Defence of Industry

By:

Aditya Ajmani
Kavita Singh
Ramnath Shenoy

Indian Fellowship Seminar

Details of the Case Study

21th May 2014 ***The Daily Newspaper Office***

Dear **Mr. Actuary,**

I would like you to write an article on the **UK Pension Mis-selling scandal.**

In the article, please provide your views on:

- The **conflict of interest** faced by actuaries
- Whether the actuaries should have acted in a more **public interest role** at this time
- How should the Profession **put across its views in the future**

The last date of submission of the article is 5th June 2014, so please plan your work accordingly.

Regards,

Mr. Editor

Agenda

- Overview
- Evolution of Mis-selling
- Pension Review
- Personal Pension vs Occupational Schemes
- Causes of Mis-selling
- Role of an Actuary
- Action by Authorities
- Solutions to prevent Mis-selling
- Conclusion

Mis-selling: Overview

- Mis-selling is the sale of unsuitable products resulting in customers being left in a disadvantageous position, due to

Product Vagueness

Forced Sales

Clever camouflaging by bundling products

Failure to gauge customer needs

Biased demographic thrust by sales force

Pensions mis-selling: Initial Research

When you add in problems like Equitable Life, the mis-selling of personal pensions and the pensions deficit issue, there has been a growing concern that actuarial work is not fulfilling expectations

Sir Derek Morris

UK actuaries are facing their biggest shake-up in the last 100 years as the government-appointed expert recommends independent scrutiny and other measures to address the "quite serious" problems and conflicts of interest they face

IPE magazine, March 2005

I have witnessed a gathering storm suddenly bursting into a deluge in the UK industry. The new dawn of personal pension introduced in 1988 as a liberating event turned into the worst nightmare in 1993/94 for the entire Life & Pension industry in its two centuries of existence

Mr. Dilip Chakraborty at the 10th Global Conference of Actuaries

Total number of UK policyholders affected by pensions mis-selling > 2 million

£4.5 billion of losses were racked up in the insurance industry. The problem of mis-sold pension products built up during the late 1980s and was fully recognised in 1993-94 when watchdogs and lawyers sought compensation for millions of customers

Oliver Wyman – Mis-selling in the UK, October 2011

Pensions mis-selling: Evolution

*Between 1988 and 1994, more than **five million** personal pensions were sold*

- *Deregulation of financial markets and an influx of foreign capital/companies fuelled the introduction of many insurance products in the 1980s*
- *The mis-selling of personal pensions derived from a **deregulation of the market by Nigel Lawson in the 1980s** that encouraged the development of unnecessarily complex products*
- *The need to reduce the otherwise large burden arising from state pensions led the UK government to introduce a number of **pensions reforms** around 1988 which resulted in the:*
    - *Launch, on **1 July 1988**, of Personal Pensions Provisions of the **Social Security Act 1986***
    - *Removal of the ability of an employer to make membership of an **occupational scheme compulsory** for its employees*
    - ***Introduction of a 2% rebate** on National Insurance Contributions for those commencing a contracted-out Personal Pension Plan*
- *During the period between **29 April 1988** and **30 June 1996**, many people were advised to take out personal pensions when they were already members of or were able to join a defined benefit scheme*

Pensions mis-selling: Evolution

*In the summer of 1991, an estimated 172,000 people were selling insurance – **one for every 200 working people in England***

- ***For the first time, employees were allowed to save for retirement themselves** instead of joining either an occupational pension scheme provided by an employer or the State Earnings Related Pension Scheme (SERPS) provided by the government*
- *Most salespeople were hired from college or unemployment and incentivised to sell to family and friends. Working mainly on commission, most would leave once their networks were exhausted, and **80% left within two years of joining a company**.*
- *In 1993-4 it emerged that **millions of consumers had changed from work-place pension schemes to private policies** over the past decade, leaving them worse off*
- *A **pensions review** to identify the cases involved and to provide compensation was announced in **1993***
- *Customers are being compensated for "any financial loss suffered" by way of:*
  - *attempting to **reinstate customers in their original pension schemes**,*
  - ***pay a lump sum** equivalent to the value of the future missed benefits from that scheme, or*
  - *to **reshape the mis-sold scheme** to track the features of the original schemes*

Pension Review Coverage

*Personal Pensions were heavily promoted on the premise that they are **portable, flexible** and **suitable** for the **modern** workforce*

Opt-outs	Non-joiners	Transfers
• Left the Occupational Pension Scheme while **continuing in the same employment**	• **Eligible to but did not join** the Occupational Pension Scheme	• Opted out or left the relevant employment and **transferred the cash value of their accrued benefits** to a personal pension

Personal Pension vs. Occupational Scheme

Contributions

Employers usually contribute to occupational schemes but not to personal pensions

Benefits

Many occupational schemes pay benefits related to final salary and years of service

More advantageous than a personal scheme, which is dependent on the growth of the insurance company's investments

Investment risk borne by the employer in the occupational scheme rather than the individual in case of personal pensions

Some people may have been badly advised, often by sales staff whose **income relied heavily on commission**, and without this being recognized by the regulators at the time

Others appear, however, to have been enticed by the availability of rebate-only pensions, which (because they required no contributions) would **maximize current take-home pay at the expense of a reduced pension later**

“In general" personal pensions were most suitable for those who moved between employers frequently (or were self-employed or ineligible for an occupational scheme)

- Treasury memorandum

Causes of mis-selling

- Breaches of control routines
- “Over-selling” of products
- Improper (often complex) products sold
- Documentation failings
- Systematic misrepresentations or omissions by salespeople
- Product bundling
- Under-informed customers

Causes of mis-selling

Institute of Actuaries of India

Too much regulatory change at the same time	Management's eye taken off the distribution control ball
New regulations had a negative short term effect on productivity	Salesmen and sales management resorted to mis-selling to solve the performance problem
Failure of sales control	Poor level of training, compliance and monitoring

*One commentator has suggested that if **investment returns** had not fallen as dramatically, then the estimated total impact could have been half of the actual total impact*

*This is an example of a major event resulting from **distribution control factors** and being magnified by **economic factors***

Role of an Actuary

An important role in ensuring the credibility of DB schemes should have been played by the actuarial profession

*According to the **Morris Review** of the Actuarial Profession (Morris, 2004), UK actuaries can been criticised on three grounds:*

- Failing to allow adequately for the persistently downward path of inflation and interest rates in the 1990's
- Failing to allow adequately for the subsequent precipitate fall in the stock market
- For not questioning the prevailing orthodoxy at the time that high equity returns could be expected to provide healthy long-term returns but with a degree of confidence only appropriate to bond investments

- *The optimistic actuarial assumptions made in the 1990s tended to reduce contributions from the sponsoring company to the detriment of the long-term prospects of the plan*
- *Sufficient measures were not taken by the Actuarial Profession to educate customers/salespersons of the potential risks in the product*

To restore trust in the actuarial profession, we must find a way to resolve this potential conflict of interest and ensure that actuaries are seen as acting purely in the interest of the plan beneficiaries

Role of an Actuary…

Actuaries should have known that personal pensions are not suitable for everybody

The sales explosion should have triggered a red flag from the Actuaries to the Company Management and to the Employer's Board of Trustees

The UK Pensions Scandal was an episode of Actuaries failing at a Company level as well as at the Profession level

Criticism faced for Conflict of Interest between Pension and Life Actuaries in the calculation of transfer values and reinstatement values

Actuaries kept busy - the first half creating the problem and the second half trying to solve it!

Remedial action by the FSA*

- *A pensions review undertaken by the FSA – called Securities and Investment Board (SIB) – and by the Personal Investment Authority:*
  - *To Identify mis-sold cases and to provide compensation announced in 1993*
  - *Victims are still welcomed reporting out mis-selling, FSA shared website www.fsa.gov.uk giving full details of the pensions mis-selling process*
- *Now firms must be authorized by the Financial Conduct Authority (FCA) to advise on financial products such as personal pensions*
- *Able to easily verify online if the firm is authorized*
- *A financial adviser to consider pension scheme offered by workplace. Employees to be advised by HR department*
- *Ways to find a financial adviser:*
  - *search online*
  - *check specialist investment publications*
  - *talk to your accountant or solicitor*
  - *check the investment pages in major newspapers*
  - *contact trade bodies, like IFA Promotion or the Personal Finance Society*

Post Scandal - Morris Review

*In March 2004, the UK government asked **Sir Derek Morris** to carry out a **wide-ranging independent review of the actuarial profession***

Principal recommendations

*Actuaries to be administered and subject to independent oversight by the **Financial Reporting Council (FRC)***

***Invite tenders separately** for actuarial, strategic investment and fund manager advice*

- *If a multi-service only contract is put out to bid, trustees should explain why they didn't issue separate tenders*

*Trustees should **evaluate their actuaries** informally every year, more formally every 3 years, and carry out a formal market test at least every 6 years*

*The Pensions Regulator should ensure that trustees have access to good practice guidance on the **effective management of their professional advisers**, including their Scheme Actuary*

*The report also discussed the need for scrutiny of actuaries in the context of more detailed matters such as **technical content and peer review***

Morris Review on *Conflict of Interest*

Trustees, accountable to scheme members

Sponsoring employer, accountable to shareholders

Recommendations from the Morris Review

Trustees, employer sponsors and the Scheme Actuary should first explicitly agree that they see ***no conflicts of interest*** *before both parties are advised by the same actuary*

If any of the three parties to the agreement decide at any point that a material conflict has arisen, the trustees should have the option of retaining the existing Scheme Actuary and the employer should then appoint a separate actuary

Guidance should be developed to assist actuaries *in the determination of issues to be taken into account when considering the materiality of potential conflicts*

Solutions to prevent mis-selling

Regulatory Solutions

- **Remuneration of financial advisers**
- **Better qualified financial advisers**
- **Increased used of Mystery Shopping by the FSA**

Industry Solutions

- **Customer Orientation**
- **Incentives Structures**
- **Professionalization /Training**
- **Transparency**
- **Enhanced Monitoring**
- **Disposing of direct sales forces**
- **Strengthening control functions**
- **Enhanced checks of product literature**

Conclusion

Public Interest

- Actuaries should strive to shape policy changes sensibly and adequately to ensure promotion of public interest

Profession as a body

- The Profession as a body should document and publish its views whenever a policy change is on the anvil
- This will provide members direction regarding how to re-orient themselves in their actuarial roles within the industry

Defence of the Industry

- We must consider whether we, as Actuaries, are playing our role efficiently and satisfactorily
- It is paramount for us to clearly define our role within the industry

Questions

Contact Details

- **Aditya Ajmani (Lead Presenter)**
  - Towers Watson
  - ajmani.aditya@gmail.com

- **Kavita Singh Sehrawat**
  - Mercer Consulting (India) Private Limited
  - kavita.sehrawat@gmail.com

- **Ramnath Shenoy**
  - Indiabulls Housing Finance Company
  - ramnath.shenoy@gmail.com