



Institute  
and Faculty  
of Actuaries

# Actuaries, pension fund investment policy and the setting of standards relating to governance in the mid-twentieth century

Yally Avrahampour PhD  
Assistant Professor  
Department of Management  
London School of Economics

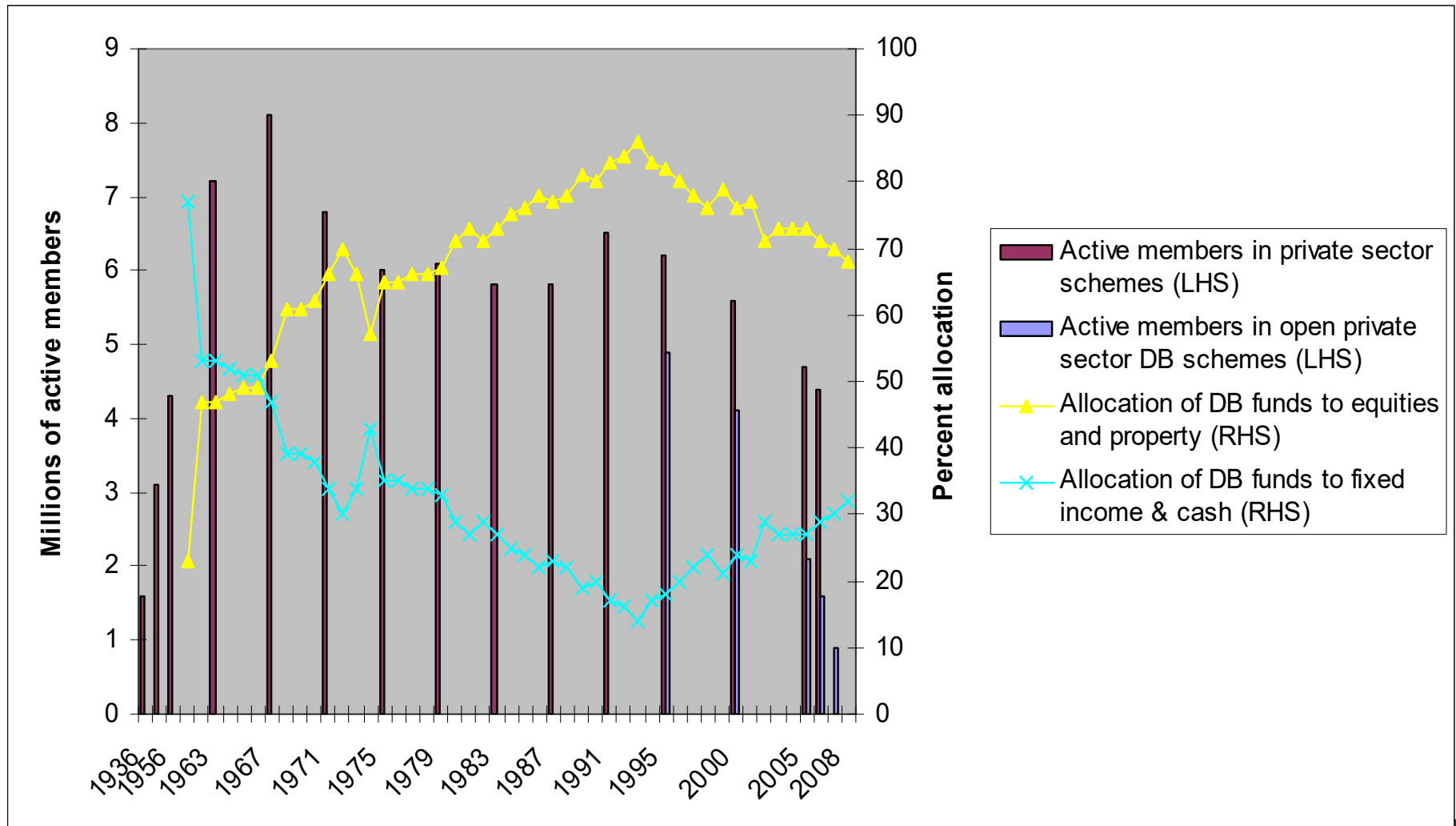
25 September 2018

# Outline

- Mid-twentieth century changes to UK occupational pension provision
  - The take-off of occupational pension provision
  - The shift from defined contribution to defined benefit
  - “Cult of equity”: the shift of defined benefit pension fund investment policy from fixed income to equities
- Pension fund governance in the 1930s
- The mid-twentieth century debate on actuarial valuation.
- The evolution of pension fund investment policy in the 1950s
- The setting of standards relating to financial market governance
  - Financial accounting and pension fund financial accounting
  - Corporate governance and investment protection
- George Ross Goobey and the Imperial Tobacco pension fund
- Pension fund governance in the early 1960s
- Conclusion



# The Broader Context in Defined Benefit Pension Provision and Investment (1936-2008)



Sources: Active membership data: Government Actuary's Department (GAD), Occupational Pension Schemes 2005 survey, Figures 3.1 & 3.3.

1936 derives from the 1979 GAD survey. 2007 active membership in open DB funds from Association of Consulting Actuaries 2007 Pension Trends survey. Asset allocation data: Year 1957: Radcliffe Committee (1959). UK Fixed income includes four percent preference shares. 1962 - 2007: UBS Pension Fund Indicators, 2007; Year 2008: WM Company

# Pension Fund Governance in the 1930s

- **Assurances:** Representation of members on trustee boards, separate auditors, solvency and interest guarantees.
- **Actuarial valuation:** 1) Assets valued at cost or market price, whichever is lower, 2) Liabilities discounted at the risk free interest rate or at the minimum interest guarantee provided by the sponsoring firm. Solvency actuarial basis.
- **Financial accounting:** It was common practice for firms to disclose the presence of interest or solvency guarantees as liabilities on the sponsor's balance sheet. Transparent, balance sheet led approach to pension fund financial accounting.
- **Risk management:** Unlimited scope for use of actuarial judgment in changing the value of assets or liabilities to manage risk. For example, if a pension fund allocated to equities, the actuaries could raise the value of liabilities or reduce the value of assets to create additional margins to protect the funding level.
- **In summary:** Limited scope for the exercise of professional discretion over the financial assumptions in the actuarial valuation. Transparent disclosure.



# The mid-twentieth century transformation of actuarial valuation practice

In the mid-twentieth century consulting actuaries became recognized as financial and investment experts.

- Puckridge (1948) proposes that pension fund assets be valued using a discounted cash flow approach, similarly to the pension fund liabilities.
- Introduces the idea that it is appropriate for consulting actuaries to engage in debate regarding the selection of financial assumptions.
- **Response in the discussion:** Rejection.
  
- Heywood & Lander (1961) propose
  - 1) that consulting actuaries use a discounted cash flow approach to value pension funds both assets and liabilities
  - 2) that a risk premium may be added to the discount rate if the pension fund invests in equities,
  - 3) that the consulting actuary should provide advice on investment policy and asset allocation.
- **Response in the discussion:** Acceptance: “this is what we are already doing”.



# The 'Cult of Equity'

In the 1950s pension funds invested increasingly in equities, giving rise to the term 'cult of equity' (Wincott 1960).

Year	McKelvey (1957)		Morgan (1957)		Radcliffe Review	Philips & Drew (1963)
	1945	1954	1953	1955	1957	1962
British Govt. + Brit Govt Guaranteed securities	42.8%	33.6%	51.3%	41.6%	34.0%	51.0%
Overseas Govt., Provincial & Municipal Securities	39.4%	30.1%			11.7%	
Securities & loans to UK Local Authorities			6.0%			
Company debentures			5.9%	5.5%	12.0%	
Mortgages (excluding loans to UK local authorities)	5.4%	5.5%			2.0%	
Real Property	2.1%	2.2%			3.0%	
Preference shares			9.2%	8.0%	4.0%	47.0%
Ordinary shares	10.0%	28.5%	19.3%	29.7%	21.0%	
Cash			2.6%	2.5%	15.0%	2.0%
Other	0.3%	0.1%				
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

The proportion of listed equity held by institutional investors rose from 17.9% in 1957 to 31.7 % in 1970. Pension funds holdings of listed equity rose from 3.4% to 9.0%.



# The mid-century setting of standards relating to governance

## Financial accounting

In 1942 the Institute of Chartered Accountants in England & Wales (ICAEW) begins to promulgate financial accounting standards.

A dramatic change for the ICAEW to intervene in the practice of member firms.

In 1953, the ICAEW deliberates on pension fund financial accounting.

*Recommendation N21: Retirement Benefits* promulgated in 1960. Adopts the disclosure requirements of the inter-war years but in a very different environment for actuarial practice.

## Corporate governance

In 1932 the Association of Investment Trusts was established to conduct investment protection.

Also, in 1932, the British Insurance Association established an investment protection committee.

The Association of Superannuation and Pension Funds (ASPF) was established in 1921 to lobby governments, not the professions.

The ASPF establishes an investment protection service in 1952. From inception until 1963, this service was managed by George Ross Goobey.



# Ross Goobey, Imperial Tobacco and the “Cult of Equity”

- George Ross Goobey born in East End, London in 1911
- Qualifies as an actuary between 1930 and 1941, working in investment at several insurance companies.
- Between 1934 and 1937 works at Legal & General where Raynes is Chief Actuary.
- Pension manager of Imperial Tobacco Group between 1948 and 1970.
- Director of Imperial Tobacco following retirement.
- Invests the Imperial Tobacco pension fund entirely in equities between 1955 and 1960.
- Value based investor focusing on yield across large cap and small cap, listed and unlisted shares and real estate.
- Council member of the Association of Superannuation & Pension Funds from 1953.
- President of the National Association of Pension Funds between 1972 and 1980.
- Advocate for equity investment by defined benefit pension funds.





# Three puzzles

In 1947 the Imperial Tobacco pension fund was allocated 50% gilts, 10% corporate fixed income, 20% preference shares and 20% equities.

Puzzle 1: In 1953 Ross Goobey sought his trustees to invest exclusively in equities. At the time, a third of the pension fund's assets were allocated to equities. Surely his policy had a greater chance of being approved by proposing a smaller change?

Puzzle 2: In 1955 the trustees accepted Ross Goobey's recommendation. The equity allocation reached 68% in 1957, 85% in 1958 and 96% in 1961. Why did the asset allocation change so slowly?

Puzzle 3: At the ASPF 1956 conference Ross Goobey argued that defined benefit pension funds should invest exclusively in equities. Surely this raised the price of equities that the pension fund needed to acquire?

Hypothesis: Ross Goobey's equity-only investment policy sought and achieved high returns. Publicizing it influenced actuarial debate.



# Pension Fund Governance in the early 1960s

- **Assurances:** Same auditor for the shareholders and beneficiaries, sponsor dominated trustee board, elimination of interest and solvency guarantees.
- **Actuarial valuation:** Much scope for discretionary actuarial judgment. Choice between: 1) Discounted income approach: calculating the value of assets and liabilities by assessing the present value of future cash flows. 2) Traditional methods.
- **Pension Fund Financial accounting:** Recommendation N21 suggests that sponsors disclose any interest and solvency guarantees as liabilities on the sponsor's balance sheet. Contributions disclosed as the cost of occupational pension provision.
- **Risk Management:** Reduced scope for actuarial judgment. Emergence of investment consulting and capital market research.
- **In summary:** Great scope for the pension manager to influence the financial assumptions within the actuarial valuation.



# Conclusion

- This presentation provides a historical account of the introduction of the setting of standards relating to governance, rather than a normative assessment of these standards.
- Change in actuarial practice over the mid-twentieth century was part of a broader evolution in the setting of standards relating to financial market governance.
- The introduction of the setting of standards relating to financial market governance in the mid-twentieth century, counterintuitively, contributed to more rather than less professional discretion.
- This outcome relating to governance was the consequence of interaction between autonomous and bureaucratized professional segments participating in standard setting.



# Questions

# Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.



Institute  
and Faculty  
of Actuaries