

# TOWARDS A CONCEPTUAL FRAMEWORK: RESPONSE TO THE CONSULTATION FROM THE BOARD FOR ACTUARIAL STANDARDS

This is the response of Hymans Robertson LLP to the consultation from the Board for Actuarial Standards on its paper 'Towards a Conceptual Framework.'

## GENERAL COMMENTS

We welcome the efforts made by the Board for Actuarial Standards (BAS) in producing its consultation paper. We are much heartened by the vast improvements in this paper compared to its predecessor, which have enabled the users of actuarial guidance to begin to understand the direction the BAS is looking to take. We would also like to thank the BAS for arranging consultation meetings, and taking this paper to the Actuarial Profession and actively seeking comments.

Overall, there is much in the paper with which we agree and we particularly welcome the stance being taken by the BAS in seeking to develop principles-driven guidance and not becoming a rule setter, though we remain concerned that the BAS is not entirely wedded to this concept and does wish to set rules, particularly in relation to limits on assumptions. We are sure that the BAS is aware that there is a fine line which needs to be trodden, balancing the many needs of the users of actuarial guidance as well as protecting the interests of the actuarial profession's clients. The need to take a proportionate approach—ensuring that new standards do not lead to higher costs for our clients, while protecting their interests—is paramount. In much of the consultation the BAS gets the balance right, but in some places we feel that the proposals will lead to far higher costs to our clients for little or no perceived benefit.

We also welcome the acknowledgement that pensions actuaries are primarily involved with helping pension scheme trustees and their sponsors understand and manage the risks inherent within their schemes; that much of the work we do involves helping them understand their risks better, leading to us being able to help them mitigate their risks in the best way they can given their own financial circumstances, and helping them implement the investment and funding strategies in the most efficient ways for them. The distinction between valuations used for life office purposes and planning and budgeting approach used for pension scheme purposes is, we feel, correct.

We give more detailed comments on the areas about which feedback was requested.

## DETAILED COMMENTS

### SECTION 3

Classifying the work undertaken by actuaries seems to us to be a sensible approach in trying to formulate which advice should be subject to which degree of control. The proposals set out by the BAS are sensible. However, we need to recognise that whatever approach is taken to classify work, none will be perfect. One of the weaknesses of the approach suggested in the consultation is that two pieces of work undertaken by an actuary, which are seemingly identical in nature, will fall into different categories. For instance, some pension schemes require trustees to set actuarial factors having taken the advice of their actuary, whereas other schemes will permit trustees to set their factors without recourse to actuarial advice (although in most instances, we would expect the trustees to seek actuarial advice). The classification set out in the consultation means that the former would fall within Category A, whereas the latter would fall within Category C. As such, these two seemingly identical pieces of work would fall within different categories, and would therefore be subject to different guidance. The result would be that the former piece of work needs a substantial report, whereas the

latter might be covered in a far more pragmatic manner, costing the client far less. Whilst we highlight this weakness, we do not have a better solution to put forward.

The BAS ask in particular for a response as to whether categories B, C and D should fall within the scope of the framework. In our opinion they should not. If we allow a system whereby an actuary undertaking work is subjected to more restrictions than a non-actuary carrying out exactly the same role, ultimately this will damage our profession. We are aware that there is a body of opinion that work undertaken for an employer in relation to the funding of the pension scheme should fall within the scope of actuarial guidance, but we do not share the view. The legislation has been written in such a way that trustees of pension schemes are required to take the advice from their Scheme Actuary: it has been designed this way to protect the trustees and, as such, it is only right that there is actuarial guidance to provide a minimum level of standards to which such advice should aspire. There is no such protection in the legislation for employers, and for the BAS—or any other regulatory authority—to impose such a requirement would clearly be an extension of the legislation, which we would argue is beyond the remit of the BAS.

#### SECTION 4

We note that the BAS has stated that its guidance will be principle-based, rather than rule-based. However, we are rather perturbed to see some comments within section 4 regarding limiting the range within which specific assumptions should fall, and we do not believe that this is an area in which the BAS should try to legislate. In the pensions field, as BAS will be aware, the assumptions for most work undertaken by actuaries are not set by actuaries themselves but instead are chosen by pension fund trustees, albeit having taken actuarial advice. To not be able to act under instruction would strike us as an unusual constraint, and we urge the BAS not to take this route. We believe that keeping the standards principles-based will ensure that actuaries are able to give their clients the best advice so that they understand the risks attached to any particular assumption, and choose their assumptions in the full knowledge of what they are doing. Placing bands around the assumptions which can be used will not aid the overall process and in some instances will prevent actuaries from giving clients the best and most appropriate advice.

We are of the view that where it is possible to develop a generic standard across all the work undertaken by actuaries, then it is sensible to do so. Outside a generic reporting standard, though, we struggle to see what other generic standards could be produced.

Our last comment on section 4 relates to the last sentence in paragraph 4.2. We find this statement a little confusing. It is not clear to us why the BAS wants to set as its primary goal that its standards will benefit society at large. Surely the primary goal is that the standards will benefit the end users of any actuarial advice, including policyholders and pension scheme members, but fail to see why the standards should aim to be a benefit to those who are not touched by the work undertaken by actuaries. Even if we were to concede that this goal is one for which to aim, we believe it would be impossible to measure. We would urge the BAS to refine how it defines its goals, so as to focus on those who will be affected by the advice given by actuaries, rather than those who are not.

#### SECTION 5

Our first comment on this section is in relation to the statement made in paragraph 5.2. The paper seeks to explain the difference between the current classification of standards between those which are Recommended Practice and those which are Practice Standards. We believe that in reality the difference between the two classifications did not affect the degree to which actuaries adhered to guidance. It is our belief that actuaries, where possible, followed the guidance as best they could irrespective of its classification. The primary reason for the difference in classification is not so much one of mandatory standards versus recommended guidelines, but more a distinction as to how non-compliance with their guidance would be treated under the disciplinary

process, i.e. the grading of the importance of the guidance itself. We do not think that the misunderstanding of this distinction is material in the context of section 5, but we thought it worth pointing out.

We are comfortable with the classification between “comply or explain” and that of a “reasonability override”. In particular, we are supportive of the application of compulsion to work which falls under Category A, subject to a reasonability override.

We are a little wary though of how the “comply or explain” process will actually work and be applied to actuaries. In particular, the BAS is seeking to apply this to work which is not reserved for actuaries alone. As such, if the way that “comply or explain” is followed in practice is that actuaries are generally expected to comply, then we will be putting actuaries in an uncompetitive position, relative to non-actuaries. As such, we would be supportive of this approach if it would be acceptable to deviate from the standards in order to remain commercially competitive. Not to do so may make the profession unattractive in certain areas in which actuaries are prevalent, such as the areas of investment consulting, where an actuarial qualification is not necessary to carry out much or all of the work undertaken. We come back to the issue of proportionality, and it will be very important for the BAS to get the balance right in this area to ensure that we do not place the actuarial profession at a competitive disadvantage.

#### SECTIONS 6 AND 7

We do not have any detailed comments on either of these sections. We agree with and welcome the view being taken by the BAS that there are substantial differences between the work undertaken by actuaries working within different fields and much of this stems not only from historical differences, but also from the way in which these areas are legislated. As such, it will be critical that any guidance issued by the BAS reflects these differences, rather than trying to force convergence where this may not be possible.

#### SECTION 8

The general principles set out in paragraph 8.2 seem to be sensible and we have no comments at this stage. Paragraph 8.3 through to 8.23 set out some basic concepts regarding actuarial work which seem fine.

We have a few comments to make on Sections 8.24 through to 8.30.

- We do not feel that it is appropriate for the BAS to place limits on the range of assumptions to be used in any particular class of calculation. We reiterate that in the pensions context it is not the actuary who sets the assumptions used in calculating technical provisions, or indeed other calculations. Instead, trustees have this responsibility. We feel that the efforts of the BAS would be better focused on setting out the principles actuaries should follow when advising trustees on these issues.
- The principle under 8.2.4 (d) also causes us some concern. Where there are gaps in data assumptions we feel that it is a job for the actuary alone, after consulting with his client, to decide on how these gaps are allowed for. In essence, we do not see this as being markedly different from the principles used to set assumptions in that any gaps in these areas should be filled in a way that is unlikely to lower any level of prudence assumed. Going beyond that is unnecessary.
- In paragraph 8.25 the BAS states that it will only stipulate a limit to assumptions if it deems it appropriate. We have concerns as to whether the BAS has the knowledge base, or even access to one, to be able to do this. The range of assumptions, as well as the scopes in which they are used, is vast, and we suspect that the BAS will not have sufficient experience or knowledge to act as it thinks it may need to do.
- We are also of the opinion that if the Government or any regulator wished for there to be limits to the ranges of assumptions which can be used, that they would have done so themselves. We do not see it as the role of the BAS to set pseudo-legislation in this area and in many cases, as noted above, it is not

actuaries who set the assumptions. As such, if the desire is for limitations as to what trustees or insurance companies can use, then this is a matter for primary or secondary legislation.

- In paragraph 8.29 the BAS, unfortunately, makes the mistake of believing that there is a legislative requirement for trustees to use prudent assumptions when calculating their technical provisions. This is a mistake made by many. The legislative requirement is for trustees to choose their assumptions prudently, and this is different from using prudent assumptions. Two separate entities with markedly different risk profiles will both be able to set their assumptions prudently, but will, in all likelihood, come up with markedly different sets of assumptions, and hence levels of prudence. The legislation has been written in such a way to permit this range, but we fear that if the BAS feels that it is its responsibility to limit these ranges, then it will be constraining the degree of freedom which trustees currently have under the law.

We are generally supportive of the production of a generic reporting standard. There is much that goes into actuarial calculations, and it is important that end users understand this. We do ask the BAS to take this forward with some degree of caution though. The closest thing which pensions actuaries have to a generic reporting standard is the current GN9. It is worth noting that much of the information currently being envisaged for a generic reporting standard is already contained within GN9, and I am sure that the BAS has noticed that valuation reports are generally at least 30 pages long, with many exceeding 40 pages. There is a reason for this; the need to comply with the guidance requires a considerable amount of information to be included within a report. None of this is meant to imply that this is not appropriate, but it is important to realise that this level of reporting may not always be appropriate in all circumstances. As such it is vital that, when the BAS is giving due consideration as to how to classify which types of actuarial work will need to comply with the general reporting standard, it fully understands and appreciates the additional costs it would be imposing on end-users if fairly long reports are required for what would otherwise be fairly trivial exercises. We know that the author of this consultation document takes a slightly different view in that compliance with a generic reporting standard should not lead to overly long reports, but I would urge the BAS to look at some standard GN9 reports to see what they see as superfluous compared to a generic standard to gain a better understanding in this area.

We have the following points to make with regards to the proposals for a generic standard.

1. In 8.36 the BAS is suggesting that all the assumptions should be accompanied by justification of their use. We again mention that in the pensions context actuaries are often using assumptions set by trustees and, as such, justifying these assumptions would seem to be unnecessary. We need to bear in mind that those same trustees would have taken a great deal of actuarial advice in setting the assumptions in the first place, and to repeat all that advice to comply with a generic reporting standard is not appropriate.
2. We do not understand the reason for wishing to disclose the aggregate undiscounted cash flows. In the pension context this is an extremely easy figure to produce, but I am unaware of any end-user ever having asked to see it disclosed. If there is a requirement to produce this figure we fear that it will just add to the many pieces of information actuaries are obliged to give to clients for no good reason, often explaining to them that we have to give it as it is a professional or legislative requirement.
3. Whilst we understand how beneficial the proposals under 8.48 would be for the users of actuarial work, we do have some reservations over the inclusion within a generic reporting standard. We feel that this would impose large additional costs on many clients who would not wish to see such an analysis. In particular, it is likely that such an analysis would be reported in no more than half a page of a report, say, but that the cost could easily represent a substantial percentage of the total cost of producing the work. There is a danger that users of actuarial work will not perceive this to be of any value, and will

see that by making this a professional obligation it is a case of actuaries further feathering their nests by forcing work onto clients which they do not wish to undertake. We would argue that if there are areas in which further information should be given to clients at a substantial cost to them, then this is something on which the Government should legislate, and not those regulating the actuarial profession. To do otherwise will, we think, damage the reputation of this profession.

One of the last questions raised in Section 8 was whether there were any practical problems in assessing probabilities. Two which we can think of are those of mortality and salary growth. The former is something which cannot be modelled stochastically with any confidence that the model may be right. We are of the opinion that those models contained within the library of projections of the Continuous Mortality Investigation are not credible. Any stochastic measures as envisaged by the consultation which ignore the mortality risk would be relatively meaningless.

We trust that you find these comments helpful. If you have any questions regarding this consultation response please address them to Brian Nimmo, whose contact details are below.

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