

GUEST EDITORIAL

BY D. M. EADIE

I was surprised and flattered to be asked to write a Guest Editorial for *British Actuarial Journal*. This follows my surprise last year, when I was informed 'out of the blue' that the Faculty were proposing to award me an Honorary Fellowship. During my career in investment performance measurement (The WM Company) and in the investment management business (Henderson), I found that clients often assumed I was an actuary, so it is very pleasing to be able to add 'FFA (Hon)' after my name, now that I am retired.

The 'logo' for the Actuarial Profession has the useful catchphrase 'making financial sense of the future'. I thought I might develop that theme by commenting on some areas which make no financial sense to me, and where I am quite confused about the role of the actuarial profession. I apologise in advance if I show ignorance or accidentally cause offence.

The main activities of actuaries are in insurance and pensions. Starting with insurance, I have some issues relating to with-profits policies, particularly those which have been sold in connection with mortgages. Many years ago, when tax relief still applied to mortgage interest, I took out a with-profits policy whose sum assured equalled my mortgage loan. This made sense, because I received tax relief on the mortgage interest payments, and I was also aware that the insurance policy would accumulate over the term of the mortgage, leading to a healthy additional capital sum made up of bonuses. It was quite clear to me that I was, as a result, saving for the longer term, while also providing protection so that the mortgage would be paid off in full if I died.

When the tax relief on interest payments was removed, the insurance and mortgage industry came out with a new product, the 'low cost endowment mortgage'. Actually, I have one of these as well, though I paid off the mortgage some time ago. At that time, it was again clear to me that this new approach introduced an element of risk, as it was not guaranteed that the bonuses on the with-profits policy would be sufficient to cover the full amount borrowed. The policy document clearly stated the 'sum assured', which was about two-thirds of the amount borrowed on the mortgage. It was not possible to misunderstand that the balance would have to be made up by bonuses over the period of the policy.

Recently, I have been reading that x-million unfortunate homeowners in the United Kingdom have received 'red' letters warning them that their endowment policies may not be large enough to pay off the mortgage on maturity. Apparently the Financial Services Authority is also involved, as

people have been ‘mis-sold’ these products. These people have, it seems, been told that the policy was ‘guaranteed’ to pay off the mortgage. I find it hard to believe that this is true, but if it is, the following questions come to mind:

- *Was the sales literature approved by an actuary?* If so, why have I not read about actuaries being disciplined by their professional body for gross misconduct?
- *Was no actuary involved?* If so, why has the actuarial profession not made that very clear in press statements? It might also be worth pointing out that the policy documents clearly stated the sums assured (unless something has radically changed since my day).
- *Is there actually any problem?* This is the part that really puzzles me. The reason for the shortfall is that inflation and interest rates have been lower than expected, and one keeps reading that property prices have been rising. As a result, the individual policyholder has had to pay less interest on his mortgage, and is probably the owner of a property whose value has increased substantially during the period of the policy. If there is a shortfall when the policy matures, he could probably pay off the mortgage simply by carrying on for a few more years. Alternatively, if he had been well advised, he would have saved some capital during the period of the loan. The situation is nothing like as bad as the ‘negative equity’ which people experienced when property prices fell (as they no doubt will again).

Given the bad publicity surrounding these products, I remain surprised that there has not been more public comment from the actuarial profession. ‘Making financial sense of the future’ should include educating the public at large, and the journalists in particular, about the financial facts of life!

Turning now to pensions, I am very concerned about the trend to money-purchase as opposed to final-salary pension schemes. I had always understood that the U.K. occupational pensions system was something to be proud of, particularly compared with some other countries which rely more on ‘pay-as-you-go’. Indeed, I have made speeches and written articles comparing the U.K. position with that of other European countries.

I do not have any ideological objection to money-purchase, and, indeed, there are some advantages if people are changing employer more frequently. However, what really worries me is that the total amount being saved for retirement appears to be dropping, when it should actually be increasing to allow for longer lives after retirement.

I had always understood that an employee needed to save at least 15% of total earnings during his working life in order to secure a decent pension. Also, it is clearly better to start as soon as possible. I do not know the facts, but my impression is that the typical final salary scheme had around 5% employee contribution, and at least 10% from the employer. From what I

have read, the employers who have converted to money purchase have taken the opportunity to reduce their contribution rates, typically to 5% or less (with some honourable exceptions). This is a national disgrace, and means we are throwing away the advantage which we had built up over previous decades.

In 1967, when I started my career with an engineering firm (Vickers Ltd), there was much *angst* about the difference between ‘works’ and ‘staff’ conditions of employment. A key issue was that the works employees had an inferior money-purchase pension scheme, whereas the staff had a ‘proper’ final salary scheme. Within a decade, this was corrected by most large employers. It is sad to consider that we have come full circle within my working life, for reasons that have not been properly thought through.

Once more, I have to ask: ‘Where are the actuaries?’ I can understand that the consulting actuaries would not wish to offend their clients, but surely it would be possible for the profession, as a whole, to point out the damage which is being done? My impression is that the intellectual framework behind these changes is based on short-term financial theory, espoused by investment bankers and accountants. If actuaries are ‘making financial sense of the future’, they should be lobbying and making media waves now, and pointing out the missing pension contributions which should be saved on behalf of the employees. Perhaps that is the critical point — if pension saving is made compulsory, it will just be seen as another tax, whereas its previous status as a ‘benefit’ allowed it be viewed as deferred compensation. The short-term saving in employment costs is simply not worth the long-term damage to our society as a whole. The argument is, of course, obfuscated by all the fuss about regulations, accounting standards, market levels, survival rates, *et al.* None of this should hide the stark reality that employers are cutting the amounts saved on behalf of their employees, when what is needed is the reverse!

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