

BOARD FOR ACTUARIAL STANDARDS: CONSULTATION PAPER ON EXPOSURE DRAFT OF PENSIONS TECHNICAL ACTUARIAL STANDARD

HYMANS ROBERTSON'S RESPONSE TO THE BOARD FOR ACTUARIAL STANDARDS' CONSULTATION ON THE EXPOSURE DRAFT OF THE PENSIONS TAS.

In February 2010 the Board for Actuarial Standards (BAS) published a consultation paper on its first Exposure Draft of the specific technical actuarial standard (TAS) relating to pensions. This is Hymans Robertson LLP's response to that consultation.

GENERAL COMMENTS

We reiterate the point made in our response to the BAS's initial consultation on the Pensions TAS, namely that the BAS's proposals are far more detailed than a true 'principles-based' approach would demand. We are pleased that the section of the Exposure Draft on assumptions is somewhat less prescriptive than was proposed in the initial consultation, but we do not support the approach taken in parts E and F of the Exposure Draft which are extremely prescriptive. We fundamentally disagree with the BAS's proposed requirements in relation to these two parts of the Exposure Draft – we discuss this in more detail later in this response.

There is a great deal of overlap between the Pensions TAS and TAS R. The former could be made a lot shorter if this duplication is removed.

We also take this opportunity to repeat another comment made in our response to the initial consultation: we urge the BAS to re-consider issuing guidance or providing an interpretation service on the grounds that this could substantially improve the effectiveness of the new standards.

COMMENTS ON THE CONSULTATION ACCOMPANYING THE EXPOSURE DRAFT FOCUS OF ADVICE DURING ACTUARIAL VALUATIONS

Through the development of the TASs we have been hopeful that the renewal of technical standards, from the existing Guidance Notes towards the TASs, would give the profession the opportunity to look afresh at how it communicates risk. In particular, in the pensions arena, the primary focus of funding advice is contained in the full valuation report, which is finalised and passed to trustees at the end of a valuation process. The report is long, contains a lot of valuable information and is time consuming to produce (and hence requires a significant part of the costs of the valuation to be allocated to it). But by giving this information at the end of the process, the reality is that few trustees (and barely any scheme members) read the reports let alone digest their contents.

As the TASs have developed we have been optimistic that the guidance framework was going to free actuaries from some of the constraints of the current guidance and allow the considerable effort expended on producing the valuation report to be used to enhance the advice given during the valuation process. In other words, to spend more effort on the communication of risk before decisions are made instead of at the end of the process when decisions have been made. We saw this as an opportunity to make the valuation process a far better risk management tool at no cost to trustees. It is unfortunate, therefore, that the focus in the draft TAS remains on the valuation report. As drafted, the refocusing of advice to earlier in the process will not be possible without duplication of work and significant cost to schemes. We fear that the pensions TAS will not help facilitate the transformation of an actuarial valuation to a better risk management tool but will instead lock us into the approach GN9 has forced us to adopt over the past few years.

As noted above, we think that this is unfortunate. There is a great opportunity to make the actuarial valuation a better product but as drafted, this opportunity will be lost. It is somewhat ironic that the Board has been persuaded to take this approach from, at best, a handful of pension scheme members who are not users of valuation reports which will be to the detriment of the many thousands of users of the reports.

DEFINITION OF USERS

We welcome the BAS's confirmation in paragraph 2.9 of the consultation that scheme members should not be considered 'users' of the report on the actuarial valuation.

IMPACT ASSESSMENT: ONGOING COSTS

The BAS states in paragraph 6.9 of the consultation that it does not consider that the TASs will result in significant additional costs for scheme funding assessments, arguing that additional costs resulting from projections will be offset by less prescriptive requirements relating to solvency calculations. There is no rationale for making this argument. As the BAS is aware, actuaries are required by law to carry out solvency calculations as part of the actuarial valuation exercise. The fact that the prescription of GN9 is being removed in relation to how the solvency basis is determined does not mean that less work will be involved. The actuary will still need to make judgements and to make, explain and justify assumptions with regard to the solvency basis (and indeed the requirements relating to the explanation and justification of the solvency assumptions is increased by virtue of TAS R). Therefore we do not envisage any cost reductions relating to the solvency calculations and we disagree with the BAS's views in paragraph 6.9.

The Board also should recognise that there are ongoing costs as a result of the need to demonstrate compliance. Whilst the Board is not setting the standard of documentation required, there is no doubt that, with more work being subject to professional guidance, there will be a need for further work to peer review against these standards and to record that compliance. We expect a recognition of these additional costs even if they are deemed necessary to achieve better standards.

IMPACT ASSESSMENT: TRANSITIONAL COSTS

In paragraph 6.13 of the consultation, the BAS estimates that the transitional costs of complying with the TASs could be 5% to 10% of the cost of carrying out the actuarial work to which the TASs relate. We consider this to be a reasonable estimate. However, given the current difficult economic climate, we find the BAS's comment that it "*expect[s] much of the cost of transition to be borne by practitioners in the same way as they absorb other costs*" to be naive. Commercial organisations, answerable to shareholders, will seek to maintain their return on capital irrespective of changes in professional guidance. Costs are unlikely to be 'absorbed'. (Other organisations may take a longer term view where they do not have shareholders to answer to.)

RANGE OF FEEDBACK

It is noticeable that there is little or no feedback from those who receive actuarial advice. As such, it is unlikely that the comments received from these groups will be representative of trustees or scheme members as a whole. Whilst we would expect the Board to give more weight to the views of users over consultancies where these views are representative of users as whole, doing so when comments have been received from no more than a handful of users is likely to lead to poor guidance. There seems to be a presumption that the motivation of the consultancies responding to the consultations is not necessarily to act in the best interests of users. We find this worrying. We believe that the feedback from consultancies is motivated by putting standards in place that will better serve users. It is likely that where there are areas of difference between the feedback from users and consultancies, then this will often be a result of the disadvantages of certain approaches not being understood by all.

There are, we believe, some deficiencies in information gathering. As such we urge the Board to widen the range of feedback it receives so that it can be truly said to represent the views of users. We also urge there to be better communication from the Board to parties from whom feedback is asked so that the arguments for and against certain approaches are fully understood. For instance, many practitioners have argued that the comparison of a best estimate liability figure against a prudent figure is at best an unreliable guide to prudence and at worst, badly misleading. It is not clear to us that these arguments are fully understood by all who respond. Until such information deficiencies are addressed we would urge the Board to put a little less weight on the feedback received from users and member representative groups.

NEUTRAL VERSUS BEST ESTIMATE

The Board has recognised that the term 'best estimate' has a range of possible meanings and values that can be labelled as such. Relabeling this to 'neutral' does not address the fact that 'best estimate' or 'neutral' is a subjective term with a wide range of acceptable values. Any comparison made against a 'neutral' estimate is, therefore, unlikely to be an objective measure of prudence as envisaged in the consultation.

DEFINITION OF 'ACTUARIAL INFORMATION'

In 4.14 the Board asserts that '*most actuaries and users of actuarial information know what actuarial information is when it is produced*'. We have the following observations to make in relation to this assertion.

- If it were true, why are so many respondents asking for a definition?
- Any two individuals are unlikely to interpret the expression in the same way. An objective definition would help.

COMMENTS ON THE EXPOSURE DRAFT

COMMENCEMENT

We note that the BAS proposes to apply the Pensions TAS to "*work performed for aggregate reports*" completed on or after 1 April 2011. This point is important in relation to the proposals set out in parts E and F of the Exposure Draft, which we will come on to later.

SECTION C - SCOPE

We repeat the two points made in our response to the initial consultation:

- (i) We are strongly of the view that strategic investment advice, particularly that which is associated with scheme funding, should be included within the scope of the pensions TAS. With scheme funding exercises increasingly reviewing both contribution and investment strategies together it makes little sense to us that only part of this exercise be covered by the TAS. Only covering half the advice in this vital area will not meet the objectives of this TAS.
- (ii) We consider that scheme sponsor work should be excluded from the scope of the pensions TAS and, where appropriate, should be the subject of a specific TAS. Our reasons are set out in our earlier response.

The draft Pensions TAS includes in its scope "*actuarial work ... to enable ... decisions on contribution requirements*" (C.1.5), "*actuarial work concerning contribution requirements or funding levels ... relating to decisions on investment strategy*" (C.1.7) and "*actuarial work for employers or scheme sponsors on any matter related to a scheme funding assessments ...*" (C.1.11). A strategic investment consultant, whether or not he or she is an actuary, might provide advice to trustees or employers which includes information on how employer contributions might vary under different investment strategies. Would such advice be classed as "actuarial work" within the scope of some or all of C.1.5, C.1.7 and C.1.11?

It is not clear what work the wording in the second bullet point of C.1.20 is meant to cover.

We have no other comments on the proposed scope as set out in part C of the Exposure Draft.

SECTION D - GENERAL PRINCIPLES

The BAS needs to make clear that the principles of D.2.1, D.2.2 and D.2.18 only apply to assumptions set or proposed by an actuary. In some areas of work the assumptions are prescribed and in others the assumptions are set by others (for example trustees or employers) and in such cases the actuary cannot be required to comply with D.2.1, D.2.2 and D.2.18.

Similarly, in D.2.12 the actuary cannot be required to explain the derivation of a discount rate which has been determined by another party.

The first sentence of D.2.5 is not actuarially sound. In our view it is rarely appropriate for assumptions to take account of material events after the effective date of calculations. To do so introduces the possibility of there being an inconsistency between two measures; assets and liabilities, for instance.

We remain concerned with the wording of D.2.8. The wording used in D.2.8 does not reflect the articulation of the Board's intentions given in 3.16 of the consultation paper. To a lay reader, D.2.8 is likely to be interpreted as prohibiting the usual approach of setting most assumptions on a best estimate basis with the margin for prudence being included in one or two specific assumptions. This is not helped by the wording in D.2.9 which implies that a best estimate mortality assumption should not be compensated for by the use of a strong discount rate. The wording should be amended to clarify this.

The requirements of D.3.7 are likely to be quite onerous. Where legal advice exists it is often the case that it does not contain any advice on the likely remedies. For example, many schemes will have taken advice regarding GMP inequality but few will have received advice on what they need to do to achieve equality. It is a legal matter, not an actuarial one, as to what the remedy might be. In order to be able to comply with D.3.7 the Board is requiring users to obtain additional legal advice for no other purpose than to comply with the TAS. This strikes us as disproportionate.

SECTION E - SCHEME FUNDING

Our principal concern with section E is its requirements relating to the Scheme Funding report in section E.5. E.5.11 notes (rightly, in our view) that a scheme funding report cannot be part of an aggregate report for any scheme funding decisions made before its completion. In some cases, the scheme funding report is signed before the recovery plan and schedule of contributions are agreed, whilst in others, the report is signed once everything is agreed and simply provides a record of the decisions made throughout the scheme funding exercise. In those latter cases (which are the majority of cases we believe), therefore, the scheme funding report forms no part of any aggregate report for decisions on contribution requirements and as such falls outside the scope of TAS P. Further, as no decisions are made following the receipt of a report in these circumstances, it is not Material as defined in the Scope and Authority.

Where the scheme funding report is prepared before all decisions are made, the trustees will, or may be users of some of the information contained in the report and therefore it may form part of an aggregate report. The scheme funding report is generally only prepared for the benefit of trustees (or scheme managers): the employer is given a copy of the report but it is not generally prepared to assist any employer decisions and therefore the employer is typically not a user. We have the following comments in relation to the relevance and usefulness of the information proposed for inclusion in the report:

- None of the information in E.5.5 to E.5.7 is likely to be material to users:

- To comply with TAS R, membership and asset data will (or should) have already been described in the actuary's advice on the various scheme funding decisions – there is no need to repeat the information.
- The benefit provisions are described in the scheme's governing documentation and there is no need for the actuary to do more than refer to the relevant documents.
- The investment strategy is stated in the trustees' Statement of Investment Principles – there is no need for the actuary to repeat the strategy back to the trustees in the scheme funding report.
- A summary of experience and material events since the previous valuation will (or should) have already been described in the actuary's advice on the various scheme funding decisions (as required by TAS R) – there is no need to repeat the information.
- Where material, actuarial measures and methods will (or should) have already been described in the actuary's advice on the various scheme funding decisions – there is no need to repeat the information.
- A summary of material assumptions and comparison with those used for the previous actuarial valuation will (or should) have already been described in the actuary's advice on the various scheme funding decisions – there is no need to repeat the information.
- Explanations of how and why the funding level has changed since the previous actuarial valuation will (or should) have already been described in the actuary's advice on the various scheme funding decisions – there is no need to repeat the information.

In short, the repetition of any of the above is disproportionate to the needs of the users and under B.1.3 should not be included.

- With regard to E.5.8, it may be useful for trustees to see projected cash flows for different categories of member, but such information will not always be material to the decisions trustees have to make and therefore there should not be a *requirement* for this in the scheme funding report or elsewhere. Also, as above, this is likely to have been provided to the trustees already in advice given earlier in the process.
- E.5.9 requires the scheme funding report to include the agreed contribution plan. However, this will not always have been agreed by the time the report is signed. In any case, the information is given in the schedule of contributions and does not need to be repeated in the scheme funding report.
- The information required under the first bullet of E.5.10 includes much which is not actuarial information – this should not be a requirement for the actuary. The actuarial risks and the other requirements of E.5.10, again, will have been discussed with trustees earlier in the process.

Our remaining comments on section E are below.

- Sub-section E.2 contains information rather than standards or principles and we therefore suggest that it is removed from the TAS.

- E.3.3 requires aggregate reports to describe and explain the implications of different funding methods and measures. However, the BAS's definition of a method (in this draft of the Pensions TAS and elsewhere) states that different methods should produce similar results and therefore this requirement, insofar as it relates to methods rather than measures, will generally not be material to users.
- E.3.6 is prescriptive ("*information ... will need to include ...*") – and all the information listed in E.3.6 will not necessarily need to be provided in every case. We suggest a principles-based standard should instead suggest information that *might be* or *should generally be* included.
- E.3.7 does not take account of situations where the solvency estimate is derived from a buy-out quote from an insurer, in which case the underlying assumptions may not be known. Even where this is not the case, any such comparison is likely to be meaningless; what trustees are more interested in is the difference in £ terms between the two figures. There is also a typo in E.3.7 – repetition of 'the' towards the end of the sentence.
- We re-iterate our view that a comparison between technical provisions and a neutral estimate is, at best, a misleading view of the level of prudence being adopted. Not only is there a wide range of what can be reasonably called a 'neutral estimate', such a comparison ignores all of the other relevant factors when assessing prudence; the investment strategy, the strength of the employer, etc. For two schemes each with a neutral estimate of 100 and with prudent estimates of 105 and 120 respectively, it is entirely plausible for the lower of the two prudent estimates to be the more prudent. For the Board to allow users to be misled into believing otherwise would be poor guidance.
- Notwithstanding the above, we find the requirement to make this comparison when giving advice under section 230 (1) (c) and (d) of the Pensions Act 2004 a little strange. The advice given under these sections is usually given once the method and assumptions to be used in the calculation of the technical provisions have been decided upon by trustees and the technical provisions calculated by the actuary. This comparison is, we believe, designed to help users decide on the level of technical provisions so would need to be given earlier in the process.
- E.4.2 refers to a "*prudent estimate of the value of the liabilities*". However, the BAS has not defined its use of 'prudent', nor of the meaning of 'value' in this context. The BAS must be aware of the debate and disagreement between certain actuaries and economists about what is the 'value' of a pension liability. If one takes the view that value is determined by price, then the best available measure of the price (and hence value) of pension liabilities is the cost of securing them with an insurer (ie the solvency basis). It is extremely unlikely that a scheme would be funded on a basis which is more prudent than the solvency basis and therefore E.4.2 is generally not applicable.
- E.6.4 states that a comparison of transfer value assumptions with scheme funding assumptions "*might need to be*" supplemented by additional information. We would suggest that such a comparison either *needs to be* or *might be* supplemented by additional information.

SECTION F

It appears that the Board ran out of steam when it reached Section F which is somewhat unfortunate. To deal with the advice which will be given to many of the country's largest funded schemes in such terms leaves the impression that the Board is less concerned about the schemes in this sector. As the Board will know, the legislative framework for public sector schemes is somewhat different from that in the private sector. As such, there are not direct parallels between the two sets of legislation. We feel that the TAS would benefit from more

information from the Board on how they believe the requirements should apply to public sector teams. As the parallels are not necessarily clear, it is likely that different users will interpret the requirements of Section F in markedly different ways.

If you have any comments on this response, please address your queries to Brian Nimmo, whose contact details are below.

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For and on behalf of Hymans Robertson LLP

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