

Sent by email

Email address: baspensions@frc.org.uk

From: Jane Beverley

Email address: jane.beverley@puntersouthall.com

Date: 18 September 2009

Reference: Response to Consultation Paper: Pensions (June 2009)

Dear Sir/Madam,

**Board for Actuarial Standards – Pensions: Consultation Paper (June 2009)
Response to consultation paper**

This letter sets out Punter Southall's response to the recent consultation paper on pensions. Punter Southall provides a full range of actuarial advice, pensions consultancy and pensions administration services to primarily large and medium-sized occupational pension schemes and their sponsoring employers.

1) General comments***We disagree with the suggestion in paragraph 8.30 that scheme members are or should be a major user of the Scheme Funding report.***

Punter Southall administers approximately 150 occupational pension schemes which, in aggregate, cover over 100,000 members. Over the last three years, we have received requests from only around 10 individual members for a copy of the Scheme Funding report.

It is therefore very unusual for members to request a copy of the report. However, there are two types of circumstance in which it is more likely that they will do so. The first is where the scheme is involved in high-profile legal action. The second is where the scheme membership is largely unionised and union representatives may be expected to take an interest in the Scheme Funding report.

We would be concerned if the Scheme Funding report were used as the basis for members' financial decisions as its purpose is different, it is historic in nature and it omits information relevant to the member's personal circumstances. We believe that the legislative disclosure requirement derives from the need for members to be able to check that their pension scheme is being run satisfactorily rather than from a need for members to take financial decisions. We therefore suggest that the BAS should consult with the DWP as to whether the legislative requirement to disclose the Scheme Funding report to members could be replaced with a more comprehensive Summary Funding Statement.

The initial scope of TAS P should be restricted to Reserved Work.

In general, we believe that there is a case for non-Reserved Work to be outside the scope of TAS P initially whilst the new framework is tested in respect of Reserved Work. In addition, it may be necessary to wait for certain issues to be resolved (for example, the provision of actuarial information by non-actuaries). To avoid potential ambiguity or the possibility of an unnecessary delay to the implementation of TAS P, we suggest that all grey areas such as these should be left out of the first version of TAS P with a view to subsequent consultation on their inclusion once the relevant matters are resolved.

Actuaries are already subject to the Actuarial Profession's Actuaries' Code.

For many areas of non-Reserved work, we do not consider that compliance with TAS P will add value to the user as we believe that the existing requirement for actuaries to comply with the Actuarial Profession's "Actuaries' Code" would provide adequate protection for users.

TAS P should contain all the Specific TAS requirements regarding pension schemes.

Whenever matters concerning pension schemes need to be covered by a Specific TAS, we believe it would be clearer to put these requirements into TAS P rather than into any other Specific TAS.

We believe that it would be appropriate to clarify that the scope of TAS P is restricted to information upon which the user can reasonably be expected to rely.

For example, TAS P should not apply to indicative actuarial information provided in a new business tender situation as there would be no adviser contract in place and no expectation of reliance.

The term ‘actuarial information’ should be defined.

We assume that this means information which is produced using actuarial techniques, but believe that it is appropriate to include a formal definition in TAS P.

To avoid ambiguity, we believe that the definition of “actuarial information” should specifically exclude advice on the employer’s covenant.

Typically the actuarial adviser does not have sufficient information to provide this advice.

We have the following further comments on various paragraphs of the consultation document in addition to those in section 2 of this letter upon which we were asked to comment:

We would like clarification of the type of pension arrangements “provided by insurance companies” to which paragraph 1.7 refers as we are unsure what is envisaged. Furthermore we believe it would be more efficient if all occupational pension schemes which are operated to some extent by an insurance company were covered by TAS P rather than by TAS I as the users and their requirements will be similar to those of other occupational pension schemes.

In paragraph 3.2 we would prefer to replace “could influence the decisions” with “could, to the actuary’s reasonable knowledge, influence the decisions”.

In paragraph 6.65 (debt on employer calculations), we would welcome clarification as to the nature of the assumptions that are expected to be on a “best estimate” basis. We have assumed that the requirement is for a best estimate of a buy-out basis; however, we thought that the drafting could make this clearer.

2) Response to Consultation Questions

I set out below Punter Southall’s responses to the specific questions raised in the consultation paper:

1. Will the proposed purpose of the pensions TAS that is set out in paragraph 2.3 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 that paragraph 2.3 will help with the above. However as the various user groups will have different (sometimes even conflicting) requirements, the BAS needs to strike a balance in terms of what is required by TAS P so that the actuarial reports produced are useful to all stakeholders (e.g. trustees, employers and the actuaries who advise them) without generating a compliance cost that is disproportionate to the value added to the client. It would be helpful if the purpose of TAS P (which refers to the “Reliability Objective”) could refer specifically to “proportionality”.

We are concerned that sometimes the report writer will not know who all the end users will be and hence cannot know their circumstances or fully anticipate their needs. For example, one of the key user groups for actuarial information is other actuaries in their capacity as advisers

to sponsoring employers. When acting as the employer's adviser, we would not want to see a reduction in the amount of quantitative information that is currently required to be provided in the GN9 report.

2. Do respondents agree that all Reserved Work concerning occupational pension schemes should be within the scope of the pensions TAS? (paragraphs 4.2 to 4.7)

In principle, we agree that all Reserved Work concerning occupational pension schemes should be within the scope of the pensions TAS as long as TAS P is flexible in relation to the detail of compliance required.

In practice, we believe that any Reserved Work arising from legislation that is within the scope of the pensions TAS must be clearly set out by the BAS in a comprehensive Appendix to TAS P to avoid inadvertent non-compliance. The list of Reserved Work set out in Appendix A of the Consultation Paper appears to be incomplete.

3. 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? (paragraph 4.11)

We understand that the "almost always carried out by actuaries" definition represents the BAS's overall intention and will not itself form part of the scope of TAS P. We believe that this definition is ambiguous and that its scope is likely to alter over time. For example, it is becoming increasingly common for investment advisers to provide informal funding updates – at what point would this work cease to be 'almost always carried out by an actuary'? We would therefore prefer TAS P to include a comprehensive list of the work in scope (as in Appendix B) and omit reference to the 'almost always' definition.

TAS P will not apply to actuarial work done by non-actuaries. Bringing such work into the scope of TAS P is thus anti-competitive and there is a risk that if actuaries (with their unique skill set) are priced out of the market by the unequal compliance requirements, the quality of advice received by the end user will be diminished.

4. Should the pensions TAS cover the non-Reserved Work listed in paragraph 4.26?

In general, we believe that there is a case for non-Reserved Work to be outside the scope of TAS P initially whilst the new framework is tested in respect of Reserved Work. On the assumption, however, that the BAS is minded to include some non-Reserved Work in the initial scope of TAS P, our comments on the individual items are as follows:

4.26 a) Yes. We consider such work to be "actuarial information". However, as noted above, it is becoming increasingly common for investment advisers to provide informal funding updates and there is therefore a risk of an unequal playing field arising. It may be appropriate for BAS to delay the introduction of this item of work while it assesses the extent to which such actuarial work is being done by non-actuaries.

4.26 b) No. We think it will be impractical to include all advice for the employer in relation to Scheme Funding within TAS P.

4.26 c) Yes.

4.26 d) Yes.

4.26 e) No. Most work on a wind-up is not actuarial (except for the relevant items of Reserved Work which will automatically be within the scope of TAS P). The case to exclude work in

connection with FAS1 wind up cases (i.e. those which qualify for the Financial Assistance Scheme and which have already agreed to annuitise) is particularly strong.

4.26 f) We agree that actuarial information relating to factors should be covered by TAS P. However, we would welcome an opportunity to comment further on the detail of this proposal at the Exposure Draft stage. We note from paragraph 4.22 of the TAS P consultation document that the BAS will take account of issues identified by the Member Options Working Party in 2006. Two of our actuaries sat on this working party and we would be happy to help the BAS in this area.

We are unclear what else is envisaged by the reference to “individual calculations”.

5. Do respondents agree that the areas of work described in paragraphs 4.29 to 4.33 should not be in the scope of the pensions TAS?

In connection with paragraphs 4.30 and 4.31, we do not think that accounting for pensions costs (UK reporting) needs to be covered by a Specific TAS and that any such inclusion in a TAS would be very short.

However, if such work is to be included in a TAS we would prefer that it were included within TAS P rather than in another Specific TAS as this would facilitate compliance. Moreover, if instead such work is included within the TAS for financial reporting it would be a disproportionately small part of that TAS compared with the areas relevant to accounting for insurance.

We agree with the proposal to exclude investment work from TAS P, but are unclear how the BAS would “strongly encourage compliance with the Generic TASs” in paragraph 4.33. If the BAS decides that compliance with the Generic TASs is necessary in connection with this work then we would prefer such compliance to be mandatory rather than strongly encouraged.

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

We believe that defined contribution schemes would be better dealt with by regulations rather than by TAS P. We note that the proposed scope of TAS P is restricted to occupational pension schemes, which would then lead to a disparity of treatment between trust-based and contract-based schemes. We believe that adding a requirement to comply with TAS P would not add value.

Whilst our view is firmly that defined contribution schemes should not be brought within the scope of TAS P at this stage, we would welcome the opportunity to comment further in the event that there is a proposal to bring them into scope subsequently.

7. Should work performed in connection with mergers and acquisitions be in the scope of the pensions TAS? (paragraphs 4.38 to 4.40)

No. Mergers and acquisitions where a pension scheme is involved is an area which requires the skill of an actuary in order to ensure that the client is able to extract the best value from the advice obtained. The work undertaken in this area often involves extreme time constraints in highly pressurised situations.

Advice is often given orally and followed up in writing. However, situations can arise where the engagement is terminated before the written advice, for instance when a deal is called off.

We believe the inclusion of this area within TAS P would be problematic and it would be better to rely on the Actuaries' Code to provide the appropriate protection for users.

8. Should work for scheme sponsors on inducements to transfer be in the scope of the pensions TAS? (paragraphs 4.41 to 4.42)

Inducements to transfer have already been addressed by the Pensions Regulator so we consider that there is no need to include these in TAS P. Additionally the information provided to members is subject to disclosure requirements and members considering a transfer out are advised to take independent financial advice.

Furthermore we are firmly of the view that it is not the role of TAS P to address specific hot topics such as this; such an approach would require frequent updates to TAS P and there would be a danger that new hot topics could be missed.

9. 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 the scope of the pensions TAS? (paragraphs 4.43 to 4.44)

No. However if any such work were to be included in a Specific TAS we would prefer it to be included in TAS P rather than in another Specific TAS (e.g. company accounts, business rearrangements).

Advisers to employers often work with only limited information. In some cases the work being carried out on behalf of the employer is confidential and additional data cannot be obtained from the trustees without alerting them to the task being carried out. In our view it would not add value to the user if TAS P were to increase the compliance requirements for this work above the existing compliance requirements.

10. Is there any other work which is not mentioned above that should be within the scope of the pensions TAS? (section 4)

No.

11. Do respondents have any comments on the proposals concerning data that are presented in section 5, especially those in paragraphs 5.7, 5.10 and 5.12?

With regard to paragraph 5.7, data should normally be sought from the employer by the trustees and not by the actuary directly.

We believe that the legal opinions required to be sought in paragraph 5.10 should be restricted to legal opinions in relation to the scheme that have already been received.

12. Are there any other data issues which respondents believe should be covered by principles in the pensions TAS? (section 5)

No.

13. Do respondents have any comments on the proposals concerning assumptions that are presented in section 6, especially those in paragraphs 6.3, 6.8, 6.12, 6.14, 6.16, 6.19, 6.33, 6.35, 6.36, 6.42, 6.46, 6.53, 6.61 and 6.63?

6.3 We agree with the proposal.

6.8 We agree with the proposal.

6.12 We do not agree that the selection of assumptions should include material events occurring after the effective calculation date. This would be impractical and would lead to delays in finalising advice without adding value to the user.

We would instead prefer TAS P to require actuaries to alert clients to events of material significance. The client would then be able to decide whether historic assumptions should be revisited or a new piece of work commissioned. In most cases, the client (trustees or company) is responsible for the final choice of assumptions and not the actuary.

6.14 To avoid obscuring the key message, we propose the following shorter wording for this principle: “Recent experience of the pension scheme should be considered.”

6.16 We agree with the proposal.

6.19 We think that the use of “any assumption” here needs further thought. Whilst the proposed principle is sensible when considering unrelated assumptions such as mortality and the discount rate, other of the assumptions are correlated and could sensibly be considered together (for example to use a net real discount rate). It may also make sense in practice to consider some of the less key demographic assumptions together.

6.33 We agree with the proposal.

6.35 We believe that this proposed principle would lead to an unbalanced approach to setting the discount rate as it focuses only on the downside risk. We do not believe that actuaries can, or should be required to, predict the direction of future yield movements. We would prefer instead a requirement for the actuary to draw the client’s attention to the risk.

6.36 We believe that this principle should be shortened to “Assumptions about future rates of inflation should take account of financial indicators.” Actuaries will then be able to use their judgement to choose which information to use. Publicly available forecasts may not always be felt to be appropriate long-term rates.

6.42 We agree with the proposal.

6.46 We agree with the proposal.

6.53 We believe that the principle proposed would be impractical. Furthermore we believe that it would lead to an increase in technical provisions as a result of capitalising the running cost in relation to accrued benefits whereas this is not required by legislation.

6.61 We do not consider that this principle is necessary as actuaries would naturally determine these assumptions in this way. The requirements in legislation are sufficient.

6.63 As trustees may choose to pay more than the statutory minimum cash equivalent transfer value, this principle should be clarified to refer to “the assumptions selected for statutory minimum cash equivalent transfer values...”

14. Respondents are asked for their views on whether a standard comparator rate for discount rates would assist users’ understanding, and if so whether a low risk rate should be used? (paragraphs 6.28 to 6.31)

It is unlikely that a standard comparator rate for discount rates would assist users’ understanding as the concept of using a discount rate to produce a present value is actually quite complicated to the lay user; the introduction of a standard comparator rate would require further explanation which is likely to over-complicate the communication and thus to obscure the key messages. We agree that a requirement to quote a comparator rate would encourage the use of the comparator to derive the discount rate.

Another problem with quoting a comparator rate is identifying the right “risk-free rate”. In practice the suggested risk-free discount rates still incorporate elements of risk (for example

reinvestment risk) and there is a danger that the actual risks faced by pension schemes (which compromise their ability to pay benefits as they fall due) would be obscured.

There is also no unique way of deriving a risk-free rate. The use of yields at long enough durations for pension schemes involves the projection of the data available from the Bank of England which in turn requires a subjective process with different in-house models achieving different answers. As the shape of the curve obtained by plotting government bond yields against duration varies from time to time, the choice of "low risk" data to include in the assessment of the comparator rate can affect the way in which the comparator rate chosen then moves over time; this could lead to inconsistency between pension schemes in the comparison described to users unless the comparator discount rate to quote is completely and unambiguously prescribed.

The discount rate is only one of a number of actuarial assumptions and we do not see how standardising this in isolation will achieve the intended result. Emphasis on a low risk rate may cause excessive prudence.

Instead we believe that it would be preferable to require an explanation of how the discount rate used has been derived instead of requiring that a comparator rate is quoted.

A comparator rate would seem particularly inappropriate in some individual calculations. For example, the use of a comparator rate in the presentation of commutation factors could hamper users' understanding. It is not clear what value to the user would be added by the disclosure of the risk-free rate in such cases.

15. Are there any other principles on the selection of assumptions which respondents believe should be in the pensions TAS? (section 6)

No.

16. 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?

We agree that the proposals are sensible.

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

No.

18. Do respondents have any comments on the proposals concerning reporting that are presented in section 8, especially those in paragraphs 8.4, 8.17, 8.18, 8.35, 8.38, 8.39 and 8.40?

8.4 Typically the actuary is not responsible for setting assumptions. Where the actuary advises upon the assumptions, he can set out the rationale underlying possible assumption choices. However the client may prefer instead to choose other assumptions and the actuary will not necessarily know the rationale behind the client's choice.

We would not feel comfortable in explaining the rationale underlying the selection of assumptions upon which we had not advised. In addition to the above scenario, the proposed principle would be problematic where there has been a change in adviser or where there has been no actuarial advice in connection with the assumptions selected for one of the exercises.

8.17 In general, the feedback we receive from trustees is that they do not find these comments helpful in Scheme Funding reports.

8.18 Actuaries are not lawyers and cannot always know when there is (or in future will be) uncertainty regarding the interpretation of existing legislation as these matters evolve as they become subject to legal challenge and legal opinion. Therefore we believe that “any legislative uncertainty” should be restricted to areas where a clear scheme-specific legal opinion has been obtained.

It is likely that an attempt to quantify the maximum liability could inadvertently mislead the user and we would prefer a qualitative approach here.

8.35 We would prefer to remove the reference to the formal report.

We would welcome clarification as to why the PPF is an intended user of the report. We do not agree that the PPF can be the end user of a report that they never see. Our understanding is that the requirement for a formal report came from the PPF rather than from legislation but that the addressee of that report was always intended to be the trustees. The PPF do not receive the report; instead information is submitted to the PPF via Exchange, the Pensions Regulator’s online reporting system. (Another user of the actuarial information contained in the report (though not of the report itself) would therefore be the Pensions Regulator.)

8.38 We agree with the underlying rationale for this proposed principle; however, we believe that it should be reworded so that the focus is about the circumstances under which the factors would need to be reviewed rather than “when” which implies a time period and without the word “robust” as we are unclear what that means.

8.39 We would prefer this principle to be reworded so that the requirement is to comment on the implications of choosing different factors rather than to give the financial impact. In practice the use of “financial impact” is ambiguous and likely to involve consideration of cashflow modelling; it would be difficult to address this in a proportionate way, particularly for sponsors and members, whose financial circumstances may be unknown.

8.40 We are content with this proposal.

19. Do respondents agree that in Scheme Funding exercises any prudent estimate of scheme liabilities should be accompanied by a best estimate? (paragraphs 8.10 to 8.15)

No. Although this sounds helpful in principle, in practice there are a number of problems and there is a danger that actuaries will feel pressured into making “best estimates” of information where they are not well placed to do so (such as future mortality improvements). Thus misleading information could inadvertently be presented to the user by focusing unduly on best estimates.

Whilst we recognise the overriding TAS principle of materiality, we feel that in practice the focus of the TASs on judgement rather than prescription will lead practitioners to conclude that they would be unduly exposed (to the risk of disciplinary or legal challenge) if they were to omit the best estimate of the liabilities were this to be a requirement of TAS P. In practice, therefore, there will be disproportionate compliance requirements on the smaller pension schemes coupled with a strong likelihood that the key message (of prudence in the overall approach adopted) will be obscured (by a disproportionate focus on what constitutes a best estimate).

When addressing prudence, it is important that the user can feel confident that the overall approach adopted is prudent in the face of information available. However, it is the trustees’ job to identify (for example) what constitutes a prudent mortality assumption and it is the actuary’s job to present the information available that the trustees could use in making their

decision on the assumption (e.g. standard tables, CMI research, the possibility of scheme-specific analysis) rather than to confirm a best estimate.

We therefore believe that TAS P should not require a best estimate. Sometimes the communication of scheme funding information will include reference to a best estimate but only where the author believes this to be appropriate.

20. 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 this 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? (paragraphs 8.20 to 8.31)?

Yes we agree that the final Scheme Funding report should include sufficient information for an informed reader to understand the financial position of the scheme. However we consider that the phrase “informed reader” in paragraph 8.30 is too wide for the intended purpose of this principle. We would be more comfortable with the alternative of “informed trustee” which we believe others have proposed.

In principle we favour approach 3; however, we would like to see a further consultation from the BAS on a prescribed list of requirements. From the point of view of the actuary advising the sponsoring employer, it may be that information about the funding process, as outlined in paragraph 8.25, would be also helpful to those users. However, we do not believe that information on the funding process should be within the scope of TAS P; rather, it would be for the Pensions Regulator to issue guidance if it felt that information was not being properly shared between the trustees and sponsoring employer.

We disagree strongly that there will be little extra work. In our experience the completion of the triennial actuarial valuation report (in line with the requirements of legislation and GN9) is generally very onerous and is a significant component of the cost of completing an actuarial valuation. This exercise will be even more substantial if more of the constituent information to include requires the exercise of judgement (and associated consideration of business risk) rather than being prescribed. The requirement to draw together and restate information that has already been provided to the trustees earlier in the process may also be time-consuming and potentially could obscure the key message to trustees (although we recognise that it will provide other user with information that they would not otherwise have).

21. Would the provision of specimen Scheme Funding reports be of value to users? (paragraph 8.32)

Yes.

22. Are there any other principles on reporting which respondents believe should be in the pensions TAS? (section 8)

No.

23. 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? (section 9)

We believe it would be clearer to put all pensions matters that need to be covered by a Specific TAS into TAS P.

24. 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? (paragraphs 10.15 to 10.17)

Yes it would be useful to include most of actuarial guidance note GN26 and also to incorporate the CMI's definitions in its Library of Mortality Projections.

25. Do respondents have any comments on the proposed transitional arrangements from the adopted GNs to TASs described in section 10?

It is not clear how the relationship between compliance with the Actuarial Profession's requirements (e.g. GN48) and compliance with TAS P will work in practice. We would appreciate more information from those two parties about the dialogue which we assume they are having on this topic.

For work intended to be covered by TAS P we believe that implementation of TAS R should be delayed until TAS P is in place. Otherwise it will be necessary to achieve compliance with both the actuarial standard GN9 and TAS R for a limited period until TAS P replaces GN9. As the TAS and Guidance Note frameworks are different, such dual compliance is likely to add a considerable and disproportionate compliance cost burden at a time when pension scheme sponsors are already facing a difficult financial climate. However, the dual compliance checks are unlikely to add value to the user as each of the Guidance Note and TAS frameworks have been developed with the intention that they are complete in their own right.

26. Do respondents have any views on whether matters which could be construed as technical or ethical such as those mentioned in paragraphs 10.5, 10.13, 10.20 and 10.24 should be included in the pensions TAS?

None of these are technical matters and they seem out of place in TAS P.

If you have any comments on the above then please contact me in the first instance.

Yours faithfully,

Jane Beverley
Principal and Head of Research