



21 May 2010

The Director  
Board for Actuarial Standards  
5<sup>th</sup> Floor, Aldwych House  
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Subject: Exposure draft: Pensions

Dear Sir

Mercer Limited is a global leader for HR and related financial advice and services. In the UK, our client base includes employers and trustees providing occupational pension schemes to employees in all sectors of industry; we provide pensions advice and services to companies in the FTSE100 but we also have a large proportion of clients that are employers classed as "Small to Medium sized Enterprises", or trustees of pension schemes with sponsoring employers in this class.

We welcome the opportunity to respond to the exposure draft for the pensions TAS published by the Board for Actuarial Standards (BAS).

As our business involves advising companies and trustees on pension arrangements, we will comment from this perspective.

The appendix to this letter sets out our answers to the questions asked in the document.

We would be happy to meet with you to discuss any of the points raised or answer any questions you have on our response.

Yours faithfully

[By email]

Alison Pollock





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## Appendix

### Exposure draft: pensions – Section 7 – issues on which the BAS has invited comment

The exposure draft addresses a number of the concerns we had with the original consultation paper and we generally welcome the amendments which have been made.

However we believe that there are still some weaknesses which need to be addressed:

- Restricting the definition of the users of a report to those “whose decisions a report is intended (at the time of writing) to assist” is appreciated, as this means that a report can be written with regard to a target audience, which helps to achieve the Reliability Objective. We consider that users should be defined as those (only) to whom the report is addressed. The first sentence has this effect, but we remain concerned that the second sentence of the definition clouds this, and we think it is unhelpful and should be removed.
- The actuarial valuation report required by legislation would have been (effectively) out of scope (for the purpose of the valuation) since no decisions are based on it. However the BAS has attempted to recast it as a helpful document to members, imposing additional requirements on it. We do not consider that this repositioning assists the BAS in meeting its Reliability Objective. It also means that the document is likely to contain information beyond that which is helpful to members in understanding the scheme’s funding, and hence we are not convinced it is satisfactory in that role either. We welcome the BAS’s decision not to explicitly include scheme members in the definition of a user for the purposes of the technical standard generally. However we are concerned about introducing the definition of an “informed reader” in relation to the Scheme Funding report required under legislation. The additional requirements complicate the guidance and seem unnecessary in the context of BAS’s Reliability Objective. In fact, as outlined above, there is a danger that by creating two separate groups of people to consider when drafting a Scheme Funding report – “users” and “informed readers” – the document becomes less useful to all parties, and it becomes less clear who can rely on its contents.
- Although the acknowledgment that there may be more than one possible neutral estimate goes some way towards easing our concerns, the change of terminology from



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“best estimate” to “neutral estimate” is not sufficient. We are still unconvinced that producing a neutral estimate alongside a prudent estimate is useful in illustrating the degree of prudence in assumptions. Further comments on this are included under part 6 below.

In the paragraphs below we provide responses to the questions raised by BAS within the exposure draft and comment upon issues we feel still need to be addressed before the final publication of the Pensions TAS.

## **1. The application of the Pensions TAS to schemes not subject to Scheme Funding (paragraphs 4.19 to 4.21)**

We believe that it is appropriate for similar actuarial standards to apply to such schemes.

The requirements in part F of the exposure draft which deals with funded schemes not subject to the Scheme Funding regulations seem reasonable in general. We note that there are no provisions for winding up in the LGPS governing legislation, so some of the requirements in part E may be less relevant (for example the requirements to provide information on solvency and wind ups). This may be addressed by the BAS principles on non-material departures, but it would be preferable to supplement the text in part F to make the scope clearer – for example, by including an explicit exemption from some requirements in part E where they are not relevant.

It is not clear to us whether part F applies to “target” DC schemes or only to DB schemes not subject to Part 3 of the Pensions Act 2004.

## **2. The definition of governing body, especially examples of schemes for which the definition is not appropriate (paragraph 4.22)**

This definition seems reasonable. However we note that the BAS definition of governing body refers to “pension schemes” and that this includes personal pension schemes. This does not, we believe, give rise to particular issues although it might be helpful if it was made clear whether the BAS does indeed intend for those entities with a degree of responsibility or governance (eg the employer) to be included under the definition of “governing bodies”.



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### **3. The proposed commencement date for the Pensions TAS (see paragraphs 4.23 to 4.25)**

This implementation date is reasonable if no material additions are made to the exposure draft, because it will cover work being done at present. However, the staggered implementation dates of the TASs do create some difficulties and we would prefer the Transformations and Pensions TASs to have the same implementation dates.

### **4. The transition to the Pensions TAS from the adopted Guidance Notes (see section 5)**

GN9 – We would encourage the BAS to amend GN9 so that if reports comply with TAS R and the Pensions TAS (between the issue of the final version of the Pensions TAS and its commencement date) they do not have to comply with GN9.

GN16, GN19, GN26, GN34, GN36, GN49 – no comments.

We understand the point made in paragraphs 5.12 and 5.13. Rather than including the guidance in legislation (which could result in unintended consequences) we suggest that the BAS uses a technical memorandum to reproduce the effect of GN28.

### **5. BAS's impact assessment and the effects that the introduction of the Pensions TAS is likely to have on actuarial information (see section 6)**

We accept the argument set out in paragraph 6.3 regarding ongoing costs of TAS compliance.

A transition cost (estimated by the BAS) of up to 10% of the cost of actuarial work is far from immaterial.

In general the benefits do justify some additional cost (paragraph 6.6), but we are not convinced that in all cases the benefits arising from TAS compliance will be sufficient to justify the costs of doing so.

Whether the estimate of a 5–10% increase in cost of actuarial work is accurate will depend in part on how materiality will be judged. While we understand that a judgement must be made on what is and is not “material”, as we have commented previously the



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widely drawn definition (which says that matters are material if they could influence decisions to be taken by users), means that the costs of compliance in practice could easily be greater than the BAS estimates.

We also consider that the lack of clarity in scope and in some definitions, and the increasing number of “principles” and specific TASs are likely to make the cost of implementation greater, without any commensurate increase in value.

## **6. The text of the exposure draft as a means of implementing the proposals presented in the exposure draft**

We have a few specific comments in response to this question.

On the scope of the Pensions TAS as set out in C.1.22 -1.23, it is unclear whether management accounts or internal management forecasts/budgets count as “financial statements” within scope. It is also not entirely clear whether US GAAP disclosures prepared for a UK entity’s management accounts qualify as financial statements within scope (where the UK entity is a subsidiary of a US parent company, but the ultimate recipient of the advice is the UK entity). Paragraph 13 of the BAS’s scope & authority document (v3) limits scope & authority to “the UK operations of entities... which report into the UK within the context of UK legislation or regulation”. This has been taken to exclude US GAAP in the past but likely to include IFRS (as UK listed entities are required to report under IFRS). On one hand, these management accounts would appear to be excluded on the grounds that there is no UK legislative or regulatory requirement for the UK entity to prepare its management accounts in this way; alternatively, because they are financially significant and material to the user, they could be in scope. Clarification would be helpful, along with an explicit statement that the TAS excludes all US GAAP work (due to lack of scope & authority) if that is the case – we note that this was given as the reason for the BAS’s withdrawal of GN13 in November 2008.

We commented earlier on the requirement to provide a neutral estimate. The Reliability Objective cites relevance and comprehensibility of information but this extra information is likely to be confusing to many trustees who are often already faced with a S179 estimate, a buyout estimate and (often) an accounting estimate when deciding on assumptions for funding. We accept that there needs to be some discussion about where the technical provisions measure sits relative to other meaningful benchmarks,



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and a proper discussion about the appropriate range of technical provisions assumptions is essential, bringing in the employer covenant and the selected investment strategy. Trustees can gain a clearer understanding of prudence from a discussion of the possible range for each assumption rather than from an estimate of the liabilities, which compounds the effects of many different assumptions and other funding decisions. We believe that there is little value in introducing a further benchmark measure.

As discussed on page 2 of this response, we think the added requirement for the Scheme Funding report to be written with regard to an “informed reader” is unnecessary and causes practical problems when drafting the report. One of the purposes of the TAS’s extra requirements is to ensure that members have sufficient information, but they are already provided with information in the form of (generally) annual funding statements. Although this is less comprehensive, in most cases it has the advantage of being carefully designed with the members’ level of knowledge and needs in mind. Attempting to make members who are “informed readers” a target audience for the report may encourage them to rely on the Scheme Funding report rather than the communications written specifically for members, and this raises problems around how much extra explanation is needed to ensure members do not misinterpret information given.

Issues in relation to the Scheme Funding report relate to communication between the trustees and members, rather than between the actuary and his or her client, and we do not think the TAS is the appropriate place to address these issues.

**7. In addition to the specific questions listed above, the BAS invites respondents’ views on any other aspects of the proposed TAS.**

Again we have a number of specific comments in response.

In order to ensure consistent interpretation of the TASs it would be helpful if the BAS would give some clarification around what it considers to be actuarial work and what constitutes actuarial information.

The introduction of requirements for defined contribution schemes seems to have had some unintended consequences on paragraphs within part C, the scope of the standard. We note that the BAS intends (paragraph 2.30) to bring DC scheme design and benefit projections within scope, but the text of the exposure draft appears to bring DC scheme



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bulk transfers, winding up, individual member calculations using factors, and accounting information in scope. Specifically, paragraphs C.1.13, C.1.15, C.1.17 and C.1.22 now include DC schemes within their scope. It would be helpful if the BAS could clarify whether or not it was intended to include DC schemes within the scope of these paragraphs.

Paragraph 3.17 of the analysis states that paragraph D.2.16 of the exposure draft applies “if a discount rate is related to the future returns on scheme assets”. This should be explicitly stated within paragraph D.2.16 because in some circumstances this explanation may not be relevant, for example if the discount rate is prescribed by an accounting standard. The wording in D.2.16 then would be of the form “Aggregate reports shall explain, in cases where a discount rate is related to the future returns on scheme assets, how the discount rates...”

Paragraph E.5.8 says that the Scheme Funding report should include projected cashflows; this requirement is too stringent in our view and could be impractical and disproportionate for some schemes (particularly smaller schemes) which do not use cashflow projections for their valuations. A similar but more proportionate requirement is covered by paragraphs D.2.12 and D.2.15 which state that aggregate reports should explain the cashflows being discounted and that this explanation should include an indication of the nature and timing of these cashflows. As a minimum, E.5.8 should be amended so it results in a similar requirement to D.2.12 and D.2.15, although we remain unconvinced that extensive cashflow information is helpful in meeting the Reliability Objective in respect to the Scheme Funding report.