

**BY EMAIL ONLY – FROM THE ACTING GOVERNMENT ACTUARY**

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Dear Sir

**BOARD FOR ACTUARIAL STANDARDS**  
**TOWARDS A CONCEPTUAL FRAMEWORK: CONSULTATION PAPER**

The Government Actuary's Department (GAD) welcomes the opportunity to comment on the proposals made by the Board for Actuarial Standards (BAS) in its November 2007 consultation paper *Towards a Conceptual Framework*.

We very much welcome the way in which the BAS's thinking has developed since the preliminary, April 2007, consultation paper. We recognise that the development of the Conceptual Framework is a necessarily evolutionary process, with the aim of meeting the Financial Reporting Council's strategic goal for actuarial practice ('Users of actuarial information can place a high degree of reliance on the information's relevance, transparency of assumptions, completeness and comprehensibility'). In moving towards this aim, we would encourage the BAS to develop a framework which dovetails with the existing roles and responsibilities of the various stakeholders (government, regulators, actuaries and, of course, decision-makers/users of actuarial advice). Our view is that flexibility is best retained, and undue disruption best avoided, by building on developments in the regulatory framework in recent years - for example, the enhanced role of the Pensions Regulator and the clarification of the actuary's role as an adviser, rather than a decision-maker.

We set out below our comments on the specific questions contained in the November 2007 paper. This response has been prepared after consultation with HM Treasury and the Department for Work and Pensions, and has focussed on matters of particular relevance for public service entities and for actuaries giving advice to such entities. We would, of course, be pleased to meet you to discuss our response.

From our perspective, the key areas of the proposed Conceptual Framework where we consider that further consideration is called for include:

> the proposal that the BAS might, in time, move towards the prescription of actuarial methods and/or ranges of assumptions. In our view, further reflection is needed on the advantages and disadvantages of such a framework, drawing on practical experience of such prescription (for example, the Minimum Funding Requirement prescribed under the Pensions Act 1995); and

> the scope of the generic Reporting Standard and the type and nature of actuarial reports for which this standard would be mandatory. The proposed content of this standard appears to us unduly focussed on regulated financial institutions with both assets and liabilities, and does not recognise the potential diversity of actuarial work (for example, in relation to the financing of unfunded public service pension schemes, or of social security arrangements). Furthermore, actuarial advice does not invariably turn on numerical calculations!

As development of the Conceptual Framework moves to its next stage, we look forward to the opportunity of commenting on the Impact Analysis of the proposals, especially as regards the generic Reporting Standard.

*1. 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?*

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

*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.*

GAD finds the proposed categorisation of actuarial work a useful and meaningful one, and broadly supports the framework suggested for deciding what is (and what is not) to be covered by BAS standards.

In particular, we strongly support firmly confining the scope of BAS standards at this stage to Category A, generally corresponding to the 'core' areas of actuarial activity, primarily in relation to reserved roles. We would, however, welcome the opportunity to discuss the proposed categorisation further with you, to explore how it would interact with the specific statutory responsibilities placed on the Government Actuary.

It seems to us that it will be important, particularly at this formative stage, to ensure that the Conceptual Framework allows for flexibility so that the framework itself, and the standards which sit within it, can be refined and developed in the light of practical experience (not least on the evolution of the distinction between 'ethical' and 'technical' matters). Particular care is called for in relation to the development of generic standards, given the range and diversity of actuarial work which they would cover. We note that the geographic scope of BAS standards will be limited to work done in relation to the UK operations of entities.

*2. 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;*

*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*

*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?*

In our view, BAS standards should recognise that, in the core 'Category A' areas of actuarial activity, actuaries are usually advisers to decision makers (eg trustees, insurers, governments), rather than decision-makers themselves. Regulation of decision-makers is for the relevant regulator (such as the Pensions Regulator or the Financial Services Authority). BAS standards should therefore apply to the information and advice provided by the actuary.

It is critical that BAS standards should recognise also the distinct nature of the legislative and regulatory requirements applying to the core areas of actuarial activity as they evolve over time (for example, insurance as compared with pensions) and should be alert to the risk of undermining those requirements or constraining the advice provided to decision-makers. We are pleased to note the BAS's acknowledgement that it would not be appropriate for the Conceptual Framework to act as a vehicle for aligning different regulatory regimes and welcome the BAS's commitment to principle-based standards.

Consequently BAS standards should, in our view, focus on process (the way in which actuarial advice is given) and outputs (the way that actuarial information is presented to decision-makers). It is arguably for regulators to determine any boundaries or limits which should be imposed, developing such rules sensitive to the particular regulatory context. From such a perspective, it does not appear to us, at this stage, that there is a particular need for BAS standards to set limits on the range of actuarial assumptions or on the methodologies which may be used, nor for an undue prescription of the content of actuarial reports, as this may act to skew or bias the scope or content of actuaries' work.

For example, in paragraph 8.29 the BAS states that it 'considers that it would be a proper exercise of its functions to specify how prudence is to be achieved in a given context (for example the calculation of a pension scheme's technical provisions)'. It seems to us that a good case could be made that any such specification, if justified, should be a matter for the Pensions Regulator, after a due process of consultation with relevant stakeholders.

*3. 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 are broadly supportive of the proposals set out in Section 5 on the enforceability of standards, and welcome the proposals for a 'reasonability override' and a 'comply or explain' approach. It appears to us that 'irrelevance' should, in addition to 'wrong' or 'misleading', be grounds for invoking the reasonability override (for example, when providing a GN9 report on an unfunded pension scheme, it would not be relevant to state the solvency level).

We feel that some further thought may need to be given to the practical implications of the proposals in paragraph 5.17 in relation to actuaries working as part of a team.

4. Do respondents agree with the proposals in Section 8 for:

a) the general principles set out in paragraph 8.2;

b) the quantification principles set out in paragraphs 8.3-8.30;

c) the generic Reporting Standard set out in paragraphs 8.31-8.55?

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.

#### *General principles*

In our view, Section 6 of the consultation document gives a particularly useful analysis of the distinct nature of different actuarial calculations, properly reflecting the different regulatory frameworks within which those calculations are undertaken. Accordingly, we broadly agree with the proposals set out in paragraph 8.2 as regards general principles, which recognise the diverse nature of actuarial calculations and the respective roles and responsibilities of the BAS and of other regulators. However, it is not clear to us that it is necessary to include a principle that assets should generally be taken at market value – notwithstanding the flexibility that will be offered to allow departure from this principle where stated and justified in the relevant actuarial report.

#### *Actuarial quantification principles*

In relation to paragraphs 8.24 to 8.30 (BAS standards relating to the calculations within the scope of the Conceptual Framework), we would restate our comments on question 2 above. We are not, at this point, persuaded that it is the BAS's role to specify, for example, permitted methods for particular calculations or to mandate limits on the range of assumptions to be used in specific contexts. Such matters appear to us, if justified, to be for government and/or the relevant regulator, after due consultation.

#### *Generic Reporting Standard*

In our view, further clarification is required as to which 'reports on actuarial calculations within the scope of the Conceptual Framework' should have to include the full range of material set out in paragraphs 8.31 to 8.55 – for example it would seem wholly disproportionate to require such disclosures in the context of a valuation carried out on the basis prescribed under section 179 of the Pensions Act 2004 to determine the risk-based levy payable to the Pension Protection Fund. It is not for the scheme actuary undertaking such a valuation to justify the assumptions used.

## TOWARDS A CONCEPTUAL FRAMEWORK: GAD RESPONSE

The proposed Reporting Standard sensibly covers matters such as the nature and objective of the actuarial calculations contained in the report, the methodology and assumptions adopted, and the rationale for those assumptions. However, we are concerned that the minimum requirements extend to matters such as:

- requiring disclosure of the total undiscounted amount of projected cash flows, and the time period over which those cash flows are projected to be paid, in addition to any discounted figures included in the report; and
- where a report on an entity includes an estimate of the value of actuarial liabilities, an assessment of the probability that the assets held by the entity at the valuation date will be sufficient to meet those liabilities.

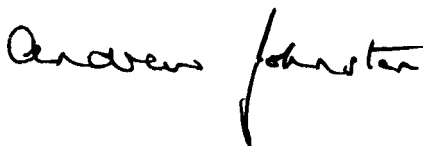
The costs involved in routinely requiring such disclosures could be significant and we are unconvinced that the benefits outweigh the costs – on the first matter mentioned above, it is not clear to us why it would be at all helpful to require the disclosure of the total undiscounted (nominal) amount of projected cash flows. In any event, the International Actuarial Association's practice guidelines for social security programs recommends disclosing future cashflow projections in real, rather than nominal, terms.

In addition, the proposals in relation to the generic Reporting Standard seem not to recognise the specific nature of the public service entities on which actuaries may be required to report (such as public service pension schemes and social security arrangements). Public service pension schemes have some fundamental differences to most other occupational pension schemes. For example, most are unfunded and most fall outside the scheme funding regime established by the Pensions Act 2004. It would be helpful if acknowledgement of such differences was embedded in the Conceptual Framework to ensure that standards paid due regard to the nature of such entities. The alternative of regularly and routinely relying on the proposed 'reasonability override' does not seem particularly helpful or efficient from the perspective of those commissioning the report.

Recognising the diversity of the contexts within which actuaries will be required to report on matters falling within the scope of BAS standards, one option might be to extend the Conceptual Framework to encompass the Reporting Standard, since it is very far from clear to us that all the proposed requirements will be appropriate for all types of work, particularly when viewed from a deregulatory perspective. This would then give the flexibility to tailor the reporting requirements of specific standards to the particular context, after a due process of consultation and a considered assessment of the costs and benefits.

As noted above, we would be pleased to meet you to discuss our response further, and we look forward to contributing to the next phase of the Board's development of a Conceptual Framework.

Yours faithfully



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**Acting Government Actuary**

cc Sue Lewis, James Templeton, Pedro Wrobel [HM Treasury]  
Chris Evans, Valerie Christian [Department for Work and Pensions]  
George Russell, Sue Vivian [GAD]