Does your actuary test your objectives?

Institute & Faculty of Actuaries (IFoA) senior review actuary, David Gordon, reveals that actuaries don't always articulate objectives to their corporate clients

As a sponsor, what are your objectives when you're agreeing how to fund your defined benefit pension scheme? Do you want to move to lower risk investments so there is less uncertainty in future years and further protect scheme members? Do you want to limit the impact on profits? Or do you simply want to minimise cash contributions up to the next valuation? When taking advice, are you seeking feedback on these objectives from your actuary?

In our latest thematic review, we found that actuaries don't always focus on articulating the sponsor's objectives or clearly communicating how they relate to funding.

Actuarial advice

In an actuarial valuation, an actuary is often employed to help the sponsoring employer reach agreement with the trustees. Our review consisted of looking at nearly 50 examples of advice given by actuaries to sponsors on funding and strategy. The trustees of course take their own separate advice from their scheme actuary.

We saw many examples of actuarial advice where the scope was a broad instruction to review the trustees' proposals and assist in responding to them without further qualification around the sponsor's overall objectives for the valuation. In such cases, the advice was then often simply a reactive commentary on areas where the valuation could be less prudent than the trustees' original proposal. This contrasts with examples we saw where the actuary articulated their understanding of the sponsor's objectives and there were often wider discussions on scheme strategy beyond simply advocating a less prudent valuation approach and lower contributions.

Why is it important to state objectives?

There are several good reasons why actuaries set out objectives in their advice:

1. It provides the opportunity for the actuary to confirm their understanding of the objectives to ensure they are aligned with the sponsor and to test whether they are appropriate. Perhaps circumstances have changed since the last valuation, so it may be worth reflecting on whether the sponsor's aims should similarly change. Articulating them brings clarity on why the advice has been given.

2. Actuaries can link their recommendations or commentary on assumptions to the sponsor's objectives. Rather than simply advocating say a higher discount rate or shorter life expectancies (both of which would reduce any pension scheme deficit) the actuary could explain why these are appropriate in terms of what the sponsor is seeking to achieve.

3. Actuaries could also describe the risks and uncertainties of following a particular approach with reference to the sponsor's stated objectives. For example, paying less money in now may improve the sponsor's finances today, which may be an objective. But this may result in increased risk of higher contributions being needed in the future. It is important for the actuary to make this clear.

4. Finally, it is helpful when looking back. This will enable the future reader to better understand the advice that was previously given, particularly if personnel at the sponsor have changed.

Code of conduct

This is also linked to the ethical code of conduct that all actuaries must follow, known as the Actuaries' Code, which requires actuaries to 'ensure their work is appropriate to the needs and, where applicable, instructions of users'. When providing funding advice, isn't reminding the sponsor of their objectives a good way for the actuary to show that their advice is appropriate to their needs?

Thematic review programme

This article has described just one of the 19 findings in this thematic review. We would like to thank the actuaries from 15 consultancies who took part in this exercise. The thematic review programme is part of the IFoA's Actuarial Monitoring Scheme, which independently reviews key areas of work in which actuaries have significant involvement and influence.

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