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Dear Sir/Madam

FRC Discussion Paper: Promoting actuarial quality

Thank you for the opportunity to comment on this paper. This response has been prepared by the Benefits Practice of Watson Wyatt and therefore primarily reflects pensions-related issues. Watson Wyatt is a global consulting firm with particular strength in the area of UK pensions. We advise over half of the 100 largest corporate pension schemes, and the firm as a whole employs over 300 qualified actuaries in the UK

We are supportive of the FRC identifying areas in which it believes the quality of actuarial advice and information can be improved. However, what we ask is that the expected benefit of any improvement identified is rigorously measured against its likely cost. In the pensions area in particular, we have seen ever-increasing legislation with the laudable intention of stopping things from going wrong, but which has had the effect of pricing too much good pension provision out of the market.

For many purchases, the consumer has a choice between quality and cost. So long as an electrical appliance meets certain minimum standards (generally related to safety), it can be high or low on the scale of efficiency, ease of use, reliability and durability. For actuarial advice, it is much more difficult to permit this degree of variation in 'quality', but in setting the expectations and standards in this area the fact that higher quality almost invariably costs more money must be acknowledged. The actuarial product (like any other) can almost always be made theoretically better by throwing in more time, more qualified people and more checking – but this does not of course always mean an overall better result for the customer taking account of affordability, timeliness etc.

Our comments and responses on a section-by-section basis are attached. If you would like to discuss any of the points we have raised, please get in touch.

Yours faithfully

Graham Everness
Senior Consultant

FRC Discussion Paper: Promoting actuarial quality

Section 2: The nature and scope of actuarial practice

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? What other features describe and distinguish the nature and scope of actuarial practice?

Yes, except that the description as drafted would appear to incorporate corporate finance and other models which would not normally be regarded as specifically ‘actuarial’ (which is not to say that actuaries could not be among the people well-placed to advise on these issues). The description could perhaps be tailored more to the traditional actuarial field by incorporating some reference to biometric and/or investment risks and uncertainty. In addition, we would suggest that actuarial work does not only encompass the use and interpretation of mathematical models but also communication of the results in an appropriate way for the recipient of the work.

On a separate point, we think that the concerns expressed in paragraphs 2.9 and 2.10 would benefit from more clarification. In particular, it is unclear to us whether the “inherent defects” giving rise to the adverse consequences listed in 2.10 are meant to refer to the “considerable uncertainty, subjectivity and sensitivity to assumptions” mentioned at the beginning of 2.9 or to the three bullet points at the end of 2.9.

A similar potential for confusion seems to arise through section 3 where an inference could be drawn that the FRC considers that actuarial advice and information is ‘high quality’ if with hindsight it turns out to be in line with actual experience, rather than ‘high quality’ being measured by reference to the circumstances and general knowledge pertaining at the time and the presentation of the information and advice in light of these. (This point ties in with our comments about ‘three levels’ under section 4 below.) This leads on to a general point that the document does not make clear what is meant by ‘high quality’; we suggest that a possible definition could incorporate “giving the end-user an adequate understanding of likely outcomes and of risk, and enabling informed decisions to be taken based on that understanding”.

Section 4: Drivers of actuarial quality

Have we identified the key drivers of actuarial quality? How can they be added to, re-defined or re-structured? Do other drivers apply in sectors apart from life insurance, general insurance and pensions?

In general, the described drivers of actuarial quality seem reasonable. However, there is some overlap between the six identified drivers. In particular, it seems to us that ‘working environment’ is substantially a part of ‘professionalism’.

Further, while understanding the desire to highlight the importance of communication, we question whether it is right to regard it as a driver of its own or whether it is just one significant application of some of the other drivers (methods, skills and ethics). If it is to be considered a distinct driver, we wonder if some other ‘non-technical’ skills or stages should be similarly considered – for example, the

need for the actuary (if he is to give high quality advice) to have understood the specific requirements and circumstances of the client, or the skills of organisation and time management.

It also occurs to us that these quality drivers can operate at three distinct levels – the world as a whole, the actuarial profession and the individual actuary. For example, for appropriate account to be taken of longevity in an actuarial calculation, it is first necessary for some group of people (almost certainly outside the actuarial profession) to have understood the factors at play affecting longevity, then some actuaries in the profession will need to reflect this in models and/or tables suitable for actuarial use, and finally the individual actuary will need to be able to understand and apply this work. Any initiative to improve actuarial quality can therefore be at the level of improving the way in which individual actuaries use the available models and data, of improving the models and data developed by the profession, or of improving the background information and expertise on which the profession bases its developed models and data.

Paragraph 4.13 mentions the traditional requirement for actuaries to have good mathematical skills, and 4.20 highlights the need for good communication skills. In search of the highest possible quality, an increasing number of desirable skills and attributes can be mentioned (for example, section 7 reminds us of the need under the new scheme funding regime for an allowance to be incorporated for employer covenant). There is nothing wrong with this in itself, of course, but it needs to be appreciated that the more extensive the skill and quality requirements the greater the pressure is likely to be on the supply of actuaries, which is already identified as a potential issue in paragraph 3.4.

Section 7: Pensions

7.6 (c) Another significant risk for scheme members is that the employer withdraws (or reduces) his pension provision for future service. This risk has proved very real for many members, with a major contributing factor being over-regulation leading to a disproportionate administrative expense.

7.13 If the paper is intending to give as complete a list as possible, bulk transfers without consent, employer debt calculations and contracting-out certificates could also be mentioned.

7.26 As well as questionable data, there may be benefit uncertainties arising from problems in interpreting scheme documents and/or legislation. For years, legislation has required actuaries to certify buyout costs for statutory purposes in circumstances where no buyout market may have existed (or where it did there was no reliable way of knowing the 'price'). There would be a general improvement in quality in its widest sense (including actuarial quality) if certain aspects of legislation were improved.

7.28 It could be added that, while many may regard allowance for future mortality improvements as inadequate, others would argue that the typical allowance is now too high. The truth is that nobody knows, and 'quality advice' in this area is heavily dependent on the specific client situation and on the way the advice is presented.

7.34 It is unclear from the document as a whole what the FRC's position is on actuaries being called upon to give advice outside their normal area of technical competence. This paragraph (and 4.25) appears to adopt the position that such temptations are a threat to actuarial quality and should be resisted,

whereas the boxed summary at the start of section 7 seems to be based on the expectation that actuaries will need to venture outside their traditional areas of expertise.

7.37 In the penultimate sentence, it is useful to draw a distinction between instances where the actuary does not give the clear advice that he is supposed to, and instances in which trustees inappropriately express criticism because the actuary has correctly insisted that the legislation places the responsibility for the decision on them.

7.46 This paragraph highlights the constraints of the FRC's remit. The advice given by the actuary might be of good quality, and the calculation of the contribution rates perfect (given the method and assumptions agreed by the trustees and the employer), but the end result in terms of the appropriateness of the funding plan for the scheme might still be unsatisfactory. However, this is a matter for the Pensions Regulator to monitor.

7.47 This paragraph expresses concern that actuarial quality can be significantly compromised by the desire to satisfy the client. We do not disagree that this can sometimes be the case, but are worried by the comments about "immediate clients being put ahead of third party interests and the public interest". We are aware that the potential conflict between a duty to put clients first and a duty to serve the public interest has been a source of some debate in relation to consultation drafts of the new Actuaries' Code, and we think it would have been helpful if you could have given examples of what sort of third party and public interest issues you have in mind here.