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Sent by post and emailed

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Dear Sir

Response to the BAS' "Actuarial Mortality Assumptions: Discussion Paper"

The Board of the Pension Protection Fund ("PPF") is grateful to have been given the opportunity to respond to this important paper, and in particular would like to thank the Board for Actuarial Standards for having granted us a short extension to the deadline for responses.

The Board of the PPF is a statutory corporation created by the Pensions Act 2004, whose main function is to provide compensation to members of defined benefit pension schemes whose sponsors have suffered insolvency. In order to carry out its role the Board of the PPF is required to make assumptions regarding mortality rates for a number of purposes. Not only does the PPF undertake annually a valuation of its own liabilities, but it also prescribes the actuarial assumptions underlying "section 143" valuations which determine whether a scheme is to be granted entry to the PPF and "section 179" valuations which form the basis of the calculation of a scheme's PPF levy. In managing its risk the Board is also concerned that trustees of pension schemes not in a PPF assessment period use appropriate mortality assumptions. It is in this context that the Board of the PPF has a significant interest in mortality statistics, and we would like to offer our thanks to the BAS for producing such a thorough and important paper.

In section 7 of its paper the BAS sets out six questions on which it particularly welcomes feedback. We will address each of these in turn.

Question 1 *Do respondents have any views on the significance of the adverse effects that the over- or underestimation of future mortality may have on pension scheme members, scheme sponsors, life insurance policyholders and life insurance companies, as set out in section 2?*

We consider Section 2 of the paper to be a good summary of the adverse consequences of under- or over-estimating future mortality rates. More could perhaps have been made of the fact that uncertainty on future mortality is inevitable and that the essence of the actuarial role in the context of mortality is to provide the advice needed so that the uncertainty can be

managed satisfactorily. Of particular concern to our organisation is the fact that underestimated longevity leads to lower funding levels and consequently a slightly higher risk that pension schemes may at some future date enter the PPF.

Question 2 *The BAS has discussed some of the issues surrounding mortality assumptions in section 3. In that context:*

a) Do respondents have views on appropriate methods of communicating the extent and impact of the inherent uncertainty involved in mortality assumptions?

b) Do respondents agree that the use of separate assumptions for base mortality and future changes in mortality, not taking the form of margins in other assumptions, would be desirable?

c) Do respondents have views on appropriate methods of communicating the significance of assumptions, both in absolute terms and relative to that of other assumptions?

a) We agree with the BAS that there are a range of different ways of communicating the uncertainty, each of which has its advantages and limitations. We believe different approaches will be suitable for different purposes and different audiences, and any approach that achieves the aim of the decision makers' understanding the implications is to be encouraged. The provider of advice should in all cases communicate the evidence base underlying the advice, as well as providing a sufficient illustration of the sensitivities of different outcomes.

b) We strongly agree with this approach. Base mortality rates and future improvements should be considered separately as the former is evidence-based and the latter is more subjective. We agree that mortality assumption components should not be reflected in other elements of the basis (for example in the discount rate) as this is not transparent and can be misleading if the same margin is serving two purposes and has not been appropriately modelled.

c) In our view it is right (in paragraph 3.18) to observe that many methods that purport to illustrate uncertainty do so only by introducing further assumptions. However, we would expect providers of advice to rely heavily upon certain standard statistics, such as life expectancy, as well as providing a sufficient illustration of the sensitivity of the results.

Question 3 *Some proposals regarding the use of summary statistics and benchmarks in reporting on mortality assumptions are considered in section 3.*

a) Do respondents foresee any practical difficulties in communicating the assumptions about subsequent changes in mortality rates underlying life expectancy statistics?

b) Do respondents have suggestions for summary statistics that can be used to describe changes in mortality rates?

c) Do respondents think that the use of benchmarks is useful, and if so, should the development of standard benchmarks for future changes in mortality be encouraged?

a) We strongly approve of the practice of quoting standard statistics, such as period life expectancy or cohort life expectancy. We do not foresee any practical difficulties in communication.

b) Life expectancy (cohort rather than period) is a good summary statistic. We favour cohort over period life expectancy as the latter reflects only the base mortality without allowance for future improvements, and so a complete picture can only be obtained by quoting multiple period life expectancies at future dates. The effect of improvements can be illustrated by reference to the life expectancy of a life of the same age at some future date.

c) Benchmarks for future improvements may be a worthwhile development. Paragraph 3.60 suggests that a benchmark scenario could, for example, be that deaths from heart attacks reduce over ten years by half. Although intuitively appealing such a benchmark would be very difficult to calculate and might not command broad agreement. More straightforwardly described benchmarks, e.g. that improvement rates are 2% per annum, may be the best that can be achieved.

Question 4 *The BAS would welcome any general comments that respondents may have on the various possibilities for standards set out in section 4. In particular:*

a) Do respondents agree that the BAS should set some standards for mortality assumptions?

b) Do respondents agree that reporting standards would play a significant role in increasing the transparency of assumptions and their comprehensibility to users of actuarial information?

c) Do respondents have any comments on how to assess the likely impact of possible BAS standards for mortality assumptions?

a) We agree strongly that the BAS should have a responsibility to set standards for actuaries about making mortality assumptions and about reporting the choice, given that these assumptions are of crucial importance and financial consequence. It would also be incumbent on the BAS to monitor the impact of the standards and mortality developments generally to ensure standards remain fit for purpose.

b) We agree strongly with this.

c) This will depend on how tightly the standards are drawn, and in any case it will be difficult to ascertain to what extent changes in pension scheme funding are being driven by the BAS standard and how much is attributable to other pressures, such as the Pensions Regulator's monitoring of scheme funding. No change in assumptions however would be prima facie evidence that the standards were unnecessary.

Question 5 *In section 5 the BAS considers possible standards for assumptions about base mortality.*

a) Do respondents believe that it would be desirable for a BAS standard to require the use of the most recent applicable published tables, taking into account both the communication problems and the practicality of setting a limit on the tables to be used?

b) Do respondents have any comments on the proposals for possible requirements for reporting on assumptions about base mortality, criteria that assumptions should meet, or limits that should be observed when setting assumptions? Respondents are asked to focus on:

- any practical problems that might arise in complying with them; And*
- whether they would further the BAS's aim of increasing the transparency of assumptions and their comprehensibility to users of actuarial information.*

a) Not necessarily, although often it would be right to use the most recent applicable table. It would not necessarily be appropriate, however, for a pension scheme that had credible experience of its own. There may also be a problem about the definition of "applicable", e.g. which variation of PxA was applicable.

b) As a general comment, we support the reporting standards. There could be practical problems with requirements that are too tightly drawn; it would not be satisfactory for a situation to arise where an actuary felt constrained by the form of the reporting standards to use an assumption that he did not actually consider was appropriate. Specific comments on the three types of proposal are as follows:

- Reporting on assumptions for base mortality: the proposals made in paragraphs 5.41 to 5.49 would seem to lead to transparency in reporting. We do not envisage any significant problems of practicality in these proposals.
- Criteria that assumptions should meet: the proposals in paragraphs 5.51 to 5.53 would seem to lead to transparency in reporting, and there are no obvious practical problems. In relation to paragraphs 5.54 and 5.55 we are hesitant over the reference to "specified requirements [for the data to satisfy] such as the minimum volume required, the length of period to which it relates and how recent it is". This would seem to curtail the exercise of actuarial judgment in an area where there may be little scheme specific data at present.
- Limits that should be observed when setting assumptions: we would not favour the setting of limits on any assumptions, not even on proscribing tables published before a certain date, since there may be occasions when older or more unusual tables are appropriate. We would rely on the requirement for evidence and explanation to justify assumptions.

Question 6 *In section 6 the BAS considers possible standards for assumptions about future changes in mortality.*

a) Do respondents agree there is no objective basis for differentiating the future changes in mortality likely to be experienced by a particular small group of lives from those likely to be experienced by the population as a whole? If respondents disagree, the BAS would be interested in examples to the contrary, together with supporting evidence.

b) Do respondents have any comments on the proposals for possible requirements for reporting on assumptions about future changes in mortality, criteria that assumptions should meet, or limits that should be observed when setting assumptions? Respondents are asked to focus on:

- any practical problems that might arise in complying with them; And*
- whether they would further the BAS's aim of increasing the transparency of assumptions and their comprehensibility to users of actuarial information.*

a) We agree that there appears to be no objective basis for differential future mortality changes. This makes it more important that clients understand the nature of the advice that they receive and can compare their own assumptions more broadly.

b) We support the concept of standards applying to future changes in mortality within a broad consensus. We are supportive of the proposals described in paragraphs 6.47 through 6.64. In relation to setting limits, we note that the proposal in 6.66 is congruent with regulatory recommendations and should be seriously considered. .

Other comments

It is incumbent on the profession and the BAS to keep up with other professions and other countries' actuaries and standard-setters in this important field. The maintenance of any new standards implies an overhead in monitoring and reviewing standards. At the present time and given its topicality there is plenty of evidence of dialogue with other groups and this should continue.

Yours faithfully



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