



Hewitt Bacon & Woodrow Limited

Morris Review of the Actuarial Profession

Hewitt's Response to the Interim Assessment

1 February 2005

Prepared for
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1. Introduction and Summary

Our response

We are pleased to set out our response to the Interim Assessment issued by the Morris Review in December 2004.

The approach we have adopted is as follows:

- In Sections 2 and 3 we set out our views on the two areas we feel particularly strongly about in the context of advising UK pension scheme clients. We have tried not to repeat material from our response to the original consultation, but inevitably there is some overlap.
- In Section 4 we have provided very brief comments on the specific options you set out in the Interim Assessment. We have excluded options that relate only to life or general insurance.

Summary

- The role of the pensions actuary needs to be redefined by legislation and professional guidance so that it is clear that the actuary can (and in most circumstances should) have a Broker role and has responsibility for fostering partnership between the sponsor and trustees.
 - The Review needs to accept the reality of the market situation which will be more and more influenced by the demise of defined benefit pension schemes. The Review should not take actions which, while they might have the intention of increasing competition, may actually have the opposite result of making the actuarial market more concentrated.
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2. The role of the pensions actuary

Introduction

We are disappointed that there was not more discussion in the Interim Assessment as to what the role of a pensions actuary should be. It is necessary to decide the role of the actuary before decisions can be made as to how the actuary is regulated and whether or not he/she can advise both the sponsor and the trustees.

You will recall that, in our response to the Review's original consultation, we described and discussed three broad roles which a pensions actuary can have. We referred to these as "Advocate", "Broker" and "Calculator".

Options

We said previously that we think actuaries can add most value when they are fully involved in making decisions on the major issues surrounding the funding of pension schemes. In other words they should not just be Calculators. The Interim Assessment does not appear to address this point, but it seems implicitly to agree with this view, and we think it would be helpful if this were confirmed in the final report.

We note the comments in paragraphs 5.92 to 5.96 of the Interim Assessment, which cover the question as to whether an actuary should act as an Advocate for only one party or whether he/she can act as a Broker between the parties, and we appreciate the difficulty which the Review feels about wishing to ensure conflict-free advice without imposing additional costs.

However we are not convinced that any of Options 1 to 3 can really work unless the role of the actuary is redefined in such a way as to make it clear that he/she is supposed to act as a Broker.

In particular, Option 2 (which appears to be the favoured option by the Review) suffers from the clear problem that the trustees will not always be aware of a potential conflict (e.g. in a situation where the sponsor is planning a corporate transaction and wishes to have advice from the actuary on the potential implications but does not wish all the trustees to know about the transaction).

Our view

- The role of the pensions actuary needs to be redefined by legislation and professional guidance so that it is clear that the actuary can (and in most circumstances should) have a Broker role and has responsibility for fostering partnership between the sponsor and trustees.
- In this situation, it would be reasonable for the actuary to have an

overarching public interest obligation towards scheme members.

- Only when the partnership between employer and trustees breaks down should it be appropriate for separate actuaries to be appointed. Where this happens, the actuary advising the sponsor should have no public interest obligation towards scheme members.
 - This approach may not result in so much work for actuaries but it would be beneficial to the long terms interests of pension provision in the UK.
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3. Competition issues

Introduction

The Review expresses concerns about the degree of competition in the actuarial market. It suggests that there is insufficient choice of providers for large pension schemes, attacks so-called “bundling” and proposes greater market testing.

Market reality

The demand for pensions actuarial work is relatively small, and this demand is expected to diminish. As defined benefit pension schemes are phased out and become treated as “legacy” arrangements, the willingness of clients to spend significant sums on actuarial fees is expected to decline.

Furthermore, there are already very high fixed costs (such as those associated with maintaining technical and research departments), education and training costs (since the long training of actuaries mainly takes place “on the job”) and compliance costs (as a result of pensions legislation and increasing regulation).

As a result margins are under pressure. So (assuming there is no unexpected move back towards defined benefit pension provision) there are two clear consequences for the actuarial market:

- Small players will find it increasingly hard to survive, and consolidation is likely.
- Firms will look for means of diversifying out of actuarial work. The successful firms will use their actuarial client contacts to lever alternative forms of income.

In the light of the above, we think some of the suggestions in the Interim Assessment are potentially counter-productive:

Bundling

Preventing the so-called “bundling” of actuarial work with other services (which in reality is simply a way for actuarial firms to leverage client relationships and diversify their services away from actuarial work) would result in a less profitable and healthy actuarial market.

Furthermore, as defined benefit pension schemes become legacy arrangements, clients will increasingly wish to outsource the running of these schemes on as cost-effective basis as possible. There is already evidence that smaller and medium-sized schemes want a greater degree of bundling than is currently available in the market, and this demand is likely to spread to larger schemes as they run down.

Actuaries and investment advice

We are concerned about the way in which the relationship between actuarial and investment consulting has come in for specific attack from both this Review and the Myners Review.

It is clear that actuarial skills have a major role to play in helping set pension fund investment strategy, and actuaries may be more likely than other sorts of investment professionals to counter the Treasury's apparent desire for pension funds to take more investment risk. Is this why there is pressure for the influence of actuaries to be reduced?

There are significant advantages to clients in using the same firm for actuarial and investment services, and our experience is that most clients would prefer to use one firm (despite the attempts of Paul Myners and the Treasury to discourage this).

Retendering

Frequent retendering has a high cost attached to it. Actuarial firms will either have to absorb these costs (though it difficult to see how this could happen given the other pressures on actuarial margins) or would have to pass them on to clients.

It is worth noting that, in the local authority pensions market (where frequent retendering is a requirement), one major firm has pulled out of the market altogether, and the market is far more concentrated than the private sector market since it is even more vital for all players to have critical mass in order to be able to withstand the high retender costs.

In any case, we do not think that the retender rate amongst actuarial firms is materially lower than for most other professions, and hence we question whether the additional costs to clients of forcing retenders can be justified.

Our view

The Review needs to accept the reality of the market situation which will be more and more influenced by the demise of defined benefit schemes. The Review should not take actions which, while they might have the intention of increasing competition, may actually have the opposite result of making the actuarial market more concentrated.

4. Options identified in Interim Assessment

A. Increasing competition

- Option 1: to the extent that the availability of professional indemnity insurance cover is acting or may in the future act to constrain entry and limit choice, ways could be explored of introducing liability caps; and/or

Most large firms already apply liability caps, though these tend to be set at quite a high level (such that substantial PI cover is still required). To remove this aspect as a barrier to entry, liability caps would need to be much lower, but this is likely to be resisted by pension scheme trustees and their legal advisers.

- Option 2: in the pensions area, unbundling the provision of advice related to statutory roles from other types of advice (particularly investment consulting services) would help open up the market to greater competition.

See comments in Section 3.

B. Greater scrutiny of performance

- Option 1: increased education/expertise of users; and/or

This is already happening; with pension schemes on company balance sheets and reported in the news, the level of attention given to pensions issues and the calibre of people appointed by companies to trustee boards is already on the increase. New legal requirements for trustee competence will ensure this trend continues.

- Option 2: regular formal reviews of advisers could be recommended or required every 3-5 years; and/or

See comments in Section 3.

- Option 3: performance measurement of actuaries could be encouraged; and/or

We would welcome this, but in practice it is difficult to find simple and objective ways of measuring a consultant's performance. Perhaps there could be wider use made of surveys such as the TNS survey of actuarial firms.

- Option 4: effective peer review of actuarial advice could provide actuaries with a set of incentives that encourages them to improve the clarity of advice they provide, both technical and in relation to underlying assumptions.

The Profession is introducing peer review requirements, and these should result in improved quality, particularly at the

smaller end of the market.

**C.
Improving user
understanding**

- Option 1: user knowledge and understanding should be encouraged by measures to raise the required standards of knowledge and expertise, of which several initiatives are already in train; and/or
- Option 2: in relation to pensions, trustees could be given information on the Profession's own guidance notes, to better understand what actuaries are supposed to do. This could be used as a basis for encouraging more systematic challenge; and/or
- Option 3: greater use of professional trustees or trustees who are members of several trustee boards.

We believe that all the above are required.

**D.
Improving clarity of
advice**

- Option 1: leave it to the market, on the basis that if users can be encouraged to challenge more effectively, actuaries will stand or fall by their ability to respond positively; or
- Option 2: improve actuarial training and CPD requirements to equip actuaries with improved communication skills; and/or
- Option 3: require clearer disclosure of actuarial advice, assumptions and key sensitivities. For example by requiring the disclosure of forward-looking financial condition reports; and/or
- Option 4: explore means by which regulatory requirements might be simplified.

We believe that all the above are required.

**E.
Reporting and
whistleblowing**

- Option 1: more comprehensive guidance from the Profession or from regulators on the circumstances in which whistle-blowing is permitted and when it is required, covering all relevant statutory, regulatory and professional provisions, matters which regulators are likely to regard as significant, and the safeguards and sanctions available; and/or

In reality it is difficult to produce such guidance without imposing a disproportionate compliance burden. Opra initially tried to adopt this approach and found that it did not work.

- Option 2: ensuring that, on the one hand, legal protections for whistle-blowers are wide and give appropriate room for individual judgment, based on good faith and what an actuary "reasonably believes"; while nonetheless ensuring that, on the other hand, duties to whistle-blow are clear, objective and enforceable, for example based on what an actuary has "reasonable cause to believe"; and/or

This is preferable to Option 1.

- Option 3: bringing whistle-blowing requirements for auditors and all actuaries more closely into line, and extending protections for whistle-blowers, e.g. supplementing the existing relief from duties of

confidentiality with statutory provisions conferring qualified privilege (ie when acting in good faith) from actions in defamation.

This seems sensible.

**F.
Role of scheme
actuary**

- Option 1: status quo – Scheme Actuary advises both the scheme sponsor and trustees, unless the actuary deems there to be a conflict, in which case the Scheme Actuary only advises the trustees; or
- Option 2: Scheme Actuary advises both the scheme sponsor and trustees, unless the trustees deem there to be a conflict, in which case the Scheme Actuary only advises the trustees; or
- Option 3: role of advising the scheme sponsor and the scheme trustees is separated in some clearly defined circumstances e.g. during scheme wind-up; or
- Option 4: role of advising the scheme sponsor and the scheme trustees is separated at all times.

See comments in Section 2.

**G.
Syllabus and
governance**

- Option 1: minor reform of the existing governance structure to promote greater academic and non-actuarial input; or
- Option 2: establish an independent body with oversight of the Profession's syllabus development along the lines of the accountancy profession's Professional Oversight Board for Accountancy (POBA).

We do not feel strongly on this point, though we would be concerned not to create an excessively complex and expensive governance structure.

**H.
Examination issues**

- Option 1: reform of the existing governance structure to improve quality control; and/or
- Option 2: involvement of full-time and dedicated professional examiners; and/or
- Option 3: involvement of an independent oversight body in exam setting and marking.

We do not feel strongly on this point, though we would be concerned not to create an excessively complex and expensive governance structure.

**I.
Broadening actuarial
education provision**

- Option 1: wider provision and accreditation of degrees that grant exemptions from the Profession's exams; and/or

Actuarial work will remain a small and specialised field, and we question whether many school leavers will be ready to commit themselves to an actuarial career by embarking on an actuarial degree. Actuarial modules in the final year of degree courses are

a likely to be a better approach.

- Option 2: promotion of post-graduate fast-track law-style conversion courses for those with university degrees.

A consulting actuary will need to learn many skills on the job by observing and working with experienced colleagues. Hence we are sceptical about the value of fast track courses.

J. Continuing professional development

- Option 1: the Profession should set out clear objectives for the CPD Scheme and clarify what constitutes formal CPD. The Profession should ensure that CPD that qualifies as formal CPD is meeting an objective of the CPD Scheme, and is not simply a tick-box exercise based on attendance at meetings or conferences; and/or
- Option 2: the Profession should consider increasing the amount and quality of formal CPD required for reserved role holders, in recognition of the importance of these roles. For example, the Profession, with regulator input, could develop tailored CPD opportunities ahead of key changes in the regulatory environment for actuaries in reserved roles; and/or
- Option 3: closer links could be fostered between those within the Profession with responsibility for syllabus development, the actuarial research community and those focused on CPD to ensure that the CPD Scheme is kept-up-to-date and reflects recent developments in other disciplines and actuarial research; and/or
- Option 4: greater input to the CPD Scheme could be given to research-oriented actuaries, overseas actuaries and non-actuaries, for example through involvement in an oversight body, constitutionally independent of the Profession containing a mix of actuaries and non-actuaries. This could monitor the Profession's performance in relation to CPD Scheme development to ensure that the scheme is kept up-to-date, that links to other disciplines and actuarial research are made and that CPD is available to all actuaries, not just to those working in traditional areas.

We believe that all the above are required.

K. CPD monitoring

- Option 1: the Profession implements its three-tiered professional revalidation proposal as currently envisaged, which introduces technical CPD requirements and annual monitoring for reserved role holders, technical CPD requirements and three-yearly monitoring for holders of the new voluntary non-statutory practising certificates, and basic CPD requirements and 10-yearly monitoring for the remainder of working actuaries; or

We support this approach.

- Option 2: as Option 1 but non-statutory practising certificate regime is expanded to cover all actuaries (except those performing statutory roles) so the technical CPD requirements and three-yearly

monitoring apply to all working actuaries; and/or

We do not see the logic in prescribing CPD requirements where the actuary is not performing a role that is deemed important enough to be a reserved role.

- Option 3: the task of monitoring CPD requirements and monitoring of compliance with the CPD scheme should be made part of the remit of the independent professional oversight body referred to above.

We do not think this would add significant value, but would result in greater complexity and costs to the CPD programme.

L.
Actuarial standard-setting

- Option 1: Actuarial Standards Board (ActSB) which is quasi-independent of the Profession (as per the Profession's proposal); or
This would be fine were it not for the need to restore confidence in the profession.

- Option 2: Actuarial Standards Board (ActSB) subject to oversight by a suitably independent body, for example the Financial Reporting Council; or

This is preferable in the circumstances.

- Option 3: the FSA sets standards in life and general insurance, and DWP/Opra sets standards for pensions.

This approach would result in disproportionate compliance costs and would be a further barrier to entry.

M.
Scrutiny of actuaries in pensions

- Option 1: maintain the status quo of no formal scrutiny; or
- Option 2: include long-term liabilities within pension scheme financial statements, which are then audited; and/or
- Option 3: introduce peer review of the Scheme Actuary as envisaged by the Profession; and/or
- Option 4: audit the Scheme Actuary's triennial valuation.

Public confidence needs to be restored, but we would be surprised if audit resulted in any significant improvement in quality, as there is no evidence that numerical errors in actuarial valuations are common. However it would result in substantial increases in costs. Option 3 is therefore preferable.

N.
Discipline

- Option 1: the disciplinary scheme remains accountable to the Faculty and Institute's Councils; or

This seems fine.

- Option 2: the disciplinary scheme is accountable to a suitable independent oversight body; and/or

It is not clear that this would add any value.

- Option 3: encouragement of closer links between whistle-blowing to regulators and the disciplinary scheme.

This would just complicate matters.
