



**Financial Reporting Council
(FRC)**

Discussion Paper

Promoting Actuarial Quality

**Response from
The Pensions Management Institute**



PMI response to the Financial Reporting Council Discussion Paper: Promoting Actuarial Quality

Introduction

The Pensions Management Institute (PMI) is the professional body for people working in the pensions sector. The PMI's members (currently over 4,000) work as pensions managers, consultants and technical specialists in consultancies and insurance companies. Many are also actuaries, pensions lawyers or company secretaries. Their experience is therefore wide ranging and has contributed to the thinking expressed in this response.

The PMI's Response

PMI welcomes FRC's discussion paper on promoting actuarial quality. Pension schemes are major consumers of actuarial work, and in most cases administrators and trustees are in a position of relying on actuarial guidance rather than being able to evaluate its quality. So we see it as very important for FRC to be proactive in the role of maintaining and developing the high quality of actuarial practice currently seen in the UK.

Turning to your questions, in so far as they relate to pensions:

Q2(i) Do you agree that the use and interpretation of mathematical models to describe financial systems, portfolios and entities is an underlying feature of actuarial work?

Yes. PMI member's interaction with actuaries is largely in the sphere of final salary pension schemes, where the liabilities are very long tail requiring mathematical modelling in order to get a feel for the current point of time balance between assets and liabilities, and looking forward over both the short and long term to gauge the adequacy of the sponsoring employer's proposed contributions to the scheme.

Q2(ii) What other features describe and distinguish the nature and scope of actuarial practice?

There is a great deal of uncertainty associated with the future of a final salary pension scheme. In addition to the structural uncertainty of the employer's willingness to continue sponsoring the scheme indefinitely, there are many unknown factors that will affect the development of both the assets and liabilities of the scheme going forward.

The use of mathematical models enables these to be quantified, but three further key components of actuarial practice are understanding the risks of different outcomes to the central assumption, analysing whether the level of risk is acceptable and the



controls in place to control the risk are adequate, and communicating the whole risk framework to an essentially lay audience in the case of pension scheme trustees.

Q4(i) Have we identified the key drivers of actuarial quality? How can they be added to, re-defined or re-structured?

We note in particular the tensions identified between the Morris Review findings and the FRC stakeholder group survey over whether Actuaries are too willing to present certainty or too reticent to give advice.

We believe that underlying this is the depth of quality that is required from actuarial practice. In effect a three stage process is required in, for example, providing the trustees of a final salary pension scheme with a valuation of their liabilities :

1. Conducting a valuation, using the mathematical models, that reveals the range of possible answers as assets and liabilities evolve over time.
2. Presenting the results to the trustees in such a way that they develop an understanding of and feel for the sensitivities involved
3. Recommending a particular central set of assumptions which will then enable the trustees and the sponsoring employer to drive the scheme forward.

By producing work of this depth, the actuary is both able to advise – which is what the client wants – but avoid the impression of giving certainty where this cannot be justified.

In some cases this process will entail rather more work (and expense) than the client may have hoped for, particularly if they just wanted a simple answer (for example to a question such as “should we ask the employer to increase contributions?”).

An important driver of actuarial quality here will be the support that the profession gives to its members to conduct full and comprehensive actuarial reviews, particularly in the face of clients who want quick and simple answers.

Notwithstanding the need to promote high quality actuarial work, we do believe that there are times when pension fund clients will seek an initial estimate of an issue, or in common parlance, a “ball-park figure”. We believe that it is consistent with a drive to higher actuarial quality to continue to allow and indeed encourage such initial estimate type work, provided the client is appropriately cautioned as to what further work should be undertaken to complete a full investigation, and as to the extent to which it would be reasonable for the client to rely on any initial estimates.



Q7(i) Have we accurately described the main features of actuarial work in pensions?

In the current economic climate you could give additional emphasis to the role actuaries have in assisting final salary pension schemes towards an orderly closure. Today only one in six pension schemes are open to new members, but the other five are not so much “closed” as on a journey – the start point of which was an open scheme with a supportive employer, the end point of which is securing the members’ liabilities in such a way that the employer has no further financial interest in or obligation to the scheme.

There are many paths that such a journey can take, and actuaries have a valuable role to play in helping employers, employees, other members, trade unions and trustees to take an appropriate path for them.

Q7(ii) Have we identified the main drivers?

Yes

Q7(iii) Have we identified the main threats to these drivers?

You could give more weight to the inherent tension in a final salary scheme between the interests of the employer and the members. Employers may quite naturally wish to run their pension scheme on a thinly funded basis, to free up capital for investment within the business. Members (and particularly ex-employees) may quite naturally wish to see a strong funding basis for their scheme, to maximise the protection of their benefits. In some ways both are right (and herein lies the rub) as a successful business may deliver higher returns on capital invested in the business than the trustees could hope to achieve by investing capital on the investment markets, and in the long run this higher rate of return adds to the scheme’s security. But achieving such a return is dependent upon the employer’s covenant, and the employer may be reluctant to disclose information pertaining to their covenant.

Q7(iv) Have we identified the main indicators that these factors are helping to promote actuarial quality?

Yes

Q7(v) Are there further steps that the FRC could take to promote actuarial quality?

Quality should not only be seen in terms of how individual actuaries are performing now against today’s standards, but should also be seen in terms of further raising the bar going forward.



In particular, we believe that it is important to promote and encourage further innovation in actuarial methods and science, so that tomorrow's pension schemes can be even better advised than today's.

The FRC should seek to find steps that will promote a culture of innovation within the actuarial profession.

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