

ACTUARIAL STANDARDS: TOWARDS A CONCEPTUAL FRAMEWORK

July 2007

On 27 April 2007 the Board for Actuarial Standards (BAS) published a preliminary consultation paper 'Towards a Conceptual Framework', setting out its proposals for a '*conceptual framework of the concepts and principles underlying the work of actuaries*'. This is Hymans Robertson LLP's response to the preliminary consultation.

BACKGROUND

Following the Morris Review of the actuarial profession, which concluded in March 2005, the Financial Reporting Council (FRC) took on the role of independent overseer of the actuarial profession. In April 2006, the FRC established the BAS, which is charged with responsibility for the profession's technical standards. The BAS has now published its initial proposals for the future structure of such standards.

The proposals are based on a concept, 'Standard Actuarial Principles and Techniques' (SAPT), which the BAS describes as being parallel to the 'Generally Accepted Accounting Principles' (GAAP) in the accounting world. One of the main proposals is to require the presentation of actuarial information to meet certain principles, taking account of the needs of those who receive and rely on such information. The BAS's initial proposals are to be followed by a detailed consultation in the autumn.

HYMANS ROBERTSON'S VIEWS

The Morris Review has done much to open up debate within the actuarial profession about how best to improve the way in which actuaries deliver advice. A key recommendation was that the body responsible for actuarial standards (i.e. the BAS) should develop a generic standard covering the content and use of actuarial communications, and we

are supportive of measures designed to improve the clarity of delivery of actuarial information and advice.

We are, therefore, in favour of the proposal from the BAS that it will develop a generic communications standard. In our view, the main priority of the BAS should be to develop this generic standard in a principles-based manner covering the following key points:

- Scope, background and objectives
- Data, methodology and assumptions
- Ranges of options, risks and sensitivities
- Recommendations and next steps
- Reliances, limitations, caveats, etc.

We note that the BAS is proposing that this generic standard be reflected in all future professional standards. Again, we are supportive of this approach though would urge the BAS to apply the principles through one generic standard rather than have them incorporated directly into each standard.

We have a number of comments on the BAS's proposals, as outlined below.

FLEXIBILITY IN COMMUNICATION METHODS

Actuaries communicate different types of actuarial advice and information in different ways, to suit the needs and wants of different clients. There seems to be an implication in the consultation paper that there

may be some restriction in this flexibility. We can understand the desire for there to be a levelling up in standards. However, we would not want the introduction of new actuarial standards to restrict that flexibility: not all clients want to receive a lengthy and detailed report in relation to each piece of actuarial information they receive.

We are concerned that requiring a 'levelling up' in the information requirements may lead to a perception that the additional work, and associated fees, signifies little more than the actuarial profession generating income for itself.

FLEXIBILITY IN MEASUREMENT OF VALUE/RISK

The consultation discusses measurement of value and risk. It is not clear if it is the intention, but we are concerned that the BAS may be seeking to constrain the ways in which actuaries measure value and risk. We are of the opinion that there is no single correct measurement method and different actuaries use different approaches depending on a number of factors and circumstances. Fundamental to our delivery of advice within Hymans Robertson is the belief that flexibility of approach is required in order to give our clients best advice. As noted above, it is not clear what is being proposed and we would welcome further information on this aspect.

SEPARATION OF MEASUREMENT AND DECISION MAKING

The consultation discusses at length the concept of separation of measurement and decision making. Whilst we agree in principle that information should not include implicit assumptions, in practice we think that this may be difficult to avoid. For example, in choosing assumptions for an actuarial valuation of an occupational pension scheme, trustees can, in theory, select from a large range of assumptions: the purpose of actuarial advice is to help the trustees understand and narrow down their choices.

It is not practicable to cover every conceivable value for each assumption when giving 'actuarial information'. In practice, actuaries typically use their judgement to recommend a small number of possible bases (i.e. sets of assumptions) which trustees then question, amend or adopt as required. Provided that the actuarial advice makes clear that the recommendations are not the only possible options, and explains the relevant risks and sensitivities, we see this as a pragmatic approach to find the right compromise between providing trustees with sufficient information to make informed decisions and not overwhelming them with superfluous detail.

SPECIFIC QUESTIONS

Our answers to the specific questions asked in the consultation are below.

1. SHOULD THE PRIORITY OF THE BAS BE TO FOCUS ON STANDARDS THAT RELATE TO ACTUARIAL INFORMATION?

We do not think that we can answer this question at this stage, as a fuller debate about the concepts of 'actuarial information' and 'actuarial advice' is needed. We see merit in making a distinction between 'information' and 'advice', but there are several areas that we think may need to be addressed before we can proceed with the proposed approach, including the following:

- Currently, 'actuarial advice' in relation to occupational pensions is defined in GN29 as being advice as defined in regulation 2(b) of the Administration Regulations¹ – i.e. actuarial advice is, "*the provision of advice on financial questions relating to the funding of, and assets of, the scheme and on questions in respect of probabilities relating to mortality and other contingencies, and any other matter relating to the actuarial affairs of the scheme.*" It could be argued that this definition includes what the BAS is

¹ The Occupational Pension Schemes (Scheme Administration) Regulations 1996

attempting to define as ‘actuarial information’. To define information as something separate to advice within the BAS’s framework when pensions legislation does not attempt to differentiate between the two is therefore likely to lead to confusion and ambiguity. It would be useful to know BAS’s thoughts on this in its later consultation.

- Notwithstanding the above comment, the definitions of ‘advice’ and ‘information’ may benefit from further clarification. For example, ‘information’ based on actuarial methods and assumptions proposed by the actuary may in fact be ‘advice’ because of the judgement exercised in the choice of assumptions.
- Another grey area which again would benefit from further clarification is the point at which non-actuarial advice or information becomes actuarial in nature. For example, advice or information on possible benefit designs may not be viewed as actuarial. But if indicative costs are attached to such advice, has it become actuarial?

2. SHOULD THE NEEDS OF THOSE WHO RELY ON ACTUARIAL INFORMATION BE THE PRIMARY FOUNDATION ON WHICH ACTUARIAL STANDARDS ARE DEVELOPED?

Yes.

We think, though, that this is a diverse group including pension scheme trustees, company directors (both of insurance companies and more generally) and actuaries themselves. Their needs are, therefore, diverse and this will need to be reflected in the standards.

3. SHOULD PRUDENCE BE REGARDED AS DECISION-MAKERS’ ATTITUDE TO RISK (EVIDENCED BY THE RISKS THEY ACCEPT OR AVOID) AND NOT AN ELEMENT OF MEASUREMENT?

We would welcome clarification of what is meant by this question and to the reference in the consultation document to ‘*standards for the measurement and communication of different levels of prudence.*’ An example of a standard for the measurement of prudence would be helpful.

We agree that it is up to decision-makers to decide whether (and if so, to what extent) they wish to seek or avoid risk and that ‘*the acceptance or avoidance of risk should be a positive decision.*’ However, whilst it is not generally up to actuaries to decide what level of risk is appropriate for their clients, it is important to note that many clients rely on their actuary to provide advice, guidance and recommendations in relation to risk and prudence, not just ‘actuarial information’ on which to make their decisions.

Indeed, some pension schemes’ rules require the scheme’s actuary to determine the contribution rate and therefore to form his or her own opinion on the level of prudence to be adopted.

As a final point, we raise the question as to whether it is always possible to have neutrality of measurement. This would seem to imply that a ‘nil arbitrage’ approach is possible.

4. WILL THE CONCEPT OF SAPT PROVIDE A USEFUL MEANS OF DISTINGUISHING HIGH QUALITY ACTUARIAL INFORMATION?

We are not able to answer this question fully at this time. To do so we think it would be useful for BAS to provide an example of how they envisage a SAPT to be drafted in their later consultation. As it stands we are unsure whether or not the concept of a SAPT refers to a ‘kitemark’ or a standard in a similar

manner to the current guidance notes adopted by the BAS.

We understand that the principle being explored is that actuarial standards will apply to entities rather than to individual actuaries. We would be broadly supportive of such a move but note that this would require substantive changes in the regulatory framework currently in place. It would be useful if the BAS outlined how it aims to implement such changes.

5. SHOULD THE BAS DEVELOP A GENERIC COMMUNICATION STANDARD AS WELL AS DETAILING SPECIFIC COMMUNICATION REQUIREMENTS AND STANDARD REPORTS IN EACH SAPT STANDARD?

The consultation refers to a '*selected standard report*'. It is difficult to envisage such reports in the context of occupational pensions and an example would be helpful. Our feeling is that the reports will only cover a small number of areas (with many non-standard reports still being commissioned), or there will be a great number of standard reports, or the standards will be very broad with significant scope for 'tailoring'.

Again, we believe that a principles-based approach would be preferable to prescription. We do not think it is appropriate for the actuarial standards to constrain what actuaries *do*, but should instead concentrate on improving the communication of what they do.

We would prefer a generic communication standard rather than a suite of standard reports, and would therefore respond affirmatively to this question if the words '*as well as*' were replaced with '*instead of*'.

OTHER COMMENTS

1. We hope that the development of the framework for actuarial standards will not impede the maintenance of existing guidance or delay making changes as required to that guidance.
2. We find it difficult to envisage how one framework will apply to all areas of actuarial work (which presumably would need to cover not only insurance and pensions work but also actuaries working in wider fields), unless it is very generic, which may then limit its usefulness.
3. We would also like to express our disappointment that the BAS did not hold any consultation meetings on its proposals. There is much in the document that is unclear, and understanding the thoughts of the BAS would have aided the process of drafting this response considerably. We would urge the BAS to hold meetings in the future.

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