

ADDRESS

BY THE PRESIDENT OF THE FACULTY OF ACTUARIES

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ABSTRACT

This Presidential Address is a call for a debate about change, to meet the demands of the 21st century. Change in how actuaries are educated to encourage wider thinking and more flexible careers. Change in how the profession is governed, to introduce more external input, to encourage more challenge of accepted practices and standards and to encourage a greater readiness to embrace change itself. To boost our public image and our influence on public policy. Change in the United Kingdom's social security and pensions systems, the better to achieve a secure retirement for tomorrow's pensioners. Change in how insurers are regulated, ensuring that consumer protection is not diminished in the process. The importance of research is emphasised, as are our relationships with other professions. These are areas where the Faculty is particularly well placed to play its part in taking the U.K. profession forward.

KEYWORDS

Education; Universities' Role; Governance; Compliance; Holistic Advice; Public Interest; Influence; Risk; Collaboration; Pensions Policy; Life Assurance; Regulation

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*O wad some Power the giftie gie us
To see oursels as ithers see us!
It wad frae monie a blunder free us,
An' foolish notion.*

Robert Burns

1. INTRODUCTION

1.1 I am greatly honoured to have been elected your 57th President. I am acutely conscious that, with the honour, comes an equal measure of

responsibility to lead the United Kingdom profession, and the Faculty in particular, at a time of considerable change and uncertainty. Having broken with tradition in the year 2000 by electing as your President someone whose career has been spent predominantly outside Scotland, you have immediately done so again. I would like to think that this is, at least in part, a tribute to the tremendous energy, enthusiasm and wisdom that David Kingston brought to his term in office. Unlike David, though, my roots are in Scotland, and so I view my Presidency, as well as a great honour and challenge, as a homecoming.

1.2 Much of what I have to say is about the need for change. But I do not want this to be interpreted as a profession in crisis. Our profession has made a great contribution to the development of financial security for ordinary people in the twentieth century, particularly through our roles in life assurance, occupational pensions and (more recently) general insurance. The amounts saved through the medium of life assurance contracts have grown steadily and, at times, spectacularly. The returns achieved have generally been good. Failures have been few and far between. People retiring over the past 20 years have been much better off than their predecessors, thanks largely to the growth of occupational pension schemes. We should be proud of our contribution to these achievements. However, the world is not standing still, and we must not rest on our laurels.

1.3 These are times of great change in the wider world and, therefore, for our profession. The world is becoming a smaller place, and the opportunities for individuals to develop their careers by working in a number of different countries are growing. Consumerism has arrived with a vengeance in a number of areas where actuaries work, notably life assurance and pensions. The pressure is on us to justify what we do and how we do it, and to explain it in everyday language. The integrity of professions is being called into question. Trust is being replaced by demands for openness, transparency and accountability. The business and financial worlds are beset by ever increasing demands for short-term results. This poses particular challenges for actuaries, one of whose defining characteristics is the ability, and desire, to take the long-term view. Communication tools have changed out of all recognition over a very short space of time. A vast amount of sophisticated information is now available to much of the wider public at the press of a button or the click of a mouse. And a good image is today a necessary — though not (yet!) a sufficient — condition to be truly effective in one's field of endeavour.

1.4 At the same time we are in the midst of an unusual, if not unique, period in economic terms — low inflation, low interest rates, high consumer expenditure, corporate profits that are both under strain and open to question, and a stock market that is both depressed and very nervous. These represent a potentially lethal cocktail for many of the institutions we advise. It is at times like these that we need to be at our most robust and penetrative

in the advice we give — to avoid undue pessimism where we believe it is not warranted, yet not to shy away from advising drastic and, very likely, unpopular action where we believe this to be required. It is also at times like these that it behoves us to reflect whether our advice in the past was as robust as it should have been, and whether there are lessons that we should be learning for the future.

1.5 Times of rapid change are usually accompanied by heightened uncertainty and insecurity. The time we are now in is no exception. Our stock in trade may be regarded as the identification, measurement, pricing and management of risks — particularly, but not exclusively, long-term financial risks — in a rigorous mathematical way. In principle, therefore, our profession has great opportunities to add value at the present time — provided we apply our skills appropriately, communicate our results effectively, and adapt our training where necessary to meet modern demands. Arguably we are not as well equipped as we should be to grasp all of the opportunities open to us, and indeed to address the threats we face. We need to ask ourselves whether more radical actions are needed to convert the aspirations of the profession's very worthy 'Vision and Values' document into reality.

1.6 In preparing my agenda and this Address, I have, of course, been mindful of the wise words of my predecessors. However, I hope they will forgive me when I say that I devoted much more of my preparation time to discovering the hopes, fears and aspirations of our younger fellows, and the views on the profession of employers and potential employers of actuaries. I believe that these are the groups who matter most, as I and my colleagues on Council and on the Faculty and Institute Management Committee (FIMC) plot the future direction of the profession.

1.7 To this end I have, over the past several months, invited small groups of Fellows who had qualified in the past ten years or so to join me for informal discussions about the profession as seen through their eyes. In all I met almost 100 Fellows in 12 separate meetings, and I am most grateful to all of them for taking the time to see me and for being so open in giving me their views. In turn, from the responses I have had, it is clear that they appreciated the opportunity to engage in the affairs of the profession in this way. I have also had discussions with senior executives of a number of major employers, and potential employers, of actuaries to seek their views on the value of actuarial training, and how it may have to change to maximise its relevance to the business and financial worlds of the future. Again, I am most grateful to those who took the time to see me and who gave me a wealth of helpful comments.

1.8 My professional career has been devoted almost entirely to the pensions field, as a consulting actuary advising occupational schemes. More recently, as I have migrated towards a more pluralistic life, I have had some involvement with government policy as it relates to pensions and social

security and have chaired a mutual life office in the period leading up to, and throughout, its demutualisation. With that background, it will not be surprising that I devote rather more of this Address to pensions and life assurance issues than to other important and varied areas of actuarial activity. However, my main reason for doing this is that it is in the pensions and life assurance fields that I think our profession faces the greatest challenges in the years ahead.

1.9 In this Address I will therefore touch on the following topics:

- the current actuarial environment;
- the governance of the profession;
- the role of the Faculty (what Address would be complete without this!);
- public interest, public policy and public image;
- working with others;
- the prospects for retirement;
- life assurance and other financial services; and
- the international dimension.

Finally, I will draw these thoughts together into some objectives for my Presidency and beyond.

2. THE CURRENT ACTUARIAL ENVIRONMENT

2.1 Let us consider first the present world of actuaries and some ways in which that world may need to change. Figures 1 and 2 show the current distribution of working actuaries in the U.K. by type of employer and area of work respectively, as at June 2001.

2.2 Life assurance companies and pensions consultancies are the main actuarial employers by a considerable distance. Given the changes that are occurring in these sectors, it is doubtful, to say the least, whether their demand for people with actuarial skills, as we currently know them, will increase rapidly.

2.3 *Education*

2.3.1 The discussions I have had have produced useful and important insights into the process by which we produce qualified actuaries. It is a system dominated by self-study, while being employed in a day job, and with syllabuses and examinations prepared mainly by practising actuaries. I believe that this process raises a number of questions, many of which have been raised before:

- Far too many people (more than 60%), carefully selected and well qualified at the outset, fail to complete the examinations at all. We are being naïve if we believe that our profession is so exclusive that this can be justified.

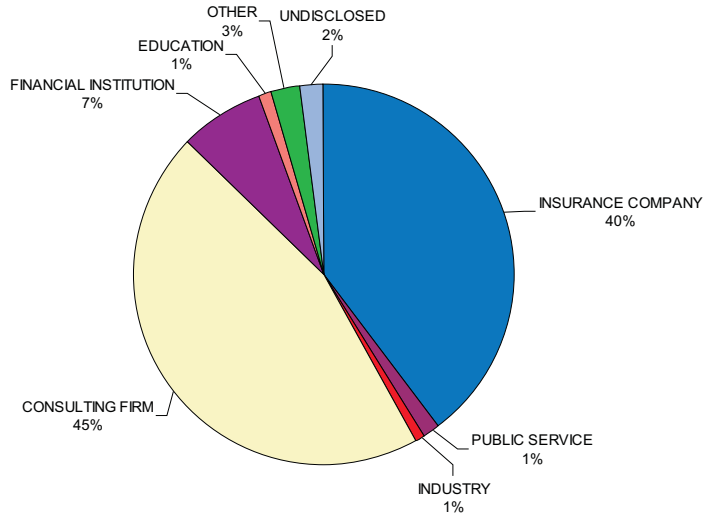


Figure 1. U.K. Fellows by employer (as at June 2001)

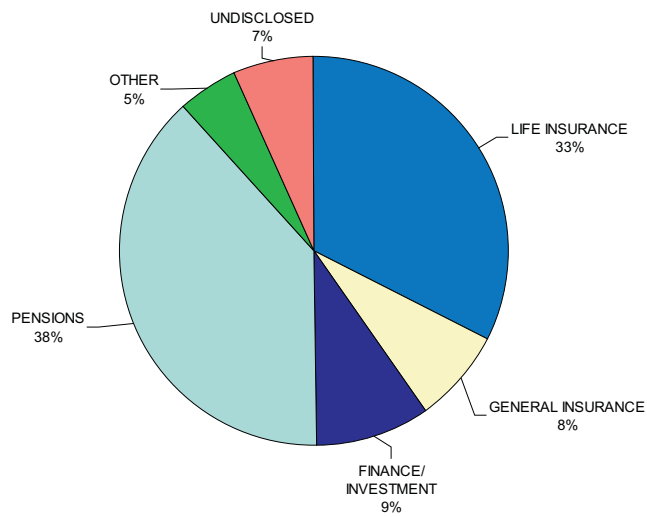


Figure 2. U.K. Fellows — predominant areas of work (as at June 2001)

- The time taken to qualify by those who do succeed, of which the median is about five years, is too long when it is seen in the context that entrants will already have spent at least three years gaining an undergraduate degree.
- Pressures in the workplace are undoubtedly higher than they used to be, which is certainly a barrier to achieving improvements in the statistics I have mentioned above. This may say something about the importance that employers attach to their students passing the examinations, but mainly, I think, it is a reflection of the times in which we live.
- “Being a member of the profession is helpful to me because of the status it confers, but I do not do an actuarial job” is a comment that I have heard many times, particularly from people working in life offices and investment businesses. I believe that this is a reflection of the content and emphasis of our syllabuses. We need to redefine what we mean by ‘actuarial’ to be much broader than the largely statutory roles in insurance and pensions which are often perceived to be the profession’s main function, even by our own members.
- Employers who recruit graduates to become actuarial students clearly do so for their own purposes — life offices to produce life office actuaries, pensions consultancies to produce pensions actuaries and so on. These employment ‘silos’ are not conducive to actuaries branching out into wider fields, which is one of the main thrusts of the profession’s ‘Vision and Values’ statement. Indeed, I do not think that this can happen within the current qualification process.
- I have found that potential employers of actuaries, for example in banking and investment management, tend to think that our syllabuses are not rigorous enough in those areas that are of most interest to them, and that this, combined with the time taken to qualify, makes the recruitment of actuaries or actuarial students a questionable investment. There is a perception, too, that actuaries, while taking a laudably rigorous mathematical approach to building their models, tend, by their training and intellectual inclination, to interpret them too literally. I have heard it said that this is one reason why some actuaries find it difficult to come to terms with the precepts of financial economics. These comments surprise me, but clearly we need to work hard to overcome such perceptions. I also believe that we need urgently to examine how best to attract, educate and develop actuaries for roles in investment management.
- Actuaries from different backgrounds tend to treat with varying degrees of rigour (or even have different understandings of) some fundamental actuarial and other concepts. One example of this, in my view, is the relatively superficial treatment given by many pensions actuaries to the financial risks for employers inherent in defined benefit pension schemes, compared with the degree of analysis given by insurance actuaries to the financial risks to insurance companies of various insurance contracts.

- Another example relates to the thinking underlying financial economics. This is widely embraced in the investment field, but less so, despite its relevance, in other fields. These suggest to me that our system inhibits cross-fertilisation of ideas and allows weaknesses to be perpetuated.

2.3.2 The changes to the education system due to take effect in 2005 will go some way towards meeting those concerns. It is to be welcomed that, after completing the core applications stage, but before embarking on the specialist papers, students will have a solid grounding in all areas of fundamental principle, using examples drawn from a wide range of business and financial areas. I believe that an important test of the depth and breadth of the generic part of actuarial training is that we should be willing to regard those who complete that stage successfully as actuaries eligible for, at least, Associateship. I was therefore very pleased that the joint Councils of the Faculty and the Institute agreed, at a recent meeting, that this was a desirable and attainable goal under the new syllabus. The specialist stage would then become a necessary requirement, along with the demonstration of appropriate competencies, to attain a practising certificate in the actuary's chosen field.

2.3.3 This represents good progress, but I do not think that it goes far enough, because it does not address directly a number of the issues I have mentioned above. Like others before me, I believe that developing a much greater role for universities in actuarial education is fundamental. We have made some initial steps to broaden the involvement of universities beyond the well-established courses in actuarial science run by the London School of Economics, Heriot-Watt University and the City University in London. However, I would like the profession to press on more rapidly, with a goal that actuaries will emerge from universities by the year 2010. I recognise that this aspiration will have implications for the existing employers of actuarial students, but I am confident that, with a reasonable transition period, such a change can readily be accommodated. Indeed, with the continued impact of technology on the processing part of our work, some employers already see advantages in the changes I am suggesting. I recognise, too, that this aspiration may pose funding difficulties for universities, owing to the manner in which their awards from the funding councils are assessed. I would like to see a dialogue between the profession and the universities to investigate ways of overcoming such difficulties.

2.4 *Compliance Influences*

2.4.1 A particular feature of the work of actuaries in recent years has been the massive growth in what is, in effect, compliance work. We see this in the world of pensions, where funding considerations have been dominated (unhealthily in my view) by the Minimum Funding Requirement (MFR) and accounting standards. The requirement to whistle-blow adds further to a

compliance mentality. We see it in the life assurance world, thanks, for example, to a prescriptive regulatory approach to financial projections and product sales, in addition to the long-established requirement to demonstrate solvency on a statutory basis. Another recent example has been the involvement full time of many actuaries in the work required to rectify past mis-selling, particularly in relation to pensions.

2.4.2 Whilst, of course, compliance with regulatory requirements must have its place, there is a danger that it can be regarded as sufficient in itself, and therefore a substitute for proper professional advice dealing with the particular circumstances of the pension scheme, insurance company or product in question. To give just one example: there are many defined benefit pension schemes being wound up at the present time, and, with very few exceptions, they have complied with all the funding and other requirements imposed by regulations. Yet many have insufficient assets to secure in full the accrued benefits of all the members. The question may be asked by others, if not by us, whether the advice tendered to the trustees of these schemes was as extensive or robust as it should have been. Another example, again in pensions, concerns the basis used for calculating transfer values from defined benefit pension schemes. Many actuaries are simply using the basis underlying the MFR without, it seems to me, paying sufficient regard to the principles underlying Guidance Note GN11. Practitioners have been reminded on more than one occasion that the MFR basis will not always meet the requirements of GN11 and has not done so recently for many schemes. Some will argue that the fault lies in the legislation and the guidance note. Either way, it is not a satisfactory situation and reflects the dangers of a narrow compliance way of thinking.

2.4.3 These thoughts lead me to question how readily we should accept statutory roles in the financial and other governance of the institutions we advise. Given the inflexibility of regulations, there are clearly potential advantages in this approach, both for the institutions and for governments and regulators. However, the profession should only take on these roles if the policy and/or regulatory intentions appear to us to be reasonable and if we are satisfied that our role, as defined, is capable of achieving those intentions. I am not convinced that our role in relation to the MFR has met these criteria. The role of the Appointed Actuary to a life office is under review by the Financial Services Authority (FSA), and may change substantially, in conjunction with the creation of a new actuarial function. As we work with the authorities to define and implement these roles, it is important that we are guided by the principles I have outlined.

2.4.4 I have heard it said on many occasions that pension scheme actuarial valuations have become a commodity product, priced to deliver the bare essentials. The same is said to have happened to corporate audits, and we all know the questions that this has raised, not only in the United States of America, but in this country too. It is, in my view, both foolish and

dangerous for actuaries to go down this type of path. I am very keen to ensure that our actuaries are trained, and encouraged, to give holistic advice to their clients and employers, and that they resist the temptation to limit themselves to what regulations may require.

2.5 *Consumers*

2.5.1 In his recent Presidential Address to the Institute, Jeremy Goford laid considerable emphasis on the importance of modern actuaries framing their advice to their employers and clients in a business context, using language that avoids jargon and demonstrates full understanding of the question being addressed. I am in full agreement with these sentiments, and would like to take the question of how we think and behave a little further.

2.5.2 Unlike many (though not all) members of other professions, actuaries tend to deal with institutional and corporate bodies. Their direct contacts with the ultimate consumer — the holder of an insurance policy or the member of a pension scheme — are insignificant. There was comparatively little pressure on twentieth century actuaries to communicate in language to which ordinary people could relate, or to visualise how these ultimate consumers would perceive the effects of the advice given. We live in an age of growing consumer knowledge and influence. Whilst I do not necessarily envisage a large growth in 'high street' actuaries advising members of the public directly, I do think that we need to test the content of our advice, and the language in which it is expressed, against the perceptions and interests of the ultimate consumer. In effect, I think that this will become an important part of sound business practice.

3. THE GOVERNANCE OF THE PROFESSION

3.1 There have been great changes to the way the profession is run between my first stint on Council in the 1980s and my second, which began in June 2001. Then, the Faculty and the Institute operated very much as separate bodies, although a certain amount of joint work was done. Now, the profession is much more unified and is, in my view, much the better for it. Another striking feature is the growth over that period in the sheer volume of work that is done, both by full-time staff and by volunteer members. We are a small profession, but the degree of volunteering we achieve remains substantial, despite the pressures of modern working to which I referred earlier. I am pleased to say that members of the Faculty play their full part in this. Nevertheless, I would like to encourage more members to become involved with the profession. Equally, I am keen to ensure that our structures and ways of working are such that our volunteers feel that they are not committing themselves to an unreasonable amount of time, that their contributions make a difference, and that they find the experience a rewarding one.

3.2 The immediate past Presidents, David Kingston and Peter Clark, made considerable efforts to ensure that the profession's board and committee structures worked efficiently and effectively. They acknowledged, at the end of their Presidencies, that more needs to be done. The structure we have, with boards dealing with specific practice areas (life assurance, finance and investment, etc.) and with specific professional areas (professional affairs, education and CPD, etc.) works well when issues are largely confined to those areas. It works less well where cross-board issues arise, and when it comes to looking ahead and anticipating proactively those matters that have not yet come over the horizon. Jeremy Goford and I do not wish to turn the present structure around, and rely instead on a series of topic-specific task forces — this has been tried with only limited success in other countries. Nevertheless, we are keen to streamline the current structure as much as possible. The elevation of the Communications Committee to the status of a FIMC Board should help to achieve the more proactive position we want the profession to be in. Apart from the general benefits from efficiencies, I believe that success in this area will help to attract more volunteers into service for the profession.

3.3 Professions — and ours is no exception — are under scrutiny as never before. Their ability to set appropriate standards and to regulate themselves objectively and effectively are being questioned. The integrity of professions and their members is not taken on trust, but must be demonstrated. It is healthy that these issues are being raised, although it can be painful for able and well-meaning people when their motives are criticised, often unfairly and on scant evidence. It would be a pity if trust, as a feature of professions, was to be abandoned and replaced entirely by openness, transparency and accountability; but trust has to be earned, and has to continue to be re-earned. We have seen many examples recently, in the commercial and financial worlds, where trust that was built up over decades was destroyed in the twinkling of an eye.

3.4 I believe it is appropriate to ask ourselves how well we deal with conflicts of interest, both as individual practising actuaries and within the board structure of the profession itself. On the former, the role of the Appointed Actuary, which is currently under review by the FSA, undoubtedly harbours potential conflicts, particularly where proprietary companies are concerned. Whilst it should be recognised that such conflicts have generally been well managed by the members concerned over the years, it is not surprising that questions are now being asked. To my mind, it is disappointing that the profession has not had an absolute requirement that Appointed Actuaries could not hold certain executive positions. Similar questions arise where Scheme Actuaries to pension schemes also advise employers, and where they are directly involved in giving strategic investment advice to trustees.

3.5 I also think that an external observer might question the objectivity of the profession's practice boards. Each board is populated almost entirely

by people whose work for employers and clients is in that practice area. Of course this has the benefit of the extensive practical experience of the members; but it could mean that awkward questions, which might affect adversely the business of, or relationship with, the employer or client, are not raised. The evidence appears to me to be that, as a profession, we have not been as successful as we might have wished in airing and debating, at an early stage, areas of potential difficulty. The cost of annuity guarantees, pensions mis-selling and the risks associated with defined benefit pension commitments are three such areas that come to mind. Nor am I comfortable that some of our guidance notes are as strong as they should be, quite apart from the concern that I have already expressed in relation to GN11 that we may not always be adhering to our guidance notes.

3.6 I firmly believe that the exercise of professional judgement is an area where actuaries can, and should, add great value. However, the nature of our work is such that two actuaries, acting with comparable expertise and with complete integrity, can come up with very different answers to a particular financial question. As financial models proliferate and become more complex, this issue is highlighted even more. In my view, in order to preserve our scope to exercise judgement, we need to impose significant boundaries on the methods and assumptions we use. If we do not, detailed prescription will be imposed by governments or regulators, and the concern I have already expressed about a compliance mentality will become a permanent reality.

3.7 The profession has responded to these issues in a number of ways. For example:

- Our Professional Conduct Standards are kept constantly under review, and were recently revised and published. I hope every member has studied them. I am, incidentally, old-fashioned enough to believe that it is not enough to publish these on the web-site. They deserve the status of a printed and bound document, despite the costs of doing so.
- We are moving forward on peer review. The pace and scope is likely to vary by practice area, and, at least initially, statutory duties will be given priority. I think it is very important that we all, young and old, embrace the principle of peer review, including the potentially controversial aspect that, at its higher levels, it should be both independent and external to the actuary's employing organisation. We need to see this as enhancing the quality and credibility of our work, not as professionally or commercially threatening.
- We are making some, albeit slow, progress in embracing and embedding the concept of life-long learning. Continuing professional development is an important part of that process. However, I do not think that a self-certification scheme, which has to be reported only by the minority of actuaries applying for practising certificates or for approval by the Institute's Designated Professional Body under the Financial Services and Markets Act, goes far enough.

- We are encouraging the boards reporting to FIMC, and their committees, to include lay members.

3.8 These are positive steps, but do they go far enough? I think not. It is interesting to observe that the accountancy bodies, strongly encouraged by government, have gone down the path of delegating, from the professional bodies to the Accountancy Foundation and its subsidiary boards, responsibility for large elements of professional, technical and ethical standards, and investigation and disciplinary matters. The Foundation and its boards are independent, and draw their memberships from a wide range of interests, with majorities from outside professional accounting practice. Whilst I do not see a need for such an elaborate structure for our profession, I believe that we can and should learn from it. In particular, I am keen that we should move forward quickly on the following:

- the introduction of a comprehensive system of independent, external peer review;
- the inclusion of a significant minority of lay members on our boards, particularly the Professional Affairs, Life and Pensions Boards; this may mean that some changes will be needed to the *modus operandi* of these boards to accommodate an effective role for these members;
- the inclusion in practice boards of a significant minority of actuaries from other areas of work;
- the inclusion in the Professional Affairs Board's remit of specific references to conflicts of interest and professional ethics; the role of Scheme Actuaries and the effectiveness of Chinese walls within firms are two subjects worthy of early examination;
- the development of a mechanism whereby lay members of boards are chosen independently of these boards; and
- the establishment of an independent Actuarial Standards Board, to strengthen the process for developing our guidance to members in major areas of actuarial activity. This was suggested by the authors of the paper 'The Fair Valuation of Liabilities' (Hairs *et al.*, 2001), but I believe it has a wider application.

Some members may regard at least some of these as controversial. It is, however, important that they are aired and debated.

4. THE ROLE OF THE FACULTY

4.1 On the evidence of recent Presidential Addresses, this paper might appear incomplete without any reference to the role of the Faculty. On the other hand, such persistent scrutiny by my recent predecessors might be interpreted as insecurity! Nevertheless, I have decided to say a few words on

the subject, particularly as, like David Kingston, I feel that a relatively detached perspective may be helpful.

4.2 The current arrangements whereby the Faculty and Institute Councils have delegated much of the running of the profession to the FIMC and the practice boards works well, in the sense that the existence of two professional bodies rather than one is not a significant factor in creating extra costs or inefficiencies. (As I have already said, however, there are other issues that do need to be addressed.) The drawing of members of the FIMC and the boards from both bodies tends to result in a better balance, both geographically and from the viewpoint of experience, than might otherwise be achieved. It is, however, important that the leaderships of the two bodies are of one mind on major strategic issues, particularly during a period of significant change.

4.3 But this merely recognises that there is a large concentration of actuaries in Scotland. It does not, of itself, justify the existence of an independent Faculty. So I have asked myself what additional value the Faculty can add, as an independent professional body, compared with the position if it were a regional society of a U.K. professional body. I should mention that, like most members of the Faculty, I have a strong sentimental and emotional attachment to it, but that should play little part in answering the question I am considering.

4.4 I suggest that this additional value manifests itself in at least the following ways:

- It is important for the profession to have close ties with other professions, both to share views on the many issues confronting professions and to achieve productive collaboration in various areas of research. As a small profession this is not always easy in the U.K.-wide context. In Scotland, however, there is a compact, though still substantial, professional community in which full participation is much easier to achieve. The U.K. profession can benefit considerably from this participation, but, to be fully effective, I believe that the Faculty needs to have the status of an independent professional body. I am certainly very keen, in conjunction with our senior staff in Edinburgh, to develop our relationships with other professions in Scotland.
- In a similar vein, the provision of financial services of all kinds — pensions, insurance, savings, investment management and banking — form a very important part of the Scottish economy. These are fields that are all important to actuaries. We should wish to influence their future development and regulation. Although the Scottish Executive's authority in these areas is limited, its interest in them is likely to grow. I therefore think that building relationships with the Scottish Executive is important from a Scottish perspective, and will be helpful to the aims of the U.K. profession. Again, I think that this can be done more effectively by an independent Faculty.

- Scotland has long had a reputation for the excellence of its professions and professional standards, and for education and research. Members of the Faculty can certainly be proud of the contribution they have made to the development of the profession both in the U.K. and overseas. Despite being much the smaller of the two U.K. bodies, the Faculty continues to attract a considerable number of members from overseas. Although I am not aware of any surveys as to the reasons why individuals make this choice, it is legitimate to speculate that the Scottish reputation may have a bearing. In any event, it can perhaps be said that the existence of an independent Faculty has served to encourage recruitment into the U.K. profession.
- A point that was put to me many times during my recent discussions with younger Fellows was that, if the Faculty ceased to be an independent body, there would be a risk that the centre of gravity of professional activity would move more towards London, with a consequent loss of engagement with the profession by the second largest concentration of actuaries in the U.K. This is a risk that needs to be taken seriously. On the other hand, we need to demonstrate, by the quality of our research, professional papers and debate in Scotland, that such a loss would be a real one.

4.5 In his Presidential Address David Kingston asked:

“Given the concentration of actuaries and students in Scotland, are we really seeing enough activity, be it research, debate or social mingling among our members?”

He established two committees to consider operational issues and services to members. The latter recommended, *inter alia*, a greater variety of meetings to meet the needs of a wider range of members than was catered for by our traditional sessional meetings. Changes have been made, but the discussions I have had suggest that we need to take further the themes of variety and relevance of our meetings.

4.6 Investment management and banking are mentioned specifically in the ‘Vision and Values’ statement in the context of marketing the profession’s skills into wider fields. I foresee a rapid expansion of these fields in Scotland, with an accompanying demand for people with the right mix of business and technical skills. It is, therefore, particularly important for the future health of the Faculty that actuaries emerge who are suited to roles in these fields.

4.7 I regard the undertaking of high quality research as an essential feature of the Faculty. A number of individuals have made great efforts to produce good original papers in recent years. Yet, the inevitable conflict between employment pressures and voluntary work makes it difficult to achieve a satisfactory stream of research. I comment further on research, as

it relates to the profession generally, later. I would like to pursue three avenues in conjunction with the Research Committee of the Faculty:

- closer collaboration with universities and other professions;
- involving our ‘out of Scotland’ members, particularly those based overseas; and
- greater use of meeting and discussion groups as seedbeds for research ideas.

4.8 In summary, I believe there is value in an independent role for the Faculty, both for Scotland and for the U.K. profession, although the arguments are not overwhelming. But, to sustain that role, we need to ensure that our members participate actively in all our professional activities, which, in turn, obliges us to ensure that these activities are relevant to our members. We also need, of course, to ensure that the Faculty is an attractive option for new members, not only those based in Scotland, but also those who live and work elsewhere. I think that our Scottish characteristics have contributed to this so far, and I expect that they will continue to stand us in good stead.

5. PUBLIC INTEREST, PUBLIC POLICY AND PUBLIC IMAGE

5.1 *Public Interest*

5.1.1 In describing the values of the profession, the ‘Vision and Values’ statement says: “One of the objectives of the whole profession is to serve the public interest ...” It goes on to say: “As individuals providing advice we identify activities which appear to be against the public interest and address the issues raised with those seeking advice.”

5.1.2 From my discussions with younger Fellows and from other research, it is clear that members believe that it is right that the profession should have a broad public interest role. This includes the maintaining of a supply of well-trained actuaries, the maintenance of high professional standards with an accompanying discipline process, and the furtherance of knowledge through research. It also encompasses the engagement in activities that inform public understanding and debate on issues where our expertise is relevant and which generally lead to the betterment of society. Indeed, these functions may be considered to encapsulate the essence of any profession.

5.1.3 Members are less clear about how serving the public interest should affect them as individuals. There is a concern that, taken literally, it could bring them into conflict with their employers or clients and raise questions about where their duty lies. There is also a feeling that this role could be a barrier to entrepreneurial and managerial success. Clarification is needed.

5.1.4 It is helpful that a group under the auspices of the Communications Board has been considering these issues with a view to producing position

papers on the public interest. It is important to make clear that the primary duty of an individual actuary is to his or her employer or client, to any other parties whom they both identify and agree should be included, and, of course, to those parties to whom a statutory or regulatory duty is owed. The duty of an actuary to the profession is primarily to abide by the Professional Conduct Standards and to other relevant guidance. An actuary who does these things has, to my mind, served the public interest. I would like to dispel any misconception that the public interest duty extends to acting as a watchdog or policeman whose primary task is to protect the public from the effects of legitimate commercial activity.

5.1.5 There will, however, be times when an actuary may be uncomfortable about the effects of the advice he or she is giving. This could happen, for example, in relation to the development of an insurance or savings product whose terms are obscure and unlikely to be fully understood by the ultimate consumer. It could happen in relation to a pension scheme, where the terms of options that are likely to be exercised are framed in a way that is disadvantageous to the member, or where the terms of special benefits (usually for senior employees) could, in some future circumstances, undermine the benefits of other members.

5.1.6 The key to the resolution of such potential difficulties should be the relationship between the actuary and his or her client or employer and the respect of the client or employer for the actuary's views. One important way of earning that respect over time is that the actuary's advice should always be put in the wider context of the client's or employer's business and expressed in terms to which the client or employer and other stakeholders can relate. In this way it becomes possible to tackle difficult questions openly and constructively, because, in the end, a potential public interest problem is usually a potential business problem as well.

5.1.7 However, relationships are not always conducive to such solutions, and it is important that actuaries should, when necessary, have an avenue within the profession to seek guidance confidentially, if they have been unable or unwilling to do so with a senior colleague. That avenue is the Professional Affairs Guidance Committee, and I would encourage all members to use it. Its secretary is Michael Scott, based in Maclaurin House. It benefits all parties if problems are resolved at an early stage. It also helps the profession to be aware of the types of problems that members are facing. This may, for example, point to aspects of the Professional Conduct Standards that should be revised or strengthened. In this context, it is as well to remember that these standards exist as much to assist and support members as to constrain them.

5.1.8 Part of the profession's public interest role is to raise issues for debate which may be controversial and which some parties might prefer were not raised. I have heard the comment on several occasions — and not just by younger members — that the profession appears slow, even reluctant, to

raise such issues. There are certainly occasions when it is more effective to deal with such issues away from the public gaze, so that members may not always be fully aware of the profession's involvement. Nevertheless, I believe that the changes I have already suggested to our governance structures will help us to be more effective in fulfilling this aspect of the profession's public interest role.

5.2 *Public Policy*

5.2.1 Our aspirations, as a profession, to serve the public interest will not be realised unless we play an active and influential role in public policy and public affairs. I believe strongly that this is a legitimate and important role for any profession. This does not mean that we need to express a view every time we speak. We can be very effective if, on appropriate occasions, our public statements are designed to encourage debate — to ask the questions rather than give the answers.

5.2.2 To be successful, I believe we must demonstrate a number of attributes. These include:

- That we speak as a profession, not as a trade body representing the particular interests of our employers and clients. This can be a difficult distinction to achieve, not least because, if we are expressing a view, it will often (though not always) be similar to that of our employers and clients, but we need to achieve it. This is one (of several) important reasons for reviewing and reforming our governance structures.
- That our views and statements are based on thorough research and that we avoid the temptation to resort to evidence that can be seen as anecdotal or opinionated and therefore, by inference, self-serving.
- That we express views and make statements that take account of the full range of stakeholders who may be affected by the issue in question, with particular emphasis on individuals and groups of individuals.
- That we are open to the views of other experts with whom we may not totally agree, and that we are willing to work with them to reach better solutions than we might have proposed on our own.
- That we are not afraid to tackle difficult questions openly and objectively, whether these questions relate to ourselves or to public policy. Governments have a natural dislike of criticism and, in my experience, are particularly sceptical of those who appear never to subject themselves to self-critical examination.
- That we communicate in clear, unambiguous, non-technical language and avoid our natural inclination to delve into detail that may be important to us as experts, but is marginal in relation to the key principles when seen through the eyes of our audiences.

5.2.3 Behaviours of the kinds I have outlined achieve respect, which I believe to be the most important attribute of those who seek to be influential in

public affairs. How have we been doing as a profession? For our relatively small membership, I believe, as Jeremy Goford put it in his Presidential Address, that we punch above our weight. We could, though, measure our size by reference, not to our membership, but to the value of the assets on which our advice, directly or indirectly, has a bearing, or to the number of people affected, directly or indirectly, by our advice. Measured in these ways we are not small, and I think that there is the potential, and the need, for us to increase our influence significantly. I look forward to playing my full part in this effort.

5.3 *Public Image*

5.3.1 Finally, in this section, I will comment on our public image. Views on our image, and on its importance, are mixed. It is easy for us to become defensive and to accept, as a disappointing, but tolerable fact of life as it were, that people who say unkind things about us do not understand us, but it does not really matter so long as we do a good professional job for those we advise.

5.3.2 A positive public image is important in the modern world, not so much because it helps us to feel good about ourselves, but because it helps us to be more effective in everything we do. It is also vital to our efforts to expand the profession and to attract talented people into it. There is no reason why we should not be able to enhance our image. We are, by and large, an intelligent group of people, although not as frighteningly bright as some outsiders think. We care about our work, and our work affects the lives of very many people. People are becoming increasingly interested in, and concerned about, savings and pensions, our two main areas of activity currently.

5.3.3 We have made progress, particularly with our corporate and institutional audiences, but we also need to make the wider public aware of who we are and what we do, not least because this would enhance our effectiveness in influencing public policy. I was very taken by a strap line, aimed at the wider public, developed by the American Academy of Actuaries. It is: 'Actuaries are the architects of financial security'. I think we can build on that. It is, perhaps, an aspiration too far to aim that, in 20 years' time, the architects will have as their strap line that they are: 'the actuaries of building design'!

6. WORKING WITH OTHERS

6.1 A feature of our profession is that many of the areas where actuaries work and undertake research are ones where professionals and academics who are not actuaries also take a keen interest and make a significant contribution. In his Presidential Address, Fraser Low said:

“We must recognise ... that we are not the dominant force in the financial services industry that we once were.”

In the case of investment management, I feel that the profession has failed to maintain a position of dominance. In other areas, such as mortality, demography and social insurance, the interest of others has tended to grow in response to the perceived importance and intellectual interest of the subject. In some areas the interest of non-actuaries comes in the form of regulators, whose staff may have a wide range of backgrounds and ways of thinking, far removed from territory with which actuaries are familiar.

6.2 To the extent that opportunities have been lost, this must reflect a perceived lack of suitability of our education and training, to which I have already referred, together with a failure to attract into the profession people with the right mix of personal and intellectual attributes for these ‘lost’ roles. There is likely to be a close connection between these two factors. Whilst some self-criticism is warranted, the entry of others into what traditionalists might regard as ‘our’ fields is largely a reflection of their growing importance and sophistication. Different ways of looking at a problem can, if they are combined effectively, often lead to a better solution than either approach on its own.

6.3 *Financial Economics*

6.3.1 An excellent and topical example of this is the role that the thinking of financial economics can, and should, play in framing the actuarial bases and investment strategies for all kinds of financial institutions, but particularly for defined benefit pension schemes. The debate over the past few years on the place of financial economics has not always been as constructive and collaborative as it should have been. In part this may be because the thinking and methodologies of financial economics derive their strength from the pricing of securities in efficient and liquid markets, whereas actuarial thinking and methodologies are based on the modelling of diversifiable risks for assets and liabilities, where no such market exists. It seems obvious to me that the two approaches are complementary. I thought Jeremy Goford put the point cogently in his Presidential Address when he said:

“So, it appears to me that the thinking behind each of these disciplines can inform the other. As financial economics informs values where there is no market, and actuarial methodologies seek to reproduce market values, we have a lot to learn from each other. It can be, truly, a both/and world of mutual understanding.”

6.3.2 There has been a pressing need for reconciliation between those actuaries who espouse financial economics and those who do not. I believe that this has been happening, and I would encourage all actuaries to include financial economics as an important area of new learning.

6.4 *Mortality*

6.4.1 The development of current and forecast mortality tables has been central to actuarial work from the beginning. During my working lifetime there has been a subtle change of emphasis in mortality studies from a consideration of the proportions expected to die at various future times to the proportions expected to survive. This is no doubt a reflection on the great improvements in mortality which occurred in the twentieth century. As a result of these, our financial and social institutions are today more vulnerable to people living 'too long' rather than dying 'too soon'. To date, our actuarial approach of modelling the future based on past observed trends, has consistently resulted in underestimates of mortality improvements. Our methods could not take account of the massive benefits which society has derived from accelerating medical advances and rapidly improving social conditions.

6.4.2 It is by no means certain that the pace of improvement will continue to accelerate — epidemics, adverse environmental factors, and the effects of obesity, asbestosis and smoking, for example, could put a considerable brake on further progress. Moreover, there is a lively current debate surrounding the question of whether there is a natural limit to the maximum human lifespan. Nevertheless, underestimates of future improvements in mortality would have major implications for life assurers, pension funds and social security systems, especially in an era of low inflation, which can make corrective measures more difficult.

6.4.3 Although, of course, no one can foretell the future, and it is essential to model different scenarios, it is vitally important that our central forecasts are as robust as possible. It seems clear that a number of other professionals could provide valuable input — geneticists and other medical experts, gerontologists, sociologists and demographers come immediately to mind. We have made some important progress through initiatives such as the Genetics Group, the Medical Panel and a series of seminars sponsored by the Social Policy Board in conjunction with the International Longevity Centre. I would like the profession to broaden and deepen the work we do with these and other professionals whose input is relevant to mortality studies, and to provide the support and resources necessary to make this happen.

6.5 *Risk*

6.5.1 The identification, measurement, pricing and management of risk would be regarded by some as territory where the profession has lost ground to other risk professionals. It is ground that it is important to retain, because it is fundamental to much actuarial science. It is also central to the future regulation of many of the institutions we advise, as regulatory thinking moves towards risk-based supervision. We have not been standing still. The Finance and Investment Board, in particular, has built up useful working relationships with other bodies such as the Institution of Civil Engineers to develop methodologies to enhance the risk analysis and

management for projects (RAMP) and other aspects of operational and business risk. The immediate Past Presidents have identified risk and regulation in financial organisations as a major development topic that spans all practice boards. They have established a task force to consider topics such as the development of modern risk theory for actuaries, solvency capital for institutions, and various aspects of risk management.

6.5.2 These are important initiatives for the profession. To take them forward successfully, we need to demonstrate our ability to learn from each other in our different practice areas. We also need to exploit to the full the considerable research undertaken by actuaries who are employed in academic settings. This is another area where there is room for improvement, and leads me to a more general point.

6.6 *Research*

6.6.1 In common with other professions, we are both a learned society, committed to the furtherance of our science through research, and an accrediting body for practitioners in various increasingly specialised areas. Much of our original research is undertaken by the small minority of our members who work in universities and similar institutions. Research is encouraged by the funding arrangements for universities. I believe that our profession would benefit greatly from closer collaboration between actuarial practitioners and actuarial researchers. There are some important instances — for example research which was undertaken in the 1980s into the costs of financial guarantees — where practitioners could, with great benefit, have adapted the theory to practical application sooner than they did. Research papers are sometimes criticised by practitioners for being too theoretical or for lacking a practical dimension. In my view such criticism is usually misplaced, because it is up to the practitioners to translate the theory into practical terms. I believe that a greater emphasis on the role of universities in our education system would be helpful, but that will take time. Meantime, I am keen to explore ideas for bringing researchers and practitioners closer together.

6.7 Looking to the future, therefore, I believe that the interest of non-actuaries in fields, which were traditionally the preserve of actuaries, should be seen as a good thing. It should strengthen the quality of the advice we give, rather than threatening the role of actuaries. We will all have to get used to working in multi-disciplinary teams; but I also hope that actuaries of the future will learn more from each other than they have in the past, both as practitioners working in different practice areas and as between practitioners and those involved in research.

7. THE PROSPECTS FOR RETIREMENT

7.1 The partnership between state and private provision for retirement is currently under considerable strain. State pension rights, traditionally the

cornerstone on which private provision has been built, can be characterised as highly complex, but inadequate to sustain a minimum acceptable standard of living (particularly for lower paid people). The issue is adequacy, not affordability. In the absence of reform, those who have been unwilling or unable to make provision for themselves, either directly or through employment, face the prospect of increasing reliance on means-tested benefits. Indeed it is estimated that up to 50% of pensioners may be eligible for means-tested benefits by the year 2050. This has major implications for people's incentive to save for retirement.

7.2 At the same time, the main source of private provision, occupational pension schemes sponsored by employers, is coming under financial pressure. The surpluses of the 1990s have swiftly been replaced by deficiencies. There are some doubts as to whether existing levels of benefits can be sustained for the current generation of employees, and serious doubts about their sustainability for future generations. Final salary schemes are being replaced, for new employees, by defined contribution schemes, often with lower contributions than would have been needed to sustain the benefit structure being replaced. These uncertainties have arisen at a time of considerable debate about the proper measurement of defined benefit pension costs. This debate is exemplified by the contrast between the accounting standard FRS 17 and the traditional actuarial approach to the valuation of pension scheme assets and liabilities.

7.3 A major challenge in tackling these issues is deciding on the right place to start. Proposals are regularly put forward suggesting more compulsion, simplification of regulations, raising the state pension age and increasing the proportion of retirement provision that is funded, to name but a few. I would suggest that three high level points of principle need to be debated and agreed at the outset. They are as follows:

- Is it the role of the state to provide pension rights to all citizens which are sufficient to maintain a basic standard of living, financed through contributions that represent a redistribution from the rich to the poor? Or is it the state's role to provide only for those in society who have not, for any reason, provided for themselves? One view of policy over the past 25 years is that the state has been moving stealthily from the first of these roles towards the second. Moreover, under current policies, that movement will continue, though perhaps at a slower pace. The policy intentions are unclear.
- What part, if any, should paid work play in providing income to older people? Many have questioned the sustainability of retirement systems in developed countries under which very little paid work is undertaken beyond the age of 60 or 65, yet life expectancy is increasing and birth rates remain low. Although it does seem obvious that working lives will, in future, need to be extended, there is as yet limited evidence of educational, training and labour market policies designed to make this attractive to older people.

- What is the nature of the pensions promise in a defined benefit occupational scheme? It is recognised in the professional community and probably by most employers that the ‘promise’ amounts to far less than a guarantee, even if the scheme meets in full the statutory funding requirements. Many defined benefit schemes are currently being wound up. In many cases the assets are insufficient to secure the defined benefits, even if the employer remains solvent and meets the statutory debt provisions. Yet I am convinced that most pension scheme members believe that a statutorily fully funded scheme provides a guarantee that the benefits will be paid in full. This gulf in understanding has major implications for actuaries.

7.4 *The Role of the State*

7.4.1 As actuaries, we have an essential part to play in debates on these issues. Whilst recognising the political sensitivities surrounding the question of the role of the state, I believe it is of fundamental importance, and certainly too important to be fudged. The World Bank described an important role of state pensions (see World Bank, 1994) as: “protecting the old from risk by defining the benefits in advance.” My own view is that universal state pension rights at an acceptable minimum level are a necessary pre-requisite to increased private provision. Not only would this reduce greatly the need for means testing, but also it would revolutionise savings incentives and remove a major source of potential mis-selling claims. Indeed, it can be argued that, without this reform, it is unlikely that other policy initiatives (stakeholder pensions, simplification of regulations and streamlining of savings products) will be effective in encouraging more long-term savings among those on average earnings and below; but the cost of providing such universal state pension rights from the age of 65 may well be unacceptably high. It follows that the minimum age from which these rights are payable will need to rise.

7.4.2 Other people have made the same point. The difficulty, however, is how best to structure the state system so that, while retaining a necessary degree of flexibility, it will stand the test of time. It seems to me that, to achieve this aim, decisions on key elements of the system need to be removed from the political process. I am attracted to the idea, floated at the profession’s Ageing Population Conference held in Edinburgh in January 2002, that decisions on the state pension age applicable from time to time, should be delegated to an independent committee, working within cost and benefit level parameters laid down by Parliament. There are reasonably close parallels with the Monetary Policy Committee, whose role in the setting of interest rates has been widely recognised as a success.

7.4.3 On the other hand, a case can be made that, as society becomes more affluent at all levels, the need for a costly, redistributive state system diminishes. The state should, therefore, become a provider of last resort. With

this model, a key question is the degree of compulsory saving that should be imposed on employees and their employers and the self-employed. Another important consideration is the extent to which contributions from the more affluent would need to be redistributed to the accounts of the less well off.

7.5 Labour Market Policies

At first sight, the subject of labour market policies to encourage older people to participate actively in the economy may not appear to be a topic of pressing actuarial interest. However, I believe it to be fundamental to the long-term financial planning of individuals, and hence to the advice we give on pension scheme design and on the level of savings required for a comfortable old age. There needs to be a national debate about the working and leisure lifestyles of tomorrow's older people. I suspect that one prominent possibility would be that full-time work would cease when people reached their late fifties or early sixties, to be replaced by a changing mixture of part-time working, re-training, education and leisure. In this scenario, retirement, as we currently understand it, might not occur until a person reaches his or her mid-seventies or even later. Some individuals have already achieved such a transition. A major challenge for government, employers, educational institutions and individuals will be to extend such opportunities to a much larger part of the population.

7.6 These are issues where the profession needs to work closely with many other professional disciplines. The Social Policy Board has made an encouraging start in this direction. I sense that the U.K.'s approach to older people, as evidenced by the state pension system and labour market policies, is due for a radical reappraisal. We need to be ready to play our full part in influencing the direction of change.

7.7 The Pensions Promise

7.7.1 At least to some extent, I feel that debates about the place of financial economics thinking in pension scheme finance, and about the suitability of FRS 17 as a measurement system for pension costs, hinge on the interpretation of the pensions promise. On the interpretation of the promise assumed by most scheme members, it seems difficult to justify a valuation rate of interest, for funding and solvency measurement purposes, other than a long-term risk free rate, taking assets at market value. In practice, much less stringent bases have been, and are being, used. While this can be justified on weaker interpretations of the pensions promise, it seems to me that recommendations based on such assumptions need to be accompanied by clear risk warnings, to employers, trustees and scheme members, that the accumulating assets might not be sufficient to guarantee in full the accruing benefits. In the modern world, we need to be more rigorous in spelling out the risks associated with our funding bases than may have been considered necessary in the past. As discussions proceed on the

replacement for the Minimum Funding Requirement by scheme specific funding standards, these points must not be lost sight of.

7.7.2 I believe that there is a very strong case that members of defined benefit schemes should be advised each year of the extent to which their accrued benefits could be secured by the existing assets of the fund. The significance of this information will, of course, depend on the willingness, and ability, of the employer to make future contributions, but that should be for members to judge.

7.7.3 The trend away from final salary schemes towards defined contribution schemes seems well established. It is often said that this change in scheme design represents a transfer of risk from employers to employees. Although in some senses this is true, it should not be inferred that final salary schemes are always less risky for employees. The change can validly be seen as the replacement of one set of risks to employees with another set. Which set of risks is the greater requires considerable analysis of individual schemes, their funding policies, their memberships and the strength of their sponsoring employers. It is inappropriate and misleading to generalise.

7.7.4 It is both pleasing and timely that the paper by Fleming *et al.* (2003), presented to the Faculty Students' Society, will form the basis for a debate at a sessional meeting in the current session. I believe that there is much work to be done in developing scheme benefit structures which accommodate employers' risk preferences whilst providing real security for employees. I look forward to this year's debate acting as a catalyst for further original thinking.

7.8 Projections

I would also pay tribute to the work that the profession has done, through the Pensions Board, in the development of standards for money purchase projections. The removal of the effects of retail price inflation is an important step forward in conveying to people what their level of contribution may deliver in benefit terms. However, I would like to persuade the profession and the Government that the projections should be enhanced further in two respects. First, projections which remove the effects of price inflation do not convey, in the context of rising living standards, what the eventual level of income will feel like when it is received many years hence. To do this it would be necessary to strip out the effect of economic growth, or some other proxy for rising living standards. Second, the projections are deterministic, and it is important that a stochastic approach is taken to give a sense of the range of possible outcomes. I do not, however, underestimate the consumer education challenge that would have to be met for these enhancements to be effective.

7.9 I would conclude this section with the view that my children's generation is facing a more uncertain retirement than did my generation at the same stage in our lives. That is not to say that they will be impoverished,

rather that it is very difficult for them to make rational plans. It is for this reason, above all others, that I would like to see a national debate about the high level points of principle I outlined earlier.

8. LIFE ASSURANCE

8.1 My experience of this sector is as a non-executive director rather than as a practitioner, and my comments mostly reflect that perspective. The industry has, for a lengthy period, been facing several difficult challenges, all of which are important to our profession, given the number of actuaries employed by life offices and the close association of actuaries with life assurance in the public mind. The issues I will touch on are reputation, regulation, capital requirements and fair value accounting.

8.2 Reputation

8.2.1 The reputation of the industry, particularly its distribution side, was badly damaged by the pensions mis-selling affair. To my mind its reputation has not yet been restored. The lack of transparency of with-profits contracts, together with the extent of discretion and the apparent lack of accountability in the exercise of that discretion, have all added to a feeling of mistrust. The difficulties of one life office, the Equitable Life, have added to concerns, but it would not be appropriate for me to comment further on this episode.

8.2.2 It is important to put these issues in perspective. Pensions mis-selling should not have happened, but it was by no means the sole fault of life offices. For their long-term savings arrangements, consumers appear to want products that provide an element of guaranteed minimum return (which may simply be protection of capital) together with exposure to the stock market in a manner which shares the risks with other policyholders through a smoothing process. This is, of course, what with-profits arrangements seek to do, but these features have a cost (which is often ignored in the media), and so it is inappropriate to compare with-profits funds with unit trusts.

8.2.3 I think that actuaries have an important part to play in restoring and then enhancing the reputation of the life assurance industry — both as managers and as technicians. Part of this is through our work on product design and marketing. The current drive for a set of simple standardised mass-market products has its place; but innovation in product design is at least as important, with the emphasis being on transparency, value for money and clear description of the product's features and risks in language the consumer will understand. I thought that the paper by Clay *et al.* (2001) was an important contribution.

8.2.4 Another aspect of the restoration of the industry's reputation is the governance arrangements of life offices, particularly those that are

proprietary, where the interests of policyholders and shareholders need to be balanced. The current proposals of the FSA seek to place more responsibility on boards, but with a lesser role for the Appointed Actuary. The case that has been made for diminishing the role of the Appointed Actuary is extremely weak. Bearing in mind the responsibilities of boards to shareholders, it seems to me to be very important that the policyholder protection part of the Appointed Actuary's role is not lost by default. It is therefore important that those in authority whose responsibility it will be to approve changes should pay close attention to potential gaps that could weaken the existing framework.

8.3 *Regulation*

8.3.1 This leads me on more generally to the regulation of insurance companies and how it is changing. Broadly, the course is set for a transition from a regime which concentrates on an examination of what the regulated entity has been doing in practice in its various operational areas to one which is risk based and concentrates on the processes by which risk is managed. Actuaries need to understand the new regulatory thinking, which is much more akin to banking, and adjust their own thinking and processes accordingly. Equally, regulators need to understand that long-term life assurance is different from banking, not least in the role that discretion plays in the fulfilment of many long-term insurance contracts.

8.3.2 For the new style of regulation to work effectively, I believe that there needs to be a strong actuarial function within the regulator to work alongside the actuarial function within the firm being regulated. I think that there are interesting potential opportunities for actuaries on the other side of the fence, as it were, as the new regime develops.

8.4 *Capital Requirements*

8.4.1 The cap on stakeholder pensions charges and the restriction, to a level percentage of contributions, on how they can be collected, have already had knock on effects on other savings and pensions products. Whilst the pressure to achieve efficiencies can hardly be criticised, the capital needed to support new business is rising. So are the risks associated with that capital, given the right of the policyholder to transfer his or her account at any time without penalty. The capital required to support with-profits funds and the guarantees in other long-term products is also rising. It is also the case that the most efficient use of capital may be constrained by regulatory requirements.

8.4.2 What does this mean for the life assurance industry and for actuaries? First, the profitability of new business, already an important topic, will assume greater prominence in the thinking of company boards. The balance of influence between the actuary and the sales director will, in my view, move towards the actuary. Second, the process where less well-

capitalised companies join stronger groups is likely to continue. David Kingston, in his Presidential Address, asked whether there were some aspects of mutuality which can be maintained, and thought it desirable that several forms of ownership should survive. This prompted the paper by Guijarro & Hare (2002). Personally, I think that the financial services sector is likely to be increasingly dominated by large financial conglomerates. Life office actuaries are, therefore, likely to find themselves working more closely with people from other backgrounds, particularly banking. This will open up new career opportunities for actuaries, as indeed it has for a few already.

8.5 *Fair Value Accounting*

8.5.1 The introduction of fair value accounting for insurance companies will require a large amount of preparatory work, both for companies and for the profession. The Life Board has already established a steering group and four working parties to consider principles, methodology and assumptions, with-profits and stochastic accreditation. In a short space of time, no less than 50 volunteers have been recruited for this work, which reflects very well on the enthusiasm of members of the profession.

8.5.2 To my mind, fair value accounting should be attractive conceptually to actuaries because of its focus on the balance sheet — the actuary's natural home — rather than the revenue account. The skills of actuaries, in placing consistent values on non-tradable assets and cash flows, allowing for the effects of discretion where appropriate, seem to me to be essential here. However, given the uses to which accounts are put, it will be important that actuaries in this field avoid using very different methodologies and models. This is an important point in support of the arguments for the establishment of an Actuarial Standards Board, to which I referred earlier.

8.6 I feel that actuaries in life assurance face a mixture of challenges and opportunities. Challenges lie in rebuilding the industry's reputation and in adjusting thinking to a new regulatory environment. Opportunities lie in the design of savings products that modern consumers want and in the general move towards balance sheet accounting, not just in insurance, but more widely.

9. THE INTERNATIONAL DIMENSION

9.1 The part played by Scotland in the establishment and growth of professions around the world is quite remarkable for such a small country. The actuarial profession is no exception. While much remains to be done in establishing the profession in developing countries, the emphasis has shifted towards harmonisation in the developed actuarial world. The Groupe Consultatif has played an important part in achieving European harmonisation in relation to mutual recognition of professional qualifications.

Further progress has coincided with the growing stature of the International Actuarial Association (IAA), which, in turn, stemmed from the recent change in the IAA from an association of individual members to an association of actuarial organisations.

9.2 The increasing globalisation of the profession will continue because the environment in which we work is becoming more global. One example is the growing influence of the International Accounting Standards Board. I expect to see international accounting standards for insurance companies and pension schemes within a few years. Another example is the increasing co-operation that is happening between regulators around the world. Much of the consultation on these matters will be through the IAA. It is therefore important that the U.K. profession maintains its representation and influence in that body. A further example is the increasingly global outlook of many of the major employers of actuaries, particularly in consultancy.

9.3 Good progress is being made towards common education standards, mutual recognition and mutual discipline arrangements. However, given the differences between existing education systems and governance arrangements, the further work and co-operation needed to achieve harmonisation should not be underestimated. From what I have seen so far, I think that there is much that we in the U.K. can learn from other countries, just as there is much that they can learn from us.

9.4 One of the undoubted attractions of the Presidency of the Faculty is the opportunity to travel and to meet both Faculty colleagues and other actuaries around the world. While I fully intend to enjoy the travel for its own sake, it also has an important business dimension to make further progress towards a truly global profession.

10. SUMMARY AND CLOSING

10.1 We are a profession in transition. Actuaries of the future will have much more of a business and customer focus than their predecessors. They will be working within different styles of regulatory regimes than currently exist. They will, to a far greater extent than at present, be working within multi-disciplinary teams. It follows that actuaries need to learn the language, and understand the thinking, of other professional disciplines. Equally, actuaries must ensure that other professionals, as well as their employers and clients, understand their language and thinking.

10.2 As a profession, we need to ensure that our operating and governance structures encourage an open, outward-looking and proactive approach, as well as being efficient and attractive to members wishing to volunteer their services. We have very important roles to play in the shaping of public policy in pensions and social security, and in the transformation of the life assurance and savings industries.

10.3 Over the next two years, I would like to see progress in the following areas, in particular:

- the development of a system of independent external peer review;
- a restructuring of our boards to include non-actuaries and, for practice boards, actuaries from other disciplines;
- an examination of conflicts of interest, particularly in relation to pension Scheme Actuaries, and, more broadly, an examination of professional ethics;
- the development of an Actuarial Standards Board;
- a transition to a much greater role for universities in the actuarial education process;
- examining how best to re-establish the role of actuaries in investment management;
- clarification of the public interest role of individual actuaries;
- the development of an enhanced public image for the profession, as an aid to recruitment and expansion into wider fields;
- enhanced collaboration with other professionals in a number of areas, including mortality studies, risk analysis and social policy;
- improved communications and understanding between actuarial researchers and actuarial practitioners;
- active participation in public policy debates, particularly relating to social security and pension provision;
- active participation in the development of new processes for the regulation and governance of insurance companies with the aim of achieving enhanced security and value for money for customers, from an industry that is reputable and profitable; and
- extending the range of professional meetings and activities available for members of the Faculty in Scotland. I would be thrilled if, over the next two years, every practising actuary in Scotland participated in an event organised by the Faculty.

10.4 Effective communication, both internal and external, will be essential in achieving these aims. An important internal message with which to end is that we all do actuarial jobs. Our approach to any problem, whether it is technical, management or business related, is influenced by our actuarial background and training. We should not feel defensive about that. We should be proud of it.

10.5 I should end with some words of thanks: to all those whom I have met for informal discussions, I hope I have reflected at least some of your views; to my main employer, Aon Limited, who have generously agreed that my time with them can be devoted almost entirely to the profession; to my secretary, Stephanie Deimbacher, who compensates so excellently for my limited IT skills and organises me so well; to Margaret, who finds much time from her own busy schedule to support what I am doing and for whom the

travel will, I hope, be some compensation; and to all members of the Faculty who have accepted me as your President. You have my assurance that I will represent you and the Faculty to the best of my ability.

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