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2nd June 2009

Ms L Pryor
Technical Director
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Dear Louise

Reporting Actuarial Information – March 2009 Exposure Draft
Lane Clark & Peacock LLP ("LCP") response

We are pleased to submit our response to the above consultation document.

By way of background, Lane Clark & Peacock ("LCP") is a leading firm of actuaries and consultants, with over 90 partners and principals, and a team of more than 450 employees across Europe. The firm provides actuarial, employee benefit, investment, insurance and risk management related advice as well as pensions administration services.

We welcome the majority of changes that have been made to the exposure draft. In particular, it feels considerably more like an actuarial standard. However, there are still aspects that we believe must be addressed before the standard can be practically applied.

We are most concerned about the proposed extension of the scope of the generic standards, particularly in relation to work that is reserved through an "other legal obligation". For example, this would mean actuaries advising two otherwise identical pension schemes being subject to vastly different levels of compliance simply because one set of rules specifies actuarial advice must be obtained in certain procedures. We have commented on the difficulties caused in our answer to your question 1 set out in the Appendix to this letter and we would strongly suggest that this proposal is reconsidered.

We believe that, along with scope, further work is vital on materiality and proportionality to ensure the practical implementation of this standard. We comment on these immediately below:

- **Definition of "material"** – The definition, as it currently stands, appears to place too much power in the hands of the "users". Unless there is some implied safeguard for the report writer in C 2.8. – C 2.10., it appears that the user can decide what would have influenced their decision with hindsight, at a later date, with no requirement for it to be subject to a reasonableness criterion.

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A workable definition might be along the lines of *"A departure from this standard is material if... the effect of the departure could reasonably influence the decision taken by users or the users' collective understanding of the information on which decisions are based when considering solely that information known by the report writer"*.

We also believe that more needs to be made of the materiality safeguard within the wording of the Standard. This would make TAS R less intimidating in particular areas of work where it can reasonably be argued that a number of requirements can be ignored because they are immaterial to the users. For example, materiality is not specifically mentioned under the headings of cash flows, probabilities and projections. Under the comparisons heading, what should be covered is subject to a materiality requirement, but not whether or not comparisons should be undertaken.

- **Proportionality** – We believe this to be an important safeguard for the report writer and note that you have referred to it on a number of occasions, along with materiality, to address concerns that TAS R may be too demanding or too difficult with which to comply cost-effectively. Given this, we suggest that C 2.11. should be extracted and find its way in modified form into the definitions section.

  We further suggest that the wording in B 1.2. is expanded to make clear that an apparent departure is not in fact a departure where the proportionality safeguard can be used. We mention this because we have a worry about how this and the materiality safeguard might be viewed in Court if they have been applied to multiple areas of this and potentially other standards so as to produce a report that, in the absence of appealing to the materiality and proportionality safeguards does not appear to be compliant.

Finally, we have concerns over the potentially wide definition of "users" as it does not seem to be restricted to the prime audience for whom the report is written. For example, it could be argued that a scheme funding report is not only of assistance to the trustees (the prime user), but is also of use to the employer, Pensions Regulator and scheme members in decisions that they may take. If so, it would be impractical for the report writer to ensure that compliance is achieved for such multiple audiences.

Our responses to your individual questions are in the Appendix and are in addition to the issues outlined above. Please feel free to contact us if you would like to discuss any of the points made.

Yours sincerely

{Sent as an attachment to an e-mail on 2nd June 2009 at 11:10}

Fiona J Morrison FIA
Partner

Enc: Appendix

Copy to: basreporting@frc.org.uk

Appendix

Response to specific questions

1. Whether the proposed additions to the Schedule of the Scope & Authority are desirable, and if so whether the suggested text achieves the aims

We can understand the attraction of introducing such a wide scope and applying the generic standards to a broad range of actuarial work without further delay, but the current proposal is far too imbalanced and costly to be workable. The inclusion of the "other legal obligation" aspect of reserved work in the scope of the generic standards means that:

- the same task in two similar pension schemes could cost significantly more in the scheme whose rules specify the actuary's advice must be obtained (and therefore all the standards' hoops must be jumped through);
- there will be difficulties in determining whether pension scheme rules provide a legal obligation for trustees to take the advice of an actuary and therefore difficulties in deciding whether certain tasks are within the scope of the generic standards; and
- to avoid the additional regulation, with associated costs, we envisage many trustees might consider amending pension scheme rules to remove references to actuarial advice.

These issues would be avoided by limiting the scope, initially at least, to the statutorily required reserved work.

This is not a perfect solution as there are areas of statutorily required reserved work that do not fit comfortably with certain principles of the generic reporting standard (for example circumstances where the answer is very obvious – possibly actuarial equivalence under section 67 of the Pensions Act 1995 when the majority of benefits are improving – or reserved advice that does not particularly involve calculations such as giving advice on assumption setting). However, the pitfalls associated with applying the standards to statutorily required work are minor compared with the very real and costly problems applying the standard to the "other legal obligation" aspect of reserved work.

There is the converse situation in general insurance. Most of the work is not reserved so would not be covered by the generic standards. This seems odd when one of the aims is convergence in reporting standards. Also, under Solvency II there will be various reports that have to be produced by the Actuarial Function Holder. However, this does not need to be an actuary so there may be confusion regarding whether or not the standards apply to these reports.

2. The proposed commencement date

Implementation of the generic standards will require the review of many reporting document templates and risk control processes to identify any areas that have not previously been incorporated and consequently the revision of document templates and processes to allow for any identified gaps. The size of the task should not be underestimated – it will be time-consuming and will require substantial input at a senior level to ensure the standards are met appropriately.

As such, it is imperative that all the generic standards are implemented together to avoid the need to repeat the exercise of amending standard reports several times at substantial cost to our clients.

Introducing the standards together also minimises the difficulty of ensuring component reports meet the relevant standards where the relevant standards are changing throughout the process.

We understand that setting a definitive date for "turning on" the generic standards is fraught with difficulties and there is not a definite start or end date for certain projects. We believe it may also be appropriate to turn on the standards for projects commencing after a certain date rather than for aggregate reports delivered from a certain date (and within this allow some judgment as to when a project is genuinely new as opposed to a further iteration of an existing project).

These difficulties can to some extent be overcome through using a trial period before the standard becomes mandatory – a precedent for this was the implementation of GN48. This would both enable more time for companies to finalise certain standard documents and also allow a certain degree of "wriggle room" if the start or end of a project was unexpectedly delayed. As part of this (and thereafter) we would like to see the BAS providing assistance to enquirers on how the standards should be interpreted.

A sensible target to start this trial might be 1st October 2010 if the other standards are likely to be ready in good time before then. This would also lead to greater certainty over the next round of Lloyd's opinion reports.

3. The definitions of "aggregate report" and "component report" in Part B of the exposure draft

We broadly support the principles of aggregate and component reports providing the definitions of "material" and "user" are amended and the scope of the standard is revised.

We do have concerns over the practicality of the proposed report definitions in the following cases:

- The definitions seem focussed on a process during which one decision is made. In a long process with multiple decisions, for example by the trustees requiring actuarial advice during the scheme funding process, we understand from the current drafting that each decision will need a compliant aggregate report. This means that for scheme funding, aggregate reports will be necessary for each of deciding the methods and assumptions to use for the technical provisions, preparing or revising the statement of funding principles, preparing or revising a recovery plan and preparing or revising a schedule of contributions. Keeping track of the component reports (eg e-mails) that make up the specific aggregate report could be unwieldy, costly for the user, and the user may not take decisions in the desired logical manner. Is there a possibility of introducing a "super aggregate report" concept that would bundle related decisions together?

- It is not clear whether it will also be necessary to produce aggregate reports when, for example, certifying the schedule of contributions / technical provisions or producing a final report of record if there are no obvious decisions that need to be made by the prime user.

- There could be situations where the decision to be made in a project is put off indefinitely (eg if the user is monitoring a situation on an ongoing basis). It is difficult to see how one would classify the aggregate report in such a situation. We particularly see this being a problem if the scope is not reduced as suggested in 1. above or if other elements, such as parts of Solvency II, were added to the scope.

4. The effects that the introduction of TAS R is likely to have on the content, form and timing of communications with the users of actuarial information

We suspect that most large reports will slightly increase in size as a result of TAS R: although most of the information is already included we suspect the tendency will be to include additional items that might be considered material rather than risk excluding them due to immateriality. However, this does depend on the definition of "material" as discussed above. It is likely certain reports, such as the scheme funding valuation report, could reduce in size as much of the required information will be referenced from other documents.

We believe the biggest change will be in the other component reports, such as e-mails to clients and follow-up letters following conversations that included material points. When these become subject to a specific standard we believe they will take a more formal style with extensive caveats and details of exactly how they are intended to be used. Clients may regard this as costly and cumbersome, and they may consequently be less inclined to ask questions.

5. The BAS's assessment that any long-term costs will be justified by the benefits to the users of actuarial information

As noted in our original response, we expect a standard setter to perform an analysis of the cost of implementing its proposals, and this has not been done. Paragraphs 3.40 – 3.46 of the analysis of responses merely assert that you believe any long-term costs will be justified. As "users" of this consultation report we would contest this is hardly in keeping with many of the principles in the reporting standard itself let alone the data and modelling standards. This issue has become even more pressing given your intention to widen the scope to all reserved work.

We believe it is very important that both the BAS and users of actuarial information understand how the proposals will affect the production of actuarial advice. The focus in these standards has very much been on the users so, without analysing the effect on the producers of reports users do not have the necessary information to decide whether the proposals in this standard are proportionate. We believe further analysis is required immediately.

In the absence of such analysis at this stage, and setting aside the inevitable initial costs of changing standard reports, we believe the new regime will increase costs for the following reasons:

- In processes with multiple decisions it will certainly be costly to ensure each combination of component reports that form an aggregate report for each decision is in line with the reporting standard.

- The cost of a report is not directly proportional to its length – although some aspects may be stripped out of reports due to them being "immaterial", all aspects will have to be considered and judged on their own merits, even if assessed as being immaterial. The time taken to consider these aspects, some of which will be new for particular practice areas, will be an additional cost.

Early indications are that the data and modelling generic standards could also increase long-term costs.

Overall, we are doubtful that many users of actuarial information will feel that the additional costs are justified by any additional benefits.

6. The proposal that TAS R should prevail in the event of any conflict with adopted Practice Standard Guidance Notes

We have some difficulties with this concept since if an aggregate report contains all information material to a user and a report *"shall not include information that is not material if it obscures material information"*, it is difficult to see how TAS R prevailing over a Guidance Note is not simply TAS R replacing the Guidance Note.

A particular issue is with the timing of providing a full report to the client, compared to an aggregate report under TAS R – for example a GN9 pension scheme actuarial valuation report. Whilst TAS R quite rightly requires all information (other than oral information later on confirmed in writing) to be received before a decision has been made, the GN9 report usually includes the actual rate of contributions agreed by the trustees and is therefore received after the decisions have been made. As GN9 would not be conflicting with TAS R in this instance, it could be that the GN9 report also needs to be provided. Whilst we fully recognise the importance of a report of record in major projects it seems unnecessary to apply standards both before and after the decision is made.

7. The proposed additional requirements described in paragraphs 4.8. to 4.18. of the analysis of responses to the previous consultation

Oral information (C 2.6.) – A sensible change provided the materiality safeguard can be used when giving answers to questions at meetings or over the phone. We would not want to see clients reluctant to ask questions because of the additional costs of the actuary having to confirm the answer in writing.

Subsequent events (C 3.10.) – Whilst we understand it can seem attractive for users to be given "an indication" of post-calculation events we also believe it could be very misleading. There are two reasons for this:

- If we are not quantifying properly the effect of the event how should users take the changes into account?

- What about other mitigating effects – eg in a stock market crash could we expect higher yields in future? It would be very costly to attempt to re-engineer a basis every time there is a significant post-calculation event and without serious consideration a related significant change could be overlooked.

Completeness (C 5.) – The additional flexibility offered by the new wording is welcome, although indications of future calculations will not always be appropriate (although possible) under the extended scope of TAS R (eg section 179 PPF levy valuations which are prepared every three years but whose assumptions and guidance change almost annually). We hope the "materiality" and "proportionality" safeguards will prevent any unnecessary additions.

8. The text of the exposure draft as a means of implementing the policy proposals presented in this document

We welcome the much improved style of this exposure draft.

The main barrier to implementation seems to be that the standard is focussed a little too much on how full reporting would look in an ideal world and that does not always translate well to small,

budget-sensitive projects. Provided the scope is narrowed and the materiality and proportionality safeguards can be used freely and with confidence (and subject to the amendments noted above) the standard should, in the main, be workable but we would like to see further confirmation that materiality and proportionality overrule the more specific requirements of the standard even though they could be argued to work against the Reliability Objective, which makes no mention of costs.

Commenting on some particular aspects of the drafting:

- Oral information – We assume that commenting on the minutes drafted by a client at a meeting (for example, commenting on the minutes of a trustees' meeting that have been drafted by the client) is sufficient to comply with the requirement in C 2.6. for material oral information to be confirmed in a report.

- Scheme rules requiring the actuary to perform individual calculations – we are aware that C 2.5. notes that one in a series of individual calculations does not need to meet the reporting requirement, but if the user is clearly the member it is not obvious that C 2.5. exempts the actuary from the entirety of the standard.

- Recording / disclosure of judgments – C 2.10. is noted, but for risk management it is likely that there will be such documentation carried out internally.

- Planning / valuation – It is not clear whether in C 3.7. the word "planning" has to be communicated to users or whether it is sufficient to describe the planning aspect of an exercise that is traditionally called (and referred to often in legislation as) a valuation.

- Comprehensibility – We agree with the principle in C 4.1. But the requirement in section C 4.2. that *"Reports will need to address the needs of, and be understandable by, all their users, however varied their levels of relevant technical knowledge"* is not feasible. By that logic, an actuarial valuation report for a trustee board would have to be written at a base level if there is just one new pension scheme trustee even though the new trustee is unlikely to be the main driver behind the decisions (a scenario you were keen to avoid in the initial exposure draft but seems to remain in the current version). We suggest that C 4.2. is modified to make it an aspiration or is deleted.

- Uncertainty – The issue of communicating uncertainty, as required by C 5.1. has been debated in the context of GN12. Our concern is that the client may only want a single answer, and giving a range (or indeed highlighting the myriad of uncertainties when attempting to model the real world) can confuse and leads to higher costs. In particular, scenarios without any mention of their (perceived) likelihood can certainly be confusing.

- Material risks – It is not clear whether C 5.4. recognises that there may be risks associated with the decision that is to be taken by the user that go beyond the expertise of the actuary (eg covenant analysis for a scheme funding valuation) and so cannot be covered in any meaningful way in the report.

- Calculation methods – We are concerned that C 5.7. c) may be impractical and may detract from the important issues for the client. For example, explaining the calculation method for share option valuation work would be difficult as the models are complex, and what the clients really needs to know is whether the calculations are compliant with the accounting standard rather than how they work.

- Probabilities – We are not clear why C 5.14. exempts probabilities, such as mortality rates, that have been adopted entirely from another source from the scope of C 5.11. This exemption seems to call into question the objective of the C 5.11 requirement.

- Comparisons – It may not be possible to carry out a comparison under C 5.15. when the previous aggregate report has been written by an actuary in another firm. If the materiality safeguard does not operate it would seem that compliance cannot be achieved.

- Rationales – The term "material calculations" in C 6.6. c) appears ill-conceived. There are countless calculations performed in a pension scheme valuation that would affect results if they were substantially wrong, but we are sure you are not expecting actuaries to explain every part of the calculation process in detail.