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Towards a Conceptual Framework: Consultation Paper

I have pleasure in providing you with comments on behalf of officials at the Pensions Regulator.

Overall we found the proposals to have moved forward in a very positive way since the preliminary paper published last April. There is now much more flesh on the bones and the difficult issues seem to have been faced. Nevertheless, particularly in the area of the principles based approach, we still need to see an actual standard to judge how effective the framework might prove in practice.

Our responses to the specific sections of the paper and the specific questions posed in the consultation follow below under their respective chapter headings.

The scope of the framework

We welcome the recognition that the distinction between advice and information is often blurred and that you have abandoned that distinction in defining your future standards' scope.

However, we are not convinced that the now proposed categorisation of "actuarial work" according to the circumstances in which it is required and whether it must be completed by an actuary is entirely successful. We are, of course, particularly concerned with the operation of the new scheme funding regime.

It seems clear enough that the "advice" the trustees are required to obtain from their actuary in accordance with section 230 of the Pensions Act 2004 will fall under category A and hence be squarely in scope. On the other hand, it is often going to be the case that the employer will wish to take his own independent "advice" during the scheme funding process. The regulator takes the view that it would be in the public interest, and certainly would give us a great deal of comfort, for both sets of advice to be covered by

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the same standards. We can see no very good reason why they should not. However, given that there is no actual statutory reference to the employer having to take advice on funding, whether from an actuary or anyone else, nor is it likely to be covered by the scheme's own provisions, we cannot see that advice actually obtained by an employer from an actuary in the context of the scheme funding regime falls within either of categories A and B. Thus it would be outside BAS standards unless you specifically included such actuarial work within category C.

In fact, we take the view that there is a case for a standard in connection with the new scheme funding regime of PA04 covering advice to trustees and to employers.

Objectives and characteristics of standards

We can see that generic standards may well have a place in the BAS pantheon, on stochastic modelling for example.

As to standards being principles-based as opposed to rules-based, it seems a laudable aim if it can be achieved in practice. The advantage of a principles basis is that it holds out the prospect of shorter standards which don't have to try to cover every conceivable eventuality. The disadvantages are that it is often difficult to establish broad principles and even where they can be, they may be capable of very different interpretations by different actuaries in similar situations.

We welcome the objective of standards addressing outputs and responsibilities and the focus on the needs of users. However, we wonder whether process can be entirely ignored. Is there not a place for insisting that end results are obtained by a sound process?

Enforceability of standards

When not complying with some aspect of a standard and explaining why, or invoking a reasonability override, it will largely be up to the recipient of the piece of work to judge whether the non-compliance is justified. This might be quite difficult. Indeed, we wonder if it is necessary to have such options if the standards are to be truly principles based? Certainly, such situations should be very much the exception.

Actuarial methods for quantifying liabilities

We concur with the distinction you draw between *valuation* and *planning*, though the current usage of *valuation* in a planning context is well embedded and indeed enshrined in legislation (eg, "actuarial valuation" under section 224 of PA04). However, your proposed definition of that distinction as it relates to its being recorded in a formal document does not seem quite watertight. The technical provisions under PA04 are recorded in formal documents yet the concept is essentially one of *planning*.

We also welcome your recognition that the different approaches to valuations in insurance scheme and pension fund contexts are really driven by their respective regulatory regimes. This is helpful.

We also note with interest your comments on valuation methods and the potential for confusion in the use of the word method. We generally support any move to enhance clarity.

Risk and uncertainty

The discussion over risk and uncertainty and the distinction you draw is highly relevant to the new scheme funding regime and we agree the conclusion that not all matters of uncertainty are susceptible to a probabilistic analysis.

We welcome the discussion of stochastic methods as we see them as a major tool for the actuary to employ when advising trustees and employers in relation to the new scheme funding regime.

We particularly welcome the attention you have given to the difficulties which are often inherent in interpretation of probabilistic information. This is often difficult enough for those familiar with the underlying ideas, let alone the uninitiated.

Applying the concepts to standards

Before commenting on the main thrusts of this section, we must point out a couple of errors (or at least, potentially misleading statements) relating to the scheme funding regime.

Firstly, paragraph 8.2 section 2 refers to contingent assets being normally valued as existing rather than future assets. This appears to give the impression that contingent assets could be added to actual scheme assets for valuation purpose. This is not the case. Also, if a contingent asset was being assessed, for example in relation to whether the trustees could agree to a certain length of recovery plan, it might well be more appropriate to value it as a future asset.

Secondly, in paragraph 8.8 you refer to TPR's permitting the use of various funding methods. In fact it is the underlying legislation which allows any accrued benefits funding method.

As to the substantive content of this section, it clearly goes to the heart of the actuarial work most relevant to trustees and employers in the pension scheme context. We are content with the general principles set out in paragraph 8.2 and welcome the full discussion of the concepts and principles relating to actuarial quantification in paragraphs 8.3 to 8.23.

As far as BAS standards are concerned (paragraphs 8.24 to 8.30) we are particularly pleased to note that you consider it a proper exercise of your functions to specify how prudence is to be achieved in a given context but only after ensuring that the relevant regulator endorses it. Clearly this is a matter highly relevant to the scheme funding regime and we would want to discuss this further with you. Nevertheless, we welcome the fact that you recognise that prudence is a proper area for an actuarial standard. You will be aware that trustees are the final arbiters of prudence but they need a proper framework in which to make an informed judgement and if that is your intention with an actuarial standard, we fully endorse it.


We support your proposal for a generic reporting standard as described in paragraphs 8.31 to 8.55.

We are attracted in theory to the idea of providing an assessment of the probability that assets held will prove adequate to meet liabilities, but we wonder whether it can be sensibly achieved in practice within the current state of knowledge. Practical problems we see in the pension scheme context are:

- should the assessment take into account the employer's covenant?
 - if it should, is it actually possible to do so, or is there uncertainty falling into the category of those not susceptible to a probabilistic analysis?
 - If it should not, should future contributions under an existing recovery plan nevertheless be included?
- is longevity improvement uncertainty susceptible to a probabilistic analysis?
- in the case of technical provisions, how should the notional investment policy underlying their calculation be reconciled with the trustees' current actual investment policy?
- a proper analysis ought to recognise the dynamic character of investment policy, yet not all trustees may have developed their thinking sufficiently to enable it to be incorporated into the analysis.
- is it practical within a reasonable cost for small schemes/employers?

We consider that much further work is needed to explore the feasibility of the proposal as far as pension schemes are concerned. Partial analyses may still be useful, of course, but explaining their relevance and interpretation will present its own challenges for actuaries and end users.

Yours sincerely



Tony Hobman
Chief Executive