

Response to Exposure Draft: Pensions

Introduction

This response to the Board for Actuarial Standards February 2010 Exposure Draft: Pensions document has been produced by Xafinity Consulting's Actuarial Practice Committee, the members of which are Fellows of either the Institute of Actuaries or the Faculty of Actuaries.

Xafinity Consulting Limited employs in total 31 Actuaries – of whom 20 are Scheme Actuaries – out of a total of around 350 staff. It provides a range of employee benefits consulting, actuarial and administration services to pension scheme trustees and sponsoring employers.

Xafinity Consulting Limited is part of the Xafinity Group, which also includes Hazell Carr, Xafinity Paymaster and Xafinity Claybrook. The Group now employs over 1,400 people throughout its offices in the UK.

Comments

We have limited our response to the following:

- Neutral estimates
- The transition from existing Guidance Notes
- The impact assessment
- Mergers and acquisitions
- Scheme Funding Report
- Some observations on the proposed text

Neutral estimates

We acknowledge the change of terminology from “best estimate” to “neutral”, which in itself is helpful. Nevertheless we continue to have severe doubts about this requirement.

It is acknowledged in paragraph 3.53 of the Exposure Draft that “there is not necessarily only a single possible neutral estimate.” To put it another way, even a neutral estimate is unavoidably subjective. In our view there is nothing to be gained by requiring the actuary to provide two different subjective figures, ie both a “prudent estimate” and a “neutral estimate” – in fact it could be quite misleading to the user.

In paragraph 3.49 it is stated that the Board has given greater weight in this regard to the arguments coming from users, as opposed to practitioners. That is surely right, but we wonder whether the users really understood that the proposed “neutral estimate” would still be a subjective one. They may have been under the impression that what was proposed was a fixed yardstick similar in nature to the former Minimum Funding Requirement.

For scheme funding, a major factor in the degree of prudence in the assumptions chosen by the trustees will be the strength of the employer covenant. For the very strong employer with a well-funded scheme, it could be argued that using “neutral assumptions” is sufficiently prudent.

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The underlying issue is that “prudent” is not defined in the legislation, leaving users to wonder “How prudent is prudent?” This could perhaps be addressed by requiring the actuary to spell out in detail **why** he considers that his assumptions are prudent.

The transition from existing Guidance Notes

GN9 – We share the concerns that, until TAS P becomes live, scheme funding reports will need to comply with both GN9 and TAS R. This will involve significant extra work and, consequently, cost. It would be helpful if GN9 was revoked immediately TAS P has been finalised.

GN16 – We do not feel that the proposal to withdraw GN16 is satisfactory (even though its text will remain available unofficially). The legislation requires an actuarial certificate and the form of that certificate should therefore be fixed, either by legislation or by the regulators. While we can accept that the form of the certificate may not be for BAS to determine, we consider that BAS should not withdraw GN16 until such time as other parties have made satisfactory new arrangements.

GN28 – The aspects of GN28 which supplements the legislation do need to be addressed as soon as possible. There is a serious risk that if it is proposed that the legislation itself is amended to explicitly include such matters, this may not be in place by the time GN28 is due to be withdrawn.

The impact assessment

Section 6.4 of the Exposure Draft states that BAS expects the cost of transition to the new TASs régime to “not exceed, say, 5% – 10% of the annual cost to practitioners and firms of performing actuarial work for governing bodies and trustees for most schemes”. It is not clear how this estimate was arrived at, and we suspect that the true figure will be significantly higher – after all, the new régime involves, in effect, a wholesale re-engineering of a firm’s actuarial processes and documentation. In the interests of transparency it would be helpful if the BAS could disclose the assumptions underlying its cost estimate.

Moreover, from the closing sentence of 6.13 it seems that BAS expects actuarial firms to, in effect, meet the extra costs themselves; this will have a significant impact on the profitability of firms. Section 6.3 states that BAS considers this will not be significant or have a material effect on the costs to users. We do not agree. In many cases it will be frankly impossible for a firm to absorb additional costs of this magnitude, especially as those costs will be incurred over quite a short period, and we expect that the majority will have to be passed on to clients.

That would be unfortunate. Particularly at a time of scheme underfunding and strains on employers’ budgets following the deterioration of the economy as a whole, trustees and sponsoring employers are likely to resist such an increase in actuarial fees for what they are likely to perceive as little, if any, added value. The extra costs are also likely to be proportionately larger for the smaller schemes. The fact that the extra costs are likely to be a very small percentage of the value of the liabilities will be irrelevant to most trustees and employers.

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Mergers and acquisitions

Whilst we welcome the decision to exclude M&A work from the initial scope of TAS P, we note that this matter is to be reviewed at a later stage. We remain of the opinion that inclusion of this work is simply impractical in view of the timescales that apply; the likely result would be that pension benefits remain in the vendor's scheme since negotiating anything else becomes too cumbersome and impractical. Is that really in the public interest?

Scheme Funding Report

We are surprised at the extent of the requirements set out in section E5 of the exposure draft.

With the move from Guidance Notes to principles-based regulation (which we welcome) we anticipated that the report at the end of a valuation would become quite short. The focus is now, quite properly, on the advice leading up to users' decisions rather than on the document of record. While some clients will still expect to receive a document of record, many will not – and will find it very difficult to understand why they are required to pay for one.

We can understand that it might be considered necessary to require some kind of Scheme Funding Report (in place of the current GN9 report) to round off the actuarial valuation process. However we feel strongly that its contents should not be prescribed in any detail; a few obvious "chapter headings" would suffice.

Observations on the proposed text

We have the following comments:

- E.4.1 states that E.4.2 and E.4.3 apply to information provided under section 230(1)(c) and (d) of the Pensions Act 2004. Those sections relate solely to actuarial advice provided in connection with the trustees preparing or revising a recovery plan and the schedule of contributions. The information in E.4.2, however, is not relevant to these aspects! Presumably the intention is that the "neutral estimate" is to accompany advice on the "prudent estimate" of the technical provisions. So, this needs to be incorporated instead within section E.3.
- E.5.8 refers to providing projected cash flows. There needs to be an indication of the time period over which the projections are to be made. Perhaps this is meant to be the lifetime of the scheme, based on the existing membership; if so, this should be explicitly stated. Alternatively, if the time period is to be left to the actuary to decide then a statement to that effect would be helpful.
- In the definition of "solvency position" in section B.2.1, the reference to "section 7(6)" of the Occupational Pension Schemes (Scheme Funding) Regulations 2005 should in fact be to "regulation 7(6)".

May 2010