Emily Brown

From: Clifford Sharp [clifford@humanvalues.co.uk]

Sent: 21 May 2007 18:11

To: basapril07

Subject: PAS & the Profession's future

Dear Mr Seymor PAS & the Future of the Profession

May I congratulate the Board on such a complete review of our function and procedures. It is so full and wide-ranging that even after several days study I doubt whether I have taken in all the implications.

I am not clear about the interaction between the statement that the BAS is to be responsible for future standards of actuarial assumptions and methodology (see the covering note and Sections 1.1) and Section 1.4.17 which places the responsibility on directors of life assurance companies and the trustees of pension funds. Section 1.4.18 indicates the members of BAS recognise the difficulties. There is also the suggestion there will be an attempt to educate them so they will be competent to do so - this is a major task which cannot be accomplished in the foreseeable future.

Inevitably perhaps the paper repeatedly calls for 'value judgements' such as:-

In the opening statement:-

Objectivity - 'reflecting *best* estimates'

Reliability and materiality - '*best practices'*

Relevance… '*the needs of users'*

Consistency - '*enabling users to compare… for a variety of purposes'*

and repeatedly throughout the Statement.

Since everyone's values differ this inevitably means the wording lacks precision. No doubt the final Report will clarify many of the issues.

This is a critical time for the Profession calling for a basic review of our assumptions and techniques. These were initially developed to provide a sound basis for life assurance which, in those days, was the prime need. They have been applied without a realistic change to the very different problems arising from pensions. We have always assumed our unit of measurement, the £. is fixed whereas we know only too well it is varying continuously.

The original clients of the Equitable were men who were worried about dying too soon whereas today the problem is that of living too long. Today's clients effecting pension contracts with life companies want a steady income from the date they decide to retire. Inflation which was not so significant for life assurance becomes of great importance for pension contracts running up to fifty years or more ahead. In addition improving mortality which provided a safety margin for life assurance now represents a growing problem.

The difference between the value of the £ when I joined the profession in 1928 and today is a factor of the order of 40. At that time many life assurance contracts had

had an element of endowment added so that life assurance contracts were becoming more of a form of saving than pure life assurance,. the importance of the life cover element being materially diminished. While inflation affected the benefits coming from such contracts which survived to maturity this was, to some extent, counteracted by the additions coming from the with profit system.

Today inflation is accepted as a continuing factor and it is time it is specifically factored into our assumptions. Run-away inflation could only be coped with if Government were to issue index linked bonds but it should be practicable to deal with a limited degree of inflation such as not more than 10%pa. Nowadays the Bank aims at limiting the rate to 2% pa which may be optimistic. Even at that rate over fifty years the £ will lose nearly two-thirds of its value which is not too long for pension contracts to run.

We are called upon to guesstimate mortality way into the future say fifty years ahead - is anyone really competent to do that? Redington summed the position up well when he said mathematics will tell you how-to calculate a premium - it will not tell you what to charge! Will our current techniques tell us 'What to charge?' If not what changes must we make to enable us to do so with a reasonable degree of assurance?

Turning to the questions on which you call for specific comments.

!. Agreed

2Agreed

3. Prudence is a 'value judgement' and therefore ill-defined. I doubt whether the majority of directors of life companies or members of Boards of Trustees of the great majority of pension funds have sufficient depth of knowledge to be able efficiently to assess the risks involved by the actuarial advice they are given. If so their opinions about 'prudence' would seem questionable.

4. Again this involves a Value Judgement - who is to determine *'High quality'*

5. Until the areas of imprecision are clarified I cannot answer this question.

These are my initial reactions - if others occur to me I will make a further submission.
Clifford Sharp FIA (1940)