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Dear Sir

### **Preliminary consultation paper: Towards a conceptual framework**

Thank you for the opportunity to respond to this consultation paper.

Our detailed comments – framed around the five specific points on which views were requested – are attached. However, we thought it would be helpful to summarise a few of our key comments upfront.

- The preliminary paper did not give enough detail for us to be able to discern what sort of guidance would result in practice and how clear and helpful we would consider it to be. We (and others) may therefore develop stronger views on the proposals as further detail emerges.
- Consequently, we recommend strongly that at or before the next stage of consultation you produce some specimen draft guidance so that readers can see how the principles are likely to be applied. We would suggest scheme funding and individual transfer values as potentially suitable areas for this in the pensions field.
- The desire should be to produce simple guidance of an appropriate nature. To achieve this, the right process for the production of guidance is as important as the principles. We would therefore like the BAS to set out proposals for the drafting process and the intended mechanism for capturing the views of users (including the actuarial profession) as soon as possible.
- We are concerned that the establishment of a ‘principles framework’ is going to be a long and detailed process which will mean that insufficient attention is given to the maintenance and updating of current standards.
- Whilst some lessons can indeed be learned from the standard-setting for accountants already undertaken by the FRC, it is important to appreciate that the objective in producing guidance for actuarial work – often highly technical and client-specific – should be fundamentally different from the desire to achieve consistency and standardisation for the readers of company accounts.

- We are very supportive of the concept that the needs of the decision-maker are paramount. As different decision-makers (in the pension field) have very different needs, this requires the introduction of flexible standards that allow for the suitable tailoring of advice to those individual needs, rather than a heavily prescribed approach.

We would be very happy to meet with you to discuss any of the points raised in this response. If you want to take up this offer, please get in touch.

Yours faithfully

C G Singer

Senior Consultant

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## **Preliminary consultation paper: Towards a conceptual framework**

This response is submitted by the Benefits Practice of Watson Wyatt. Watson Wyatt is a global consulting firm with particular strength in the area of UK pensions. We advise over half of the 100 largest corporate pension schemes, and the firm as a whole employs over 300 qualified actuaries in the UK.

As requested, we have tried to structure our response by reference to the five questions set out on page 21, although several of our comments range somewhat wider than those specific questions might have envisaged. Unfortunately, some of our comments are not as fully developed as we would have liked, because – presumably in consequence of the ‘preliminary’ status of the document – there is insufficient detail for us to be able to work out what the proposals would mean in practice and also because ‘alternative proposals’ are not generally offered.

We can see the benefits of setting out a framework in which actuarial standards would be produced, but are not convinced that its value is such that it justifies such an extensive up-front process as the BAS appears to envisage. We would urge that in parallel with the development of the framework the BAS starts to draft some new or revised standards, not least because actual draft standards would help to road-test the emerging framework and would enable users to understand the concepts better.

There is evidence (eg paragraph 1.2.4) that the thinking of the BAS is significantly influenced by the standards produced by the Accounting Standards Board. In this regard it is worth stressing that the only work done by accountants that is subject to these standards is in relation to financial reporting mandated by law. By contrast, a much wider range of actuarial work has been (and presumably in future will be) subject to standards produced by the BAS. The analogy of auditing standards may therefore prove unhelpful in deciding how best to set actuarial standards, unless the BAS does intend to restrict significantly the scope of its actuarial standards (if so, it would be helpful if this were to be confirmed).

### **Focus on standards that relate to actuarial information**

- 1** We think that a distinction between ‘actuarial information’ and ‘actuarial advice’ will not be easy to draw in practice. A lot of our work involves a combination of the two. Sometimes the ‘advice’ will be given at a separate stage from the ‘information’; for example, when setting the assumptions for an actuarial valuation or a transfer value basis, the trustees will first need to take actuarial advice, before (on the basis of that advice) they can obtain the actuarial information. On other occasions, ‘advice’ is implicit in the ‘information’ that is provided; for example, if an analysis of the impact of risks is being produced, the actuary will need to judge which particular risks are material to the exercise.

In particular, in drawing the distinction between information and advice, into which category does the BAS envisage that various statutory certificates (e.g.

those relating to the ‘reference scheme’ or to a ‘schedule of contributions’) would fall?

We agree that standard-setting in relation to actuarial advice is inextricably linked with the setting of ethical standards. Urgent dialogue with the actuarial profession is therefore necessary to ensure that standard-setting by the profession and by the BAS move forward in a consistent and coherent manner.

Whilst we appreciate that the BAS cannot tackle everything at once, we do have concerns if a specific focus on one area means that little or no attention is given to some of the Guidance Notes passed over from the actuarial profession which are in urgent need of review. For example, the current versions of GN9 and GN49 were, of necessity, produced ahead of implementation of the new scheme funding provisions under the Pensions Act 2004 and it was, we understand, the profession’s intention that they be revisited in early course to take account of practical experience. A particular concern of ours with GN9 is that, with recent changes in the buyout market, the ‘gilts minus at least 0.5%’ basis (set out in paragraph 3.5.10) is no longer appropriate.

### **Primary consideration is needs of the decision-makers**

- 2** We are generally supportive of this principle. However, the needs of different decision-makers can vary significantly and any ‘standard’ needs to acknowledge this.

Many of our clients are trustee bodies for the largest pension schemes. Whilst these clients do have many ‘core’ needs in common, their detailed needs can be very different and they want (and expect) tailored information and advice. The individuals concerned – ‘laymen’ in a pensions and frequently also in a more general financial context – have limited time to devote to their trustee duties and so rely on us to provide proportionate, pragmatic and practical advice, consistent with their particular needs. Although the trustees are (usually) the ultimate decision-makers, they look to us to use our judgement to decide how best we can help them in their decision-making role. It will not add value – and, worse, may be positively detrimental – if we are obliged to provide them with overengineered output solely to comply with a standard.

In paragraph 1.7.19, the paper states that “it is for decision-makers to determine the degree to which they take account of actuarial information”. We would like to point out that in cases where the actuary has a statutory role, the actuary himself needs to make decisions, taking account of the ‘actuarial information’. (This ties in with comments we made in 1. above regarding to the relationship between advice and information.)

### **Prudence not an element of measurement**

- 3** On a purely theoretical level, we accept the point that you are making, i.e. that measurement should seek to be neutral so that the decision-maker can make his

own unbiased choices on prudence and risk management. However, this is not always achievable in practice. Although nowadays in the world of discount rates there are in general reasonably widely accepted ('neutral') measures for so-called 'economic values', the same cannot be said for 'best estimate' yields where these are required (for example, currently, for individual transfer values). Moreover, where the measurement depends on future mortality rates, any calculation basis is inevitably subjective and involves some element of prudence (or otherwise).

We infer from paragraph 2.1 that the views of the BAS on determination of 'value' are still in development (along with the other concepts discussed in section 2). The last sentence of 2.3.3 suggests a very strong commitment to 'market consistent' measures; but the last sentence of 2.3.2, which we agree with, points out that "a single philosophy may not adequately cover the range of actuarial information". When the BAS makes more specific proposals in this area, it would be helpful if it could make clear how it would see the proposals being applied to scheme-specific funding. Here the legislation provides for two distinct measures. A 'solvency' estimate related to market prices for buying out the liabilities (albeit that these market prices often have to be 'assumed', because of the absence of a comprehensive market) is required for disclosure purposes, but the legislation is centred on 'technical provisions' which are not marked to market.

We were also interested in the concept of 'forecasting', as distinct from 'valuation', introduced in section 2.6. We wonder if you envisage that a pension scheme triennial valuation (as required under Part 3 of the Pensions Act 2004 and based on technical provisions) is really a 'forecast' rather than a 'valuation' – this would be a point worth a specific comment when you consult further in this area. We have some reservations about the actual word 'forecast' (the idea that actuaries can tell you exactly when they expect you to die!), and suggest that words like budgeting, planning or projection may be preferable.

### **Concept of SAPT**

- 4 To enable us to comment to the extent we would have wished on the concept and its likely suitability for distinguishing high quality actuarial information, the consultation paper would need to have included a lot more detail as to how it might operate in practice, with one or more worked examples in relation to existing Guidance Notes. We would urge the BAS to include some detailed worked examples of this sort in the follow-up consultation paper – these would give readers a much better understanding of the impact of the proposals. When more detail is given at a later stage, we should be able to make more substantive comments on the proposals, which may include some stronger objections.

In paragraph 1.7.2, the need for the information to be "complete and reliable" is recognised. We would suggest that another important word to add is "suitable".

The press release that accompanied the issue of the consultation paper mentions four SAPT principles. These do not appear to be explicitly set out in the

consultation paper itself, although section 1.7 does contain some material that we assume is relevant to them. Our comments relating to the four principles are:

- On ‘Objectivity’, please see our comments (under 3. above) on the limitations of market-based methodologies and also the observations on ‘standardised measurement’ below.
- We strongly endorse the ‘Materiality’ principle, and would stress again that what is ‘material’ will vary from client to client and the actuary (or other provider of the information/advice) will need to make judgements here. We are minded to suggest a further core principle of ‘Simplicity’ (i.e. that the information provided should not be more extensive than is necessary for the particular purpose), unless this idea is already sufficiently incorporated within the ‘Materiality’ principle. We can see potential conflict between the objectives indicated in the second sentence of paragraph 1.7.18 (if the principle of ‘materiality’ is intended to encompass ‘simplicity’) and the third bullet of paragraph 1.7.17.
- We are concerned at the possible implications of the aspiration set out in paragraph 1.7.20. By and large, we do not consider ‘Consistency and comparability’ to be a pertinent principle to trustees of pension schemes. Trustees are usually trustees to a single scheme and consistency of approach and presentation has no value to them, but merely limits innovation and the tailoring of advice. And as well as there being a range of different users (trustees) the pension schemes themselves also differ significantly, with a variety of different designs and important differences in circumstances (including differing impacts from employer covenant).

Paragraph 1.7.10 mentions consideration of “whether measurement should be standardised” (and there are other references along these lines in the document, including in paragraph 1.7.2). It is not clear whether such standardisation would be restricted to stipulating the form of measurement in different scenarios (a distinction between ‘single best estimate’ and ‘potential range’ is mentioned) or whether the ‘standardisation’ would spread also to the stipulation of methods and/or assumptions. We are strongly opposed to new standards that would impose a ‘one size fits all’ approach on pension schemes – such an approach was widely criticised under the Minimum Funding Requirement, and it would be a contravention of the intention of the ‘scheme-specific’ legislation that replaced it if prescription were to be re-introduced through actuarial standards. Another significant problem with prescribed actuarial bases is that it is very difficult to keep them up-to-date with changes in financial conditions and other developments.

Paragraph 1.7.6 appears to favour a general prescription of the content of actuarial information over a contractual agreement, on the ground that third parties would prefer this. But why should the needs of third parties take precedence over those

of the actual client, and should third parties be relying on information that has been prepared for someone else?

### **Generic communication standard**

- 5** We agree that it is not easy to develop a generic communication standard across all actuarial information and advice. Such a standard could be unsuited (in places) to one or more areas of practice. However, if it is confined to high-level principles it could still be a useful document (although it may prove better to have two versions of the standard – one for insurance and one for pensions).

A generic communication standard would not work if the BAS wants to set out in detail what it believes should be communicated and how. However, we are concerned if it is the intention of the BAS to lay down detailed requirements on communication (as opposed to principles). Although all the many disclosure requirements of the current GN9 (on presentation of scheme funding advice) may be reasonable in themselves, the overall effect is to generate actuarial reports that are driven by the need to comply rather than focussed on the needs of the client. As the consultation paper elsewhere acknowledges, the needs of the decision-maker are paramount and these will not normally be best satisfied by the provider of the information being required to produce it in a rigidly predetermined form.

The six items listed are all, in our view, potentially applicable to any piece of actuarial information but a key word is ‘relevant’ – i.e. there will be particular circumstances in which one or more items would not be applicable. An interesting example to consider is money purchase illustrations. When it introduced the statutory illustrations that are covered by the guidance in TM1, the Government decided that for the purpose and ‘audience’ in question it wanted very much to concentrate on a single projected figure and did not want attention distracted from this by comment on the assumptions and on variability. This contrasts with the actuarial profession’s guidance in GN34 (which of course pre-dated TM1), which stresses clearly the need for discussion of the implications of the assumptions not being borne out.

A general point related to this question is that we would urge the BAS to recognise the very different needs of the recipients of advice in the pension scheme field and the insurance company field. As pensions advisers, we would not welcome actuarial standards which reflected too much of an ‘insurance company’ situation; and we would expect insurance actuaries to make the ‘reverse’ comment. On the subject of this insurance/pensions dichotomy, we note that, in this preliminary consultation paper, section 2.5 and Appendix 6 seem to relate to an ‘insurance’ issue and it is unclear to us to what extent, if any, they are supposed to be applied in a pension context.

## **Scope**

Appendix 5 consists of a table setting out categories of actuarial information. We are unclear as to what extent the BAS thinks that this is a definitive list, or to what extent it is a skeleton to be worked on. One particular item of work which didn't seem to be covered was Asset/Liability Modelling. Would such work fall outside these standards?