferably

between different firms of actuarial advisers. We believe that this is likely to provide better consumer protection than tightened regulation.

2.39 – 2.43 No comment.

Chapter 3

We have no comment on these questions.

7 September 2004