Investment case study - Advising a new client

04 December 2013

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Agenda

- Highlights of the case
- Major Stakeholders in the case
- Benefit schemes & relevant regulations
- Investment guidelines -- Statutory employee benefit schemes
- Issues faced by the Investment Actuary
- Issues faced by the trustees
- Responsibility of the Investment Actuary
- Summary and Questions

Highlights of the case

- An Investment Consulting firm hired for giving investment advice to the employee benefits scheme
- Trustees not happy with Previous Advisor
- Trustees expect the Consulting Firm to manage investments closely
- Currently, three Fund Managers look after the current investments

Highlights of the case

- Director of a Fund managing firm also a director of the Consulting Firm
- Full review of the current investment arrangements requested by Trustees
- New monies expected into the fund

Highlights of the case

- Trustees want
  - Allocation of new money to take place only after review
  - To keep the overall cost down

- Trustees don't want
  - To keep money out of market
  - To wait for long time for report
  - A complex report

Major Stakeholders in the case

- Trustees, sponsor and the beneficiaries of the benefit scheme
- Investment consulting firm
- Fund managers
- Regulators governing the investment of benefit schemes
- Previous Advisor

Responsibilities of Investment Actuary

- Make suitable assumptions and judgments based on experience for assignments
- Use knowledge in giving high standard advice
- Confidentiality
- Maintain records of all documents related with assignments

Responsibilities of Investment Actuary

- Maintain Professionalism at all stages of the assignment
- Report any breach of professional guidance
- Keep himself up to date with all relevant GNs, PCSs, rules and regulations related to the assignments
- Not limit to regulations set by Actuarial profession but also consider other regulatory bodies e.g. SEBI

Benefit Schemes and relevant regulations

The details of type of pension Scheme is not clear, however, it may be:

- Gratuity scheme – Payment Of Gratuity Act, 1972
- Provident Fund (PF) & EPS – Employees' Provident Fund & Misc. Provisions Act, 1952
- Other non statutory benefit schemes –Leave encashment, Superannuation, Loyalty bonus

Investment guidelines – Various Employee Benefit schemes

Gratuity Fund Scheme Investments and P F Investments

- Deposits with banks
- Fund with any Insurer (More liberal investment pattern)
- PF Investment also governed by Rule 67 of the Income Tax Rules, 1962
- Any remaining funds to be allocated as per schedule below

Type of Security	Max Allocation
Government Securities	Upto 55%
Debt securities (Term > 3 years) TDR by Scheduled commercial banks (Term > 1 year) Rupee Bonds by IBRD/IFC/ADB (Term > 3 years)	Upto 40%
Money Market Instruments	Upto 5%
Stock of companies having derivatives	Upto 15%

Issues faced by the Investment Actuary

- Why was there a dispute between the Trustees and the previous adviser

- Whether Trustees permit contacting the previous adviser- In relation to review of their work

- Whether it is acceptable to criticize previous consultant's work

How to manage the issues

- PCS States that *"the actuary should contact the other actuary at as early a stage as possible to ask whether, he is aware of any professional reasons to be considered in accepting the appointment or any particular considerations which ought to be borne in mind before giving advice."*

So the Investment Actuary should ask the previous adviser if the Previous adviser is aware of any reasons because of which the Investment Actuary should decline the assignment

- If the Trustees do not permit contacting the previous adviser- Perform the review with the information available from previous adviser's report
- PCS: Sec 8.2 states that.... *Criticism of one member's work by another member is acceptable, provided that the criticism is properly reasoned and believed to be justified*

Issues faced by the Investment Actuary

- What should be the terms of engagement
- How to manage the client's request of discussing the issues in meeting
- Client does not want a long and complex report

How to manage the issues

- Scope of work
  - Should be clearly defined in the engagement deed
  - Should include the professional fees, timelines and the type of advice to be given
- Must manage client's expectations, so the main issues should be discussed in meeting
- *SEBI (Investment Advisers) Regulation 2013, Sec 19.1(e) states that all records must be maintained for Investment Advice provided, written or oral*

So, the report must be produced to the client and it must include necessary details

Issues faced by the Investment Actuary

- Is the Consulting Firm competent for being 'Eye and Ear' of the client i.e. can the Consultant provide services like Fund Managers?
- Whether the issue is Competence in terms of Individual's expertise or Competence of firm in terms of resources?

How to manage the issues

If the issue is Competence in Terms of Individual's expertise:

PCS: Sec 3.2 states that Actuaries must not give advice, unless:

a) satisfied of personal competence in the relevant matters, or

b) acting in co-operation with, or with the guidance of, someone (not necessarily an actuary) with the requisite knowledge and experience

PCS : Sec 3.1 An actuary is expected to use best judgment in formulating advice, whilst paying proper regard to any relevant professional guidance or other guidance. He must keep himself abreast with updated professional guidance and adhere to that

So, If the Investment Actuary thinks these codes are not met, he must decline the assignment

Issues faced by the Investment Actuary

If the issue is Competence of firm in terms of resources :

SEBI(Investment Advisers) Regulations, 2013, Third Schedule, 3, states that

An investment adviser shall have and employ effectively appropriate resources and procedures which are needed for the efficient performance of its business activities.

So, if the investment Actuary believes that there are not sufficient resources, he must either employ appropriate resources, reduce the scope of assignment or decline out rightly.

Issues faced by the Investment Actuary

- Director of a Fund managing firm also a director of the investment firm.

This Leads to Conflict of Interest

How to manage this issue

PCS: Sec 5.1 states that Clients are entitled to assume that advice given by an Actuary is unaffected by interests other than those of the client….

- So it is a responsibility of the Consultant to declare the Conflict of Interest to the client at the earliest

- To avoid Conflict of Interest
  - Request client to employ different adviser for review of the work of this Firm
  - Review the work of this firm, while maintaining the Independence, provided client agrees for this
  - Decline the assignment

Issues faced by the Investment Actuary

How to invest the bulk transfer receipt ?

- Funds may be parked in the risk free assets until the review is complete

- For any other risky investments:

SEBI (Investment Advisers) Regulations,, 2013, 17 (d) states that Investment adviser shall ensure that it has a reasonable basis for believing that a recommendation or transaction entered

into:

- *meets the client's investment objectives;*
- *Is such that the client is able to bear any related investment risks consistent*
- *Is such that the client is able to bear any related investment risks consistent with its investment objectives and risk tolerance*
- *is such that the client has the necessary experience and knowledge to understand the risks involved in the transaction.*

So the Consultant must ensure that, if the investment is in risky assets, the client must understand the risks.

- Statutory guidelines relating to investment of the benefit schemes – Mentioned on slide 10 must be followed

Issues faced by the Investment Actuary

- Awareness issues

- Regulations and the SEBI guidelines of the relating to Benefit Schemes must be carefully studied

- PCS Sec. 2.2 states "A *member has a duty to the profession and must not act in a manner, which* denigrates its reputation or impugns its integrity."

  So, it is responsibility of Consultant to ensure that he is aware of all the necessary regulations to protect himself as well as the Profession

Issues faced by the Trustees

- Previous Advisor –Not proactive enough
- Trustees want to keep the overall cost down as the scheme is poorly funded
- Don’t want to wait for ages for a complex report

Issues faced by Trustees

To keep overall costs down

How the Consulting Firm can help

- Consulting firm is hired to advise the trustees on the investment management to maximize their returns

- Should suggest different ways in which the overall costs of the scheme are kept to the minimum

Issues faced by Trustees

Poorly Funded Scheme

How the Consulting Firm can help

- The Consulting firm should find out the reasons for poor funding
- Review relevant regulations in relation to funding of the benefit scheme
- Talk to the previous advisor or compare with other schemes
- Investigate possible steps to improve the level of funding
- Can investigate the possibility of Scheme re-design
- Can transfer their funds to NPS which is now available to all employees since 1st May,2009

Issues faced by Trustees

Don’t want complex report

How the Consulting Firm can help

- A report with simple statements can be produced with Qualified statements / Disclaimers / Caveats

- Quality of the report should not be compromised

- While choosing any alternative - Follow the Professional Code of Standards and all other rules set out by profession

Summary

- Consulting Firm asked to advice a Pension Scheme
- Trustees not happy with previous advisors
- The firm is expected to submit simple report and in little time
- Various professional and regulatory issues faced by the Investment Actuary in Consulting Firm
- Some of these are Conflict of Interest, Managing Client’s expectation, Criticism of work of Another Actuary
- GNs and PCSs provide guidance which can help in managing these issues
- However, GNs and PCSs are not exhaustive, so the Investment Actuary must apply himself to the situation
- Can seek guidance from other senior members in the profession

QUESTIONS?