

The Director
Board for Actuarial Standards
5th Floor, Aldwych House
71-91 Aldwych, LONDON
WC2B 4HN

21 May 2010

e-mail: thomas.mcdougall@scottishwidows.co.uk

Dear Sirs

Exposure Draft: Pensions, February 2010

Scottish Widows Pensions Actuaries thank you for the opportunity to reply to the exposure draft TAS Pensions. Taking each of the questions in section 7 of the exposure draft in turn:

1. The application of Pensions TAS to schemes not subject to Scheme Funding:

We have no further comment.

2. The definition of governing body:

We have no further comment.

3. The proposed commencement date

We agree that the proposed commencement date of April 2011 is sensible.

4. The transition to the Pensions TAS from the GNs:

We would be grateful for further clarity on the transition from the current GNs. For example, until April 2011 scheme actuaries advising on funding must comply with both TAS Reporting and GN9 (for now we do not consider possibility that GN9 might be amended to allow departure if comply with TAS Pensions early). We would welcome further explanation of how you expect this to operate in practice.

GN28 contains helpful guidance for actuaries on an area of law where there is little detail to follow and we are pleased that BAS is addressing this with the DWP.

If GN26 is removed then we would encourage BAS to produce a glossary of actuarial terms.

5. Impact assessment and the effects that the introduction of the Pensions TAS is likely to have on actuarial information:

You have not provided details of the parties consulted and questions asked so we cannot know the context leading to your conclusions. However, based on our knowledge of client requirements we feel that there are areas where users of actuarial information would assess the impact of the current wording of TAS Pensions as requiring a disproportionate amount of work, with associated cost, which is not in their interest.

Our comments are focussed on paragraph E.4.2 and the commentary under 3.48 to 3.52:

General comments regarding E.4.2 and 3.48 to 3.52

We believe that the key point is that the intended users of the Scheme Funding Report are the trustees and the report is not written for use by third parties e.g. employers who have different objectives. The trustees' main objective in funding the scheme is to arrange contributions which are adequate to ensure that the benefits promised to members are met when they fall due. The trustees' preferred outcome for this objective would be to set contributions based on Technical Provisions which are close to the estimate cost to buy-out the benefits promised to date. However, in practice most sponsors will only agree to a lower target for Technical Provisions and most trustee boards will agree to some reduction below the cost to insure the benefits. For example, where the sponsor covenant is adequate, trustees will usually agree to an employer request to invest in return seeking assets and to take advance credit for some of the anticipated higher returns from this strategy, leading to a lower estimate of Technical Provisions. In this circumstance, the trustees will assess the prudent levels of returns by reference to the ability of the sponsor covenant to withstand a future requirement for increased contributions if experience is worse than assumed.

For example, prudent returns may be by reference to a risk free measure or returns expected for investments similar to those which would be held by an insurer if the benefits were insured; and mortality assumptions may be by reference to an estimate of the assumptions that an insurer would use when reserving or pricing for annuities.

It is natural that prudence is relative to an estimate for the cost to insure the promised benefits. Prudence is not assessed relative to a 'neutral', 'unbiased' or 'best' estimates because this does not inform the trustees' decision about risk tolerance in achieving their objective.

Specific comments in reply to paragraphs 3.48 to 3.52

3.48 – We strongly object to the amended proposal for a neutral estimate. The amendment from ‘best’ to ‘neutral’ estimate does not address the fundamental issues. We believe that it is important to focus on the position for trustees to pension schemes because they are the intended users of the Scheme Funding Report. We believe that it will not assist the achievement of the Reliability Objective if the BAS judgement on this issue is clouded by the objectives of parties who are not the intended users of the Scheme Funding Report, such as scheme sponsors who for understandable reasons will often wish that prudence is communicated relative to a best/unbiased/neutral estimate. (Separately, we would be sympathetic for the BAS proposal in relation to advice given to employers for Scheme Funding, but that is not the subject here.)

You do not state in which capacity it is that those stakeholders and users whom you found supportive of the proposal were responding. In many cases, trustees may also hold position within sponsoring companies and might not respond as trustees – we believe that the BAS should be wary of responses from potentially conflicted trustees. We would also note that for some practitioners the introduction of additional mandatory work will serve commercial interests.

3.49 – We disagree that quantification of a neutral estimate or range of estimates will improve the intended users (trustees) understanding of the degree of prudence. We believe that a neutral estimate has no real meaning for trustees deciding on Scheme Funding. For example, presumably it is possible to argue that a ‘neutral range’ might be anywhere from the estimated cost to insure the benefits down to an amount lower than the prudent estimate (assessed relative to the estimated cost to insure the benefits). In most cases this range is likely to be so wide as to make its communication useless for the trustees’ decision making purposes in the context of the Scheme Funding exercise. Furthermore, any quantification of a neutral estimate (or even range of neutral estimates) would not help in communication of the degree of prudence – it would only obfuscate the communication because it is not relevant to the Scheme Funding exercise.

3.50 – We note that approximate estimates could be sufficient however this does not address the problem where the measure to be estimated is not understood. We believe that confusion over the meaning of a neutral estimate will be inevitable due to its lack of relevance in the context of the trustees’ objectives and risks for Scheme Funding. For example if trustees use a discount rate of 6% for equities as being prudent enough because the employer can cover the difference to buyout and a volatility reserve, what is a neutral estimate of equity returns? We believe that the answer to this question is not an actuarial matter.

3.51 – Your Reliability Objective is in relation to the intended users of actuarial information. For the Scheme Funding Report the intended users are the trustees of the pension scheme. Therefore, we believe that the purpose of TAS Pensions in relation to Scheme Funding Reports should be to assist trustees. We do not understand why BAS says “the purpose of our standards is not to assist any one party in a negotiation” when, for the Scheme Funding Report, the purpose is to assist only one party (the trustees).

3.52 – We agree that the communication of neutral estimates would not assist the communication of risk and uncertainty. We believe that it follows that it would not assist the communication of prudence either because prudence is relative to risk (that the sponsor covenant cannot withstand adverse experience).

Our proposal regarding E.4.2

In short, we propose that TAS Pensions should not introduce any new requirements for quantifying a ‘neutral’ estimate (or ‘best’ estimate or similar other description). We note the existing requirements of TAS Modelling and feel that to be sufficient and therefore feel that E.4.2 (and E.4.3) should be removed from TAS Pensions.

However, if BAS retains E.4.2 (and E.4.3) then we suggest that:

- BAS clarify what is their intention of the meaning of neutral. Currently, it appears that a very wide range of interpretations is possible.
- A mechanism is introduced whereby it is possible for trustees to waive the requirement for advice from their Scheme Actuary on neutral estimates. This could be analogous to the position described for scheme sponsors under 2.19 (although that precise method for permitting departure would not appear to apply for Reserved Work so something different would be required for trustee advice).

Additional comments on other impacts of proposed TAS Pensions

A specimen report could be very useful in reducing the transitional impact of TAS Pensions and we continue to encourage BAS to provide this.

We repeat our view that ongoing compliance with TAS Pensions will require a significant increase to costs for trustees and sponsors of small pension schemes (for reasons outlined in our reply here to 5. above and 6. below, and in our previous reply to prior consultation) and that those users of actuarial information are likely to see the costs as disproportionate.

6. The text of the exposure draft as a means of implementing the proposals presented in this report:

Our comments are:

- a) We are concerned that D.2.10 (requirement to explain any change in the rationale) and D.2.12a) (requirement to explain the derivation of discount rate) will in some circumstances be impossible for the actuary to implement in practice. For example, often trustees, after taking extensive advice, will provide instructions without providing an explanation of their underlying rationale or the derivation of assumptions instructed and, in these circumstances, it would appear that it is not possible for the actuary to comply. We would be grateful if the requirements are restricted to rationale/derivation for information provided by the actuary and any other relevant matters of which the actuary has been made aware.
- b) We are concerned that the ‘any’ in D3.6 (requirements around overriding legislation) requires the actuary to identify areas where there may be uncertainty between benefit definitions and overriding legislation. This would be straying from our area of expertise into that of the lawyer. We would ask that this be brought into line with D.3.5 to require the actuary only to include an explanation of any uncertainty in benefit definitions due to overriding legislation as identified and instructed by the client.
- c) D.5.3 (requirement to explain accuracy for accounting purposes) appears to require that the actuary anticipate any (which we interpret as ‘all’) circumstances where approximate calculations might give information “materially inaccurate for accounting purposes”. We agree that the actuary should clarify with the entity, so far as is practical, what its materiality requirements are and disclose his/her approach to meeting those requirements. However, we do not agree that the actuary is ever likely to be in a position to know what is material inaccuracy in all circumstances. Therefore, in practice the actuary will never be able to comply with D.5.3 as it stands. We would propose that the D.5.3 is clarified on this point.
- d) E.5.8 (the requirement to disclose cashflows) appears to require that different cashflows are illustrated separately for different categories of members. We suggest that BAS modify this to require that only information on the overall scheme cashflows must be provided, and that the level of detail within that is left as a matter for client instruction. In many cases, trustees to small schemes’ needs will be wholly met by simple and approximate information on overall cashflows.

- e) Under E.5.9 (content of report) we are unsure why it is a requirement for the Scheme Funding Report to included details of contribution agreements as that information is provided in other formal scheme documents certified by the actuary, held by the client and available to the members. We propose that this is removed as a requirement, knowing that in many cases it will be included as a matter of practice.

Yours faithfully

A handwritten signature in black ink, appearing to read 'T.P. McDougall'.

Tom McDougall
For Scottish Widows Pensions Actuaries