

This is comment on the BAS Pensions Exposure Draft as amended April 2010.

## FITNESS FOR PURPOSE

Thousands of people make their living out of occupational pensions – administrators, fund managers, actuarial advisers, legal advisers, IFAs and others. But the purpose of occupational pensions is not the provision of work for these people. The purpose is to foster the employer/employee relationship which is a backbone of life for millions of people. This draft “standard” is not fit for that purpose.

It is not fit because it deliberately denies the fact that some scheme members need to make decisions influenced by the content of actuarial valuations. As Directive 2003/41/EC puts it

*“Proper information for members and beneficiaries of a pension scheme is crucial. This is of particular relevance for requests for information concerning the financial soundness of the institution, the contractual rules, the benefits and the actual financing of accrued pension entitlements, the investment policy and the management of risks and costs.”*

## BACKGROUND

Before June 2003 companies could jettison their final salary schemes in an underfunded state, leaving the scheme members with what little the assets provided. Actuaries knew the Minimum Funding Level provided negligible security but the scheme members were not told. Those who suffered directly were eventually largely compensated. Subsequent regulation raised the bar on funding requirements. But unrecoverable damage had been done to all scheme members’ confidence – they now knew to fear what they were not being told.

With scheme members seeing pensions as a less certain benefit, employers saw less reason to pay for the schemes, a circle that has contributed to poorer provision as a trend.

The Morris review articulated the role “insufficient transparency” had played and noted (amongst other things) “professional standards that have been weak, ambiguous or too limited in range, and perceived as influenced by commercial interests”. The review recommended a new Actuarial Standards Board.

The Actuarial Profession made proposals that would have maintained more of its self-regulation. The Professional Oversight Board viewed these as putting excessive emphasis on the *“best interests of the actuary's immediate client, rather than third parties and the public interest”*.

## WHAT HAPPENED NEXT

The Board of Actuarial Standards has developed this standard by accommodating consultation responses rather than considering needs. Since the responses were heavily weighted by the actuarial profession, the result is very much what the profession would have written for itself – weak, ambiguous, and limited, with an undue emphasis on the actuary and those who pay the actuary.

## A FATAL FLAW

The big mistake is a mistake of logic – the belief that scheme members are not users of an actuarial valuation because many scheme members are not users of any actuarial valuation. The correct logic is to note that some scheme members (and those who advise them) do need the information that should be in an actuarial valuation and that makes scheme members, as a category, users. This mistake was noted in an early consultation response. The attempt to cover it up by the introduction of the idea of an “informed reader” does not work. It is scarcely credible that anyone would be reading a valuation for amusement. When a valuation is read, it is read in order to make use of its content.

The exclusion in *“Those people whose decisions a report is intended (at the time of writing) to assist”* does not work either. It introduces a contradiction – what is the status of the people the report is intended to assist, but not at the time of writing? How can the report be intended to assist their decisions, but the author not be aware of that intention?

It also contradicts inevitable practice. An actuarial valuation contains decisions made by trustees about parameters, and agreements between trustees and employers. The document cannot be written until those have been established. So at the time of writing the decisions will already have been made so that, if the exclusion was effective, the document could not be said to be assisting the trustees with those decisions.

The fact is that the particular authoring time is irrelevant. What is relevant is the ultimate aggregate of the intended users. The Directive and the regulations make some scheme members intended users and no fudge can cover up that fact.

## ABOUT GUIDE VERSUS STANDARD

Practitioners decide for themselves whether their activity follows guidelines. A standard independently constrains a practitioner – the standard allows somebody else to check whether the standard has been met. BAS has written some guidelines and called it a standard.

The general public is familiar with standards that are prescriptive and hence allow testing whether they have been met. If your car has a broken light bulb then it fails its M.O.T. You cannot argue that you never go out in the dark so it does not matter. The engineer will not argue that it is only one parking light amongst many lights and hence not material. Similarly, if you have your house rewired the lighting circuit will need an earth wire. You cannot successfully argue that the lighting has worked for decades without an earth wire and without anybody getting hurt. The electrician will not omit the earth wire,

even if he sees no need for it. The purpose of a standard is to ensure that a testable standard is reached in practice - some possibly unnecessary work is a small price for the benefit of having a standard.

It is possible for principles to replace prescription provided that it can be tested whether the principle has been applied. For instance there might be a list of items which were not requirements but were subject to the “provide or explain why not” principle. Or lists of items might be avoided by requiring “the information necessary for users of category X to make decisions of category Y”. A principle could be as broad as “provide what is necessary for another actuary to validate your numbers”. But the BAS guideline/standard does not have any such principles. The principles it has are of the “practitioner is always right” type – placing the actuary as the judge of materiality and proportionality.

Paragraph 4.5, relating pensions work to international accounting standards, gives a clue as to why BAS is comfortable with such a loose standard – BAS is not recognising the role of audit. In the flow of information from the business to the shareholder there is a professional, the auditor, charged with the duty of ensuring the discretions allowed to the accountant are not taken too far. In the flow of information from trust to scheme member, the actuary is essentially his own auditor. This makes a firm approach to actuarial standards vital.

## STANDARD WRITING TECHNIQUE

The Board of Actuarial Standards is one of many organisations that set standards. The International Standards Organisation(ISO) has rules for how standards should be developed. The accurate use of terms and language is a cornerstone.

This pensions draft uses a common word, “shall”, in an uncommon sense (B.1.2, B.1.3) – something ISO deprecates. That being the case, another word is needed for the usual sense of “shall”. That word is “must”.

A scan of the draft shows that “must” is largely used to repeat requirements in pre-existing regulations. The only new “must” (which 4.5 says is implicit) requires the actuary to apply judgement reasonably. That is not a useful component since even without a standard actuaries are not free to make unreasonable judgements. The standard provides no additional test of reasonableness.

On terminology, we find that “technical provisions” is defined to mean “technical provisions” as established in Regulations. Yet “actuarial valuation” as established in the Regulations is renamed “Scheme Funding report”, and “actuarial report” is not defined or renamed. (The document uses “actuarial report” both in its regulatory sense and in another sense.) BAS may think it can do a better job than Parliamentary draftsmen but can this justify an unnecessary step for the reader, in consulting the definitions to discover whether established meanings are maintained or not?

## SUMMARY

The circle back to pre-Morris Review is being completed. We are offered a standard that is weak (lacking in both rules and constructive principles), ambiguous (e.g. “at the time

of writing”), and limited (e.g. deliberately denying scheme members the benefits of transparency).

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