

22 May 2009

The Director
Board for Actuarial Standards
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Dear Sir/Madam

Exposure Draft: Reporting Actuarial Information

Thank you for the opportunity to comment on this exposure draft. This response has been prepared by the Benefits Practice of Watson Wyatt and therefore primarily reflects pensions-related issues, although representatives of other Practices have reviewed it and their comments have been taken into account. Watson Wyatt is a global consulting firm with particular strength in the area of UK pensions. We advise over half of the 100 largest corporate pension schemes, and the firm as a whole employs over 300 qualified actuaries in the UK.

In general, we consider that this second exposure draft is a significant improvement on the first and we commend the BAS for taking on board some of the feedback received. As usual, though, our response will tend to focus on the areas where we still advocate change.

Appended to this letter is a response to each of the eight specific questions posed in section 5 of the consultation document. We would highlight the following key comments:

- If the BAS is wishing to bring the TAS into force for certain work before the subject-specific standards are completed, we would suggest that this is done by listing the particular work that is to be in scope rather than by implementing a general extension to ‘reserved work’
- The BAS should put back the mandatory ‘in force’ date until October 2010 or January 2011, unless it has clear evidence that its ‘Reliability Objective’ would otherwise be significantly compromised in the short term
- We think that the wording adopted in the latest draft and the inclusion of too much specific detail have resulted in a standard that appears to be rules-based rather than principles-based, and this is likely to frustrate the BAS’ objective that the standard will result in information that is more focused on users’ needs
- More work is needed to clarify the application of the ‘proportionality’ principle, on which the BAS appears to be relying heavily to ensure that the standard is not unduly onerous
- The definition of ‘user’ still needs clarification.

The Appendix also includes some specific comments relating to accounting work and investment consulting, the principal concerns being:

- Uncertainty as to the extent to which the TAS would in practice apply to accounting work, and the possibility that it could turn a set of accounting numbers for compliance purposes into a much wider risk analysis
- The potential for ‘additional compliance costs’ (whether perceived or actual) to make it unattractive to commission a UK actuary to perform certain non-reserved work, where such a person would be eminently suited to provide the advice or other service.

We would be very happy to meet with you to discuss any of the points raised in this response. If you want to take up this offer, please get in touch.

Yours faithfully

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Senior Consultant

Watson Wyatt: Response to specific consultation questions on Exposure Draft of generic TAS on *Reporting Actuarial Information*

1 Additions to Scope & Authority

We are not in favour of a blanket expansion to include all 'reserved work'. This largely reflects a view that the definition of 'reserved work' is not always effective at identifying the work that is most in need of standards, and can give rise to anomalies and problems in identifying where the specifically 'reserved work' ends and other, consequential and often at least equally important, work begins. For example:

- In pension scheme funding work, the giving of advice on certain matters and specified final calculations and certificates are 'reserved work', but other more general, but still vital, advice within the overall process is probably (strictly speaking) not. On the other hand, some 'reserved work' such as PPF valuations has little if any need to fall within a generic standard like this.
- In pension scheme accounting work, for FRS17 the directors are obliged to take advice on the assumptions from an actuary. Our understanding is that this does *not* come under the current definition of 'reserved work', because FRS17 does not specify what 'actuary' here means (i.e. a fellow of the Institute or Faculty). However, if the BAS were to rule that this were 'reserved work', there would be a difference compared with IAS19, where the use of an actuary is only 'encouraged' even though the work is to all material intents and purposes the same. This example raises two general points: uncertainty as to precisely what is covered by the definition of 'reserved work' and the likelihood that some inconsistencies will emerge from the definition (whatever it is).

In the medium term, we assume that this proposed expansion will have little impact as the vast majority of such work will fall under subject-specific TASs. We assume therefore that a main reason for it is to bring forward application of TAS-R, rather than waiting until the subject-specific TASs have been developed. If the BAS believes that it is imperative to start bringing in TAS-R sooner rather than later, we would suggest that a targeted approach under which particular pieces of work are specified as falling under the TAS would be significantly preferable to a blanket application to 'reserved work'.

We support the second proposed addition under 'user expectations'.

2 Commencement date

As a point of principle, we do not believe that a TAS should apply to work that had already commenced before it is published. If it does, then extra costs to users are likely to result from the need to revisit work that has already been (at least partly) done, and we would regard this as contrary to the intention stated by the BAS in the last sentence of paragraph 37 of the Scope & Authority. (The only exception to this should be if the BAS believes that its 'reliability objective' would be seriously compromised by an additional delay, and the extra cost is therefore clearly justified by the benefits of earlier introduction.)

A lot of pension scheme valuations will be undertaken with effective dates of 31 March 2009, and in general will not be signed off until the second quarter of 2010 (ie after the proposed commencement date for TAS-R). However, the process of providing advice for these valuations should, in most cases,

already have started. Normally, the trustees will not sign off the Statement of Funding Principles (SFP) until the end of the process, so even if they have made provisional decisions on the methods and assumptions at a considerably earlier stage in the process, it would seem that the actuarial information that was provided earlier for this purpose would need to be checked against TAS-R (and if necessary amended) before the provisional decisions are confirmed and the SFP adopted. It is likely to be the more complicated valuations from this tranche which are not finalised until after 31 March 2010, and these are the schemes for which any element of backdated compliance would be likely to be most onerous and costly.

Another practical effect of commencing TAS-R before replacement of existing GNs with subject-specific TASs is that there will be a period during which compliance with two separate sets of standards will be required, with a potential increase in costs (see 6 below).

In conclusion, therefore, we believe (assuming that TAS-R is published in July) that the commencement date should be put back to October 2010 at the earliest (and preferably to January 2011).

An alternative approach, which also has merit from the point of view of smoothing the transition to a new standard and thereby avoiding disproportionate knee-jerk reactions 'to ensure compliance', would be to introduce the TAS first as 'recommended practice' rather than as a mandatory standard. We believe that this approach was used successfully a few years ago when the Actuarial Profession first introduced 'compliance review' requirements for pension scheme actuaries.

3 Definitions of 'report'

The definitions of 'aggregate report' and 'component report' appear to us to be a very complicated way of giving effect to the well-expressed underlying principle in paragraph 1.9 of the analysis on the earlier draft, which (we think) is that the users have received in one way or another (but in an appropriate form) all the information relevant to the 'decision' in question. The complex 'report' definitions are a specific example of the point we make under 4 below, which is that a reader of the document will be unlikely to feel that it looks like a 'principles-based' standard.

It seems to us that compliance with TAS-R is assessed by reference to the information provided in relation to each 'decision' (dependent on actuarial information) that the users make. In practice therefore it appears that the requirement is that for each such decision there is a written document that identifies that decision and the actuarial information pertaining to it – the information itself either being in that document or in one or more other documents to which that document refers. Consequently, we wonder if the separate 'aggregate' and 'component' report concepts could be dispensed with.

4 Effect on communications with users of actuarial information

We agree that the standard should have the effect of shifting emphasis away from one 'big' report to the totality of information provided to users, and agree that this is a desirable result.

However, we do not think that the standard as currently drafted will have the effect suggested in 3.46 of the Analysis, that the information will be better-focused on the users' needs (see under 5 below for further comment). We fear that the way that the standard is drawn up and worded will not encourage the use of the actuary's judgement. According to 1.9 of the Analysis, the text contains 25 requirements, the

vast majority of which have the appearance of being ‘rules’ – to be met in relation to each ‘user decision’. This is likely to foster a ‘tick box’ approach based (perhaps) on a large table with a column for each ‘decision’ in the overall process and a row for each of the TAS’ requirements.

The shame from the BAS’ point of view here is that it seems clear that this was not the BAS’ intention, which we are sure (from remarks at workshops as well as from comments such as those in 3.10 and 3.48 of the Analysis) was for a much more principles-based approach involving significantly greater use of judgement.

5 Costs and benefits

For larger, ‘regular’ items of work, such as pension scheme funding valuations, we would not expect that (long-term) there would be any significant change in the cost of compliance. However, as 3.43 in the Analysis acknowledges, there will be short-term costs, and our comments on ‘commencement date’ in 2 above are made with a view to minimising these.

We fear that, for smaller and less ‘regular’ items of work, the new standard will increase costs because actuaries will feel obliged on each occasion to go through a well-documented process to demonstrate either compliance with each of the perceived ‘rules’ in the standard or that non-compliance is justified on materiality or proportionality grounds. While the BAS may well feel this is desirable, we do not think that it will necessarily create the benefit suggested in 3.46 of the Analysis, that users will receive information that is “more focused on their needs”. We agree that there is scope for this benefit to emerge across BAS standards as a whole, but do not think that this generic standard will contribute to that particular objective because it appears to contain so many specific across-the-board requirements.

6 TAS-R to prevail if conflict with GN

We are happy with this proposal.

We do, however, have concerns that, where the TAS and a GN impose different requirements that are not in ‘conflict’, there will be an additional compliance burden because of the need to satisfy both standards. We do not share the view in 4.5 of the analysis that extra work would not be required to comply with TAS-R as well as GN9; TAS-R contains additional requirements on, for example, post-effective date events and projected results at the next valuation. This is another argument against bringing forward the in-force date of TAS-R to some time before the replacement of existing GNs with subject-specific TASs.

7 The proposed additional requirements

We are happy with the explicit clarifying provision in C2.6.

The new requirement in C3.10 to report material post-effective date events or changes is a significant addition to the standard. Our understanding, from comments made at BAS workshops, is that the word ‘indication’ is intended to allow considerable freedom as to the extent of the information provided in compliance with this paragraph. However, this will not be obvious to readers, who might assume that it is tantamount to a requirement to re-work the figures in the report, whereas our hope is that the BAS’ intention is to allow – dependent on the circumstances such as the nature of the decision in question, the

timescale in which the decision is to be made and the preferences of the client – anything ranging from a simple reference to the recent event/change and the fact that it would impact the advice provided if it had been allowed for, to a full re-do of the work. Accordingly, we would suggest that C3.10 is re-expressed in terms of a basic requirement to draw attention to material events/changes.

We do not object to the principle of C4.8 but are concerned about the specific reference to ‘prudent’ in C4.9. We would say that there is a difference between terms like ‘best estimate’ and ‘central estimate’, where more than one definition is possible, and a term such as ‘prudent’ where there is supposed to be an accepted underlying definition but it is the practical application of that definition to the individual circumstances that is variable.

The new C5.9 is an improvement on earlier proposals on cash flows, although (as with C3.10) we think that the wide scope as to how this requirement is met (discussed in 4.12 of the Analysis) could be better communicated by a word other than ‘indication’. We would also suggest that the inclusion of an explicit requirement on something like this (in a generic standard) is an example of straying from ‘principles’ to ‘rules’.

While we can see that it will often be beneficial for users to be given an indication of the possible outcome of similar sets of calculations in the future, we do not believe that it should appear as a mandatory requirement (only to be dispensed with if it can be demonstrated to be disproportionate or immaterial) in a generic standard. Even more than C5.9 above, we regard C5.18 as imposing a rule rather than setting a principle; the underlying principle here is presumably that the information should include discussion of how the entity might develop in future, to the extent that this is relevant to the decision being made now (for example, in deciding on a contribution strategy now, the trustees of a pension scheme would normally want to be aware of the likely implications of a proposed strategy on the funding position expected at the next triennial valuation). In 4.14 of the Analysis there is an implication that this requirement is needed to ‘balance’ C5.15, but we are not convinced that a comparison with previous similar reports should be a *requirement* either (even though we agree that it is often a useful aid to user understanding and/or check on the results).

We do not object to the principle underlying C6.4b) and C6.6b) but are not clear why it is considered necessary to add this explicit point to the other provisions on assumptions and the rationale for them. Again, this appears to be straying from principles to rules.

8 Text as policy implementation

The most significant comment we have to make on this question is one that we have already made in reasonable detail under 4 and 5 above, so we will simply summarise it here – we do not think that the text as drafted will properly deliver the BAS’ stated aim of a principles-based standard involving best use of the actuary’s judgement and resulting in information that is driven by the needs of the particular user.

Other comments in the Analysis document where we see some tension between the comment in that document and the way the Exposure Draft is worded are:

- 3.17 & 3.27. These comments indicate that the materiality and proportionality provisions will prevent the TAS from being unduly onerous. This point overlooks the fact that the need to

consider materiality/proportionality and document a conclusion that something is immaterial or disproportionate can itself be onerous.

- 3.30. This paragraph cites PPF levy valuations as an example of work serving a very limited purpose and therefore requiring minimal compliance with many of the requirements of TAS-R. Superficially this may be correct but on closer examination it is not that simple. For example, why is it necessarily the case that C5.15 and C5.18 can be deemed to all intents and purposes inapplicable? Certainly, it is very unlikely that the PPF will have any interest in such comparisons and projections. But what about the trustees (who are the addressees of the report) and the employer? Is the actuary entitled to assume that if they are interested (for planning purposes) in the possible result in three years' time they would have asked specifically for this at some other point, rather than expecting it to be produced as part of this report? Somewhere underlying this question is the question of who is/are the 'user(s)' of this report (see further comments later).
- 3.33. This paragraph states that pension scheme members are not considered to be 'users' of a scheme funding report (which is what we would hope, given the requirements of C4). However, it is difficult to reconcile this with the actual definition in B2.1, which includes those "for whose benefit a report is written", unless a very narrow view is taken of the word 'benefit' (which would then in general make it difficult to consider that any 'third parties', including regulators, were within the definition).
- 3.34. The BAS is correct in stating that the proposed standard would not permit non-compliance simply by delivering some of the information orally. However, it is not clear that avoidance of the standard is prevented for certain decisions (where regulation does not require any 'evidence' of advice), by providing *nothing* in writing. An example of where this might happen is advice to an employer on a relatively small pensions issue, where the choice after a short telephone call is whether or not to confirm something in writing. The prospect of having to ensure that any written confirmation is TAS-compliant will create an incentive for the two parties to agree not to bother with any written follow-up – the 'proportionality' concept may well not be of assistance here because of the earlier-mentioned need to ensure that this can be seen to be justified.

A few further comments on specific provisions of the draft TAS are:

- The 'proportionality' requirement in C2.11 does not simply provide permission to be 'proportionate'; it makes it a breach to be 'disproportionate'. We think that this could place actuaries in an unreasonable position – caught between a rock and a hard place. Apart from anything else, it begs the question of who judges proportionality (or materiality). It seems to us that, for the BAS' concept for the TAS to work, it needs to be the actuary who makes this judgement. On this basis, it can be argued that omitting to do something required by the standard cannot in itself be a breach if the reason for the omission is that the actuary had judged the matter to be immaterial or disproportionate. The omission could then only give rise to a breach if the actuary's judgement in the matter could be shown to fail the test of C2.8 by not being "reasoned and justifiable".
- We have already mentioned issues with the definition of 'user'. C3.3 requires a statement of who the 'users' are. Does this statement in effect enable the actuary to define 'users' for the

purpose of the report, or would it be a breach of the standard if the actuary failed to identify, as a 'user', some third party (such as a regulator) whom the BAS (or the Actuarial Profession) later decided should have been regarded as a 'user'? Also, as C3.6 and the definition in B2.1 acknowledge, 'addressee' and 'user' are not necessarily the same and indeed it appears conceivable that the 'addressee' might not be a 'user'. On this basis, it could be concluded that the PPF is the only 'user' of a PPF levy valuation (even though it is addressed to the trustees) and the standard can be applied accordingly (see earlier comments on 3.30 of the Analysis) – is this the intention?

- C5.1 to C5.6 is an example of wording that could generate over-engineering. The underlying principle is presumably that an appropriate degree of comment should be given on the risks and uncertainty attached to the actuarial information. The proposed wording contains separate requirements for 'uncertainty' and 'risk' (even where the two are closely related), requires separate consideration for *each* source of risk/uncertainty, and implies that separate comments should be made on the nature of each risk, its significance and the approach taken to it. The point here is that the implied number of separate requirements to satisfy is potentially huge.
- Either there is a lot of overlap between C5.7, C6.4 and C6.6 or there are a lot of subtly different requirements to be considered relating to assumptions and methods. Could these sections not be brought together and rationalised/simplified?

Finally, we note the reference under 'status' to the currently-unpublished Appendix I. We cannot recall having seen any discussion as to the rationale for including this in BAS standards. We assume that its purpose must be to give background to the standard, with that background potentially being of assistance in interpreting the standard. Consequently, it is important that any status of the Appendix in interpretation of the standard is made clear (particularly bearing in mind the current B1.1), and if it does have practical status in this respect the contents of the Appendix should be subject to consultation along with the main part of the standard.

Accounting work

We are unsure of the extent to which the requirements of TAS-R will apply to such work, including (in particular) pension cost accounting for company accounts. Assuming that none of this work is classified as 'reserved work' (but see the comments regarding this in 1 above), it will only fall into scope if it is included in the pensions-specific standard or if a separate standard is created for accounting work.

As we have stated before in response to previous consultations, we have serious doubts as to whether this work should be covered by a BAS standard at all. There has never been an actuarial standard for IAS19 and the standard for FRS17 has only ever been 'recommended practice', and as far as we are aware this absence of a standard (or mandatory standard) has not caused problems. Moreover, the existence of geographically-limited standards in an international subject like company accounting gives rise to some significant practical issues. As we understand it, a BAS standard in this area would apply to work carried out by a UK actuary for a UK parent, but not by a UK actuary to a Dutch parent or by a Dutch actuary to a UK parent. If this type of approach is replicated across countries other than the UK, then (bearing in mind also that organisations like the UK actuarial profession might or might not separately oblige their actuaries to follow 'local' standards), it would be easy to end up with a structure under

which there are perverse constraints or incentives to use (or not to use) an actuary from a particular country for advice on the accounting figures for a company in that (or a different) country.

If a subject-specific TAS is nevertheless developed to cover pension accounting work, we think that the application of parts of TAS-R to such work needs to be seriously considered. Clarity would be needed as to who are considered to be the 'users' of the report (some of the issues here are similar to those for PPF valuations mentioned in the comments on paragraph 3.30 under 8 above). Among other things, this would drive the interpretation of the parts of TAS-R concerned with risk. For example, there is currently no need to include much of the analysis indicated in C5.1 to C5.6, but is C5.4 (in the context of pension accounting work) requiring comment on the risk that the numbers in the report do not turn out to be appropriate accounting numbers or is it instead (or as well) requiring a general assessment of risks within the pension plan itself? If it is the latter, then the TAS is helping to turn a compliance report aimed at providing a set of accounting numbers into a more general risk analysis of the scheme, with the potential to increase costs significantly. Another example of this is C5.18, where forward-looking projections may well be considered of use by some companies in their planning, but many other companies would we think wish to resist the imposition of a specific requirement for this (with its associated additional cost).

Investment consulting

The concern here is that a lot of investment consulting work might be carried out either by actuaries or by non-actuaries. In general, therefore, to avoid a disincentive to use the services of actuaries (often in circumstances where their qualifications and skills would, if not essential, be eminently desirable) the scope of mandatory BAS standards (which might be perceived by commissioners of work as adding to compliance costs) needs to be limited. This is probably primarily a matter to be considered when deciding on the scope of subject-specific standards (to which TAS-R and other generic standards would then apply), but is also a general point worth bearing in mind when making final decisions as to which 'requirements' should be retained in a generic standard and which should be dropped.