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Mind the gap...
...and how to bridge it

by Laura Brown and Neil Wharmby

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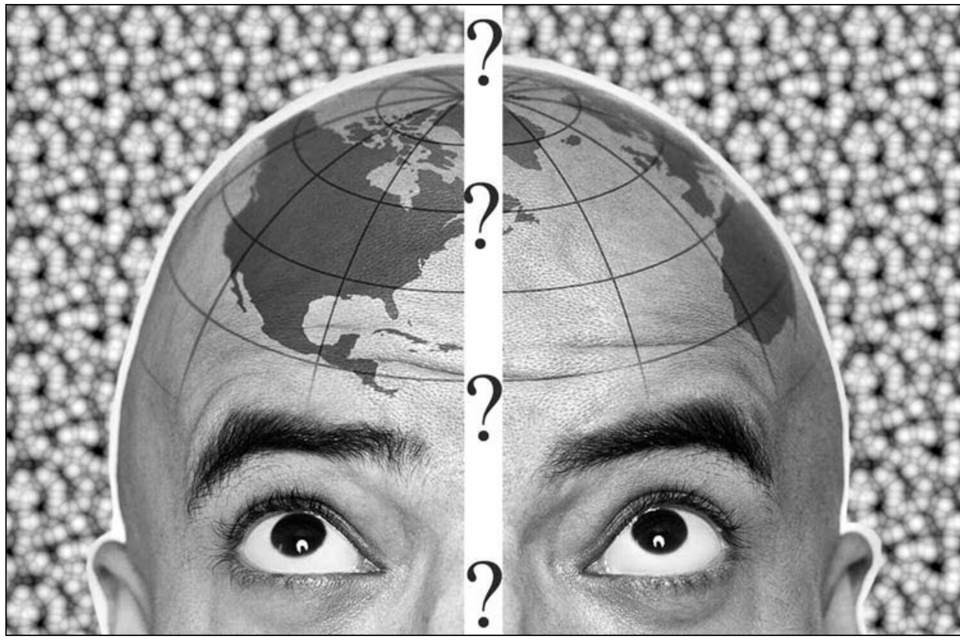
The paper is meant to encourage jovial, but perhaps thought-provoking debate. As both the authors work in the retirement benefits field, it is inevitable that this paper will be flavored by pensions. However, we would hope that this will not prevent the non-pensions actuaries from joining the debate. We would like to make it clear that in presenting this paper, we do not intend to be critical of any particular actuary, firm or professional body.



Chapter Three

Why don't we say on the tin exactly what we do?

Perhaps one of the problems that the profession has created is its ability to express something very complex, in numerical terms, as a single figure or outcome or, in words, through a carefully defined term. The trouble is, how much is lost during this simplification process and how much more complexity or uncertainty should we expose to others?

As pensions actuaries, the authors have spent many years between them getting to grips with some of the standard terminology traditionally used in actuarial pension fund communications. There will be occasions when some terms may have their uses, but our challenge to actuaries is to move away from standard terminology and formulaic advice and explain in plain English what the real story is. The actuarial Guidance Note 26 (GN26), which thankfully invites actuaries to exercise professional judgement as to the funding methods to be used and also states that there is nothing to prevent members explaining the funding method in their own words, provides an ample library of examples to take a look at.

This Guidance Note emanated from a paper on pension fund terminology in 1984. Both of us were still at school at that time (in fact one of us had only just had her first day) and the world has moved on a long way since then. However, many of the terms are, we suspect, still in use to this day. Whilst some of the terms may be a useful shorthand when communicating with colleagues, or other members of the profession, we think that it is time to discontinue their use as far as possible and to move to telling clients, in as simple or as complex a way as they desire, exactly what is going on.

Use less terminology and speak the same language as the client

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Put on a good show, be entertaining, tell a story...

For example, the aforementioned GN9 allows an actuarial method to be described by using one of the GN26 defined funding methods when completing the Regulation 30 disclosure certificate. But given that this disclosure certificate is (presumably) for the benefit of non actuaries, how useful is this in practice? After all, whether the projected unit credit method or attained age method is used in valuations of larger, mature defined benefit schemes is, in our view, academic. The difference between the modified contribution rate and the standard contribution rate (remember those?) might, however, be more important. But even those terms, in our view, could be dispensed with and replaced with a clear explanation to clients as to how their funding objectives will be met.

One TLA[2] which has its limitations is PSR, or 'Past Service Reserve' (usually used in conjunction with a long list of numerical assumptions). We much prefer something along the lines of 'the amount of assets that you would need to hold now to be able to meet the benefits promised under the Scheme assuming those assets are invested [W% in equities and X% in bonds, shifting to a Y%/Z% split over N years] and allowing for a cautious estimate of the returns expected to be achieved in those assets in future.'

Yes, it's a bit of a mouthful, but we would argue that it's much easier for a non actuary to understand a description written in plain English than to expect them to refer to a definition in Guidance Note 26, the valuation report or elsewhere. (Consider how annoying it is for us actuaries to continually refer to definitions of words appearing in lengthy legal documents!

And whilst we're on the subject, why stay with just one single Past Service Reserve. Why not show several to illustrate the certain uncertainty that goes along with pension funding? Why hide the actuarial truth behind the smoke and mirrors of a single figure valuation? Why not project, rather than discount? Why pretend that a market based valuation method is any better or worse than a traditional discounted cash flow valuation? These sorts of ideas are not new—Simon Carne goes a long way in addressing this in his 2004 paper, which was excellent, particularly from the point of view of communication.

We're not getting into any financial economics arguments here, nor entering into an equity/bond matching asset debate. We're simply saying that we should explain what we're doing rather than summarise it in some preformed actuarial jargon that means nothing to our clients.

Chapter Four

Are you an actor or an actuary?

I'm sure we've all been there—cool party, reasonably loud music, approached by good looking guy/girl, conversation eventually hits the buffers:

"So what do you do for a living?"

"I'm an actuary"

"Oh really, an actor! What sort of parts do you play?"

2 TLA is a three letter acronym for 'three letter acronym'.

Do you come clean and then spend the rest of the evening desperately trying to make mortality exciting, or do you attempt to maintain the cool(?) impression that you have artistic talent, only to reveal the truth when you are too far down the line to retain trust and credibility?

Let's not concern ourselves now with this dilemma. The point that we're trying to make here is that clients want a good show and, to achieve that, we now have to be both an actor and actuary. Technical ability is, of course, essential in our role, but to get the message across, an appropriate degree of confidence (but not arrogance) and a good deal of stage presence is needed. If the audience are not entertained, they will not listen or, at best, they will find it hard to listen and may choose not to hear the important small print!

What clients really want is a good story. We're not talking about fairy stories—despite the advertisement in *The Actuary* for this paper referring to the brave knight Sir Derek—but about conveying the important messages in a single and clear fashion.

So, on a vote of personality versus technical ability, we'd go for the former.

Pantomime

We would prefer not to go as far as pantomime, but how many times have you said to your clients, "it's behind you!"? Do we state the obvious often enough?

For example, in pension funding, does actuarial mathematics cloud the basic principle that you need either investment return or contributions to be able to secure the pension? On investment return, it's not only the annual rate of return you might be able to achieve but also the time available over which to achieve it.

Going back to the party situation (and let's assume you've corrected the actor/actuary misunderstanding and disclosed that fact that you 'value' pension schemes), the next question you face is 'which pension should I buy?' Apart from this question revealing that there's still hours of conversation left before you can expect the definition of actuary to be fully understood, it shows that there is a need for us (and others) to provide some very basic financial education. Detail about charges and past performance comparisons is generally superfluous because we usually find that it's a complete revelation to the poser of the question that he may actually have to pay money regularly into an arrangement to secure a pension, and that the longer (or more) he pays and the later he retires, the higher that pension will be. These obvious concepts might indeed be fairly obvious to actuaries, but they are not in our experience well understood by the public.

How many members of the public, and how many companies now operating defined contribution schemes, appreciate how much really needs to be invested to provide adequate retirement provision? How many members know what the difference is between equities, bonds, gilts and other asset classes? This all leads us on to the next section. ☐

Remember the big picture—state the obvious if necessary...

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