The Actuarial Profession
making financial sense of the future

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Dear Paul

The Actuarial Profession welcomes the opportunity to comment on the proposals made by the Board for Actuarial Standards (BAS) in its consultation paper *Towards a Conceptual Framework.* We are pleased with the development of thinking since the initial consultation paper in April 2007. We are keen that there should be swift progress from the adoption of a framework to the introduction of new technical standards produced by BAS to replace those it adopted from the Profession. Obviously until that happens it is also essential that BAS keeps those adopted standards up to date. We look forward to seeing how the framework will contribute to the relevance, transparency of assumptions, completeness and comprehensibility of actuarial information and advice.

As you are well aware BAS standards are enforced not by statute but by the Actuarial Profession requiring that its members follow BAS technical standards (either written by BAS or adopted from the Profession). In addition the Profession requires its members to follow its own ethical and conduct standards. The two sets of standards need to be complementary and work in conjunction with regulation. However they should not 'gold-plate' regulatory requirements.

We think the Financial Reporting Council, and those bodies which pay for the actuarial regime should, in the public interest, press for Government and Regulators also to require entities to follow relevant BAS standards. If this does not happen there is a danger that, unless the work is reserved in law or regulation to an actuary, then it could be undertaken in a way which does not meet applicable standards. By actuary we actually mean a member of the Faculty or Institute of Actuaries. A person who is a member of another European actuarial association, free under European legislation to work in the UK, is not bound by the requirements of the UK Profession to follow BAS standards. We note for example that a major European regulatory development such as Solvency II is unlikely to involve a reserved role for an actuary.

We think that BAS should prioritise the production of technical actuarial standards, having regards to the public interest, and should explain its thinking in that respect. We recognise that

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BAS may find, on analysis, that what commentators appear to be clamouring for (for example standardisation of mortality assumptions) are not easy things to deliver in any sensible way.

We were broadly in agreement with BAS's approach summarised on pages 3 and 4 of the document. However we had most concern with the section on *application of standards* - allowing this to depend on the circumstances in which work was commissioned seems to introduce potential inconsistency. We also think that a *"reasonability override"* will need careful definition.

We support the division of actuarial standards into generic and topic-specific categories. We are supportive of a principle-based regime but we all have to realise that technical actuarial standards by their very nature will incorporate rule-like dimensions. BAS will also have to deal with the public expectation (sometimes referred to as "the Tiner principle") that standards will lead to an outcome where two actuaries in the same circumstances produce very similar results.

We consider that the BAS suggested categorisation of work could be ambiguous in some situations of practical application. We think it would help understanding if BAS gave examples.

We are also concerned that BAS places undue emphasis in its categorisation on whether the work is a regulatory requirement or a contractual requirement to a beneficiary, as opposed to the significance of the matter to the commissioning entity itself.

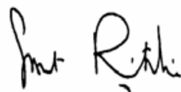
We think it is an omission in the consultation paper not to explain how BAS standards and UK accounting standards (produced by another FRC operating body) will be developed in concert. FRS17 has, for example, had a great impact on the work of pension actuaries and on public perceptions of related issues.

We give as an attachment responses to the specific questions in the consultation document from the perspective of different branches of actuarial practice.

We think that BAS should develop a conceptual framework which is living and flexible. Once BAS starts to produce standards under the framework we will all understand it much better. It would be remarkable if that did not lead to changes. We would hope that would not distract BAS from focussing on the real need: the production of technical actuarial standards.

We intend to continue to work closely with BAS to make the regime for all standards which affect actuaries to be as effective as possible. We are very happy to meet to discuss any aspect of our response.

Yours sincerely



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Question 1: Categories within the scope of the framework

Following the terminology of Section 3, the BAS has determined that Category A should fall within the scope of BAS standards and that Category E should fall outside. In that context: a) Do respondents consider the five categories drawn up by the BAS (defined in paragraph 3.9) provide a meaningful way to determine which areas of work should be within scope and which should not?

BAS needs to define its scope because it has neither statutory backing nor a statutory definition to work to, operating instead on a voluntary basis. The Actuarial Profession agreed to require its members to follow technical standards produced by BAS but no other entity has done so. Unless the Financial Services Authority and the Pensions Regulator (or Government) require regulated entities to follow a specified BAS standard for specified pieces of work then there is a risk that a non-actuary might undertake the activity and the standard would not be followed.

The category basis does not actually define "actuarial work" so we are left with the rather circular definition of "work done by an actuary".

Broadly speaking the Profession believes BAS's aim in categorising different types of actuarial work in order to determine which area of work to be within scope of BAS standards is commendable. However, we think that some of the definitions look a bit tortured, probably because the standards can only be made to apply to actuaries. It would make a more robust regime if the standard was followed by anyone undertaking the work because it applied to regulated entities.

Category A includes work relating to 'Reserved Roles'. If only an actuary can do it then it must be because there are specific actuarial requirements and hence there should be standards that back this up. We do wonder if BAS will be able to identify all the types of work that an actuary does by "virtue of a legal obligation to a beneficiary" and produce standards accordingly. It might be better leave it as the more traditional definition of just "reserved advice".

It is pertinent to note that currently the only General Insurance actuarial role required in UK regulation is that in relation to Statements of Actuarial Opinion for Lloyd's syndicates. There is also one special situation mentioned in legislation, namely the Lloyd's Actuary role, and we expect that the current holder of that post (Henry Johnson) will respond separately.

Category B would be better phrased along the lines of "Work than an entity is required… to commission, from an actuary or another individual with similar competence." We believe this is BAS's intention but it would reduce fears of the possibility of accidentally encompassing some non-core-actuarial situation where entities are required to commission work of a separate nature, for example legal work.

Trying to establish whether a particular type of non-compulsory work fits into category C or category D could be a rather convoluted process as it involves considering whether the entity concerned is subject to any obligatory requirements relating to beneficiaries.

We were not sure where non-mainstream actuarial work, such as acting as an expert witness, would fit into the categories.

The situation of non-executive directors who are actuaries also need to be considered, if only to dismiss it. Could it be said that some of their work falls within category B (as many matters under FSA rules, including deciding the basis for the annual valuation, are the responsibility of the board)? It can probably be argued that this work is not 'commissioned' of NEDs. However, the case of an actuary appointed to be the person providing independent input to the exercise of discretion under with-profits policies (COBS 20.3.2 (3) (b) or (c)), who may be a NED in the case of (c), it is may be less clear that this work is not commissioned. There is a similar concern with regard to trustees of pension schemes who are actuaries but who are acting as trustees, as the responsibility for deciding on funding assumptions now rests with trustee boards.

We feel that BAS should not try to pigeon-hole everything into these categories, but use them loosely and develop flexibly with experience.

b) Which, if any, of Categories B, C and D do respondents consider should be within the scope of the framework?

We agree that work covered by category A should be covered by BAS standards.

As an entire Category, B should be within the framework only on the basis outlined: that it is not compulsory but any actuary doing the work would '*Comply or explain'.*

We can envisage some specific circumstances within Category C that might give rise to the need for BAS standards.

The Profession thinks that Category D seems simply too diverse to contemplate ever including any BAS standards. However any such work undertaken by an actuary would be covered by the Actuarial Profession's ethical standards.

We agree that peer reviews and the work of the Reviewing Actuary should not be subject to technical specific standards, but reviews should nevertheless be carried out against the background of relevant technical standards. The profession may wish to set ethical standards relevant to reviewing actuaries or other peer review activities, as indeed it already has in GN48.

c) The BAS would also welcome feedback, and real examples, indicating whether the non-regulatory element of Category B exists in practice or illustrating any concerns that the definitions are wrongly capturing or omitting areas of work.

The change in the definition of category B suggested above to "…commission, from an actuary or another individual with similar competence" might help to capture better the right type of work.

In the context of life insurance, we consider that the proposed categorisation might work something like:

Category A
Investigations/calculations under IPRU (INS) 9.4 and INSPRU 1.3 and the preceding recommendation of a basis (Actuarial Function Holder (AFH)).
Reports under SUP 4.3.16AR (3) & (4) on compliance with PPFM and general with-profits TCF (With-profits Actuary)

Review of policy charges where the policy specifies this as the duty of the actuary.

Category B
Independent Expert report on Part VII transfer.
Individual Capital Assessment
Actuarial elements of annual accounts under IFRS
Financial Condition Reports (at least to the extent required by GENPRU 1.2.73)
Review of policy charges where the policy does not specify that this will be done by the actuary.

Category C
Premium rate setting and calculation (note that the formal responsibility on the AFH to monitor the adequacy of premium rates is essentially a solvency preservation check rather that a stand-alone premium adequacy check, as it only requires that the premiums together with the existing surplus assets do not result in insolvency)
Surrender value basis setting and calculation
Bonus recommendations (note that this is not a required function of the with-profits actuary, who is only required to comment on the fairness of the board's intended declaration)
Policyholder benefit illustrations
Embedded value calculations (if not a required part of the accounts)
Appraisal values
Asset/liability management.

Category D
Work in 'non-actuarial' activities such as sales, marketing, underwriting, administration and IT.

We note the Individual Capital Assessments (ICAs) are not required to be commissioned from an actuary and so this work should fall in Category B rather than A as 3.15 would appear to suggest. There is, however, a requirement on the Actuarial Function Holder to provide advice to the board on capital adequacy:

> *"SUP 4.3.13R An actuary appointed to perform the actuarial function must, in respect of those classes of the firm's long-term insurance business which are covered by his appointment :*
>
> *(1) advise the firm's management, at the level of seniority that is reasonably appropriate, on the risks the firm runs in so far as they may have a material impact on the firm's ability to meet liabilities to policyholders in respect of long-term insurance contracts as they fall due and on the capital needed to support the business, including regulatory capital requirements;……."*

Guidance will be needed from BAS as to which requirement takes precedence. If BAS considers that SUP4.3.13R does not refer to the ICA at all but to some other actions required of the Actuarial Function Holder, the ICA will be Category B.

The definition "work an entity is required to commission by regulation" might bring more items within the scope of category B rather than C than might at first be envisaged. For example, all with-profits companies are required to prepare and publish Principles and Practices of Financial Management (PPFM). Doing so may require a multi-disciplinary project, but with significant actuarial involvement in many cases. Does BAS intend, for example, this to be considered a Category B activity?

Similarly, in the pensions area, one of many examples is that scheme trustees are required to commission an annual report to members, and sometimes will commission their actuary to do this. No-one would regard this as 'actuarial work' as it could be done equally well by any other pensions-literate person. We presume that BAS has no intention to produce a standard for this type of work.

Perhaps more significantly, the scope of the Financial Services Authority "Treating Customers Fairly" (TCF) regime extends what could be interpreted as regulatory requirements to *any* area of work leading to the exercise of discretion by the firm. For example, activities tentatively listed under Category C above, such as assessing that premium rates are fair or regularly reviewing surrender values or bonus rates could, for with-profits policies, be said to be a requirement of the TCF regime and so automatically categorised under B for with-profits policies rather than C (and so automatically subject to generic standards rather than at BAS discretion).

Although less significant, assistance may also need to be given with the definition "relating to the assets and liabilities". By example or otherwise, it should be made clear by BAS that, where the "liability" is an insurance policy, then any sales or administration-type activity relating to policies do not fall within category C even though, in one sense, they relate to the liabilities.

On the asset side, it is unclear where BAS intend the work of actuaries to fall. For example:

- who is the 'beneficiary' of the work of an actuary in investment management?
- who is the real beneficiary of the work of an actuary in defined benefit pension scheme investment advice, where members depend on the rules of the scheme for their benefits, not investment performance?

It would appear that it is not intended that managing the assets of a life office falls into Category B by virtue of being required under the contract between the office, as direct beneficiary, and the fund management company. Presumably it would it be category C by virtue of being 'related to classes of assets and liabilities falling within Category A or B'. Could this therefore mean different standards applying to actuaries employed by fund management or advisory firms depending on whether they were advising on insurance and pension funds or advising on other investors' assets?

We would also like to address the question posed by BAS in 3.25. As we set out in our attempted categorisation above, although some non-profit life policies do require charges or surrender values to be reviewed periodically by an actuary, other non-profit policy types only say that they will be reviewed by the company. Usually an actuary will also do the review in the latter case.

More generally, we think that the BAS scope rationale pays insufficient attention to the primary user of actuarial information and advice, such as the management and board of the life insurer or the trustees or sponsor of a pension scheme, relative to the secondary users such as the FSA or Pensions Regulator. We feel that such primary users are entitled to expect minimum technical standards in all actuarial advice, whether there is a regulatory requirement for that advice or not.

FSA rules now unambiguously put the ultimate responsibility for all matters, actuarial or otherwise, on to the management and boards of life insurance companies. We now also have an almost similar position for pension schemes, with the responsibilities of boards of trustees

for funding assumptions, and boards of directors of sponsoring employers for accounting assumptions. It is therefore perceptually important that all aspects of actuarial advice they may seek, whether directly or indirectly required by regulation, should be subject to the same standards, where they exist. For example, we consider that a firm has the right to expect equal professional competence in setting mortality rates for premium rating or the appraisal of a possible acquisition as for reserving. If it chooses to have a non-actuary set its rates or advise it on price, then it should knowingly accept the risk that different, possibly lower and less informed, standards apply.

Moreover, many larger life insurance organisations in the UK operate on a group structure where the holding entity is not a regulated company. There is often a group actuarial department headed by a group actuary, who may well be the most influential actuary in the group, possibly being the only actuary (at least in an executive capacity) on the main group board. It seems inappropriate that such an influential individual should be providing actuarial information and advice only at category C (at least if category C activities like these are not to be subject to generic standards, nor to specific standards where BAS so determines). Where this advice involves the assimilation of information about UK and overseas operations, the board cannot even rely on the involvement of more junior actuaries subject to category A or B standards. Similar considerations apply to consulting actuaries providing advice to groups (perhaps on multi-billion pound M&A transactions.)

We do not consider that life actuaries would be commercially disadvantaged by the obligation to adhere to well-considered and generally accepted standards. Indeed, we consider that the presence of such standards would be likely to enhance the standing of actuaries in the eyes of employers relative to alternatives. We also think that this is what the public would expect – just as people would expect a doctor to be just as professional in treating a serious illness ('required') as in giving, for example, health advice to holidaymakers ('not required'). However, it is critical that the standards imposed are appropriate and not over-prescriptive, especially in relation to the format of reporting, for example.

Whilst not disagreeing with the generality of the statement in 3.6, we would point out that a With-profits Actuary has an obligation to provide a report direct to with-profits policyholders as well as an obligation to report to the life company's board.

Question 2: Proposals regarding the objectives and characteristics of standards in Section 4

The BAS has set out proposals regarding the objectives and characteristics of standards in Section 4. Do respondents agree with them, specifically the proposals:

a) to introduce some generic standards, to provide coherence and consistency across areas of work, in addition to topic-specific standards as is the case now;

A hierarchy of standards is a definite advantage. Those areas that are common to all areas of actuarial work can be addressed once in generic standard and for the bedrock of actuarial thinking. This will enable the topic-specific standards to be uncluttered and able to focus on specific material.

However, it is unclear quite how generic and topic-specific standards will work. We are clear that a generic standard might be on the contents of actuarial reports in general and a topic-specific standard might be on the assumptions and methodology for, say, a life company 'peak 1' valuation. We are not sure, however, if BAS envisages setting, say, a 'cross-disciplinary' generic standard on longevity improvement assumptions, which would apply to all activities in Categories A and B (and C, if specified) or, rather, to incorporate the results of its research into this subject into each of its topic-specific standards in some way.

If generic standards of this second type are envisaged, their interaction with the proposed categorisation needs to be considered before the framework is finalised, as for example they would automatically apply to Category A activities such as all reviews of policy charges required to be done by the actuary. This would not necessarily be inappropriate but should be achieved deliberately and after due debate rather than as an almost accidental by-product.

We would be supportive of generic standards on matters such as longevity improvement and asset valuation. This would address directly one of the major concerns of the Morris review, the different approaches taken by life and pensions actuaries where unconstrained by regulation. Other areas where generic standards may be appropriate include the calibration of stochastic models, appropriate assumptions for management and policyholder actions in stress scenarios, appropriate assumptions for estimates of solvency of pension schemes, or other areas where statute or the FSA rules are themselves more principle-like.

b) that standards be principle-based, rather than rule-based; respondents are asked to identify any advantages or disadvantages that they consider may flow from this approach; and

In principle we support a principles-based approach to standards. The world is moving to principles-based regulation and the BAS is right to follow suit. The main advantages of principles-based regulations are that they:

- capture the spirit and thus can be enduring
- are likely to be comprehensible by non-technicians
- reduce the likelihood of loop-holes that can be exploited and any subsequently required revisions to close them.

The main disadvantages are that they

- are potentially subjective
- are more difficult to enforce as a result of this subjectivity

- can leave scope for widely varying outcomes
- do not necessarily give actuaries the level of guidance they might be seeking.

In practice, the distinction between principles-based and rules-based approaches is not clear-cut, as principles can be set at different levels and the lower the level, the more like rules they become. For example, a standard in respect of the content of a report on a particular issue could consist of a single principle - that the report must cover all matters needed to enable the user of the report to take informed decisions on the issue in question – or it could comprise a list of matters that might be covered with a principle for each, explaining the factors to take account in deciding whether this item should be covered, and if so how. The first approach is likely to require the actuary to think more carefully about the needs of the user, but the second may give rise to greater uniformity. We do think that in some standards BAS will have to have rule-like requirements.

Many of the technical guidance notes BAS adopted from the Profession relate to the implementation by actuaries of specific regulatory requirements, which are mostly rules-based. It may be difficult to produce satisfactory principles-based standards in this context, particularly if one of the aims of those standards is to reduce subjectivity. The Consultation Paper acknowledges that standards which are limited to a specific context are more likely to resort to rules; it even envisages in 4.11 that standards relating to the selection of an individual assumption might be expressed in terms of a numerical range. This seems to be going further in the direction of rules than any existing guidance on assumption setting.

When developing standards, BAS will need to consider carefully how (in most cases) three elements fit together: the regulatory position, the technical standard, and any ethical or conduct standard from the Profession. Close co-operation between BAS and the Profession will be needed as BAS decides what is not in its scope in order that there are complementary ethical and conduct standards (or information and assistance material) developed by the Profession. This will be particularly important in relation to the standards which relate to role-holders (Paragraph 4.16). The new regime should not seek to 'gold-plate' existing regulation.

A principle-based approach seems particularly appropriate for generic standards such as one on the content and style of actuarial reports, where it may be difficult to make specific rules of sufficiently generic application.

For topic-specific standards, we consider that there is likely to be a need for principles in some situations and for more detailed rules (or specification of valid ranges for particular assumptions) in others. For example, there is already guidance for life actuaries relating to the need to make an appropriate and prudent allowance for the continuation of or variability in trends in longevity improvement (e.g. GN46 10.2.3). This could be considered to be a principle rather than a rule. Yet this remains one of the areas where BAS is being requested to set more specific standards with some urgency.

c) that standards address outputs and responsibilities, as now, with output-based standards focusing on the users of actuarial services and their needs as decision makers?

We agree with this approach, although in many circumstances the actuarial content will merely be part of a wider decision-making process. It is important that this concept does not lead to users unrealistically to expect standards to be framed on the basis that actuaries will be capable of meeting non-actuarial needs.

Not all risks can be controlled by output-based standards; some risks can only be controlled by controlling processes. Many of the existing Pension GNs adopted by BAS are of this nature, requiring actuaries to follow certain processes and make certain disclosures in addition to regulatory requirements.

We disagree with the comments on page 17 under the heading “responsibilities” where it is stated that it is unusual for an insurance policy contract to create an ongoing responsibility to be discharged by an actuary. As mentioned above, it was, and may still be, common for policies to require the actuary (or the ‘appointed actuary’) to keep charges under review, to determine surrender values, to determine rates of bonus, to determine the pricing basis of units, etc.

Actuaries also continue to be cited in legal documents such as schemes of transfer under Part VII of FSMA2000, where it is common for the With-profits Actuary to be given a gatekeeper role over the exercise of discretion in certain matters.

We agree that the standards should generally be phrased in terms of the outputs to be delivered rather than the responsibilities for providing the output. We would go further, and question whether any technical standards needed to be phrased in terms of responsibilities. If required, any prescription of responsibilities not in regulation or contract may better be covered by ethical standards under the responsibility of the profession.

Question 3: Practical issues or problems in relation to the enforceability of standards

Do respondents foresee any practical issues or problems that they consider should be addressed in relation to the enforceability of standards, as set out in Section 5, in order to ensure the efficient functioning of the enforceability proposals?

We agree that all standards should have the same status with regard to the disciplinary process for non-compliance without proper reason. However, we do not feel that the distinction between 'comply or explain' and 'reasonability override' has been particularly convincingly made. For example, in paragraph 5.12(b) 'explain' (as in 'comply or explain') is defined as having to contain justified reasons. 5.13 further says the reason must be 'proper'. 5.15, in reference to the reasonability override, then uses identical terms ("failure to have proper reasons for the departure") in relation to the supposedly different concept.

There may be circumstances in which it is appropriate to allow departure from the standard only on the explicit instruction of the commissioning entity or based on the specific circumstances of that entity. There may be relevant parallels in accounting standards.

Enforceability requires a number of things to work in concert. The standards must be specific enough to make transgression provable. The actuary in question must be capable of determining that he or she is subject to that standard. The transgression needs to be identified by someone. The relevant Disciplinary regime must be able to interpret the standard appropriately.

We think a case can be made for retaining the possibility of issuing comply or explain standards for work in category A. When new or emerging techniques are involved, an initial comply or explain standard can be a good way of moving to a mandatory standard in the longer term.

In the life insurance field, as in other fields, work can be divided into two areas. That where the entity commissioning the advice simply asks for an answer (or a distribution of possible answers) to a specific question, and that where the entity either has a specific responsibility to make certain decisions itself and to instruct the actuary in certain aspects of the work or where it decides of its own accord to so instruct the actuary.

The prime example of the latter is the investigation under IPRU(INS)9.4, where the firm is specifically required to seek the advice of the actuarial function holder (AFH) on the basis to be adopted (advice which may incorporate a range of discretion), to make its decision on whether to accept the recommendation or whether to change it and to commission the AFH to carry out the investigation on the basis specified by the board.

A pensions example would be advice and calculation of transfer values. Most trustees are required by their trust deeds to seek actuarial advice on the basis and assumptions to be used. However under new regulations to come into force later this year, the responsibility for the assumptions chosen will lie with the trustees, and so calculations of individual transfer values will then be a mechanical exercise by actuaries, applying the trustees' chosen basis (whether or not that is in line with the actuarial advice which was given, and whether or not the same actuary as gave the advice is requested to calculate the values).

In the first of these two examples, it would be reasonable for technical standards to apply to, say, the AFH's recommendations on longevity improvement. However, it would be

inappropriate for them to apply to the longevity improvements used in the investigation if they were specified by the firm outside the reasonable range recommended by the AFH. In the pensions example, it would be reasonable for standards to apply to the giving of advice on assumptions, but not the carrying out of calculations on an already specified basis.

Another situation might be where the management of a group requires a particular approach or assumption to be taken on, for example, embedded value, for consistency across a wider group.

In some situations there may be ethical considerations which would require disclosure of the differences in view to the commissioning entity or, on occasions, 'whistle-blowing' to a regulator. However, this is a matter for ethical, not technical, standards.

If FSA were to mandate that firms had to specify that the IPRU(INS)9.4 investigation was to be carried out in line with relevant BAS standards, then this potential 'gap' might disappear.

Whilst we therefore agree that there are some circumstances where standards must be capable of not being followed, we believe that such situations should generally be limited to those where this is required of the actuary by instruction of the commissioning entity.

Where actuaries work as part of a team, but are not in overall charge of a piece of work, and the team leader decides to overrule the advice of the actuary on a matter relating to the actuary's part of the work (or in relation to another part of the work), this seems to us to fit the description of an overrule from the commissioning entity. Also, as above, ethical considerations might arise which required appropriate disclosure of the overrule within or outside the report on the work.

We anticipate that BAS will thoroughly research and expose draft standards and keep existing standards up to date. This is needed so that situations where there is an error in the standard (including one where it could be claimed that the standard was not appropriate for a particular situation) will be avoided except on very rare occasions. It is also important that standards will be promptly corrected when necessary changes are identified, so that overrides for this reason will be very rarely, if ever, required.

We think it is important that technical standards do not go beyond legislation or regulation in specifically requiring a particular actuary to carry out a particular piece of work (e.g. as the present GN2 does in relation to FCRs). It is also important that standards provide sufficient flexibility in how an actuary arrives at a conclusion (e.g. on the appropriate mortality basis to recommend for a valuation) to reflect all reasonable methods (but yet do not allow inappropriate laxity in the research necessary before making such recommendations).

Question 4: Proposals set out in Section 8

Do respondents agree with the proposals in section 8 for: a) the general principles set out in paragraph 8.2;

As high-level principles these seem to cover the ground adequately. We would encourage BAS to push the distinction between 'valuations' and 'planning reports', given in 8.2 1 and elsewhere, more into the public arena.

We are, however, concerned with the statement that, to fit in with other regulators' *rules* (our italics), BAS standards will set out how they should be implemented. As BAS has stated the intention to adopt a principle-based approach; we are left wondering quite how principles can be used to explain how to implement rules (which, in the case of FSA, derive themselves from the FSA principles).

b) the <u>quantification</u> principles set out in paragraphs 8.3-8.30;

There are some real problems here, which give rise to difficulties in the proposed reporting standard below. The proposals have not taken on board fully the work done on cash flow estimation by BAS's Values Working Party. They do not appear to recognise the large differences which can be caused by the risk factors affecting cash flows, from uncertainties regarding, in many cases, some or all of inflation, mortality, optionality, and discretionary awards. Moreover, 'best estimate' is not fully quantitative by any means – for example, two actuaries can give very different FRS17 valuations for a pension scheme, and FRS17 is a best estimate standard.

In addition, there is no reference to the accountants' concept of "recognition", namely whether or not a specific cash flow is to be included in the calculation. This is currently a live issue in the context of embedded values, for example.

Section 8.24 refers to BAS standards on permitted methods or measures, and to limits on the range of assumptions. We appreciate that these are only standards which BAS **may** specify, and that they may not apply to General Insurance, but we caution that the implementation of these concepts is fraught with difficulty for General Insurance.

In 8.29, the legislation stipulates that it is trustees who have the responsibility to determine prudence, not actuaries - so if BAS follow through with this (in an area where the European Union, the British Government, and the Pensions Regulator have all deliberately not provided definitions), they will be setting standards for trustees, not actuaries. We consider this to be out of scope unless there is prior agreement from the Government and/or the Regulator that they will require such a standard to be followed by the entity.

c) the generic reporting standard set out in paragraphs 8.31-8.55?

Any standard on reporting, as opposed to a standard on work, should cover consideration of the audience and the purpose of the report. It may be that this is envisaged by BAS, but it is not mentioned in the section on actuarial reports in the Conceptual Framework. It is important that the format of reports is not over-prescriptive, as this can make getting the correct message across to the commissioning entity more difficult.

Assumptions

The extensive disclosures proposed in 8.36 risk burying the readers in detail. If every report on a realistic balance sheet, say, had to rehearse the rationale for all the economic scenario generator, lapse, management actions, and take up rates assumptions, they would simply be too unwieldy. Referencing to earlier reports should be allowed and any material changes highlighted.

One example is in relation to an Independent Expert report for a transfer of business, which falls under Category B. To disclose all material assumptions (such as those underlying an

ICA assessment) would lead to a voluminous report which is in our view not fit for the purpose of the Court. It may be that "Comply or Explain" could apply in this situation, but is that what is intended?

In 8.36 both 'best estimate' and 'central estimate' are undefined and it is not clear why they are in italics. It seems appropriate for BAS to define these terms, rather than leaving them to be explained "as used in the particular report". It may also be necessary to distinguish between the use of these terms when describing the output of calculations and when used in respect of an assumption in the calculation.

Cash Flows

We disagree with the statement in 8.16 that actuaries do not conventionally disclose their cash flows. Many life office actuarial reports where the format is not prescribed by regulation do graphically display cash flows (e.g. FCRs, analyses produced for ALM purposes, etc). Similarly, outputs for pension scheme ALM exercises will show future cash flows, and describe their sensitivities, as will the actuarial assessments of the finances of social security arrangements. However, we accept that the purpose of this is not to demonstrate the effect of discounting.

There are real practical and cost implications with the proposal for disclosure of cash flows. Simply requiring an aggregate figure (which is no more than a 0% discount rate value) seems to give no useful information to anyone - we can't see what it would be used for, and more importantly nothing is said about disclosure of the uncertainties to which it is subject. Further, the Morris Review was critical of actuaries giving single-figure answers. Similar comments apply in relation to 8.41, where it is unclear what relevance this amount would have either in the context of a stochastic calculation for market-consistent purposes or for a 'real-world' ICA.

However, we do support the disclosure of year by year cash flows in appropriate circumstances (e.g. to support a pension scheme ALM exercise), subject to appropriate disclosures. We also note that although it should be easy to provide a simple aggregate 0% discount figure (useless though that is), getting proper cash flow estimates is not a trivial exercise in many cases.

In other circumstances we feel that a simple statement of the investment returns assumed to equate the value of the asset and liability cash flows is likely to be of far more use to the commissioning entity, as this is something it can consider for reasonability relative to its own views or advice from other parties on such matters.

Risks

We do not agree that all the matters listed in 8.48 should be covered in all reports. We would wish to see sufficient flexibility so that the different aspects of a matter could be presented in different reports and at different times throughout the year and in different formats to a 'valuation' report. Typically, a life office would complete an annual cycle of valuation, ICA and FCR, with each being reported separately yet providing the board over the year with all the point value and planning information it needs. Many supplementary reports on bonus recommendations, ALM matters, product pricing, etc would also be received. It is the collective content which is important – everything together would simply be overwhelming to any board.

For a pension scheme, a triennial funding valuation should have full disclosure of assumptions and sensitivities – but interim annual actuarial reports are simply updates from triennial reports, on the same basis, and so it would not be cost-justified to have to repeat much of the supporting work every year.

Preparing the disclosures envisaged in 8.52 in relation to the derivation of probabilities could be very time-consuming, and cost/benefit analysis of this would be required to justify it.

There is a need to consider carefully which elements are needed for each type of actuarial report - e.g. the requirements for a full triennial valuation report in respect of a pension scheme should be much more extensive than say for a report certifying an individual transfer value.

The distinction made between "work" and "reporting" is very important for General Insurance actuaries. Some common types of General Insurance work, such as in relation to companies' technical provisions and ICAs for companies and Lloyd's syndicates are likely to fall under Category B, but whilst there is effectively a requirement to commission work (albeit not necessarily from an actuary), there is not a requirement to commission a report. It is quite common for the directors and senior management of companies and syndicates to prefer a brief summary of the results of and issues arising from in-house work rather than a comprehensive report such as outlined in Section 8. This Section is silent on the circumstances in which a report is required, and we suggest that this should be addressed in the standards.

Our interpretation of Section 8 is that it is envisaged that BAS standards on reports will only apply to Categories A and B, thus excluding much General Insurance actuarial work. GN12, adopted by BAS, currently covers reporting on all General Insurance work, and it is important that BAS is aware of the implication of the proposed Conceptual Framework in removing some types of General Insurance work from these standards. We acknowledge that this is an issue on which it is difficult, if not impossible, to reach unanimous agreement even amongst General Insurance actuaries, and our General Insurance Board (or successor Executive Committee) would be happy to discuss the way forward with you further. It may be appropriate for the FSA to be involved in such discussions.

d) the proposal set out in paragraph 8.48(d) for actuarial quantification of liabilities to include an assessment of the probability that the assets held by the entity at the valuation date will be sufficient to meet those liabilities; respondents are asked to focus, in particular, on:

- ***any practical problems in assessing the probabilities which the proposal calls for; and***
- ***any limitations on the usefulness of the information if one or more of the probabilities has to be omitted from the assessment.***

Accurate estimation of these probabilities would presumably require simulation in which all variables were modelled stochastically - a huge task. It would also be necessary to make assumptions about future management actions (including withdrawal of distributable surplus), the effect of new business etc. Restricting the risks included (section 8.48d and 8.49) is likely to mean that the probability of adequacy will be over-stated, and this will need to be explained. All in all a lot of work for potentially not much gain.

Such a requirement really does require a cost-benefit analysis, and a reasonable expectation that this would be understood by and meet the needs of the users. There is firstly an appreciation of what users want and need, and then definition of which types of report it would be appropriate for, over what time periods, and indeed a standard for how it should be carried out, and communicated, otherwise we will end up with a huge variety of subjective approaches, giving answers all over the place, at great expense to users.

There is a particular issue with this proposal for General Insurance, since the scope of much actuarial work assessing liabilities does not include consideration of the assets. It seems highly likely that the clients (internal and external) of General Insurance actuaries would object strongly to the imposition of this requirement.

Other issues which may impact on the Conceptual Framework

In addition to the specific questions listed above, the BAS invites respondents' views on any other issues that may impact on the Conceptual Framework. To ensure that the significance of their point is fully appreciated by the BAS, respondents are encouraged to indicate how their comments affect the proposed Framework.

Geographic Scope
It is important for the geographic scope of the standards to be defined clearly and precisely. To this end, we consider that the definition of "work done in relation to UK entities" needs some further expansion. A significant amount of worldwide General Insurance business is written in the UK, and Lloyd's actuarial opinions are required by regulation for the US situs business (which is actually written in the UK). Where an overseas insurance operation is a material asset of a UK insurance operation, it seems appropriate that the same level of standard should apply to the whole work, even where the UK actuary simply incorporates the overseas work (e.g. in a group ICA, which is actually a requirement on a UK-regulated subsidiary to ensure is carried out (GENPRU 1.2.49)).

Similarly, we suggest that there is ambiguity in relation to an actuary conducting work in relation to the Group operations of an entity whose head office is in the UK. We also believe that where work, for example assessment of the appraisal value of a potential overseas acquisition by a UK group, is carried out by a UK-based employee of the group or by a consultant contracted under UK law, then this ought to be subject to UK standards. When we see actual standards the Profession may require the standard to be followed by those of its members who are fully regulated by the Profession even though based abroad. Overseas-based actuaries who qualified as FIA or FFA but are now regulated by a local actuarial association cannot be required to follow a BAS standard.

Actuaries working in teams
We had some difficulties with section 5.17. It may be quite difficult to monitor whether 'one or more of the actuaries in the team take responsibility for the final product'. We think the Conceptual Framework will need to be much clearer on what is intended. We would want to minimise the risk of actuaries consciously avoiding this position, which may cause problems within the team and more widely for the reputation of the Profession.

As currently worded, the section might have consequences which are presumably unintended. If a Finance Director or Chief Financial Officer is also an actuary (which is not

an uncommon situation) and has actuaries working as part of a team producing the financial statements, then it would appear that all the work on the financial statements falls into Category B, which is obviously inappropriate as accounting standards apply to such statements. Similarly, a Chief Risk Officer who has an actuarial qualification and actuaries working as part of an ICA team would then be required to ensure that all the ICA work complied with actuarial standards.

Production of standards

There are no references in the Consultation Paper to the governance process by which individual standards will be drawn up, consulted upon, and implemented. We would find it helpful for BAS to publish what it intends in this respect.

We think it is an omission in the consultation paper not to explain how BAS standards and Accounting standards (produced by another FRC operating body) will be developed in concert. FRS17 has, for example had a great impact on the work of pension actuaries and on public perceptions of related issues.

Feedback on material set out in Sections 6 and 7

In particular, as noted earlier in this paper, the BAS regards Sections 6 and 7 of the Consultation Paper as setting out matters of current and historical fact, together with logical analysis based on those facts, rather than matters of judgment or policy. The BAS would welcome respondents' feedback on the material set out in those sections if respondents believe any of it to be ill founded, but asks respondents to take note that the implications for the Conceptual Framework of this material follow in Section 8, which therefore provides a more effective opportunity for making comments.

We disagree with the statement in Section 6.6 that regulations require the inclusion of a margin for adverse deviation in technical provisions for general insurance.

The third bullet point in section 6.20 should refer also to life assurance policy pricing. Pricing might also well be added to the second sentence of section 6.18

The analysis in the Example in section 6.20 omits reference to the range and skewness of the results.

The reference to 'different techniques' in the penultimate sentence of section 6.31 should be to 'different assumptions', though it might be that both 'techniques' and 'assumptions' should be referred to.

We agree the conclusions which BAS reach on the distinction between 'valuation' and 'planning' work-types. In the life field, we recognise that pillar 1 valuations are different from pillar 2 ICAs, the latter being a 'planning' technique around the amount of capital required to enable liabilities to be met to a particular level of probability. We also recognise that regulations drive different valuations for peak 1, peak 2 and IFRS.

It is not necessarily the case, however, that life actuaries mainly 'value' and pensions actuaries mainly 'plan'. Both types of actuaries carry out both activities depending on regulatory requirements and the needs of the commissioning entities.

We are also happy with the concept that the central estimate of the amount of assets needed will depend on how the assets are to be invested. However, we would urge caution in allowing results on this basis to be presented by actuaries to commissioning entities without appropriate explanation and quantification of the risks of failure to achieve the objective in adverse scenarios, either as part of the report or elsewhere in the regular cycle of actuarial advice.

We would also comment that the use of point valuations is fast diminishing as the main tool of actuarial management of life companies, except possibly for those with particularly simple asset and liability structures. Stochastic and deterministic scenario analysis is now the main tool. Indeed, FSA now requires to see management demonstrating that ICAs are used to guide management decisions. We would suggest that point valuations were a tool of the time, when computational technology did not permit the more useful analyses of today – a conservative point valuation being the equivalent of today's low probability outcome stress. We suggest that standards should recognise explicitly that the point valuation has less informative value in almost all circumstances than scenario analyses and should not be encouraged by itself as an acceptable technique except in response to regulatory requirements.

Even a so-called market-consistent valuation, whilst of value as far as financial liabilities which are fully replicable in liquid markets are concerned, has less certainty than its name appears to imply when the liabilities are also dependent on non-financial contingencies which cannot be replicated.

In the context of the valuation of an entity for sale or purchase, it should be for the actuary to advise the buyer or seller of a range of values dependent on future assumptions and for the buyer or seller to decide whether the risks or opportunity cost of proceeding or not proceeding with the transaction at a particular price is acceptable to it.

On page 25 of the Consultative Paper (under "9.6.5 Statutory Solvency Valuations"), it is implied that the investment assumptions of a life office under a pension buy-out policy is unlikely to be higher than the yield on gilts coupled with a cautious estimate of future investment income. Whilst this may be an approximation used for pricing purposes to generate a particular profit margin, there is no reason why the pricing should not be based on the yields on the assets actually intended (typically a significant proportion in sovereign stocks, corporate bonds or commercial mortgages) with the future yield assumptions being those implied from current forward yield curves (which can be locked in), with separate margins being added for profit/risk.

In 8b) of the example in 6.20, we are uncomfortable at the description of "the opposing view of the world" as plainly incorporating a measure of prudence. It might better be described as reflecting investor perspectives, in which case the "one view of the world" would be optimistic in anticipating out-performance before it is delivered.

We also find that section 6 in general gives little recognition to the need to value financial options inherent in insurance contracts (or pension funds for that matter) by methods which are more discriminatory than deterministic discounting of estimated cash flows. The use of market-consistent valuations, whether by stochastic modelling, closed form solutions, replicating portfolios or otherwise, for this purpose is largely overlooked in the arguments made.

7.20 states that it was until only a few years ago widely believed that past longevity statistics together with an extrapolation of improvement trends provided a sound basis for projecting future longevity. We are not certain what point BAS is trying to make here. Ultimately, any projection of future mortality effectively analyses past experience and trends and uses either pure statistical techniques or a combination of causal analysis, statistical techniques, and judgement to project the future course of this experience.

There have been, and still are schools of thought which believe on causal grounds that the future trend of longevity improvement will moderate compared to the recent past. On the other hand, there are hypotheses which lead to the conclusion that past trends may accelerate.

Whilst the stochastic analysis of longevity improvement trends may be in its infancy and capable of criticism, we consider that any approach which demonstrates to entities the uncertainty of such trends, even if only a relatively simple one based on several conceivable future scenarios (e.g. current improvement slows, stays same or accelerates), is better that nothing at all. Ongoing research at universities and elsewhere into stochastic and causal analyses should be encouraged. Similar considerations apply to disclosing and improving the modelling of the uncertainty in other areas, such as policyholder behaviour (e.g. persistency) and operational risk.

The section on 'Understanding probabilities' seems misconceived. It is based on applying inadequate definitions to examples (7.26 and 7.27). The problems highlighted disappears if the percentage is adequately defined i.e. percentage of what!

Nevertheless we welcome BAS's identification in 7.36 of the importance of explaining probabilities in actuarial information properly and of pointing the users of that information to the correct inferences that may be drawn from them.

7.15 is not quite correct in implying that 'risk-neutral' is simply an alternate way of saying 'market-consistent'. Rather, it is just one way to achieve a valuation which is market-consistent.