

## Towards a Conceptual Framework: BAS Consultation Paper

These comments are in the form of the contribution I would have liked to make to the Consultation Meeting on Tuesday 15 January had I been able to attend.

The paper is generally a great improvement on the Preliminary Consultation Paper. In my view, it just needs to push transparency a bit further in two regards:

First, a glaring piece of bias needs to be redressed. It is in the comparison of the two views of the world in the highlighted example on pages 29 to 31. The give-away of the bias is in the paragraph under 8(b) on page 31: “The approach ... [of] not taking credit for the expected out-performance *plainly* incorporates a measure of prudence.” This is reminiscent of Winston Churchill’s marginal note to a speech: “Argument weak here, **SHOUT.**”

The view 8(b) is expressed as ‘not allowing for the expected out-performance’. This is a misrepresentation of the ‘market value’ view, 8(b). There is no harm in allowing for expected out-performance provided one makes one’s estimate allowing for the risk of not achieving the out-performance.

The bias in the Framework is that an estimate that fully allows for the risk of not achieving the out-performance is described as cautious and incorporating prudence when it results in a market value, which reflects a balance of buyers and sellers – an 8(b) estimate is not a cautious estimate; it is more like a ‘balanced’ estimate.

With this understanding, relative to the ‘balanced’ estimate of 8(b), the estimate 8(a), that does not allow fully for the risk of not achieving the out-performance, could be described as ‘unbalanced’, ‘incautious’, ‘imprudent’, or even ‘optimistic’.

Nevertheless, the distinction between *valuation* and *planning* is very well made.

The tangible results of the use of 8(a)-type estimates are there for all to see in the failures to meet the reasonable expectations of some pensioners due to underfunding, or must we now call it 'bad planning'?

I would like to see, whenever a type 8(a) estimate is made, the equivalent 8(b) estimate, allowing for the risk of not achieving the out-performance assumed, as, for example, in 8.39. Here, to use the language 'the value of the assets required today in order to meet the liabilities as and when they fall due ...' is inappropriate when out-performance of the assets is assumed. Such a statement should include that out-performance of the assets has been assumed and that, if it had not, the value of the assets required (which is now appropriate to say) is twice, or whatever, what the fund is actually holding.

My second issue is that the Framework can push transparency further by emphasising that *planning* is about determining the future cashflows (including cashflows that incorporate some expected out-performance, if so desired). The language that is used about *planning* should be very clear that it does not include or allow a present value – of assets or liabilities. So, for example, to describe the aim of a *plan* as 'to arrive at a provisional amount for *budgeting* or *target-setting purposes* is too close to a 'valuation' not to allow for the risk of not achieving the out-performance. Whilst not trying to redraft, is not the aim of a plan to determine what future cashflows from what assets will provide the liability outflow on the assumptions made?

And, finally: Where did the suggestion come from, in 8.37, that undiscounted cashflows should be shown? This suggestion would, at best, cause confusion and, at worst, bring the Profession into disrepute. All our technical skills are directed at supporting the notion that £1 tomorrow is worth less than £1 today. To suggest that actuaries should be party to adding these apples and pears is asking them to mislead. There is not even a suggestion that these amounts should be inflation-adjusted before summing them. Our communications are difficult enough without having to explain a nonsense of showing undiscounted cashflows. Can someone explain what is the magic in a zero discount rate? As far as discount rates are concerned, zero is merely a transient number somewhere between +1 and -1, both of which can be valid

discount rates. A zero discount rate has no validity; it is not even a floor of possible discount rates. It must go, or damage our reputation.

One of the best statements in the Framework is buried in 8.43 and 8.55: “The BAS considers that one of the keys to good reporting of actuarial work is to address the *implications* of the information in the report.” This is so important that much more can be done to encourage this vital communication than is envisaged in the Framework.

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