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ADDRESS

BY THE PRESIDENT OF THE INSTITUTE OF ACTUARIES

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[Delivered to the Institute of Actuaries, 27 September 2004]

RESTORING CONFIDENCE IN LONG-TERM SAVINGS

ABSTRACT

This Presidential Address highlights the national problem of inadequate savings for retirement by the current working population. It examines what can be done to restore confidence in long-term savings and, in particular, looks at the contribution that individual actuaries and the Actuarial Profession can make. The Address also examines the origins in the current shortfalls in final salary pension schemes and the lessons to be learned from recent events, before going on to comment on the lessons from the report on Equitable Life by Lord Penrose.

KEYWORDS

Long-Term Savings; State Pensions; Occupational Pensions; Pension Funding; Solvency; Life Insurance Regulation

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1. Setting the Scene

1.1 The Institute of Actuaries is 156 years old this year. The Faculty of Actuaries will shortly celebrate its 150th anniversary. In March 2004, the Government announced a review of the actuarial profession, to be carried out by Sir Derek Morris. Potentially, the outcome of this review could be the most significant event in the history of our profession in the United Kingdom.

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1.2 The terms of reference for the 'Morris review' are set out in the Appendix.

At the time of writing this Address, the Morris review team has published a Consultation Document, including 88 questions, and requested responses by 10 September 2004. As the responses from the Actuarial Profession and others will be published before this Address is delivered, it would not be appropriate to comment in detail here, so I will restrict myself to a few brief observations.

The Consultation Document is broken down into three main strands:

— the role of actuaries, the Profession and the actuarial services market;
— the current regulatory framework of the actuarial profession; and
— the roles and responsibilities of the Government Actuary's Department (GAD).

On the second strand, the regulatory framework, we can point to several important initiatives, all of which were started well before the review was announced:

— a new, independent disciplinary scheme, which is already in place, and on which Lord Penrose commented favourably in his report on Equitable Life;
— the introduction of peer review, which is being progressed by the Pensions, Life and General Insurance Boards in their respective practice areas;
— proposals for practising certificates, to be revalidated every three years, on which we shall shortly be consulting the membership; and
— initial proposals for an independent body to set actuarial standards, the details of which are being worked up by a taskforce, and will then be put out for full consultation.

We recognise that the outcome of the Morris review is likely to recommend changes to the way in which the profession is governed. We hope that the initiatives described above will be endorsed by Sir Derek Morris, and we look forward to other constructive recommendations that will strengthen the profession and further improve its governance, in accordance with the expectations of today's society.

1.3 The announcement of the Morris review came as part of the Government's response to the long awaited report by Lord Penrose on Equitable Life. The report ran to over 800 pages, and its detailed analysis of events put the conduct of Equitable Life's actuaries, its directors, its auditors and the regulators under the microscope. None of them emerges unscathed from his scrutiny, although Lord Penrose admits to viewing events with the benefit of hindsight. The fall from grace of such a venerable institution has caused understandable shock waves. However, it is worth remembering that this was not a case of fraud or misappropriation, as in certain earlier

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notorious collapses of financial institutions. Being a mutual fund, the assets of the with-profits fund were redistributed amongst different groups of policyholders. Indeed, some Equitable Life with-profits policyholders have done very well, notably those whose policies matured between 1989 and 2000. In Lord Penrose's judgement, it was the 'overpayments' to this group which were the main cause of Equitable Life's eventual problems. On the other hand, some groups of policyholders have suffered reductions in benefits below their expectations, as a result of the redistribution.

The actuarial profession (as distinct from individual members) was also subject to comment and criticism in the Penrose report. We have been actively working to identify the lessons to be learned and, where appropriate, to implement changes. I will return to this topic of the lessons to be learned in a later section. Reading the report as an actuary whose background is in the pensions field, I was struck by the number of parallels which could be drawn between with-profits life insurance and final salary pension schemes. I would strongly encourage all actuaries to read Chapters 19 and 20 of the report. I would be surprised if you did not find some food for thought in relation to your own area of work.

1.4 It is a cliché to say that we live in a time of great change. I am sure that numerous previous Presidents have made this comment in their Addresses. Sometimes, it is instructive to step back from the current plethora of new laws and regulations and to look back over a longer period. We can then observe the significant changes that have occurred, which may otherwise have been less obvious because they have happened gradually and incrementally. If I look back to the early part of my career, some 25 or more years ago, I can see a number of substantial changes which have taken place in our society: firstly, a move away from collective ways of organising affairs to a greater emphasis on individual rights and responsibilities; secondly, a move to more openness and transparency; and thirdly, a greater willingness to challenge those in a position of authority. I do not comment on whether these changes are for the better or for the worse. I simply observe that they have happened, and, as a consequence, the world in which we operate as actuaries is very different now from what it was 25 years ago.

For instance, back in those days, no one questioned the way in which with-profits bonuses were set by life office actuaries, nor the way in which the finances of final salary pension schemes were managed. It was simply accepted that the processes were opaque, and understood only by other actuaries. Today, there is an irresistible clamour for openness, transparency and accountability.

The changes in society which I have described have had profound implications for the financial services industry, and go part of the way, some would say a long way, to explaining the gradual decline in popularity of with-profits savings and final salary schemes. Both of these financial vehicles involve 'cross subsidies' between different groups of members, for the

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greater good of the whole membership. By contrast, unit-linked savings and defined contribution pensions eliminate much of the potential cross subsidy. The individual consumers have their own accounts, where they can see exactly what is happening to their money. Thus, individual rights plus openness and transparency are catered for.

The decline of with-profits and final salary pension schemes, which I am arguing reflects a significant shift in our culture and society over the past 25 years, also has profound effects for the actuarial profession. Advice in relation to these two types of savings institutions has been a major source of employment for actuaries. Final salary pension schemes, in particular, have been a major growth area for actuaries. Actuaries, on their own, cannot reverse powerful trends in society, even if we would wish to, although we may hold out hope that the pendulum will one day swing back. Meanwhile, we have to live with the world as it is, not the one that we would like it to be.

At the same time as these changes in society have been gradually happening, we have seen major shifts in the economic and social environment in which we operate. Rapidly increasing longevity and falling birth rates are changing the shape of our population. The country moved during the 1990s to a low inflation/low interest rate environment, after two decades in the 1970s and 1980s of high inflation. We are told that the country is awash with personal debt, with dire predictions of the fallout should the economy falter. All these changes have contributed to a massive savings 'gap', with a large proportion of the current working population seemingly heading for an impoverished retirement.

1.5 Amidst this turmoil, the standing of the actuarial profession has undoubtedly come under threat. The life insurance industry, with which we are closely associated, has experienced the pensions mis-selling saga, the Equitable Life affair, and now is under pressure on mortgage endowments. Final salary pension schemes, with which we are also closely associated, have hit the headlines, as thousands of members have lost some or all of their accrued pensions following their employer's insolvency. We have been publicly criticised by some politicians, parts of the media and other commentators.

I believe that we need to take a long, hard look at recent events. In my view, it is wrong to pretend that everyone else was at fault except actuaries. Neither do I subscribe to the view that 'it was all the fault of the actuaries'. I think that we should be honest with ourselves and the outside world, admit to those areas where, with hindsight, we recognise that we could have done better, and put into practice the lessons that we can learn. I also believe that our record in the recent past is not all bad. We have had our positive achievements, and we could usefully 'put the record straight' by pointing these out.

1.6 The preceding paragraphs have set the scene.

When considering what to include in my Presidential Address and what

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theme, if any, there should be for my Presidency, I was struck by the sheer volume of changes in the profession which are already in the pipeline:
— a revised education syllabus, with the first examinations under the new system due in April 2005;
— the four initiatives described in Section 1.2, covering professional standards, competence, peer review and discipline;
— the revised regulatory roles for actuaries in life insurance being introduced from late 2004, coupled with new reporting requirements for insurance companies and new accounting standards; and
— a Pensions Bill heralding new requirements for final salary pension schemes and for Scheme Actuaries, coupled with a radically new and simplified tax regime for pensions from April 2006.

It seemed to me that the actuarial profession had more than enough big issues to cope with, and that there was no need for an incoming President to introduce yet more. I was confirmed in that opinion when the Morris review was announced. Council and the staff clearly need to devote sufficient resources to responding to the Morris review effectively. We are in danger of becoming severely stretched just to meet our existing commitments. I therefore make no apologies for presenting a pragmatic, practical and 'down to earth' Address. It may lack a soaring vision for the profession. Instead, it does, I hope, offer plenty of practical ideas for improving the image of the profession and for meeting the challenges which we face over the next two years and beyond.

There is one particular major national issue, to which I have already alluded, which falls squarely within our sphere of influence as actuaries. I refer to the so-called 'savings crisis' or 'savings gap'. While not wishing to be alarmist, there appears to be clear and compelling evidence that large numbers of the current working population are heading for an impoverished old age, unless current savings levels are substantially increased. I believe that actuaries and the actuarial profession have a public duty to use their training, skills and experience to help tackle this national problem. A prerequisite for dealing with the nation's 'savings gap' is the restoration of confidence and trust in long-term savings. Actuaries and the actuarial profession, on their own, cannot do this, but there is much that we can contribute to the restoration effort. My thoughts on this form the first part of my Address. I then go on to discuss:
— the origins of the current shortfalls in the funding of final salary pension schemes, and what lessons can be learned from this experience;
— the lessons to be learned from the Penrose report and how the profession is responding to these; and
— our 'corporate plan' for 2004/05, highlighting some of the many positive developments taking place within the profession.

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2. Restoring Confidence and Trust in Long-Term Savings

2.1 A major challenge facing our country over the next 20 years is to increase the amount of long-term saving by the population. There are many 'barriers' which discourage people from making long-term savings. A recent and powerful addition to those barriers is the loss of confidence and trust in long-term savings' vehicles. This has arisen from a series of failures in the savings arena, as mentioned in Section 1.5.

In the following paragraphs I briefly describe the background to the so-called 'savings crisis' or 'savings gap' in the U.K. Much of this will cover familiar ground, but I will comment on what I believe that the actuarial profession and individual actuaries can, and should, be doing to help restore confidence and trust in long-term savings. These comments are in *italics*.

2.2 Before starting, it is worth observing that there are two groups in the population who are largely unaffected by the 'savings crisis': firstly, those who have well paid jobs (or have inherited wealth), who will be able to accumulate sufficient assets to ensure a comfortable retirement; and secondly, at the opposite end of the spectrum, those who are unable to work or who have very low paid jobs, who are simply unable to save and who will be reliant on state benefits in retirement. In between are the majority of the population, those in middle and junior management, clerical and manufacturing jobs, plus many of the self employed and owners of small businesses.

The poorest group are extremely important, and it is right that Government policy should be focussed on providing adequately for them. In terms of the savings crisis, however, it is the middle group on which our attention should focus.

2.3 *Demographics*

The shape of the U.K. population is set to change significantly over the next 20 years. The 'baby boomer' generation is coming up to retirement. Recent studies have indicated rapid improvements in longevity for those born between 1925 and 1945 — the so called 'cohort effect', referred to in a paper presented to the Staple Inn Actuarial Society in 1999 by Richard Willets (Willets, 1999) and also the subject of further papers presented to the Faculty and Institute earlier this year ('Longevity in the 21st Century' (Willets *et al.*, 2004); 'The Cohort Effect: Insights and Explanations' (Willets, 2004)). Consequently, there will be a substantial increase in the number of retired people by 2020, and they can expect to live significantly longer than previous generations. At the same time, the birth rate in the U.K. has fallen well below the 'replacement rate', so there will be fewer young people coming into the workforce. This latter aspect was well covered in the booklet 'More Babies? Who needs them?', published in May 2004.

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Our series of lectures on ageing population issues, organised jointly with the International Longevity Centre, has covered a wide range of topics, with speakers from the U.K. and overseas, from a range of disciplines. They have been well attended, with visitors outnumbering actuaries, and have engendered lively discussions. In my view, they are a model of how our profession can, and should, work in partnership with other organisations in a way which benefits the public interest and also helps to enhance our reputation. The recent paper by a joint working party (Willets *et al.*, 2004) illustrated the advantages of harnessing research in medical and social fields to our own statistical methodologies, to enhance our understanding of possible future trends in longevity.

We should continue to work with those in other disciplines to understand and quantify the forces driving future longevity. We should focus our efforts on the implications of demographic change for insurance and pensions.

We should publicise the findings of any work which we do in the field of demographics, particularly longevity. The media has a fascination with the subject, so it is an ideal field for us to obtain positive coverage for the profession and its contribution to the national debate on these issues; but we do need to make very clear the limitations of our work, as Tom Ross wrote in an article in the Financial Times *earlier this year:*

> "*As flattering as it is that people believe that actuaries should be able to predict the future, we can't and we don't pretend to. Actuaries model what could happen in the future — using past events and present trends as critical components of the analysis — so that businesses and governments can plan ahead with an understanding of the risks that might affect those plans.*"

2.4 *The Increasing Cost of a Pension*

Many current youngsters expect to stay in full time education until their mid 20s, hope to retire, like their parents, in their mid 50s, and are likely to survive until at least their mid 80s. So, 30 years of savings while in employment would have to support 30 years of retirement; but, when I was at school, the majority of the male population left school and entered the workforce at age 16, most retired at or after age 65, and they might expect to live until their late 70s. The expectation then was almost 50 years of work to support fewer than 15 years in retirement. These crude figures suggest that current workers need to save at about three times the rate of that earlier generation.

Thus, the need to save for retirement is greater now than it has ever been, and will only increase. However, the improvements in longevity, coupled with the fall in interest rates, have pushed up the price of an annuity. From the consumers' point of view, the amount of pension which can be purchased for a given level of savings has been, and still is, falling. Their reaction, inevitably, is that there is little point in saving for this thing called a pension, because the cost keeps rising all the time.

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More generous state retirement benefits, which would limit the need for private savings, could be achieved only by tax increases and/or significant redistribution of wealth. There are no signs that a future Government would be prepared to grasp such a nettle.

In the absence of any prospect of significantly better state benefits, the current working population only has three choices:

— to have a smaller income in retirement;
— to save more; and/or
— to retire later.

Surveys of the general public indicate a widespread lack of understanding of the amount of savings required to enjoy an adequate income in retirement. When questioned about their plans for retirement, people frequently express an intention to retire at an early age and to enjoy an expansive lifestyle in retirement. Their level of planned savings, however, is only a small fraction of the amount required to achieve their ambitions. In practice, I would expect most people to adopt a combination of all three choices listed above. In particular, when they find they have not saved enough to provide even a barely adequate income in retirement, they will be forced to remain gainfully employed, possibly on a part-time basis, for longer. This will have major implications for employers, especially in the light of the European Directive banning age discrimination, due to be enacted in U.K. legislation in the autumn of 2006.

We need to keep reminding the general public, opinion formers and policy makers that the current working population only has the three choices outlined above. There is no magic fourth option. There seems to be considerable opposition to the idea of retiring later, but the two alternatives to later retirement also involve significant sacrifices. So, we must keep spelling out the choices in very simple terms. Eventually, I believe that the public will come to accept that later retirement, which goes with the grain of increasing longevity, has to form part of the solution.

We need to speak out clearly on many of the related issues, on which the public would expect actuaries to have a view. Our contribution to the national debate should be based on appropriate research and cogent analysis. Examples of some areas on which we could usefully comment publicly are:

— *the amount of savings needed to provide a satisfactory level of retirement income and the relationships between amount of savings, target retirement income and planned age of retirement;*
— *the implications for society and for employers of a 'demand' for continuing employment from older citizens with inadequate savings; and*
— *experience in other countries, such as Sweden, where the level of state pension is automatically reassessed following regular independent reviews of life expectancy in Sweden (see, for example, 'Raising the State Pensions Age: are we ready?' (Pensions Policy Institute, 2003)).*

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2.5 *Consumer Debt*

Levels of average debt per household have risen sharply in recent years. Student debt is on the increase. These trends are bound to curtail the ability to make long-term savings. Indeed, for many families, the need to pay off unsecured debt (credit cards, store cards, etc.) is even more pressing than the need for long-term savings. Much of the increased debt is secured debt, in the form of mortgages, with families using the rise in house prices to take out larger loans, partly in order to finance current consumption.

We need to be aware that, despite our focus on long-term saving, it is not the top priority in financial terms for many families.

2.6 *Housing*

The role of housing in long-term saving is an important one. Clearly, repaying a mortgage over 25 years is a genuine form of long-term saving. My concern is that some families are expecting their housing asset simultaneously to perform three functions:

— to provide a home;
— to provide a source of funds to finance current consumption; and
— to be the main (or only) plank for building up savings for retirement (as evidenced by several surveys of attitudes to retirement saving).

It seems to me that this approach may buckle under the strain of trying to perform all three tasks. If that happens, it is the third one which will inevitably suffer.

Using a housing asset to provide retirement income can be achieved either through 'downsizing', or through equity release. Downsizing, i.e. moving to a smaller, cheaper property and investing the balance of the sale proceeds, has some drawbacks. For instance, if your greatest pleasure in retirement is having your grandchildren come to stay for the weekend, then swapping a three bedroom house for a one bedroom flat is not very appealing. Research by the Pensions Policy Institute (2004) ('Property or Pensions') concluded that, for most people, particularly those outside the south east of England, the housing asset is unlikely to be more than a partial solution to the provision of adequate retirement income, whether by downsizing or by equity release.

Equity release products fall squarely within the actuarial ambit. The Actuarial Profession has had two working parties on equity release, the first one reported in 2001 ('Report on Equity Release Mechanisms'), and the second is due to report later this year. The key issues here are to ensure that the products are carefully designed to meet customers' needs, and that the sales process is well regulated. These are particularly necessary, because there is an added degree of vulnerability for elderly purchasers. We are concerned with the Financial Standards Authority (FSA) rules on illustrations for lifetime mortgages (FSA, 2004), due to come into effect on 1 October 2004.

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In our view, these illustrations are misleading, as they fail to show the range of possible adverse outcomes. We must continue to express our concerns on this issue.

We should continue to speak out if we have concerns with the development of the equity release market. It is too important a part of the solution of the 'savings crisis' to allow it to fail. We need to press for simple, customer-led designs of products, and a well regulated sales process, with realistic illustrations.

2.7 *Complexity*

One of the major barriers to retirement savings is the complexity of the products and of the framework of the pensions system. This applies, not only to the state pension arrangements, but also to occupational pension schemes and private pension provision. To a considerable extent, simplicity is the enemy of fairness. There is such variety in the human condition and in personal circumstances that, in order to achieve equity between individuals, extensive and complicated rules are written into the system to cover every eventuality. Nevertheless, there is considerable scope to simplify, by removing unnecessary complications without creating inequity.

State pension arrangements, encompassing the Basic State Pension, the State Second Pension (S2P), its predecessor, the State Earnings Related Pension Scheme (SERPS), and the Pensions Credit, have extremely complex rules governing the entitlement to, and the calculation of, the benefits. Since these arrangements form the foundation of pension provision, simplification needs to start with the state benefits. However, this is not an easy task, as there are many complicated linkages between benefits under the U.K. welfare system.

In recent years, the introduction of the Pension Credit has further increased the complexity of the state system, while bringing the issue of means testing to the fore. The arguments for and against means testing are not as one sided as many commentators would suggest. The Government's highly laudable objective is to target resources where they are most needed. Hence, the introduction of the Minimum Income Guarantee (MIG). However, the MIG penalised pensioners with savings income or capital, and appeared particularly harsh on poorer pensioners with modest savings. The solution was to introduce a 'taper', so that the means tested welfare benefit is not reduced pound for pound in respect of income from private savings. The more gradual the taper, the fairer the system from the individual's point of view, but the more expensive to the Exchequer. Moreover, the more gradual the taper, the higher up the income scale the means tested benefits will bite, so that more pensioners will be caught in the means tested net. This is a dilemma for any Government designing a means tested regime. The Pension Credit taper has been set at 40p in the pound, so that an individual loses 40p of Pension Credit for each £1 of personal savings income, within certain limits.

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When this tapered design is coupled with the proposal that Pension Credit limits will rise in line with National Average Earnings (another highly laudable objective), but state pensions and most occupational pensions are only planned to increase in line with price inflation, the resulting projections show between two thirds and four fifths of all pensioners being potentially subject to a means tested regime by 2050. (Pensions Policy Institute, 'The Pensions Landscape' (2003), quoting estimates by the Institute of Fiscal Studies and the Department for Work and Pensions). At this stage, even the staunchest supporter of the Government's approach must start to have some doubts.

The arguments against means testing are well known:

— It is unsatisfactory to require large numbers of pensioners to go through the indignities of the means testing system.
— Take up rates are well below 100%.
— Means tested benefits cost almost ten times as much to administer as a universal benefit.
— There are issues of 'moral hazard', i.e. individuals may squander their savings in order to maximise their state welfare benefits.

In addition, it is frequently claimed that the existence of extensive means tested benefits in retirement acts as a disincentive to save, and makes it difficult for advisers to recommend retirement savings to large sections of the workforce. The counter arguments to these last points, which some commentators have put forward, are that no one, acting rationally, would plan to rely solely on means tested benefits in retirement, and, together with the existence of the 'taper', this means that advisers can safely recommend that 'it always pays to save'.

My personal view is that a highly simplified, universal, first tier state pension, at a level which avoided the need for additional means tested benefits, would have tremendous advantages. It could cut out many of the complications in the system. At the same time the disincentives would disappear, as the need for individuals to save in order to enjoy a reasonable standard of living in retirement would be clearly signposted.

The downside from this proposition is that increased state retirement benefits might be paid to those who have less need of them. On balance, I think that the advantages would far outweigh this disadvantage. The other argument against my proposition is that it would cost too much. I am not convinced about this, particularly as the universal benefit would replace the combination of the Basic State Pension, S2P and Pension Credit, and because the cost could be adjusted by a suitable, small increase in the age at which the full pension could be drawn. As always, the major problems in any redesign of the state scheme are the transitional arrangements, and here the current means tested benefits have an important, but temporary, role to play.

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I mentioned earlier that simplification is not only a matter for state benefits. The Inland Revenue's simplification of the tax regime for pensions is a major achievement, for which they deserve much congratulation. (I never expected to write that sentence!) The changes are the most radical since 1921, and the simplification is on a monumental scale, reducing eight tax regimes to one, and making Inland Revenue limits largely irrelevant to over 95% of the population.

By comparison, the Pensions Bill from the Department of Work and Pensions (DWP) seems, in simplification terms, to be a missed opportunity, which detracts from its otherwise worthy objectives.

Nor is simplification only a goal for governments. The designs of savings and protection products by insurance companies and of occupational pension schemes are frequently far more complicated than they really need to be. Partly that is due to a desire to be fair to all, as mentioned earlier. Sometimes, however, I wonder whether it has not resulted from an 'expert', who is designing the product or scheme, wanting to show how clever he or she is. This is an area where actuaries, with their natural tendency to absolute precision and accuracy, may have contributed to the complexity of the designs. Often, a 'rough and ready', but simple, solution may be better than a precise, but complicated, one.

The other aspect of simplification is in the way that savings and protection products and pension schemes are communicated to policyholders and scheme members. Good communication, written or spoken, requires a clear understanding of who the recipients are and what existing knowledge of the subject they have. The communication material needs to build on that existing knowledge in order to lead the reader or listener through the topic, without 'losing them' on the way, until the required messages have been successfully communicated.

The ability to communicate complex technical matters clearly to lay persons has always been a key skill for actuaries, but it is probably more important than ever today. Many actuaries, myself included, are not naturally good communicators. We have to learn how to communicate, and, in my experience, there is no substitute for hard work and lots of practice, together with a willingness to be self critical of one's own efforts and to seek advice and guidance from those more experienced or talented at communicating. It truly is a case of life long learning!

So, what can actuaries do in this important area? We should be passionate about simplification, whether in relation to regulation by Government, or in our own product or scheme design. We should support the Government wholeheartedly when it tries to achieve real simplification, as with the recent Inland Revenue tax changes, and we should continue to press it when it seems to be missing an opportunity. We should root out unnecessary complications in our own arrangements, wherever we can.

We should communicate with clients, policyholders and pension scheme

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members in plain English, avoiding jargon, and keeping firmly in mind the needs and capabilities of those to whom we are communicating.

We should contribute constructively to the national debate on the future of state pension provision, but, in order to do so, we need to become better informed about the scope and costs of the variety of welfare and means tested benefits.

2.8 *Consumer Education*

One of the problems that we face in this country is the low level of understanding of financial matters generally, coupled with a low level of numeracy. Clearly, this is not a problem that the actuarial profession can solve on its own; but we can make a positive contribution by assisting those organisations which are taking initiatives to tackle the problem. Most notably, the FSA has identified seven key projects as part of a national strategy for improving financial capability, including projects related to schools, young adults and families, projects on reaching people through the workplace, retirement planning, borrowing and the role of 'generic advice'. I would hope that the actuarial profession would fully support these and other initiatives, and that individual actuaries would become actively involved.

I also believe that there is much that we can each do in our daily lives to promote a greater understanding of financial matters. One way which I particularly favour is identifying some 'simple truths', which even those who are not particularly financially literate can understand, and which bear repeating over and over again. One such 'simple truth' has already appeared in Section 2.4, namely:

— As we are all living longer and this has increased the cost of providing a pension, there are only two ways to avoid a lower income in retirement: to save more; or to retire later.

Two more current favourites of mine are:

— If a savings product offers an investment return above the rate of return obtainable from a safe investment, then the product must involve some risk that you might lose part of your capital.
— When saving for retirement, there are only two sources of money: contributions and investment returns. This means that:
    — The earlier you start contributing, the less you will have to contribute to achieve the same target.
    — The lower the investment return you get, the more you will need to contribute, and vice versa, to achieve the same target.

These 'simple truths' may sound very trite to experts, but the important point is that, if people can grasp a few fundamental underlying principles, this can give them the confidence and motivation to get started.

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An important element of consumer education is the need to find a way of helping people to understand uncertainty, which is at the heart of actuarial work. The future is inherently uncertain, yet words like 'promise' and 'guarantee' are used all too freely in financial services. Guarantees are very expensive to provide, whereas 'best endeavours' come at a much more affordable cost.

Instead of using the word 'uncertainty', actuaries tend to use the word 'risk'. Often we use risk to mean volatility, which has both an upside and a downside. The general public understands risk in its adverse sense only, and, indeed, some risks are only adverse, e.g. the risk of loss due to fraud. They attach much greater importance to the chance of suffering a loss than to any potential for profit.

The actuarial profession should support, as best we can with our limited resources, those organisations engaged in raising national standards of financial capability.

As individuals, we can all, in our day to day work, pass on some 'simple truths' to those with whom we come into contact, to help increase basic understanding.

We need to manage consumers' expectations better, being especially careful with the use of words like 'guarantee' or any phrases which imply that there are guarantees, when in reality there are only 'best endeavours'.

We need to become much better at explaining risks and uncertainties to consumers. When we are using risk to mean volatility, we need to be aware that individuals generally attach greater importance to the risk of loss than to any potential gain.

2.9 *The Move from Defined Benefit (DB) to Defined Contribution (DC)*

The complexity of pensions and the lack of understanding amongst the general public are reasons why the most successful way of achieving meaningful retirement savings levels is when employers organise pensions on behalf of their employees. Occupational pensions, in particular final salary schemes, were hailed as a great success until the late 1990s. Since then, the trickle of closures of final salary schemes has turned into a stream and then a torrent. Now, the majority of people moving to a new job with an occupational pension will be offered a defined contribution scheme. There is clear evidence from published surveys that the contributions being paid into many of these schemes are woefully inadequate to provide a decent pension. Worse still, many employees decline to join their employer's scheme.

Previously, the greatest concern was those who did not have access to an occupational pension scheme. Now they have been joined by those who have access, but fail to take advantage, and by those who, though members of a company pension scheme, are nevertheless heading for inadequate benefits.

There are many challenges and opportunities for actuaries in the field of defined contribution pension schemes. In particular, it seems to me to be highly desirable that members are strongly encouraged to review their

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contributions regularly. This involves providing them with realistic projections of likely outcomes on a range of scenarios, and communicating clearly the uncertainties involved. Other areas for actuaries include generic advice on investment strategy and on the conversion of savings to income at retirement. Both of these also require good communications skills. The biggest challenge for actuaries will be the need to communicate with individual members, rather than with employers or trustees, as we have been used to doing.

A recent development has been the burgeoning recognition that there are different ways of designing occupational pension schemes, which lie between the two extremes of final salary and defined contribution. Assuming that the aim is to provide a pension that bears a certain relationship to pre-retirement income, the three main risks identified are the 'final salary' risk, the 'pre-retirement investment' risk and the 'annuitisation' risk. The alternative designs are distinguished by the degree to which these various risks are shared between the employer and the employees. There is considerable scope for innovative design, and many pensions actuaries are now addressing these issues. I suspect that, initially, much of this innovation will be treated as commercially confidential by the consulting firms, but I would hope that the relative merits of different ideas can soon become the subject of open discussion and scrutiny, within and beyond the profession. I also hope that actuaries will take heed of my advice to keep things simple and will not try to be 'too clever', producing a technically superb design that few can understand.

The actuarial profession should speak out about the amounts that need to be saved to provide particular levels of income in retirement.

We need to continue to develop the skills to enable us to provide value added advice in a DC pension environment.

We should encourage the development of alternative scheme designs which share risks between employers and employees, while not forgetting the need to communicate openly to the employees about the nature of the risks which they are bearing.

2.10 *Compulsion*

Faced with the problems of inadequate savings, many commentators, almost with a sense of despair, argue in favour of the introduction of compulsory contributions. The Government was wary of these calls and instead set up the Pensions Commission, chaired by Adair Turner, to investigate and report in 2005. We were indebted to Adair Turner for an excellent speech at Staple Inn in September 2003, where he gave a masterly analysis of the macro-economics of pension provision. Some of his conclusions, of which there are echoes in this address, bear repeating here; although my précis does not do justice to the original:

— "Faced with an ageing population and falling fertility, one of three things must happen: future pensioners must be poorer than today; future

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workers must be induced to give up more of their consumption in taxes or savings; or retirement ages must rise. My hunch is that an increase in retirement age will have to take most of the strain.''
— "Private DC funded provision seems to have some attractions (as it) achieves improved incentives to later retirement; but private DC pensions also have big problems, (as they) expose individuals to huge return risks, large complexity costs, if the product is sold on an individual basis, and increased complexity of best advice, if the state system is means tested.''
— "If a significant element of DB could be maintained within the total system, that would be an attractive result. The optimal way forward may require solutions which are neither classic DC nor classic DB. There is a lot of creative thinking to be done — including by the actuarial profession.''

The question of compulsory contributions which Adair Turner has been asked to address is highly political. Where I think that there has been inadequate public discussion so far is on the potentially adverse implications of compulsory contributions:
— Inevitably, compulsory contributions would have to be set fairly low, in order for them to be affordable for the lowest paid. However, the level of compulsory contributions is likely to become a de facto maximum level for many. The Trades Union Congress (TUC) has argued for compulsory employer contributions, but it is difficult to see any Government imposing significant additional costs on businesses, particularly small businesses.
— Research has shown that families have varying abilities to save during different phases of their lives (see, in particular 'Family Fortunes — a Guide to Saving for Retirement', the paper by Deborah Cooper (Cooper, 2002)). What matters is the amount saved throughout a working lifetime, and it may make more sense to reduce or stop saving during periods of heaviest expenditure, relative to income, provided that the shortfall is made up during other periods. There is also the point made earlier, that, for some families, repaying short-term debt may be a higher priority than retirement saving.
— For many people with their own small businesses, the sale of the business is intended to fund their retirement. Compulsory saving would deflect them from reinvesting in their businesses (although a case for compulsion could be made on grounds of diversification).
— The schemes to which compulsory contributions are made could not be allowed to 'fail'. The public would demand capital guarantees, if their contributions were invested in defined contribution schemes, or benefit guarantees, if they were invested in defined benefit schemes. This points towards massive investment in risk free assets (i.e. gilts or cash deposits) in order to deliver the guarantees upon which the public would insist.

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If compulsion were to be rejected, the alternative approach should be the introduction of more powerful incentives to encourage people to make long-term, as opposed to short-term, savings. The principal current incentive of tax relief on contributions is poorly understood and of little help to the lower paid. A more imaginative approach, which first caught my attention nearly ten years ago, would be to provide the equivalent of 40% tax relief to everyone, but dress it up in a more appealing way by offering £2 from the Government for every £3 saved by the individual. The public is very familiar with 'buy one get one free' offers in supermarkets.

I believe that the debate about compulsion will escalate over the next two years, and we should engage in that debate. Our role should be to communicate clearly the implications of alternative policies, based on a careful analysis of all aspects of the problem.

2.11 *Summary*

I hope that, by the actions which I have proposed, actuaries can contribute to the restoration of confidence and trust in long-term savings, either collectively by engaging in national debates and by speaking out on key issues or, as individuals, by actions, possibly repeated many times, in our day to day work.

There is one further action, which is the most important of all. It has been emphasised by my predecessor, Jeremy Goford, during his Presidency, and I have no hesitation in reiterating his theme. We should focus on the needs of the consumer, i.e. the scheme member in a pension scheme or the investor in a savings product. As Jeremy is fond of saying: "We should look at things through the customer's end of the telescope." We must continually ask ourselves:

— *Is this savings product or pension scheme designed to meet the customer's needs?*
— *Is it being operated in the customers' interests?*
— *Will it deliver what it promised?*
— *Are we creating expectations, either deliberately or unintentionally, that we may not be able to meet?*

However, all our efforts will come to nothing if there are further failures in the savings system. These would simply erode confidence even further, and make it harder than ever to restore trust. In the next section I will consider the so called 'pensions crisis', its causes and what lessons can be learned by actuaries from our experience. In the following section I will consider the report by Lord Penrose on the Equitable Life affair and the lessons we can learn from that.

3. The 'Pensions Crisis'

3.1 The term 'pensions crisis' is sometimes used in the media to refer to

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what I have termed the 'savings crisis', discussed in Section 2. Sometimes it is used more narrowly to refer to closure of final salary schemes and their replacement by defined contribution arrangements. I use the term here to refer to the emergence of significant deficits in defined benefit schemes, the most painful manifestation being the loss of accrued pension rights suffered on the insolvency of the employer.

The hardship for those worst affected is a cause of great concern. It has been magnified by the sheer disbelief that it was possible to 'lose' a company pension. So often, when contrasting different types of pension plans, final salary schemes have been described as leaving the employer bearing all the risks, while DC schemes leave the member bearing all the risks. By implication, for the members final salary schemes were safe and secure. Rarely was the description of the final salary scheme taken a stage further, to explain that, if the employer fell by the wayside, the risks transferred back to the members, especially and in unequal measure to those not yet retired.

As we shall see, it took an unusual combination of several adverse circumstances to highlight the reality of these risks. If nothing else, this serves to underline the inherent uncertainty of the future.

3.2 The emergence of large deficits came as a shock to sponsoring employers, to trustees and to scheme members and to commentators. For the previous 20 years, in many cases, they had all been used to hearing that final salary schemes were, at worst, adequately funded, and, at best, well funded with scope for reduced contributions to absorb any surplus. A major reason for the shock was because the deficits became highly visible following the phased introduction of a new accounting standard (FRS 17) for reporting pension costs in company accounts. FRS 17 initially required disclosure in a note to the accounts of, amongst other items, the deficit or surplus, determined on a tightly defined basis that included the use of the market value of the assets and a discount rate for valuing the liabilities derived from the yield on AA corporate bonds.

Many commentators have described FRS 17 as one of the main causes of the 'pensions crisis'. I believe this to be incorrect. FRS 17 is the 'messenger'. The message it delivers may be unpalatable, but that is not a reason to blame the messenger. While FRS 17 was going through its exposure and consultation stages, we had many discussions with the staff of the Accounting Standards Board. In our formal response to the consultation (Response to Financial Reporting Exposure Draft 20, February 2000), we stated that, although we believed that the approach was technically correct to meet accounting principles, we had significant concerns about the practical implications. In particular, we were concerned about how employers would react to the volatility of the surplus or deficit figures appearing on their balance sheets. It is somewhat ironic that the first two years after the introduction of FRS 17 coincided with a period of sharply falling stock markets worldwide, coupled with falling interest rates.

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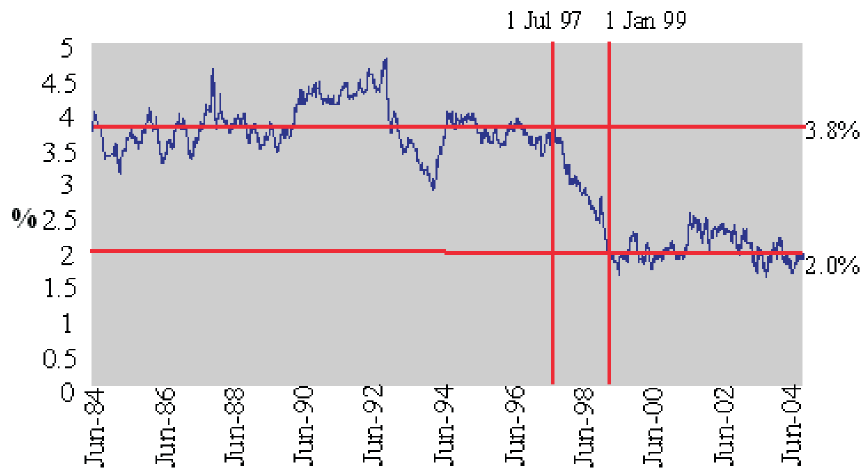

Source: Datastream

Figure 1. Index-linked gilt yields, 1984 to 2004

3.3 If FRS 17 was not the cause of the 'pension crisis', then what were the causes? I believe that the two main causes were:

— the sharp fall in long-term interest rates, especially the real yield on index-linked government stocks, during 1997 and 1998 (see Figure 1); coupled with
— the sharp increase in projected longevity, as revealed initially by results of CMI investigations published in late 1998 and early 1999.

Given the long-term nature of pension funding, the cumulative effect of a fall in interest rates can be substantial The two factors described above combined to increase the costs of current accrual of benefits for a typical pension fund by more than 50% over the two-year period from July 1997 to July 1999. In addition, the assets required to meet pensions already accrued in the past rose by nearly as much for a typical pension fund.

3.4 Initially this massive increase in costs for past promises was masked by the booming equity market, which peaked in the U.K. at the end of 1999. Subsequent falls in equity markets in 2000 and 2001 could, perhaps, be seen with hindsight as 'corrections' to the so called 'dot.com boom' in share prices. However, the further falls in the summer of 2002, to a low in March 2003, led to deficits in even previously well funded schemes. Although markets have recovered somewhat since March 2003, they are still (at the time of writing this) well below the level of spring 2002.

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3.5 Other factors have contributed to the present situation, but, I believe, they are secondary, rather than primary, causes. The removal of Advanced Corporation Tax (ACT) relief on dividends from U.K. shares in July 1997 has been a very unwelcome contributor to the current situation, and deficits would have been significantly smaller without this change. It is claimed to have cost U.K. pension funds £5 billion p.a., or £35 billion in total over the last seven years. I believe that this figure overstates the impact. At the time of the change, account was taken of the simultaneous reduction in corporation tax. Subsequently, considerable play was made about the other ways that companies were finding to reward shareholders, such as share buy backs. Even if one accepts the full figure of £5 billion p.a., it is less than 1% of the total assets of U.K. pension schemes. Compared to the figure of 50% in Section 3.3, I would maintain that the ACT change is only a secondary factor in the growth of pension deficits.

I believe that one reason why this factor is often given such prominence is that the figure of £35 billion is close to the numbers quoted for the total deficits in FTSE 100 companies. However, a deficit or surplus in a pension fund is the relatively small difference between the two very much larger numbers, representing the assets and liabilities of the fund. A small change in either the assets or liabilities can have a relatively big impact on the size of the deficit or surplus.

3.6 Another factor was the introduction of automatic pension increases on benefits accrued after 5 April 1997, in line with price inflation, but capped at 5% p.a. (Limited Price Indexation, or LPI). Many schemes, including the majority of the larger schemes, were already either providing automatic LPI or were funding on the basis that they planned to continue providing such increases, albeit using discretionary powers rather than automatically. For the minority who were not already doing either of these, there was an option to reduce the underlying benefit accrual to compensate for the cost of the increases being imposed. However, in the climate in 1996, which was the time when such a decision would have had to have been made, reducing benefits would have been a difficult move in terms of employee relations. It is ironic that the sharp increase in pension costs, referred to in Section 3.3, occurred immediately after the newly imposed legislation took effect.

The main consequence of the introduction of automatic LPI, which was the latest in a long sequence of Government imposed indexation requirements, was to reduce the flexibility with which trustees and employers could respond to adverse circumstances. By switching future increases from discretionary to automatic, the Government reduced the trustees' ability to invest in risky assets, such as equities, and to share the risks with the members, i.e. by turning the discretionary increase 'tap' on or off, depending on the performance of the scheme's investments. It is true that deficits today would be smaller if there were no obligation to provide future pension increases. However, this would be achieved only by condemning pensioners to a

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decreasing income in real terms. In effect, the argument is that deficits would be smaller if the benefits were reduced.

3.7 In summary, therefore, the principal causes of the emergence of substantial final salary scheme deficits were the significant fall in real interest rates, the sudden increase in estimates of future longevity and the final year of three consecutive years of falling equity markets. It is reasonable to ask the questions:

— To what extent, if any, could these three events, and their concurrence, have been foreseen?
— To what extent should the actuarial profession accept some responsibility for the outcome?
— What lessons can actuaries learn from these events?

I suggest that it would be a useful exercise for some independent research to be carried out into the origins and development of current pension fund deficits. This would help to answer the first two questions above.

3.8 Earlier in this section, I set out my views on the causes of the deficits. I will now comment on some areas where actuaries have been criticised, and suggest some lessons which have already been, or still need to be, learned.

Firstly, it is my personal view that, as a profession, we have not, in the past, been sufficiently clear in our dealings with clients about the difference between funding a pension scheme and the solvency of that scheme. In our advice to our clients, we focussed almost exclusively on long-term funding. Trustees and employers, in communicating to their members, followed suit. For example, it was commonplace to read in trustees' reports to members that their scheme was 'fully funded'. Any member reading this would naturally deduce that their benefits were secure.

In recent years, we have given increasing prominence to the solvency position when advising clients. However, trustees and employers were not keen to pass this information on to their members, particularly once solvency levels had fallen below 100%. They were naturally reluctant to highlight bad news to their members.

Behind the scenes, quite a lot of work had been going on in the actuarial profession to encourage changes. As long ago as 1997, the Pensions Board set up a working party to consider issues surrounding communicating solvency in the new Minimum Funding Requirement (MFR) environment, which reported in 1999. This reflected our concerns that there was a widely held misapprehension that the MFR was a solvency test, which had never been the Government's intention. The working party's report was subsumed into the Actuarial Profession's review of the MFR for the Government in 1999. Our report on that review, presented in May 2000, included a strong recommendation that members should receive regular information about how secure their benefits would be if their scheme were to wind up on the insolvency of their employer.

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During the winter of 2001/02, the profession had two representatives on a Consultation Panel set up by the Department for Work and Pensions to assist the Department in developing its new legislation. The Government had decided to replace the Minimum Funding Requirement by a regulatory regime based on a scheme specific funding approach. We pressed very hard for the regular disclosure to members of the security of their benefits in the event of the scheme winding up. After initial scepticism, the members of the panel were won round by the force of our arguments. The DWP commissioned a market research project to find out how members might react to being given this information, and the results were gratifyingly positive.

As a result of these initiatives, we undertook a major review of our guidance in this area (GN9: Funding Defined Benefits — Actuarial reports: Version 7.0). After detailed consideration and extensive consultation with the membership, changes came into effect in March 2004, which require the scheme's financial position on a 'buy out' basis to be clearly communicated to trustees in valuation reports. We have, of course, no power to ensure that trustees pass this information on to scheme members. We are waiting for confirmation that this requirement will be included in secondary legislation once the Pensions Bill is enacted.

The profession's representatives on the DWP Consultation Panel, referred to above, also initially suggested and pushed very hard for the introduction of a Statement of Funding Principles, which is now part of the Pensions Bill currently before Parliament. This Statement is to be agreed between the trustees and the employer, after taking advice from the Scheme Actuary. I believe that this will create an ideal opportunity for actuaries to explain clearly, and in some depth, to their clients the principles of both funding and solvency. It also gives us the opportunity, when reporting back to the trustees on the results of an actuarial valuation, to explain the dynamics of a pension fund. We need to put greater emphasis on the 'analysis of variance', i.e. how did the fund move from last time's result to this time's? We should couple this with greater use of stochastic modelling, which, until now, has been primarily used for asset allocation purposes, but has clear benefits when used in conjunction with a statement of funding principles. For many schemes, scenario testing would be useful, either in addition to, or instead of, stochastic modelling.

3.9 It has been suggested that actuaries were slow to recognise the sharp improvement in longevity. The picture here is clouded, and some research into actual timings would be helpful.

It is important to remember that mortality tables used by actuaries have included an allowance for improving mortality from one generation to the next. Until the 1990s, the rate of improvement amongst the retired population had remained fairly steady for many years. However, we now know that the generation born between 1925 and 1945 is exhibiting much

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greater rates of improvement than previous (or subsequent) generations. This is known as the 'cohort effect', about which Richard Willets first produced a paper in 1999 (Willets, 1999). This generation entered the pensioner (i.e. over age 65) mortality statistics gradually from 1990 onwards.

The Continuous Mortality Investigation analyses data from insurance companies about ages of policyholders at date of death. The analysis is carried out in four-year bands, and for 1991 to 1994 it followed the normal timescale adopted in the past for these investigations, which meant that information was first published in late 1998 and a new annuitant mortality table based on this experience was published in 1999. Recognising the significant new trends which had appeared for the first time, the data for the next four-year band, 1995 to 1998, were analysed much more rapidly, and an updated report appeared as early as September 2000. It is debatable, therefore, whether pensions actuaries would have become aware of the change in expectations of pensioner longevity before 1999. There is then a natural time lag, due to the three-year cycle of actuarial valuations. This means that some pension funds would inevitably not have been valued according to the new tables until 2002.

There remains the question as to whether the profession, generally, should have been aware of the potential of the 'cohort effect' impacting on pensioner longevity from an earlier date. I understand that the GAD, which studies population mortality, had identified it slightly earlier than 1999 amongst the pre-retirement age group. It is possible, too, that more interaction with epidemiologists and academics working in the field of demography might have alerted the profession earlier. Certainly, our long standing links with others working in related fields have improved, as evidenced by the most recent working party paper, 'Longevity in the 21st Century' (Willets *et al.*, 2004). We will continue to rely heavily on our statistical methods for projecting mortality improvements, but, in future, I would expect these to be increasingly supplemented by information from other sources.

One thing that the leadership of the profession can do is to ensure adequate general publicity of improvements in longevity, which will help individual actuaries when they have to deliver unwelcome news of increasing pension costs to their clients.

A recent development has been the collection by the CMI of pensioner data from large occupational pension schemes, to augment the existing annuitant data collected from insurance companies. Pensioner longevity is now firmly 'on the radar screen' of every pensions actuary, and there can be no excuse in future for not keeping up to date with the latest developments.

3.10 A further criticism which is made is that actuaries condoned 'contribution holidays' in the late 1980s and 1990s, when valuations showed significant surpluses. The suggestion is that actuaries should have insisted

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that employer contributions continued, despite the existence of a large surplus. As a sweeping generalisation, this criticism strikes me as being wrong. Looking back at one of my own valuation reports for a very large scheme in 1996, the liabilities were valued on what I considered to be a very prudent basis, yet, as a result of favourable investment experience, the surplus was twenty times the amount of the ordinary annual contributions. Given the circumstances of the time, it would have been quite unreasonable in that case to try to insist on further money being paid into the fund. Yet that same scheme, as a result of the combination of events since 1997, as described in Sections 3.3 and 3.4, is now facing a deficit, equal to about ten times the company's ordinary annual contribution. However, that deficit has virtually all arisen since spring 2002, at which time its valuation showed a broadly 'all square' result on both a funding basis and on a solvency basis.

Not all schemes which had contribution holidays had surpluses as large as in my example, so the grounds for taking a holiday may have been less clear cut in other cases. I also think that it would be fair to say that we actuaries were a bit slow in adjusting our thought processes from the world of surpluses to the world of deficits. With the benefit of hindsight, we should perhaps have been warning clients of the more extreme potential downside risks somewhat sooner than we did.

One factor which should not be forgotten is that in many schemes the contribution reductions, or 'holidays', were accompanied by significant improvements in benefits to members. For employers and trustees, these improvements conveniently did not appear to cost anything, because they were 'paid for out of surplus'. I know that many actuaries warned their clients that there were real costs associated with any benefit improvement.

Another common price paid in return for a contribution holiday was to convert previously discretionary pension increases into automatic increases. When coupled with the statutory inflation protection for early leavers' benefits, introduced in stages between 1985 and 1991, this had the effect of significantly raising the bar in terms of any solvency test, as was to become painfully apparent when interest rates, longevity and equity markets all moved against pension funds between 1997 and 2002.

At this point, I would make one other observation. Throughout the 1980s and 1990s, I and other pensions actuaries remember being relentlessly chided by our clients for being extremely cautious in our assumptions. So, it is somewhat ironic that we are now being criticised, with the benefit of hindsight, for not acting sufficiently prudently over exactly that same period.

3.11 Reference in the previous section to downside risks brings me to the question of investment policy. There has been some criticism of actuaries for not pointing out sufficiently the risks of equity investment for pension funds. This has been highlighted by the actions of the Boots pension fund, which adopted a wholly bond-based investment strategy. Such a strategy was in stark contrast to the conventional wisdom in the U.K., which, for several

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decades, had been that pension funds, as long-term investors, should hold a very large proportion of their assets in equities.

One example of this conventional wisdom occurred in the Myners report on institutional investment in the U.K. The report recommended the abolition of the MFR, because it was distorting investment strategy. A pension fund could match its MFR liabilities by investing, with a bit of over simplification, a proportion of its assets in bonds equal to the proportion of its liabilities which related to its retired members, with the balance of its assets invested in U.K. equities. Most funds were mis-matched, because they held a smaller proportion in bonds than the proportion of total liabilities which related to retired members. For instance, a typical mature pension scheme might have had 50% of its liabilities in relation to retired members, but have held around 75% of its assets in equities and only 25% in bonds. To move to a position which 'matched' its MFR liabilities would mean raising the bond proportion to 50%. The criticism of the MFR in the Myners report implied, therefore, that backing current pensioner liabilities with bonds was a 'distortion'. This seems to many actuaries to be an extraordinary conclusion, although it was a widely held view in the investment management community at the time.

There has been much debate in the actuarial profession about the proper measurement of pension liabilities and the optimal investment strategy to meet those liabilities. This debate was largely triggered by the seminal paper by Exley, Mehta & Smith in April 1997 (Exley *et al.*, 1997). It has, at times, been quite a heated debate, but I believe that most pensions actuaries are now agreed on a number of key points:

— Pension liabilities are bond like in nature.
— Investment strategy must start from a consideration of the scheme's liabilities, not simply focus on the risk/return characteristics of the different asset classes (as widely practised until the 1990s).
— It is unacceptable to take credit in advance for the expected outperformance of equities over bonds without acknowledging the additional risks involved.

In many respects, I think that the actuarial profession has moved further and faster than many non-actuaries in embracing these views. I find that, among trustees, employers, and investment managers, there is still a widely held belief that over the long term it is 'certain' that equities will outperform bonds, and therefore the contributions required to provide pensions will 'definitely' be lower if the funds are invested in equities.

We have been explaining the risk and reward trade offs from different investment strategies, through the asset/liability studies we carry out for clients, for nearly two decades, but we still have much work to do. In particular, the risks of equity investment are not just short-term volatility, but include long-term downturns, such as that experienced in Japan over

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the last 20 years. These explanations will fall naturally within the discussions between actuaries and trustees (and employers) about the Statement of Funding Principles, referred to in Section 3.8. That will also be the place to pick up the difficult issues relating to the strength of the employer's covenant, which are relevant to considerations of investment strategy.

As an aside, it is disappointing that the Government did not take up our suggestion that the new Statement of Funding Principles should be combined with the existing Statement of Investment Principles, as funding and investment principles are, in my view, inextricably linked. I would like to see the Actuarial Profession recommending a combined statement as 'best practice', ideally in conjunction with other pensions organisations.

3.12 What lessons can we learn from the 'pensions crisis'?

— Individual actuaries need to think through and explain clearly the implications of different courses of action open to their clients. For instance, concentrating on long-term funding has implications for short-term solvency.
— We need to provide clarity on the limitations of our work. For instance, we make an allowance for improving pensioner longevity, but we must make it clear that the allowance may prove to be inadequate, or over cautious.
— We must be aware of economic or demographic changes when they manifest themselves.
— The leadership of the profession should ensure that there is adequate publicity for newly observed trends, so that the clients of individual actuaries are prepared, particularly for 'bad news'.
— The profession must speak out if we have concerns, particularly if, as is likely, these concerns affect the consumer. A recent example where we have spoken out is in relation to the Pension Protection Fund, where we wrote an open letter to the Secretary of State requesting clarity in the Government's objectives and consistency between those objectives and public statements on the degree of protection to be provided. Much of our work with Government will continue to be done behind the scenes, as in the past, but we should not be afraid, where the occasion demands it, to speak up publicly for what we believe to be right.
— On an individual basis, we must be prepared to 'think outside the box'. Lindsay Tomlinson, in an article in *Pensions Week* in November 2003, provided just such an example in relation to inflation. He wrote:

> "When you are living in a particular economic environment, it is almost impossible to envisage that environment changing dramatically. We have become used to living with inflation in low, single figures ... and any suggestions of runaway inflation are risible.
> A generation ago, we were equally convinced that inflation was here to stay. Anyone who asserted that gilt yields would fall below 5% p.a. would have been thought to be certifiable."

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He ended his short, thought provoking article with the words: "Think about your risks and expect the unexpected.'' For any U.K. actuary who qualified since 1991, and for every student actuary in the U.K., (two groups which together make up a large proportion of the profession), price inflation above 5% p.a. would be a new experience. Yet, the economic conditions in the United States of America today currently harbour many features that could lead to rapidly increasing inflation, which could then be exported worldwide. Are we prepared, as actuaries?

— Going forward, we will have to face the challenge of financially managing the large number of closed pension schemes, as they become more and more mature and increasingly disconnected from the original sponsor, as a result of corporate reorganisations. The life insurance industry faces a similar challenge, with increasing numbers of closed with-profits funds. There will, I am sure, be scope for cross fertilisation of ideas between pensions and insurance actuaries.

— Finally, one important lesson is that our role as advisers to trustees, particularly in relation to the Statement of Funding Principles, brings with it greater responsibility than ever. We will need to distil the range of available choices to a manageable number, and, in doing so, we will inevitably be making important decisions on behalf of the trustees. We will then need to explain those choices and their implications in a clear and understandable way, so that the trustees can arrive at an informed decision. The manner in which we give the explanation and the extent to which we 'steer' the trustees will have an important bearing on the outcome. Much will rest upon our shoulders, and we need to be equal to the task.

4. The Penrose Report

4.1 I now turn to the subject of life assurance, where it is clear to me that actuaries working in this industry are going through a period of profound change.

The long established Appointed Actuary system, which has been copied in other countries, is being replaced with two distinct actuarial roles: Actuarial Function Holder and With-Profits Actuary. In addition, there will be a new role of Reviewing Actuary, who will advise the auditor. At the same time, some of the responsibilities of the Appointed Actuary are reverting to the board and senior management, with the Actuarial Function Holder and the With-Profits Actuary providing advice to the board and management.

The reporting requirements for with-profits funds are being substantially revised, introducing the 'twin peaks' approach, of a regulatory peak and a realistic peak. Boards of with-profits life offices have, since April, been required to draw up and publish Principles and Practices of Financial Management (PPFM) in relation to their with-profits funds. The principles

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are high level, and expected to change rarely, while the practices are much more detailed. Further regulations on treating with-profits policyholders fairly are under consultation. These are designed to make the operation of with-profits funds more transparent.

At the same time, the International Accounting Standards Board (IASB) is developing 'fair value' accounting standards for insurance companies. Owing to the difficulties of obtaining international agreement, interim compromise proposals are being adopted.

The Life Board has been extremely busy responding to FSA consultation papers and drawing up actuarial standards for the new actuarial roles, together with technical guidance in relation to the new reserving and capital requirements, which all need to be in place by 31 December 2004. The Accounting Liaison Group has been active in commenting on IASB proposals. In addition, three excellent briefing papers have been produced by the Life Board, for the benefit of interested non-actuarial readers in the media and elsewhere:
— 'Basics of With-Profits Endowments';
— 'Falling With-Profits Payments'; and
— 'Annuities'.

The life insurance industry is also affected by:
— a charging cap on stakeholder products, which has a knock on impact on other savings products;
— changing regulations on distribution channels;
— continued uncertainty over the basis for illustrations;
— ongoing consolidation within the industry;
— increasing numbers of closed with-profits funds;
— loss of confidence in with-profits as a savings vehicle, referred to in Section 1; and
— the impact of low interest rates, increasing longevity and three years of falling equity markets (as discussed in Section 3 in relation to pension schemes) on reserves, capital requirements and investment strategy.

I do not propose to elaborate here on the tough challenges facing actuaries working in the life insurance field. Suffice it to say that just listing all the changes does scant justice to the complexities involved. The profession will continue to look to the Life Board for strong leadership in guiding actuaries through these turbulent seas to what, we must hope, will be calmer waters ahead.

Many of the comments in Sections 2 and 3 are relevant, in different forms, to actuaries working in life insurance, none more so than the final paragraph in Section 3.12. There will be significant responsibilities resting on actuaries when advising the directors and management of insurance companies.

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4.2 The long awaited report by Lord Penrose into the affairs of Equitable Life was published by HM Treasury in March this year. As mentioned, it is over 800 pages long, and the conclusions, in Chapters 19 and 20, are well worth reading. As a pensions actuary, I approached the report with some scepticism, being rather unsympathetic to Lord Penrose's conclusions, as reported in the press. However, I found his remorseless logic and detailed legal arguments very convincing, and, by the end of the report, my scepticism had largely gone. It would be inappropriate to discuss here the conduct of any individuals, but there are lessons that the profession can learn from Lord Penrose's report. This was the subject of a well attended and interesting sessional meeting in May this year. The Life Board, the Professional Affairs Board and the Pensions Board have been through the report, considering the question of what lessons can be learned. In the following sections, I have picked out a few of the larger themes which seemed to me to be the most important. That is not intended to suggest that we should ignore the many other aspects not mentioned here.

4.3 Lord Penrose has commented that our standards leave too much open to the exercise of judgement by individual actuaries. (Evidence to Treasury Select Committee, 16 March 2004: "The [actuarial] guidance was far too general and left far too much to individual judgement.")

We clearly need to respond to this call for more prescriptive standards. However, there is a delicate balance to be struck between sufficient tightness in the standards, to narrow the scope for variation between different actuaries, and over prescriptive rules, which turn the actuary into a mere 'box ticking' technician, to the exclusion of any professional judgement. It is also important that, in setting more prescriptive standards, we do not stifle innovation and that we leave some room for flexibility, since the circumstances in which the standards may have to be applied in the future could be very different from today's. The solution to this dilemma may lie in developing a clear distinction between 'principles' and 'rules' when setting standards in future. 'Principles' would allow the exercise of judgement in their application to specific circumstances, while 'rules' would need to be closely followed.

As mentioned, a task force headed by Tom Ross is actively developing proposals for an independent Actuarial Standards Board. When these proposals have been refined, the Faculty and Institute Councils will need to consult their memberships. This is an area where we can also expect that the Morris review will be making recommendations.

One particular aspect of standard setting, which I see as very important, is the relationship between the profession, an independent standards board and the regulators. The FSA regulates insurance companies (and the DWP and the pensions regulator regulate pension schemes), including prescribed roles for actuaries, while our actuarial guidance sets mandatory standards for the actuaries carrying out those roles according to the regulations. It is

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therefore essential that our standards dovetail with the regulations. In order to achieve this, it is essential that we form a close and harmonious working relationship with the regulators.

It has been acknowledged by the FSA that the Profession has, in the past, and quite properly, produced guidance for the Appointed Actuary, in order to fill gaps in regulation that impacts directly on the company. It is expected that the FSA will fully take over the regulation of companies, and the Profession will regulate the activities of actuaries. However, until then, we will liaise with the FSA on remaining gaps, and will not feel inhibited from filling them ourselves if we feel that it is in the interests of the security of policyholders' benefits.

4.4 Lord Penrose commented on the combined role at Equitable Life of the Appointed Actuary and Chief Executive. (Chapter 20, paragraph 58: "... it is clear that on no account should it be permitted that the appointed actuary should also be the chief executive.") This is not a situation which could happen today, but it does highlight potential conflicts for an actuary carrying out a statutory role in relation to an insurance company of which he or she is an employee. The issue of conflicts of interest has also been relevant for pensions actuaries, who may advise both the trustees and the sponsoring employer. The legal issues are complex, and have been recently studied in depth with our legal advisers. Their advice has been published in order to assist actuaries in this difficult area. Suffice it to say here that any actuary in today's world must understand the importance of recognising potential (as well as actual) conflicts of interest and of managing those situations with great care. The legal position continues to develop, as further cases in relation to other professions are heard by the courts.

4.5 Lord Penrose recommended that the profession should be proactive in disciplinary matters. (Chapter 20, paragraph 60: "It is not enough for the actuarial profession to await complaints. The people best placed to identify the need for disciplinary intervention are co-professionals.")

He drew attention to the particular needs in relation to long-term financial transactions. Unlike other professionals, who have direct and individual contact with their client (e.g. doctor and patient), the advice of actuaries does affect large numbers of people who have no direct contact with the actuary, and little or no understanding of the implications of decisions being taken. This analysis emphasises the responsibility placed on actuaries. It led Lord Penrose to conclude that the Profession should be more proactive in disciplinary matters. This is something which ties in closely with some of the areas in the Morris Review Consultation Document, and we are considering this very carefully.

4.6 Lord Penrose made a strong suggestion that the Actuarial Profession should intervene whenever it considered that the interests of policyholders could be adversely affected. Although this quotation appeared in the context of disciplinary intervention, it might well be interpreted as referring to direct

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intervention with individual insurance companies. (Chapter 20, paragraph 60: "It would improve the public image of the profession if it were seen to accept responsibility for direct intervention where it was thought that the administration of life funds was likely to threaten the legitimate interests of policyholders.") While pleased by the confidence expressed by Lord Penrose in our abilities, we have some concerns about such an interventionist role. It seems to me that such intervention should be carried out by the regulator, who has the necessary powers, which we clearly do not have, nor do we seek. However, there is an important role that the profession could play, in alerting the regulator to any concerns which we have, whether about a particular office, a particular product marketed by a number of offices, or on a more generic issue. This role, which I believe that we should be willing to accept, points again to the need for a close working relationship with the regulator, something already mentioned in a different context in Section 4.3.

4.7 Lord Penrose commented memorably on the respective roles of actuaries and auditors in the auditing of the financial statements of an insurance company. (Chapter 20, paragraph 49: "Allowing ... the auditor to express a view about the assets ... while allowing ... the actuary independently to certify the liabilities is like commissioning the two legs of a pair of trousers from different tailors.") He proposed a joint opinion by the auditor and actuary, with the actuary taking responsibility for the long-term liabilities on the balance sheet. He went on to say that his proposals could be held in reserve, as new FSA requirements were being implemented. These requirements are that there will be a single opinion by the auditor, who will be required to appoint an independent actuary to give a view on the reasonableness of the actuarial valuation of insurance company's liabilities, including the methods and assumptions used.

These difficulties over the respective roles of auditors and actuaries apply to all long-term financial institutions, where the auditor has to rely on an actuary in relation to the value placed on the future liabilities. In insurance, both life and general, there is a difference between the scope of a regular audit, based on 'best estimates' of future events, and prudent reserving for a demonstration of solvency, which would include contingency margins to cover more extreme events — unfamiliar territory for auditors.

It seems to me that there is scope for some constructive dialogue between the accounting and actuarial professions. Indeed, the FSA has indicated that it is considering whether to pursue Lord Penrose's proposal for a joint opinion.

We are disappointed that, in the meantime, the FSA has bowed to pressure from the Auditing Standards Board, and weakened the protection for policyholder benefits by denying them a public certificate from an actuary that the liabilities make proper provision for policyholders' benefits.

4.8 Lord Penrose reached two firm conclusions in relation to policyholders' expectations: firstly, that such expectations were created, not

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just by the terms of the policy, but also by the content, tone and frequency of subsequent communications; and secondly, that those expectations, once created, needed to be provided for. It was not sufficient to reserve only for guaranteed benefits. There are, of course, dangers in providing for expectations that are not guarantees. The FSA and the industry must encourage full disclosure of what amounts of liability are in respect of guaranteed benefits and what are best estimates, in current conditions, of discretionary expectations.

The lessons that we need to learn from this are that we must be careful, if we are advising companies which are communicating with policyholders (or members of a pension scheme), only to create expectations that can be reasonably delivered. We must be alert to changes in expectations over time, and, if it becomes necessary to lower expectations, this must be very clearly communicated. There is also a need to be aware of how gradual changes in society's attitudes may have an impact on what constitutes 'reasonable expectations'. Incidentally, it is worth noting at this point that, despite the criticism of the U.K. life insurance industry, there have been no instances where guaranteed benefits have failed to be paid during the recent adverse financial conditions, and only two minor instances in living memory. All the recent difficulties relate to failures to meet customers' expectations.

4.9 I have mentioned, in Section 2, the importance of explaining future uncertainty to consumers. Nowhere is this more critical than in the illustrations given for savings products sold by insurance companies. The Actuarial Profession has a task force, set up under the auspices of our Finance and Investment Board, which is considering the whole area of projections and illustrations. It is also relevant to occupational DC pension schemes, as mentioned in Section 2.9. Thus, it is a subject that covers virtually all branches of actuarial work. It seems to me that the key to the solution must lie in holding regular reviews of progress of the customer's savings vehicles and providing updated illustrations and projections. Just giving customers the information at the point of sale, and then ignoring them for ever after, is clearly unsatisfactory.

5. Corporate Plan

5.1 For the first time, the Profession has produced a corporate plan, setting out:
— six key purposes of the profession;
— five strategic priorities;
— a set of ongoing activities or strategic aims in the medium term (say five years); and
— a long list of specific activities for the financial year March 2004 to February 2005.

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Previously, the profession's workload had been created from the 'bottom up', with each Board planning its own set of activities, many of which were reactive rather than proactive. This year, there has been a more 'top down' approach, which has resulted in better planning in the use of scarce resources and more coordination between the work of different Boards. Inevitably, since this was the first year, there was a continuing element of the 'bottom up' approach in the list of activities for 2004/05, but I am confident that the process will improve rapidly now that it is established. The corporate plan was drawn up shortly before the Morris review was announced, which underlines the need to be adaptable and flexible in response to changing circumstances. The list of activities illustrates the enormous breadth and scope of work carried out by the profession. I doubt if many of us, even those who are members of Councils, fully appreciated the sheer range of issues being tackled. In the following sections I highlight a small number of these strategic aims and activities. Once again, this is not intended to lessen the importance of all the other activities too numerous to mention individually.

5.2 On the regulation front, I have already mentioned (Section 4.1) the extensive new guidance being prepared by the Life Board, which is clearly of major importance. Likewise, the Pensions Board will be producing guidance to cover the role of Scheme Actuaries in relation to the new scheme specific funding regulatory regime, including the drawing up of Statements of Funding Principles.

The General Insurance Board is consulting members on statutory actuarial involvement in life reserving, and has produced a discussion paper setting out a range of options. Following the consultation, the Board will be responding formally to the FSA request for feedback on this issue.

These important tasks are in addition to the very important ongoing work on peer review, the extension of practising certificates, and the major development of an independent Actuarial Standards Board.

5.3 The Education and CPD Board has developed a modernised examination structure, designed to be internationally compatible, which will come into operation during 2005. A key task in 2004/05 is, therefore, to bring all the hard work of the past few years to a successful completion, by delivering the first set of courses and exams under the new structure. It is vital that this proceeds smoothly, as any shortcomings in this area could potentially harm the profession's reputation.

5.4 The profession has always had a certain amount of research activity. I suspect that, in the past, it has largely been carried out in response to particular areas of interest of individuals, i.e. a 'bottom up' approach. Research is one key aspect of the profession which should benefit from a more proactive 'top down' approach to planning the use of resources. We need to continue to foster links with academics, both actuaries and those working in related fields.

One area of research which I have found particularly interesting is

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behavioural finance. Academic research is beginning to provide insights of genuine practical application, which can contribute positively to solving the problems of narrowing the savings 'gap'. Actuaries have much to learn from this work, and, I believe, could contribute much in return.

5.5 Our profession has always been few in numbers. In recent years much thought and energy has been given to trying to find ways to expand the areas of work of actuaries, with a view to increasing the size of the profession. This is taking on a greater sense of urgency, as the employment prospects, in the fields of final salary pension schemes and with-profits life assurance, seem likely to decline.

Our experience to date, through the Wider Fields Board, and subsequently through the separate Finance and Investment and Social Policy Boards, suggests that there are severe limitations to the ability of the leadership of the profession to generate an increased demand for actuaries. What we can do is facilitate events, such as networking evenings or jointly sponsored seminars, for individual actuaries who are interested in moving to a different role. We can also lend our support to groups of actuaries who want to carry out research in a related field. In 2005, we will be offering two new subjects at the specialist level in our examinations, in Finance and in Health and Care.

The pensions consulting firms appear to be responding to the threatened reduction in final salary work by expanding into the 'softer' human resource consulting fields, where actuarial skills are less essential. A more fruitful area for development, which might in due course be populated by actuaries with a grounding in insurance, is in the field of risk management. Developments in corporate governance have placed issues of identification of business risks, both financial and operational, and their management through mitigation, much higher up the agenda of boards of directors. In some respects actuaries have a head start, because of our experience with insurance companies and pension schemes. It has been observed that the very existence of these financial institutions depends on accepting financial risks, which then have to be carefully managed, whereas most other organisations are intent on avoiding risks.

The Society of Actuaries in the U.S.A. and the Canadian Institute of Actuaries are both actively trying to promote the expertise of actuaries in the field of enterprise risk management. They argue that actuaries have much to offer, since others who are actively involved in this field "deal with the objective, known qualities and verification, but are less effective when addressing correlations, aggregation and disaggregation of risks, long-term uncertainties and the concept of risk as opportunity for strategic decision making and leadership at the enterprise level." They have also observed that the demand for risk management analysts, up to Chief Risk Officer, is primarily coming from multinational companies, so that international cooperation amongst the actuarial professions in these promotional activities

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would be highly desirable. One feature in North America is the upsurge in undergraduate courses in risk management, coupled with multi-million dollar government funding for university departments specialising in this new 'hot area' for applied research, so that new entrants to the job market tend to have a good grounding in quantitative financial analysis. At this point in time, it seems unclear whether the growth of employment opportunities in enterprise risk management represents a threat or an opportunity to the actuarial profession in North America. We are keeping in close contact with these international developments, while formulating our own views as to the best way to proceed here in the U.K.

5.6 There is much work carried out within the profession in support of our public interest role, in terms of contributing to the national debate on a wide range of issues. I have already referred to the series of joint seminars with the International Longevity Centre, to the paper on Family Policy by Deborah Cooper (Cooper, 2002) and to the pamphlet 'More Babies: who needs them?', all sponsored by the Social Policy Board. The Board continues to be active in a number of other areas which are relevant to the savings issues discussed in Section 2.

Another area sponsored by the Social Policy Board is the contribution by the profession to the debate on the use of genetic information in life assurance underwriting. This raises complex moral, ethical, medical and social issues, as well as going to the heart of the rationale for pooled insurance (as opposed to 'social insurance'); namely, the ability to set the price for insurance cover according to the degree of risk brought to the pool. It is good that a number of actuaries are playing a leading role in this debate, which will undoubtedly have a higher profile as the end of the current moratorium on the use of genetic testing results comes to an end. I foresee a major need for clear and consistent education for politicians, the media and other opinion formers, to explain the essential nature of insurance, so that debate over genetic testing is not bedevilled by widely held misconceptions.

There was a good example of this problem on the BBC Radio 4 'Today' programme earlier this year. A spokesman from Norwich Union was being interviewed by John Humphrys about a new method of setting premiums for house insurance. Premiums were normally set according to the postcode, with higher premiums where there was a risk of flooding. This meant homes which were not subject to risk of flooding, but happened to share a postcode with some that were, paid an equally high premium. Norwich Union had devised a more sophisticated approach that enabled them to set the premiums more accurately. John Humphrys showed little interest in this underwriting breakthrough. Instead, he persisted in asking questions about the 'very high' cost of insurance for those homeowners whose houses were prone to flooding. Eventually, not satisfied with the patient explanations he received, he ended with the indignant statement: "But I thought the whole purpose of insurance was to spread the risks." It would make an excellent

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exam question to require students to write a letter to John Humphrys in response to that statement. I defy any actuary to produce a single sentence 'soundbite' that would do the trick on the 'Today' programme!

This little anecdote does clearly illustrate how far we still have to go to explain concepts that are familiar to us, but a complete mystery to intelligent laymen.

On a completely different subject, another current project of great interest, under the auspices of the Finance and Investment Board, is the investigation into the future demand for bonds and gilts from insurance companies and pension schemes, and the implications for the supply side and for other assets classes. This is an excellent example of the profession looking to the future, anticipating a problem, and focussing on the implications of different approaches to dealing with the problem.

6. The Way Forward

6.1 In this Address, I have looked at the serious national problem of inadequate savings for retirement. I have made practical suggestions for the contributions that actuaries can make, both individually and collectively, towards restoring confidence in long-term savings. I have also examined the lessons to be learned from the pensions 'crisis' and the Penrose Report.

I have tried to paint an honest and balanced picture. There are some aspects of our past behaviour which, with the benefit of hindsight, I believe could have been improved on. At the same time, there are other aspects of which we can be proud.

6.2 Going forward, I would highlight the potential for each individual actuary to make a contribution towards enhancing the profession's image and reputation. I believe that our greatest chance of success will be if we are all pulling together in the same direction. In particular, individual actuaries can contribute in several ways in their day to day work:

— ensuring customer focus, as advocated by Jeremy Goford in his Presidency;
— improving communication skills, as advocated by Peter Clark in his Presidency, and here I would emphasise simplicity, openness and the need to find better ways of explaining uncertainty; and
— espousing simplicity in design — it is better to be roughly right than precisely wrong.

6.3 The responsibilities resting on the leadership of the profession are particularly heavy at the present time. Our key task is to respond, on behalf of the profession, to the ongoing Morris review and its eventual outcome next year. As I have mentioned, we will approach this with an open mind to

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all constructive proposals, yet confident in the initiatives which we had already taken to bring changes to the profession's governance.

At the same time, we need to deliver the key priorities in our corporate plan. In addition to those two major tasks, I would pick out from the many suggested actions in this Address:

— developing closer relationships with the regulators;
— speaking out publicly when we have serious concerns which are not being addressed; and
— providing a supportive framework for our membership in these difficult times, e.g. by being the first to publicise any future 'bad news' about increasing longevity (or should that be 'good news'?), and by preparing further background papers for journalists and others on topics of current interest.

6.4 The projects described in Section 5 are merely representative examples of the huge amount of activity within the profession. We are a small profession in terms of numbers, but I believe that we punch well above our weight in our own fields. We give valuable help to the Government and regulators behind the scenes, we engage in national debates on issues where our expertise can be useful in providing insights, while managing the educational, research and regulatory aspects of our profession. All these achievements are the result of an enormous amount of hard work by a large number of volunteers. I am continually impressed by the willingness of actuaries to put themselves forward (not forgetting the support of their employers), and the enthusiasm which they show in contributing to the work of the profession. I hope, during my term of office, to be able to thank personally as many of you as I can. Today I would like to thank you all collectively, coupled with a heartfelt plea addressed to all actuaries: "Please keep up the good work. Your profession needs your continued support more than ever over the next two years."

6.5 Finally, and to end on an optimistic note, I believe that the actuarial profession contains many highly intelligent individuals, who are hard working, enthusiastic, thoroughly professional, and who make a positive contribution to society. With these qualities, and despite the current uncertainties which we face, I am convinced that our profession has a great future. We must all work together, with renewed effort, to ensure that we achieve that great future.

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APPENDIX

TERMS OF REFERENCE OF THE MORRIS REVIEW

"Consider what professional and/or other regulatory framework would best promote recognised, high-quality and continuously developing actuarial standards, openness in the application of actuarial skills, transparency in the professional conduct of actuaries, accountability for their actions and an open and competitive market for actuarial advice in the U.K.

In doing so:

— Take into account developments in the actuarial profession, in regulation, and in the financial services market, in the U.K. and abroad.
— Examine the role of actuaries in the financial services sector, including in providing actuarial opinions in relation to audited accounts.
— Build on the work of recent government and regulatory initiatives.
— Examine the relationship between the Government Actuary's Department and the actuarial profession and with other parts of government.

Recommend a framework that will be independent in representing the public and consumer interest, and be accountable, flexible, transparent, and no more burdensome or restrictive than is clearly justified.

Make recommendations on the future role of the Government Actuary, the functions of his Department and its future institutional status."

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