“The Lights are On, but No-one is at Home”

By Jeremy Andrew

ABSTRACT
This paper identifies a widening gap between the way in which actuarial material is being presented to boards of trustees and the capacity of those boards to assimilate the information and take informed decisions. There is a need for interpretation and distillation. Either the actuarial profession must satisfy this need, or the actuary will be relegated to the back-office. The paper sets out some guidelines which may help to bring the actuary back into the decision-making process.

KEYWORDS
Communication; trustees; interpretation.

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1. INTRODUCTION

1.1. I have been described as “too boring” and “ideologically blinkered”. I am not a communications expert. Like most actuaries, I have been the butt of jokes whose punch-line comes down to a statement that an actuary is the purveyor of correct but useless information. So, please forgive my writing about communication as I am unquestionably unqualified to do this.

1.2. I have, however, been a trustee for most of the last 11 years and have been on the receiving end of reports and recommendations from peers in the profession. I can best summarise the reaction from my fellow trustees to many of these presentations with a quote from the chairperson of one committee who said to me, after a particularly complex presentation of an asset-liability model and how it could be used for a particular fund: “The lights are on, but no-one is at home. Go away and work with the presenter and come back with something that we can understand and use.” Hence the title of the paper and my desire to share with colleagues how we can perhaps try to produce something that trustees <u>can</u> understand and use.

1.3. Before I became a trustee, I was convinced that the reports I wrote should be discussion documents. I thought, rather naively, that, interacting with the trustees, using the report as a basis, I could help them gain a better understanding of the financial position of their fund, now and in the future, and better equip them to take decisions that needed to be taken.

1.3.1. Much of this approach was a negative reaction to an older generation of actuaries whom we younger actuaries (at the time) perceived as telling their clients what to do and giving them little, if any, idea of the flexibility that might be available to them in managing the risks faced by the funds and their stakeholders. We regarded their approach to their clients much as we would doctors: prescribing medication to sort out symptoms or cause, with very little explanation of why or what the pills were aimed at achieving, or what their side-effects might be.

1.3.2. As a trustee, I have now been exposed to documents that explore an issue in very considerable detail, identify matters that need to be considered with regard to that issue (and might set out the financial consequences of alternative approaches to dealing with these matters), and don't include any objective as set by the trustees or give any recommendations at all as to how the trustees should deal with the matter. It is as if the trustees had given the actuary the alternative approaches that the trustees were considering and had asked the actuary to identify problems associated with these approaches and, perhaps, to quantify the financial implications of each. The actuary becomes a technician not a problem solver.

1.3.3. With this sort of approach, I think that the pendulum has swung too far in the direction of a discussion document. This doesn't meet the needs of busy trustees, most of whom are not well versed in actuarial matters.

1.4. For my sins, I was also for some years a regulator, and both before and after my service in Pretoria, part of the Retirement Matters Committee of the Actuarial Society of South Africa which was defining what should be in statutory valuation reports of pension funds, so I share responsibility for some of the communication requirements with which the profession is beset. I realise that these are intended, often, for an audience other than the trustees who pay our bills. We have, quite simply, got our priorities wrong and we are producing reports for fellow actuaries, who might work at the regulator, perform a peer review or act for one or other stakeholder, and not for the trustees. It is this second audience of actuaries who, all too often, are actually giving their clients information in a form the client can use. This must increase the cost to stakeholders, and weaken the role of the valuator.

1.5. This paper is an attempt to sketch a different role for the actuary as

1.5.1. a consultant, establishing the problems faced by the trustees and helping them find solutions; and

1.5.2. an "interpreter" of increasingly complex information, whose job it is to distil that information to the level at which trustees can make whatever decisions are required, without the trustees losing a feeling for the risks involved.

As a profession, we are uniquely equipped to fulfil these roles. If we don't meet trustees' needs, the consultant and interpreter roles will be taken up by others and actuaries will find that they are relegated to the back-office, producing numbers which others interpret and use to take decisions without actuarial participation. This will impoverish boards of trustees because there is no certainty that non-actuarial interpreters understand the risks and can correctly respond to issues raised by the trustees.

1.6. This is intended as a very light paper for discussion. No research has been performed, and no search of the literature was conducted. There is therefore no bibliography.

1.7. I must also apologise to the actuaries who advise the boards of trustees on which I sit. They may recognise their work in some of the examples. I have used dramatic license to exaggerate some of the examples for effect in this paper. I would not like the profession to feel that the comments in this paper are reflective of these individuals' work. I must also put on record that I have seen at least one of them perform quite differently in two different situations: one where he is fully part of the decision making in the board of trustees and one where he is kept at a distance for most of the time, with his work discussed in sub-committees. The effectiveness of his contribution is hugely different in the two situations: where he is more involved he is considerably more effective. This has helped me to crystallise my own thoughts as to the desirable role of the actuary in the closing section.

2. WHO IS THE AUDIENCE?

2.1. THE TRUSTEES

2.1.1. Most South Africa management boards of retirement funds ("trustees") consist of an extremely diverse mix of people in terms of home language, age, education and experience of retirement funding, finance and investment.

2.1.2. Most trustees are part-time trustees, in that they are employer appointed or member-elected trustees with full-time jobs other than their trusteeship role. They are busy people. The retirement fund is frequently only top of their agenda in the brief period over which they prepare for, and attend, a trustees' meeting once a quarter.

2.1.3. Diversity of educational levels amongst the trustees has grown subsequent to 15 December 1998, by which time it was mandatory for members to be given the right to elect at least 50% of the board of management of a fund. It is not uncommon, in any situation where there is a significant blue collar component to the workforce who belong to the fund, to find a fair proportion of the trustees have only secondary education.

2.1.4. There is also a much greater ideological diversity. Many trade union trustees have ideological positions quite different to those of your average actuary. It was in this context that I was told that I was ideologically blinkered: a senior shop steward trustee felt that I was just not understanding where he and his colleagues were coming from and what they were trying to communicate as trustees. I didn't speak the same language or have the same frame of reference.

2.1.5. This is not to say that the employer-appointed trustees know everything: far from it. I will never forget the chairperson of a board who also happened to be the chief executive of the participating employer saying to one of my colleagues who was presenting on the investments of the fund: "why are you asking me to take investment decisions: I make metal castings; I'm not an economist or investment expert, and cannot be expected to make these decisions; we pay you to make them and if you make the wrong decisions, we'll fire you".

2.1.6. It is not a "given" that the trustees are familiar with the rules of the fund, concepts such as defined benefit or defined contribution, or the funding model according to which the funding level and future contribution rates are set in a defined benefit fund. Most trustees are unfamiliar with investments. Trustee training is effective for the most part only in sensitising the trustees to some of the issues.

2.1.7. The trustees may well not understand the risks that the fund and the members face or the mitigating strategies that have been put in place. Despite Circular PF130, many funds do not have a risk management policy, and many have not integrated this risk management into the daily work of the trustees and their consultants.

2.1.8. In particular, where funds use asset-liability modelling techniques to set their investment strategy, very few trustees appreciate, other than in very broad terms, what the actuary is doing and what the results of the exercise are conveying in terms of risk and potential reward. The "black box" that determines the results is very sophisticated.

2.1.8.1. In a presentation to the European Pension Fund Investment Forum in 2007, an actuary noted that the results of asset-liability models need to be interpreted for even the skilled trustees of major funds in the European Union.

2.1.8.2. To put this in a South African context, when I joined the board of a large fund, I found that two previous asset-liability model reports (including recommendations) were sitting on a shelf without any action having been taken and despite the existing investment strategy being significantly different to the recommendations of the two reports (which were consistent with each other). The output of the asset-liability models had not been understood.

2.1.9. All of this is complicated by cultural factors. There are two, from my experience, that seem particularly relevant to what happens in a board of trustees:

2.1.9.1. A Professor of Law mentioned to me that he is finding it increasingly difficult to get appropriate levels of debate in his classes, because, with changing demographics and greater cultural diversity, he is finding more students unwilling to challenge the views of others when the students feel uncertain of their knowledge. From my experience in diverse boards, trustees who have little industry and technical knowledge are very quiet in discussions on technical aspects, despite possessing considerable intelligence. I have found fellow trustees happier to express contrary views in private, or within a discussion with their fellow trustees, than in front of the "the expert". This is a world away from my own cultural history as a trustee, namely that there is no such thing as a stupid question, and that trustees have a duty to demand explanations of terms they don't understand and must satisfy themselves that they know enough to make an informed decision.

2.1.9.2. There are also cultural views on how to behave within a group discussion. I have several times been reprimanded for using language or behaviour that was not sufficiently respectful of my fellow trustees or of persons addressing the board of trustees or that was perceived as too assertive. Many trustees are incredibly polite, despite, perhaps, disagreeing strongly with what they have heard. The sort of challenge that I was brought up to expect to give and to get, may be viewed as impolite. Silence is preferred to open challenge. On one occasion, an employer appointed white trustee deeply offended several black colleagues – I challenged the white trustee, my black colleagues remained silent – and only afterwards did the black trustees tell me that that they were so angry they couldn't speak.

2.1.9.3. It is much more difficult, under these circumstances, to elicit contrary views in a meeting and it is quite possible for a presenter to leave a meeting feeling positive about the outcome, only to find that his proposal is subsequently rejected.

2.1.10. My conclusion from this sort of experience is that

2.1.10.1. robust debate is less likely today within a board of trustees than it might have been 10 or 20 years ago;

2.1.10.2. the presenter is less likely to know how his presentation was received by the audience;

2.1.10.3. it takes much longer to obtain buy-in from all the trustees; and

2.1.10.4. it is absolutely essential that the presenter takes the material to a level at which his audience can make informed decisions. This means that the issues over which decisions are required must be identified, highlighted, and the consequences of each decision explained, all in terms that today's trustees can be expected to understand.

2.1.10.5. It may be necessary to have one-to-one discussions with the trustees, who may express their views more readily in this forum than they will in a full trustees' meeting.

2.1.11. Then there is the complication of the volume of material that the trustees have to digest. Until I became a trustee of a large fund, I didn't appreciate how much the trustees have to process for a single trustee meeting. In large funds that operate primarily through subcommittees of the board at a detail level, a discussion document that might be appropriate at subcommittee level becomes an intolerable burden when all the material is compounded across all of the subcommittees and the issues reach the level of the main board. The result of this is that many of the trustees just don't read more than the covering memorandum and hope that the highlights will be presented before a decision is taken. In any subsequent discussion, these trustees may be silent. Worst of all, they may defer to the "expert" (either within the board of trustees or the presenter) because they do not feel confident in their understanding of the issues to make an informed decision.

2.1.12. It is essential that the actuary presents the critical decisions that need to be taken simply, with only sufficient background material that an intelligent reader can appreciate the consequences of the decision to be taken.

2.1.13. What I've written above must please not be read as a criticism of today's trustee. Many of my fellow trustees have proven themselves in their work environment, are intelligent, have remarkable skills as negotiators, understand the stakeholders, and have an excellent grasp of the issues that really make a difference. They may just not understand some of the concepts that we, actuaries, take for granted and they may be impatient with the technical detail that we relish.

2.1.14. At the other extreme of trustees are people who are financially sophisticated and understand many of the issues that actuaries work with, but come from different disciplines, such as economists, bankers, investment experts and, often, engineers. They do not understand the implicit conservatism which is so much part of our professional training. They want assumptions justified with reference to past experience as modified by future expectations. To illustrate, trustees receive a presentation on past investment performance over an extended period of time and are asked to approve the actuary's assumptions with regard to future performance: the trend line of South African equity performance shows an annual real return of the order of 9%; the actuary proposes to use 6%; they will want to know why the actuary wants to use the lower figure. They are quite happy to be shown the risk implicit in assuming a continuation of this past experience, but they don't want the actuary to impose his own (conservative) view. I've experienced more scepticism about the role of the actuary and less trust of the resulting picture of the financial position of a fund from this type of trustee than the financially less-sophisticated trustee.

2.2. THE REGULATOR

2.2.1. The staff in the actuarial department of the Financial Services Board are fairly representative of the staff preparing the reports that they receive: a mix of the inexperienced (who are likely to be in a majority) through to the experienced.

2.2.2. Most actuarial valuation reports will not be seen by the experienced personnel. Only cases identified as problems will be escalated for review by these people.

2.2.3. The staff processing the generality of cases may well not have English as their home language and cannot be relied upon to pick up nuances where the actuary preparing the report is identifying an issue but expressing it in such a way as not to offend the trustees or the employer. I recall vividly a funding level which was expressed as "x% excluding certain reserves" and the actuarial department of the FSB at the time failed to investigate adequately on receipt of the report what the "excluding certain reserves" meant. Years of litigation could have been spared if this had been picked up and followed through at the time.

2.2.4. Where a skilled actuary prepares a report and wants to make sure that he can always point to a paragraph and say "I identified the issue", it is easy to express it in a way that the inexperienced trustee and regulator will completely miss the significance of what is being written. With thousands of reports flowing through a department it is just impossible to pick up these nuances.

2.2.5. The actuarial department of the Financial Services Board is, however, staffed with actuaries and trainee actuaries who can be expected to understand what the actuary is doing. They also have the benefit of seeing many reports, and of capturing key elements of those reports into a database which they use to compare valuation reports. They might pick up issues that the trustees miss altogether unless the issues are brought to the attention of the trustees by the actuary, and will be more aware of whether the actuary's assumptions are within the range that other actuaries are using than the trustees who see only that report.

2.3. FELLOW ACTUARIES (PEER REVIEWERS AND ACTUARIAL CONSULTANTS TO STAKEHOLDERS)

2.3.1. Here the situation is very different. A statutory valuation report, for example, is prepared to professional standards as laid down by regulations and the professional guidance notes, deliberately to provide an independent actuary with sufficient information to appreciate the result and to check its reasonability.

2.3.2. The peer reviewer can be expected to understand the report, and will check that the professional guidance notes are being implemented.

2.3.3. I suspect that most reports are actually being written with fellow actuaries in mind and not the trustees.

3. WHAT IS THE ACTUARY BEING ASKED TO DO BY THE TRUSTEES?

3.1. STATUTORY VALUATION REPORTS

3.1.1. The trustees expect the actuary to perform his job to professional standards. This expectation includes the selection of the assumptions and methods to be used to value the fund and their justification with reference to economic and demographic circumstances.

3.1.2. Where the actuary wants their input, he can ask for it but only in a context of how the trustees would feel about the results of the valuation if that particular assumption is used. He can't ask the trustees to make the decision on the assumptions to be used. If there is a range within which he would be comfortable, and the outcomes are financially significantly different, then he can ask them to advise what outcome they feel more comfortable with.

3.1.3. The trustees have concerns that they expect the actuary to answer:

3.1.1. Is the fund financially sound? (The trustees need to be shown that this question can only be answered with reference to past service and future service, separately: past service by comparison of the accrued liabilities to the value of the assets and future service by comparison of the cost of accruing future benefits and the contribution rates, nett of expenses including risk premiums.)

3.1.1.1. Where there are constraints on the actuary's findings, these constraints need to be explained. (Such a constraint might be the use of existing actuarial surplus to fund part of the future service contribution, in which case, for how long is this subsidy possible.)

3.1.1.2. Where this conclusion is affected by issues such as the assumptions and funding method, these issues need to be explained simply and the financial effect of the assumptions identified and explained.

3.1.1.3. It is essential that the trustees are told what the situation would be on termination of the fund, either at the valuation date or the end of the next control period if one is being used. One of the most serious potential risks to the trustees will be the winding up of the fund with the fund having assets with a market value less than the value of the minimum benefits in terms of the Pension Funds Act. This difference would then fall on the employer as a debt.

3.1.1.4. If there is a deficit, how can this be eliminated? If there is a resulting increase in the employer contribution rate, can this be afforded by the employer? Is there any flexibility in this funding plan to cope with changing economic fortunes of the employer? Is the Registrar's consent needed before the funding plan can be implemented?

3.1.1.5. If there is a surplus, what do the trustees and stakeholders do with the money?

- Can the employer take a total or partial contribution holiday? For how long?
- Can benefits be improved? By how much? What about the members who do not benefit from the improvement – are the trustees at risk of being found not to have acted with impartiality towards the various categories of member?
- Does the fund remain competitive in terms of the benefit levels offered?

3.1.1.6. In DC funds where the risk premiums are paid from a fixed contribution rate, is this contribution rate adequate at the moment and will it remain adequate in future? (This could relate to both insured and self-insured options.)

3.1.1.7. In DC funds where the risk premiums and administration costs reduce a single defined contribution, is the amount being saved for retirement going to provide an adequate benefit, or is this amount being eroded with increasing expenses to the extent that benefit levels might be inadequate?

3.1.2. Can the fund afford full inflationary increases for pensioners? Can the fund give more, such as a catch-up over a longer period? If the fund can't afford CPI increases for pensioners, why not? How does this relate to the fund's pension increase policy? What pension increases are we going to be able to give in future? Is there anything that can be done in future to remedy any failure to inflation proof the pensions?

3.1.3. Is there a trend in any of the financially significant areas that should cause a trustee to take notice? Should the trustees alert stakeholders to this? (This could be increasing longevity of pensioners, or increasing mortality and / or morbidity of active members, for example, or significant and potentially long-term changes in expense levels?

3.1.4. Is there cross subsidy from active members to pensioners or vice versa (or between other clearly identifiable groups of stakeholders)?

3.1.5. Can the fund afford the death and disability benefits that are currently being offered? How long will the fund be able to continue to do so, if risk premiums are increasing?

3.1.6. Does the asset mix remain appropriate in terms of the liabilities? Does the risk implicit in the asset mix present future problems for the funding level or the contribution rate? If the actuary finds anything inconsistent with the approved strategy or the mandates given to the investment managers, this might highlight a real problem on the investment front. If the investments will not satisfy issues such as the inflation risk to which members are exposed, or is unlikely to satisfy the liquidity needs of the fund, the investment strategy will need to be changed.

3.1.7. If a fund is mature and benefit payments are exceeding new contribution income, how is this trend going to manifest itself going forward and to what extent must the trustees make provision for it?

3.1.8. Are benefits inadequate or is the level of benefit perceived to be deteriorating?

3.1.8.1. This will often be demonstrated when trustees come forward with problems emanating from their particular constituencies. For example, pensioner representatives may come forward with concerns about particular categories of pensioner who are experiencing hardship, or a member-elected trustee might highlight a particular category of early retiree whom they perceive to be worse treated than others. Particularly in DC funds, as members retire there can be comparison with other members who retired from similar positions previously and seemed to have done better in relation to their earnings at the time.

3.1.8.2. An alternative motivator might be the Human Resources department of the employer if they are finding there are unfavourable comparisons with other employers' benefit structures and these impede hiring new recruits.

3.1.9. In a defined contribution fund, where the actuary assists the trustees to determine an appropriate bonus rate to accrue to members' individual accounts, there will inevitably be a balancing act: comparing a declaration close to market returns against the danger of having to claw back part of the declared bonuses in future as a result of a market fall and setting an interim bonus rate for the next period which preserves equity between the surviving and exiting members. Many of the same considerations will apply with regard to the distribution of expenses that are not naturally offset against new contributions or investment returns.

3.1.10. Where there is under-performance, why has it happened and is underperformance expected to recur? This will be answered in part by the analysis of the change in the financial position of the fund over the inter-valuation period (and previous similar investigations.) If it is expected to recur, what will be the consequence of bringing assumptions into line with these expectations? Perhaps the most serious aspect of this can occur with underperformance caused by assets which are inappropriate in relation to the liabilities. It is quite different if the mismatch is temporary or if it is expected to be long-term.

3.1.11. There may be environmental changes (such as the recent changes to the Divorce and Pension Funds Acts which give the court the right to award part of the member's pension interest to a non-member former-spouses). Does the fund need to adapt to these changes? What will the financial impact be?

3.1.12. Is the actuary aware of operational problems at the administrator or investment manager? The actuary may become aware of such operational problems in a way that is hidden from the trustees. For example, there could be:-

3.1.12.1. large payments of "late payment interest" because claims are settled late;

3.1.12.2. the administrator could have difficulty in providing the actuary with the information which he requires, or this information may arrive in a haphazard form;

3.1.12.3. the actuary may have difficulty in reconciling the benefit payments over the intervaluation period to the accrued liabilities at the previous valuation;

3.1.12.4. in a defined contribution fund that offers individual choice of investment medium, the actuary may have difficulty reconciling the assets, as understood by the investment managers, and the balances in individual member accounts as maintained by the administrators. Differences should only be the result of timing in the execution of switch instructions in that the administrator may well use the unit price last available when the instruction was given to switch member portfolios, but the investment managers will use the prices that actually applied at date of disinvestment; and

3.1.12.5. the analysis of the change in the financial position across the intervaluation period may not balance.

3.2. OTHER INVESTIGATIONS

3.2.1. The trustees must have a problem otherwise they wouldn't ask for an investigation to be performed (unless it's a statutory valuation, in which case the trustees haven't a choice). This might seem a trite statement, but I have certainly seen many hours spent on investigations that were peripheral to the real problem. For example, in one situation the pensioner representative on the board of trustees was asking for the cost of different levels of enhancement to spouses' pensions to be quantified; for some time, the actuaries were executing these instructions without having established what his problem was; when the pensioner representative was challenged by fellow trustees it became clear that his problem lay primarily with low pensions paid to the surviving spouses of former pensioners who had retired a long time ago; and then another solution became apparent, namely to motivate an increase in real pensions related to the period since the member retired.

3.2.2. The first task of the actuary must be to find out what the trustees' problem is. The client may not be aware of the root cause, but rather of symptoms, as in the example given in the previous paragraph. The actuary will have to delve to establish if there is a deeper root cause.

3.2.3. If data must be analysed, the actuary must get appropriate data that he can use to investigate the problem.

3.2.4. Then the actuary must identify if there are possible solutions, quantify the cost and benefit implications of those solutions, and present these to the client. It is important here to note that the trustees will not be concerned at the technical aspects of the solution. It may be more appropriate to present the technical details in the form of an appendix than in the body of the report. The trustees want to know that their problem has been understood, one or more solutions have been identified, and, simply, the cost / benefit implications of each.
Where one possible solution stands out, the actuary should recommend this to the trustees.

3.2.5. There may be constraints on the potential solutions imposed by the trustees or other stakeholders (such as a requirement in the rules that the employer must approve an increase in the contribution rate). It will be important for the actuary to establish such constraints at an early stage and to build this into the solution.

3.2.6. If the actuary confines his activities to what he is asked to do, only, without exploring the problem itself, he ceases to be a problem-solver and becomes a technician. This becomes particularly dangerous where there is a "gate-keeper" between the actuary and the trustees – in many smaller funds this might be a single individual such as a benefit consultant, while in large funds it might be a subcommittee of the board of trustees – and the gate-keeper doesn't himself really appreciate the concerns of the trustees.

3.2.7. To achieve this level of interaction with the trustees, the actuary must win their confidence and be an active participant in their deliberations.

3.3. OTHER AUDIENCES

3.3.1. Regulators and actuaries representing stakeholders should have their needs satisfied in supplementary reports or appendices. They do not pay the bill: the trustees do and their concerns should be paramount.

3.3.2. An alternative might be to structure a covering report to the trustees addressing their specific needs with the report for the regulator attached. The latter can contain the detail which the regulator and other actuaries require.

4. TRUSTEES SELDOM WANT A DISCUSSION DOCUMENT AT BOARD LEVEL ALTHOUGH THIS MIGHT BE POSSIBLE AT SUB-COMMITTEE LEVEL.

4.1. I am frequently presented with the result of an actuarial investigation presented as a discussion document. A whole number of issues are raised. Possible solutions may be proposed, but there are no recommendations, as such.

4.2. This can be incredibly frustrating for the busy trustee if the agenda for that subcommittee or board meeting is large, but entirely appropriate if the matter will be discussed at a small subcommittee before finalising a proposal for the board. It matters therefore for the actuary to determine where his report will be discussed and to frame the report for the particular audience.

4.3. In my experience, big meetings are hopeless venues for technical discussions. The latter rapidly becomes confined to one or two trustees and the presenter, the rest of the trustees are lost, and quickly revert to "The lights are on, but no-one is at home" scenario.

4.4. What trustees do want is a presentation or document that sets out the following, preferably in only a few pages:

4.4.1. The actuary has understood their problem and describes this succinctly.

4.4.2. There is at least one solution, and this solution is expressed clearly.

4.4.3. The cost / benefit aspects of the different solutions have been analysed and a summary is presented.

4.4.4. Where there are risks associated with the different solutions, these risks are spelt out and mitigating strategies are summarised simply.

4.4.5. If trustees have alternatives, a recommendation is made as to which of the alternatives seems best to meet the trustees' needs.

4.5. The detail of any investigation should be set out in Appendices. The actuary must understand that most of the trustees won't read these appendices. However, the appendices should contain sufficient information to enable the actuary to satisfy any professional issues that might arise subsequently.

4.6. The critical aspect is that the trustees get sufficient information to make an informed decision or exercise their discretion in an appropriate manner and can describe afterwards what issues were considered and why they took the particular course of action that they did. The trustees need to have their summary document highlight the issues taken into account, the proposed solution (or alternative solutions), the reasons for the recommendation of these solutions, and the cost / benefit of those solutions.

5. COMPLEX REPORTS GATHER DUST ON SHELVES

5.1. Where a report fails to present the issues simply so that the trustees understand where and how they must exercise their discretion, the report will disappear onto the shelves. The trustees will take no action at all. Witness for example the two asset-liability reports which gathered dust on the shelves of the fund as mentioned earlier.

5.2. The more technically complex the presentation to the trustees, the more likely it is that the presentation will gather dust, or, if the trustees recognise that the matter requires a decision, they will delegate it to a subcommittee or to an individual (maybe the benefit consultant) to bring them something that they can understand.

6. THE ACTUARY AS INTERPRETER

6.1. A fair proportion of many presentations can be cynically viewed as “look how much work I’ve done” and “aren’t I clever” rather than being of use to the trustees. The trustees expect a professional to have done his or her work properly, to professional standards, and to express this within his report, but it is not helpful to the trustees to have to wade through this before they can establish what they are critically interested in.

6.2. Trustees, regulator and stakeholders have complex information to assimilate before they can exercise their discretion properly.

6.3. They are usually overworked and are under pressure because they get large amounts of information shortly before decisions are to be made.

6.4. They need help to interpret this complexity, extract the decisions they have to make, and distil the information provided so that they can understand what the impact of their discretion will be.

6.5. In a technically complex matter, particular care must be exercised by the actuary. I’m going to illustrate this with reference to asset-liability modelling:

6.5.1. A trustee can appreciate the modelling of future benefit payments and future new contribution income relatively easily.

6.5.2. A trustee can appreciate the assumptions built into the various asset classes with regard to relative yields and volatility in those yields.

6.5.3. It becomes more and more difficult to explain clearly what happens inside the model, thereafter, as the performance of the assets and liabilities are modelled, and how this information can be used to determine optimal portfolio structure.

6.5.4. The actuary can play an important role in helping the trustees to interpret the information and to set their objectives for the fund, which can be input into the model, to enable the investment portfolio to be constructed and the risks to be explained to the trustees.

6.6. The actuary is in a particularly good position to perform this role. He understands the impact of many of the decisions that are taken on both the assets and the liabilities and can help the trustee or stakeholder to appreciate the interaction. He is trained to appreciate much of what is done in performing the modelling and other calculations that populate reports on the investigations performed.

7. THE ACTUARY AS CONSULTANT AND FACILITATOR

7.1. One of my favourite descriptions of an actuary was the slogan printed on t-shirts for actuaries' children at an actuarial convention in Australia many years ago: "My daddy is a financial engineer."

7.2. The actuary understands the interrelationship between assets and liabilities, on the one hand, and benefits and contributions, on the other hand, as few other professions do. We also stretch from the big picture of the financial impact on the fund to the detail of what happens at individual member level. We understand the numbers and how benefit rules play out in practice.

7.3. This equips us as a profession to understand and to find solutions to many of the financial problems that impact stakeholders in retirement funds.

7.4. We have, however, lost at least some of the trust that might once have applied.

7.4.1. We have allowed ourselves to be moved away from the front line of direct trustee involvement, weakening our relationship with the trustees and our ability to build that trust. Benefit consultants liaise with the trustees and, in a significant proportion of cases, tell us what the trustees would like us to do. Partly I suspect this is a fee issue (actuaries are much more expensive than benefit consultants and the use of benefit consultants can be cost-effective from a fund point of view), partly this is a result of time pressure on the actuaries (the actuary may be handling a portfolio that is just too large to permit extensive trustee involvement), and partly this reflects our own introversion in that benefit consultants can be found who are better communicators than we are, and who can interact with the trustees at an interpersonal level more easily than we can.

7.4.2. We are sometimes too technical for our audience and lose them.

7.4.3. We have competition from other professionals involved with retirement funds, particularly benefit and investment consultants.

7.4.4. We can be perceived as arrogant or as not sufficiently receptive to what they are trying to tell us. There are a wide range of possible reasons for this, from cultural differences through to different knowledge bases.

7.4.5. We share with the benefit and investment consultants employed by our own firms a potential conflict of interest relative to other services that our firms may offer clients. Increasingly trustees are becoming aware of the possible conflicts present in their consultants who act as gatekeepers for the provision of services to the fund and who may influence the trustees to place work with associated companies. When there are scandals with any of the firms in the industry such as bulking / secret profits, these damage all of our relationships of trust with trustees.

7.5. I believe that we can build trust if we work much more as consultant and facilitator, understanding the emerging dynamics within boards of trustees, to help trustees:-

7.5.1. Identify the problem

7.5.2. Identify possible solutions

7.5.3. Identify the decisions that the trustees need to take, and

7.5.4. Explain the impact these decisions might have on the outcome and the financial consequences of the various solutions.

7.5.5. It is essential that this is done simply, and the issues are not buried.

7.5.6. In the background will be the technical work that we perform to quantify the financial consequences.

7.6. This will mean that we will have to broaden our interpersonal and communication skills.

8. THE ALTERNATIVE

8.1. If the actuary doesn't perform this role of consultant, facilitator and interpreter, someone else will, because the trustees are not equipped to do this on their own, or no action will be taken at all and the trustees will consign the actuary's work to a shelf to gather dust.

8.2. Who are the alternative consultants and facilitators?

8.2.1. The obvious choices are the benefit and investment consultants with whom many of us have been working.

8.2.2. A less obvious choice is a growing group of independent specialist trustees who are remunerated as trustees and who are brought onto boards of trustees to strengthen the technical understanding of the trustees.

8.3. Can they do the job? The answer to this question is really dependent upon what skills they have and how they are trained. I have had very positive experiences with both benefit and investment consultants and independent specialist trustees. I have also, sadly, had some negative experiences. Neither of these "professions" have technical and ethical standards that their members must uphold if they are to perform these functions, as happens in an established profession such as our own. There is bound, therefore, to be a greater breadth of competency amongst practitioners.

8.4. If the regulators perceive a lack of competency and consistency to be harming the interests of the consumers that they are there to protect, the regulators will take action and impose rules. Inevitably such rules will have elements of "one size fits all".

8.5. We run the risk of either becoming technicians confined to the back room, seldom let out in front of a client and then only with the consultant present or being constrained to work within a set of rules established by regulators. Both would deny us the useful role that we can play.

9. CONCLUSION

9.1. We have lost control of an industry where we were once dominant. We have failed to communicate effectively, so trustees have sought other people, who understand them better and who can talk their language, to bridge the gap. We are now sharing influence with other people who do not have a professional foundation to their work, which ensures adequate technical and ethical conduct. If we do not get out there, and consult and communicate more effectively, and win back control of the industry, standards may slip. If the regulator perceives that there is a lack of standards, the regulator will impose standards which may not suit all clients.

9.2. Trustees don't want complexity revealed; trustees want complexity simplified.

9.3. Because we know this is not feasible in many situations, what we need to do for the trustees is to help them identify their problems, separate out the principal decisions that have to be taken, highlight the discretion that the trustees have in making those decisions and the impact that these decisions have on the outcome, and help our clients to find solutions to their problems, without burying the trustees in technical jargon and unnecessary statistics.