



NAPF's Response to the Morris Review of the Actuarial Profession

Introduction

- 1 The National Association of Pension Funds has represented funded pension arrangements provided in the workplace for over eighty years. We are the only independent body in the UK representing the collective interests of pension schemes - a major customer of actuarial services. We have therefore drafted this response in the interests of pension schemes, who collectively provide benefits for around 12m UK citizens and their families.
- 2 The rest of this paper is structured around the main issues in the Morris Review's June Consultation Document (CD) affecting pension schemes. We have not sought to answer every question, but where our response is relevant to specific questions in the CD this is shown. We have focussed our response on the role of the Scheme Actuary, as this is so central to the business of defined benefit pension schemes but also touches on work undertaken by actuaries in the supply of service and advice in other areas. The role of actuaries within life offices is also relevant to us however as many occupational schemes also allow for Additional Voluntary Contributions, and smaller defined benefit schemes often contract with insurance companies who provide benefits for them.

The Role of Scheme Actuary

- 3 (Q's 1.3, 2.9) Before the 1995 Pensions Act there was no legal requirement for pension schemes providing final salary or other defined benefit pensions to appoint a Scheme Actuary although it was customary, and seen as good practice, for schemes to appoint their own actuary to provide ongoing advice. Indeed, many schemes included such a requirement in their trust deed and rules. The 1995 Pensions Act codified what was generally regarded as good practice. There is of course no legal requirement to have a Scheme Actuary in trust based money purchase (defined contribution) occupational pension schemes.
- 4 Pension Schemes are governed by trustee boards who have generally found it helpful to have professional advice available from an individual who knows the scheme and the background to it. This is particularly important for medium and smaller sized schemes. Without such a role set out in statute it is possible that trustees' decisions could be more heavily influenced by those with other interests such as the employer/sponsoring company, or the insurance company which

provides benefits and manages investments on behalf of the scheme.

5 That said, the role of Scheme Actuary is more narrowly defined in statute than the role currently performed by most Scheme Actuaries. In a strict legal sense the role is currently confined to:-

- carrying out periodic (usually triennial) MFR valuations of the scheme for trustees
- certifying the Schedule of Contributions required to ensure continued compliance with the MFR
- preparation of actuarial statement for disclosure purposes
- advising on the calculation of transfer values
- reporting on the impact of excluding discretionary benefits from transfer values
- certification of bulk transfers without consent
- calculation of liabilities on a wind-up
- calculation of a debt on the employer
- preparing contracting-out certificates
- whistle blowing to the regulator
- certification of scheme modifications which affect accrued entitlement
- calculation of benefits to be granted in respect of pension credits on divorce

6 The Pensions Bill, currently before Parliament, will change the Scheme Actuary role in a number of ways, but much of the detail will be set out in regulations yet to be published. Extra duties will include

- calculations required for the risk-based element of the PPF levy
- carrying out the periodic actuarial valuation on the scheme-specific basis (which is not currently a specific responsibility of the Scheme Actuary)
- preparing an actuarial report in years when a valuation is not undertaken
- certification of the technical provisions
- advising on and certification of the schedule of contributions
- advising on the assumptions and methods to be used in calculating the technical provisions
- advising on the statement of funding principles
- advising on recovery plans
- modifying future accruals of benefits
- additional reporting obligations to the regulator

They are also likely to include calculation and certification of liabilities for the purposes of the calculation of the risk-based element of the PPF levy

7 It is undoubtedly the case that because schemes have to have a Scheme Actuary by law, then that person will become lead adviser to the scheme. They are likely to be made aware of material issues by trustees (indeed, the engagement letter will usually require the client to make the actuary

aware of matters affecting scheme funding), and will often attend meetings of the trustee board. One measure of the importance that trustees attach to the Scheme Actuary is reflected in the fact that their typical role is wider than that laid down by statute. A relationship of trust with the trustees develops over time which usually puts the actuary in a strong position of influence, where their advice is sought on a range of issues which go wider than the formal 'Scheme Actuary' role (for example, many Scheme Actuaries also provide advice to trustees on general benefits design, operational issues and on investment strategy). Smaller schemes, especially smaller insured arrangements, may have a less inclusive arrangement with a Scheme Actuary whose appointment may well be of a shorter duration than larger schemes.

- 8 This arrangement undoubtedly has some benefits for schemes in that experience and knowledge is built up in one trusted individual who can, to some degree, act as a 'one stop shop' for advice on a range of issues, taking a strategic view of the risks and consequences of options. It does, however, inevitably place that individual in a strong position of power and influence over schemes and their trustee boards. This is particularly the case in smaller schemes. In time the Pension Bill's requirements for trustees to be familiar with the issues that affect their decision-making may help mitigate this.
- 9 Checks and balances on the advice given by the Scheme Actuary generally do exist, at least for larger firms. The major actuarial houses, for example, have in-house peer review systems and processes. This may not always be possible however for smaller providers of actuarial services to schemes. Trustees themselves are tending to review the performance of their advisers more regularly, and we expect this trend to continue.
- 10 (Q's 1.3, 2.11, 2.35) We note that in the personal pension business (which includes stakeholder and group personal pensions) and in several other areas within insurance companies, the financial statements include an actuarial assessment of the long-term liabilities. The insurance company's auditor is required to provide an opinion on these financial statements which therefore covers the long-term liabilities. Auditors ensure that they have access to actuarial advice in order to do this work, but it is done as a routine part of the annual audit. A similar approach could perhaps be considered for DB pension schemes; indeed, the requirement for a true and fair opinion on the assets and liabilities of a pension scheme as set out in the EU directive may require this at some point in the future. We would be supportive if it could be done in a way that does not add unduly to cost. It should not, for example, require anything beyond the auditors' adoption of Statement of Auditing Standard 520 "Using the work of an expert" so that work on running calculation routines is not duplicated unnecessarily. We would not wish to see yet another method used for scheme valuations: the current plethora of methodologies in this area is confusing enough.

- 11 (Q's 1.17, 2.9) Looking to the future, if the statutory role of Scheme Actuary is retained, then it is possible that the narrowly defined role could be performed by anyone competent in actuarial principles and approaches relevant to DB pension schemes. Such competence would need to be demonstrated initially by passing appropriate exams. We note that only part of the training undertaken by actuarial students is relevant to the role of Scheme Actuary.
- 12 It is unusual for the contracts between an entity such as the trustees and the service provider to be in the name of an individual when the individual is working as part of a professional firm. The NAPF would not anticipate any less comfort to the trustees if the contractual relationship set out in pensions legislation was changed such that the appointment was with a professional firm. As within the accounting and legal professions, there can still be named person with overall responsibility for opinions being given. A by-product would be greater flexibility eg through unforeseen sickness or other absences of the scheme actuary.
- 13 Additionally, when disciplinary procedures are required to be invoked these would then be against the firm as a whole rather than the individual. There are ramifications in that a major law suit against a firm, for example, could have much wider consequences, but there would be significant benefits in the consistency of advice given and the extent to which individuals within a firm took an interest in the activities of their colleagues, which could indeed have a beneficial effect for trustees.
- 14 It is manifestly the case that actuarial advice has contributed significantly to the funding position of DB schemes currently. Government – in limiting surpluses and setting the Minimum Funding Requirement – has also played a major role.
- 15 Actuarial assumptions and calculations also feed through to company accounts, and eventually their perceived profitability for investors, through the adoption of accounting standards (FRS 17 and IAS 19) for pension schemes.

The Market for Actuarial Services

- 16 (Q1.22) While the introduction of a statutory role of Scheme Actuary inevitably led to some increase in demand for actuarial services, the main driver of demand as far as pension schemes are concerned has been the complexity of government regulation in the area of occupational pension schemes. An extremely arcane system, with numerous layers of rules and regulations, has developed under successive governments with an additional raft of requirements enshrined in the 1995 Pensions Act and the secondary legislation derived from it.
- 17 Pension schemes will still face a complex regulatory environment after enactment of the current Pensions Bill, despite the government's stated

policy objective of simplification. If anything the Pensions Bill will add to, not subtract from, the total regulatory burden borne by pension schemes and thus to the potential work of Scheme Actuaries.

- 18 However, as noted in paragraph 5, provision of advice on some issues such as compliance with regulations, scheme administration, and fund investment strategy need not necessarily be matters for the Scheme Actuary. One possible way forward would be for separate contracts to be let for such supplementary services, and for trustees to regularly monitor the effectiveness of such arrangements.
- 19 A general trend in the market, partly a result of the current regulatory burden but partly also related to cost and risk of provision, is for defined benefit pension schemes (especially final salary, the dominant model to date) to close to new members and for DC based provision, which does not require a Scheme Actuary, to be introduced. A growing trend, if our predications about the likely overall impact of current changes is correct, could be for DB schemes to close altogether to future contributions. Some schemes, where they can afford it, may buy out scheme benefits from insurance companies; others may choose to outsource the running of their closed scheme to a specialist third party.
- 20 (Q's 1.23, 1.28) Pension schemes as customers currently have access to a range of providers of scheme actuarial services and there is some competition in the market. The market is however concentrated at the large end into four major actuarial consulting firms, and it is normally the case that the pension scheme of a large listed company (FTSE 100) or local authority will contract with one of the "big four" actuarial houses.
- 21 (Q1.23) There is evidence that new firms are entering the market for provision of actuarial services to pension schemes. In general entry barriers to the business are relatively low, and any firm with qualified actuarial professionals can enter the market provided they can secure professional indemnity cover. P.I. cover appears to be the most significant issue faced by prospective market entrants.
- 22 (Q1.24) Pension schemes can and do switch their Scheme Actuary. In general contracts between schemes and their actuary have no notice period and trustees are increasingly reviewing their advisers at regular intervals against more objective criteria than previously. There is a range of potential providers available when trustees wish to implement a change. It is however unusual for contracts to be terminated. It is fair to say there is some inertia in the system.
- 23 (Q's 1.25, 2.10) In general terms it is the case that trustees have not always understood the advice given by their Scheme Actuary. Actuarial advice is however being increasingly challenged by trustees and there is a noticeable trend taking place whereby trustees are better informed and more confident about their role, an inevitable result of the higher public profile of pension issues and developments following the Myners report.

The Pensions Bill provisions should result in higher standards of trustee awareness and understanding, and greater scrutiny of the advice they receive.

Regulation of the Actuarial Profession

(Q's 1.14, 2.2, 2.3, 2.31)

24 (Q's 1.34, 1.36) It is the NAPF's view that regulatory arrangements for the actuarial profession need to be modernised and brought in line with standards of good practice which are increasingly being followed in regulatory arrangements for other professions, and by independent regulators.

25 The principles of good regulation should apply to the actuarial profession, which sets standards of professional practice, as much as to other bodies who set standards and regulate in the marketplace. These principles are:

- **transparency**: visibility of process and how decisions are made
- **openness**: meaningful consultation with interested parties
- **proportionality**: the burden imposed should be proportionate to the benefit derived
- **accountability**: to those receiving services, and to the wider public interest.

26 Measured against these principles we believe regulatory arrangements for the actuarial profession still have some way to go, despite some welcome recent developments.

27 On transparency, the process by which the profession develops its own standards and guidance is not always clear to those who are affected by actuarial advice and decisions. NAPF has found it quite difficult to input into the process because of lack of transparency as to how it works. The profession tends to be inward-looking.

28 On a related point, we do not consider that the profession conducts meaningful consultation with interested parties and those affected by its decisions on standards as a matter of routine. Draft guidance is usually only made available late in the process, and due regard is not always given to input and comment from interested parties. When guidance is set after consultation, there is no feedback on why some suggestions have been taken on board and others disregarded.

29 (Q's 1.10, 2.12) On accountability, NAPF considers that while individual actuaries should be primarily accountable to their clients, all members of the profession - particularly the professional bodies - should take account of the wider public interest. Clearly 'the public interest' is a tenuous and value laden concept that requires judgement in its application. Most organisations which operate in the public interest address this by ensuring that public interest non-executive directors are appointed onto their

governing body, specifically to ensure that the public interest is safeguarded. We consider that this governance model is also appropriate for the Actuarial Profession, and that such non-executive public interest directors should comprise at least 50% of governing body(ies).

- 30 (Q2.36) The first priority of actuaries should be to their client, and we consider that actuarial opinions should be disclosed to the client. It should be the client's responsibility to disclose relevant information to scheme members or policy holders. However if there is a major public interest matter at stake then the actuary should formally report it to their professional body.
- 31 The presence of external non-executive public interest directors would also help ensure that conflicts of interest were better managed. There are three main areas that require attention. One is for the provision of advice by the same actuary to both the trustee and the sponsoring employer of the same scheme. Another is in the monitoring and supervision of members of the profession to ensure that standards of proper professional practice are maintained. The third is in the enforcement of professional standards.
- 32 (Q2.12) In the case of an individual Scheme Actuary providing advice to both the trustees of a scheme and its sponsoring employer, we consider that there could be real conflicts of interest. These will become even more acute with the enactment of the current Pensions Bill. We therefore believe that such practice should generally be prohibited except perhaps on issues such as costing a proposed benefit improvement. However, provision of advice to both scheme and sponsoring firm by the same actuarial service provider should still be permitted provided that appropriate Chinese walls are put in place by the provider and acknowledged by the trustee board.
- 33 (Q.2.31) In order to command confidence and ensure that standards are properly set, overseen and monitored, it is usual to have an element of independence in the supervisory body itself. The accountancy professional, for example, has a two tier regulatory system where the professional institute sets ethical standards and monitors and discipline, whilst an arms length independent body (the Financial Reporting Council) sets professional standards and monitors the professional bodies. This means that those setting standards are less likely to be influenced by professional members and their interests. A risk-based approach is followed for monitoring and supervision.
- 34 (Q's2.39, 2.40) Such an element of independence is even more critical when it comes to dealing with problems and complaints, and enforcement of professional standards against individual members who may be in breach. In order to ensure due probity of process and confidence in the system it is essential, in our view, that the decision making body for enforcement of professional actuarial standards is sufficiently impartial and distanced from actuarial business such that it can take a fair and objective

view, without any real or perceived conflict of interest.

The Role of the Government Actuary's Department

- 35 (Q1.29) Until comparatively recently the Government Actuary's Department concentrated on advice to public sector schemes and (former) nationalised industries. However it now competes with private sector providers in some cases for pension scheme business. The impact of this appears to be minimal.
- 36 (Q3.3) We are not entirely satisfied with the way in which the GAD fulfils its public interest role. The work it does in this area can be constrained in that sometimes the questions it is answering are tightly framed by the questions asked of it by Ministers. GAD is not always as independent and objective in its work as we believe it should be – for example, in the way in which it calculates National Insurance rebates for pension schemes.
- 37 We consider that GAD's recommendations to Government should be subject to some sort of peer review or audit process, in order to safeguard the quality of advice given.
- 38 We consider that any reasonably sized actuarial firm in the market could perform the services currently provided by GAD provided they had the same access to relevant data. GAD is currently the repository of an important and unique data set.