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CREATING THE CONDITIONS FOR THE UNITED KINGDOM LIFE MARKET TO FLOURISH

A Discussion Meeting

[Held by the Institute of Actuaries, 28 October 2002]

Introduction

The United Kingdom life industry is going through a period of unprecedented change and challenge. This is set to continue, driven, among other things, by economic conditions, market forces, regulatory change and new accounting standards.

The profession has an important role to play in helping the industry to respond to these challenges, and ensuring its future success. This meeting is a chance to meet and discuss these issues and explore what we, as actuaries, can do.

ABSTRACT OF THE DISCUSSION

Mr P. R. Bradshaw, F.I.A. (opening the discussion on the future of distribution and products in the United Kingdom)**:** The President focused his Address on those members who have been qualified between three and eight years. I am going to do the same here, and refer to them as 'successors'.

This is the most positive moment for successors which I can remember. There is an undercurrent of concern, reflecting the current difficult times, but it seems axiomatic that the core services that we offer to the public are in demand now more than ever, and that the agenda for change is more radical.

Change is challenge, but it is also opportunity, and the opportunities today are gigantic in their scope. My advice to successors is never to underestimate the scale of the opportunity which change creates. Be bold. You should not be tinkering with the system that you inherit; you should be reinventing it. Bill Gates did not choose to build a better calculator.

Distribution and products are the theme which I have been asked to address. I take that as meaning retail services, because the title itself highlights the scope of the change necessary. I do not believe in a future product-based world, nor in a world where distribution is seen as some quite distant part of the business. As in so much of retail financial services, where we do not use jargon we end up with ambiguity. The term 'product' means a packaging of services. A personal pension plan is a product. That word 'product' has come to have all sorts of connotations, many to do with unacceptable complexity and opacity.

The future is clearly about defining and pricing a service, and defining and pricing it in the clearest possible terms. Starting with a pure marketing perspective, there are only three core services which we can offer. The first is the genuine world of insurance, the collective pooling of risk for which there is clear and identifiable need. This market is both growing and not subject to huge criticism, except that it seems extraordinarily short-sighted to pay the scales of commission which are in the market to non-regulated, and sometimes poor quality, distribution.

The second service is in the accumulation of assets, which is where the industry is subject to criticism and accounts for the sombre title of this discussion. This is the area to be reinvented, probably not in the legal context of the life industry. It is intrinsic to our society that access to capital markets for retail customers is essential for them and for the financial system. A U.K. customer has available packaged arrangements from the life industry and from the unit trust or the mutual fund industry. Both are guilty of packaging a product and pretending that it represents a lifelong best bet for the customer. Neither industry has moved from the simplistic model of selling a product at high initial cost, but with little or no consideration for the changing needs of the customer after sale. Both are largely dependent on the IFA distribution channel. The life industry has a reputation for poor public relations, and our cousins in the unit trust movement emerge unscathed from the reality that their service is much more expensive than ours. They completely avoid criticism of selling fashion funds at the top of markets — technology funds being the worst example. I may be disappointed in my endowment; I am horrified by my technology ISA. Both suffer totally from the distribution system, the providers', and indeed the regulators', refusal to recognise that what may well have been good advice at the time needs constant revisiting in the light of the changing world.

Many of us are engaged in what I call the United States or Australian 'Wrap' model. I know that there are very many different variants being prepared for launch. The common themes are high technology dependence, and a view that asset allocation and analysis are far more important than product, and can be achieved at an individual customer level through the utilisation of technology. A suitably Anglicised version is likely to become dominant within, perhaps, five years, simply because customers have ceased to trust packaged products. Customers today are individuals with individual needs. This is not just about a new product. The impact is huge, one that the profession should grasp with both hands. If we are expert at analysis and risk management, then we face the challenge of providing the tools and the advice within a much broader and completely open framework.

The profession should take the lead here, debating all of the issues openly and honestly. To do so we will have to abandon at least two 'sacred cows':

(1) There is the nonsense of pretending that a life fund is a sensible investment medium for anyone who is not guaranteed to be a capital gains tax payer over his or her whole life. The distortion caused by dancing around the reality that life funds are taxable on income and gains, whereas 99% of customers are taxpayers only on income, does us no favours.

(2) The distortion of deterministic projections, which are merely our best guess at a range of probabilistic outcomes, has surely led to the bad image which we have. I do not have any idea of what investment returns will be next week, let alone in 20 years' time, but in presenting an upper and lower range we define our customers' expectations.

The premise of customer service going forward is to recognise that reality, and continually to advise the client about the funnel of doubt, which narrows as it nears his objectives. Economically, we would prefer a customer to keep quiet for 25 years, and that has been our historic position. It will not do going forward. Our proposition must be that we will work with that customer over that period to maximise the possibility of attaining his or her individual goals. That is a valuable, worthwhile and fundamentally honest service, although not an easy one to achieve. Attainment will challenge our communication skills and require reinvention of our corporate structures, integrating our distribution and service functions. When I say 'service' I mean service, not call centres.

My thinking has increasingly turned to the third area where we can offer a service, that of asset disposal. In an age when there are more people over age 60 than under age 16, our offerings are relatively underdeveloped. Longevity is the largest financial risk that individuals face today, and eventually our society will have to face the reality that most people will leave this world with the same assets with which they joined it — precisely zero. Pooling that survival risk may emerge as the great marketing and technical challenge of the next 20 years, and one where our expertise is of huge potential value.

The future of distribution, in this context, is an area where strategy is detail and execution is everything. Starting with simple mass market products, for a whole series of reasons the imperative of simple products sold either direct or by low skill sales people seems to gain dominance. First, I am passionate that anyone with credit card debt should always repay that before buying anything else. I spent the early part of my career wondering why foreign actuaries often concentrated on one side of the balance sheet. I now find much debate on the savings gap equally naïve. There is not much point in having a stakeholder invested in anything if, on the liability side of a personal balance sheet, you are paying 18% p.a. interest. Secondly, we, as a profession, should be leading the debate about the reality that, if mortality continues to improve, the chances of anyone retiring at age 65 in comfort are minimal.

Moving on to my personal comfort zone, the IFA market. When I was a youngster, the life industry was strongly integrated. We thought that we could do everything from distribution to information technology. The years have taught us that outsourcing to experts is better. That analysis surely extends to the increased market share of the IFA community, albeit, in reality, the dominant market share of that sector is not something which entered into many life company strategies ten years ago. The IFA market is consolidating rapidly, partly with the assistance of life company assets. Whereas much of this is welcome, it is also dangerous. Life companies are notorious control freaks, and so are IFAs.

Throughout my career I have only met three people capable of running a direct sales force. Think carefully before you believe that your company has the necessary skillset to manage something that is as difficult as distribution. It is early days, but it is already disturbing to see that the capital flowing into the sector is being passed to business owners rather than being used to build up infrastructure. One has only to wander round the average IFA's office to realise the degree to which a paperless world has totally passed them by. The regulator seems to have encouraged this almost Dickensian environment — paper absolutely everywhere. The future, and one of the key attributes of the Wrap proposition is effective mechanisation, and that is the area where capital is needed.

We are currently witnessing much debate about the meaning of independent advice. Much of that seems anachronistic, being based on polarisation, which itself is a legacy of product-based marketing. The commission debate is backward looking and, again, totally product based. I detect a hunger in the IFA market for a service based on trail income. Whether that is called commission or fees is an essentially academic distinction. It is not designed to achieve a cheaper offering; it is an attempt to offer a more intrinsically valuable service at a fair price. It appears that the future for distribution must be with relatively large-scale firms. The old cottage industry of IFAs is fated to mature and develop into larger and more organised entities. The interesting question is the degree to which those larger groups are controlled by the life industry. Intrinsic to that debate is the other stark reality, that the gross margin paid by the customer is falling, both because of the well-publicised reality of political and regulatory pressure, and because lower asset prices and lower returns inevitably reduce much of the margin which has been historically available. If annual investment returns over the next period are to be 5% or 6%, then it is hard to see, commercially, how any proposition on conventional lines will support more than 1% p.a. as a gross margin.

In this environment, large sections of the IFA community probably have little practical choice other than to disappear under the shelter of the life industry, especially those sections dependent on the current huge commissions paid on with-profits bonds, and there are sections of the IFA community which cannot see any alternative to product-based marketing. Equally, the stronger sections, probably with a higher net worth customer base, will be very well advised to explore the value chain implicit in the Wrap proposition, and recognise that the underlying relative profitability of their businesses can be transformed, but not if they are beholden to a manufacturer.

The question is asked: "How can the profession ensure that the life industry flourishes?" The major challenge is that the asset accumulation market will, over the next five years, move from a product-based sale to an holistic personal service. Many of the techniques evolved in wholesale markets will become available to retail customers. We are discussing asset and risk management at an individual level. All of our professional analytic skills are required to ensure that our customer and distribution systems get the very best possible advice. Secondly, we have shied away from difficult risks. Term assurance has flourished because mortality improves. We have to think much more carefully about the nature of longevity risk. The babyboomer generation is about to encounter a whole new series of personal problems associated with ageing. Those are hard risks to manage; but surely our task is to meet society's needs.

Distribution is changing around us. It will probably take a decade to mature. The issues involved are mostly managerial. It will no longer be appropriate to view distribution as 'them', and the life company as 'us'.

There are two certainties: the management of financial risk remains in high demand, the fact that this is moving to customer level, and thus totally open and transparent, is a great opportunity for our profession; and the nature of the demand of society is changing rapidly. Old solutions are challenged everywhere, from with-profits through to longevity risks. The one overwhelming certainty is change, and to all those successors, all those newly-qualified, I say: "Welcome these changes. You can change the world."

Mr A. J. M. Chamberlain, F.I.A. (opening the discussion on the future regulatory environment)**:** Mr Bradshaw has described to us the changes in the market place which we have seen or he expects us to see.

I intend to explore some of the changes in the prudential regulatory environment expected over the next few years. I am not going to explore the subject of the proposals to change the Appointed Actuary system, but I hope that some others from the floor might choose to do that later. Much of what I say is drawn on published material from the Financial Services Authority (FSA) or from other sources. We are still at the very early stages of development of many of the ideas, though by now the FSA itself probably has a much better idea than the rest of us what is going to happen.

I shall briefly consider five main areas: the baseline for prudential regulation, which will change to best estimate or fair value accounting; the FSA's goal of consistency; risk-based capital assessments; stress and scenario testing; and the European Union solvency standards and the changes there.

First, there is best estimate or fair value. International accounting developments are running at a fast pace, though not fast enough to meet the aspirations of both the FSA and the E.U. The use of international standards in the accounts of all quoted E.U. companies is mandatory from 2005, but as yet for insurance these do not exist in full. This is expected by many commentators to lead to significant problems of inconsistent treatment. The FSA has made clear in the meantime, through policy statements, reports, and in various speeches by senior figures, a preference for basing life insurance regulation on published accounts meeting such standards. This is consistent with the basis of regulation for other institutions, but a radical change from the prudent reserves with which actuaries are familiar.

The clear advantage of this approach is that constructive obligations can be included without doubling up on margins. The drawback is likely to be a risk of losing focus on solvency in published data, which may make useful analysis in that arena more difficult for outside observers. This is a significant change, potentially, from the old 'freedom with publicity' regime, used for some 130 years.

That said, the FSA does recognise that the ideas that it has cannot be fully implemented under the Third Life Directive and Solvency I regimes. The new accounting standards and Solvency II regime will be required, and the latter is not expected for five years.

Mr Clive Briault of the FSA stated recently, in a speech, that the FSA: "will seek to achieve much greater consistency across sectors in our regulation. Similar risks should be treated similarly unless there is a good reason for making a difference or our international obligations prevent harmonisation." He went on to say, and actuaries will welcome this: "This is explicitly not a one size fits all approach."

There is little doubt, however, that the banking regime of regulation developed by, among others, Mr John Tiner, is favoured by the FSA, and forms the basis of their current thinking. Indeed, the cynic might wonder whether proposals around the Appointed Actuary system are not partly driven by a feeling that banks manage perfectly well without them.

Given the background of all the senior people in FSA prudential regulation, it is not surprising, but a little disappointing, that they seem to want to harmonise so closely to a standard which was designed for a particular sector. However, it does look as if an understanding of banking approaches to regulation is now an essential tool for life assurance actuaries.

A much more positive area of change is in the arena of risk-based capital. Although there may be concerns about a baseline plus capital approach, not least from the perspective of taxation, this does seem to be the FSA's current preference. The strange dismissal that extra tax payable by life assurance from policyholders' funds is somehow in the interest of society at large sits, I submit, uncomfortably with both the FSA's statutory duty to protect consumers and with initiatives such as Sandler's to increase savings in the U.K. However, that is what the FSA has said.

To return to the positive, the FSA approach seems sensibly to be framed around the total resource requirements of firms, based upon a prudent assessment of need rather than adding on arbitrary margins to best estimates. The need for regulatory certainty, however, seems to be driving the FSA towards formulaic models to guide the new internal capital assessment, which firms must make for themselves, and this raises issues around combining the capital requirements for different risks.

Actuaries should welcome the inclusion of stress and scenario testing in deriving these requirements, the inclusion of operational risk and more detailed credit risk analysis, on top of the more familiar market and insurance risks, and the somewhat limited credit risk that we take into account under the current rules.

If I had more time, I would discuss the supplementary capital assessments and the ability to use economic capital models. I mention the following, however: stochastic models will undoubtedly grow in importance, but we will need to look at models that predict capital requirements, which themselves are driven off such models, requiring some sort of double projection.

Turning to Solvency I, which most life actuaries are already aware of, this is still based upon the Third Life Directive regime, using substantial solvency requirements unrelated to underlying risks. For the present, this will remain the minimum standard irrespective of any FSA requirements, which means that the industry faces the greater of two capital requirements and a need to watch both bases carefully. It is possible, however, that the resilience reserve will disappear from the U.K.'s version of the E.U. based regime, although something similar will form a fundamental part of internal capital assessments.

There are, however, some parts of the directives, for example the First Life Directive Article 17(1)(a)(4), which tend to lead in the opposite direction. However, the accounting profession has had no difficulty in ignoring these sort of risks in signing off accounts that comply with the Accounts Directive, which requires you to follow the Third Life Directive regime.

I should like to spend a long time talking about Solvency II. However, it is still a relatively distant change, but some things are beginning to look quite likely. First, a scheme derived from the banking Basel Accord is quite possible as the basis of Solvency II, with the pillars, including a Pillar 1 formula-based capital floor, forming a key part.

Secondly, it must be quite likely that Solvency II will require some form of stress and scenario testing to prove the adequacy of resources over and above the formulae. This will meld well with the FSA's approach. The FSA is seen as a leading thought centre within the insurance supervision community in Europe, although, of course, anything European does end up much more political than technical.

Mr P. D. Needleman, F.I.A. (opening the discussion on the role of the actuary)**:** We have heard from Mr Bradshaw about the changing nature of life insurance, the market and the products, and the core services that insurers will offer. As he stated, the management of financial risk will be central to this offering. Mr Chamberlain has provided an overview of the changes in regulation, and where they are heading, primarily towards a risk-based approach to supervision. Indeed, there will be a greater focus on the responsibility of directors, with the emphasis on having the appropriate systems and controls in place.

We are already seeing a significant increase in the level of supervision and regulation. This will create many interesting challenges for the industry, and actuaries working within the industry and an increase in areas of work requiring actuarial input.

In terms of the role of the actuary specifically, the FSA has proposed a split of the responsibilities of the current Appointed Actuary with the head of actuarial function, who will have responsibility to advise the directors on the appropriate valuation of the liabilities, and a new Appointed Actuary role for with-profits business, providing advice to the directors on the exercise of discretion. The FSA have also put forward proposals for a With-Profits Committee of the Board, and that there should be principles of financial management for the operation of with-profits business.

If we look at the current FSA proposals and how they affect the statutory role of the actuary, we do see a clear shift in the responsibility to the directors. The FSA is proposing to curtail the responsibilities of the Appointed Actuary quite severely. The current certification of the liabilities by the Appointed Actuary will be removed, and replaced by a more general directors' certificate, which will be subject to audit. As a profession, we believe that this represents a weakening of customer protection, and we have yet to be persuaded that this weakness will be corrected by other measures.

So, what role will actuaries play in the life company of the future? Most of the current work of the actuary in a life office falls within the following areas:

— solvency and capital management;
— product development and pricing/terms of businesses;
— exercise of discretion/treating customers fairly;
— investment management;
— compliance/risk management;
— corporate planning/restructuring; and
— financial reporting.

The statutory role of the Appointed Actuary, in particular the current role to place a value on the liabilities, is clearly encompassed by the first of these, the solvency and capital management, but the role is wider than that, and encompasses elements of certainly the first five points. Many actuaries are also involved in financial reporting, in corporate planning, and often in other areas such as internal re-structuring or mergers and acquisitions as well.

Consider first solvency and capital management. As is the case now, actuaries will still be responsible for carrying out the statutory valuation and choosing appropriate assumptions and methods, and, in addition, there will be increasing emphasis being placed on the use of risk-based capital models. So, we can expect quite a lot of activity in that area. This will involve a good understanding of all of the risks to which insurance companies are exposed. Actuaries are uniquely placed to advise on insurance risk and market risk, but probably we have some way to go before we can claim to be experts in credit risk or operational risks.

Next, let us consider the areas of product development and pricing and other aspects of 'terms of business', for example, encashment terms. I have also considered here the exercise of discretion. A cynic might say that the traditional role of the pricing actuary, in the last 25 years, has been all about passing risk back to the customer and developing complex charging structures so as to hide the overall level of charges. Clearly that has gone, and we are going to see much simpler and more transparent products and charging structures. Instead of avoiding risk, it is likely that we will need to spend more time ensuring that we price for risk properly, so that there will still be an ongoing and an increasing role for actuaries in this area.

In relation to the exercise of discretion, we will need to provide advice in the context of greater visibility and transparency and greater constraints on the exercise of discretion. Working closely with lawyers and others, the profession still has a central role in this area, and the regulators recognise this in so far as with-profits business is concerned. It is slightly surprising that the FSA has not recognised the extent of discretion in unit-linked business, and see no need for an extension of this role to unit-linked products.

In other areas, such as investments, actuaries will no doubt continue to have a significant role to play, in particular in strategic asset allocation, asset liability management and hedging of asset/liability risk. I would also expect to see actuaries contributing, or possibly leading, in the areas of compliance and risk management. This would involve learning new skills and operating within a framework of systems and controls and risk mitigation practices, perhaps more familiar to banks, and perhaps less familiar currently to insurance companies.

So, in this brave new world how and where can the profession best contribute to the life industry to help it continue to flourish? In my view, we should be able to make a significant contribution in all of these areas. In future, in-house actuaries will be able to participate more fully as part of the senior management team, perhaps without the label that the current Appointed Actuary has as the sole guardian of the policyholders' interests. However, they will continue to play a key role in the traditional areas of valuing the liabilities, solvency and capital management, and customer protection. For consultants and other external actuaries, there is likely to be significant additional work within audits, compliance reviews, and providing independent opinions to directors who will be facing an increasing burden of responsibility.

Most importantly, we need to consider what skills and attributes actuaries will need to contribute fully in these areas. Not only will technical skills continue to be important, but, more than ever, the ability to innovate and to communicate effectively will be crucial, as will project management skills.

Mr C. D. Sharp, F.I.A. (in a written contribution on the role of the actuary that was read to the meeting)**:** When, in the early days of Equitable Life, our basic techniques were developed, and for a century or more after that, the basic problem that we faced was how an individual could provide out of income for the then quite appreciable chance of dying too soon, leaving his dependants without sufficient capital or income to support them. Because of continuing improvements, largely medical in nature, our mortality forecasts were too high, but this did not matter because it was 'on the safe side'. Today the problem for most is that of living too long, so that improving mortality undermines our forecast and our fallibility in this area is being exposed. I now give a favourite quotation from Robert Burns:

"O wad some Pow'r the giftie gie us
To see ourselves as others see us!
It wad frae mony a blunder free us,".

In the *Financial Times* Fund Management section of 14 October 2002 there is an article by Robert Bruce poking fun at our inability to 'make financial sense of the future'. He writes: "Actuaries treated pensions like a small black box that only they could look at. There was no transparency. A few years ago actuaries passed their judgements with almost uncontested authority. This was mainly because everything went so well for so long. But circumstances have changed and some people are now questioning the reliability of actuaries' forecasts."

He then refers to the crisis surrounding Equitable Life; the arrival of the accounting standard FRS 17, which has forced greater disclosure of pension fund assets and liabilities; and the dramatic increase in life expectancy which, to some extent, had been factored into our forecasts, but which proved to be woefully inadequate. He goes on: "There is now widespread scepticism that actuaries can get their crucial forecasts right", and: "the failure of actuaries to spot the accelerating trend is forcing the number crunchers back to the drawing board." Finally: "What could raise everyone's hackles ... is the fact that all this might not have been necessary if actuaries had accurately forecast the future in the first place."

There have been other senior people who have questioned the way in which the profession has behaved over the last ten or 20 years. At the then President's invitation, Julian Farrand, the Pensions Ombudsman, in June 1999 gave a pointed review of our operations, drawing attention to weaknesses which, to the best of my knowledge, have not yet been tackled. Then again, one of the most obvious of our limitations is that we talk of actuarial science, which is nonsensical when our methodology ignores inflation, one of the most obvious features of our monetary world. What our clients, especially our pensions clients, need from us are contracts which, to the best of our ability, maintain purchasing power and do not just provide a certain (or uncertain?) number of monetary units of indeterminate value. How can we realistically claim that we make financial sense of the future when we disregard a factor which, almost certainly up to retirement, is likely to have far more effect on the final outcome than those mortality rates of which we make so much?

What then should we do to restore the trusted position that we once held?

— We must establish clearly that, as Redington so aptly said, we are not wizards, but are trying 'to home in onto a moving target in an increasing funnel of uncertainty', and that no one can foresee the effects on mortality of the improvements in medical and other techniques almost certain to come during this century.
— We must revise the contracts being offered by the life assurance and pensions industry to allow for a certain degree of inflation.
— We must find out what needs to be done to re-establish the values which distinguished us as a profession rather than a trade association — but that is too big a subject to tackle here.

Mr P. A. Hately, F.I.A.: My comments refer to Mr Bradshaw's contribution. I am a great believer, in order for our customers to get much more value out of the industry, that we should bring sales and service together. To do that for the benefit of all our stakeholders, we need the 'dinosaur' actuaries to stop comparing themselves in the pecking order in the primeval swamp based on annual premium equivalents. This arbitrary measure is unaffected by surrenders, has nothing to do with lapses, has nothing to do with customer value, or even profit. If the dinosaurs, their press officers, their trade bodies, and journalists stopped using annual premium equivalents, that would have a knock-on effect to all kinds of ways in which the industry is managed, and we might then start to provide our customers with more value.

Mr C. G. Lewin, F.I.A.: My comments concern the question of capital adequacy. Actuaries cannot accurately forecast what the future will be. We know a lot about what the past has been, and we can make some judgements about what we think the range of future outcomes might be, but sometimes they will be outside that range.

A lot can be learnt from the position of the early fire insurance companies, which were formed in the 1680s-1690s, when the experience of the Great Fire of London was very much in people's minds. That was the main reason for the growth of fire insurance. The problem which faced the proprietors of those companies was that, in normal years, there would be just an ordinary claims experience, but then, every so often, there would be another large fire which would cause a lot of damage and large claims. There was a great deal of experience in provincial towns, where quite large proportions of the towns burnt down in the latter quarter of the 17th-century/the first quarter of the 18th-century.

So, what could the proprietors of these companies do about it? They adopted two solutions. One was the solution of raising capital in the normal way from investors, putting it on deposit as a kind of perpetual reserve. However, the second method was more ingenious. If they did get one of these exceptional events, they would expect all of their policyholders to contribute towards the pot. In other words, the companies became mutuals. Leaving aside the question of the practicality of collecting the contributions, there is something to be learnt from this approach. If you are going to set yourself up in business, promising to pay unfortunate people sums of money in the event of calamities arising, you need to have sufficient capital resources, not just enough to meet the range of circumstances within normal expectation about the future, but the ability to meet abnormal circumstances as well.

That is the problem that we are seeing today with what has been happening in the stock market, and also for general insurance companies with what has been happening in some of their claims experience, which has been outside the range of likely possibilities that they envisaged when those policies were originally written.

The challenge which faces us is how to raise that capital, or at least get the promise of contingent capital, and what is it that can be offered as a quid pro quo for that capital so that people or institutions are willing to provide it? Reinsurance companies are not the only answer; they are part of the answer, perhaps. It may be that we need, contingently, to tap other sources of capital altogether, ones with which we are currently unfamiliar. I suggest that addressing that particular issue will be enormously important for us, and not just for life assurance companies, but for pension funds as well.

For example, from the pension fund field with which I am more familiar, the situation at this moment is that many final salary schemes, if they were wound up today in circumstances where their sponsoring employers were not solvent, would not be able to pay all the promised benefits. Indeed, some active members would suffer more than proportionately because of priority rules. There are various possible ways in which the capital behind those funds might be increased. Firstly, there may be some lucky occurrences on the stock market; the stock market may bounce back, or perhaps companies should put in more money; but then you come to more esoteric ideas: perhaps companies should contingently charge some of their assets in favour of the pension fund; or perhaps there is scope for more insurance of sponsoring employers. For the larger pension funds, which have good quality employers behind them, companies could possibly enter into some kind of a club whereby there would be a whip round, as it were, of some kind if one of the funds got into difficulty.

I mention these as an illustration of the range of possibilities which might be considered. I am sure that this is not a complete range.

Mr K. Sandom, F.I.A.: When the idea of personal pensions, or at least providing private savings for pensions, was first mooted through the Hillard Miller Tucker Report, it was basically to provide deferred annuities. This was changed by the Government over time, and by competition, tradition, insurance company practice, policies, bonus declarations, and everything else into providing all-embracing endowment assurances with an annuity option and sometimes a guarantee. We know that the latter proved most embarrassing for one particular insurance company, and many have suffered.

Basically, what was needed was a very-long-term contract for the individual employee to save for his retirement. Long-term contracts are what actuaries are trained to understand. I submit that a simple reversion to a long-term deferred annuity contract with all the relevant options would provide a straightforward system, which the Government and pensioners would understand. That is £100 per month buys you, say, £x pension plus a deferred bonus on maturity. Long-term contracts have the advantage of enabling the smoothing experience over a long period.

Mr A. H. Silverman, F.I.A.: There are a couple of things which matter to the future size of the life industry: public policy on long-term non-pensions savings; and the drift of tax policy on savings in general.

On the first, the U.K. Government wants people to build up savings and have offered tax incentives, which are now focused mostly on pensions, but these have diminished a little over the years. (Mr Chamberlain touched on this point.) The question is: "Are the reduced incentives for non-pensions long-term savings correct now and for the future?" As a profession, we should continue to promote the arguments in favour of incentives and we should be thinking about what our role should be.

Second, as regards tax policy, more generally, the drift in recent years has been clear and at times explicit. Anything that is shown to conflict with tax neutrality between consumption and savings and between different savings products is automatically labelled unfair. Policy can favour long-term savings in different ways. Simple tax incentives are one way, matching government funds of credits, independent of tax status, another. And, of course, compulsion is working well in some countries. We need to consider our position in the U.K. Long-term savings, locked in for a period of years, used to be encouraged as a matter of public policy, if only to limit the extent to which citizens would become a burden on the state, and, to an extent, that objective is still valid and voiced by the Government. We are increasingly only left with exhortation on the part of the Government, and a gradual weakening of the actual tax incentives for saving (outside of pensions), because these incentives all conflict with tax neutrality.

Mr P. H. Simpson, F.I.A.: In a time of change, where in five years' time half of the market may be dominated by people who do not currently write insurance, where the products are likely to be very different, where the relevance of insurance to asset management and to savings policies are perhaps minimal, we should be focusing on that future rather than on the past. We are supposed to make sense of the future.

Mr M. S. C. Pike, F.I.A.: The actuarial profession has been, to outsiders at least, quite quiet on the whole issue of the change of the role of the Appointed Actuary proposed by the FSA. I have some concerns about the profession seemingly sitting back and taking FSA criticism. First, the actuarial profession needs to be conciliatory with the FSA and maintain a dialogue with it. Equally, as with any political game, there is a need to demonstrate strength. I would have thought that there was a place for a robust defence of any criticism of the role of the Appointed Actuary. We, as a profession, find it too easy to criticise ourselves, but maybe that is because we set very high standards for ourselves to achieve. We ought to carry on acknowledging our weaknesses, but also to press ahead with improving the role of the actuary in the life assurance industry. For example, we should press ahead with the ideas for peer review and for actuarial certification of reserves in the public domain.

It seems extraordinary that we, as a profession, are going to allow that to be removed. I understand that various members of Council are having discussions with the FSA, and was surprised that Mr Needleman did not make any reference to those in his remarks. I have written to Mr John McFall, the Chairman of the Treasury Select Committee, who has expressed some sympathy with our position, that public certification of actuarial reserves was an important thing.

While members advise that there may be plenty of work arising out of the proposed changes, we should not be too short term in our thinking. The role of the Appointed Actuary is an important one, not only for current Appointed Actuaries, but for the younger members of the profession, who may look to the role of the Appointed Actuary as a significant stepping stone in their careers and with a significant role to play.

The President (Mr J. Goford, F.I.A.): Let me bring you up-to-date on our discussions with the FSA. I shall not disclose those that are still confidential.

There is no way that the Appointed Actuary will survive in the style as we knew it in the past. What we do need is adequate customer protection. That is what we did, and that is what we need in the future. We are working with the FSA to make sure that, in our view, the bits and pieces of customer protection are there at least as strongly as they were in the past. We have a new function, called the 'Actuarial Function', to advise boards and senior managements. There are now two actuaries instead of one. As has been said, the Appointed Actuary role should be extended to discretion in non-profit as well as with-profits business.

We believe that we need certification: for customer protection; and for perception of customer protection, which is just as much as good as the reality; and also to support the Actuarial Function and the Appointed Actuary, working day-to-day with their management, in having the credibility to shift their management in the direction of the policyholder.

Mr John Tiner of the FSA is fully aware of our position. His response, at the moment, is that the risk-based supervisory process, together with the fact that the Actuarial Function is an approved person, will give the same status to that individual in dealing with management as the Appointed Actuary previously had. Frankly we are not persuaded, and that is what we have said. Nevertheless, as Mr Pike mentioned, Mr McFall is in favour of certification, so is Mr Colin Brown, who is Chairman of the FSA Consumer Group, and so are many of the people to whom I have talked. We will do our best, and we will make our position perfectly clear. We are still working with the FSA to try to achieve our ends. Nevertheless, if you analyse the bits and the pieces, provided that the Actuarial Function has the backbone, as an individual in the organisation, to stand up to management in the same way as the Appointed Actuary did, then we have a good degree of customer protection there, not as much as we would like, but we have it there.

That is where we are going. We are being robust with Mr John Tiner and with Sir Howard Davies at the meetings that we have had with the FSA.

Mr M. R. Kipling, F.I.A.: Mr Chamberlain explained about the moves towards international accounting standards. Currently, many savings-related life insurance contracts are going to be classed in the future as financial instruments. Therefore, there seems to be no reason why the FSA should want to see any different form of certification, or audit standards, depending on the nature of the issuer of the financial instrument, be it a bank or an insurance company. This suggests that the FSA's intended approach of requiring director certification of reserves, and not specific actuarial certification, is the direction that is inevitable. However, of course directors are required to seek the advice of competent individuals when valuing such instruments. I hope that for many types of financial instrument, especially those involving long-term liabilities, actuaries will continue to be the experts to ask for many years to come.

Other assets will continue to be classed as insurance policies, where it seems even more likely that actuaries will be the people to ask for advice, but even this is by no means certain, particularly for general insurance liabilities. Moreover, once one accepts this for general insurance liabilities, why should one necessarily accept that it has to be extended to life insurance liabilities? However, I agree with the FSA proposals that the new Appointed Actuary role makes sense, but only in with-profits companies as part of the independent confirmation of the fairness of the exercise of directors' discretion.

Following the President's suggestion at the ordinary general meeting held in September, I read a particular book on banking capital assessment. I was surprised to see how basic many of the value-at-risk techniques were, not for market risks, where the derivative and other valuation techniques are very well developed, but for banks' core credit risks. There are two lessons in that book for our profession, as it works with the FSA towards common capital standards, which Mr Chamberlain foreshadowed. The first is that we should seek to examine whether we can use some of the simpler banking credit risk value-at-risk approaches in setting some of the insurance company capital requirements under the new FSA regime. Second, if we cannot comfortably adopt the banking standards, which sometimes require very small probabilities of capital inadequacy, we should at least ask whether this does not demonstrate deficiencies in the techniques, but questions our wisdom of continuing to write those risks in the first place.

Mr N. B. Masters, F.I.A.: Mr Kipling raised the intriguing question that the regulators may no longer regulate the financial instruments in our insurance business. That is a real possibility, and was floated recently at the international supervisors' annual meeting. Also, on the international side, the International Actuarial Association (IAA) is preparing a major paper on risk-based capital (RBC), and the way that it might fit into a Basel-type structure. It is a project that has been running for about 18 months now. There is a first paper out on the IAA web. A second paper is about halfway through preparation, and it is hoped that it will come out in about May 2003.

The good thing about the paper is that the international supervisors, the International Actuarial Insurance Supervisors (IAIS), have already recognised that this is an extremely useful piece of work. It looks as if Basel is actually more like the kind of approach that we have had described in this discussion. So, it will fit in with the integrated prudential approach. Also, and perhaps on the back of the IAIS expressing support for what the IAA is doing, the E.U. Commission has started talking to the IAA about how it might incorporate the work of the IAA into Solvency II. In consequence, I feel that, for the successors, there is a great deal of work that will come from the IAA's RBC paper, and that it will influence the banking sector as well.

There is also a statement that is going to be placed on the IAA website within the next couple of weeks. It is called: 'The Role of the Actuary in Prudential Supervision'. It is a policy statement which has been agreed by all the actuarial associations in the IAA, and was distributed to E.U. regulators last week. So, we are not entirely sitting back and letting the regulators roll over us.

I now consider product design and some of the other issues that came up. First, I wonder whether or not the presumption that equity performance will give us the extra 2% p.a. over gilts is now redundant, and whether the myth of additional equity performance driving product design should now be consigned to the dustbin. Those who do design additional equity performance into products will find that they are reporting large losses at outset under the new IAIS rules, because equity performance is not written into the IAS rules. Many of our current problems appear to stem from the cult in the equity, which served us well in the 1960s through to the end of the 1990s, but how many people got out on 31 December 1999?

We have discussed capital management and profit management separately. We can tie these together, because the system comes together if a company works to a particular level of creditworthiness. If a company prices its products, and runs its capital and capital base to a particular creditworthiness, and promotes that out into the marketplace at a fair price, then the system comes together.

What is then left for competitive advantage is risk management and risk mitigation. As early speakers have said, that is going to be our core business in a decade's time. We will be the experts on operational risk. To date, at best we have measured risk. In the future, we need to manage risk.

Mr G. J. Thompson, F.I.A.: I shall talk about the role of the actuary in the retail investment scene, and, as an Australian, consider whether the Australian 'Wrap' experience can help solve some of the issues facing the U.K., such as uneconomic distribution, the quality of advice, transparency, choice for the customer and the savings gap. This is looking to major change and not just tinkering with the situation as it is. If these changes occur, what does this mean for actuaries?

In broad terms, in Australia the Wrap has led to the decline of traditional insurance as a product. Policies such as pensions and with-profits policies are very rarely sold. In fact, traditional insurance is hard to find now, because the actual nature of the Wrap does not suit these products. When the Wrap is introduced, products are seen as something that is tradeable, like a share orientated trust with low upfront fees. So, the introduction of these vehicles has actually changed the product structures in the market. This is leading to a decline in the actuarial functions that accompany the provision of these products as the legacy of past products declines. For example, I was working in an IFA network, and we delivered our investments almost totally through unit trusts, with very low fund fees, and through shares. To do this, and to support our advisers, we dealt mainly with fund managers, investment research houses, investment modelling experts and economists. Very rarely did we have an actuary involved.

We did not use the traditional products. We purchased the investments through a generic no-fee tax wrapper, so the pension itself is just a legal structure sitting in the Wrap, and does not have to be delivered by the traditional provider. With this value chain of buying investments that are tradeable, we did not have the job of smoothing assets or having complex pricing structures built within the products, as is currently the case. The finances of the Wrap itself depend on the amount of money that you can invest, the speed at which you can do that, and the margin that you can take on funds held. This really becomes like an accountant's job, how much money is flowing and the margin.

What used to be insurance investment products have been substituted by unit trusts and shares, because these offer the customer flexibility to trade; they can see the fees very clearly; they can have the choice within the Wrap structures to buy and sell. So, the client has more control.

How does the client achieve his end objectives with this control? This is done by the management of the portfolio being shifted to somebody other than the actuary who might be running the life fund. That could be the adviser. I know that there is a big gap there. There are a number of advisers in Australia now, trained to the point where they can start doing asset allocation and investment strategies for the client; there are investment experts who can do this for clients at an individual level. Fund managers will do it; and, in some cases, although it is only a small segment, the clients will do their own investment allocation. This means that the client's objective of smoothing, and so on, is achieved at an individual level by personalised investment portfolio advice. This came about because customers have come to accept that investments are tradeable things. They understand the idea of market value fluctuations, and their objectives, particularly the smoothing, can be delivered through their own management of asset allocation and other aspects of the portfolio.

Recently, with the stock market problems in Australia, there has been stability in customers' portfolios. There has not been any switching out of shares as occurred last time we had such a problem, so, with education, the customers in Australia have come to accept this way of managing their investments, and that is borne out in practice.

This evolution took about 12 years to occur. Customers' understanding of the nature of the benefit of long-term investment in shares is another aspect that was necessary, along with the risks attached. Someone mentioned the idea of the cult of shares. That certainly exists in Australia. I am just talking about some of the conditions that apply there, which may not apply here. That was assisted by compulsory retirement funding, because that forced everybody in the community to have to look at their investment assets once each year at least.

They have income drawdown at retirement. It is not compulsory to take an annuity, so the investments flow through generally in shares and are managed in the drawdown stage. People have become involved in floats a great deal over the past few years, so they have become familiar with shares, and there has been a huge education through advisers and the press about how you manage your portfolio: "Is it transparent, do you know what you are getting for the money you are paying, and who is doing what to provide the service?" Also, there have not been any industry issues such as pensions mis-selling to put negative vibes into the industry.

The whole thing was also supported by technology, suitable regulation and a huge amount of competition between advisers. So, the question is, given all that: "Is it likely to fit the U.K. market?" It seems to me that the search for more economic distribution delivering real value, which was mentioned earlier, the availability of technology, the direction of regulation, and the stresses on with-profits and defined benefit plans, are all favourable to the adoption of a new model for both product evolution and distribution, perhaps along the Australian lines, but it would be an adaptation.

However, against that, it seems to me that regulation in the U.K. is very paternalistic, and we want to avoid further issues such as mis-selling. Customers are also cautious. They are not used to investing in shares, and may be reluctant to move in that direction in the current share environment. Also, there is no compulsion of retirement funding, and there is not yet in the market a lot of education, which looks at how people should manage their affairs, as distinct from buying products.

These factors will probably cause some kind of drag on the adoption of the ideas; but this opens a window of opportunity in the U.K. that is not in Australia, and that is a chance for life offices, if they want to, to develop products that fit into the Wrap environment. If you take the view that a normal with-profits policy does not work, you have an opportunity to come up with a new type of with-profits policy that could sit within a Wrap, and some of the features of that would be: transparent or nil fee structures; simple and explanatory ways of smoothing returns; and making it really clear to the client; trade-offs between getting investment returns smoothed and the loss of trading flexibility on one hand and financial guarantees on the other. In other words, can you sell some sort of product into a Wrap which is not totally tradeable, such as a share?

If these new products are introduced successfully, the traditional role of the actuary will be continued forward. However, if not, actuaries will need to market their services in competition with these investment managers, the modelling experts and the research analysis analysts, because they are the ones who, at a retail level, or through the networks, are promoting the asset allocation. Actuaries have all the skills to do this, but, to exploit them, their offering may need to be differentiated from these other players, perhaps through the types of modelling offered, and accompanied by clear communication skills to the end client. I am sure that, as a profession, we can do that, but it is quite a challenge if the distribution challenge referred to earlier happens in the next few years.

The President (Mr J. Goford, F.I.A.): Is there a size of portfolio at which it seems relevant to switch from buying a product to managing your financial affairs — a watershed of size?

Mr Thompson: In Australia, it is not the same for all Wraps, but at about £30,000/£40,000 of assets they would become viable. The point is that we are talking about a Wrap as a product, which is actually used as an administrative platform. So, if an adviser has many clients from £200,000, and some at £10,000, he would put the whole lot on. It really means that you look at the portfolio and see whether, as a whole, it is worth placing in a Wrap.

Mr D. L. Richardson, F.I.A.: Mr Bradshaw's presentation was very interesting, and raised many questions about future developments in the life industry. For me the most important question for actuaries is: "How we can influence those future developments?" It is a much broader question than just the role of the Appointed Actuary, which, although a key role, is just one part of the senior management of life companies. In the broader context, influencing senior management, its agenda, and actually participating as part of senior management requires a number of skills. There are communication skills; speaking the same language as the incumbents, who are increasingly from an accounting background and often with an MBA. We need to overcome our tendency to caveat our advice, and come up with firm proposals and firm advice.

Further, we need to develop a view or views, not just on the internal operations of the company, but also on the external perspective. Chief among these would be understanding the ways in which investment analysts and rating agencies look at businesses. Sometimes their perspective is not in line with how we, as actuaries, look at things. We cannot argue that we know better; we have to realise the reality of the situation, which is that their views help to drive the company's performance.

In order to influence senior management, we need to emphasise what our core competencies are, what we can offer on top of the skills that the senior management have themselves. That clearly lies in our understanding of insurance risk, of financial market risk, and, most importantly, the complex interaction between the two in insurance companies. There have been many comments about risk management. Certainly we need to improve on credit risk, but those first two areas are where our core competence lies and where we should focus our efforts. As one of the 'successors' identified by the President, that is certainly where I will be devoting my energies.

Mr D. I. W. Reynolds, F.I.A.: I despair of this debate. It is meant to be about what will make the life insurance industry flourish. It has been internal, navel gazing about how do actuaries survive. If that is what we keep discussing here, we will not survive.

Mr Bradshaw introduced: "What will create a flourishing life insurance industry?" First, let us not define it as a life insurance industry. In statutory terms it is long-term insurance. How do we make more flourishing a market in personal financial risk, protection, whether it is against mortality, critical illness, long-term care, or longevity? That probably comes back to the financial education of the population at large. To a great extent there is a flourishing savings industry. It may be distorted by uneven tax playing fields, but all the big life insurance companies provide individual savings accounts (ISAs), they provided personal equity plans (PEPs), they provide other means of savings, for example, unit trusts, not just life insurance savings contracts. Then there is the FSA 'decumulation'. Mr Needleman was much better in describing it as asset disposal. Here again that is likely to be something that is flourishing.

How is the industry going to get bigger? It certainly is important that it does so, for a variety of reasons, for the economic reasons that saving equals investment in old Keynesian terms. At the moment the debate is: "If people do not save they may have a poor old age; but if they do not save then there is not any money to invest and we know what happens over the long term if there is no investment." I am not talking about personal investment here, but about economic investment.

We have had several discussions about various aspects of the industry and how it may change, but let us talk about the industry, and not ourselves. If we talk about how the industry can operate on low capital with low margins, we will have jobs to do. If we talk about what jobs we have, we will not.

Mr P. J. L. O'Keeffe, F.I.A.: The title of the discussion is 'Creating the Conditions for the United Kingdom Life Market to Flourish', and we have had a discussion about what is going to help the U.K. actuarial profession to survive. Mr Bradshaw suggested that the life assurance industry had three major activities: insurance activities, which I translate as being term assurance and annuities, unique selling points which only insurance companies can provide; asset accumulations; and asset disposal. He said little about asset disposal, but I translate that as being matters like long-term care, which is a pretty effective way of disposing of your assets. There is nothing which says that what we brought into and accumulated during this life is going to be any less than we take out of it. With increasing longevity, we need to ensure that there is money around to look after us in those rather depressing latter years.

There is a huge opportunity for U.K. life members to address asset disposal. For example, a reasonably successful professional person, maybe a general practitioner or a university professor, who manages to earn £60,000 a year by the time when he or she has retired, then on current norms, is going to be looking for a pension of £40,000 a year in retirement. At current rates a pension of £40,000 a year requires a capital sum of £800,000. You cannot accumulate that figure under the current capping arrangements which are in force, assuming that you have not been earning £60,000 since you are 20. Even if you take the most generous product that is around, and make the maximum provision that you are capable of making, you are not going to have a standard of living in retirement that you regard as being decent. If you divide those figures by two and three, you get much closer to the average type of person in this country. However, the problem is exactly the same. The average person in this country is not going to be able to provide £300,000 in capital, which is needed to provide the living conditions that he is looking for. That is the challenge for the life insurance industry: to provide the asset accumulation packages that are going to allow a family to have a reasonable level of income in retirement. The idea of working on until ages 65-70, and so forth, is much more difficult.

I do not agree with Mr Masters when he talked about equity performance being dead. We have lived through so many extraordinary exceptional years over the past 20 years, and we are unlikely to see those again, but memories do tend to get too short. Because we are now living in an environment where equities are underperforming fixed-interest stock, we think that these will last forever. In the long run there is no doubt that equity performance will return to the point where it is the sensible stock to invest in, but the returns are unlikely to be 10% to 20% p.a.

There is one other area that I want to address. This is an area where life offices could be taking a much more bullish view — the area of annuities. If you look at buying an annuity these days, you shy away from it. You might as well put your money into fixed-interest securities as take the return that is available on an annuity from a life office. The response from the media is that we should keep our money in the fund and do some sort of draw-down system. Over the next 15 years or so we will be able to manage the money that is in there to get a better annuity coming out of it. Then, by the time we are aged 75 interest rates will be better and we will be able to buy a bigger annuity.

That is the theory, and perhaps for the people at this discussion that is something they can look at with some equanimity. They know enough about the market to be able to manage their assets, in order to be able to produce something like that performance, but it is not true for the vast majority of the population. What the vast majority of the population ought to be realising, if they are going in for draw down of income over the first 15 years or so of retirement, is that they are taking a risk in doing that, which the insurance companies are not prepared to take.

Mr P. G. J. McNamara, F.I.A.: I make one exhortation to the profession, through the Institute, on the whole issue of education, echoing the financial literacy points that a number of speakers have picked up. If this industry, in its wider form of savings investment protection, is to flourish, there is a massive gap in the knowledge of the general population and in the press which needs to be addressed in understanding the products and the decisions that need to be made around the long-term savings industry. The profession is helping and guiding, directly and indirectly, through other agencies that debate and increase awareness, which is a positive contribution to a flourishing life industry that we would all like to see.

Mr D. R. Linnell, F.I.A.: As Mr Reynolds and other speakers have said, we are product driven, by definition, in the pensions market because of the ludicrous state of the regulations and the legislation for pensions. Unless we can actually get to a single pension contract for money purchase savings, on a simple basis, preferably with a lifetime savings limit rather than the sort of weird limits that are on it at the moment, then, in a low return/low inflation environment, with only a small amount to spend on advice and administration and coping with moving money between different artificial pockets, I start to despair for the future of life offices. If we can turn that round, and actually make a major move to get some sense into pensions, then there ought still to be a major role to play.

Mr P. R. Bradshaw (closing the discussion on the future of distribution and products in the United Kingdom)**:** I am surprised that more speakers did not stand up and say: "What a load of rubbish you are talking", because I was trying to be controversial. Maybe you all agree, or maybe the radical nature of change is all accepted.

I thank Mr Thompson for his contribution on the Australian experience, which, I suspect, was very heavily driven by the compulsory nature of pensions, which is a whole different debate here. I disagree with the strong emphasis put on shares. To me a Wrap proposition is about asset allocation between various classes of asset, and a complete focus on shares is what we all did in the 1990s, and it is not what we are going to be doing for the next 20 years. I defend the quality of debate, as well as acknowledging that our profession has some difficulty between looking forward and generating new business and with unravelling the consequences of some past business. Our profession has to absorb both of those concepts.

I agree with an observation earlier on, that the traditional measures of how well a management team is doing, based on annual premium equivalent, are absolute nonsense. I have always felt that my role was to create a profit rather than to generate some huge new liability on some big, inflated balance sheet.

I disagree with the comment on financial incentives in our business. We live in the real world, and it is our job to convince populations of the need for financial probity. I agree with Mr Ron Sandler, in that I do not believe that tax incentives do anything other than rather arbitrarily and rather expensively move money around the system.

Mr O'Keeffe picked up on the fact that I had not covered asset disposal in depth. He was right, and it was because there is not much to talk about. Where I disagree with Mr O'Keeffe is that he said that the doctor needed £800,000 to generate £40,000 of income. Mr O'Keeffe discussed a product issue, which was how we were going to get this doctor to save to get his £800,000 for his pension. The reality is that he has probably got his £800,000 already: it is called his house. There is no way in which we are sensibly, responsibly, prudently saying to the doctor: "You have worked for 45 years. These are your total assets; these are your total risks going forward; and they are horrendous by the time you get to age 65, but we should be absorbing that risk; we should be insuring against longevity risk, long-term care, and so on."

Mr Chamberlain (closing the discussion on the future regulatory environment)**:** When I introduced the topic, I described what was going on. I was rather expecting to get some challenges to what was being proposed by the regulators. The regime that they are introducing is going to be fairly complex to run, to an extent that for those who are thinking about the future of the actuarial profession there is a great deal of work in the complexity of the testing and the sort of things that they are going to be demanding; but is that actually good for the industry? Is it good for the consumer? It may increase the font of human knowledge, but does it mean that only a monolithic organisation will be able to survive the regulatory jungle? Will it actually stifle competition by stopping innovation, by stopping new players coming into the market? I was hoping that more speakers would pick that one up.

I shall now try to distil some of the comments that have been made, and put a rather more aggressive frame to one or two of them, and I hope that those speakers will forgive me. Mr Lewin said that we need to find new ways to raise the capital to cover the new risks that a buoyant life insurance sector is going to have to take on, principally, as has been indicated, in this new asset divestment framework, as well as the old risks that are in the various marketing operations of the past.

Mr Silverman raised some extremely valid points in relation to the need for the Chancellor of the Exchequer to start thinking about how he will give people an incentive to save in the future. For example, do we need limits on the amount of savings that people can put into pensions, or is that simply a legacy of the tax free cash sum?

I should like to rephrase what Mr Pike said. To make the industry more successful, the confidence of consumers in it must be increased, not decreased. Will consumer confidence be increased by saying: "Trust the directors"? We know that: "Trust the actuary" is an outmoded concept, but is "Trust the directors" that much better?

The other point that I should like to distil from the discussion was something that Mr Kipling and, to a lesser extent, Mr Masters were talking about. Maybe we should be looking at things a little differently. Life insurance companies have been about taking risks over periods of time. If other institutions want to play that game, let them. Essentially, if you take risks and have a long time span, setting the liabilities calls for judgement. Fortunately for those of you who are interested in the future of the actuarial profession, Parliament may have actually provided the answer. Part XXII of the Financial Services and Markets Act 2000 actually lets the FSA require Appointed Actuaries for any firm. Maybe the test should not be whether it constitutes a long-term insurance liability, but whether it has those factors of risks being assumed over a long period of time. Maybe that solves the FSA's conundrum as to why banks have not historically needed an Appointed Actuary, but life insurers have, and why, in a more unified world, there may still be a role for that post.

Mr Needleman (closing the discussion on the role of the actuary)**:** I think that Mr Bradshaw and Mr Chamberlain have covered most of the points that I wanted to touch on. I make no apologies for the fact that much of the debate was about the role that we, specifically as a profession, could play in the industry, rather than the headline catchphrase about how we were going to solve all of the ills of the industry.

Actuaries have played an important role in the area of consumer protection in the past, and we believe that we can continue to contribute significantly in this area going forward. It is inevitable, at this time of significant change, that these aspects should be at the top of our minds.

Mr Pike questioned whether I, or others, had said anything about the profession speaking out regarding its views on the proposed changes in the role of the actuary. Our position is very much one of trying to maintain and, indeed, improve consumer confidence and protection. I agree with Mr Chamberlain that it is crucial if people are going to be prepared to entrust their savings and protection to the industry in the future.

In terms of the role that we, as actuaries, can play, a number of speakers talked about the core skills that we have in the management of financial risk. We can use those skills in two ways. For companies, the whole question of risk management and mitigation and the move towards risk-based capital are going to be fundamental to the management of their capital position and consumer confidence. That is surely an area where we can contribute and help the industry to flourish within firms.

At the individual consumer level, I am conscious of the need to provide better financial advice and for consumers to understand the trade-offs between risk and return and the uncertainties in saving for the future. We are already seeing some innovative solutions, including the use of stochastic financial projection methods. I have seen some of these, and they really do give you a feel of the uncertainty of the outcomes and the trade off between risk and return. Those are the sorts of things which we, as a profession and as an industry, are involved in developing, and are examples of things that can be done to address some of the issues that have just been discussed.

The President (Mr J. Goford, F.I.A.): Where we are is that the industry — and we must remember that we are the profession, which is not the same as the industry — is having to change very fast. The regulators are bringing change upon it, and much of the industry has not yet understood the length of time that it is going to take for the regulators to get it where they want it to be. We are not going to go head-to-head with the regulators just for the sake of preserving something that was, although it has served well, invented 130 years ago and reinforced 30 years ago.

What we are doing is taking both the higher ground and the lower ground, and, as was mentioned on the higher ground, are working with the way that the regulators think in this openness and accountability new system, and their systems and control, and create a new definition of trust, so that we can hold our heads up as actuaries. Also, to plunge down into the detail and to do the analysis of what the virtues of the Appointed Actuary system are; in particular how it protects the customers' interests; and to make, as we have been making, a simple checklist of the attributes that the Appointed Actuary function brought to the insurance companies, those that are worth preserving. We find that these are present in the new system in one form or another, and are exercised either under actuarial control or with actuarial oversight.

The regulators have worked ten years with the banks; they have changed the culture, and they think that they can do the same to insurance companies; they are going to apply a similar model to do so, and they are determined to do that. We can observe what they do, and comment and criticise as to whether what they are doing is achieving the objectives of customer protection with which we are so familiar.

However, we are doing it because of customer protection and not, *per se*, either to preserve the profession or to preserve the industry. If you read more closely what Mr Bradshaw was saying, that the industry might well be very different in 20 years' time than it is today, we will have a huge role to play in bringing capital and customers together to make that happen.

There are always two things for actuaries to do. One is to avoid the downside. As has been mentioned, there is a trail of legacy business that has to be looked after for the next five, ten, 15 or 30 years, and that is a proper job that needs to be done to protect the customers' interests.

We are here to create the upside, both in so far as there is discretion on existing products, but also in the products and the benefits of the future. Something that I should like us to move towards, which is a longer-term objective, is to insist that it is actually not products that need regulating, it is benefits that need regulating in the market. It is that connection between the customers' needs and the benefits that are required to meet those needs. Needs and benefits are as much as the customer and the salesman need to discuss. How that is turned into products is a matter for the provider to support the salesman in providing those benefits.

I should like to see — I do not see it happening in my Presidency or in five years — regulation split between needs to benefits as market conduct regulation and benefits to products as a quite separate piece of regulation on the responsibility of the provider. That would make life a lot simpler. The other thing that we can do is to make life simpler in terms of the benefits and the products that we design, and maybe to the point of rendering much of what the FSA does unnecessary.

A flourishing industry which needs our help, support and advice requires both the pro-active avoidance of downside problems for customers and the pro-active creation of upside benefits for customers and shareholders. Let us try to keep the customers' interests in mind, and look through our direct clients and employers, obviously working with them, because they are our clients and they are paying us, but let us keep even more in mind the benefits and the needs of the customer.

It remains to me to express my own thanks and, I am sure, the thanks of us all, to Mr Bradshaw, Mr Chamberlain and Mr Needleman, and to all those who have participated in this evening's discussion. I thank also the many under ten-year qualified people for attending.

WRITTEN CONTRIBUTION

Mr D. G. Heeney, F.I.A.: During the discussion the terms 'insurance' and 'savings' were often used interchangeably. This may lead to confusion, and I would urge the profession to consider clarifying and emphasising the distinction, obvious though it may seem. The basic principle of insurance is clear. It involves the pooling of financial resources by a group of members to provide a collective fund out of which those members unfortunate enough to suffer an 'insurable event' may be compensated. Importantly, therefore, the process involves a redistribution of financial resources — those who suffer events which allow them to claim from the fund take away (proportionately) more than those who do not. Such arrangements need to be managed carefully to ensure that this redistribution operates in a 'fair' way. This has been one of the profession's key roles — we argue that our expertise in applying mathematics to assess issues involving long-term financial uncertainty objectively enables us to make a unique contribution to this complex and potentially emotive task.

Savings, on the other hand, tend to be individual. There may be administrative efficiency in running collective investment vehicles, in which large numbers of individuals participate, but the process essentially involves each individual accumulating his or her own 'pot'. There is no redistribution between individuals.

The U.K. life market is currently based on products which involve insurance and savings components in a diverse range of combinations. Banking products, however, do not involve insurance, and this may be the most compelling basis on which to argue that a unified regulatory framework is inappropriate.

This rationale might lead to the conclusion that further segregation of 'protection' and 'investment' products is necessary. This, in my view, would be a particularly undesirable consequence of our misguided tendency to think in terms of 'products' rather than of 'customer needs'. It was suggested at the meeting that the needs of individuals have changed fundamentally — the main concern, historically, was the financial impact on one's family of dying early; now the greater risk is of living too long. I disagree — people have always faced both the risk of dying with inadequate wealth to support their surviving dependants and that of outliving their wealth. The balance of probabilities may have shifted and the relative ages at which these risks become financially significant have changed over time, but that is all.

Bundled insurance arrangements have provided effective solutions in the past, and I believe that they can continue to do so in the future. A small minority of people will die young or suffer illness or incapacity which prevents them from working for a prolonged period. Others (perhaps a growing proportion, but still a minority) will live, either in good health or not, to very old age with inadequate means to support themselves. If the criteria can be set appropriately, extreme cases of financial hardship, which would otherwise occur, could be prevented via insurance benefits, the burden of which would be shared among the majority whose experience turns out to be less extreme. Encouraging participation in such arrangements, in my opinion, represents the best chance that the U.K. economy has of tackling the demographic challenges that lie ahead.

There are clear similarities to the principles of taxation. In fact, I would also argue that arrangements which include a genuine long-term insurance component offer a benefit to society as a whole which make them more deserving of preferential tax treatment than those solely involving individuals providing for themselves (commendable though that may be).

The recent trend of unbundling financial products will, in my view, encourage people to focus on specific needs to which they can relate directly (and, perhaps more significantly, will encourage advisers to target clients on this basis). This will invariably involve short time horizons rather than life long financial planning. It also reduces the scope for cross subsidy which lies at the heart of the insurance principle.

'Creating the conditions for the United Kingdom life market to flourish' will, therefore, require a shift towards bundled benefit packages covering a spectrum of customer needs over long time periods. These packages should be based firmly on the value of collective insurance. They will involve a significant 'investment' component, because one of the key insurable events that we should be providing for is financial hardship arising from longevity; but this approach differs fundamentally from the management of individually owned pots of money, and should be regulated (and perhaps taxed) in a different way.