

First Actuarial response to the Pensions Consultation paper.

On behalf of First Actuarial plc, I am pleased to comment on your consultation document of June 2009.

Our comments reflect that we are pensions actuaries advising a range of schemes with a particular focus on those at the smaller end of the market.

All TASs provide the actuary with the freedom to use some judgement in their application. We welcome this freedom in deciding whether a matter is material or in ensuring that the amount of additional work required to comply with the TASs is proportionate given the scale of that particular piece of work. However, the test will be if, and when, the use of that judgement is ever challenged at a subsequent date, where the benefit of hindsight may colour one's views.

For example, should the credit crunch and the resulting impact on financial conditions have been foreseen by all actuaries? We would argue no. But with the benefit of hindsight, we could argue that greater weight should have been given to scenarios that were highly unlikely to occur but which would have had a substantial impact had they occurred. But does that mean that the advice provided pre credit crunch was inappropriate? We would argue no. So in checking to see how judgement has been applied in determining whether a matter is material, we would like to suggest a slight amendment as shown below in bold italics:

A matter is material if, at the time the work is performed, it (or information resulting from it) could ***reasonably be expected to*** influence decisions to be taken by users. A matter that is immaterial when considered in isolation may be material when considered in conjunction with others.

Moving onto the specific questions asked.

Q1: Will the proposed purpose of the pensions TAS... help to ensure that users of actuarial information can place a high degree of reliance on its relevance, transparency of assumptions, completeness and comprehensibility?

We believe it will.

Q2: Do respondents agree that all Reserved Work concerning occupational pension schemes should be within the scope of the pensions TAS?

Yes.

Q3: Do respondents agree with our intention that the pensions TAS should apply to work in connection with occupational pension schemes which is almost always carried out by an actuary and which is used to make important financial decisions or which might affect the level of benefits payable to members?

Yes, but the TAS will need to be clear on the exact work that is covered. Use of 'almost always' may give rise to ambiguity with the meaning possibly changing over time.

Q4 to Q10: These questions all relate to whether certain areas of non-reserved work fall into scope. Before we answer the questions directly, we feel it necessary to comment on this issue more generally.

Our understanding is that the reason why non-reserved work is currently outside of scope, is that such work need not be undertaken by an individual holding a scheme actuary certificate. There is concern that where non actuaries may be able to give advice in relation to such work, that the additional requirements needed to comply with TASs may be to the commercial disadvantage of actuaries.

Given that the key objective of all TASs (whether generic, or specific – such as TAS Pensions) is to enable the Reliability Objective to be met, it would appear rather strange that only some aspects of actuarial work should be in scope. Surely all users of actuarial information are entitled to expect those standards to be met. And in practice, where information is being provided by an actuary, the user is likely to assume that the Reliability Objective has been met.

We suggest that TAS P (and hence all of the generic TASs) should be adopted as best practice, rather than mandatory, for all non-reserved work.

Q4: Should the pensions TAS cover the non-Reserved Work listed in paragraph 4.26?

Yes, as best practice, rather than mandatory compliance.

Q5: Do respondents agree that the areas of work described in para 4.29 to 4.33 should not be in the scope of the pensions TAS?

Looking at each area in turn:

Accounting for pension costs – in the same way that GN36 currently embellishes the Accounting Standard, we would support this falling under TAS. We do not have strong views as to whether this should fall under a specific TAS for Financial Reporting, or be incorporated into TAS Pensions.

Investment strategy – We believe that the provision of asset liability modelling or advice on liability profiles and strategic asset allocation should be covered in TAS Pensions. Advice relating to funding of the scheme is covered by TAS Pensions and therefore it makes sense to include the other main area, actuarial advice on investment strategy. It would appear that the Board are advocating that this work may fall into scope at some later date, a view that we would support.

Q6: Should the following areas of work performed in connection with defined contribution schemes be within the scope of the pensions TAS:

- a) **scheme design:** We support actuarial advice on this matter being included in the scope of the pensions TAS, as best practice, for the reasons stated in the consultation report – the design affects the benefits members ultimately receive.

- b) **benefit projections:** We believe that benefit projections received by members do play a part in influencing their decisions on future pension provision. Legislation requires certain money purchase projections to be provided in accordance with guidance by a prescribed body (the Board of Actuarial Standards). This guidance is comprehensive, covering both the statutory basis for calculating the assumptions, calculating the projected values and the disclosures required. On the assumption that TM1 will remain in existence, we do not feel it is necessary for there to be any further requirements regarding such illustrations
- c) **any other work?:** The BAS could state that it would be best practice for any actuarial advice, for any purpose, to follow the TASs, where not already required to do so.

Q7: Should work performed in connection with mergers and acquisitions be in the scope of the pensions TAS?

It would appear to go against the Reliability Objective to exclude actuarial work undertaken as part of mergers and acquisitions. The timescales for completing the work are indeed very short and full data may not be available. But given the decisions that are made on the back of the information received, it is critical that the users understand any short cuts etc that have been taken and how reliable the results may or may not be.

Although it may be difficult to 'dot every i' or 'cross every t', it should be possible to meet the broad principles required by the TASs. Elsewhere in the consultation document, the BAS asks whether a standard funding report would be helpful. We would suggest, that for actuaries to fully appreciate how they should comply with TASs in this scenario, that an outline aggregate report/checklist is provided for a merger/acquisition.

Q8: Should work for scheme sponsors on inducements to transfer be in the scope of the pensions TAS?

Yes, but as best practice, rather than a mandatory requirement. It is also not clear whether advice to the trustees on their response to such an exercise would fall within scope. It would currently appear to be out of scope.

Q9: Is there any work for scheme sponsors other than work on scheme funding where agreement is required and inducements to transfer, that should be in scope of TAS P?

Q10: Is there any other work which is not mentioned above that should be within scope of pensions TAS?

In answer to both Q9 and Q10, we would recommend that all actuarial advice given to scheme sponsors, should, as best practice, follow the TASs.

Q11: Do respondents have any comments concerning data that are presented in section 5, especially those in paras 5.7, 5.10 and 5.12?

5.7: Agree with the proposed wording.

5.10: By legal opinion, is this referring to legal opinions sought by the scheme trustees, or is it looking at other legal judgements that might impact on the scheme?

5.12: The requirement to seek information about any practice of granting discretionary benefits suggests that you need to obtain information about past practices that are now obsolete. Although the materiality objective could be used to avoid doing this, it would be preferable if the wording was amended to “any **relevant** practice of granting discretionary benefits...”

Q12: Are there any other data issues which respondents believe should be covered by principles in the pensions TAS?

No.

Q13: Do respondents have any comments on the proposals concerning assumptions that are presented in section 6, especially...

6.3: Benchmarks are not appropriate in a scheme specific funding regime.

6.8: Agreed.

6.12: Our comments relate to the selection of assumptions taking into account any material events that have occurred since the effective date of the calculations.

Legislation requires the assets and liabilities to be valued at the same date and this will always be the valuation date. When carrying out a scheme funding exercise, the level of technical provisions must reflect assumptions at that date. However, it is possible to take account of experience being different to assumed when deriving the future assumptions required to meet any deficit at the valuation date.

But care is needed to consider the effect of that experience on both the assets and liabilities. For example, the assets of a scheme may be invested in bonds and since the valuation date may have increased in value by 10%. Although the assets have increased by 10%, it must be remembered that the liabilities assessed using a discount rate based on bond yields will also have increased, as the increase in asset value will have been accompanied by a fall in yields. It is therefore important that if, when advising on suitable assumptions, account is to be taken of any material events which have occurred after the valuation date, that allowance takes into account both the effect of the event on the assets and liabilities.

Furthermore, we would hope that the need to take account of post valuation date events was the exception rather than the norm. That is it is understood and expected that assets and liabilities will move since the valuation date (and not always in the same direction). Only if events since the valuation date mean that the results of that valuation cannot be relied upon should we be considering adjusting for post valuation date events. It would be preferable if the requirement to take account of post valuation date events was weakened to ‘may’ rather than ‘should’.

6.14: For small schemes, any analysis of their mortality experience may be misleading and no guide to future experience. Comments in 6.15 in the consultation paper recognise this. It would be preferable if the requirement also recognised this.

We suggest the wording is amended as follows “Any recent **statistically credible** experience of the pension scheme should be analysed...”

6.16: Agreed.

6.19: Agreed.

6.33: Agreed.

6.35: Agreed.

6.36: Can paragraph 6.36 regarding inflation be amended to say “Assumptions about future rates of inflation should **be made after consideration** of financial indicators and publicly available forecasts” or “Assumptions about future rates of inflation **should consider** financial indicators and publicly available forecasts”. We feel that the proposed wording “should take account of” leaves little room for the actuary to set an assumption in any way other than purely based on these factors, rather than allowing judgement to be exercised regarding perhaps distortion due to supply/demand issues or other factors.

6.42: We agree that it is important for clarity to distinguish between the assumption deemed to reflect current expectations and the allowance for future improvements. However it should be recognised that for small schemes, the current estimates for mortality are likely to be based on standard tables with adjustments being made to those tables reflecting data published by the Office of National Statistics and/or the Continuous Mortality Investigation Bureau of the Actuarial Profession; small schemes are unlikely to base their estimates on their own members’ current mortality experience, due to lack of credible data. We are concerned that the current wording might appear unduly onerous for small schemes as it might be interpreted as requiring a scheme analysis. We suggest that wording along the following lines be inserted at the end of the paragraph: “**The selection of current mortality rates may include adjustments to standard tables to reflect variations arising from pension amount, occupation and regional factors, reflecting either published analysis or where statistically credible, scheme analysis.**”

6.46: There is no reference to the term ‘selected’, which is deemed to cover both the advice provided by the actuary, as well as recognition that the ultimate decision may lie with the trustees or sponsoring employer.

Furthermore, it should be remembered that when selecting assumptions relating to discretionary increases, the extent to which these may be funded for in advance will depend on the powers set out in the Scheme Rules.

6.53: We support the need to include a reserve for future expenses in liability calculations, but cannot see why it is necessary to split the running costs to distinguish between those relating to accrued liabilities and those costs associated with future liabilities. For example, the costs of administering the scheme will largely depend on the size of the scheme membership and not the size of the liabilities accrued in the past and to be accrued in the future. Any attempt to split those expenses between past and future accrual of benefits is unlikely to be that meaningful. We are also unsure as to how we might go about determining such a split of costs in practice and the manner in which we would then allow for the costs in

the funding valuation. For example, is it the intention that the past service costs should be added to the past service liabilities and funded for by way of any deficit payments? Should future service costs be allowed for in the usual way – either by the employer meeting the costs directly or via an addition to the future service contribution rate paid to the scheme?

6.61: We support the move away from the current GN9 approach to the principle based approach set out.

However, it is not always possible to obtain annuity rates from providers, particularly for small schemes, and providers are not always willing to disclose their basis, so this information may not be readily available. The PPF basis could be regarded as providing a reasonable proxy to annuity rates, but the PPF cannot be thought of as a provider. We suggest that the wording be revised to say “should be determined taking account **of market information relating to possible annuity rates**, the nature of pension scheme liabilities and the level of relevant bond yields.”

6.63: We agree that the assumptions adopted by the Trustees for the calculation of cash equivalent transfer values should be justifiable in relation to those adopted for Scheme Funding, and vice versa. But in both cases, the actuary is only responsible for giving advice on the assumptions. The final decision as to the choice of assumptions for both cash equivalent transfer values and scheme funding rests with the Trustees and/or Employer. The legislation requiring cash equivalent transfer values to reflect best estimate relates to the minimum cash equivalent transfer value. Trustees could choose to adopt a more generous basis.

Q14: Would a standard comparator rate for discount rates assist users’ understanding and if so whether a low risk rate should be used?

We do not favour use of a comparator for the discount rate.

If assets are invested in equities, then providing a comparison of the expected return on equities against a low risk rate may imply that the low risk rate is guaranteed to be achieved, when this is only the case if such low risk assets are held to maturity.

We appreciate that users of actuarial information will find it helpful to be able to compare the results of a valuation against other figures. But this must be by way of consideration of the basis as a whole, not just one element, the discount rate. Trustees are generally provided with a range of different valuation results on different bases as part of a valuation, including an estimate of the solvency valuation (buyout basis), cash equivalent transfer value basis and PPF levy valuation basis. And the Employer will also have obtained pension cost accounting figures (such as IAS19, or FRS17).

For scheme funding, where the level of the technical provisions is required to reflect the strength of the employer covenant, it could be argued that an appropriate comparison would be a self sufficiency basis. The difference between the basis adopted for the Statutory Funding Objective and that required to be self sufficient (ie with no further recourse to the employer for finances) gives a measure of the dependency on the Employer for future funding. A self sufficiency basis would typically use a discount rate reflecting the expected return on low risk assets, but also contain further margins relating to other assumptions, such as mortality.

Q15: Are there any other principles on the selection of assumptions which respondents believe should be in the pensions TAS?

We haven't identified any.

Q16: Do respondents have any comments on the proposals concerning modelling and calculations that are presented in section 7, especially those in paragraphs 7.6 and 7.10?

7.6: No, we agree with the proposed wording.

7.10: We agree that it is critical that any instructions given by the scheme actuary to scheme administrators should be clear. The proposed wording includes "procedures for checking the calculations". We do not think it is intended that we tell the administrators how to do their job. Rather, we believe the intention of this wording was to cover when cases should be referred to the scheme actuary for review. We suggest that the wording is amended from "procedures for checking the calculations" to "**when calculations should be forwarded to the scheme actuary for review**".

Q17: Are there any other principles relating to models and calculations which respondents believe should be in the pensions TAS?

We haven't identified any.

Q18: Do respondents have any comments on the proposals concerning reporting that are presented in section 8, especially those in ...

8.4: Agreed.

8.17: Agreed.

8.18: We agree that where there is uncertainty about the definitions of benefits to be paid, that it is helpful to the user if they are given some indication of the maximum liability. However, as recognised in the consultation paper, 'in some cases such an estimate would be difficult or even impossible to calculate.' Would we be correct in thinking that where this was the case, that the actuary would use the 'proportionate' clause to remove the need to provide such figures?

8.35: In our experience, the PPF levy valuation report is provided to the Trustees to enable completion of the Scheme Return and is not provided to the PPF directly. We do not see any need for this requirement.

8.38: We agree with the requirement, but rather than stating "how robust the factors are", believe that it would be more useful to the user of actuarial information if it was set out under "the circumstances in which the factors would no longer be suitable". For example, cash commutation factors may be suitable where the yields underlying the factors fall in the range x% to y%.

8.40: Agreed.

Q19: Do respondents agree that in Scheme Funding exercises any prudent estimate of scheme liabilities should be accompanied by a best estimate?”

Although we're in agreement with the need to perhaps show other measures of funding besides the prudent SFO basis, we're concerned that if we just show the prudent SFO basis next to the best estimate basis, the SFO basis might look overly strong. We're also concerned that people get wedded to a set of numbers and so will think best estimate is *the* best estimate basis rather than a best estimate, which is perhaps as difficult to determine as an appropriately prudent basis. If there is going to be a requirement to show best estimate alongside the SFO results, we would also like to see the buyout basis or self sufficiency basis being required to be presented at the same time / in the same section of the report. This is so that there is a comparison with the SFO basis on both sides of the prudence scale, not just the weaker side i.e. we think it would be appropriate to show a stronger (buyout) basis alongside the SFO basis, as well as a weaker (best estimate) one.

Q20: Do respondents agree with our conclusion that the final Scheme Funding report should include sufficient information for an informed reader to understand the financial position of the scheme, and that is best accomplished by defining the intended users and decisions accordingly? Do respondents agree with our conclusion that this would result in little extra work?

Legislation states that the Scheme Funding report is disclosable to members, on request. However, this in itself does not require the report to be written with members' level of pensions knowledge in mind. The Summary Funding Statement is designed to provide members with information relating to the funding position of the scheme in a more readily understandable format.

However it is important to recognise that the Scheme Funding report provides a valuable resource to informed readers: for example to trade union representatives when scheme changes are being considered. This does not necessarily mean that such readers should be deemed to be users of the report. But we should recognise that the disclosure requirements were introduced to provide scheme members with access to full information about their scheme. It is important that the new style reports do not disenfranchise members in this area – either by being impenetrable or being a partial account.

Further, the requirement suggests that “informed readers who will make decisions based on the financial position of the pension scheme....”. We would suggest that at the very least ‘will’ is replaced by ‘may’.

We support the approach set out in para 8.26.

Q21: Would the provision of specimen Scheme Funding reports be of value to users?

The provision of such a report would give a clear indication of what was expected and we would welcome this. However, the report should not be thought of as a standard (for example, it should not be used as a comparison in any disciplinary case).

Q22 Are there any other principles on reporting which respondents believe should be in the pensions TAS?

No.

Q23: Do respondents think that actuarial comparisons in pensions should be covered in the pensions TAS or in a specific TAS covering similar matters across all areas of actuarial work?

Preferably in the pensions TAS to avoid having to refer to lots of different TASs.

Q24: Do respondents have any views on whether it would be of value to users of actuarial information for the BAS to maintain a glossary of actuarial terminology and if so, what should it contain?

A glossary is needed – with all pension and actuarial terminology explained.

Q25: Do respondents have any comments on the proposed transitional arrangements from the adopted GNs to TASs ?

We are generally happy with the proposed transition from GNs to TASs. But we would stress that the new standards should not be deemed to apply retrospectively, as is currently intended. Carrying out an actuarial valuation of a pension scheme may take up to 15 months to complete and it would not be reasonable to require actuaries who have complied with current guidance notes in the early stages of a valuation to then have to revisit that work to ensure compliance with the specific and pensions TAS. Such work would need to be carried out on a scheme by scheme basis and result in additional costs to clients. This will be unwelcome to firms and their clients.

We therefore recommend that the requirement to comply with the generic and pensions TASs relates to valuations with an effective date after the implementation date of the TASs, rather than the date the aggregate report is provided (the latter meaning that valuations with an effective date before the TAS implementation date would be caught by the new requirements).

Q26: Do respondents have any views on whether matters which could be construed as technical or ethical should be included in the pensions TAS?

We would hope that the Actuarial Profession and the Board for Actuarial Standards could work together to decide where each of the areas mentioned should be covered.

We hope that you find the above comments helpful.

Wendy Handcock FIA
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