

**RESPONSE TO THE BAS  
EXPOSURE DRAFT: PENSIONS FEBRUARY 2010**

20 March 2010

The following comments all address the BAS aim of increasing the reliance that the users of actuarial information can place on it. Here “reliance” includes that the information should indicate the degrees of reliability; and also particularly for reports, that the information being offered is complete as necessary for fitness for purpose of the reports, here including being safe to use.

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**(1) Definitions and use of: “Best”, “Prudent”, “Neutral”, “Central”, etc. types of Estimates**

(1.1) The TAS R, C.6.8 & C.6.9 usefully already says: “. . . shall state the intended meaning of . . .” For the Pension TAS, it should be repeated but extended: “. . . shall state *and fully define* . . .”

Why?

- because it will avoid the unwanted possibility that only a bland minimal “statement” is made which gives quite insufficient information to the users – who actually need a precise self-explanatory definition.

However, it could be argued that TAS R C.6.8/6.9/6.10/6.11 taken together do cover the above point because they variously refer to “state”, “descriptions”, “explanations” and “definitions”. But is it perhaps arguably unclear. If so it may cause some confusion, and the lack of clarity be prone to exploitation.

(1.2) The Pension TAS, needs to say somewhere, like: “that all measures, assumptions or judgments, and estimates, must be neutral, unless they are stated as being “not neutral” for some particular reason – in which case the rationale for that should be explained.”

Why?

- because: B, page 38 does define “neutral”, and it would seem to relate, in general, to the the normal, expected, ideal, desired, case. So using non-neutral measures, assumptions, judgments, etc. ought to be regarded as exceptional, and highlighted as such, i.e. as “not neutral . . . . because, etc.”

(1.3) One particular type of estimate needs to be stated in the Pension TAS as a “must have” requirement to calculate it and state it in the Reports . This estimate should be based on the values of all the assumptions – quantitative and qualitative – being considered as “speculative risks” i.e. the values of the assumptions are assigned such that there is data, or expert judgment, of an *equal chance* that the “correct values” could be either equally higher or lower.

Why?

- because this type of “central”, or “middle” estimate, is an important, “*crucial*”, and easily understood, “*reference level*” for comparison with other estimates like “prudent”, “75% confidence level estimate”, (see below), or others.

## **(2) Risks: e.g. E.2.3. and E.5.10,**

(2.1) Unfortunately the form of words used in the Draft, for example, in E.2.3. and E.5.10, still makes too much vagueness possible, ***and therefore likely***. That will very substantially undermine one of the stated main intentions of the new Pensions TAS, regarding “risk”, and *therefore that likelihood crucially needs to be eliminated as far as possible*.

The Pension TAS therefore needs to require like as follows: “ For the estimates of key result items like “shortfalls”, “liabilities”, etc. the users need risks to be presented in terms which indicate the plausible possible ranges of values of *that key result item* - taking into account, with best endeavors, as far as is reasonably possible, *all* the known risk factors.

The presentations might be in terms of estimated (plausible) best, middle, worst case values of the key result item, or confidence levels, or other equally suitable terms.”

Why?

- because it is only of limited use, *and not at all sufficient*, to just give some intermediate perturbation information of how various movements in individual risk factors each individually affect the key result item, like “shortfall”, “liabilities”, etc. This type of fragmented information does not allow the users to form a proper view of the *overall* confidence levels, or appropriate *overall* reliability, of the key result items.

(Here we additionally note, that for the satisfactory presentation of the risks in the written Reports, the risks should be fully and effectively understandable by the informed readers like trustees and employers, *without the need for additional verbal explanations by the Actuary or extensive debates with him/her.* )

(2.2) Additionally, the Pension TAS needs to require like as follows: “Where estimates of key result items like “shortfall”, “liabilities”, etc. are quoted, if the values are to be used for further predictions, decision making, or further calculations, the confidence levels of the estimates should be taken into account. If a confidence level is assessed as being “insufficiently safe”, for the further use, then a more prudent and safer estimate should be used. The Actuary should recommend to the Trustees and/or Employers as appropriate, what level of confidence, (perhaps as a numerical confidence level e.g. “75%”) may be regarded as “sufficiently safe”, or “sufficiently prudent”

Why?

- because in many cases, even so-called “prudent” estimates do not have a sufficiently high confidence level of being *better, or equal to*, the “correct” values, and therefore arguably are *unsafe to use*.

This *critical issue*, of inherently low confidence level even in the so-called “prudent estimates” of the key result items, would appear to somewhat account for the development of the large shortfalls over the last many years.

Thus the above requirement in the Pension TAS, *is crucially needed* in order to substantially help prevent the further build-up of shortfalls in the years ahead, and/or to reduce them.

(2.3) In **E4**, and maybe also elsewhere, and also in the TAS R, it would be useful to say as a *general requirement* that “the various estimates of the key results like “shortfall”, “liabilities”, etc. must *be fit for purpose*, here including that it must be indicated to what extent they are *sufficiently safe to use*.”

Why?

- as above for (2.2)

### **(3) Discretionary practices D.2.20/21/22/23.**

(3.1) **D.2.21** for “previous grants of discretionary benefits”; replace with “previous grants of discretionary benefits, and previous assumptions regarding funding for discretionary benefits”

Why?

- because the actual *payment* of discretionary benefits / pension increases and the inclusion of allowance for such increases in the *assumptions* made for working out the shortfalls and funding levels are often somewhat separate issues. Both are equally important.

( Remember one can include for such increases in the assumptions, but not pay them out, or vice-versa; - which then usually, very inconveniently, requires a special injection of extra funds.)

(3.2) **D.2.21 Delete** “any existing policy regarding the exercise of discretion”

**Replace with like:** “The history of discretionary practices should be summarized – both in terms of its inclusion in the assumptions made for making the estimates of shortfalls, funding levels, and the like, and its payment to the pensioners.

Additionally, where useful, any rationales for the past discretionary practices should be outlined”.

Why? – Because:

(i) Many Trust Deeds *particularly* provide for the possibilities of discretionary increase *specifically* to compensate for inflation, and state or imply that the award of such increases should be considered every year, *afresh*, i.e. *regarding the situation at that time*.

It would be inappropriate to recognize, or encourage, a blanket policy, intended to be permanent, but which actually is counter to what was/is stated in or implied by the Trust Deeds.

(ii) the existing form of words further encourages those Employers and/or Trustees, who use the unethical circular argument, or “policy” device, of saying:

“we are being fair: will pay discretionary increase when there is an adequate surplus”

=> “ but we therefore do not need to allow for discretionary increases in the assumptions”

=> so there never will be an “adequate surplus” to pay out discretionary increases – because, not being in the assumptions, they have not been specifically funded for. . .

(3.2) **Add in as a new D.2.24., like** : “The information must include data on the decline in value (w.r.t. RPI) of the pensions in payment - including for the those longest in retirement, and the surviving spouses.”

Why?

- because such data seems anyway to be *needed as “material”* according to TAS R. e.g. C.5.1 and elsewhere. Here we note that the data is indeed *necessary*:-

- (i) for the Trustees and Employer to make properly informed and ethical decisions
- (ii) for the Actuary to assess the risks, or agree them with the Employer and/or Trustees that if the decline in values become extreme then the Employer will likely be obliged to pay out, and /or want want to pay out, discretionary increases *eventually*, perhaps to avoid damaging publicity, pensioners’ action, etc. – and so require the making of appropriate assumptions regarding funding *now* to prepare for that, - and make it less difficult to implement those likely obliged and/or wanted increases later on.

Note that the Employer, and also the Trustees if dominated by the Employer, will not want to be confronted with that pension loss of value information, - that is why it is necessary to make sure they have it as “material” and are thus then obliged to see it take it into account – because it is a right and ethical requirement that they do so.

Note that the *present* Board of Directors of the Employer, may be prone to want to insist on not funding *now* for increases *later on* – because “later on” . . . “can be looked after by the successor Directors in place at that future time” – actually an unethical behavior of the present Directors.

**(4) Transparency , Traceability, Credibility, & Conformity**

**Regarding the advice given by the Actuary**

The TAS R C.4.9 seems to somewhat already cover the required documenting in the report(s) of any differences of opinion and/or judgments, between the Actuary, Trustees, and/or Employer, regarding accuracy or appropriateness, for the setting of assumptions, measures and methods.

(4.1) TAS R C.4.9. needs to be restated somewhere in the Pension TAS with “Actuary” in place of “person”.

(4.2) An additional sentence is also needed like: “Additionally, where advice given by the Actuary is not acted upon by the Trustees and /or Employer, that should be documented in the Report. Additionally, where the Actuary is unable to give advice on some material matters, then that should be documented in the Report.

The absence of any such statements signifies that the Actuary is in agreement with all the Assumptions, Measures, and Methods, used in the Report.”

Why?

- because the overall processes of: Parent Company, Employer, Trustees, Administrator, Actuary, Scheme Member, Pensioner, is inherently difficult to properly operate, and is prone to malfunction as well as easy “abuse of process” - which sometimes is exploited.

To maximize the quality of the process, maximize the confidence of the scheme members and pensioners, minimize undue risk, and thus overall achieve higher credibility, it is clear that the Actuary, as the professional, is *pivotal*.

Thus his/her judgments and advice needs to be given more weight and more transparency particularly if they are not heeded by the Trustees and/or the Employers.

It will also re-emphasise the professional responsibilities of the Actuaries. This is also to the substantial benefit to the individual actuaries, as well as to the Actuarial profession as a whole.

(4.3) A copy of the TAS R, and this TAS Pensions should be included, say as an Appendix, in all Reports to users. ( i.e. actual hard copy, not just a Reference or a website.)

Why?

- because: As above, plus very helpful to users – particularly those interested in a deeper understanding, or wanting to make a more informed scrutiny.

(4.4) References: Add like: “ Where sources of information are cited, these references must be stated so that they can be reasonably easily located and obtained by the users.

Why?

- because: As above. Also, for examples regarding “mortality”, one might now just see cited: “PMA92 / PFA92 standard tables”

It would be more helpful to have a fuller reference like ”PMA92 / PFA92 standard tables as available from Continuous Mortality Investigation (CMI), etc. . . .”

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I hope the above is useful.

I would be glad to receive by e-mail any comments, or requests for clarifications.

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