

***O.P.A***  
***Occupational Pensioners' Alliance***

**Morris Review of the Actuarial profession**

**Written Submission**

**September 2004**

## **1. Introduction**

1.1 The Occupational Pensioners' Alliance (OPA) comprises members from some 40 occupational pensioner organisations nationwide and represents the interests of over 1 million active, deferred and pensioner members.

1.2 We welcome the opportunity to make comments on the Actuarial Profession. We will restrict our detailed comments to those matters affecting Occupational Pension schemes, but may have views in other more general issues.

## **2. General Comments**

- 2.1 The role of the Scheme Actuary is perceived by most members of occupational pension schemes as an independent, highly skilled professional responsible for providing valuations of their schemes based on trends in inflation, investment returns, age profile, longevity etc. Members rely almost solely on the triennial valuations to judge how well their schemes are performing and how well they are being managed by the Trustees. The fairness, accuracy and independency of the Actuarial Report is therefore of great importance and significance.
- 2.2 Scheme Actuaries also advise the Trustees and sponsoring companies on actions to take when there are surpluses. Scheme Actuaries set the future service contribution rates to be paid by employers as well as advising on how a deficit will be cleared.
- 2.3 Scheme Actuaries will also provide advice on the costs of improving scheme benefits.
- 2.4 Members of occupational pension schemes, particularly pensioners and those close to retirement, rely heavily on the good management and investment performance of their schemes to provide the pensions they were promised and expect to receive and continue to receive, since they have no opportunity to make good any shortfalls. The Scheme Actuary therefore has a crucial role, together with the Trustees, in safeguarding the pension promises made to members of schemes. This is of great significance today when we hear of many

schemes being wound up with insufficient funds to pay all the pension promises, and forcing the Government to set up the Pension Protection Fund and Financial Assistance Scheme. Because of the high profile of the failures members in existing schemes are increasingly worried about the health or otherwise of their schemes and rely even more heavily in the Actuarial Valuations being meaningful.

2.5 All too often members have seen surpluses in their schemes eaten up by employers only to find large deficits now that investment returns have plummeted. Members ask why the Actuaries have allowed companies to take contribution holidays knowing that investment returns are cyclical and that they were equally likely to reduce as to increase.

2.6 A factor contributing to the deficits in schemes is that people are living longer. This has been known for some time and yet it seems that Actuaries have only just reacted to the phenomenon and are only now making more realistic allowances for longevity in their calculations. “Too little too late”, is an often used comment.

2.7 The lack of proper accounting for longevity and Companies being allowed to take contribution holidays are seen by members as the fault of Actuaries not acting as “guardians” of the sustainability of the funds on their behalf.

2.8 The OPA accept that the Trust Deed and Rules play an important role in determining what powers the Actuaries have regarding setting contribution rates but feel strongly that Actuaries have let down the members.

### **3. Responses to Questions**

**3.1 Q1.1 What do you see as the main value provided by Actuaries and, conversely, what are their weaknesses? In general, are Actuaries properly equipped for the roles that they perform?**

3.2 Actuaries are skilled in matters relevant to assessing risk and returns needed to cover future liabilities etc. The advice given by Actuaries to Trustees is therefore of vital importance in determining the investment profile and hence the long term viability of a scheme. However, there is a weakness in the conflicts of interest as referred to in para 1.17. To whom are the Actuaries responsible? They should not be responsible to the sponsoring employer, yet this is often perceived to be the case by scheme members, particularly if the employer always has an in-built majority of Trustees.

**3.3 Q1.3 Do you think that there is still a need for particular roles for Actuaries to be reserved by statute and, if so, which roles and for what reasons? If not, why not?**

3.4 The OPA believe that it is important to maintain an independent role of Scheme Actuary to provide the regular valuation reports and advice to the Trustees. The changes to scheme funding regulations proposed in the Pensions Bill place a duty on the Trustees to agree a Statutory Funding Objective and a Statement of Funding Principles. The Trustees will therefore rely heavily on the advice given to them by the Scheme Actuary in carrying out their statutory duties.

**3.5 Q1.5 If roles reserved exclusively to Actuaries are maintained, do you think that there is a need to introduce greater peer review and scrutiny of such work?**

Scrutiny of the work of Actuaries is of great importance if the Trustees are to judge whether or not the appointed Scheme Actuary is providing them with the information required and that this information can be relied upon. It is questionable whether the Professional bodies of which the Actuaries are members should provide this scrutiny. Pension scheme members would be sceptical of the veracity of reviews carried out by fellow members of the same Professional body. It would be preferable to have an independent body to scrutinise the work of the Actuaries and of the Professional bodies.

**3.6 Q1.8 Are Actuaries sufficiently accountable for their actions? To whom should Actuaries be primarily accountable - to their clients or employers, to pension fund trustees or sponsors, or to a broader public interest, which encompasses the strength and stability of the insurance and pension sectors and the interests of those consumers involved?**

3.7 The OPA believe that Actuaries have not been sufficiently accountable for their actions. The primary purpose of any pension scheme is to provide pensions to the members of the scheme. It is accepted that, in general, the sponsoring company bears the risk of the scheme; however we have seen many sponsoring companies reneging on their pension promises and closing their DB schemes,

which are in deficit, to remove the risk, despite having benefited from substantial contribution holidays. Actuaries should have been more protective of the long term viability of the schemes by demanding some contributions. If this had happened then many schemes currently in deficit would possibly now be in surplus, albeit small, or at the very least have small deficits. For this reason it seems clear to the OPA that the Scheme Actuary should not be responsible to the sponsoring company but to the members of the scheme through the Board of Trustees. The Trustees should then be accountable to the members through an annual meeting.

**3.8 Q1.10 Are Actuaries sufficiently liable for their actions? If Actuaries provide poor advice, to whom should they pay compensation?**

3.9 Actuaries are not sufficiently liable for their actions. If poor advice is given they should pay compensation to the scheme.

**3.10 Q2.3 Does the Profession's dual responsibility for representing its members to the outside world and regulating them in the public interest create a conflict of interest? Is this conflict acceptable?**

3.11 Yes. See the answer to Q1.5 above.

**3.12 Q2.8 Will the FSA's realistic reporting basis make actuarial calculations more accessible for nonActuaries?**

**3.13 Q2.9 Should the Scheme Actuary's role be reserved exclusively for Actuaries? Could other professionals provide similar advice?**

3.14 The pervasive failure of the UK's actuarial activity is that it has been allowed to develop into too much of a "Black Box". Parameters are supplied to the Actuary, the Actuary produces a few numbers, and an exercise of some skill beyond the understanding of the layman is assumed to have occurred. It is these parameters, effectively chosen by the employer, which also affect the outcome of many actuarial valuations.

3.15 This assumption suits the Actuaries who are selling their skills. This assumption suits those trustees who choose to hide behind it; they can say "*we took professional advice*" and the courts will be tolerant of them even when the resulting choices are clearly not in the interests of the scheme members. But the assumption damages the interests of the members.

3.16 The assumption is by-and-large false. A computer program does the derivation of the few numbers in an actuarial report from the detail demographics of the scheme and some other parameters. The suite of computer programs employed use algorithms that anybody with a modicum of arithmetic ability can understand; and even people with no arithmetic ability can run the programs. The skills are in the setting of parameters and in the choices amongst algorithms, not in the calculation.

- 3.17 Q2.10 Do pension scheme trustees have the expertise and information to question and challenge the advice of Scheme Actuaries? In the absence of effective challenge from trustees are Scheme Actuaries effectively making policy decisions by default on the distribution of benefits between different generations of pensioners and on funding strategies?**
- 3.18 In general the answer is no, Trustees often do not have sufficient knowledge to challenge Actuaries. However this is being addressed in the Pensions Bill under the clauses “Requirement for knowledge and understanding: individual Trustees”. When enacted this should make many Boards of Trustees consider seriously the skills and expertise of their members and the training required to enable the Board to challenge the advice provided by experts including Actuaries.
- 3.19 Contrasts can be drawn between Actuaries and statisticians. Statisticians make a good living advising which statistical tests are appropriate to particular circumstances, and a few statisticians develop new forms of test. But generally statisticians, unlike Actuaries, do not suggest that only they can execute tests in their field of expertise. Statisticians understand the theory of the chi-squared test; many more people apply that test. Statisticians believe:
- 3.20 *The long-range contribution of statistics depends not so much upon getting a lot of highly trained statisticians into industry as it does in creating a statistically minded generation of physicists, chemists, engineers, and others who will in any*

*way have a hand in developing and directing the production processes of tomorrow. - W.A.Shewhart & W.E.Deming*

- 3.21 Why can't Actuaries be more like statisticians? Why cannot Actuaries accept that:
- 3.22 *The long-range contribution of actuarial ideas depends not so much upon getting a lot of highly trained Actuaries into the pensions industry as it does in creating an actuarially minded generation of trustees, administrators, and others who will in any way have a hand in developing and directing the pension scheme activity of tomorrow.*
- 3.23 The overall need is to restore a connection between Actuaries and scheme members, via Trustees.
- 3.24 The question must be asked as to whether currently the lack of sufficient challenge to the Actuary is due to the predominance of sponsor company Trustees on many Boards. In which case it is not the Actuary making decisions by default on the distribution of benefits between the generations, but the sponsoring company. However it cannot be ruled out that Actuaries are indeed making such decisions.
- 3.25 Funding strategies are coming under the auspices of the Pensions Bill and as such Trustees will be responsible for their determination (se Q1.3). Actuarial advice therefore becomes more important as does the ability of Trustees to

understand and challenge that advice. Where there is a majority of sponsor company Trustees, there is a conflict between what the company wishes to do regarding its pension scheme and what is in the best interests of the members. Independent Actuarial advice will be fundamental to this debate to allow the Trustees to negotiate the funding strategy with the sponsoring company.

**3.26 Q2.11 Is there sufficient audit or peer review of the Scheme Actuary's advice to provide checks and balances on the influence that could potentially be exerted by the Scheme Actuary?**

3.27 See Q1.5 above

**3.28 Q2.12 To whom should the Scheme Actuary be accountable? What will be the effect of the intended removal of the minimum funding requirement on the potential for conflicts of interests if the same Scheme Actuary is advising both the trustees and the pension scheme sponsor? Is there a need for a separation of these roles?**

3.29 The Scheme Actuary should be responsible to the members of the pension scheme through the Trustees.

3.30 There will be great potential for conflict of interest under the proposed scheme specific funding proposals. There is a clear need for a separation of these roles. This could be a "Chinese Wall" within a company, or preferably different

companies providing actuarial advice to the pension scheme and sponsor company.

**3.31 Q2.13 To what extent has actuarial advice contributed to the way occupational pension schemes are funded in the UK? How will the Pensions Bill's proposals affect the role and power of Actuaries advising pension schemes sponsors and trustees?**

3.32 Actuarial advice has clearly had a very marked effect on the way occupational pension schemes are funded. How good that advice has been for the long term viability of schemes and so the long term standards of living of the members of those schemes is open to question.

3.33 The Pension Bill's proposals will bring into sharp focus the role of the Actuary as the Trustees will have statutory responsibilities regarding strategies and funding principles. There will be a need to transmit this information to the members of the scheme.

3.34 The overall need is to restore a connection between Actuaries and scheme members, via Trustees. Actuaries have lost understanding of the scheme members' situation. Actuaries knew that the Minimum Funding Requirement was not meeting the intention of the Goode Report (that a fund should buffer the members from the company's misfortunes) and yet they were party to its weakening, when it should have been strengthened. Members' are disconnected because they only get a snapshot of the fund every three years and even for that

snapshot they get no numerical information on its sensitivity to the chosen parameters.

**3.35 Q2.33 Do you agree with Lord Penrose’s assessment of the lack of openness and transparency of the profession to non-Actuaries, including other professionals, and their clients?**

3.36 Yes. See above.

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

3.38 As soon as Actuarial reports or reviews have been completed. The members should also be made aware of any reports made by the Actuaries under the whistle blowing provisions, or when wind-up or the PPF become involved.

3.39 OPA recommends that, by a mixture of encouragement, the establishment of good practice, and regulation:

3.40 - Trustees should empower themselves to run calculations based on a spread of parameters, before agreeing with the actuary on a particular set of parameters.

3.41 - Trustees should communicate their resulting understanding to the scheme members, for both actuarial reports and actuarial reviews.

3.42 From these beginnings, a widespread education and accountability will follow, and in turn an open competitive actuarial profession, free from today's aura of black magic.