Society of Actuaries in Ireland **NEWSLETTER**

October 1993

In November 1992, the Faculty and Institute of Actuaries sent to all Fellow members a copy of the Groupe Consultatif agreement on mutual recognition. The covering letter drew attention to the obligation on any actuary practising abroad to join the local actuarial association. Many members do not seem to be aware of the implications of the agreement.

* All Fellows, Associates and Students of the Faculty and Institute, and other EC Associations practicing in the Republic of Ireland are obliged to join the Society.

* Professional supervision of all such members practicing in Ireland is the responsibility of the Society and not the original Association.

If you are aware of anyone who should be a member but is not, please bring it to their attention.

A consequence of the GC agreement is that Continuing Professional Development (CPD) of all Irish based actuaries is now the responsibility of the Society. A committee has been set up under Paul Kelly to make proposals taking into account Irish conditions and circumstances. Paul would welcome suggestions and comments, and can be contacted on Dublin 6616448, or c/o R. Watsons & Sons, 9 Windsor Place, Dublin 2.

Council for 1993/94

At the Annual General Meeting held in June, a new President and Vice-President and two Council members were elected. Allowing for those whose terms had not expired, and those co-opted at the first meeting of the new Council, the full membership is:

President:	Jim Kehoe
Vice President:	Bill Hannan
Hon. Secretary:	Yvonne Lynch
Council:	Michael Brennan
	Frank Downey
	Jimmy Doyle
	Colm Fagan
	Brendan Johnston
	Brendan Kennedy
	Bruce Maxwell
	Des Ryan

The Chairmen of the various committees are as follows:

Communications:	Brendan Kennedy	967235
Constitution:	Michael Brennan	2831301
Education:	Frank Downey	2800257
Finance:	Colm Fagan	6766333
Functions:	Yvonne Lynch	4751888
General Insurance:	Jimmy Doyle	6670288
International:	Bruce Maxwell	7042606
Investment:	John Feely	6617077
Life Assurance:	Bruce Maxwell	7042606
Pensions:	Des Ryan	4782866
Student Liaison:	Brendan Johnston	6767591

Endowment versus Annuity

Aisling Kennedy reports on the paper by Brian Woods presented to the Society on 7th October 1993.

Brian's paper set out to make a comparison between the traditional annuity method of mortgage repayment and the endowment method. The paper was produced as a result of a recommendation by the Chairman of the Working Party on Premium Reviews that some stochastic work should be carried out in relation to mortgage endowment policies.

The relative merits of the different mortgage methods have been the subject of much public debate over the past few months, and the strong interest of the insurance industry in this subject was evident from the large attendance of around 40 actuaries.

Brian's approach was to forecast the course of key financial variables over the 20 year period of a typical mortgage using the Wilkie model. He compared 'value' and 'risk' for both mortgage methods. Value was defined for this purpose as the surplus/shortfall at the end of the term: in order to compare the 'value' of the two mortgage methods, the net cash outflow on the annuity method was adjusted to equal the net cash outflow on the endowment method, with any resultant surplus or shortfall on the capital repayments accumulating to the end of the term. It was difficult to derive a suitable measure of 'risk' - Brian explained why it would have been unsatisfactory merely to define risk as the variability of 'value' before going on to use a definition of risk as the maximum increase in the net funding rate over the initial net funding rate.

It was clear that the annuity method is less 'risky' and so the principle objective of the paper was to quantify to what extent the endowment method compensates for higher risk by providing higher expected values. Brian concluded that to the extent that mortgage interest relief is available, the endowment method did not always provide a higher value than the annuity method in a majority of the simulations. Some of his other conclusions were:

* that a policy of full equity investment should be followed throughout the term of the mortgage in order to 'allow the endowment its full potential'.

* that premium review systems are effective in reducing risk without reducing the superiority in average value over the annuity method.

* that the use of a lower 'target rate' for the purpose of calculating endowment policy premiums also reduced risk while sustaining the superiority in average value; however, this does result in a more expensive approach than the annuity method in terms of the net cash flow over the term of the mortgage.

* that the maintenance of mortgage interest relief is key to the viability of endowment mortgages.

* that investment performance better than that forecast by the Wilkie model will result in the risk/value equation moving significantly in favour of the endowment method.

A lively discussion followed Brian's summary of the key points in the paper.

As usual in relation to the Wilkie model, many speakers commented on the 'equity-bond earnings gap' predicted by the model (stated in the paper to be 1.8% per annum over the 20 years of the simulation). Various statistics and sources were quoted to illustrate that this was at odds with the expectation of a higher gap based on historic experience. As stated in the paper, better equity performance would favour the endowment method. It was noted however that the average equity yield predicted by the model (8.2% per annum) was compatible with the new Irish Insurance Federation dual illustration rates of 7% and 9%. One speaker also pointed out that the Wilkie model was based on UK data which was not necessarily suitable for Ireland in view of the much higher volatility in the performance of Irish equities - the Investment Committee is to produce a version of the Wilkie model adapted for Ireland sometime next year. Some speakers also disagreed with the author's assumption that the gap between mortgage interest and wholesale deposit rates would be 1.5%.

Not everybody agreed with the measure of risk chosen by the author. It was pointed out that an increase in the net funding rate in the final year of the policy would have far less impact than an increase in the early years of the mortgage. However, nobody was able to suggest a suitable alternative approach.

Both the author and a number of speakers drew attention to Section 3.3 of GN1 which gives the Appointed Actuary responsibility for policyholders' reasonable expectations. It was pointed out that endowment mortgage holders tend not to be aware of the possibility of premium increases resulting from periodic premium reviews. It was felt that premium increases should not pose insurmountable problems given the volatility of the interest payments under both methods (although various fixed rate mortgages are now available to eliminate variability in interest payments over periods of up to 10 years).

A number of comments were made in relation to the public relations issues for the life assurance industry. The point was well made that endowment mortgage policies comprise only 6% of the business of Irish life assurance companies but that any bad publicity in relation to mortgage business could also impact on other products. It was noted that circumstances have changed in various respects since endowment mortgages began to be sold in Ireland, notably Life Assurance Premium Relief was then available and there was not the same consensus regarding the prospects for a continuing low inflation environment. A number of speakers commented on the difficulty of 'managing change'. Care will need to be taken to ensure that endowment mortgages are only sold in appropriate circumstances i.e. where mortgage interest relief applies, the borrower does not intend to trade up or repay the loan early etc.

Various speakers expressed concern about the paper's conclusions on a smoothed investment policy. Individual borrowers should not take on the risk of full equity investment without any smoothing in the final years. The author suggested that the most efficient method of smoothing would be for the borrower to take 20% encashments in each of the last 5 years of the policy to pay off part of the outstanding mortgage (although ths would not work for with-profit policies).

There seemed to be general agreement for the broad conclusions that endowment mortgages would continue to be attractive in certain circumstances and that the key factors were the continuing availability of mortgage interest relief and investment performance superior to that simulated by the Wilkie model (whether because the Wilkie model proves to have been too conservative or as a result of 'value added' by good investment management.

Update

GN11 (ROI)

The revised guidance note on transfer values issued recently by the Society is now in force, and must be observed by all members. The forthcoming members' handbook will include the note, but in the meantime, copies are available from the Society.

Pensions Act Funding Certificates

All members should be aware of the deadlines for the submission of Funding Certificates to the Pensions Board. The latest permissible Effective Date for the first Certificates is 31st December 1993, which means they must be submitted before the end of September 1994.

By the end of August 1993 only 412 of the 2200 registered defined benefits schemes had submitted Certificates, which seems to indicate a substantial backlog. This may be caused in some cases by the mistaken impression that the submission deadline for **all** Certificates is September 1994. Of the 412 Certificates submitted, 86 were late.

It appears that a problem is building up. The Pensions Committee would welcome any information and views that members might have - contact Des Ryan on 4782866.

Pensions Act

An item on the rules governing contribution refunds is in danger of becoming a serial. There was an error in the correction in the last newsletter. The correct version is as follows:

From 1st January 1993, no refunds of members' contributions may be given on withdrawal in respect of service since 1st January 1991, except if a member has less than five years' service. Contributions made before that date may be refunded, subject to 25% Tax.

Thanks to those who took the trouble to point out our errors. This correspondence is now closed.

Pensions Board Submission

In July, the Society made a submission to the Legislation Review Committee. A brief summary of the points raised is set out below: copies of the full submission are available from Jim Kehoe.

The submissions welcomed the success of the Pensions Act in improving the protection of members of occupational schemes and guaranteeing access to information. The submission was concerned only with identifying points of detail to improve practicability of the Act and its Regulations. Points raised were:

* **Normal Pensionable Age** - Clarification may be needed to link the definition of NPA to the age from which preserved benefits are payable.

* **Preservation of Benefits** - A difficulty arises where the fixed benefits are improved for serving members, but it is viewed by Trustees as a benefit improvement rather than a revaluation.

* **Funding Certificates - subsequent events** - The Certificate could be misleading to members if the solvency is affected by known subsequent events. It was suggested that a declaration by the Trustees/Actuary should cover such known events' effect on solvency, and that there should be an Actuary's statement that in the normal course of events and given the assumptions, the scheme will meet the Funding Standard for three years from the Effective Date.

* **Protecting Defined Benefits** - It was suggested that in a wind up any surplus should be first applied to the difference between the actuarial reserve for past service benefits and the deferred annuity cost of purchasing them.

* **Benefits Anomaly** - An anomaly in the wording of the Act could result in excessive benefit being valued on leaving service where the member was entitled to benefits for pre-Scheme service.

* **Early Retirement Options** - where members are entitled to retire immediately on full benefits without actuarial reduction although not at NPA, the minimum funding standard should reflect the immediate value.

* **Marriage Gratuities** - There are inconsistencies between the Act, equal treatment legislation and Revenue practice for schemes which allow a female to cease membership of a scheme on marriage and receive a contributions refund (and in some cases a gratuity). The solution recommended was to ban refunds except on leaving service. Equal treatment would only be achieved by a ban on marriage gratuities, but in any event gratuities should not be permitted for service for which preserved benefits are provided.

Exams and Education

Seven new actuaries qualified in Dublin in the Institute examination results last July. They were:

Derek Hunter
Cuimin MacMahon
Feargal O'Shea
Eugene Quinn
Nigel Tennant
Enda Walsh
Martin Considine

Many congratulations to each one.

Overall, the Dublin exam results were not as good as usual. The percentage of passes were:

Subjects 1 - 6:	45%	(Institute 55%)
Subjects 7 - 10:	37%	(Institute 37%)
Overall:	43%	(Institute 40%)

Recruitment of new students in Ireland this year seems unlikely to exceed eight, compared with a high of fifty some years ago. A result of the low numbers in this and recent years is that there will be few classes organised by the Society in any exam subject in '93/'94.

On the move ....

***Colm Fagan** has left Lifetime to set up a consultancy, Life Strategies, specialising in life assurance actuarial and strategic consulting.*

Brendan Kennedy has left Irish Life

***John Edmondson** has left Irish Life to join Rothschilds International as Finance Director*

John Crowe resigned from Lifetime to devote himself fulltime to his business interests

Calendar

Full details of each meeting will be circulated to members beforehand.

18th November	Bill Hannan 'Unit Pricing'
12th January 1994	Maurice Whyms 'Practical Applications of FAS'
February 1994	Life Assurance Seminar
25th March 1994	General Insurance Seminar
8th March 1994	Visit of John Martin
13th April 1994	Colm Fagan 'Bancassurance'
6th May 1994	Annual Dinner
25th May 1994	AGM, followed by a meeting on Financial Reinsurance
30th May 1994	Golf Outing

Further meetings may yet be added to this list.