THE SOCIETY OF PENSION PROFESSIONALS

making pensions work

3 August 2023

Dear Director of Actuarial Policy
Financial Reporting Council
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SPP response to Consultation on proposed amends to Technical Actuarial Standards for Pensions

We welcome the opportunity to respond to this consultation.

Executive Summary

Regarding proposed amends to TAS 300, we have some concerns that the wording that has been proposed to amend the scope of TAS 300 to cover "scheme funding and financing" will broaden the scope to a greater extent than the consultation suggests is intended.

On proposed amends to TAS 310:

- We strongly disagree with the proposals within P5.1 of TAS310 that require the actuary to consider "all relevant matters that they consider to represent soundness of a CMP scheme" within their viability assessment. This potentially over-extends the remit of the actuarial certification, which we believe should be restricted to actuarial matters only.

- Some of the requirements on modelling and assumptions suggest a broad range of alternative scenarios and sensitivities need to be considered, which may not be appropriate in all circumstances, are likely to increase costs for the end user, and may increase pressure on the actuary to recommend alternative assumptions or approaches. We propose these requirements could be pared back in a number of cases.

- We propose that the FRC should mirror definitions of terms that are already defined in legislation (for example "central estimate").

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- We disagree with the focus on problems caused by downside (or specific) scenarios with little focus on the challenges that upside scenarios can cause.

Detailed Response

1. **What are your views on the proposed changes to the scope of TAS 300? Are there any other areas of pensions work that you consider to be inadequately covered by TAS 300 and should be included?**

   The consultation proposes changing the scope of TAS 300 to cover all "Technical actuarial work concerning pension scheme funding and financing". The consultation indicates that this is to clarify that the TAS applies to 'funding and financing' work performed for both trustees and sponsoring employers. However, 'scheme funding and financing' without the specific limitations as set out in the existing scope (focusing on work required by legislation, primarily the Scheme Funding assessment) could encompass a very wide range of work relating to a pension scheme and potentially widens the scope for trustee work as well as for work for employers. Whilst we recognise that some aspects (such as discussions with trustees and/or employers around longer term funding strategy) would potentially benefit from inclusion, others, such as company accounting advice or ad-hoc funding updates, would not appear to fit with the drafting of section 2 (with 2.4 and 2.7 onwards being particularly focused on trustee advice and scheme funding). Is it the FRCs intention to broaden the scope in this way?

   We do not consider that there are any other areas of pension work that are inadequately covered.

2. **Do you agree our intention to defer any changes to requirements under scheme funding and financing until there is greater legislative certainty? Do you have any other specific concerns in relation to provisions on scheme funding and financing that you believe require addressing over a shorter period?**

   The timing of changes to TAS 300 is unfortunate given that details of the new funding regime are yet to be finalised. Ideally, any further changes once a new funding regime is in force should be considered and put in place as quickly as possible (albeit with adequate time for consultation). This will give actuaries the time to understand and efficiently implement any new requirements, noting that advice in respect of scheme funding valuations is often provided over a period of many months. It would be preferable to avoid having to change standard documents more than once, for changes to new funding regime and then also for changes to TAS 300 (particularly given changes have already been needed to allow for the revised version of TAS 100).

3. **What are your views on the proposed changes to TAS 300 in relation to the frequency of review of the actuarial factors? What are your views on the proposed changes to TAS 300 in relation to the timing of review of actuarial factors?**

   In respect of the proposal for paragraph 3.1, we are broadly comfortable with this but would not expect that there should be a requirement to be overly prescriptive or detailed about the circumstances or timing of the next factor review. This could be challenging to achieve and we would prefer to maintain the ability to use judgement in the future.

   In paragraph 3.2 we would suggest changing the phrase "seek to arrange for the review to be undertaken" to "consider carrying out a review". In our view, it is not always necessary or

desirable to do a factor review at the same time as a valuation, for example, if a review had been conducted recently or if the commutation factors are not used in the valuation or if they are already market related.

We would also note that for smaller schemes (which may have fewer members reaching retirement age), it could be disproportionate to review factors every three years, however, we agree that consideration should be given every three years as to whether a review should be carried out.

4. **Do you consider the proposed changes to Section 3 would enable decision-makers to reach a fully informed view in setting actuarial factors?**

In some cases, paragraph 3.4 could require a lot of extra work to be carried out in order to provide a comparison of the factors relative to all of the insured, cash equivalent transfer value and long-term objective bases.
In addition, it is not entirely clear what is meant by "an estimate of the cost of purchasing an insured annuity", is this a bulk annuity purchase or individual annuities? The consultation mentions both pensions freedoms and the maturing of scheme's liabilities as a reason for the change, and so we suggest this is clarified. It is also worth noting that the costs of purchasing an annuity will vary significantly for individuals, and there could be practical challenges in making a robust comparison.
Where schemes already have a buy-in in place and are approaching buy out, the factors that the insurer will apply once the scheme has been bought out would also be relevant.
Whilst we note that the requirement is for relevant comparisons, we think this would be clearer if the word "could" was added to the sentence, i.e. "relevant bases could include…" This would allow actuaries to exercise judgement on whether these bases are relevant to their scheme.

Paragraph 3.5 – It is not clear exactly what is meant by "de-risking transaction". We assume this would include a buy-in, which is essentially a change to the investment strategy, but would this also include a planned future transfer to a superfund or insurer? In the latter cases, we are unsure of the implications of this beyond planned changes to the scheme's investment strategy.

5. **Do you consider that the remit of TAS 300 includes specifying how actuarial factors are set, either in relation to the value for money members should get from cash commutation or in making allowance for future changes to investment strategy in CETV factors? Please explain your rationale.**

Yes, subject to the comments made above.

6. **Are there other provisions relating to actuarial factors which you believe should be introduced?**

No.

7. **What are your views on the proposed provisions in section 5 in relation to bulk transfers? Do you think that the proposed provisions would ensure the actuarial advice given to decision-makers would allow them to be fully informed when considering potential bulk transfers?**

In our view, there is a lack of clarity over the scope of the advice the bulk transfer section is supposed to apply to. We understand that the FRC has stated that this would not necessarily

cover a buy-in, as that is primarily an investment strategy decision. However, once a scheme has a buy-in in place, they cannot transfer to a superfund, so the options are limited to converting to a buy-out or running on (perhaps indefinitely). Would strategic advice about journey planning or taking initial steps to ensure a scheme is buy-out-ready fall under these provisions? Further detail about exactly what is required in relation to buy-in to buy-out transactions would be useful.

In paragraph 5.7, we would suggest adding "material", i.e. "… made aware of all material risks and other factors relevant to this view.

8. **Do you consider that the proposed changes to TAS 300 on modelling work relevant to superfunds would help mitigate the risks associated with pensions practitioners' lack of familiarity with features of the modelling required?**

Yes, we consider that the proposed changes are reasonable.

9. **Are there other provisions relating to bulk transfers which you believe should be introduced into TAS 300?**

No.

10. **Do you have any comments on our intention to have an effective date for TAS 310 of within one year of the first CMP scheme being in operation? Is there an alternative timing that would be more appropriate? Please provide any supporting evidence for alternative timings.**

Ideally, TAS 310 would have been in place before advice was given on the first CDC designs, although we recognise the practical challenges in achieving this. Given the nature of CDC schemes, scheme design is key and many aspects are 'set in stone' once the design is formalised in the scheme rules. Subsequent valuations must follow the design set out in the scheme rules. It is therefore crucial that the scheme design fits with the contents of TAS 310.

This would suggest that TAS 310 should be brought into effect as soon as possible. However, it is also important for TAS 310 to be well drafted and there may be significant changes following this consultation, which will need careful consideration before TAS 310 can be finalised. We also note that there are few CDC schemes currently, or shortly expected to be, in operation (and none so far building up any CDC benefits), so the application of TAS 310 may be relatively limited, perhaps giving some comfort that its implementation can be delayed if necessary to get the content right.

11. **Do the proposed provisions provide sufficient clarity of requirements for practitioners to set central estimate assumptions? Please set out any areas of setting CE assumptions you believe require further provisions, including reasons for these.**

The TAS would introduce a new definition of "central estimate" which is not the same as the definition in the legislation. The legislation defines a central estimate as "an estimate that is not deliberately either optimistic or pessimistic, does not include any margin for prudence and does not incorporate adjustments to reflect the desired outcome". We would propose that the FRC instead mirrors the definition in the legislation to avoid potentially conflicting definitions. On a more practical note, the current definition could be interpreted to require stochastic modelling to be undertaken in order to assess the likelihood of actual experience being higher or lower than the proposed assumption, which may not be appropriate in every circumstance.

In many instances, actuaries would also be advising on central estimates, rather than setting them themselves and so the wording of P2.2 and P2.3 should be revised to reflect this.

12. What are your views on the proposed provisions in relation to CMP modelling? Do you expect the proposed requirements on communication to support intended users in making relevant decisions based on modelling? Do you believe there are further items where additional requirements would be appropriate?

- P3.1 requires models to "reflect the complexity of scheme benefits". We are not sure what the words "the complexity of" are intended to add. In practice, the benefit structure of a CDC scheme is likely to be significantly simpler than (for example) a legacy DB arrangement. It may be that the actuary considers that modelling all complexities is not required. We suggest this wording should be replaced with "reflect the scheme benefits".
- P3.2 proposes a stochastic modelling of the probability of the live running tests being failed at some point in the future. Given the complexity of these tests and their reliability on data entries such as the number of new joiners, there seems little to be gained from this assessment being on a stochastic basis, noting this may not be an appropriate requirement in all cases given these assessments need to be revisited on an annual basis in order for an actuary to continue to provide their viability certificate. However, we agree that stochastic modelling would be useful when looking at the probability of benefit adjustments.
- P3.2 suggests models should be able to "identify scenarios (including probabilities)" relating to certain events happening. Stochastic modelling can identify many scenarios where benefit adjustments are negative, but these will be hard to communicate other than in a broad sense. Similarly if undertaking scenario testing, it may be reasonable to come up with a scenario where benefit adjustments are negative, but difficult to place a probability on this scenario. We would suggest this wording be replaced by "identify scenarios in which and estimate the probability that:" to separate out the need for scenario testing and stochastic modelling.
- P3.2 focuses on downside scenarios in isolation – in practice upside scenarios might be equally likely and also present challenges for the management of CDC schemes. A focus on downside outcomes might bias decision making towards making central estimates which err towards prudence. It also focuses on very specific events, whereas other events may be more appropriate depending on the scheme design (for example, where a scheme sets minimum and maximum annual benefit adjustments). We would suggest items a to c are therefore set out to be examples to consider modelling rather than specific outcomes that must be modelled. In particular, we note that for many design set up to target increases in line with inflation, there will be many scenarios that lead to negative real increases (broadly 50% of all scenarios), and it may not be perceived to be helpful to consider these in significant detail.
- We note that P3.2 does not suggest a period over which the probabilities should be assessed. We do not think a specific period should be set by the TAS 310, but it would be helpful to state that the actuary should select an appropriate period.
- Paragraph 3.18 of the consultation document indicates that stochastic modelling might not be required to form a view on soundness, despite the expectation set out in P3.3, that stochastic modelling should be used. We believe the comments in paragraph 3.18 (that an alternative approach can be used provided this satisfied P3.1 and P3.2 and the reliability objective) should be included within the TAS, if that is FRC's intention. However, in principle, we are generally supportive of the use of stochastic modelling for CDC schemes at least during the initial design phase.

- We are not sure what P3.4 is intended to achieve. Clearly changing the underlying model could result in significantly different modelling results, but simply confirming that this is the case (which would appear to satisfy this requirement) would not to be of particular benefit. We are concerned that any change to the wording of this requirement could easily introduce a very onerous requirement, which increases cost for the end user without adding significant benefit.
- On P3.5, it is not clear whether this is a requirement to comment on one or two credible alternatives, or the possible range of credible alternatives. The latter seems virtually impossible to satisfy as there would be a huge range of "credible alternative modelling". Even considering one or two alternative models seems disproportionate, given the complex nature of the exercise. This is therefore potentially an extremely onerous and costly requirement, particularly if a quantitative evaluation is required, as most practitioners will not have models set up that allow them to easily adjust their stochastic modelling assumptions, which may not be appropriate in all circumstances. Our preference is to remove the requirement completely – or to simply require communication of the fact that different models could produce very different outcomes.
- More fundamentally, we are concerned that requiring consideration of alternative modelling could lead to pressure on the actuary to adopt more optimistic approaches, and in turn, this could lead to contentious benefit reductions being deferred and unsustainable expectations being set.
- P3.6 could be extended to include which variables have not been modelled in a stochastic manner and why.
- P3.10 partially mirrors the wording in P3.2 and our concerns over that paragraph, as set out above, are similarly mirrored. We note that the "identify scenarios (including probabilities) where" wording has morphed into "explain scenarios where". We suggest this could be expanded to consider both scenario testing and stochastic modelling (if both have been used in the modelling as per 3.2).

13. What are your views on the proposed provisions in relation to Scheme design? Do you envisage any difficulties in meeting the requirements of these provisions. Please provide details to accompany your response.

The P4.1 requirement to use data which is "as comprehensive as possible" seems an unnecessarily high benchmark, suggesting all data conceivably possible to collect would need to be collected. The requirement is particularly onerous given that it could be applied to very early preliminary and therefore approximate assessments of a possible CDC arrangement, where very little may be known about the future membership. We would suggest the use of data that is "appropriate to the advice being given, to the extent that it is available". In addition, we are not sure why these requirements should not also apply to schemes which are in the process of applying for authorisation.

14. What are your views on the proposed provisions on completing assessments of scheme viability and certifying soundness? Do you consider it is appropriate to require practitioners to consider areas beyond those outlined in legislation when certifying soundness? Please give reasons for your response.

We agree with the conclusion not to define soundness within the TASs, given that legislation has chosen not to define this either, and so there will likely be an element of judgement for trustees

in concluding what this means (and noting that many trustees will not be bound by a definition of soundness included in the TASs).

We are not supportive, however, of the requirement within P5.1 for actuaries to consider "all relevant matters that they consider to represent soundness of a CMP scheme" within their viability assessment and would propose that this requirement is removed. It is not clear to us that actuaries are best placed to consider all of these issues and so would propose that the actuary provides their certification on the basis of actuarial matters alone. However, we believe it could be reasonable to require the actuary to draw the trustee's attention to non-actuarial matters which they may believe to be relevant in considering soundness.

With regards to the list of factors to consider under P5.1, we do not necessarily believe all of these are appropriate to consider. For example, it is unclear exactly what is meant by "risks to intergenerational fairness" given that a CDC design will inevitably result in some cross-subsidies between members. Further, any scheme which is set up with the initial intention of providing benefit adjustments in line with price inflation will be expected over time to end up in a position where expected benefit adjustments fall below price inflation – this does not, however, mean that the scheme design is not sound.

With regards to P5.3 – we note that it may be possible to provide updated advice, taking into account changes in conditions, without necessarily fully updating the stochastic modelling, but nevertheless providing an indication as to how the key modelling outputs (e.g. the central expectation and shape of distribution) would have changed.

With regards to P5.4e, we believe the reference to "a description of the scenarios where the scheme would no longer be sound" suggests it may be possible to be definitive on all scenarios that arise (and that this would be beneficial to the end user). We would propose this requirement is qualified to something like "a description of the most likely anticipated scenarios where the scheme would no longer be sound".

With regards to P5.4f, as noted in our response to question 12 above, for many scheme designs there will be a high degree of probability / large number of scenarios where benefit adjustments will results in negative real increases to accrued benefits. We would not necessarily suggest this means that the scheme design is not sound, and so would question whether the reference to negative real increases is needed within this paragraph. P5.4f should also cover upside scenarios.

On a more minor point, we believe that the reference to "running tests" in 5.4d should refer to "live running tests".

15. Do you agree that the considerations for a practitioner certifying scheme soundness via a viability certificate are the same as those a practitioner should communicate to trustees in their own consideration as to whether the design of the scheme is sound for their viability report?

No. As stated above, we believe the actuarial certification should be restricted to actuarial matters. However, we believe it may be appropriate for the actuary to be required to draw the trustee's attention to non-actuarial matters which they may believe to be relevant in considering soundness.

16. **Are there any other areas in relation to soundness (including practitioners' communications of their work on soundness) which require further standards? Please provide as much detail as possible.**

    No.

17. **What are your views on the proposed provisions on actuarial valuations for CMP schemes? Are there other key areas of judgement beyond the central estimate assumptions? Are there further areas you would expect to be included? Please give reasons for your response.**

    We note that P6.1a requires consideration of the consistency of assumptions adopted for an annual valuation with those adopted for the gateway tests. While this may be reasonable for the first annual valuation, we believe there will likely be a reducing benefit in this comparison thereafter. We would instead propose that consideration is given to the consistency of the assumptions with those adopted for the most recent valuation (either the previous annual valuation or, for the first such valuation, those underlying the gateway test assessment).

    We think that it is unhelpful to consider other "credible central estimate assumptions" as suggested in P6.1b. We think that only the most central estimate should be considered. Detailing alternative credible central estimates could encourage the use of slightly prudent or optimistic assumptions. This would cause intergenerational cross-subsidies and unfairness. P3.6c already requires practitioners to communicate the impact on modelling results of the use of alternative assumptions so that the user has an indication of the materiality of key assumptions, without the need for these to be pitched as "credible alternative central estimate assumptions".

    We note that P6.1c and P6.2b require consideration of post valuation experience. We believe that in many cases allowance for post valuation experience may be unnecessary given that valuations are conducted annually, impacts are spread over many years through the benefit adjustments and there may be tension with regulatory timescales for finalising valuations. While this may lead to the conclusion in many cases that post valuation experience is not material, as it may not alter the intended user's decision, the inclusion of these paragraphs seem likely to encourage actuaries to adopt an alternative approach to minimise personal risks to them. This may simply increase costs to the end user from undertaking these additional assessments (which could be needed at multiple points during the annual valuation process) without providing any additional benefit. We would therefore propose that these requirements are simply left for individual actuaries to consider using their own judgement without being explicitly included within the TAS.

18. **Do you agree the required content of the valuation report set out in Appendix A is reasonable for CMP schemes? Is there further content which should be included?**

    We believe some of the required content should be restricted to "material" or "key" items – for example, the experience referred to in paragraph e and the risks referred to in paragraph h.

    You could also consider whether paragraph f should be expanded to provide a quantification of the key factors leading to the benefit adjustment being different to last year's – we consider that the actuary and trustees should review and understand this as part of their work on the valuation, similar to an Analysis of Surplus for a defined benefit scheme.

19. **What are your views on the proposed provisions in relation to factors for CMP schemes? Do you envisage any issues complying with provision P7.4 regarding selection risk? Are there certain groups of members you believe this may disadvantage? Please provide reasons for your response.**

These provisions appear broadly reasonable. Although we may suggest two small additions:

- On P7.2, the statement that factors "should be cost neutral on a central estimate basis" should perhaps be qualified by a reference to the scheme rules – perhaps by adding ", where this is consistent with the scheme's rules". In some circumstances, how factors are set may be dictated by Scheme Rules and so an actuary may be constrained in their ability to advise that factors be set on a central estimate basis.
- We also suggest that it is the "principles of cost-neutrality" that should be followed rather than factors being required to be cost-neutral in every possible aspect. For example, the Trustee may have determined that it wishes to set factors on a unisex basis or using grouped population assumptions, which may not strictly be cost-neutral vs individually set factors.

20. **Do you agree with our impact assessment? Please give reasons for your response.**

We broadly agree with the impact assessment in relation to the items it describes but note that the impact of expanding the scope of TAS300 is not considered. As noted in our response to Q1, more clarity regarding what the wider scope is intended to cover and consideration of the impact of this would be desirable.

Regarding TAS 310, we agree with the benefits of introducing TAS 310 and that additional costs will arise largely due to the introduction of new regulation enabling Collective DC arrangements. However, we believe there are some areas, as noted elsewhere within our response, where those costs could be disproportionately high under the current drafting of TAS 310.

Yours faithfully,

Response ends.-

Defined Benefit Committee, SPP

Chair, Collective Defined Contribution Group, SPP

Chief Executive, SPP

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