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FAO Natasha Regan
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Dear Sir/Madam

Joint Forum on Actuarial Regulation discussion paper: *A risk perspective*

Thank you for the opportunity to respond to this discussion paper. This response has been prepared on behalf of the Benefits Practice of Towers Watson, a global firm with a substantial presence in the UK pensions consultancy market; the firm provides advice to around one-half of the top 100 pension funds in the UK.

We welcome the initiative of this group of bodies to look together at the landscape in which 'actuarial work' is or may be carried out, and to seek to identify areas in which that work might be managed in order to benefit the public interest. We consider it of fundamental importance, however, that the practical outcome of this initiative is not (just) further regulation of members of the actuarial profession, but includes actions which help ensure that actuarial work is commissioned (rather than dispensed with) when it is appropriate and that such work is carried out either by members of the profession or by others who are subject to the same standards.

Using the paragraph numbering of the paper, we have the following more specific comments:

1.4 Traditionally, actuarial work has been thought of quite narrowly, usually restricted to work that is dependent on mortality or other life contingencies. However, it is increasingly being recognised that the "principles and/or techniques of actuarial science" can be used in a much wider range of work that involves considerations of uncertainty and risk, such that the distinction between work carried out by members of the actuarial profession and other finance-based professionals is increasingly blurred.

There is a nucleus of actuarial work which is either formally reserved to the Profession or is still in practice its primary preserve, but beyond this there is a wide area of work that can be considered 'actuarial' but for which the premise "in the main, actuarial work is performed by members of the actuarial profession and by entities which are advised or controlled by them" does not apply. Bearing in mind that the work within the 'nucleus' has been the main focus of the FRC since it took on responsibilities in relation to actuarial oversight, it is important that the current initiative has particular regard to the potential implications of any new regulation for work outside that nucleus. A clear danger of introducing new requirements in relation to such work on members of the actuarial profession, where these requirements would not apply to anyone else doing the work, is that such work may them tend to be commissioned from those who are not subject to the same professional standards, with a consequent risk to the quality and reliability of that work. This is an illustration of the general point that 'over-regulation' is potentially as much of a risk to the public interest as is perceived 'inadequate regulation'.

1.5 The duties of actuaries (and other professionals) to act in the best interests of their clients are well established, with the attendant need to avoid situations in which there is an irreconcilable conflict of interest with another client or other party. To the extent that the professional also has a 'public interest' duty, the potential tension between this and the fundamental duty to the client needs to be acknowledged. To what extent is a marketing professional commissioned to make a tobacco product relatively attractive to buy supposed to have regard to the view that the public interest is best served by encouraging everyone to desist from buying any such products at all? Is a tax accountant obliged to seek the most efficient way to arrange a multinational company's affairs so as to minimise its tax liability, or does he have a public interest duty to dissuade the client from such an approach? And is it the 'right' thing for an actuary to identify idiosyncrasies in the PPF levy Determination which would enable his client to pay a significantly reduced levy (ultimately – in a zero-sum game – to the detriment of all other schemes and their sponsors)? If it is the case that these tricky questions will in practice be decided by the court of public opinion (often sitting with hindsight), then this should be explicitly acknowledged.

There is also a specific reference in 1.5 to a public interest risk being associated with something that would impact on "a substantial group of individuals". Applied to the medical profession, for example, this could leave sufferers from a rare genetic disease significantly less protected than those with more common illnesses (with a similar type of outcome being possible in relation to actuarial work where this involves a 'costing' of the risks associated with various diseases). There is something that seems incongruous about this apparent discrimination against 'small minorities'.

1.6.2 This paragraph states that the JFAR has "approached [its] analysis from [its] regulatory perspective". It's not obvious what the practical effect of this is, but a potential outcome is that there will be a tendency to look to regulation within the limited remit of the bodies concerned, with the consequent danger mentioned under 1.4 above, rather than to come to more holistic conclusions.

3.4.2 Analysis of and any reaction to the risks associated with 'group think' need to be appropriately balanced with the benefits of dedicated, centralised research and of collaboration between actuaries in identifying optimal solutions to problems. 'Group think' in itself is not necessarily bad; it depends how it is developed, applied and reviewed.

3.4.3 There is a fundamental dilemma when it comes to explaining issues like 'risk and return' to consumers – it is not in general possible to produce communications which satisfy a range of readers both in this respect and with regard to their length (and therefore how likely they are actually to be read and understood). While everyone – including actuaries – still needs to do their best to address this dilemma, the tension needs to be recognised and some compromise often has to be accepted. The 'SMPIs' produced under the Disclosure Regulations are an example of this; in the interests of making things as simple as possible for the member, the legislation (for better or worse) provides for a single figure, rather than for the range that would help to illustrate volatility and risk.

3.5.4 Focusing heavily on (and regulating in relation to) the risks of certain actions, such as entering into Asset-Backed Contribution arrangements or other liability management exercises, can act as more of a deterrent than it should do and trigger the counter-risk that actions which would have been desirable and beneficial are not taken forward, resulting in sub-optimal outcomes. Over-regulation of defined benefit pensions has contributed substantially to their demise; while each bit of regulation may well have protected someone, the overall effect has been to catalyse the replacement of such pensions with other arrangements which might overall be considered inferior – a development which could be argued to be contrary to the public interest.

3.6 Among other things, this section correctly identifies that the world is an ever-changing place, and actuaries (like others) need to be able to develop and evolve their work and approach accordingly, and to balance the use of evidence as to what has happened in the past with an appreciation that the past is not necessarily a good indication of what might occur in the future. There are risks associated with responding too slowly (3.6.1) and risks associated with responding too fast (3.6.2). A danger for regulators is that, either generically or in relation to a specific area, a particular adverse effect or other perceived problem leads to actions which might address one of these risks (responding too slowly or too fast) but exacerbate the other.

As ever, we would be very happy to discuss any of the points raised in greater detail if you wish.

Yours faithfully

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