

Hymans Robertson's consultation response to the Board for Actuarial Standards' Exposure Draft of the Technical Actuarial Standard on Transformations

In June 2010 the Board for Actuarial Standards (BAS) published a consultation paper on its Exposure Draft of the specific Technical Actuarial Standard (TAS) relating to transformations ("TAS T"). This is Hymans Robertson LLP's response to that consultation. Please note that our comments are focused on the TAS as it relates to pension schemes.

General Comments

We reiterate the point made in our response to the BAS's initial consultation on TAS T, namely that while we are supportive of the aims of the standard, we still believe that there is a strong case for the principles ultimately to be incorporated within the pensions and insurance standards as appropriate. We welcome the removal of content which duplicated material covered by other TASs and the clarifications around terms such as "proper emphasis". We also welcome the removal of a requirement for actuaries to provide a view on "fairness".

We note that the purpose of the standard (A.1.2) makes specific reference to providing sufficient information on risk to assess the impact of transformations on **security** of benefits. Security is not mentioned explicitly in the purpose of either TAS R or the exposure draft of the Pensions TAS ("TAS P"). Given that the most significant risk relating to security in the context of the transfer of assets and liabilities is the change in the sponsor covenant, it would seem appropriate to also emphasise within the Transformations TAS the limitations of actuarial advice in this area, and hence the limitation of the TAS itself in achieving the "completeness" element of BAS's reliability objective. We are particularly concerned over the BAS's continuing view that actuaries have the experience and skills to form views on the strength of covenant of an employer, such as the requirement in D.4.15. In doing so the BAS is explicitly encouraging actuaries to go beyond their training and to act in breach of the Actuaries' Code. We urge the BAS to remove any references to actuaries forming a view on the strength of employer covenant to avoid the situation where actuaries need to choose between breaching either the Actuaries' Code or the Transformations TAS.

The structure of the TASs and behavioural aspects

The BAS has stated on several occasions that they do not wish actuaries to adopt a 'tick box' approach to the TASs. We ask the BAS to reflect on whether the approach they are adopting is likely to encourage or discourage a tick box approach. To date, across the three generic TASs and the two specific TASs (in the pensions area) we have well over 50 principles to adhere to, spread across many pages of text. In order for actuaries to ensure that they have addressed all of these principles appropriately, and are able to demonstrate that they have done so, there is little alternative other than using checklists. The BAS has said on several occasions that it is not mandating any particular approach in demonstrating compliance but has notably not suggested that any other approach exists. It is clear that the structure of the TASs is forcing actuaries to use checklists and develop a tick box approach; the very behaviour that the BAS is saying it wants to avoid.

Our suggestion is that the BAS changes the structure of the TASs. Firstly, as outlined above, we see that there is no need for separate TASs such as the Transformation TAS, not least of which is that large part of section D are restatements of aspects of the generic TASs. Secondly, as principles driven standards, the structure would better meet your own objectives if the principles are captured succinctly over no more than a page in each TAS. Where there is felt to be a need for explanation of a principle, then this should be in a separate section of the TAS. This way, it should then be straightforward for an actuary to be able to ensure that they have adhered to the TASs by

scanning a list of principles across four pages at most rather than having to pick through 50 pages or more as at present.

We ask the BAS to reflect on whether the approach taken to the TASs is encouraging the tick box approach you wish to see avoided.

Transfers from public sector schemes

In contrast to the proposals for the Pensions TAS, the unfunded public sector schemes are in scope for the purposes of TAS T, which we welcome. However, this is tempered somewhat by the exclusion of with consent transfers. The reality is that all transfers from a public sector scheme are done with the members' consent meaning that these transformations are outside the scope of TAS T. Of all the risks around transformations, one of the largest is those of members moving from a public sector scheme to one in the private sector. In its conceptual framework, the BAS states that the "TASs are intended for the benefit of the public". With the likely increase in transfers of members out of public sector schemes over the next few years, it is difficult to see how this standard meets this intention. We would expect that an independent body such as the BAS would seek to protect the rights of all members of pension schemes irrespective of their employer and if there are good reasons for their rights to go unprotected, then those reasons be published. As it stands, we feel that this standard, and its development, fails to meet the principles of the Better Regulation Executive, to which the FRC adheres, i.e.

- **Proportionate:** Regulators should only intervene when necessary. We feel that intervention in this area is necessary.
- **Accountable:** Regulators must be able to justify decisions and be subject to public scrutiny. On this issue, the BAS has not justified the exclusion on transfers from public sector schemes and hence have not subjected those reasons to public scrutiny.
- **Targeted:** Regulation should be focused on the problem. The reality is that in the next few years there will be more members transferred from public sector schemes than between private sector schemes. The TAS is not targeted towards the biggest risk.

Consultation accompanying the Exposure Draft

Our comments on specific paragraphs of the consultation are below.

- 2.10 We accept the similarity between pensions and insurance transformations of the emphasis on the impact on beneficiaries, but wonder if BAS is satisfied that the actuary's ability to assess the key risks is sufficiently similar in the two types of transformation, given the importance of sponsor covenant in determining the likelihood of pension benefits being paid.
- 2.15 We accept the need to assess the impact of transformations on beneficiaries, but suggest that this might be better achieved by adding the additional principles to the Pensions and Insurance TASs as appropriate - perhaps as a separate section in a similar manner to how Section E of TAS P focuses on Scheme Funding. The purpose of TAS T does appear to fit within that included in TAS P (as shown in A.1.2 of both documents).

- 2.27 We find the comment in the second sentence both puzzling and worrying. Users of the TASs need to be able to place strong reliance on the definitions given to terms in the TASs. Otherwise, it is difficult to know whether an actuary is complying with the TAS. If the BAS is saying that the definitions given are just one interpretation and others are valid, then this needs to be explicitly stated, though we think that this would be far from helpful.
- 2.29-30 The clarification here is helpful, but we note that consistency of wording, in particular the definition of “actuarial work”, with the corresponding sections of TAS P will be needed.
- 3.20 We note that the BAS is making the argument that users’ attention should be drawn to the broad impact of other parties if only to prepare them for proper debate. Whilst we do not have an issue with this as a general concept it does not seem to have a place in a technical standard and is not an argument the BAS has used elsewhere such as the Pensions TAS when negotiation over assumptions might be expected. Even so, this concept does not seem to be a reason for other parties interests to be taken into account when setting assumptions. We will come back to this later.

Responses to Questions in Part 7 of the Consultation

7.1.1 Proposed commencement date of TAS T.

We agree with the proposed date of 1 October 2011.

7.1.2 Impact assessment and effects of TAS T on actuarial information.

We are concerned that TAS T will have limited and isolated impact on the ability of Trustees of pension schemes to make informed decisions in relation to the transfers of assets and liabilities. The BAS acknowledges in paragraph 6.6 of the consultation accompanying the Exposure Draft of TAS T that additional analysis and reporting will add to cost, but suggests that the percentage increase in costs will be modest. This might be true for the exercise as a whole, including legal fees, but we are concerned that the cost of the actuarial information will increase significantly and disproportionately to the additional benefit that accrues to the user in terms of the reliability of decision making, if this is not in conjunction with expert professional advice on the sponsor covenant.

7.1.3 Text of exposure draft as a means of implementing the proposals presented.

In addition to the issues raised above, please see some more detailed points below.

Comments on the Exposure Draft

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| A.1 Purpose | See above comments on the limitations of actuarial advice in relation to security of benefits as a result of changes to sponsor covenant. In particular, the advice an actuary can give will not extend to helping users assess the security of benefits; such advice will need to be sought from specialists in this area. This needs to be acknowledged by the BAS or it will be setting unrealistic expectations of users. |
| B.1 Interpretation | We suggest that the any guidance included in TAS P regarding what constitutes “actuarial work” should be repeated here. |
| B.2 Definitions | The definition of governing body should presumably be amended for consistency with that ultimately used in TAS P. |

Within the definition of **implementation** (presumably only included as it occurs in the definition of **model**), the term **specification** is used but not defined elsewhere in TAS T (we recognise that readers familiar with the TASs will know to refer to TAS M!).

Scope

C.1.4 For clarity, we suggest that "below" is replaced by "in the remainder of this Part".

Principles

Assumptions
D.2.1 In the pensions context, a transformation will usually involve conflicting interests between parties. For instance, trustees will want to ensure that members are protected which could push the choice of assumptions in a certain direction. Employers, on the other hand, may want to minimise the costs in a transformation which can be achieved by the use of different assumptions. This principle seems to force actuaries to not focus solely on member protection but to take account of the employer's interest. Forcing actuaries to compromise their advice in this way will be to the detriment of members. It is unclear why the BAS has this in mind.

Assumptions
D.2.4 In the final bullet, reference is made to "guarantees which reduce or eliminate the risk". Perhaps BAS could include material in the significant considerations to clarify what sort of guarantees this means (e.g. the existence of the PPF is something which reduces, but does not eliminate risk for many beneficiaries).

Data
D.3.1 to D.3.4 Restatements of TAS D and TAS M requirements seem unnecessary and should be removed. The wording in D.3.2 and D.3.4 seems unnecessary as these would be issues considered in order to comply with TAS D and TAS M.

Reporting
D.4.1 to 4.2 For actuaries to indicate any material change to the likelihood of the payment being made as expected, they would have to have formed a robust and defensible view as to the relevant sponsor covenants before and after the transformation, or may be perceived to have done so by users. This is potentially at odds with section 2.2a) of the Actuaries' Code (*Members will not act unless they have an appropriate level of skill or knowledge*). We suggest that the final bullet in D.4.2 is removed from TAS T, or it should be clarified to restrict the changes to those within the expertise of the actuary.

Reporting
D.4.3 to 4.5 Ditto with respect to the first bullet of D.4.5, and the requirement to indicate how the material risks are affected by the transformation. Note that whilst it is entirely reasonable to state the nature of the risk, i.e. a reduction in the strength of the sponsor covenant, as required in D.4.3, Trustees are normally expected to seek professional advice elsewhere (or form their own view) as to whether it has taken place and, if so, to what extent.

D.4.3 and D.4.4 require that comments and advice are given in relation to material risks. D.4.5 then refers to 'changes' to material risks. It is not clear, therefore, what the requirements of D.4.3 to D.4.5 are.

Further, to manage the expectations of users, the BAS should acknowledge that actuaries will not necessarily know all the risks, and may be that actuaries should be required to state this and suggest supplementary advice is sought as well by users.

Range of assumptions D.4.9 to 4.11	Whilst recognising the instruction 'might need to include' in D.4.11, D.4.9 requires the actuary to define a range of plausible assumptions (<i>plausible</i> defined in the 2003 Compact Oxford English Dictionary as <i>seeming reasonable or probable</i> . We fear that the debate on what assumptions are plausible will follow a similar (or perhaps more divergent) course than the one on neutral assumptions. There might be some consensus that one end of the plausible range is the set of strong assumptions of a buy-out / gilts / self-sufficiency measure. It is not clear, though, how far beyond "best estimate" might be considered plausible. On a not entirely flippant note, we also draw BAS's attention to the second definition of "plausible" in the OED – <i>skilled at producing persuasive or deceptive arguments</i>).
Range of assumptions D.4.12 to 4.13	Notwithstanding the override in B.1.2, we suggest that it would be helpful to insert the word "material" before "change" in D.4.12. Also, is the use of the phrase "value of interests" intended to convey actuarial value? If so, is this test to be performed on the full range of plausible assumptions? This is potentially onerous as it stands, and would leave actuaries with a challenge to navigate the thin channel between the clashing rocks of this instruction and the requirement of TAS R not to obscure material information.
Range of assumptions D.4.15	We can only repeat the comments we made above under 'General Comments' and in relation to D.4.1 and D.4.2. Actuaries, certainly in the pensions context, cannot give a commentary on the security of benefits without, in most cases, breaching the requirements of the Actuaries' Code.

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For and on behalf of Hymans Robertson LLP

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