



BAS Consultation Paper: Pensions

Comments from Xafinity Consulting Limited

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1. Introduction to Xafinity Consulting Limited

Xafinity Consulting Limited employs 28 Actuaries – of which 18 are Scheme Actuaries – out of a total of around 350 staff. It provides a range of employee benefits consulting, actuarial and administration services to pension scheme trustees and sponsoring employers.

Xafinity Consulting Limited is part of the Xafinity Group, which also includes Hazell Carr, Xafinity Paymaster and Xafinity Claybrook. The Group now employs over 1,400 people throughout its offices in the UK.

2. Responses to the specific questions raised

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?

Yes.

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)

Yes.

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)

Yes, but see response to the next question.

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

Yes, where the work relates to actuarial information provided to an occupational pension scheme's governing body – that is, the items listed in sub-paragraphs (a), (c), (d), (e) and (f) of paragraph 4.26.

We note that it is proposed that TAS P will also cover work for scheme sponsors in relation to Scheme Funding decisions (paragraph 4.14 and 4.26(b)). However, BAS are proposing (paragraph 4.44) to exclude "other work carried out for scheme sponsors", such as risk reduction exercises, on the grounds that any changes directly affecting the benefits of members must be approved by the trustees (for whom actuarial advice will be covered by TAS P). The rationale for this difference is unclear - as the responsibility for Scheme Funding decisions rests with the scheme's governing body (irrespective of whether employer agreement or simply employer consultation is required), the argument put forward in paragraph 4.44 equally applies to Scheme Funding advice to sponsoring employers. We are not necessarily suggesting that such Scheme Funding advice to employers should fall outside TAS P, rather pointing out the inconsistency in the arguments.

Paragraph 4.18 states that, in relation to work connected to bulk transfers, BAS has yet to decide whether this will be covered by TAS P or by a separate TAS covering business rearrangements. We suggest that actuarial advice to the trustees of the transferring or receiving scheme (as appropriate) is covered by TAS P. In other words, the outstanding issue of deciding the appropriate TAS should be restricted to work carried out for scheme sponsors (and such work could in any event fall within paragraph 4.44).

2. Responses to the specific questions raised

As an aside, we note that the phrase “if not covered by a TAS covering business rearrangements” at the beginning of paragraph 4.26(e) needs to be deleted.

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?

Yes.

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

a) scheme design; (paragraph 4.35)

b) benefit projections; (paragraph 4.36)

c) any other work? (paragraph 4.37)

Our primary concern is that actuarial information falling within (a) and (b) above is equally applicable to trust-based (ie occupational pension schemes) and contract-based (e.g. group personal pension) defined contribution arrangements. We note, however, that BAS is proposing to limit the application of TAS P to work carried out in relation to occupational pension schemes (paragraph 2.6). We believe, therefore, that it would not be appropriate to include DC work within TAS P if the scope is dependent on the form of the ‘wrapper’ (ie trust or contract).

As regards any other work, we note that under the Employment Equality (Age) Regulations 2006 age-related contributions to a defined contribution occupational pension arrangement will not be age discriminatory if the aim in setting the different rates is to equalise – or make more nearly equal - the amount of benefit for comparable aggregate periods of pensionable service to which members of different ages who are otherwise in a comparable situation will become entitled under the arrangement. A similar situation exists in relation to age-related employer contributions to a personal pension arrangement. Any assessment to determine whether a particular age-related contribution scale satisfies the non-discrimination test is likely to be carried out by an actuary. Our comment above (in relation to (a) and (b)) on the scope of TAS P applies equally here.

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. Whilst we believe that M&A work should be covered by a TAS, we believe the intense time constraints under which information has to be provided to company decision makers would make it impossible to comply with TAS P. We suggest instead that the issue is separately addressed within the proposed TAS on business rearrangements, where a measured approach can be adopted.

2. Responses to the specific questions raised

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

Possibly, but (perhaps) only to the extent that the work carried out for an employer forms part of the information material relied on by the members covered by the inducement exercise. In other words, where the members concerned are clearly “users” - as defined within the (draft) TAS R - of the actuarial information.

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.

10. Is there any other work which is not mentioned above that should be within the scope of 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?

The proposed principle in paragraph 5.10 needs to be more explicit as to the meaning of “any relevant legal opinions”. We suggest the text should read “Where there is uncertainty about the impact of overriding legislation on the calculation of benefits, the data sought should include any legal opinions obtained in relation to the scheme in question.”

In relation to the proposed principles set out in paragraphs 5.7 and 5.12, each should begin with “Where, appropriate,”.

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 that BAS should not set any benchmarks.

6.8 – Agree.

2. Responses to the specific questions raised

6.12 – We disagree with the second sentence of the proposed principle that the selection of assumptions should always (our emphasis) “also take account of any material events which are known to have occurred after the effective date of calculations”. For example, consider a Scheme Funding valuation. The initial part of such a valuation is a comparison of the value of the assets at the effective date of the valuation with the value of the liabilities (the Technical Provisions) at that date. If the assumptions used to value the liabilities reflect material events after the valuation date, those assumptions will be inconsistent with the asset value, which must be the audited market value at the effective date of valuation. However, in certifying the adequacy of the contributions in the Schedule of Contributions to eliminate a funding deficit, it would be appropriate for the actuary to take into account post-valuation developments, where these are material. We note, nevertheless, that Scheme Funding legislation currently explicitly allows the actuary to base his or her certification of the Schedule of Contributions on the position at the valuation date, without having to consider subsequent developments. Accordingly, we suggest that the actuary be required to consider whether to take into account post-valuation date developments.

6.14 – The comment about small schemes in paragraph 6.15 would need to be incorporated within the proposed principle itself.

6.16 – Agree.

6.19 – Agree.

6.33 – There is a problem here over the phrase “anticipated changes”. That is, anticipated by whom? For example, should account be taken of a change that the actuary thinks ought to occur at some time in the future, even if the trustees have not commented to that effect? Or should account only be taken of a possible change in investment strategy if the trustees have signalled that they expect to make such a change in the future? In our opinion, the approach will depend on the purpose of the task in hand.

6.35 – The proposed principle could be interpreted as a requirement to include a margin for prudence in all cases. This would not be appropriate. For example, the legislation on transfer values requires the trustees to determine assumptions with the aim that, taken as a whole, they should lead to the best estimate of the initial cash equivalent.

6.36 – Agree.

6.42 – Agree in principle, but it needs to be made clear that the intention is that current mortality rates and future improvements should be considered separately, rather than the actual rates having to be different. For instance, for some schemes and for some situations, a margin for prudence might be included within the base table, with the result that the same rates are used throughout. Clarification is also required as regards the second sentence in relation to small schemes, to reflect the fact that insufficient data to determine assumptions for current mortality rates on a scheme-specific basis.

6.46 – Agree.

2. Responses to the specific questions raised

6.53 – The analysis suggested is not meaningful. What should be considered is the form of future expenses – that is, whether ‘fixed’ or dependent on the number of members by type (active, deferred, pensioner) – and the extent to which allowance for future expenses should be included within existing Reserves, rather than being met through additions to future contributions (whether as a percentage of salaries or as monetary amounts). This would address the points raised in paragraphs 6.49 and, particularly, 6.51.

6.59 – We disagree with the statement that the drafts of TAS R and TAS M mean that estimates described as prudent should be accompanied by an indication of the level of prudence involved. In any event, such an indication may be impossible to provide. For example, in relation to Scheme Funding and mortality, it is clearly more prudent to assume that all scheme members will live to age 120 than to assume all will live to age 100. But how prudent is either of those assumptions, given the great uncertainty on future mortality experience? The BAS proposal seems to imply that a “best estimate” can always be obtained, which is clearly untrue, even if the term were defined (which it is not). In any event, as noted by BAS in paragraph 6.58, what is prudent will be correlated to the strength of the employer covenant, a point again referred to by the Pensions Regulator in its June 2009 statement ‘Scheme Funding and the Employer Covenant’.

6.61 – The meaning of “possible” annuity rates is unclear. See also our response to Question 15, below.

6.63 – We strongly disagree with this proposal, since a justification of the assumptions for cash equivalent transfer values relative to those for scheme funding may be extremely difficult, if not impossible, for the following reasons:

- (a) The transfer value legislation requires the trustees to determine the assumptions such that, taken as a whole, they should lead to the best estimate of the initial cash equivalent. That is, the emphasis is on the overall basis, not the individual assumptions.
- (b) In contrast, the scheme funding legislation refers to prudence in relation to the economic and actuarial assumptions, the discount rates and the demographic assumptions separately, rather than to the overall basis.
- (c) The term ‘best estimate’ within the transfer value legislation is not defined (and the Pensions Regulator in its associated guidance recognises this by stating: “However, trustees should recognise that ‘best estimate’ is not a precise concept and they will often need to be pragmatic and accept choices which seem to them reasonable in the light of the information and advice they have obtained”).
- (d) As noted in our comment in paragraph 6.59, the prudent scheme funding assumptions may not have been derived from a “best estimate” starting position. Even if they were, the individual “best estimate” assumptions may not be reconcilable with the assumptions – taken as a whole - to derive the best estimate of a cash equivalent.

2. Responses to the specific questions raised

- (e) The fact that scheme funding assumptions will be reviewed, typically, only every three years, whereas transfer values need to reflect up-to-date market conditions.
- (f) The scheme funding basis being determined having regard to the scheme membership as a whole, whereas transfer values may reflect (to some extent) individual member-by-member assumptions. By way of illustration, transfer values typically allow for different discount rates before and after the assumed date of pension commencement. In contrast, scheme funding valuations are more likely to use a single discount rate throughout.

Indeed, we note that the Pensions Regulator has now recognised the validity of these arguments. In its draft guidance on the calculation of cash equivalent transfer values, it had stated that the two sets of assumptions should be capable of rational reconciliation. The finalised version of the guidance has a much weaker statement, namely that the trustees should consider how the two bases relate to each other.

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)

We believe a comparator based on low risk assets would be useful in certain circumstances, for example when advising trustees on the discount rate for a Scheme Funding valuation or in relation to setting a basis for individual transfer values (Cash Equivalents). It would however be irrelevant, for example, in relation to PPF levy calculations, where the approach to setting the discount rate is prescribed. Accordingly, if a principle along the lines of that set out in paragraph 6.31 is included, it will be necessary to include at the beginning "Where appropriate,".

In addition, as the discount rates chosen for different purposes will have different relationships with the comparator (as noted in paragraph 6.28), it may be difficult in all cases to explain the relationship to the user, as envisaged by the text in paragraph 6.31.

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

In relation to the debt on employer calculations under section 75 of the Pensions Act 1995, paragraph 6.66 provides that BAS does not envisage any express guidance within TAS P. However, as the calculation of the amount of the liabilities mirrors that for the assessment of the solvency position under the separate Scheme Funding legislation, it would seem appropriate to extend the principle set out in paragraph 6.61 so that it relates to the section 75 debt assessment as well.

2. Responses to the specific questions raised

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?

7.6 – Despite the intention set out in paragraph 7.5, it is not clear from the proposed wording that the phrase “future increases to benefits” is meant to cover the treatment of future salary increases. In addition, as the actuary is required to advise on the choice of funding method, there should be a requirement that the actuary covers the differences between the available methods.

7.10 – For greater emphasis, we suggest that, in the first bullet point, the words “do and do not” are added before “apply”.

17. Are there any other principles relating to models and calculations which respondents believe should be in the pensions TAS? (section 7)

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 – Agree.

8.17 – Agree.

8.18 – Whilst understanding the rationale behind this paragraph, we have concerns over the second sentence of the proposed principle. If the maximum liability were easily quantifiable we suspect that any uncertainty over equal treatment issues would have already been resolved, given that the Barber judgment occurred nearly 20 years ago. We accordingly believe the second sentence should be removed.

8.34 – This refers to the approach used to make prudent approximations (in a section 179 valuation) being reported to the user (which, as noted in paragraph 8.35 is the PPF). This fails to recognise that the PPF only wants the results of such a valuation to be supplied to it electronically, via the Pension Regulator’s Exchange system.

8.35 – We believe such an explicit principle is unnecessary, as by virtue of TAS R it will be obvious that the “user” is the PPF.

8.38 – Agree.

8.39 – Agree.

8.40 – We disagree, for the reasons given in our comments on paragraph 6.63 in relation to Question 13.

2. Responses to the specific questions raised

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)

We strongly disagree, for the reasons set out in our responses on paragraphs 6.59 and 6.63 under Question 13. Moreover, we note that neither the scheme funding legislation nor the transfer value legislation define the meaning of “prudent” or “best estimate”.

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)

Whilst we note that legislation requires scheme funding documents – including the final Scheme Funding report – to be available on request to scheme members, we strongly disagree that scheme members should be explicitly denoted as “users” as defined within the (draft) TAS R. Legislation already provides for members to be supplied automatically with a Summary Funding Statement, which is intended to be their principal source of information on scheme funding matters; moreover, the Pensions Regulator has given guidance (in Code of Practice 3) on what scheme trustees should include in such Summary Funding Statements, beyond the matters specified in legislation.

There is also the issue of the meaning of the undefined term “informed readers” in relation to scheme members. For example, a pension scheme may cover “shop-floor” employees as well as company directors, whilst another may cover just the former – so, should the contents of the report differ and if so, in what way? This also sits uncomfortably with the proposal in paragraph 3.2 that a matter is material if it could influence the decisions to be taken by users.

Accordingly, we recommend that the principle should instead explicitly recognise that the scheme members are not “users”.

We nevertheless agree that the report should include the information listed in the bullet points in paragraph 8.30. Such information is clearly needed by scheme trustees and sponsoring employers.

In relation to “other material information”, see our comments on Question 26 (in relation to GN9).

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

Possibly, although there is the risk that it would become a standard document which would not necessarily meet the needs of individual schemes.

2. Responses to the specific questions raised

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)

These should be in TAS P as such matters are primarily issues for the scheme trustees as the decision makers. It would be inappropriate to include them within a separate business rearrangements TAS, which should be restricted (in a pensions environment) to advice given to scheme sponsors.

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 it should contain? (paragraphs 10.15 to 10.17)

We believe a glossary is required, for the following reasons:

- (a) As noted in paragraph 10.15, it may be beneficial to “users”.
- (b) It could also shorten actuarial reports. For example, by allowing actuaries to refer users to the glossary as an alternative to having to describe in detail a particular funding method.
- (c) The scheme funding legislation requires a scheme's technical provisions to be calculated using an “accrued benefits funding method”. Whilst this term is not defined in the legislation (an oversight?), the Pensions Regulator (in its code of practice 3) does refer to the four accrued benefits funding methods currently recognised by the actuarial profession, as set out in GN26.

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

Actuaries should not have to comply with TASs and adopted GNs at the same time unless it is 100% clear as to which sections of existing GNs will still apply on a transitional basis and that there is no inconsistency between TASs and those retained GN sections. Unless this occurs, there will be uncertainty and, in particular, unjustified costs.

2. Responses to the specific questions raised

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?

GN9 (paragraph 10.5) –

- (a) The first bullet of paragraph 10.5 should be construed as ethical, so should not be covered within TAS P.
- (b) We believe the second bullet of 10.5 should be included in TAS P. This is relevant, given the TAS requirements on comparisons.
- (c) We note that, contrary to the statement in paragraph 10.8, the proposal in paragraph 8.30 does not relate to how members' benefits might be affected on a subsequent wind up. Rather, it just covers the situation had a winding up occurred at the effective date of valuation. We agree that trustees should be aware of the possible impact of their funding strategy on the level of members' benefits in the event of a future winding up and that this should be covered within TAS P. As noted in paragraph 10.8, this could include a quantification of the reduction in benefits, but it should not be compulsory. It should be up to the individual actuary to determine the amount of detail, on a scheme-specific basis.

GN16 (paragraph 10.13) –

- (a) In the absence of any amendment to the legislation (c.f. paragraph 10.11), we believe that, as a technical standard, TAS P should state:
 - Whether regard needs to be given to a winding up test and to the financial strengths of the transferee and transferor employer.
 - Whether a certificate can be given where the proposed transfer is from a defined benefit scheme to a defined contribution scheme (or vice versa).
 - Whether the actuary should or should not take into account the terms and conditions for future service benefits under each scheme.
- (b) If GN16 is withdrawn without the above being covered within TAS P, it is likely that the existing difficulties already highlighted in paragraph 10.11 will be exacerbated, with the consequence that many actuaries may be unwilling to provide such certificates.

2. Responses to the specific questions raised

(c) As regards "ethical" matters that should be included within TAS P, we suggest that actuaries be required to point out to the trustees that:

- The certificate, whilst being a necessity for a transfer to take place, must not be taken by the trustees as their authority to make a transfer without members' consents.
- In giving the certificate, the actuary is not expressing an opinion as to the reasonableness of the amount of the transfer value.

GN28 (paragraph 10.20) – No comment.

GN49 (paragraph 10.24) –

- (a) On balance, we suggest that it would be better to construe the matters covered within the first bullet as technical issues, as by omitting these from the advice the actuary is, in effect, limiting that advice.
- (b) The second bullet is sufficiently covered by (draft) TAS D and TAS R, in relation to data adequacy, so no addition requirement is needed within TAS P.

3. Other Comments

Application of TAS P

We do not understand the rationale for the comment in paragraph 1.7. A defined benefit occupational pension scheme that is an insured scheme still has to have an individually appointed scheme actuary. Any advice given by that actuary to the scheme trustees should be within the ambit of TAS P. Greater clarity is therefore required on the meaning of the expression “actuarial work carried out for insurance companies in respect of pension arrangements provided by insurance companies” in order to understand precisely what BAS have in mind in suggesting this is instead covered within a TAS on insurance.

Materiality

We are disappointed to note from paragraph 3.2 that BAS intend retaining the definition proposed in the drafts of TAS D and TAS M, namely that a matter is material if it could influence the decisions to be taken by users. This raises the issue of the actuary being able to mind-read! The issue is exacerbated where the users comprise a large group of individuals – we refer in particular to our comments on paragraph 8.30, set out in our response to Question 20.

We strongly recommend that in the proposed definition in paragraph 3.2, “reasonably be expected to” is inserted before “influence”.

Terminology

The suggested TAS P principles are expressed in terms of things that the actuary “should” do. We note, however, that formal guidance from the Actuarial Profession has in recent years been revised by replacing previous references to “should” by “must”. We presume the use of “should” within the pensions TAS consultation paper is deliberate, reflecting the BAS’s principles-based approach to technical actuarial standards.

Individual calculations and factors

Paragraph A.19 in Appendix A correctly states that whether work related to individual calculations and factors is Reserved Work will depend on the terms of an individual scheme’s trust deed and rules. In order to provide additional clarification, we suggest TAS P notes that unless the work is commissioned by the trustees from a (named) individual it will not be Reserved Work. That is, if the scheme’s documentation provide for such advice to be provided by a firm of actuaries, then the work will be Non-Reserved Work.