ADDRESS

BY THE PRESIDENT OF THE FACULTY OF ACTUARIES

JOHN STEWART RUSSELL RITCHIE

[Delivered to the Faculty of Actuaries, 20 November 2006]

RESPECTING THE PAST, CREATING THE FUTURE

ABSTRACT

This Presidential Address is delivered towards the end of the 150th anniversary year of the Faculty of Actuaries, and is timed to coincide with the International Actuarial Association and Groupe Consultatif holding meetings in Edinburgh. It deals with the growing globalisation of the Profession, reviews the key developments arising out of the Morris Review and the implications of current changes. It then moves on to examine communication and the role the Profession can play with the media. A comparison between actuarial practice in life and pensions follows, with suggestions for a closer alignment between pension expectation and pension reality. Comment is made about the prospects for healthy life expectancy. Finally, the relationship between the Faculty and the Institute of Actuaries is debated, and a consultation with Faculty members is launched.

KEYWORDS

Faculty 150th Anniversary; Globalisation; Change; Morris Review; Public Interest; Strategy Review; Expanding Funnel of Actuaries; Communication; Life; Pensions; Healthy Life Expectancy; The Faculty; The Institute

CONTACT ADDRESS

Stewart Ritchie, AEGON Scottish Equitable, Edinburgh Park, Edinburgh EH12 9SE, U.K. Tel: +44(0)131-549-3250; Fax: +44(0)131-459-1144; E-mail: stewart.ritchie@aegon.co.uk

O mathematicians, shed light on this error. Leonardo da Vinci

1. Introduction

1.1 The title of this Presidential Address reflects two themes which seem to me particularly appropriate in time and place — its origin is international and my address is being given at the end of the Faculty's 150th anniversary year, when we face the major strategic opportunities and threats of the twenty-first century.

1.2 I first came across the expression 'respecting the past, creating the future' when we were visiting my wife's sister and her family in Australia. It was the title of a workstream at Melbourne High School, which my nephew attended. When I googled the expression I found the earliest reference to be in the United States of America. Its international appropriateness is not just because we have been graced by the presence of the International Actuarial Association (IAA) for the last few days, but also because international developments are becoming ever more crucial to the future of the United Kingdom Actuarial Profession.

1.3 Worldwide we are a growing profession but still small. A fascinating paper called 'Actuarial Supply and Demand' by an Australian actuary, Julian Gribble, was presented at the International Congress of Actuaries in Paris this summer. He calculates that there are about 40,000 actuaries in the world, but estimates demand at approximately twice that number, with the excess of demand over supply concentrated in the so-called developing world. I hope and believe that the U.K. Actuarial Profession can continue to play a significant role in helping to meet that demand, largely under the auspices of the IAA. I note with pride that we are hosting in Edinburgh a joint Groupe Consultatif and IAA Education Seminar today and tomorrow. Chris Daykin, one of our Honorary Fellows, has been prominent in the IAA's current pioneering education work, as has Steve Handler, a South African former Faculty Vice President.

1.4 I am indebted to Barbara Lautzenheiser, former President of both the Society of Actuaries and the American Academy of Actuaries, for a further insight on this subject. She notes that, while there are only 40,000 actuaries globally, there can be very few people in the world whose lives have not been affected by the work of actuaries. There are many people who have life, health or pension cover, either privately or through their government. But there are countless more who use transport which is covered by insurance, visit or work in buildings which are insured, and so on. Their lives are made more secure by the work of actuaries, even if they don't know it. We should be proud that as few as 40,000 of us can have a positive impact on the lives of such a large proportion of the world's population.

2. The Role of a Presidential Address

2.1 A Presidential Address to a professional body can be many things. For example the President may seek to use it to provide visionary and inspirational leadership, or to pass on the distilled wisdom of his or her many years of professional experience, or to publish a list of instructions which he or she expects the professional body to implement. In keeping with the Faculty tradition, this Presidential Address is certainly not a list of instructions. Such an approach is doomed to failure because the professional body will only adopt those *it* believes to be sensible, and the rest will be paid lip service in committees until they are quietly forgotten.

2.2 I am extremely conscious also that there is no immediate right of reply to this Presidential Address. As you will see, this does not prevent me from making some radical suggestions, but they are suggestions and they will stand or fall on their merits, not because 'the President' said they should be implemented.

3. Where We Are Today

3.1 The U.K. Actuarial Profession has been subjected to considerable change in recent years, most of it driven by external events. First we had the Equitable Life problem, which led to the Penrose Report, which in turn led to the Morris Review. The first two of these could be thought of as being essentially relevant to life actuaries, but the Morris Review affects the whole U.K. profession. To the extent that Sir Derek Morris addressed questions which are not unique to the U.K., it is also clearly of interest to other Groupe Consultatif and IAA members.

3.2 At this point I want to highlight the debt of gratitude which we owe to our recent Presidents. Tom Ross and Harvie Brown have had to deal with Penrose and Morris respectively, in conjunction with their Institute partners Jeremy Goford and Michael Pomery. If Nick Dumbreck and I can hand over to our successors having done as good a job as those four, I for one will be well satisfied.

3.3 We took an early decision to work constructively with the Morris Review, and I think the outcome has fully justified that decision. In my view the Morris Report was no less than an audit of the U.K. Actuarial Profession, culminating in a series of recommendations which are sensible, practical, in the public interest and in the profession's interest. In particular, independent standard-setting with clear objectives is a concept which I whole-heartedly endorse. Anyone who doubts this need look no further than the controversy over Guidance Note GN11 (and its proposed revision in EXD54), regarding calculation of transfer values from defined benefit schemes. As Sir Derek Morris said in Paragraph 6.3 of his final report — our standards have at times been weak and ambiguous, and have failed to resolve contentious issues. It is impossible to write clear and unambiguous standards when we try to satisfy all shades of opinion within the profession, and our processes make it extremely difficult to resolve issues on which the profession is split. The Board for Actuarial Standards will doubtless learn from this, and I fully expect it to make decisions which will prove controversial in some sections of the profession. When it does so, it will be important for those actuaries who believe BAS to be correct to be as vocal as those who disagree.

3.4 There is of course a great deal more which could be said about where we are today, but I will allow more comments on this to emerge as I go through my other chosen issues.

4. Public Interest

4.1 Working in the public interest is one of the things that distinguish a profession from a trade body, but it is a very difficult thing to pin down in practice. Sir Derek Morris touched on it in his report and our Professional Conduct Standards also reflect on it.

4.2 In my view we should expect individual actuaries to perform their function honestly and ethically, working in the best interests of their clients. This in itself serves the public interest, but may not be very different to the behaviour of honest colleagues who are not members of the professional body. On top of this actuaries have whistle-blowing responsibilities, again driven by public interest.

4.3 But the Profession as a body has its own public interest responsibilities to speak out when it perceives the public to be at risk. This is something stronger and more pro-active than the individual actuary's responsibility. Indeed there may be times when speaking out in this way may be contrary to the immediate commercial interests of some members of the Profession.

4.4 I hope this simply-expressed view of public interest may help the Profession and its members in applying public interest in practice.

5. The Strategy Review and the Future of the Profession

5.1 Following the acceptance of the Morris Review recommendations, the leaders of the U.K. Profession instigated a major strategy review and consulted widely on it. As a result we have redefined the future strategy of the profession as focusing on supporting members throughout their careers so they have the skills, attributes and knowledge appropriate for the evolving needs of the U.K. financial sector, primarily as quantitative risk professionals. To turn that aspiration into reality we have embarked on a major programme of work, divided into seven streams, namely:

— Knowledge services;
— University-based education;
— Qualifications and re-branding;
— Regulatory liaison;
— Overseas;

— Fair financing;
— Structure.

5.2 Nick Dumbreck and I are steering this, and it is our responsibility to ensure that members of the profession are kept informed of the progress of these work streams.

5.3 I believe that there is an excellent future for actuaries as quantitative risk professionals. We do not have a monopoly in risk measurement or risk management, but we have great core strengths on which to build. For example in mortality we are unrivalled in our expertise, and the Continuous Mortality Investigation is a jewel in our crown. Equitable Life notwithstanding, we maintain pre-eminent status as life office risk professionals.

5.4 In the last twenty years we have moved strongly into general insurance. In pensions we retain a central position and I am confident that this will survive the gradual transition from defined benefit to defined contribution — the long term risks are the same, it is simply that they are distributed differently in defined contribution compared to defined benefit. The need for expert measurement, management and communication of those risks remains.

5.5 Investment is another area of traditional strength for actuaries, but here my sense is that we have lost some ground to other risk professionals. I think we should aim to win back ground by working with other professionals as part of a team, demonstrating our added value.

5.6 The way to consolidate and expand our influence in all of these areas must surely be to continue the development of powerful modern techniques and tools and make sure our young actuaries know how to use them. This rather begs the question 'what about our experienced actuaries — shouldn't they be keeping up to date with these techniques too?'

5.7 I think the answer is 'it depends'. Experienced actuaries may be doing a much wider range of things — an expanding funnel of actuaries. We have been busy beefing up our Continuing Professional Development (CPD) to make sure that experienced actuaries are keeping up to speed in areas which are relevant to them. For some of them that will involve detailed current knowledge of the latest quant techniques. But for others it may be enough to know that such techniques exist, so that they can call in other specialists when appropriate.

5.8 In these sentiments I specifically include financial economics. This examination subject is labelled 'Core Technical 8', so it is part of the foundation learning for all our actuarial students. Yet financial economics remains a controversial subject among many older actuaries. I do not deny the right of actuaries to debate the merits of rival theories — indeed I encourage it. But I expect actuaries not to criticise something they have not studied, especially something that has now passed into our basic learning.

5.9 I am aware that in some countries experienced actuaries are having to sit CPD examinations, and failure means the withdrawal of their qualified membership of the professional body. I hope it does not come to that in the U.K. I urge all actuaries to fully and enthusiastically embrace the new CPD regime, in letter and in spirit. Otherwise they may find something a lot less to their liking.

5.10 I am also aware that some actuaries, who consider themselves near the rim of the expanding funnel, question whether they should remain actuaries at all. 'Why', they ask, 'should I put myself at risk of a gratuitous professional complaint while bearing the burden of CPD and a subscription?'

5.11 My answer to that is to point to what such actuaries can gain from their continued membership — the fellowship of their peers, the facility to keep up to date in areas relevant to them and to keep abreast of developments in new fields. You don't know what you don't know. The more general point here is that we need to keep selling the profession to our own members, as well as the world at large.

6. Communication

6.1 In the early 1990s an urgent case came across my desk. It was a pension policyholder who was threatening to expose my company to the press. The problem had begun when the policyholder had written to us saying "I am 54 and I want my money out". We had replied to him saying that because his policy was a tax-approved pension it could not be surrendered for cash. What we had said was perfectly correct, but a complete misunderstanding of his request.

6.2 The key to the problem lay in the first part of the sentence 'I am 54 ...'. What he was really saying to us was that he was old enough to take the policy proceeds as early retirement benefits, and that was what he wanted to do. What he heard us say was that he had given us his money but now we were refusing to given it back to him. No wonder he was angry and threatening to go to the press. Once we checked with him that he wanted his early retirement benefit, and then we gave him a quotation for that, he was perfectly happy.

6.3 There are I think a few broad conclusions to draw from this:

— People generally do not use technical language in financial matters, and do not understand it when used back to them.

— We can and should use our influence to help financial education among adults and children, but it can never be a substitute for communication that is honest, straightforward and transparent.

— By and large people can accept downsides which are properly explained to them in the context of the whole deal. If they can't accept the downsides perhaps it means that the deal is not right for them.

6.4 Perhaps unusually for actuaries my working life has involved substantial experience with the media. I hope that I can use that experience for the Profession's benefit. In his Presidential Address of 2004, Harvie Brown said "as a Profession we need to be more outspoken when we see that things are going wrong or could go wrong". I completely agree, because it is part of our public interest role. This aspect of communication is one of the hardest things for us to implement, for at least two reasons. First, the decision-making process within the Profession can be cumbersome, but sometimes the need to speak out is urgent. Also, by speaking out we will inevitably offend people whose interests are threatened by what we say. Some of these people will be actuaries.

6.5 My proposed way of working with this is to consult in draft with relevant key people (such as the Institute President, relevant Board Chairs and our communication professionals) as opposed to seeking the agreement of entire boards or committees. If the Board Chair thinks there is a need for wider consultation, at the expense of some loss of time, then we must respect that.

6.6 One way in which the profession can communicate in the public interest is to correct serious errors when we see them arising. Here are a few examples:

— Describing a defined benefit scheme as 'fully funded' when it is 100% of FRS17 or indeed IAS19. The problem here is that FRS17 is simply a method and set of assumptions chosen by a group of people. It is potentially a very valuable line in the sand but it carries no assurance that the members will get the benefits accrued to the 'as at' date. As my specimen figures will demonstrate later, FRS17 is not a measure of the ability of the scheme's assets to secure its liabilities in the open market, any more than was the ill-fated Minimum Funding Requirement. It may be legitimate to use a line in the sand as an interim funding objective, or stepping stone, but the ultimate goal must surely be for the fund to have enough assets to secure the liabilities. If we don't explicitly accept this, then when schemes could secure their solvency position they may not choose to do so, and the solvency position could once again decline.

— Using the term 'renegotiate' when what is meant is 'impose'. I have seen this arise in the context of the proposal to allow solvent employers to reduce the value of accrued defined benefits. It is hard to understand why deferred members would or should agree to negotiate down the value of their entitlement — unless of course a side-payment of equivalent value is involved.

— Ignoring the time value of money. It is a fundamental principle of compound interest that £1 at a future date is worth less than £1 today, yet people often talk about future money in the face value terms of today's money. For example, the Government tends to use future face values when it wants to portray something as expensive, but applies a discount rate when it wants to portray something as cheap.

— Most mortality and annuity specialists I know would have no hesitation in buying an annuity with their pension pot when they retire, yet many lay people seem to believe 'annuities are bad value because the insurance company keeps the money when I die'. As a result of changed legislation and product innovation it is now much easier to counter the 'what happens when I die' concern, but there remains the problem that there appears to be very little difference between an annuity yield which seems to absorb capital and a deposit yield which seems to preserve capital. People appear to have great difficulty in conceiving long term risk. As actuaries I think we need to make a greater effort to explain in plain words how an annuity is insurance against outliving your assets and the risks of alternative underlying investments, with particular reference to inflation risk.

7. Comparing Life and Pensions

7.1 Most of my career has been as a pensions specialist working in a life office. This has given me the chance to compare and contrast the two fields of actuarial practice in a way which might not naturally arise for most actuaries. In this section I do not attempt a comprehensive analysis of the origins of 'the pensions crisis'. Others have already covered this ground very well, notably Michael Pomery in his Institute Presidential Address of 2004. Instead I focus on a few key relevant points.

7.2 In the early 1990s the gross redemption yield on long gilts dropped below 9% p.a. At that time 9% was the common long term investment assumption of pensions actuaries. Leaving aside questions of future changes in legislation, expenses, mortality, inflation, salary progression and investment conditions, the key point was that actuaries were now using funding assumptions and methods which were likely to undershoot the cost of buying out with a life office if a sponsoring employer became unable or unwilling to underwrite the defined benefits which the employees had been led to expect. I was sufficiently concerned about this that in April 1993 I published a paper entitled 'The Crisis in Final Salary Scheme Funding', but pensions actuaries and their clients generally seemed to view this as an acceptable risk. The argument seemed to be that the greater good was to maximise defined benefit provision, taking credit in advance for the expected benefits of equity investment, because that reduced contributions for the employer. Perhaps they were right. We don't hear complaints from the members of defined benefit schemes who are receiving, or will receive, their full expected pension, but who might not have done so well if their employer had stopped the defined benefit scheme ten years ago.

7.3 At this point I note that in Autumn 1993 the Pensions Law Review Committee, under the chairmanship of Professor Roy Goode, published its report following the Maxwell scandal. That committee contained two actuaries, both Faculty Fellows. One of them was Harvie Brown, who of course was our President from 2004 to 2006. The other was David Berridge, my mentor and boss, who would surely also have become Faculty President had he not died tragically young. In its recommendations the Goode Committee suggested that there should be statutory minimum solvency levels based on cash equivalent transfer values, that these should be the minimum winding up benefits, and the actuarial profession should tighten up GN11. We will never know how employers would have reacted if some such concept of solvency had become the funding standard in the mid 1990s. What is indisputable is that today there is a serious solvency problem for defined benefit schemes which do not enjoy a taxpayer's guarantee.

7.4 Recently I asked some colleagues to produce specimen figures for the reserves likely to be held to cover the same defined benefit but in the different contexts of (a) a 'middle-of-the-road' set of on-going funding assumptions, (b) financial reporting standard FRS17 and (c) a rule of thumb proxy for life office buyout. The detail is in the Appendix, but for a 45-year old single male with a £1000 a year pension coming in to payment at age 65, with annual inflation-proofing in retirement capped at 2.5%, the specimen reserves were:

On-going scheme funding basis	£4,910
FRS17	£5,795
Buy-out	£9,501

(Source AEGON U.K. June 2006)

7.5 None of these reserves include an allowance for expenses. The buy-out figure at least ought to do so, because it cannot be assumed in this case that there is an employer willing to pick up the annual expenses bill, but I did not want to over-dramatise the figures or get into the difference between a buy-out cost and the reserve the life office would then set up for the liability.

7.6 The differences are less extreme for members older than 45, and more extreme for younger members, as brought out in the Appendix. It is important to remember also that these figures were a snapshot at a point in time (June 2006) and could get better or worse in the future.

7.7 The key point which I want to bring out from this exercise is that there remains a potentially large gap between even FRS17 and buy-out. Those who complain that FRS17 is too stringent should reflect on this. As a pensions actuary I understand why people argue that the buy-out market appears artificially expensive, but as a life office person I note that the life office is taking a long term risk which is difficult, if not impossible, to hedge, and that substantial extra reserves over best estimate must therefore be set up.

7.8 This leads naturally to the question 'why is it that a life office needs a large reserve over best estimate, but a pension scheme offering the same benefit does not?' This question was addressed by a Fellow of the Institute, Mr John Ball, in a letter to the Financial Times on 3 February 2004 when he wrote:

> "... it is arguable that the pension promise made by an employer to its staff has become exactly analogous to the promise made by an insurance company to its policyholders. How long will it be before the regulators cotton on to this and require pension plans to submit to the same reserving regime as insurance companies? If this were to happen, the bandwagon from equities to bonds would become unstoppable."

7.9 An additional insight on the equities versus bonds issue was offered by one of Mr Ball's then colleagues, Mr Kevin Carter, an investment specialist. In the Financial Times supplement FTfm on 4 July 2005, he was quoted as saying:

> "a reliance on the equity risk premium to bail pension funds out of their deficit problem is probably a false reliance."

7.10 This reserving question is one which has not escaped the European Commission in the context of the scope of Solvency II. At its meeting of 5 April 2006 in Brussels, the European Insurance and Occupational Pensions Committee of the European Commission decided to shelve this meantime, but "The Commission would revisit the issue again when starting the reviews foreseen in the Directive". I understand that the EIOPC debate on this topic largely divided according to whether a particular country had one regulator covering both life and pensions, or two separate regulators.

7.11 In the meantime I suggest that many people regard pension as deferred pay, and if employers do not regard their defined benefit provision as deserving near-certainty of provision, perhaps they should have an obligation to spell this out to the employees in plain words. This goes against the grain for employers. The last thing an employer generally wants to do is to tell the employees what would happen if the employer became insolvent. Our Pensions Board has in recent years had some notable success in instigating and supporting solvency disclosure, but I fear that members generally do not read this and even if they did, would not understand the significance for the security of their benefits.

7.12 Therefore the 'fool's paradise' I worry about is not the one described by the Pensions Commission on page 125 of its first report. Rather it is the state of ignorance in which members of private sector defined benefit schemes are encouraged to live. I do not believe this communication problem is too difficult to address. It could be something as simple as the following:

> "For you as a member younger than 65, there is enough money already in the fund to potentially guarantee just over half the pension you have earned so far. The rest depends on the ability of your employer to pay for it in future. If your employer can't pay for it the Government has set up a Pension Protection Fund which may give some help. A more detailed explanation is available in Section 3 of the Scheme Actuary's Report dated 3rd June 2007."

7.13 There will be those who argue that explicit disclosure of this nature will just worry people and lead employers to close down 'good' final salary schemes even faster. To them I say that it is not worth fighting for something that can only survive in a fog of ignorance.

7.14 If employers do regard their defined benefit provision as deserving of a similar degree of security as life office non-profit policyholders, then surely they have to aim to fund their scheme at something close to life office buy-out. I accept that many schemes are too large to actually buy out with a life office, but no scheme is too large to run itself as if it were a life office.

7.15 In a life office if you mismatch between assets and liabilities (whether through choice or out of necessity), you hold extra reserves to cover the mismatch. Therefore while the scarcity of supply of suitable gilts or investment-grade bonds is a problem, it makes a given level of security more expensive, not impossible. However, and at the risk of stating the blindingly obvious, if the assets are worth a lot less than the liabilities, matching doesn't work. You cannot match a black hole.

7.16 I am not convinced that the bond shortage problem is insoluble. If we regard U.K. plc as having economic growth prospects averaging say, 2% to 3% a year indefinitely, then overall we should be able to meet our defined benefit pension promises. The Pension Protection Fund goes some way towards helping overcome the pension solvency risk of a particular employer — but it offers only partial protection. Its own solvency depends partly on factors it does not and cannot control, and it is not underwritten by the State.

7.17 There are many other steps which individual employers can take to improve the security of their defined benefit promises, but all of them have a price tag which the employer must be prepared to pay. Earmarking of assets outside the pension scheme means that those assets are not available to the employer for other purposes for as long as they remain earmarked. Raising capital to inject into the pension scheme has a cost but at time of writing a financially strong company can raise capital at a modest premium over gilts. If the XYZ Company did that, the ABC company pension scheme could buy some of the XYZ bonds rather than gilts. If a hundred of the biggest and strongest U.K. companies did it, their pension schemes could have a wide range of high quality bond investments. The weakness of this idea is of course that to serve the need of the pension funds the bonds would have to be of much longer duration than most commercial bonds today and perhaps also have considerable index-linking. Investment actuaries and other investment professionals are coming forward with partial solutions to this problem by creating liability driven and risk-sharing investment products, but it would surely be a significant help if there were a greater supply of investment-grade long dated company bonds.

7.18 The problems of matching assets and liabilities are not restricted to traditional investment considerations. There is also the huge uncertainty about future mortality. In January we had an excellent paper on longevity bonds and other mortality-linked securities presented to the Faculty by David Blake, Andrew Cairns (a Heriot-Watt professor who is also a Faculty Council member), and Kevin Dowd. This holds out the hope of the "development of flourishing markets in a brand new class of securities". Here is another example of where actuaries can be at the forefront of an area of risk management which can be of great social benefit.

7.19 I am indebted to Paul Greenwood, an Institute Council member for a further insight. He notes that to avoid financial scandals three things must be aligned — the legal position, the financial position and consumer understanding. At the moment, if we regard the legal position for a solvent employer as being 100% of buyout solvency, the financial position as being a current funding position or PPF subvention level of say 70% of buyout solvency, and the consumer understanding as being all over the place, then I think we can see that there remains considerable potential for financial scandal in the area of private sector defined benefits.

7.20 *Never forget that if the employer becomes insolvent before the pension scheme becomes solvent, the members do not get their promised level of benefit, the PPF notwithstanding.*

8. Healthy Life Expectancy

8.1 It is all very well to talk about people living longer, but will the extra years of life be healthy? To help answer this question the Faculty commissioned a piece of research as part of our 150th anniversary celebrations. The result was an excellent paper presented to our Faculty Sessional Meeting on 20 February this year, entitled 'Healthy Life Expectancy Measurement in Scotland' by Angus Macdonald (another Heriot-Watt professor who is also a Faculty Council member), Jennifer Straughn and Matt Sutton.

8.2 This fascinating paper was based on National Health Service Scotland hospital records of individuals which had been linked into a longitudinal data set spanning more than 20 years. The availability of the data in this form is very unusual, I understand. The Faculty paper re-states some of the results already produced by NHS Scotland's own research.

8.3 The key conclusions I draw from the paper are:

— that regional variations are even more significant in healthy life expectancy than in life expectancy; and
— that healthy life expectancy is improving, but not as fast as life expectancy.

In other words, we are getting better at keeping people alive faster than we are getting better at curing them.

8.4 These are important and sobering insights. My reasons for giving the paper a further mention here are because I think these conclusions are so significant for future planning, and because the international comparisons in the paper may be of interest to our guests from the IAA and the Groupe Consultatif who may not be aware of the paper's existence.

9. The Future Relationship between the Faculty and the Institute

9.1 Today I am *not* proposing a merger between the Faculty and the Institute but what I *am* doing is launching a consultation exercise to find out what our members think. Your Council and I believe the time is now right for this to happen.

9.2 I said earlier that a President cannot lead the members of a profession where they do not want to go, but how do you know where they want to go if you do not have an informed consultation with them?

9.3 It is now twelve years since Malcolm Murray's Presidential Address last raised this issue for serious debate. He said:

> "The issue cannot be swept under the carpet nor, in my view, should it be determined by drift over time. The options need to be set out and the arguments for each debated openly."

9.4 Two years later his successor, Paul Grace, recorded in his Presidential Address the outcome of Malcolm Murray's initiative, when he said:

> "Various ideas were floated at a Sessional Meeting held in March 1995. Against the background of that discussion, a working party, established by the President, developed a possible structure for discussion with the Institute. An outline of the ideas appears in *The Actuary*; basically, the intention was to create a structure for the actuarial profession in the U.K. that would enable it to speak with one voice and to spread the costs equitably across the membership, but at the same time retaining the characteristics of the two separate bodies. This proposed structure was rejected following discussion at the joint meeting of the two Councils in Birmingham 12 months ago. That meeting did, however,

establish a Steering Group to progress some of the ideas — in particular the establishment of a joint organisation, which could manage the 'day-to-day' affairs of the actuarial profession in the U.K. and speak for the two separate professional bodies on most issues, reducing the time it takes to reach decisions, mainly on submissions to the authorities. Steps taken two years ago to create the various boards, and, in the case of the Institute, a Management Committee, had helped considerably, but it was still necessary to refer some items to Councils for decision. Against this background the 'Faculty and Institute Management Committee' has been established. It is intended that usually a third of the members of the Management Committee will be drawn from our own Council, and it will meet in Edinburgh on several occasions each year. The individual members of Council serve on at least one of the boards or joint committees that report to the FIMC, with Council meeting less frequently to discuss strategic issues and matters appertaining solely to the Faculty.''

9.5 For brevity, I have not quoted this section of Paul Grace's Presidential Address in full, but both this and Malcolm Murray's Presidential Address are available in full in the British Actuarial Journal through the U.K. profession's website.

9.6 Since then another decade has passed, during which time cohorts of senior actuaries have retired and equally talented young people have joined us. Over this period the Faculty and Institute have worked ever closer very much in the way Malcolm Murray and Paul Grace envisaged.

9.7 We have, especially over the last decade, moved steadily towards a de facto merger. Our finances are now almost completely integrated, to the point where all categories of member and student pay an identical subscription regardless of whether they are Faculty or Institute. We have common boards for all our relevant activities, from pensions to professional affairs. We have a common secretariat. Perhaps most tellingly, we have a common set of examinations, so that for Fellows and Associates qualifying today we cannot point to a scrap of difference between one who chose to study with the Faculty and another who chose to study with the Institute. For the Faculty and Institute to decide to separate back to where they were twenty years ago would be not just inconceivable but, I suspect, physically impossible. For example, can you imagine the resource required to re-establish our independent Faculty Board of Examiners?

9.8 So there is no going back. Some people argue that today we have the best of all worlds, through the efficiency of joint operations combined with the separate existence of a Faculty of Actuaries. This gives us a separate identity through which we can express our Faculty tradition, make sure that our own members are properly served, obtain high quality volunteers motivated by loyalty to the Faculty, and obtain two votes instead of one in international forums. All of this is true, but begs the questions of the degree to which each could be maintained in a completely merged body, and what the value of each would be in that new context.

9.9 Some people argue that we should retain two bodies but have each responsible for separate functions. For example, the Institute could be responsible for general membership services and discipline, while the Faculty became the custodian of our profession's 'Crown Jewels', our knowledge and research. See in particular the article written by Shane Whelan, a Fellow of the Faculty, published in *The Actuary* in November 2005. This may be worth considering further, and will form part of our consultation with members, but I remind you that we are a very small profession which has just given up one of its biggest duties, namely technical standard-setting. Would the creation of such a sub-division be sub-optimal from an efficiency viewpoint?

9.10 As I described earlier, the U.K. Actuarial Profession is in the middle of a major restructuring exercise, enthusiastically endorsed by both Councils. If ever there is to be a 'right time' to consider a merger of the Faculty and Institute, surely this is the time. There will be people, perhaps some in this room tonight, who will condemn me in strong terms for raising these issues, and say that by doing so I am weakening the position of the Faculty. To them I must answer that I disagree, and remind them of Malcolm Murray's words that I quoted. If the outcome of our consultations with the membership is a clear steer that we should not merge, then that fact and the reasons for it would be obvious to all concerned, including our colleagues in the Institute.

9.11 If we were starting with a clean sheet of paper to design a structure for the U.K. Actuarial Profession fit for the twenty-first century, I do not think we would have two separate bodies, established in different legal jurisdictions, with one management committee answerable to the two governing councils of those bodies separately, and with one of the bodies one sixth the size of the other. From a strategic viewpoint I invite members of the Faculty to think about the scenarios that could evolve from this structure as the new century progresses.

9.12 One of the great advantages of modern times is the ability to communicate fast with large numbers of people all over the world. This evening an email will be sent to every Faculty member and student for whom we have an email address, referring to this section of my Presidential Address and inviting them to give me their views on this issue. Paper copies will be posted to those for whom we do not have an email address. In the email I am stressing that this is not a vote but a survey of opinion, and I am inviting respondents to express views on various questions, copies of which are available as handouts this evening.

9.13 In all of this I have said almost nothing about the attitude of the Institute, yet it takes two bodies to decide on any merger, should it come to that. It would be quite improper for me to attribute any view to the Institute or its Council, but equally it would have been very foolish for me to stand up here today and say what I have said without at least having sounded out the Institute President. This I have done, and he is content that what I have said is not unreasonable or unacceptable from his viewpoint.

9.14 There will be people who will suggest all this is a done deal, and they are only being consulted for the sake of appearances. This is not so. Your Council has not considered whether it wants a merger, let alone started negotiations with the Institute. Your Council has simply decided that the time is right to sound out the members.

9.15 I urge all members and students of the Faculty to respond to this consultation by the end of this year. I cannot say in advance of those responses what action your Council or I will take, but we are committed to keeping you fully briefed. I can assure you that we will communicate with you as soon and as often as there is something substantive to say.

10. Summary

10.1 In this Presidential Address I have tried to cover a number of subjects in varying degrees of depth.

10.2 The Profession is at a crossroads both nationally and internationally. In deciding our national direction we cannot ignore globalisation.

10.3 We are adapting to the new world of the Board for Actuarial Standards and indeed the Professional Oversight Board. I do not underestimate the difficulty that this bedding in may cause, and individually we may not agree with some of what emerges. When that happens it could be important for those who do agree to be as vocal as those who do not.

10.4 Public interest is a difficult issue for professions but we can't turn a blind eye. Communication is extremely important to the effective discharge of our public interest responsibilities.

10.5 I do not believe that life and pensions exist in parallel universes under different laws of actuarial science. I believe that pensions can only justify different reserving treatment to the extent that the benefits are explicitly not guaranteed, and the members genuinely understand and accept that. I know that we must start from where we are, and many employers with defined benefit schemes are in dire straits, but if we do not embrace this as a target, we will never set a course to achieve and capture defined benefit solvency, and scandals will recur. This issue has been fudged for too long.

10.6 The future relationship between the Faculty and Institute needs to be re-examined for fitness of purpose in the new post-Morris, globalised world.

11. Conclusion

As we come to the end of our 150th anniversary year, it is right that we respect and celebrate our past. If we are to have as glorious a future we must be as open to change as were our predecessors one hundred and fifty years ago.

References

Blake, D., Cairns, A.J.G. & Dowd, K. (2006). Living with mortality: longevity bonds and other mortality-linked securities. *British Actuarial Journal*, **12** (to appear).

Brown, H.W. (2005). Address by the President of the Faculty of Actuaries, 4 October 2004. *British Actuarial Journal*, **11**, 41-61.

Grace, P.H. (1997). Address by the President of the Faculty of Actuaries, 14 October 1996. *British Actuarial Journal*, **3**, 29-49.

Gribble, J.D. (2006). Actuarial supply and demand. Presented to 28th International Congress of Actuaries.

Macdonald, A.S., Straughn, J. & Sutton, M. (2006). Healthy life expectancy measurement in Scotland. *British Actuarial Journal*, **12** (to appear).

Morris Review of the Actuarial Profession (2005). Final Report.

Murray, G.M. (1995). Address by the President of the Faculty of Actuaries, 3 October 1994. *British Actuarial Journal*, **1**, 41-59.

The Pensions Commission (2004). *Pensions challenges and choices*. The Stationery Office, London.

Pomery, M.A. (2005). Address by the President of the Institute of Actuaries: 'Restoring confidence in long-term savings', 27 September 2004. *British Actuarial Journal*, **11**, 1-39.

Ritchie, J.S.R. (1993). The crisis in final salary scheme funding. Ritchie Paper Number 1. Copies available from the author.

Whelan, S. (2005). Global science divided by local professions. *The Actuary*, November 2005, 28-29.

APPENDIX

COMPARATIVE RESERVING FOR PENSIONS

Benefit

£1,000 p.a. payable from age 65. No increases before retirement. No guarantee paid. Single life only. Increases in payment are 'new' LPI (i.e. RPI capped at 2.5% p.a.). Pension paid monthly in advance.

Assumptions

Ongoing Funding Basis:

Investment mix	—	50% equities and 50% fixed interest
Interest	—	6.07% pre-retirement and 5.09% post-retirement
Mortality	—	PA92 (M or F), year of use with medium cohort improvements

FRS17 Basis:

Interest	—	5.09%
Mortality	—	as above

Estimated Buyout Basis:

Interest	—	3.8%
Mortality	—	90% of above

Assumptions common to all bases: LPI of 2.0%, no allowance for expenses.

Specimen Reserves

Age	Sex	Ongoing	FRS17	Buy-out
25	M	1,617	2,212	4,876
45	M	4,910	5,795	9,501
65	M	14,187	15,475	17,759
25	F	1,733	2,392	5,347
45	F	5,289	6,298	10,472
65	F	15,335	16,882	19,543

Source: AEGON U.K. June 2006.

Printed by Bell & Bain Ltd., Glasgow