

BAS standards

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Standards
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Exposure Draft: Pensions

Introduction

This paper sets out Hewitt's view of the Board for Actuarial Standards' (BAS's) Exposure Draft on Technical Actuarial Standard for Pensions.

We think the Pensions TAS will help BAS to meet its reliability objective. However there are some areas in which further changes are required.

Key issues

A new definition of neutral measure introduced to address concerns over the previously proposed 'best estimate'. However, this brings with it significant complications. We previously suggested that the pensions TAS should require the actuary to discuss the calculation of a best estimate liability with their client, but that if the client does not want the actuary to calculate it there should be no obligation on the actuary to do so. Your suggested solution, requiring disclosure of an even vaguer measure makes matters worse rather than better.

We are also concerned that certain types of investment advice will be in scope despite BAS's stated intention that this should not be the case.

The issue of actuaries being placed at a commercial disadvantage was raised in the initial consultation and BAS have taken steps to address this problem in some areas. However, the failure to define 'actuarial work' means there continue to be issues, particularly in the relation to winding-up and DC schemes.

We address your specific questions below and these issues are covered in more detail in response to your question 6.

1 - The application of the Pensions TAS to schemes not subject to Scheme Funding (4.19 to 4.21)

This seems reasonable. Our only comment is that paragraph F.1.1 might be extended to state that, "For the avoidance of doubt where there is no analogous provision under such scheme's governing documents or relevant legislation, this standard does not create any requirements."

2 - The definition of governing body, especially examples of schemes for which the definition is not appropriate (4.22)

The proposed definition may inadvertently include advice to a local authority acting in its role as an employing authority, because it is also an administrative authority. To avoid this possible interpretation we suggest the examples provided in the definitions be amended to refer to "... and a **local authority when acting in the role of administering authority...**".

We also suggest that the examples be extended to make it clear that the unfunded arrangements discussed in paragraph 4.22 of the Analysis of Responses are included within the definition.

3 - The proposed commencement date for the pensions TAS (4.23 to 4.25)

The proposed commencement date of 1 April 2011 is reasonable, provided the final version of TAS P is published in the summer as suggested (ie at least six months before the commencement date) and there are no significant additional requirements added to the exposure draft.

If additional requirements are introduced the commencement date should be deferred because projects already underway would otherwise fall within scope of the (amended) pensions TAS.

4 - The transition to the Pensions TAS from the adopted Guidance Notes (Section 5)

From a private sector perspective, GN9 can be disapplied at the same time as the pensions TAS comes into force. In respect of Local Government schemes, the application of GN9 has always been problematic as it was drafted with private sector schemes in mind. We would prefer that GN9 be disapplied with immediate effect for these schemes, now that TAS R is in force. This is a significant issue as LGPS valuations are being carried out in 2010. Requiring compliance with both GN9 and TAS R will not aid the comprehensibility of the report.

The requirements of GN28 remain relevant and are not covered by the new BAS standards. This guidance note should remain in force until alternative guidance is available.

5 - The impact assessment and the effect that the introduction of the Pensions TAS is likely to have on actuarial information (Section 6)

The initial costs of confirming compliance are significant and we have no reason to dispute your estimate of 5% to 10% of the annual cost of actuarial work for governing bodies. This is a very large cost and we question whether the benefit to users is proportional. We note that BAS's expectation is that the cost of transition "will be borne by practitioners in the same way as they absorb other cost". This appears to be an implicit admission that users will not be prepared to pay for this additional work as they will not see commensurate value.

We agree that in the long term, the additional costs of complying with TASs should not be significant as many (perhaps most) of the principles set out in the TASs are already established best practice.

6 – The text of the exposure draft as a means of implementing the proposals presented in this documents

Our comments on specific aspects of the draft text are set out below –

The new **definition of 'neutral'** has been introduced to address the problems associated with 'best estimate' (which we note that few of the formal responses to consultation supported and many were strongly against). This new definition introduces its own significant problems – we do not believe there is such thing as a 'neutral' estimate of the value of liabilities. In the context of scheme funding, for example, it is not clear whether a 'neutral' estimate would be a best estimate of the funds required to meet future liabilities based on best estimate investment returns etc or an indication of the cost of securing liabilities with an insurance company. The fact that the term could reasonably be interpreted as either of these two extreme measures suggests that the definition is extremely unhelpful – we think you can only have a neutral estimate of a specified measure of the value of liabilities. We suggest that the pensions TAS should require the actuary to discuss the calculation of a best estimate liability with their client, but that if the client does not want the actuary to calculate it there should be no obligation on the actuary to do so. (We also note that the definition of 'neutral' includes the concept of

a 'neutral measure' in bold, suggesting it is a separately defined term, which it is not. Fortunately the concept of a neutral measure does not appear to be used anywhere in the body of the TAS - we believe it is flawed in the same way as the concept of a 'neutral' estimate of the value of liabilities discussed above.)

The **definition of users** remains unclear and problematic. Our view is that it should be restricted to the addressees of the report and any other parties explicitly stated as being expected to make decisions based on the report. The opening sentence of the definition appears consistent with this. However, the examples that follow suggest otherwise – it is not clear why the definition section should include examples, especially where they do not appear consistent with the definition.

With regards to **investment work**, the analysis of responses highlights that the original intention of BAS was to exclude investment work from the scope of the Pensions TAS, and that few respondents disagreed (para. 2.28 of the Analysis of Responses). There appears to be a contradiction between the intentions set out here and the exposure draft, which potentially brings aspects of investment work into scope through paragraph C1.7.

In assisting our clients in deciding on an appropriate investment strategy, we rely on asset liability modelling work. This frequently involves the projection of future contribution requirements and funding levels under various alternative investment strategies, and so could potentially be covered by C1.7.

Your intention is to exclude investment work from the scope of the Pensions TAS and this should be made clear. Additionally, asset liability modelling is often performed by non-actuaries, and we believe that forcing compliance with these standards could place actuaries at a commercial disadvantage when competing with non-actuaries. We recommend that as such paragraph C1.7 be removed.

As a minimum, paragraph C1.7 needs to indicate clearly exactly which investment work (if any) is in scope and which is not. Our reading of C1.7 is that:

- advising on an investment strategy aimed at returning the funding level to 100% over a particular period would be in scope, but
- advising on an investment strategy aimed at achieving x% p.a. above relevant gilts over a particular period would not be in scope.

In addition, the proposed wording could include within scope any investment work that illustrates the impact (or even the approximate impact) on funding levels.

Paragraph C1.16 does not adequately address the issue of which work relating to **winding-up** is in scope, as suggested in paragraph 2.23 of the Analysis of Responses. This paragraph simply lists work which is included with no suggestion that the list is exhaustive. A similar point applies to paragraph C1.20 in the context of **defined contribution work**. These are examples of areas in which the lack of a definition of actuarial work is unhelpful. We do not think that BAS's suggestion that actuaries should 'know what actuarial information is when it is produced' (paragraph 4.14 of the Analysis of Responses) is any help. Again, there is a risk of actuaries being put at a commercial disadvantage unless BAS can provide clarity.

The most obvious solution would be to provide exhaustive lists of the work in scope in these areas.

Paragraph E3.6 refers to '**material**' (in bold), suggesting the TAS definition applies. However, in this context it seems the usual English definition is more appropriate. (E3.6 requires a range of options for each **material** assumption. If a range of options is presented for a particular assumption this will presumably mean the assumption becomes **material** under the TAS definition – even for the most inconsequential assumption – where users are required to make a decision.)

We are not convinced that BAS should specify such a long list of information to be included in a '**Scheme Funding Report**' for a hypothetical 'informed reader', given that:

- Legislation already sets out the information which must be communicated to members, in relation to scheme funding, in summary funding statements; and
- This report is finalised after the relevant decisions are taken by users and BAS standards already require relevant information to be communicated to users before decisions are made.

One aspect of the proposed requirements for Scheme Funding Reports which appears particularly unnecessary is the requirement to include projected cashflows for different categories of membership (paragraphs E5.8).

More generally, these Scheme Funding Report requirements do not appear to help BAS satisfy its reliability objective. However, not following the detailed requirements for Scheme Funding Reports would not be considered a departure from the TAS, under paragraph B.1.2, as it would not have a material effect.
