

The Director
Board for Actuarial Standards
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Sent by email as requested

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Dear Sir

BAS Consultation Paper: Towards a Conceptual Framework

I am responding to the above consultation on behalf of the Pension Protection Fund (PPF). The Pension Protection Fund was established by the Pensions Act 2004. Its main function is to pay compensation to members of eligible defined benefit pension schemes when there is a qualifying insolvency event in relation to the employer and where there are insufficient assets in the pension scheme to cover the Pension Protection Fund level of compensation.

Although PPF is not a regulated entity as such (by for example Financial Services Authority), it is required to perform functions as prescribed by the Pensions Act 2004 or in regulations made under this Act. The Board of PPF must accordingly, make an annual valuation prepared and signed by the appointed actuary of the assets and liabilities of the Fund, it must appoint an actuary to perform a valuation in accordance with section 143 of the Act for each scheme which is under assessment for entry to PPF and, under section 179 of the Act, requires information on assets and liabilities that are authorised by pension scheme trustees on the advice of their actuary. These valuations are subject to guidance provided by PPF and published on our website: www.pensionprotectionfund.org.uk. PPF also publishes early retirement factors for use by actuaries of schemes in assessment to compute compensation for such cases. In the most direct sense, therefore, PPF is an entity which requires work under regulation that can be performed only by a member of the profession and which would be subject to standards set by the Board of Actuarial Standards (the BAS). Such work, with PPF acting as principal, would clearly fall under the category A proposed in paragraph 3.9 of the consultation paper.

PPF undertakes a range of investigations and calculations designed to equip the Board to assess the risk to PPF of its role as pension fund "of last resort", to price those risks in the form of an annual levy on eligible schemes and to develop investment and other strategies appropriate to the risks and the Fund's financial obligations. Although PPF is required by legislation to produce a levy estimate, the nature of the technical work to support this pricing activity or to set its funding targets are not set down in regulation. Unlike an FSA regulated entity we are not explicitly required to obtain actuarial input for this category of work.

This work would, we believe, probably fall under category C of the proposed framework on the assumption that such work for PPF “related to a class of assets or liabilities that fell within the scope of work covered by category A”.

Our response is based on this understanding of the role of PPF as an entity that requires actuarial work under both direct regulation and also in support of activities that relate to regulated assets and liabilities or the principal role of PPF as defined by the Act to provide compensation to pension scheme members.

Overall we found the direction of the framework as indicated in the consultation paper clear and well-structured. This should lessen the risk that the development of detailed standards might be hampered in future over questions of definition rather than substance.

As an insurer of pension schemes’ obligations in stressed scenarios we are very aware of the different approaches within pensions and insurance towards actuarial work as highlighted in chapter 7 of the consultation paper. Although, as the BAS notes, one could ascribe those differences to the “top down” influences of different regulators, there are competitive market pressures that are leading to convergence; particularly the ability and actions of companies to transfer pension liabilities to FSA regulated insurance entities so voluntarily moving to a different regulatory basis. Similarly, the creation of the PPF, which is obliged under Section 143 of the Act to value the cost of buying out pension compensation for the purposes of establishing eligibility for compensation and Section 179 of the Act which explicitly uses a more insurance based approach to calculating liabilities, also represents a bridge between the two regimes.

The BAS seeks to deal with the issue of the different traditions by emphasising clarity of purpose of the relevant reports and by encouraging more formal expressions of risk within the reports. This is helpful but it seems to us that the needs of a pension scheme member are not different from those of an insurance policyholder as regards the security of his or her investment and that the professional bodies should seek to express that security with common terms and standards. It appears that this may not be such a problem if the BAS sought wherever practicable to introduce generic standards rather than sector-specific.

We are generally supportive of the explicit incorporation of risk considerations in actuarial work as reflective of the needs of the entities for which the work is undertaken. To date, the most influential input in this direction has been regulatory - from the FSA in its Individual Capital Assessments of insurance companies and banks. We are unclear how the BAS proposes to establish a similar regime without this regulatory driver, when the work would appear to fall under category C for which there is no specific regulatory requirement and for which standards are envisaged to be on a “comply or explain” basis. It would appear that the novelty of this work within the traditional areas of the financial world, the voluntary nature of its commissioning and the option to avoid adherence to any standard would at the very best result in a very inconsistent application of the standard and therefore its impact.

As noted above, PPF currently publishes guidance on those valuations that it is required by legislation to obtain from pension schemes. It would seem that such work would benefit from the application of standards and that this would give the Board of PPF greater confidence in the quality of the work being undertaken. We would therefore expect our requirements to be supported by the standards and that we will where possible align our requirements to the standards. However, we would want to avoid a situation where the standards inadvertently over elaborated the regulatory requirements or even counteract them. We appreciate, therefore, a recognition in the framework of the primacy of regulatory requirements to ensure that the potential for conflict is avoided.

We attach as an annex to this letter our detailed comments on the questions set out in the consultation paper. Should you require clarification of any of the points made please do not hesitate to contact me. It should be noted that this response has been prepared independent of the Chairman of The Pension Protection Fund in view of his membership of the BAS.

Yours faithfully



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Response of PPF to BAS Consultation Paper: Towards a Conceptual Framework

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.

We are attracted to the logic of the five categories to help the debate on scope at a principle level and recognise that more precise wording would have to be devised if these working definitions were to practical application. In particular:

- We recognise the problem of defining actuarial work that is not just work performed by an actuary or by reference to regulatory requirements. However a strict interpretation of the definitions of categories B, C and D would include **all** kinds of work.
- We assume the BAS would have a definition of actuarial work to supplement these categories which are presented to help the conceptual development. There is, however, an argument for the definition of category B to be amended by inserting “normally but” before “not necessarily from an actuary”. This would aid the authority of the BAS to own such standards.
- The wording “falling within the scope of” used in the definition of category C is intended to cover pensions and insurance for which actuaries also have a regulatory role. We think this wording is quite vague.

We are not able to offer other examples of category B work to supplement those described in the consultation document.

In considering the inclusion or otherwise of categories B, C or D in the scope of the standards it is first necessary to know the work likely to be covered, secondly whether there is a need for standards and lastly whether the BAS is the appropriate body to prepare those

standards. We believe it would be relevant where the work is normally performed by actuaries and where the profession has a lead in terms of expertise and experience. This would suggest that the scope could include B and C but most probably only in limited circumstances.

In practice the enforceability of standards depends on the disciplinary and regulatory frameworks that support them. Actuarial standards are capable of enforcement only where they are backed up with disciplinary measures affecting the profession or by obligations on commissioning entities that are enforced by their regulatory authorities. Where these do not apply, any standards can only be voluntary. Thus, while the categorisations will help in discussions, it is more likely that the scope will be driven by the need for standards and their applicability.

- 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?

We agree with the proposals contained in Section 4. In particular, we feel that a principles-based approach would stimulate a broader reach of the advice being made and potentially be more accessible to the recipients of the work.

- 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 agree that the users of actuarial work will be best served with clarity over what a standard represents and how it is to be enforced. Thus the conclusion that the BAS has reached to separate standards from recommendations and for the latter type be issued by the profession as information and assistance is, we believe, the correct one.

Similarly, the requirement on actuaries to comply or explain in those regulatory assignments that are undertaken for which an actuary is not necessarily required to perform the work by the relevant legislation, will aid clarity for users and assist their understanding of the status and quality of the work being undertaken. A Board, for example, would be able to assess the quality of key controls in an organisation by reference to the adherence or otherwise with appropriate and relevant standards.

Equally if the BAS decide to issue standards for prescribed pieces of work that are not required by regulation then we agree that the “comply or explain” approach would be suitable for internal assurance purposes.

- 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.

We agree with the general principles, the generic reporting standard (which will be a valuable contribution to quality and clarity) and the general direction of the quantification principles. We support the formal inclusion of the requirement to consider and report on the risks to the entity in actuarial work but sense that more definition of what is expected in these risk reports (which could be potentially quite extensive) is required.

Our specific comments are as follows:

- 8.2 (and elsewhere) This section indicates that the requirements of regulators have primacy over the standards and that regulators have the option in future to specify that work be undertaken in accordance with relevant standards. As mentioned in the covering letter PPF (which is not a regulator) issues guidance for its valuations required by regulation and specifies a basis for valuing contingent assets in connection with its levy determination that is not in accordance with the principle set out in the framework document. We would recommend that the override be expressed in terms of *regulations* not regulators.

- 8.8** In its own guidance on measures, PPF has taken a prescriptive approach. This reinforces the point made in the covering letter that the distinction between the pensions and insurance traditions are blurred and not necessarily driven by regulatory considerations.
- 8.9** In our experience of pension scheme transfers to PPF, the quality of data has been both an inhibitor of speedy process and a potential risk to PPF that we have sought to minimise. It is our view that actuaries could take more responsibility, shared with colleagues in the pensions administration and auditing professions, for ensuring the accuracy and completeness of data. In contrast the framework document implies that the emphasis is on the articulation of the risks and uncertainties of basing decisions on poor data. We would be supportive of specific standards in relation to data.
- 8.12** This fits in with our approach with specific constraints and limits on the permitted range of assumptions
- 8.15** We generally agree with the improved clarity that cash flows will provide on the grounds that this will aid understanding of the risks that the relevant entity faces. The information will have to be given appropriate context where, for example, indexation applies.
- 8.33** And onwards. We welcome the drive for reporting standards which will aid clarity and understanding.
- 8.48** With regard to the proposal to include assessments of the probability that assets will be insufficient to meet liabilities, we recognise the need to express some degree of caution in the results of actuarial calculations but are not persuaded that the simple concept proposed will encapsulate these sensitivities adequately. We believe an entity needs to understand both the range of possible outcomes and also their impact to form an accurate view of its financial position and that these features will not be apparent from a simple probability.