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6 July 2007

Director, Actuarial Standards
Financial Reporting Council
5th Floor
Aldwych House
71 - 91 Aldwych
LONDON
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Dear Sirs

We are pleased to be given the opportunity to comment on the paper issued by BAS in April 2007 regarding steps towards a conceptual framework. Our comments are set out below.

Introductory Comments

We support the BAS aim of establishing and improving actuarial standards, ensuring that they are consistent and comprehensive, and thereby promoting high quality actuarial practice.

We also support the development of an appropriate conceptual framework, if this will help generate consistency between actuarial standards.

However, we do not believe that it is appropriate for BAS to abandon work on the establishment and improvement of actuarial standards whilst it works towards a conceptual framework. Although we are not asking for additional guidance, there are many areas in the existing pensions guidance that have been causing practical difficulties for many months and are in urgent need of attention. We will write separately about this.

Work to improve the current guidance should not be seen as getting in the way of developing a conceptual framework, or as dangerous before the completion of the conceptual framework. Accounting Standard setters (including the ASB) have all developed conceptual frameworks alongside a programme of updating accounting standards. This parallel development has proved valuable, with emerging work on the framework informing amendments to standards, and the effect on the standards helping to illustrate the meaning and interpretation of the draft conceptual framework. This helps both by building confidence in the framework and by identifying where the concepts need further work to make them workable.

We are also concerned that BAS may be trying to be too ambitious in the degree of consistency that is achievable across the different strands of actuarial advice. The accounting standards all have the focus of being motivated by a single target - providing a true and fair view for the company accounts (with an equivalent perspective for IAS). It is therefore possible to apply a single set of measurement principles to all the accounting standards. The problem with actuarial work is that it is constrained by different requirements in different areas:

- True and fair view - insurance and pensions accounting;
- Prudent compared to fair value - reserving for insurers;
- Prudent compared to expected investment returns (with the prudence required by legislation to be included in the value placed on the liabilities, not as an asset reserve) – pension funding; and
- Best estimate compared to expected investment returns – cash equivalent transfer values.

Because the legislative (etc) criteria are different (and inconsistent with each other) it is not possible to apply a single measurement framework to all these areas (although greater consistency in terminology and disclosure would be helpful). It would be helpful for “fair value” measures to be clearly distinguished from measures that are not based on “fair value”, but the terminology chosen to distinguish fair value amounts should recognise that this is just a subset of actuarial work, not the whole of it. We would suggest describing such measures as “fair value” rather than as complying with “Standard Actuarial” principles etc – which implies that other normal actuarial work does not. Accountants do not smear historical accounting as not being standard accounting practice - it is just not fair value accounting.

We are concerned that BAS has insufficient input from pensions actuaries with recent practical experience. This is demonstrated both by suggestions in the preliminary consultation paper that clearly do not reflect legislative requirements imposed on pensions actuaries, and in the lack of maintenance of pensions guidance in the last year. We would be happy to work with to try to help fill this gap.

Finally, we believe that the paper is difficult to read and grasp, containing many abstract concepts with a lack of concrete examples. We wonder what your stakeholders will make of it, particularly the trustees of pension schemes which are helping to finance BAS.

Response to Specific Consultation Questions

- We believe that the distinction between actuarial information and actuarial advice as presented is largely a semantic distinction and has little practical application.
- Actuarial standards should be driven by the needs of those for whom the advice is prepared. In some cases, e.g. company financial reporting this will be shareholders, but in most cases it will be the client. In the pensions area, this means it should be driven by the needs of the plan trustees, not members. This is an important distinction between accounting standards (which relate to the production of reporting for stakeholders other than the client) and much actuarial advice, which BAS seems to have missed.

- Actuarial standards need to be tailored to legislative requirements and the purpose of the work. The treatment of risk, risk premia, prudence, etc will reflect these circumstances.
- Accounting standards are all focused on a common objective of providing a "true and fair view". Actuarial information must meet a variety of inconsistent criteria in different areas. It is unlikely that a single set of measurement principles can be found to cover all these areas. Inconsistent objectives are bound to lead to inconsistent approaches. This should not be regarded as a criticism. In particular, "fair value" would not be an appropriate measure in many areas. For example, the government proposes that cash equivalents should be based on discounting at a best estimate of expected investment returns, and has explicitly ruled out use of fair value. Whether or not you agree with the government as to whether this is how cash equivalents should be calculated, this is the framework within which actuaries will have to calculate cash equivalents. We do not believe that it will either help users or enhance the standing of the actuarial profession if large areas of actuarial practice are being labelled as not following Standard Actuarial Principles and Techniques, simply by complying with, for example, legislative requirements.
- If BAS can develop a generic communication standard that works across all actuarial areas, this would be helpful. BAS will need to consider the likelihood of success before investing significant resource in this project. With many of the standards for which BAS is responsible in need of updating, we question whether this is currently the best use of BAS resources.

Detailed Comments on Content of Consultation Paper.

1.4.15 of paper says that in SAPT the value placed on liabilities should not incorporate prudence. This is not consistent with legislation on scheme specific funding which requires that the value placed on the plan liabilities should incorporate prudence (relative to best estimate investment returns).

1.5.5 et foll require neutrality of measurement – i.e. the value placed on liabilities should not reflect investment policy etc. This is appropriate for actuarial measures that are intended to be fair value, but are not consistent with legislation on scheme specific funding which requires that the value placed on the plan liabilities should incorporate prudence (relative to best estimate investment returns). Similarly, the intention is that legislation will require cash equivalent transfer values to reflect expected investment returns on the pension scheme's actual investments.

1.7.6 says that actuarial reports shouldn't contain the information that the actuary's client (i.e. the trustees in most situations) want or need, but instead information that third parties would find useful. This does not reflect the fact that company accounts are prepared and audited for the benefit of shareholders, not the company, because legislation requires this (not because accounting standards say so). Many actuarial reports are (in accordance with legislation) prepared for the benefit of decision making by the client, not for members (or policyholders etc), so treating members as the primary audience would be inappropriate. Extrapolating from one particular

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accounting requirement (relating to company annual accounts) to all areas of actuarial work is unhelpful. Many accounting reports similarly are prepared for the use of the client only and are not expected to cater for the needs of third parties. It is just that they are not the accounting reports that are covered by Financial Reporting Standards.

1.7.17 Again, the definition of reliable is inconsistent with legislative requirements for pension scheme funding valuations and calculation of cash equivalent transfer values.

2.3.3 If the objective is cash flow budgeting (funding valuations), the fair value of the liabilities is an inappropriate measure. The paper has ignored the range of objectives of actuarial advice (including where this is imposed by legislation).

Appendix 5 shows the lack of input from pensions actuaries. Advice to pension plan trustees about how cash equivalent transfer values should be calculated is prepared for the trustees, and is not even available to members. It is certainly not meant for decision making by members.

Yours faithfully

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