

MORRIS REVIEW OF THE ACTUARIAL PROFESSION

Response of the Investment Management Association

The IMA represents the UK-based investment management industry. Its members include independent fund managers, the investment arms of banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of about £2 trillion of funds (based in the UK, Europe and elsewhere), including authorised investment funds, institutional funds (eg pensions and life funds), private client accounts and a wide range of pooled investment vehicles.

The interest of IMA members in the Review is primarily in the role of investment consultants to pension fund boards of trustees. This is not a role reserved to the profession, but in practice the Scheme Actuary may take on a broader advisory role to trustees, covering matters such as asset allocation advice and fund manager selection. (Although the Myners Report recommended that the asset allocation advisory function should be separated from that of Scheme Actuary, recent research on behalf of the DWP¹ found that two thirds of schemes employing both actuarial and investment advisers used the same firm for the two functions.)

The Pensions Act 1995 requires pension fund trustees to consider “proper” advice in writing before taking investment decisions² and written advice on the Statement of Investment Principles, which among other matters covers asset allocation³. The effect of these provisions could be held as requiring independent asset allocation advice at the outset of the process, ie before the appointment of any fund manager. In principle this could be expected to lead to a greater number of separate specialist mandates, determined by the prior decision on asset allocation.

This indeed appears to have been the case. The 1990s saw a significant shift away from balanced mandates to a range of specialist mandates. It would be a mistake to attribute this process wholly to the provisions of the 1995 Act, since the trend towards specialist mandates had begun well before it. But the 1995 Act may have reinforced this trend, and could inhibit any future move to an alternative system.

It is undeniable however that the legislation gives a central role to the trustees’ investment adviser, a role frequently performed by the scheme actuary. In addition, however the firm may also offer other services to the trustees. Examples include the following.

- Fund manager selection
- Fund management services, eg multi-manager services
- Commission recapture programmes under which arrangements are made for recovery of commission from brokers

Conflicts of interest may arise between many of these functions. For example, responsibility for manager selection could have the potential to influence asset

¹ DWP Research Paper 213 “The Myners Principles and Occupational Pension Schemes”, July 2004, section 9.1

² Pensions Act 1995, section 36

³ *ibid*, section 35

allocation strategy in a way which maximised the number of selection exercises. And there is an obvious potential conflict between giving investment advice and offering investment products oneself, one which press reports of a recent survey⁴ suggest may be of concern to many trustees. Commission recapture can be directly contrary to the fund manager's duty to provide best execution for his client by forcing him to transact through different brokers at a higher cost than would otherwise be the case.

The IMA is not aware of widespread detriment for pension funds arising from these potential conflicts, although there is a certain amount of friction between fund managers and commission recapture agents. It is unclear however what safeguards are in place to prevent them from becoming a problem. In the financial services industry generally, firms are expected to manage conflicts of interest so that their clients do not suffer detriment, and this is a key aspect of the supervision exercised by the FSA. Scheme actuaries are however exempt under the Financial Services and Markets Act 2000, so there is no statutory check on their conduct of business.

An alternative to statutory regulation of the activity would be to broaden the duties placed upon the trustees. At present they are required to appoint advisers who are authorised or exempt under the Act, or (for the purposes of the Statement of Investment Principles) who has appropriate knowledge and experience. There is no requirement to satisfy themselves that any conflicts of interest will be properly managed. That could be addressed by the regulations that will be made under the Pensions Bill currently going through Parliament.

The role of actuaries in relation to investment decisions made by pension funds is one example of the general point raised in the review with which we agree. Actuaries have over time become increasingly involved in roles which are no longer specific to their profession alone. While we do not question the competence of the Institute and Faculty of Actuaries to oversee those roles which actuaries carry out in fulfilment of a statutory obligation, we think it is open to doubt whether they are equipped to exercise sole professional and regulatory oversight over other roles, particularly where others who may have such roles are subject to regulation by, for example, the FSA. This is one of the weaknesses of the current Pensions Bill. Another example is the calculation of pension fund liabilities, where the statistical methods are arguably an actuarial issue, but the choice of the discount rate used in these calculations requires economic rather than actuarial expertise.

However, if the Institute and Faculty are not to exercise professional oversight in such areas, then this raises the question whether any other body should do, and if so which body.

⁴ The Pension Fund Partnership, 6th Annual Survey of Occupational Pension Schemes (2004)