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1 February 2008

Mr Paul Seymour
Chairman
The Board for Actuarial Standards
Aldwych House
71-91 Aldwych
London
WC2B 4HN

Dear Paul

We welcome the opportunity to comment on the proposals made by the Board for Actuarial Standards (BAS) in its Consultation Paper "Towards a Conceptual Framework". We consider the proposals set out in this Paper a major step forward from the material set out in the Preliminary Consultation Paper published in April 2007, on which we expressed some important reservations.

We suggest that BAS should deliberately leave the draft Conceptual Framework (once finalised) as a draft for a couple of years, whilst the first few standards are prepared, so that the Framework is not crystallised until experience has been obtained of applying it in practice.

However, we have some concerns over the draft generic reporting standards proposed in Section 8 of the Consultation Paper. Many of the disclosure items, whilst appropriate in some circumstances, would be inappropriate for most actuarial tasks. If implemented, they would multiply the cost to users of obtaining actuarial advice several times. We consider that it would instead be helpful to include the final document as part of the Conceptual Framework, which will not be mandatory for actuaries, rather than as a standard, which would be mandatory. The reporting framework would serve as a menu of disclosure requirements that would be considered for applicability (and cost/benefit) for topic-specific standards.

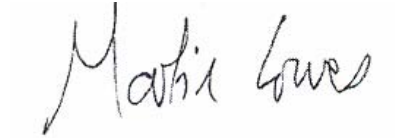
Also, we would encourage BAS to prioritise now its work on the development and updating of technical actuarial standards. There has been no progress on the standards applicable to pension schemes since BAS took responsibility for them 20 months ago. Swift action is now required, without waiting for the fine tuning of the Conceptual Framework. Development and updating of actual standards will show what works and what does not, so will help rather than hinder completion of the Conceptual Framework.

Our detailed comments on each of the questions posed by the Consultation Paper are set out in the attached Appendices.

Hewitt

Mr Paul Seymour
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Yours sincerely

A handwritten signature in black ink that reads "Martin Lowes". The signature is written in a cursive style with a large initial 'M'.

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Enclosures

Appendix 1 – Scope of the Conceptual 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.

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?

We agree that the five categories are a useful step in deciding which areas should be within scope.

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 in Category A should be within the scope of BAS standards. We also agree that the work that we believe BAS intends to be in Category B should be within the scope of BAS standards but with the status of “Comply or Explain” (but see comments in Appendix 3).

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.

There is a wide range of work that relevant entities are required, by regulation or by virtue of a legal obligation to a beneficiary, to commission. This includes work such as preparation and audit of the report and accounts. As drafted, all such work would be covered by Category B. The introductory sentence that A to E are categories of “actuarial work” does not help narrow down the definition, because “actuarial work” is itself not defined. Further, the concept of “actuarial work” that must be commissioned “not necessarily from an actuary” is tortuous. We would suggest for example, defining Category B as “Work that an entity is required to commission, from an actuary or from someone with related competencies”.

In particular, we are concerned that investment advice may fall within the definition of category B as drafted. We do not believe that this would be necessary or appropriate; as such advice is already highly regulated.

We suggest that the suggested geographic scope set out in paragraph 3.38 should be re-visited. It appears to us that, contrary to what is suggested in that paragraph, for example:

- advice to a UK parent by a UK actuary in relation to the pension cost accounting in its consolidated group accounts for its overseas pension schemes should be within scope; but
- it is unlikely that BAS can regulate advice given by a non-UK actuary to a non-UK parent in relation to the pension cost accounting in its consolidated group accounts for its UK pension schemes

Appendix 2 – Characteristics of Standards

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

In theory, a hierarchy of generic standards fleshed out by topic-specific standards appears helpful. In practice, we believe that it will be difficult to apply a single generic standard across the whole spectrum of work that falls in category A (never mind B). The draft generic reporting standard is an illustration of this. The issue is that pension legislation and pension plan documents require actuaries to perform many repetitive calculations for individual members, that only involve judgment when the approach to such calculations is reviewed periodically with the trustees. This work will fall into category A, but the “reports” on such work do not justify most of the disclosure suggested in the draft generic reporting standard.

Also, while in principle it feels helpful to have a hierarchy of standards, in practice that means that an actuary doing a task has to check he/she has complied with the requirements in the standards at each level, rather than being able to read and comply with just the one relevant standard. If it proves possible to develop any generic requirements that are genuinely applicable to all (or almost all) actuarial work, it may be more helpful to include them in the conceptual framework (which will not be mandatory) and then repeated in relevant standards. This approach may in particular be helpful for the generic reporting “standard”, where the suggested disclosures are meaningful across the range of actuarial work, but which may be unnecessarily detailed for some actuarial tasks. As part of the conceptual framework, it would become a menu of disclosures to be considered for inclusion in individual standards.

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

We support a move towards principle-based standards, although we believe that this should be applied pragmatically rather than rigidly. Rules may be more appropriate in some circumstances.

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 principle we agree with this, with the important caveat that (despite the suggestions to the contrary in the April preliminary consultation paper) the “users” referred to will generally be the clients who commission the work.

Also, BAS needs to be careful that where it is the client, not the actuary, who (for example) decides the assumptions on which a calculation is based, the actuary cannot control many aspects of the “output”.

Appendix 3 – 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?

Our main concern is that even in relation to work that falls in Category A (work that must be commissioned from an actuary), aspects of the work may be decided by the entity (for example the assumptions to be used for a scheme specific funding valuation), and cannot be controlled by the actuary.

For aspects that are determined by the entity (whether for work that falls under Category A or Category B), the value of requiring the actuary to provide an additional set of outputs or explain why not (the client did not want to pay for this?) is less than obvious.

Running through this is the theme that BAS does not really seem to have grasped the issues generated by trying to regulate outputs, where BAS only has authority over actuaries, and those actuaries do not have control over significant matters that affect the outputs.

Appendix 4 – Applying the Concepts to Standards

Do respondents agree with the proposals in section 8:

a) for the general principles set out in paragraph 8.2;

We agree with the principles set out here.

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

We agree the thrust of these principles, but have some concerns over the details:

- in 8.10, adding a margin to the value of liabilities to allow for data inadequacies makes the presentation more (not less) misleading - as this will then be a biased estimate (however, widening the range of possible values would be a valid approach)
- in 8.25 and 8.29, it appears that BAS is inadvertently assuming it can regulate entities (where they rather than actuaries decide assumptions for example)

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

We believe that most of these proposed disclosures are appropriate for some (but only some) “reports”. However, most of them will be either completely inappropriate or will fail to satisfy any cost-benefit analysis in most circumstances. The problem is that actuarial work covers a wide spectrum, with varying requirements. In particular, pension legislation and pension plan documents require actuaries to perform many repetitive calculations for individual members that only involve judgment when the approach to such calculations is reviewed periodically with the trustees. This work will fall into Category A, but the “reports” on such work do not justify most of the disclosures suggested in the draft generic reporting standard. At the other end of the spectrum, the package of advice on the triennial funding valuation should probably (taken as a whole) cover most of the suggested disclosures.

Before proceeding further with this, BAS should draw up a list of all actuarial “reports” to which it could potentially apply, and check that all the requirements are appropriate for all the “reports”. We believe that the answer is that they do not. This issue is acknowledged in 8.47, but we believe that the issue is far wider than suggested therein, and that the proposed approach is unworkable.

Further, the Consultation Paper fails to consider how the standard would be applied:

- where the work is split between different actuaries (for example where advice on assumptions for employer pension cost disclosures is given by the employer actuary, but the calculations are carried out for the employer by the scheme actuary because this is more cost-effective)
- where the process is carried out in a number of stages, such as for a pension scheme funding valuation, where the legislation requires a staged approach; it would be repetitive and costly to repeat all the disclosures at each stage, and indeed most of the disclosures will simply not

be possible at the earlier stage. The suggestion at the consultation meeting was that reports at later stages of a process could meet the disclosure requirement by cross-referring to earlier documents. This will simply make the later reports unreadable, contrary to the objectives expressed by BAS and Morris.

We therefore consider that it would be preferable to include the final document as part of the Conceptual Framework, which will not be mandatory for actuaries, rather than as a standard, which would be mandatory. The reporting framework would serve as a menu of disclosure requirements that would be considered for applicability (and cost/benefit) for topic-specific standards.

We have a number of comments on individual elements of the proposed requirements.

8.36(b) This does not allow for

- the possibility of the actuary who advises on or decides the assumptions being different from the actuary performing the calculations, as for employer pension cost reporting (as discussed above) or
- where the assumptions are imposed by a regulator, as for PPF s179 valuations

8.37 The reference to a time period is misguided: for pensions and annuities the cashflows at least in theory continue forever, albeit becoming immaterial after a while. We believe that this disclosure will in any case tend to mislead rather than inform users. This is particularly true in a pensions context where the projected cashflows will reflect projected future inflation. The number produced will not be in any way comparable with the current asset value (which will not reflect expected future growth) and will therefore serve to mislead many users.

8.42 A review of risks is sensible only for “reports” that will be used as a basis for decisions that should reflect those risks. For example, looking at the scheme specific funding process as a whole, it is clearly necessary for the risks to be addressed. However, we cannot see any reason to address them in the reporting of a s179 valuation. Or in the report to an employer on the calculation of its pension costs under FRS 17. Even for tasks where a review of risks is appropriate, many of the risks would be outside the scope or competence of the actuary to assess, such as assessing the employer covenant in connection with pension scheme funding.

8.44 If there is to be any discussion of risks at all, it seems odd to require reporting only of actions taken to mitigate risks, and not of actions that have not been taken that could mitigate risks, nor of actions taken (albeit for valid reasons) that deliberately increase risks (such as choosing to invest in return-seeking but unmatched assets).

8.52(d) It is generally for the client (eg the trustees) rather than the actuary to decide what probability of adequacy (and over what period) is sufficient.

d) for 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

We are extremely sceptical of the cost/benefit of this proposal, and indeed whether users will understand the proposed disclosures. The simply stated proposal in the Consultation Paper fails to address a host of issues including for example:

- over what period the probability is measured (the probability varies by period) or whether the intention is to assume the entity runs on forever
- what investment policy is assumed over the period; it may not be sensible to assume an unchanged strategy for a closed and diminishing portfolio
- how to incorporate (or not) future accrual/premiums/contributions
- how to reflect the employer backing of a pension scheme (it would be misleading to ignore this, because the employer backing is the reason for setting Technical Provisions less than an insurer would reserve, but impossible to take the employer backing into account quantitatively)
- should the probability reflect or exclude future pay increases, discretionary benefits (or, in an insurance context, bonuses)
- how to reflect the actions that would be taken if the financial position deteriorated (for example a change in future contributions)
- it is impossible to put meaningful probabilities on the outcomes for some assumptions, such as life expectancy
- any probability quoted will therefore take account of some but not all uncertainties, and hence will be misleading

Setting aside any consideration of cost versus benefit, any requirement to disclose the probability that the assets will be sufficient to meet the liabilities only serves any purpose at all for “reports” that will be used as a basis for decisions that should reflect the risk of the assets proving insufficient. For example, we cannot see any reason for such disclosures for the reporting of a s179 valuation. Or in the report to an employer on the calculation of its pension costs under FRS 17.