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RISK—A SURVIVAL COURSE FOR THE PENSIONS ACTUARY

PENSIONS CONVENTION, YORK, 16-18 MARCH 1998

When Ms Jenny Segal's committee began planning the 1998 pensions convention the Pensions Act was at the front of the minds of pensions actuaries, but there was a strong sense that other conference organisers had done the immediate issues arising to death. Consideration was therefore given to a Pensions Act-free zone, and although, in the end, this proved impractical, a strong focus on wider issues was maintained. One hundred and forty actuaries took up the challenge of the two-day survival course.

In his keynote address, Mr Duncan Ferguson, Institute President, appealed to actuaries to be bold in their advice, and not to avoid hard issues for fear of the consequences of error. This was clearly a requirement key if actuaries are to be highly valued (and hence rewarded) for dealing with important issues and not merely number crunching. This theme was to be repeated throughout, in many different guises.

THE PROGRAMME

In taking the wider view, a programme was built around the theme of the different risks faced by the various stakeholders in the pensions arena, and how actuaries could help:
— professional risk;
— consumer's risk;
— sponsor's risk;
— funding risk;
— society's risk; and
— personal risk.

Under most of these headings, a plenary session was followed by related workshops. A programme block was, however, retained for re-runs of earlier sessions which had proved popular.

PROFESSIONAL RISK

Mr Alan Fishman addressed a plenary session on the role of the model professional. He reflected that the public expected 'professional' service from all service providers, but that the concept of professionalism amongst actuaries still meant something deeper, and should be protected. The Institute and the Faculty could not go too far in examining and re-examining our stance on professional matters in the areas not obvious to our public, but still fundamental, such as education and debate on the public interest.

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Breakouts then considered the professional processes:

— CPD in the future;
— are there too many guidance notes;
— the pensions actuary abroad;
— avoiding future scandals;
— professional liability; and
— lessons from other professions.

CONSUMERS' RISK

The plenary session for this section was a review of the mis-selling scandal and the prospects for a repeat. Mr Bob Ferguson of the Financial Service Authority (FSA) told a salutary tale of "how much easier it is to make a mess than to clear up afterwards", and the central role of the values and practices prevalent a decade ago in the life industry, which could not be changed overnight simply through introducing a rule book.

Looking ahead, he set out the FSA's intentions to avoid regulatory fragmentation, implement risk-based supervision, and emphasise senior management responsibility. This would have to be against a background of better public education and product communication.

Breakouts then considered:

— the personal pension review in detail;
— future regulations;
— 'whistleblowing' experience under the Pensions Act 1995;
— simplifying Inland Revenue limits; and
— winding up defined benefit schemes.

SPONSOR'S RISK

After lunch Mr Mark Sullivan opened up sponsor's risk, with a review of the experience on benefit design in the United States of America and the uncanny way in which U.S. ideas, like salary caps and (conflicting) minimum and maximum funding levels, cross the Atlantic. Perhaps more fundamental was the emphasis on healthcare issues rather than simple retirement income, which had come to dominate the U.S. debate. Breakouts then considered:

— risk control in schemes;
— the dangers of miscommunication;
— moving from defined benefit to defined contribution;
— coping with ageing populations; and
— flexible benefits.

The section concluded with a debate on active against passive management, with Mr Peter Stanyer speaking in favour of active and Ms Nancy Dickey

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against. There was spirited debate about the prospects of a market dominated by index-tracking funds and the increased opportunities for active managers (and corporate governance risks) which might then be created. Ms Dickey contended that there was an intermediate role for active managers using quantitative techniques to provide a defined level of additional risk taking at known cost for clients, where this was appropriate.

A more specific issue concerned the role of Minimum Funding Requirement (MFR) risk management in the context of liabilities valued by reference to equity returns. A careful distinction needed to be drawn between removing manager risk associated with the MFR, which a passive stance could do, arguably subject to a performance penalty, and hedging MFR risk entirely, which no equity portfolio could do. Mr Stanyer's statistics indicated that the latter risk was much larger, and should be emphasised accordingly.

Funding Risk

For many pensions actuaries funding issues represented the crunch day-to-day issue, given the uncertainty over the funding of defined benefit schemes occasioned by the 1997 Budget and changes to corporate dividend distribution policies. Mr Andrew Smith and Mr Paul Thornton reviewed the question as to whether there was a market value for pension liabilities, and, perhaps more crucially, the outcomes which arose from concluding that the answer was yes. There was agreement on the platform that the use of so-called 'market value' bases had a key role for corporate reporting, disclosure and solvency purposes. Debate remained over the use of an equity risk premium allowance.

It was also apparent that the MFR basis, and particularly its link to equity dividends, was no longer tenable. It became abundantly clear that, whilst detailed MFR calculations were still only in the experience of a minority of delegates, the convergence of declining dividend growth and poor 1997 overseas investment performance had made MFR an issue for many more schemes than expected, and that, whilst a review was under way, some tricky issues would arise for clients subject to MFR valuation in the meantime.

Breakout sessions considered:

— optimal funding theory;
— valuation methods in the MFR era;
— practical uses of derivatives;
— targeted money purchase schemes;
— overseas techniques; and
— investment asset models.

Society's Risk

Mr Stuart Ritchie addressed a plenary session on the future of state pensions, somewhat constrained by being a contributor to the still confidential Government

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review. The overall feel of the debate was the slightly unsatisfactory one that, whilst most actuaries had no short-term stake in the state welfare system, either as advisers or material beneficiaries, if the profession could not help guide the development of the system, who would? Breakout sessions then considered:

— the impact of European Monetary Union;
— impending tax changes;
— healthcare/long-term care;
— contracting out of state benefits;
— details of changes to future state pensions; and
— state provision overseas.

PERSONAL RISK

The finale was to address personal risk for delegates — a debate on the future of the pensions actuary. By way of a shake to complacency, solicitor Mr John Quarrell offered his own view of the mistakes made by the legal profession, and the risks to the actuarial profession in following suit, but, in fact, the message was similar to that with which the Institute President started — our professional status depends on maintained credibility on big issues, not a narrow focus finding a few safe areas in which to practice.

CONCLUSION

The upshot of two days' debate was probably greater concern over the risks faced by pensions actuaries, but at least a shared solidarity — if we cannot remove all the risks, at least we can talk about them and stake our claim in discussions with other affected parties.

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