



# Heath Lambert Consulting

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## **PRIVATE & CONFIDENTIAL**

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Dear Louise

### **Response to Consultation Paper on Pensions**

Further to the consultation paper issued by the Board for Actuarial Standards relating to Pensions, I am pleased to enclose the response on behalf of Heath Lambert Consulting Limited.

In summary we:

- see no basis for a subject specific TAS,
- are concerned that there are no professional standards for areas where actuaries have the key professional judgements,
- found the definitions to be vague and devoid of clear principles,
- found the interaction with legislative requirements not to recognise the structure of the legislation
- were concerned that actuaries were effectively assigned responsibilities in areas where they are unqualified or inexperienced (legal opinions and corporate risk assessment).

We regarded these issue to be more important than many of the specific questions asked and so have devoted our attention to these areas. I hope this is helpful

Best wishes

Yours sincerely

Nigel R Bankhead BA, FIA  
Head of Actuarial Services

## Response to Consultation Paper on Pensions

Heath Lambert provides objective actuarial and consulting advice to a range of pension schemes and companies (largely in the small to mid cap range) on a high value added basis. These pension schemes are not large and they are most affected on a cost per capita basis by the UK regulatory regime which largely imposes fixed requirements with no allowance for the size of the entity in question. Our response to the consultation is made against this background and we are pleased to contribute to this development.

### 1. Response to Proposal

- 1.1 The proposed Pensions TAS largely details with generic issues and does not discernably deal with any matters that are particular to pensions. Moreover no case is made for the existence of a separate Pensions TAS, especially based on the content of the exposure draft provided.
- 1.2 Professionally unjustified divisions in the actuarial approach taken to different subjects create unnecessary divisions and inconsistencies which are not healthy. This subject area exposure draft can serve only to perpetuate those divides.
- 1.3 No examination of the criteria that justify the existence of a separate TAS has been provided, so we have added our analysis of the position.

Factor	Life Insurance	Pensions	Comment
Payment types	life insurance & annuities (pensions)	pensions(annuities) & life insurance	no difference
Valuation contingencies	demography, payment increases, discounting	demography, payment increases, discounting	no difference
Legal constitution	company	trust	no professional difference
Entity & payment taxation	some differences	some differences	no professional difference
Prudential control & credit risk	different	different	no professional difference

### 2. Professional Philosophy

- 2.1 The fact that BAS has taken no position on the meaning and determination of "value" is apparent from previous work. The absence of a set of principles in this area has regrettably resulted in the position that BAS is entirely silent on the primary determination of questions of value and appears to have assumed the position of a

secondary regulator, which simply completes unspecified detail within the primary frameworks of other regulators. This is noteworthy and disappointing.

## 2.2 A particular criticism made by Lord Penrose in his report on Equitable Life was that

“the actuarial Profession as a whole failed to develop any coherent principles or rules of practice by which to test objectively the approach of an actuary”

It is against this background that the question has to be posed of whether this exposure draft really addresses that criticism.

## 3. Comments on the Exposure Draft Text

### 3.1 Reference B2 Definitions - funding assessment, funding level

The use of the word “value” is used in a number of places, but as noted it has no definition and is potentially confusing.

### 3.2 Reference B2 Definitions – measure

The statement is made that different measures of an asset or liability may produce different results. On the face of it this sounds like the truism that dividing a fixed number (the numerator) by a varying number (the denominator) will produce different results and is hardly worth a mention. However, when the statement is combined with the position that assets are required to be included at fair (market) value for virtually all purposes, and therefore that the statement relates to varying liabilities without any change to the asset value, the intention becomes much more questionable.

### 3.3 Reference B2 Definitions – neutral

This is a weak and relative reference rather than a strong and absolute reference. For example it does not require a measure to be appropriate to produce an intended reference outcome (such a market or fair value) and it could result in entirely meaningless results, provided that the individual components could be rationalised as “neutral”.

### 3.4 Reference B2 Definitions – required funding assessment

**As defined, this measure is subject to BAS standards and those of no other regulator.** It is noteworthy that in this exclusive BAS area it has nothing to say.

### 3.5 Reference C.1.7

It is difficult to understand how calculations intended to be used to assess contribution requirements could be relevant to investment advice.

### 3.6 Reference C.1.11

It is difficult to understand why the legal requirements that apply to users of actuarial information should be a determinant for the application of the standard. The correct

approach for actuaries should not depend on whether or not the user is legally obliged to commission the advice.

### 3.7 Reference C.1.19

This application is noted but it is difficult to understand how the standard operates for this purpose.

### 3.8 Reference C.1.24

This section raises some interesting principles. Criticism has already been made of the lack of primary actuarial principle in the standard, as it would be for actuaries to determine the meaning and application of their own professional principles. However, they have no authority to determine the proper interpretation of principles established by other standard setters and this determination, as it applies to financial reporting, is an audit responsibility. As such this section is only operable providing that the interpretation is self evident.

### 3.9 Reference D.2.3

This section sets out what appears to be the principle of purpose specific assumptions, without any guidance on the purposes envisaged and whether there are any limits on this intended approach. For example is it reasonable to be unreasonable, if that is the intention.

### 3.10 Reference D.2.12-16

One of the primary areas of difference between different areas of measurement is discount rate. BAS offers no opinions in this area even when the application is **subject to BAS standards and those of no other regulator**. In contrast the guidance on a much less important area, namely mortality, in D.2.18 is detailed. It looks as if the big questions have been avoided and the small ones addressed.

### 3.11 Reference D.3.1-4

It is unclear whether this section concerns future intent, or past practice. Past practice should already be reflected in the data and so a **mandatory requirement to obtain data direct from the "party" is entirely unnecessary**. For example salary data is generally deleted from payroll systems annually and the historic records are maintained by the trustees. A requirement to obtain historic data from the plan sponsor is therefore unnecessary. However, this section may well be intended to apply to intended future actions (to the extent that these are known and reliable). However, this does not fall into the category of statistical information and it is unclear what weighting, if any, BAS envisages that statements of intent should have.

### 3.12 Reference D.3.6

This is the most objectionable part of the exposure draft. A particular criticism of Penrose was that

"Consideration of the accounting and legal issues that inevitably arise in the regulatory process should be fully integrated into the primary process. There is a

tendency to refer issues for legal advice once they have been focussed in more general discussion. One has the impression that actuaries have at times acted as if they were fully qualified in accountancy, law and other disciplines so as to need no outside support"

**Actuaries have no legal training or authority, yet on the face of it, it appears that this is an instruction to actuaries to make legal judgements. If the law is uncertain then any necessary clarification must be obtained by the trustees prior to commissioning actuarial work.**

### 3.13 Reference E.2

This represents an area where BAS has gone beyond the extent of the regulation and introduced requirements of its own. This is interesting because the UK legislation is based on the EU IORP Directive and then introduced into UK legislation. **There has been substantial opportunity for the relevant issues to be fully explored and the requirements determined, it is therefore unclear as to why the BAS feels it has the remit to change or extend them.**

Equally some of the statements made are simply not credible. The first bullet of section E.2.2 concerns the commercial risk to the corporate sponsor. This is not an area that pension actuaries assess. However, this is all watered down by the fact that there is no standard, but purely a descriptive outcome of a range of practice "there are many ways of indicating the extent of uncertainty and risk". In our opinion a standard should set out requirements and not be a commentary on varying practice.

### 3.14 Reference E.3.6

There is no obvious requirement for the first bullet point of this section.

The third and fourth bullet points are irrelevant to the setting of assumptions based on statistical fact.

### 3.15 Reference E.3.7

This requirement requires greater clarity, particularly the meaning of "to be adopted" and "comparison". The assumptions used for Scheme Funding are decided by the trustees whilst those used for solvency are determined by the Scheme Actuary. If the results and the assumptions are shown together in the final report their appearance would then be in the past tense. Equally it is not clear whether comparison is intended to mean disclosed, commented upon, or rationalised. There is no requirement for actuaries to aid the decisions taken by the trustees on assumptions setting and so this area should be clarified.

### 3.16 Reference E.4

This section appears to wish to change the requirements of the primary legislation which of course it cannot. The process for the determination of actuarial assumptions, the calculation of technical provisions and their certification are all specified by primary and secondary legislation. However, the absence of a proper definition of "neutral" or "prudent", and the fact that the references are to the value of

liabilities rather than technical provisions make this a very difficult section to comment on with certainty, or to reference to the legislation.

The concept of prudence can mean either rational and sensible or cautious and the intended meaning here is not clear. We would use the definition of sensible or cautious, but if the other definitions were used it may be consistent with an overstatement of liabilities and an understatement of assets.

Prudence is a general concept and in financial reporting it is used (without conflict) in combination with fair or market value, and a principle that the amount of a liability is not dependent on how it is financed. Equally prudential regulation is built on the principles that measurement should be objective and that capital provides the ability to absorb risk. The principles and intention that underlie the content of E.4 are entirely opaque.

An example of the confusion arises as follows. If "neutral" is related to market value (i.e. the value of liabilities for external settlement) then most "prudent" technical provisions would generally be of a lower amount, which some may argue fell more into the category of reckless than prudent. Or perhaps even an intermediate category of two words that rarely occur together being that of "prudent recklessness". However, this is not an exercise in semantics but is a serious issue. UK pension schemes generally lack financial independence and on the failure of the corporate sponsor result in members losing the benefits promised and many being admitted into the PPF. In our opinion to combine this outcome with the word "prudent" is offensive to the victims of such circumstances. The funding of pension schemes is clearly a matter of public policy at either the EU or UK level and any capital, asset or contribution requirements will be determined through that process. If as a matter of public policy the asset level requirement has been set below that required for financial independence it certainly should not be endorsed by an actuarial tag of prudence.

### 3.17 Reference E.5.8

We question the need for this item which simply seems to be detail that would increase cost with no added value.

### 3.18 Reference E.5.9-11

The Scheme Funding report is defined as being that required by legislation but the content detailed in these sections is contained in other legislative documents.

## 4. Response to Questions

No comments are made on the other question posed on page 3 as the issues already raised are the most important.