

26 August 2010

The Director
Board for Actuarial Standards
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Dear Louise

Exposure Draft: Transformations

Thank you for the opportunity to comment on this consultation paper. This response has been prepared on behalf of the retirement benefits practice area of Towers Watson, a global firm with a substantial presence in the actuarial consultancy market. The firm provides advice to around one-half of the top 100 pension funds in the UK and overall employs over 300 actuaries in the UK.

Is a separate TAS needed?

We note from the analysis of responses to the earlier consultation paper that the Board is currently still minded to proceed with a separate Transformations TAS despite the almost universal opposition to this idea expressed by those who responded – even the single respondent in favour of a separate TAS on this subject appeared to reject the idea that it was appropriate to have a single TAS covering both pensions and insurance ‘transformations’ and instead favoured a separate TAS in each specialist area. Nevertheless, we understand that the BAS is still open to arguments that this is not the best way forward and we will therefore advance some arguments again in this response.

While it is true that the general Pensions TAS principles might be applied differently in ‘transformations’ situations, a similar comment could also be made about many other specific situations including transfers/member options and accounting for pensions (in both of which, as with ‘transformations’, the considerations can be fundamentally different from, say, with funding). In a pensions context, we do not agree with the BAS’ emphasis in 2.13 of the response analysis to the effect that actuarial work in connection with bulk transfers and scheme modifications is unusual in that it is helping trustees make decisions “which might affect the benefits received by... beneficiaries” rather than supporting “the making of management decisions”; in the context in which pension scheme trustees operate, most of their actuarially-based decisions have a potential impact on their beneficiaries’ benefits and these ‘transformations’ can be seen just as much as ‘management activities’ as are decisions on funding and on actuarial factors. In particular, decisions on actuarial factors most definitely “... affect the benefits received by... beneficiaries” and are far more commonplace than transformations (a key difference being that factors typically involve member options rather than compulsion).

Advice relating to a transformation will often cover issues regarding funding levels and contribution requirements, as well as the impact on beneficiaries. It is not clear to us that such funding advice involves any principles not already covered in the draft Pensions TAS.

To what extent are specific (additional or expanded) principles needed for transformations (or indeed for other activities such as accounting or setting individual factors)? Largely, this appears to come down to whether the BAS’ approach is truly principles-based or, in practice, significantly rules-based. It seems to

us that the vast majority of the additional principles proposed for the Transformations TAS can be regarded as re-statements of principles that already exist in the generic TASs or proposed Pensions TAS, but with a particular focus for the 'transformations' context – i.e. they are in essence giving further direction as to how an underlying principle should be applied in that context. (The exception to this would seem to be what is proposed at D.4.12 to D.4.17 in the draft, covering the 'fairness' concepts which we continue to believe to be inappropriate for the legislation-driven pension transformations within scope of the TAS.) We would hope that a good actuary would be able to apply the underlying principle from the generic or Pensions TAS and (where material and proportionate) end up in a sufficiently similar place to the BAS, without the BAS needing to have given its specific direction. Indeed, we think there are some dangers in the selective spoon-feeding of additional directions on particular principles in that (unless the context of the additional directions specifically acknowledges the amplification of the underlying principle, as in D.3 of the draft) the underlying principle might be undermined by the amplification sowing doubt in the actuary's mind as to the appropriate application of the original principle.

To the extent that the BAS concludes that it is appropriate to expand on underlying principles for the 'pension transformations' context, we consider that the best way to do this would be by including additional specific material in the Pensions TAS, in a similar manner to what we understand is proposed for individual calculations, accounting and scheme funding. For one thing, this should make it easier to be clear to what extent and in what way the additional material is amplifying underlying principles or is introducing something new (thereby avoiding the potential problem identified above). And, for another thing, it would make it easier for actuaries to ensure compliance with the TASs. As the BAS rightly says (2.18 of the analysis) the TASs are not intended for the convenience of actuaries, but the BAS would ignore at its peril the fact that the greater the number of 'principles' to be complied with and the more they are spread around, the greater the cost (ultimately borne by the client) of compliance checking, regardless of whether or not this results in anything different actually being included in what is delivered to the client. Accordingly, if the BAS believes that the additional material needed to cover pensions transformations is too great to be included in the Pensions TAS, we consider that the Transformations TAS should be designed to replace the Pensions TAS for this category of work, rather than to supplement it.

Purpose of the TAS

The other 'general' issue we still have about the TAS as proposed is connected with the stated 'purpose' and with the part of the analysis document discussing this (2.24 to 2.27). As described in 2.24, the original consultation paper had two arms to the 'purpose' of the TAS; however, the exposure draft includes only the first of these and the second (which related to "cases where the actuarial information is a determination made by an actuary", which in a pensions context we interpret as being the provision of the statutory certificates) has been dropped, without any accompanying comment by the BAS. In some ways we welcome this 'dropping', having pointed out in our response that this purpose wasn't well-supported by a TAS structure in which any requirements that do not feed into user decisions can seemingly be considered to be inapplicable under the definition of 'material'. But we also infer from the comment in 2.27 that the BAS does not support the view on this that we (and, apparently, some other respondents) expressed – which all leaves us very unclear as to precisely what the BAS does think (and indeed intend) as regards the difficult issue of the applicability of this and other TASs to statutory certificates which are not necessarily considered, in themselves, to lead to user decisions.

For pensions transformation work, the key point is that only the certificates themselves are 'Reserved Work' (and covered by C.1.2 of the draft). We agree that trustees should be encouraged, when proposing bulk transfers or scheme modifications, to seek the wider advice covered by C.1.5 and C.1.6, but they are under no regulatory obligation to do so and, even if they do, they are able if they wish (under the BAS' Scope & Authority) to instruct the actuary not to comply with the TAS. This then raises the question of whether or not the TAS still expects the actuary, even where the client has declined (deliberately or otherwise) not to commission such work, to provide all the information indicated by the TAS before he delivers the 'Reserved Work' (i.e. the block transfer certificate or actuarial equivalence statement). We believe that the answer is 'no', on the ground that by declining to commission the work the client has indicated that it does not want the information for its decision-making and merely wants the certificate that the legislation requires it to obtain, but it remains very unclear whether this is what the BAS thinks and/or intends.

There can be good reasons why the trustees decide to commission little or no advice from the actuary (other than the statutory certificate). A transformation will often be initiated by the scheme sponsor who will generally have taken actuarial advice, which may have been shared with the trustees who might then conclude there is no need to duplicate this advice. Likewise, trustees will invariably commission legal advice on various aspects of the transformation, and this might reduce the need for advice from the actuary.

Questions specifically posed

Our responses to the three questions specifically posed in section 7 of the document are set out in the annex to this letter.

If you would like to discuss any of the contents of this response, please get in touch.

Yours Sincerely

Graham Everness and Simon Fox

Exposure Draft: Transformations – response to specific questions*1 Commencement date*

We do not have any issues with the proposed commencement date of 1 October 2011.

2. Impact assessment

The impact assessment given in the consultation document is very high-level and subjective. The anticipated additional costs are merely described as “modest”, which we assume is meant to indicate that they can be considered small and justified by the anticipated benefits (stated in very general and unquantified terms in 6.3). We accept that this very imprecise analysis is a consequence of the fact that the costs and benefits are very difficult to estimate in advance and we do not claim that we could do it better. However, what we would say (but the assessment in the paper does not) is that the underlying conclusion that the benefits will justify the costs is subject to a high degree of uncertainty and there is a significant risk that it will turn out to be incorrect.

Our particular concern in relation to BAS standards generally is that there is a non-negligible cost in going through the process of ensuring compliance even where (as, for example, 6.5 of this document acknowledges is often the case) there is no material difference to the end product. There is scope for this problem to be especially bad if the BAS proceeds with a Transformations TAS on top of a Pensions TAS and the generic TASs; the BAS should not underestimate the overall effect that can result from having so many separate ‘principles’ (spread across a variety of documents) applying to a single piece of work, with each of these ‘principles’ carrying its own (albeit individually small) contribution to a compliance overhead.

3 Text of the draft

- C.1.2 See comments in the main text of the letter – the applicability of many of the principles to Reserved Work is quite limited.
- C.1.4 Perhaps there should be a clear statement that for non-Reserved Work the standard applies only to those areas where the user has commissioned actuarial advice, as a reader of the TAS might otherwise assume all the key principles are directions that must be complied with, regardless of whether or not any advice has been requested.
- C.1.5 – C.1.7 It would be helpful if some comment could be included in Section B setting out criteria for judging whether or not work is “actuarial work” (as we understand is being considered for the Pensions TAS).
- C.1.6 There should be a clear statement that modifications affecting only future service benefits are not in scope. (Such modifications do not seem to be ‘transformations’ within the spirit of the TAS.)
- Further, modifications to past service benefits in excess of early leaver benefits (e.g. replacing final salary linking by early leaver revaluation) are generally held not to affect subsisting rights and so not require Section 67 certification. There is an opportunity to clarify whether such modifications fall under C.1.6.
- D.1.2 We note that Regulation 12 of SI 1991/167 and GN16 have specific references to discretionary benefits, which has sometimes been a difficult area in practice. The draft Transformations TAS contains no reference at all to such benefits although the draft Pensions TAS does have a reference in D.2.20. This is another area where there are clear benefits in keeping all guiding principles for an exercise as far as

possible 'in one place' rather than scattered over multiple TASs.

D.2.1 – D.2.4

These general comments on assumptions do not add much to the 'fit for purpose' requirements of D.2 of the draft Pensions TAS but may sow seeds of doubt in the actuary's mind and lead to over-engineered advice.

For example, if commenting on the funding implications of a pension transformation, it would be unusual to depart from the existing funding (and if appropriate solvency) assumptions.

Also, the Modification Regulations (SI 2006/759) essentially specify that cash equivalent assumptions are used for an actuarial equivalence statement so D.2 should perhaps explicitly acknowledge the possible existence of underlying statutory requirements.

D.3.1 – D.3.4:

Again, these paragraphs do not add greatly to the principles already included in TAS D and the draft Pensions TAS.

Pension scheme trustees may be concerned that D.3.2 potentially questions their integrity or that of the scheme sponsor or administrators. Arguably for a funding valuation, the party providing the data might have an interest in 'influencing' the result so we fail to see why transformation work should be singled out for this special caution.

D.4.2

The third bullet point could be clearer – e.g. is this primarily concerned with benefit security (which would more naturally fall within D.4.3)?

D.4.3 – D.4.4

While we can see that *changes* to the material risks are important to identify, as provided by D.4.4, we do not see why it is necessary to state all risks that exist before and after the transformation, and therefore believe that these two paragraphs should be combined to focus on any changes consequent upon the transformation.

D.4.7

The first bullet point is rather cryptic and would benefit from clarification.

D.4.9 – D.4.11

We believe it should be for the actuary to decide what, if any, sensitivity analysis is appropriate to a specific exercise without the over-bearing direction of D.4.10.

Regarding D.4.11, there *may* be circumstances where it would be helpful for trustees to understand that a certificate could not be given if some assumptions were pitched beyond a certain range but such information is not commonly provided in pension transformations (many of which are not in fact very sensitive to assumptions) and we would have thought a reasonable actuary would identify this where relevant.

D.4.12 – D.4.17:

It appears to us that these paragraphs should have their own heading (rather than being included in the 'range of assumptions' section).

These paragraphs are to our mind over-prescriptive for most pension transformations. For example (D.4.14), the fact that another party (the one proposing the transformation) may stand to gain from the exercise is not in itself ordinarily a relevant factor for the trustees – what is relevant to them is the impact on beneficiaries (and whether they are disadvantaged), regardless of whether or not the

sponsor (or someone else) is gaining an advantage.

D.4.16

This only applies where an opinion on fairness is required, or for some other reason is given. In general, reports on pension transformations do not include such an opinion. To avoid possible misunderstanding by readers, it would be better if this point were more obvious.

General - DC
issues

Regardless of whether there is a separate Transformations TAS, or an additional section within the Pensions TAS, there may be merit in setting down a specific marker in relation to DC Benefits (and if appropriate DB/DC comparisons) as in our experience these sometimes involve difficult judgements.