



BOARD FOR ACTUARIAL STANDARDS

**CONCEPTUAL FRAMEWORK FOR
TECHNICAL ACTUARIAL STANDARDS
AND
SCOPE & AUTHORITY OF TECHNICAL STANDARDS**

EXPOSURE DRAFTS

MARCH 2008

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PART I

ANALYSIS OF RESPONSES TO THE CONSULTATION PAPER: TOWARDS A CONCEPTUAL FRAMEWORK

ANALYSIS OF RESPONSES TO THE NOVEMBER 2007 CONSULTATION PAPER

INTRODUCTION

- F1 In November 2007, the BAS published a consultation paper on a *Conceptual Framework* for technical actuarial standards. The emphasis was on *technical* standards, because that is the area in which the BAS has primary responsibility. The Actuarial Profession retains the primary responsibility for setting ethical standards.
- F2 The BAS received 45 written responses to the *Consultation Paper*, which have been published on the BAS website at www.frc.org.uk/bas. In addition, the BAS held meetings around the country with a combined attendance of around 500 people. Two of the meetings were open to the public; the remaining meetings were with specific groups, such as local actuarial societies and the Working Groups which have been advising the BAS.
- F3 This analysis (or *Feedback*) identifies the issues that arose and discusses the conclusions arrived at by the BAS in the light of the feedback. The analysis that follows gives equal weight to comments made at consultation meetings and comments made in written responses. Part II of this document contains an exposure draft of the proposed *Conceptual Framework for Actuarial Standards*. Part III contains an exposure draft of the proposed *Scope & Authority of Technical Standards*.
- F4 The BAS will shortly publish an exposure draft of the reporting standard which was also trailed in the *Consultation Paper*.

SUMMARY

- F5 The overwhelming message coming through from the responses is one of support and endorsement for the general thrust of the proposals, although almost all those who took the trouble to respond in writing had concerns about specific details.
- F6 There is general support for:
- standards being compulsory (rather than recommendations) with exceptions defined narrowly;
 - a combination of topic specific and generic standards, generally principles-based; and
 - the quantification principles proposed.
- F7 The categorisation of work in five groups, A to E, for the purposes of determining the scope of standards, was generally found to be helpful, but views were decidedly mixed on which categories should be in scope. The strength of the arguments for widening the scope was broadly matched by the strength of arguments for narrowing it.
- F8 Each of these points is addressed in more detail in this *Feedback*.

- F9 Many commentators remarked, in the context of their general support for the proposals, that they would like the BAS to make rapid progress with the development of the standards. The BAS is most keen to do so and will shortly be publishing specific proposals for the content and structure of the new book of standards.

RESPONSES FROM THOSE OUTSIDE THE ACTUARIAL PROFESSION

- F10 Of the written responses, forty were from actuaries or organisations responding from an actuarial perspective; only five responses were from organisations with a different set of interests (Association of British Insurers, Pensions Management Institute, the Pensions Regulator and two individual accountants). In addition, the BAS heard, in person, from the FRC's Stakeholder Interests Working Group which meets regularly to discuss a range of topics relevant to the FRC's work on actuarial matters.
- F11 The BAS would have welcomed still more responses from users, especially those representing the views of pension scheme trustees and insurance company directors. The *Consultation Paper* was sent to many trustee bodies and insurance companies, as well as to many other non-actuarial groups, all of whom were invited to respond. The BAS will, in future, explore ways of encouraging much greater participation from users and would welcome suggestions (from any source) that could help to achieve that goal.

CONTINUOUSLY IMPROVING THE STANDARD-SETTING PROCESS

- F12 Historically, consultation on actuarial standards has started at the exposure draft stage. It was a very deliberate decision on the part of the BAS, taken at its inception in 2006, to break with that tradition by opening its thought processes to consultation at an earlier stage. So far as the BAS is concerned, the decision has been amply rewarded by the attention which respondents (albeit mainly actuaries so far) have given to the ideas and the effort that so many respondents have clearly put into their responses.
- F13 This is an evolving process on both sides. The BAS is learning from the form and content of the responses how better to communicate its ideas in a consultative manner. The BAS believes that, by providing analysis and feedback (as in these pages), the quality of the communication between the Board and the public will improve still further and will build trust in the process.

SCOPE OF STANDARDS (Section 3 of the Consultation Paper)

Overview

- F14 The first major issue addressed in the *Consultation Paper* was the question of scope – essentially asking the question: how much of actuarial work should be addressed by technical actuarial standards? The *Consultation Paper* proposed that actuarial work be classified under five headings, A to E (see below), of which the BAS proposed that Categories A and B should be within the scope of standards and categories C, D and E should be outside that scope, save for any specific areas of categories C and D (but not E) which were identified by the BAS as requiring standards.

- F15 The five categories were:
- A Work that an *entity is required*, by regulation or by virtue of a legal obligation to a beneficiary, *to commission from an actuary*;
 - B Work that an *entity is required*, by regulation or by virtue of a legal obligation to a beneficiary, *to commission, not necessarily from an actuary*;
 - C Work *not covered by A or B* above, *but relating to classes of assets or liabilities falling within the scope of any work covered by A or B*
 - D Work *relating to classes of assets or liabilities falling outside the scope of any work covered by A and B*
 - E *Monitoring* the work of another actuary.
- F16 Many respondents were supportive of this categorisation of work and almost all supported the proposal that Categories A and B should be in scope and that work in Categories C and D should be outside the scope of standards unless specially designated by the BAS. But there were a few respondents who wanted the scope to go wider, perhaps embracing *all* work done by actuaries, and some respondents who wanted to narrow the scope down just to Categories A and B, or even just to A.
- F17 Having considered the responses, the BAS concluded that, so far as topic specific standards are concerned, a case had not been made out either for expanding the proposed scope, or for reducing it. The BAS decided, therefore, to pursue its original proposal in relation to topic specific standards.
- F18 Several respondents suggested specific areas of work in Categories C and D as candidates for standards. This was consistent with the Board's proposal to write standards for certain areas from those two categories. Frequently mentioned candidates included pensions advice to employers (as distinct from advice to trustees which typically falls within Category A); M&A work relating to the protection of beneficiaries (as distinct from pricing the company to be bought or sold); and asset-liability modelling. The BAS is minded to include the first two of those three suggestions in the initial round of standards being developed.
- F19 The principle of generic standards was well received, but the scope of these standards, as proposed by the BAS, was (unintentionally) open to more than one interpretation. In taking the idea forward, modifications to the proposals have been made, which are discussed in more detail below.

Over-complication of the categories

- F20 Despite this support in principle, there were a significant number of respondents who thought the categorisation was complex, especially for clients and users to understand. Several respondents thought that actuaries would be required to inform recipients of information which category the underlying work fell into. It was not the BAS's intention to create that impression.
- F21 The categorisation was developed in order to enter into a discussion with the wider world regarding the scope of standards. Once the decision on scope is taken, it will be for the BAS to develop standards for the areas so designated.

Users will, no doubt, have an interest in knowing whether a piece of work is governed by a standard and whether the standard is compulsory (see the discussion on enforceability below), but the BAS agrees with respondents that it would be unnecessary, and overly complex, if users needed to be told the basis on which the BAS had decided to write the standard (which is essentially all that the categories are).

- F22 The exposure draft of the *Conceptual Framework* (set out in Part II of this document) describes the framework as a “public statement of intent by the BAS to its stakeholders ... imposing a discipline on [the BAS] to comply with this document or publicly amend it.” The position for users (and actuaries) will be simple: if there is a standard, the work that it relates to (identified clearly at the beginning of the standard) is in scope; if there is no standard, the work is out of scope.
- F23 The proposed scope of BAS standards, to be known as Technical Actuarial Standards (TASs), is set out in the exposure draft of the *Conceptual Framework*, adopting the decisions described below.

Should standards apply to all areas of work?

- F24 Several respondents argued that the BAS should write standards for all areas of work. The position some of these respondents took was that the BAS should write standards relating to each and every area of work addressed by an actuary, including the examples in the *Consultation Paper*, ie nuclear power decommissioning costs, customer loyalty programmes and pricing models for utility businesses, and many others that were not listed in the *Consultation Paper*.
- F25 Some of these respondents may have been envisaging that it would be only the generic standards that applied in such areas, rather than asking the Board to write topic specific standards right across the range of all work done by any actuary. But, as discussed later in this *Feedback*, this approach calls for the generic standards to be applicable to a very wide range of work whilst not becoming anodyne.
- F26 Several respondents looked at the proposition from the perspective that the BAS was proposing to *exempt* Category E (and Categories C and D) from standards, as distinct from not writing standards for those categories in the first place.
- F27 The fundamental principle articulated by this group of respondents was that actuaries should be required to comply with all standards that are applicable to the work they are doing and not have any exemptions. Put like that, the proposition is not at variance with the BAS’s own view. The BAS did not actually propose that any categories should be *exempt* from observing standards. The BAS proposed that, for Category E (and for most of Categories C and D), there just would not be any relevant technical (as opposed to ethical) standards.
- F28 For example, in relation to peer review (described in the *Consultation Paper* by the more formal term, “compliance monitoring”), which some respondents highlighted, the BAS took account of the fact that the responsibility for these standards rests with the Actuarial Profession, not the BAS.
- F29 In short, the decision that the BAS will not develop technical standards on monitoring activity follows from the fact that this is a responsibility which is

discharged by others. This is true for all aspects of “monitoring” including audit as well as peer review. The general proposition is that the BAS will set standards for original actuarial work. Any monitoring of that work should have regard to the standards relevant to the work, but the BAS will not develop technical standards on the *process* of monitoring.

Topic specific standards

F30 Following the reasoning set out above, the BAS concluded that the five categories, A to E, can be reduced to four, of which three are potentially within the scope of standard-setting and one is not, as follows:

Cat Description

A *Reserved work:* Work that is reserved to actuaries by regulation is a likely candidate for a topic specific standard (see paragraph 4.6-4.7 of the Exposure Draft).

B *Work that is required but not reserved:* Other work that is required by regulation or other legal obligation, but not reserved to actuaries, will be considered as a candidate for a topic specific standard if the work is sufficiently frequently carried out by actuaries (see paragraphs 4.8-4.11 of the Exposure Draft).

E *Monitoring the work of another actuary:* Monitoring falls outside the agreed scope of BAS standards. The general proposition is that the BAS sets standards for original actuarial work. Any monitoring of that work should have regard to standards relevant to the work, but the BAS will not develop technical standards on the process of monitoring (see paragraphs 4.12-4.14 of the Exposure Draft).

C/D *Other work:* The BAS would not routinely expect to write topic specific standards for work that is not required by regulation or some other legal obligation, but there may be specific areas that the BAS decides should be the subject of a topic specific standard. The BAS will identify these areas of work from time to time and will consult publicly before a decision is made (see paragraphs 4.15-4.18 of the Exposure Draft).

F31 Whilst work required by regulation or other legal obligation is within the scope of standard-setting, that is not to say that every piece of such work commissioned from an actuary requires a topic specific standard. Judgement will be exercised by the BAS on a case-by-case basis, taking into account the results of an impact assessment. Likewise, any proposal to develop a topic specific standard in relation to non-required work will be the subject of an impact assessment.

Generic standards

F32 The principle of generic standards was well received, but their proposed scope caused some difficulties. The result of this has been that the responses received have opened up a number of options for the BAS to consider. The basic principle is that generic standards will be generic to defined categories of work; they will not be universal. The question is: which categories of work should they apply to?

F33 The difficulty in deciding on the scope of generic standards is best illustrated by reference to Category B (work that is required but not reserved to

actuaries). As a number of respondents pointed out, if an insurance company's finance director is also an actuary, Category B captures not only a report to the board on the insurance liabilities (which the category was intended to capture), but also the finance director's report on all other accounting matters.

[The final decision on the accounts themselves is, of course, for the board as a whole, not the finance director (whether or not the finance director is also an actuary). It is the report(s) to the board on which the directors make their decisions that fall within Category B.]

- F34 This is just one example of many that emerged during the consultation period – others included the position of actuaries as pension scheme trustees or non-executive directors of insurance companies – which made it apparent that applying generic standards to all work in Category B would cause the standards to apply in areas which the *Consultation Paper* had not intended and which were not suitable for actuarial standards. Ideally, there would be a revised definition of Category B which captured only work for which BAS standards were intended to apply but, as yet, the BAS has not found such a definition.
- F35 The problem is less stark in relation to Category A which is, by definition, work reserved to actuaries. But the argument has been put that, unless the BAS is aware of every circumstance in which work is reserved to actuaries – which means being aware of every (potential) legal obligation to commission work from an actuary – the application of any standard (generic or otherwise) right across the spectrum of Category A means imposing a standard on work without the BAS actually knowing what the full range of work is.
- F36 The BAS has decided that, rather than applying generic standards to all work falling within Categories A and B (ie all work which is required by regulation or other legal obligation), generic standards will be compulsory only in the case of work which falls within the scope of a defined list of work which will be set out in a Schedule to the *Scope & Authority* and updated from time to time. The list will initially be restricted to work which falls within the scope of the topic specific standards. The list will not be changed without proper consultation.

Geographic scope of standards

- F37 The BAS will develop standards in the context of UK legislation and regulation. The geographic scope of standards will be limited to work done in relation to the UK operations of entities and any overseas operations which report into the UK within the context of UK legislation or regulation. This definition of scope, which is set out formally in the *Scope & Authority* document, applies regardless of the location or domicile of the person carrying out the work.
- F38 If an overseas regulator or an overseas entity elects to have a standard applied in relation to work which falls outside the geographic scope described in the previous paragraph, those making the decision to apply the standard must take responsibility for ensuring that the standard is appropriate in the local conditions.

PRINCIPLES-BASED STANDARDS (Section 4 of the Consultation Paper)

- F39 There was a lot of support for the idea of standards being principles-based. But there was also a lot of concern about the BAS's ability to deliver this. The point was made that the proposals for the generic reporting standard (in section 8 of the *Consultation Paper*) looked fairly rules-based, particularly in relation to the requirements for some very specific disclosures.
- F40 The BAS recognises that the criticism is well-founded. The BAS's intention is that standards will be written in a manner which favours principles over prescriptive rules. The BAS recognises that, if this goal is to be met, standards will need to be written in a less rules-based voice than the *Consultation Paper* implied.

ENFORCEABILITY (Section 5 of the Consultation Paper)

Overview

- F41 There was widespread approval for the proposal that all BAS standards should be essentially compulsory, rather than making recommendations, as is the case for approximately half of the Guidance Notes inherited from the Actuarial Profession.
- F42 But a significant number of respondents interpreted the proposed relaxations (described as the *reasonability override* and *comply or explain*) as much more widely drawn than was intended. Several respondents saw the relaxations more in the nature of loopholes or get-out clauses and some even saw the relaxations as making some standards "optional". Some respondents welcomed this (unintended) freedom and others saw the proposals as too weak.
- F43 The BAS considers that, subject to a careful rewriting of the proposals so that their limited nature is clear, they should be pursued. The reasoning is set out in the following paragraphs.

Reasonability override

- F44 Those who argued against the override proposal generally addressed the proposition as though it were a brand new idea and therefore a relaxation that was not justified by the reason given, viz "to protect against (unforeseen) circumstances in which it would be positively wrong or misleading to apply a particular standard."
- F45 In fact, the existing GN regime has an override (in paragraph 4.2 of the PCS) which permits departure from Practice Standard (ie compulsory) GNs provided the departure is "adequately disclosed to the client and there is reasonable justification."
- F46 The Accounting Standards Board and International Accounting Standards Board also have overrides as follows (known colloquially as the "true and fair override", although the term is not used in the formal documents):

ASB

The requirement to give a true and fair view may in special circumstances require a departure from accounting standards. However, ... the Board envisages that only in exceptional circumstances will departure from the requirements of an accounting standard be necessary.

IASB

[I]n the extremely rare circumstances in which management concludes that compliance with ... a Standard ... would be so misleading that it would conflict with the objective of financial statements ... , [the entity should] depart from the requirement ...

- F47 The override proposal in the *Consultation Paper* was not very different from the ASB/IASB approach and was tighter than the current Guidance Note regime. The BAS recognises that actuarial work is very different from accounting work and has followed the precedents set in the accounting standards regime only where the read-across truly justifies such an approach. But the BAS consider that this issue is one case where following the accounting precedent is well justified. In the opinion of the BAS, the responses which disapproved of the proposal did not contain a compelling argument for abandoning it, nor anything which suggested that the ASB/IASB precedent is a bad one.

Comply or explain

- F48 The comply or explain proposal was intended to be available to actuaries in wider circumstances than the override. The label “comply or explain” was interpreted by many in the same way as the term is used in the corporate governance context and so the requirement (in the BAS proposal) for a *justification* of the non-compliance was often not noticed. As a result views varied as to whether the proposal was a good idea or not.

The way forward

- F49 The BAS has decided to drop both the descriptors (*reasonability override* and *comply or explain*) used in the *Consultation Paper*, because these two labels seemed to contribute to the perception that the exceptions were more widely drawn than was the intention. Instead, the BAS will rely on a revised, and more precise, wording for the (limited) exceptions.
- F50 As foreshadowed in the *Consultation Paper*, the proposals have been defined more formally in the *Scope & Authority* document than was appropriate at the consultation stage. The precise wording is now set out in the *Scope & Authority*, the exposure draft of which forms Part III of this document. In brief, the BAS has concluded that:

a) Materiality

Immaterial departures from a standard need not be considered as departures and need not be disclosed. Departures would normally be considered material if their combined effect could influence the decisions taken on the basis of the work in question. Further departures from a TAS are permitted or required as set out in (b)-(d) below.

b) Reserved Work (formerly Category A)

Departure will be required if, in extremely rare circumstances, compliance with a standard would be wrong or misleading. The departure must be limited to the minimum extent necessary to eliminate the wrong or misleading information.

c) Work that is Required But Not Reserved (formerly Category B)

In addition to departures required in rare circumstances in (b), if the objectives for which a piece of work was commissioned would be better met by departing from some of the requirements of a standard, departure is permitted so long as the resulting information satisfies a “reliability” test set out in the *Scope & Authority*.

Where it is feasible to do so, without adding disproportionately to the costs, the report on the work should include a quantification of the effect of the departure or the implications of the departure.

d) All other work (formerly part of Categories C and D)

In addition to departures required in rare circumstances by (b), and permitted by (c), those commissioning work may instruct those carrying it out to depart from the requirements of a TAS.

- F51 In all cases, particulars of any material departure from a standard should be identified in the report on the work and the reasons for the departure stated. The report should also state clearly that it is not to be passed on to a third party without all the information relating to the departure being included in the document that is passed on.

Actuaries working as part of a team

- F52 The *Consultation Paper* endeavoured to make it clear that, if an actuary is working as part of a multi-disciplinary team and the actuary does not have the authority to determine the final product, TASs would not be compulsory.
- F53 This is an important practical point, particularly now that so much emphasis is put on multi-disciplinary teams. Compulsion in such circumstances would act as a deterrent to non-actuaries choosing to employ, or to work alongside, actuaries if the appointment of an actuary to the team restricted the non-actuaries’ freedom to decide how to carry out a project – or if it exposed the actuary to a professional misconduct charge when those in charge of the team exercised their right not to adopt a particular TAS.
- F54 But this is not a new point. It arises already quite frequently in general insurance. The BAS proposal was merely to codify in the *Scope & Authority* something that is addressed at present in individual standards (for example paragraph 1.3 of GN 12).
- F55 Some respondents suggested that it is not always certain who is in charge of a team, especially if there are co-signatories to a document. Others saw the proposal as creating a perverse incentive for actuaries consciously to avoid being in charge.
- F56 To address these points, the BAS has amended the language (now set out in the exposure draft of the *Scope & Authority*) so that the decisive test is whether one of the actuaries in the team has the authority to determine (or alternatively to veto) the content of the final work product, regardless of whether anyone else might have a similar power. As a practical matter, any actuaries who are unsure whether they have the requisite authority should seek to ensure compliance with the relevant TASs: it will soon become clear whether they have the authority to do so.

- F57 An actuary who is, in reality, in a position of authority, but seeks to give the authority away temporarily when compliance with a TAS is inconvenient, would almost certainly be in breach of the test and would thereby expose themselves to the risk of disciplinary action for not ensuring compliance with the TASs when, in truth, they had the power to do so.

Miscellaneous points

- F58 Further comments on enforceability included proposals that:
- Disciplinary sanctions should apply equally to actuaries and non-actuaries alike.
 - Non-actuaries should not be allowed to say they followed standards unless they also say they are not an actuary.
 - New or emerging techniques in reserved work (Category A) should first be subject to a “comply or explain” regime, before becoming mandatory later.
- F59 The first two suggestions are outside the BAS’s power to implement. It would be a matter for other regulators to apply sanctions to non-actuaries if they wish to and if they have the power to. The third suggestion seems to be based on the premise that a BAS standard might impose a “new or emerging technique” as a compulsory requirement. This seems inherently unlikely. The BAS would have to be very confident of a new technique before imposing it. The consultation process would flush out any unjustified confidence.

QUANTIFICATION AND RISK (Sections 6 and 7 of the Consultation Paper)

Overview

- F60 In general, respondents acted upon the exhortation at the end of Sections 6 and 7 of the *Consultation Paper* to focus their comments on the implications for Section 8, rather than debating the discussion material *per se*.

Quantification

- F61 The two main issues addressed in Section 6 (the distinction between valuation and planning and the regulatory origins of the difference between the financing of pension schemes and insurance companies) were widely accepted. The valuation/planning distinction was widely affirmed in responses.
- F62 There were very few respondents who resisted any aspect of the analysis exemplified in the shaded passage between paragraphs 6.20 and 6.21. Some of these respondents disliked the description of the risk free calculation as “prudent”. As one put it, the “central estimate” calculation was “optimistic” and so the “risk free” calculation could be more conservative without being “prudent” in absolute terms. Crucially, nothing in the BAS’s example really turns on this use of language, but the BAS is not persuaded by the argument that the *central estimate* in a probability range could fairly be described as “optimistic”.
- F63 The same respondent proposed that any calculation of the central estimate must be accompanied by a calculation at the risk-free rate. The *Consultation Paper’s* reporting proposals did, in fact, require sensitivity tests, with assumption changes as one of the possible methods. The respondent’s

proposal is, therefore, in line with the BAS's thinking, but the BAS does not consider it appropriate to impose one single discount rate as the required test.

Risk and uncertainty

- F64 The analysis in Section 7 on risk and uncertainty was generally either welcomed or not commented on.
- F65 A few respondents challenged the BAS's distinction between applying a probability to a large population and applying it to an individual. Several actuarial commentators thought the calculation of a pension scheme transfer payment (cf paragraph 7.32 of the *Consultation Paper*) involved the application of individual, rather than population, probabilities. These commentators obviously know how to calculate a transfer value: it is the distinction between the two applications that was not fully understood.

APPLYING THE CONCEPTS (First part of Section 8 of the Consultation Paper)

Overview

- F66 On the whole, the *Concepts* section of the *Consultation Paper* was well accepted. The main bone of contention was the possibility of the BAS prescribing limits on assumptions. There were also some less significant concerns about the proposed principles for the valuation of assets.

Limits on assumptions

- F67 A significant number of respondents were very concerned by the suggestion that the BAS might one day propose limits on assumptions and/or "specify how prudence is to be achieved". Some objectors argued that the past history of the Minimum Funding Requirement for pension schemes indicated that the prescription of assumptions did not work. Others questioned how quickly the BAS could change the limits if market circumstances demanded it. Some also challenged whether this proposal was a proper function for the BAS, as opposed to government or (other) regulators. In contrast, the Pensions Regulator publicly expressed itself "particularly pleased" that the BAS might develop standards which addressed prudence.
- F68 A number of respondents commented that it is typically not the case any more that actuaries set assumptions: it is for the users of actuarial information, such as trustees of pension schemes and life office directors. That point is true, so far as it goes, but the actuaries advise – and are required to do so in many circumstances. So a limitation on assumptions (if there were to be any) would relate to the actuaries' recommendations and/or to a requirement on actuaries to disclose when an assumption was outside the BAS's range, rather than limiting the freedom for the entity to ask (or instruct) an actuary to make calculations outside the BAS's range.
- F69 The BAS recognises the strength of views on this issue (in both directions). As much as this was a big point for many respondents, it was made clear in the *Consultation Paper* that it was no more than an early trailing of a point that does not need to be decided for some time to come. Accordingly, the BAS has deferred its decision on this point. The exposure draft of the *Conceptual Framework* retains the notion that standards may put limits on assumptions, but takes no firm position either way. The draft of the *Conceptual Framework* is also clear that any prescription on assumptions would be determined only

after discussion between the BAS and the relevant other regulators, as well as public consultation and conducting an *Impact Assessment*.

Valuation of assets

- F70 The valuation of assets at market value was not disputed as a general principle, but there were several respondents who suggested that there might be certain types of asset for which market value might not always be the right answer. Examples included:
- insurance policies held by a pension scheme as an exact match for (some of) the liabilities; if the match is *exact*, the quantification of the assets and liabilities should cancel each other out; and
 - some contingent assets, such as a sum of money promised in the future.
- F71 There were also comments regarding assets that have fallen substantially in value between the valuation date and the valuation report and a challenge to what is meant by “market value” on a day when the asset values might have changed significantly.
- F72 The BAS accepts all of these points and will act on them.

Proportionality

- F73 The question of proportionality when applying standards to smaller entities (or even exemptions for smaller entities) was raised by a number of respondents. In most all cases, the point related to the BAS’s proposals for a generic reporting standard. The BAS is publishing, separately, an exposure draft on the reporting standard and addresses proportionality of reporting in that document.
- F74 On the general issue of proportionality, it is difficult for a regulator to resist calls for proportionate regulation, especially a regulator which professes to be principles-based. The BAS would certainly not want to resist such calls. But it is important to be careful not to be proportionate in favour of the wrong people. The fees for carrying out an additional step in a piece of work relating to a pension scheme with only ten members might add disproportionately to the cost, but the pension scheme is just as important to each member in a ten-person scheme as it is in a scheme with 100,000 members.
- F75 On the other hand, it should be borne in mind that there are relative savings to be made when writing about, for example, the assumptions relating to a ten-person scheme. With so few members, and therefore such a small population to analyse, the actuary will inevitably suggest assumptions that are rather more “off the shelf” than is the case for a large scheme and, therefore, have less original material to write on each occasion.
- F76 The BAS will always bear in mind the cost of implementing standards, and the question of proportionality. The possibility of exempting actuaries from part of (selected) standards when working for smaller entities is not ruled out at this stage, but neither is it ruled in. It has not been necessary in the past and the BAS is far from convinced that a case has been made out for it now.

REPORTING STANDARD (Second part of Section 8 of the Consultation Paper)

- F77 Section 8 of the *Consultation Paper* also contained proposals for a generic reporting standard. The BAS’s analysis of the responses to the consultation

and its proposals for taking the idea forward are set out in a separate exposure draft to be published shortly.

NATURE OF THE CONCEPTUAL FRAMEWORK (Section 2 of the Consultation Paper)

F78 There were very few comments which directly addressed the new objective of the *Conceptual Framework* as a framework for *standards* as opposed to a framework for actuarial *work*. Those who did comment took widely contrasting views:

- One organisation (an accountancy professional body) argued that the BAS should not have a conceptual framework at all.
- Another organisation (an industry trade body) expressed the view that the proposals did not constitute a conceptual framework.
- A practising accountant argued that the scope of the Framework should follow the accounting model.
- A professor of accounting described the BAS's approach to the framework as "refreshingly unlike accounting conceptual frameworks."

CONCLUSIONS

As described above, the BAS has decided to proceed as follows:

- The *Conceptual Framework* will be in the nature of a public statement of intent by the BAS to its stakeholders – a discipline imposed by the BAS on itself to comply with the *Conceptual Framework* or publicly amend it.
- The BAS will proceed with its proposal to write topic specific standards for work which is:
 - reserved to actuaries (formerly Category A)
 - regularly carried out by actuaries and which is required by regulation or other legal obligation, but not reserved to actuaries (formerly Category B)
 - outside those two categories, but only in specific cases that the BAS decides to include (formerly part of Categories C and D)

The BAS does not intend to write standards on monitoring the work of other actuaries. The responsibility for such standards rests elsewhere.

- Generic standards will be compulsory only in the case of work which falls within the scope of a defined list of work which will be set out in a Schedule to the *Scope & Authority* and updated from time to time following proper consultation.
- The geographic scope of standards will be limited to work done in relation to the UK operations of entities and any overseas operations which report into the UK within the context of UK legislation or regulation.
- Standards will favour principles over rules.

- BAS standards will be compulsory subject only to the following exceptions:
 - matters which are immaterial to users' decisions
 - in exceptionally rare cases, where applying a standard would be wrong or misleading
 - in the case of work which is not reserved to actuaries, if the purpose for which the work was commissioned is not well served by complying with a standard
 - in work which is not required by any regulation or legal obligation, if the entity commissioning the work instructs that a standard should not be followed.

In all the above cases, any departures from standards must comply with strict disclosure requirements.

- A decision is not required at this early stage on whether the BAS might one day prescribe limits on actuarial assumptions.
- The general principle relating to the valuation of assets will allow greater flexibility than was set out in the *Consultation Paper*.
- Proportionality is an important consideration when setting standards. The possibility of exemption for smaller entities is not ruled out, but it is not expected to be necessary.

PART II

EXPOSURE DRAFT:

A CONCEPTUAL FRAMEWORK FOR TECHNICAL ACTUARIAL STANDARDS

CONTENTS [OF THE CONCEPTUAL FRAMEWORK EXPOSURE DRAFT]

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1 INTRODUCTION & SUMMARY

STATUS AND PURPOSE OF THE CONCEPTUAL FRAMEWORK

- 1.1 The Financial Reporting Council (FRC) has as one of its strategic goals that:
- Users of actuarial information can place a high degree of reliance on the information's relevance, transparency of assumptions, completeness and comprehensibility.¹
- The Financial Reporting Council is the UK's independent regulator responsible for promoting confidence in corporate reporting and governance. The BAS is an operating body of the FRC.
- 1.2 BAS standards are a key component in the achievement of this goal. This *Conceptual Framework for Technical Actuarial Standards* is designed to give coherence and consistency to BAS standards, by setting out the objectives and characteristics which will be common to BAS standards, including the basic principles and concepts that will be applied in each standard.
- 1.3 As such, the *Conceptual Framework* is a public statement of intent by the BAS to its stakeholders. That is not to say that the *Conceptual Framework* is set in stone. This is the first time that an actuarial framework has attempted to cover the ground that this document covers and there may need to be changes along the way. But, by publishing this statement of intent, the BAS is imposing a discipline on itself to comply with this document or publicly amend it.
- 1.4 The *Conceptual Framework* is not a standard, nor does it have the status of a standard. The *Conceptual Framework* does not, of itself, create or impose any requirements on actuarial work. It is only when material appears in a BAS standard that it becomes a requirement. (Section 5 addresses the status and enforceability of BAS standards.)

TECHNICAL ACTUARIAL STANDARDS ("TAS")

- 1.5 The *Conceptual Framework* applies only to technical standards, which will be called Technical Actuarial Standards ("TASs"). Ethical standards are a separate matter. The Actuarial Profession² has the initial responsibility for setting ethical standards, with POB³ having oversight of this process. The BAS has a reserve role to set ethical standards if asked to do so by POB or if it otherwise considers this appropriate. But it is not the role of the BAS to set out objectives or characteristics for ethical standards ahead of the Profession.
- 1.6 The Profession's standards which were adopted by the BAS at its inception (known as Guidance Notes or GNs) contain some ethical material which will need to be deleted, to reappear, if appropriate, in the Profession's ethical standards. This exercise will take place in due course.

¹ The FRC's *Strategic Framework*, April 2007, Strategic Outcome Four.

² The Actuarial Profession is the name by which the Institute of Actuaries and the Faculty of Actuaries are known when working together. At the time of writing this document, the Councils of the Institute and the Faculty have indicated their intention to recommend to their members a merger of the two bodies. Pending any revisions to this document to reflect such a merger, references in this document to "The Actuarial Profession" include any successor body.

³ The Professional Oversight Board, another operating body of the FRC.

2 OBJECTIVES AND CHARACTERISTICS OF STANDARDS

OBJECTIVES OF TECHNICAL ACTUARIAL STANDARDS

- 2.1 At the highest level, all standards must contribute to the FRC's strategic goal that users can place a high degree of reliance on actuarial information. In pursuit of that goal, TASs will set out concepts, principles, rules and terminology from which those complying with standards will be able to determine the appropriate techniques, methodologies and assumptions to be applied to their work and the means of communicating the output.
- 2.2 As set out in paragraph 1.1, the FRC's strategic goal for actuarial practice lists four aspects of reliance: relevance; transparency of assumptions; completeness; and comprehensibility. It is the BAS's view that actuarial information cannot be regarded as "complete" unless it includes an indication of any uncertainty inherent in the information. This aspect of uncertainty, and the appropriate communication of that uncertainty, will be a key feature of TASs.
- 2.3 TASs are intended for the benefit of the public, rather than for the protection of actuaries. Actuaries may gain an indirect benefit from the enhanced reputation that may be expected to flow from the development of TASs, but the existence of standards is not a substitute for professional judgment, or consideration for the needs of the user(s), when delivering an individual piece of work.

CHARACTERISTICS OF TECHNICAL ACTUARIAL STANDARDS

- 2.4 Individual TASs will be:
- a) limited to a specific, defined context ("specific TAS"); or
 - b) generic to all work falling within the range specified in a Schedule to the *Scope & Authority of Technical Standards* ("generic TAS").
- 2.5 The BAS wishes to avoid a "tick-box" approach to standard-setting. As noted in paragraph 2.3 above, professional judgment and consideration for the needs of the users is paramount. With that in mind, TASs will be written in a manner which favours principles over prescriptive rules.
- 2.6 This approach does not exclude specific rules, where appropriate, as a means to convey the requirements of the standard. But neither does it exclude a standard (or a part of a standard) stating only the principle(s) to be followed. Standards will be articulated at a level of detail sufficient to enable those carrying out work to have a clear understanding of what is required in order to comply with the standard. Standards will not be so rigid that they prevent the continuing development of actuarial methodology.
- 2.7 The more generic the scope of a standard the more likely it is that the standard can be completely (or predominantly) defined by principles without spelling out detailed rules. The *Scope & Authority of Technical Standards* [set out in Part III of this exposure draft] explains that compliance with a TAS depends critically on applying the spirit and the reasoning behind the standard, as well as following any detailed rules.

FORM AND CONTENT OF A TAS

- 2.8 Each TAS will have its own specific objectives. Those objectives will be identified, standard by standard, and clearly stated in the standard, in the form of an opening statement setting out the purpose of the TAS, its scope of application and any legal and regulatory authority that underlies the standard.
- 2.9 Each TAS will provide a clear rationale for the principles underlying the standard. The principles will follow from this *Conceptual Framework* (see, in particular, Section 3) and will be explained and justified in a way which enables the reader of a standard to follow the reasoning from the underlying concepts through to the requirements of the standard. The objective, across all TASs, will be that the standard should not only be intelligible to lay readers, but also be intelligible to readers (whether lay or actuarial) who are new to the issues addressed in the standard.
- 2.10 In addition to the explanatory material contained within the TAS itself, the process of developing standards will include a consultation process during which discussion, including other options, will be exposed for comment. The reasons for the rejection of the options that were not selected will typically be explained in the commentary accompanying the exposure draft of the TAS.
- 2.11 Some of the material in TASs will address the *outputs* of actuarial work (or *processes* leading to outputs). Other material may address the *responsibilities* of actuaries. In this context, the *outputs* of actuarial work are, for example, the results of a calculation and the *processes* are the calculation itself, together with all the elements that go to making up the calculation. The *responsibilities* of actuaries are the duties they are under, typically (in the context of standards) as a result of regulations.

3 CONCEPTS TO BE ADOPTED IN TECHNICAL ACTUARIAL STANDARDS

THE STARTING POINT

- 3.1 The BAS will apply the following four precepts in the development of TASs:
- 1 *Liabilities*: The range of actuarial liability calculations is too diverse to fit within one single approach.
 - 2 *Assets*: Existing assets are to be taken at market value (or an estimate of the value in exchange in the absence of a market), and future assets by reference to the discounted value of future cash flows, unless specifically required otherwise.
 - 3 *Uncertainty*: Actuarial information cannot be regarded as complete unless it includes an indication of any uncertainty inherent in the information.
 - 4 *Consistency*: The quantification of liabilities and assets should be carried out using methods and assumptions that are consistent with each other and consistent with the identified risks.

Liabilities (Precept 1)

- 3.2 The first precept is that the range of actuarial calculations of liabilities is too diverse to fit within one single approach. TASs will recognise different approaches in different contexts.
- 3.3 In particular, TASs will recognise that calculating an actuarial liability for *planning purposes* may require different considerations from the calculation of a liability for a *valuation* and that, within each of those two objectives, further differentiation of approaches is desirable.
- 3.4 This distinction between the process of *valuation* and the process of *planning* is more than just a matter of semantics. The aim of a *valuation* is to crystallise an amount which can be applied to a transaction or recorded in a formal document, whereas the aim of *planning* is to arrive at a provisional amount for *budgeting* or *target-setting purposes*. The actuarial assumptions appropriate to a *planning* exercise may well (and typically are) different from the assumptions appropriate to a *valuation*. See Appendix [A in this exposure draft] for more details.
- 3.5 The recognition of a range of valuation (and planning) approaches does not place actuarial work in a special position. Multiple valuation approaches and philosophies arise in other disciplines. Economics, accountancy and finance between them recognise, for example, value in use, value in exchange, fair value, net realisable value and other measures.

- 3.6 TASs will also distinguish, where appropriate, between *methods of valuation* and *measures of liability*. The actuarial literature has often used the term “valuation method” to characterise different *measures* of the liability being quantified, rather than different mechanisms by which the valuer seeks to quantify the same (uncertain) amount of liability. Again, see Appendix [A] for more details.
- 3.7 The BAS recognises that the word “method” appears in legislation and “valuation” appears in many pension scheme trust deeds and other legal documents, none of which can realistically be changed at this juncture. Accordingly, in the interests of clarity of understanding, the BAS will write standards in a manner which reflects the relevant legislation and other relevant legal documentation, but the BAS will also seek to explain the true meaning of the terms identified above, so that those using a TAS can better understand the calculations being referred to.

Assets (Precept 2)

- 3.8 The general approach to the treatment of assets in TASs will be that existing assets are to be taken at market value (or value in exchange in the absence of a market) and future assets by reference to the discounted value of future cash flows.
- 3.9 In those cases where it is part of the actuarial calculation to take into account assets which the entity is not due to receive until some *future* date (for example future premiums), the quantification should follow the principles set out in this section, from paragraph 3.19 onwards.
- 3.10 In some actuarial contexts, there are assets which are not owned by the entity, but which have been contingently assigned to the entity. These contingent assets may be in existence at the time of the calculation, in which case they should be taken at market value (or value in exchange), or they may arise in future, in which case they should be calculated as future assets using the quantification principles below. The determining factor is by reference to existence, not ownership.
- 3.11 Specific TASs may set out alternative principles where necessary, for example where it is appropriate to take into account significant changes in value of assets after the valuation date (and even extreme changes *on* the valuation date). For some planning purposes, it may be appropriate to focus on the future cash flows from the assets, rather than their current market value.

Uncertainty (Precept 3)

- 3.12 As discussed in paragraph 2.2 above, the BAS takes the view that actuarial information cannot be regarded as complete unless it includes an indication of any uncertainty inherent in the information. TASs will set out principles on how to inform management of uncertainty, what to inform them of and, potentially, when or how often to inform them.
- 3.13 Some economists and actuaries draw a distinction between *uncertainty* and *risk*, using the following (or similar) classifications: ⁴

⁴ The origin of this classification is usually attributed to *Risk, Uncertainty, and Profit*, by Frank H Knight, originally published in 1921.

- 1 *A priori (or mathematically derivable) probabilities*: these include, for example, the chances of a particular outcome from tossing an unbiased coin, or selecting particular cards from a pack of playing cards. These results can be calculated without needing to observe coin-tossing or card-dealing.
 - 2 *Statistical (or empirically derivable) probabilities*: these cover outcomes for which the probabilities can be derived from observing past experience and drawing statistical inferences. Obvious examples include human features, such as the chance that a randomly selected male will be above a certain height or have eyes of a particular colour.
 - 3 *Estimates for which there is no basis on which to assign probabilities*: these cover outcomes for which there is no past experience or for which past experience is not a plausible guide to the future. So, for example, the chances of finding life on Mars has no prior statistics to guide us. The chance that a new invention will need to be recalled from sale on safety grounds could be estimated by collecting statistics from past inventions, but if the product is unprecedented (the first mobile phone, for example) statistics from previous inventions would not provide a meaningful guide.
- 3.14 All three categories are relevant to the presentation of actuarial information. The third category (no basis on which to assign probabilities) is sometimes called *uncertainty* to distinguish it from the first two categories (mathematically and empirically derived probabilities) which are called *risks*. Although this distinction between *risk* (quantifiable) and *uncertainty* (unquantifiable) tends to appear more in academic literature than in day-to-day business terminology, it has a significance for actuarial work and, in particular, the presentation of actuarial information which will be addressed, where appropriate, in TASs.
- 3.15 It is outside the scope of the BAS to set standards for managing risk. Management of risk is for managers of the entity.

Consistency (Precept 4)

- 3.16 The fourth precept is that quantification of liabilities and assets should be carried out using methods and assumptions that are consistent with each other and consistent with the identified risks. Where different methods are used in combination with each other (eg deterministic and stochastic projections), they too should be consistent with each other.
- 3.17 This approach does *not* mean that the assets and liabilities should always be quantified in an *identical* manner or using identical assumptions. In a typical actuarial exercise which tests whether the assets are (expected to be) sufficient to pay off the liabilities as they fall due, the future sales proceeds of the assets (ie their market value) will need to be estimated. The process of projecting forward the market value of the existing assets at their assumed growth rate is appropriate for this exercise and mathematically equivalently to discounting the liabilities at the same assumed rate.
- 3.18 The precept of consistency does not, therefore, call for the liabilities to be quantified at the current market value whenever the assets are valued in that way. To do so would ignore (expected) future market conditions and would not always meet the objectives of the calculation.

CONCEPTS AND PRINCIPLES OF ACTUARIAL QUANTIFICATION

- 3.19 The calculations that arise in actuarial work comprise, and are defined by, the following ingredients:
- the *nature and objective* of the calculation;
 - the *data* provided
 - the *assumptions* made;
 - the *cash flows* allowed for; and
 - the *risks* taken into consideration.
- 3.20 Each of these ingredients is described in more detail in the paragraphs below.

Nature and objective

- 3.21 For calculations which are specified in regulations or other legal obligations (defined more formally in Section 4 as “Required Work”), the nature or the objective of the calculations is often specified in the regulations or legal instrument which gives rise to the work in the first place. Alternatively, the regulator’s statements might simply say that the entity is to follow TASs and/or recognised actuarial practice. Where required, TASs set out how to implement the rules contained in those statements.
- 3.22 For all calculations which are the subject of a TAS (whether or not the calculations are the subject of regulations), the nature or objective of the calculations will be set out in the TAS, usually in the definition or description used by the BAS to identify the class of work the TAS relates to.
- 3.23 There may be more than one calculation *method* which can be used to achieve a given objective. For example, the valuation of a conventional business might be assessed using price/earnings ratios or by discounting future expected cash flows.
- 3.24 Likewise, there may also be more than one calculation *measure* which can be used to achieve a given objective. For example, the Pensions Act 2004 permits the calculation of the technical provisions of a pension scheme to use a variety of different liability measures, for example measures which include or exclude allowance for future expected salary increases.
- 3.25 Where appropriate, having regard to all the relevant circumstances, including the prevailing regulatory environment, TASs may specify one or more permitted methods of valuation and/or permitted measures of liability for the purposes of a particular class of calculations and a particular calculation objective.

Data

- 3.26 In an ideal world, the data underpinning actuarial work will always be available in precisely the form needed for the intended calculations and will be complete and accurate. In practice, that is not always the case. Sometimes, it may be necessary to form a view whether the data is suitable for the proposed calculations and, on occasion, to adjust the quantification methodology to allow for limitations in the available data.

- 3.27 Alternatively, or in addition, a margin may need to be incorporated within the quantification process, within the results, or within the range of possible results to avoid a misleading presentation of the entity's financial position.
- 3.28 TASs may specify tests to be carried out on the data used for specific calculations and/or adjustments to be made to compensate for uncertainty in, or inappropriateness of, the data.

Assumptions

- 3.29 Actuarial calculations almost invariably depend on one or more assumptions about the course of future events. Commonly encountered examples relate to the longevity of beneficiaries, the return earned on investments, expenses and several other economic, financial and demographic factors.
- 3.30 TASs may potentially address the selection of an individual assumption by way of:
- a) *qualitative aspirations*, for example that the assumption should reflect recognised and authoritative views and not merely the individual actuary's personal views (or vice versa, in circumstances where it is the case-specific judgement of the individual that is paramount);
 - b) *qualitative prescription*, for example that the assumption should be determined by reference to a stated criterion;
 - c) the *mechanism* (or *link*) by which particular types of assumptions should be used to address specified risks; or
 - d) *quantitative limits*, for example that the assumption should be set within specified numerical boundaries.
- 3.31 In the case of (d) above (quantitative limits on the range of assumptions), limits may be expressed in terms of a formula or yardstick by which the assumption range automatically alters with changing circumstances, or by expressing limits in absolute numerical amounts. The BAS has no current plans to set numerical boundaries on assumptions. But this Conceptual Framework does not preclude the BAS from imposing limits where, after due consultation, this is determined to be appropriate in the light of all relevant circumstances.
- 3.32 For some calculations, the entity's own regulator may impose specific constraints or limits on the permitted range of assumptions. These constraints may be expressed qualitatively, for example a requirement for prudence, or quantitatively, for example a best estimate. Alternatively, the constraints may be expressed according to a rule or formula (for example imposing a maximum or minimum on the permitted assumption).
- 3.33 The constraints imposed by the entity's regulator may be sufficient and without any need for qualification or amplification. But there may be circumstances in which the regulatory objective would be well-served by additional input from the BAS, either at the regulator's request or at the suggestion of the BAS. This will only be determined after discussion between the BAS and the regulator (and after public consultation, as is the case for all BAS standards).

Cash flows

- 3.34 The cash flows adopted in actuarial calculations are typically derived from a combination of underlying facts and assumptions about those facts. The facts consist of matters such as data relating to beneficiaries and scheme or policy documents which specify rules to determine the level of payments made to the beneficiaries. The assumptions relate to the possible future courses of events relating to those beneficiaries and the payments they will receive.
- 3.35 But where an entity has a practice, for example, of making payments in excess of the contractual minimum, the decision whether to estimate the cash flows by reference to the contract or the established practice is one which depends on the objectives of the calculation, not facts or assumptions.
- 3.36 In some such circumstances, the entity's regulator may impose a principle to be applied. Where the regulatory objective would be well-served by additional input by the BAS, and in other appropriate circumstances, TASs will specify (further) principles to be applied.
- 3.37 Conventionally, actuaries do not disclose the cash flows underlying a quantification exercise. Actuaries tend to disclose only the discounted value, ie the (reduced) amount, at the valuation date, which equates to the future cash flows, after allowing for investment returns at the assumed rate. TASs may identify information relating to the undiscounted liability cash flows to be disclosed in addition to the discounted values.

Risks

- 3.38 The entities with which actuarial work is concerned typically face a range of risks. But not all of the risks that an entity is faced with are reflected in actuarial work. For example, the failure to win new business is a key risk for many insurers, just as it is for most businesses. But the impact that the loss of new business has on the actuarial calculations falling within the scope of TASs is limited to the effect on the expense reserves.
- 3.39 By definition, every risk relates to something which cannot be known with certainty. So, for every (material) risk which might affect the outcome of the actuarial calculation, there needs to be an assumption to address that risk.
- 3.40 The major risks associated with typical areas of actuarial work are, by nature, economic, demographic or (in the case of general insurance) liability-driven. TASs may need to address other types of risk also. For some calculations, the entity's regulator may identify a number of risks, or risk categories, which must be taken into consideration.
- 3.41 Where mitigating actions have been taken by management, it may be appropriate for the actuarial calculation to reflect that action. But where such mitigating action is reversible and no allowance has been made in the calculations for the possibility of such a reversal, this amounts to an (implicit) assumption that the mitigating actions will be kept in place.
- 3.42 TASs may specify types or classes of risk which must be taken into account for the purposes of actuarial calculations and, as noted in paragraph 3.30 above, the mechanism (or link) by which particular types of assumptions should be used to address specified risks. TASs may also specify the extent to which it is appropriate that steps taken to mitigate risks should be allowed for and requirements for explicit disclosure of any implied assumptions.

4 THE SCOPE OF TECHNICAL ACTUARIAL STANDARDS

INTRODUCTION

- 4.1 This section addresses the scope of work for which Technical Actuarial Standards will be developed, both in terms of the type of work and its geographical scope. The enforcement of TASs is described in Section 5 and set out more formally in the *Scope & Authority of Technical Standards* [an exposure draft of which is set out in Part III of this document].

TERMINOLOGY

- 4.2 For the purposes of this section of the *Conceptual Framework*, the following terms are required. Formal definitions of these terms are set out in the *Scope & Authority*:

Required Work: Work carried out in order that the entity commissioning the work complies with regulations, or with some other legal obligation, that requires the entity to have the work carried out (or makes certain outcomes conditional on the work having been carried out).⁵

Reserved Work: A particular category of Required Work for which the regulations or other legal obligation require the entity in question to commission the work from an individual who holds a prescribed actuarial qualification (usually Fellowship).

For the purposes of this definition, Reserved Work does not include – and the BAS does not intend to develop TASs for – work assigned by regulations only to the holder of a unique post, such as the Government Actuary, Lloyd’s Actuary.

Required But Not Reserved: This term refers to work which falls within the class of Required Work, but which is not Reserved Work.

Reliability Objective: This is the objective that users of actuarial information should be able to place a high degree of reliance on the information’s relevance, transparency of assumptions, completeness and comprehensibility, including the communication of any uncertainty inherent in the information.

- 4.3 In addition to the formal definitions of these terms set out in the *Scope & Authority*, the terms *regulation* and *legal obligation* used above are also defined there. In brief, a regulation is a rule or an order issued by an appropriate authority and a legal obligation is any obligation enforceable at law (eg a contract, trust deed, court order etc).

⁵ By way of example, the requirement for a pre-paid funeral plan to obtain an actuarial report applies only if the plan wishes to be exempt from certain other regulatory requirements. That is sufficient to bring the work within the definition of Required Work.

AREAS OF WORK TO BE COVERED BY TECHNICAL ACTUARIAL STANDARDS

- 4.4 The BAS has concluded that the need for actuarial work to be the subject of technical standards can be described as follows, with more details set out in the paragraphs that follow:
- *Reserved Work*: Work that is reserved to actuaries by regulation is a likely candidate for a TAS (see paragraph 4.6-4.7 below).
 - *Work that is Required But Not Reserved*: Other work that is required, but not reserved to actuaries, will be considered as a candidate for a TAS if the work is sufficiently frequently carried out by actuaries (see paragraphs 4.8-4.11 below).
 - *Monitoring the work of another actuary*: This work falls outside the scope of the BAS. The general proposition is that the BAS sets standards for original actuarial work. Any monitoring of that work should have regard to the TASs relevant to the work, but the BAS will not develop technical standards on the process of monitoring (see paragraphs 4.12-4.14 below).
 - *Other work*: The BAS would not routinely expect to write TASs for work that is not Required Work, but there may be specific areas that the BAS decides should be the subject of a TAS. The BAS will identify these areas of work from time to time and will consult publicly before a decision is made (see paragraphs 4.15-4.18 below).
- 4.5 The BAS recognises that a commissioning entity may make it a contractual term that a piece of work must comply with a TAS of the entity's choosing. The entity and the person carrying out the work (whether or not they are an actuary) should first agree that the TAS is applicable to the work. This is most likely to be the case in respect of a generic TAS, but there may be circumstances in which a specific TAS can be applied beyond its formal scope.

Reserved Work

- 4.6 Work that is reserved to actuaries has typically been the subject of standards in the past. More recently, other regulators such as the FSA have written regulations for entities which effectively cover the ground that might otherwise have been the subject of standards. Whether those regulators continue to set regulations in that way or rely on a general regulation requiring compliance with BAS standards will depend on the evolving division of responsibilities between the BAS and other regulators.
- 4.7 For the purposes of this Conceptual Framework, the position is that the BAS will work in a relationship of mutual co-operation with the relevant regulators so that regulations and TASs, taken together, cover the required ground.

Work that is Required But Not Reserved

- 4.8 The decision that the BAS will also develop TASs in relation to work that is Required But Not Reserved is the result of a balanced analysis. On the one hand, the potential benefits to be gained from the creation of actuarial standards do not vanish simply because the regulators do not compel the use of an actuary.

- 4.9 On the other hand, the fact that the work in question does not, by definition, have to be commissioned from an actuary means that the BAS has no standing to insist that the entity should commission work which complies with BAS standards.
- 4.10 The BAS is mindful of the practical risk that, if a TAS restricts the output from work done by actuaries, but not the equivalent work done by others, entities may, on occasion, be deterred from choosing an actuary for the work, particularly if the result of following actuarial standards is expected to be adverse to the entity's own interests. The BAS has no brief to encourage entities to use actuaries in preference to any other service provider, but there might be risks to beneficiaries, and perhaps to the entities themselves, if those who commission work were deterred from using actuaries just at a point in time when the training of the actuary and the ethical code of the profession, were most needed.
- 4.11 The BAS has addressed this by stipulating that, where the objectives for which a piece of work was commissioned would be better met by departing from some of the requirements of a relevant TAS, an actuary may depart from the requirements so long as the departure is identified, the reasons for the departure are given and the result is not in conflict with the Reliability Objective set out in paragraph 4.2 above. The details relating to permitted departures from TASs are set out in full in the *Scope & Authority* document.

Monitoring the work of another actuary

- 4.12 The decision that the BAS will not develop technical standards on monitoring activity follows from the fact that this is a responsibility which is discharged by others. This is true for all aspects of "monitoring" including audit and peer review.
- 4.13 An individual commissioned by an auditor to review actuarial information is working as part of the audit function. The reviewer (whether an actuary or not) will need to take into consideration any TASs applicable to the entity's work, but it is for other standard-setting bodies, not the BAS, to develop standards that apply to the audit function.
- 4.14 In relation to other forms of compliance monitoring (the term which has replaced "peer review" in actuarial literature), this responsibility for developing standards was assigned to the Actuarial Profession, overseen by the POB, when the BAS was created.

Other work

- 4.15 The key feature of work which is not Required Work is that the entity commissions the work at its own discretion, to meet a need that it determines for itself and with terms of reference which the entity is free to choose.
- 4.16 This work has a far wider range and diversity than the work hitherto covered by standards written by the Actuarial Profession. To develop standards for this work, in general, would constitute a very significant increase in regulation, an increase which could only be justified if there was substantial evidence that regulation on this scale was now required.
- 4.17 This does not rule out entirely the prospect that some areas of non-Required Work will be the subject of a TAS. Individual proposals will be considered on

a case-by-case basis. [The *Feedback* accompanying this exposure draft identifies some specific areas currently under consideration.]

- 4.18 Moreover, an entity commissioning work for which there is no specific TAS is at liberty to make it a contractual term that the work must comply with one or more TASs of the entity's choosing, selected most likely from the range of generic TASs.

THE ROLE OF IMPACT ASSESSMENTS

- 4.19 Whilst Required Work (both *reserved* and *not reserved*) is within the scope of standard-setting, that is not to say that every piece of Required Work commissioned from an actuary will be the subject of a standard. Judgement will be exercised by the BAS on a case-by-case basis, taking into account the results of an *Impact Assessment*. Likewise, any proposal to develop a TAS in relation to non-Required Work will be the subject of an *Impact Assessment*.

GEOGRAPHIC SCOPE

- 4.20 The BAS will develop TASs in the context of UK legislation and regulation. The geographic scope of TASs will be limited to work done in relation to the UK operations of entities and any overseas operations which report into the UK within the context of UK legislation or regulation. This definition of scope, which is set out formally in the *Scope & Authority* document, applies regardless of the location or domicile of the person carrying out the work.
- 4.21 If an overseas regulator or an overseas entity elects to have a TAS applied in relation to work which falls outside the geographic scope described in paragraph 4.20, those making the decision to apply the TAS must take responsibility for ensuring that the TAS is appropriate in the local conditions.

5 THE ENFORCEABILITY OF TECHNICAL ACTUARIAL STANDARDS

OVERARCHING AIM

5.1 It is the intention that TASs published by the BAS will be complied with by actuaries: TASs are more than just recommendations. The extent to which TASs are to be treated as compulsory requirements is set out in this section. In brief, and subject to the more detailed requirements set out below:

- In the case of *Reserved Work*, TASs will be compulsory subject to required exceptions which will apply only in very rare cases.
- In the case of work that is *Required But Not Reserved*, an actuary may depart from the requirements of a TAS in limited circumstances, so long as the result is not in conflict with the Reliability Objective.
- In all other cases (ie *non-Required Work*), those responsible for commissioning work may instruct those carrying it out to depart from (specified) TASs.

Material departures will be subject to strict disclosure requirements.

HISTORICAL CONTEXT

5.2 Previously, when the Actuarial Profession was responsible for issuing technical standards, some of the standards, classified as *Recommended Practice*, were in the nature of (short) manuals of good practice with little or no compulsion attaching to them. The Actuarial Profession has indicated that it intends to continue issuing helpful material with the intention that the material will provide background information and educational content, including a balanced digest of conflicting views on actuarial techniques.

5.3 In the context of the long term goal of the BAS to pursue continuous improvement in actuarial standards, reflecting evolving commercial practices, economic developments and expanding actuarial know-how, the professional body has a key role to play (along with other organisations) as a source of new ideas and a means for conducting and co-ordinating research. The BAS wishes to encourage that role.

5.4 The BAS is likely to carry out research of its own, in the context of its standard-setting role, and will publish the results as and when appropriate. But the BAS will not develop “good practice manuals”, or the equivalent by another name.

AUTHORITY OF BAS PRONOUNCEMENTS

5.5 The authority for BAS standards derives from the powers of those bodies which decide to recognise BAS standards and adopt any or all of them as a requirement imposed on individuals or entities which the body in question has power over. Specifically:

- The disciplinary schemes of the Actuarial Professional Bodies and the Accountancy & Actuarial Discipline Board recognise the authority of BAS

standards by providing that any departure from a BAS standard may amount to misconduct, rendering the actuary liable to disciplinary action.

- The regulatory regimes for pensions and for insurance have recognised certain BAS standards for the purposes of requirements imposed on the entities they regulate.
- Compliance with BAS standards is likely to be taken into account when the adequacy of the work of actuaries is being considered in a court of law or in other contested situations.

COMPLIANCE WITH TECHNICAL ACTUARIAL STANDARDS

- 5.6 The requirements to comply with TASs will be set out in the prevailing *Scope & Authority* document published by the BAS. The *Scope & Authority* will set out the formal position in relation to the following issues.
- 5.7 TASs are intended to assist in the achievement of the Reliability Objective defined in paragraph 4.2 above. In applying TASs, it will be important to be guided by the spirit and reasoning behind them, as well as following any detailed rules. The spirit and reasoning (as well as any rules) are set out in the individual TASs.
- 5.8 Compliance with all relevant TASs will be compulsory for actuaries, except to the extent of any departures permitted or required by the *Scope & Authority*, in pursuit of the principles set out briefly in paragraphs 5.9.
- 5.9 Immaterial departures from a TAS need not be considered as departures and need not be disclosed. Departures would normally be considered material if their combined effect could influence the decisions taken on the basis of the work in question. Further departures from a TAS are permitted or required as follows:

a) Reserved Work

Departure will be required if, in extremely rare circumstances, compliance with a TAS would be so wrong or misleading that it would conflict with the Reliability Objective. Departure should be restricted to the minimum extent necessary to remove the conflict with the Reliability Objective.

b) Work that is Required But Not Reserved

In addition to departures required in rare circumstances described in subparagraph (a), if the objectives for which a piece of work was commissioned would be better met by departing from some of the requirements of a TAS, departure is permitted, so long as the departure is not in conflict with the Reliability Objective.

Where it is feasible to do so, without adding disproportionately to the costs, the report on the work should include a quantification of the effect of the departure or the implications of the departure.

c) All other work

In addition to departures required in rare circumstances by (a) above, and permitted by (b) above, those commissioning work may instruct those carrying it out to depart from the requirements of a TAS.

- 5.10 In all cases, particulars of any material departure from a TAS should be identified in the report on the work document and the reasons for the departure stated. The report should also state clearly that it is not to be passed on to a third party without all the information relating to the departure being included in the document that is passed on.

ACTUARIES WORKING AS PART OF A TEAM

- 5.11 Where one or more actuaries work as part of a team alongside non-actuaries, with the actuaries contributing only part of the work, the actuary(ies) are not required to apply TASs unless one or more of the actuaries has the authority to determine the content of the final work product. Whether or not a particular individual has the authority to determine the content of a document is a matter of fact which, in the event of an allegation of misconduct or negligence, may have to be determined by the appropriate tribunal, having regard to all the available evidence relating to the specific circumstances.

VOLUNTARY COMPLIANCE WITH TECHNICAL ACTUARIAL STANDARDS

- 5.12 Even though an entity, a firm or an individual who is not an actuary may not be obliged to apply BAS standards, the BAS recognises that:
- employers or clients of actuaries may agree to make it a contractual condition that a particular piece of work be carried out in compliance with one or more stated TASs, so long as the standard is relevant to the work;
 - other regulators may make it a requirement of their regulatory regime that an entity or an individual adopts appropriate TASs; and/or
 - entities or individuals who are not actuaries may apply TASs voluntarily and, if they do so, may assert that the information they have produced complies with TASs published by the BAS.

A MATTERS RELATING TO THE CONCEPTS OF VALUATION AND PLANNING

PURPOSE OF THIS APPENDIX

- A.1 This appendix explains the thinking behind the BAS's decisions set out in paragraphs 3.2-3.7.

METHODS OF VALUATION vs MEASURES OF A LIABILITY

- A.2 In actuarial literature relating to the assessment of liabilities,⁶ the term "valuation method" is often used to refer to a *measure* of the liabilities, not the method of quantifying them. When the language is used in this way, given the same data and the same assumptions, two different valuation "methods" will (deliberately) arrive at different outcomes. For example, in the context of pension schemes, the method of valuation known as "projected unit" takes into account prospective future salary increases which the method known as "current unit" ignores (by design).
- A.3 This use of the word "method" is quite different from normal business parlance, in which two different "methods" of valuation would normally be intended to produce similar results. For example, when an unquoted business is valued for sale, the valuer often uses more than one method of valuation so as to provide a cross-check of one calculation against the other. If the two results differ widely, the valuer will look for an explanation in order to narrow the gap.

VALUATION vs PLANNING

- A.4 Many actuarial calculations have a particular feature in common: they derive a single monetary amount which, at the effective date of the calculation ("the valuation date"), equates to a stream of cash flows payable on other dates.
- A.5 The underlying real-world principle by which a single monetary amount can be linked or equated to a stream of cash flows is the economic activity of *investment* (and *disinvestment*) in which a sum of money is exchanged on a given date for a series of cash flows at later dates (and vice versa). In financial terminology, the calculation which converts (a stream of) cash flows at one or more date(s) to an equivalent figure at another (earlier) date is known as *discounting*.
- A.6 Readers familiar with mathematical terminology will recognise *discounting* as an *operator* applied to a series of cash flows and to the dates associated with those cash flows to arrive at a single sum of money associated with another date. Mathematically speaking, the date to which the cash flows are discounted can be earlier than, later than, or during the time span of the other cash flows, although it is usual to talk about *accumulation*, rather than *discounting*, when the specified date is after the cash flows.

⁶ The most prominent example is perhaps the actuarial standard known as GN 26, *Pension Fund Terminology*, which the Profession first issued in 1996 and retained until handing over responsibilities for standards to the BAS.

- A.7 Discounting calculations may arise in two different contexts:
- a) The first type of calculation is performed in circumstances where the goal is to arrive at a result which will be applied to a transaction or in a formal document such as accounts or a regulatory return. Examples of this type of calculation include:
 - liability values for regulatory returns
 - accounting values for statutory accounts
 - transfer or surrender values paid to individuals
 - appraisal values for the purchase or sale of a business.
 - b) The second type of calculation is performed in circumstances where the goal is to arrive at a provisional amount for planning or target-setting purposes – typically to calculate the quantum of assets that an entity needs to hold in order to pay off specified liabilities when they fall due. Examples of this type of calculation include:
 - funding assessments for pension schemes
 - developing a bonus distribution strategy in a with-profit life fund (or, in traditional actuarial terminology, a control method for the release of surplus)
 - reviewing the adequacy of general insurance premiums.
- A.8 In purely *mathematical* terms, there is no difference between the first and second type of calculation. But in practical terms, there are subtly different real-world interpretations of the two calculation types which may, therefore, require different inputs, even though the mathematics is identical.
- A.9 The end result of the process in the first class of calculations is the adoption of an amount for the purposes of a transaction or a formal document. In ordinary English, this process is known as a *valuation*. In the second class of calculations, the end result is a provisional amount for the purposes of *planning, budgeting* or *target-setting*. Outside the actuarial environment, the processes of *planning, targeting* and *budgeting* are not typically known as *valuations*. Several commentators have, over a period of years, criticised the unusual way that actuaries have used the word.⁷

FINANCIAL MANAGEMENT IN INSURANCE AND PENSIONS

- A.10 Historically, legislators and policymakers have deemed that life insurance companies should not become insolvent. Regulations have been created which require life insurers to operate in a manner which is demonstrably solvent, with safety margins built in on top – all designed to reduce the risk of insolvency to a level which society (or the regulator on society's behalf) deems acceptable. If the safety margins are breached, the regulators take action. In extreme cases, the life insurer will be forced to stop writing business, along with various other consequences. The safety margins vary over time, but the basic principle that safety margins exist and should not be breached has been in place for many decades.

⁷ The first was probably Professor John Kay, an eminent economist, addressing the Institute of Actuaries' discussion of *The Comparative Value of Pensions*, in October 1981.

- A.11 The position for pension solvency is fundamentally different. The story is changing over time and the current position has been in place only since the coming into force of the Pensions Act 2004. But as matters stand at the moment, and in the past, there has never been a solvency level or safety margin below which schemes were not permitted to fall and still be allowed to remain in existence. The current legislation defines “solvency” at a level that very few schemes meet or aspire to (known as the *buy-out* cost).
- A.12 But the legislation allows schemes to continue to operate well below that “solvency” level. A lower, scheme-specific target level of funding is set (known as the *technical provisions*), but schemes are permitted to continue operating even with assets less than the *technical provisions*, so long as there is a *recovery plan* to eliminate the shortfall over time. The *recovery plan* must be acceptable to the statutory regulator who (in keeping with the legislation) will typically allow several years to make good a deficit.
- A.13 This distinction has been crucial in the financial management of life insurance and pension schemes. So long as life insurance managers are necessarily preoccupied with not allowing the assets to fall below a target level (essentially, solvency plus a safety margin), whilst the managers of pension schemes are free to let the assets fluctuate above and below the target level, or (as in the past) are not set any target level at all, the management of these two financial entities is bound to be different.

PART III

EXPOSURE DRAFT: SCOPE & AUTHORITY OF TECHNICAL STANDARDS

SCOPE & AUTHORITY OF TECHNICAL STANDARDS

HISTORICAL CONTEXT

- 1 Following the Morris Review of the actuarial profession, published in March 2005, HM Treasury asked the Financial Reporting Council (FRC) to take on responsibility for setting technical actuarial standards.⁸ The FRC created an operating body, the Board for Actuarial Standards (BAS), to fulfil that obligation. Further details regarding the role of the BAS, the composition of its Board and the nature of its work can be found on the FRC website at www.frc.org.uk/bas.
- 2 In addition to the technical actuarial standards under development by the BAS, there are a number of Guidance Notes (GNs) which were issued by the Actuarial Profession⁹ before the BAS came into existence. With effect from 19 May 2006 (and, in some case, 6 April 2007), the BAS adopted a total of 37 of the Profession's GNs. A further eight GNs were retained by the Actuarial Profession and remain under their authority and control. The GNs adopted by the BAS can be found on the FRC website.
- 3 The 37 GNs adopted by the BAS will be deleted over time by the BAS as new standards are introduced to replace them. In the meantime, they continue to be known as GNs. Where necessary, the legacy GNs will be revised, remaining under the GN banner, if a change is deemed necessary before the replacement standard has been developed. Some of the legacy GNs may be deleted without replacement if the BAS determines the GN to be obsolete or out of scope.

INTRODUCTION

- 4 Technical standards developed by the BAS are designated Technical Actuarial Standards (TASs).
- 5 This *Scope & Authority of Technical Standards* relates to such TASs and, where stated, to the GNs adopted by the BAS. This document explains the authority, scope and application of TASs and GNs. It also describes the procedure by which the BAS issues new standards.
- 6 TASs are developed in line with the *Conceptual Framework for Actuarial Standards* published [currently as an exposure draft] by the BAS. As stated in that document, the *Conceptual Framework* itself is not a standard. The *Conceptual Framework* exists to provide coherence and consistency to TASs. The *Conceptual Framework* does not create or impose any requirements on actuarial work. It is only when material appears in a TAS (or in a GN) that it

⁸ HM Treasury also asked the FRC to take on responsibility for oversight of the UK Actuarial Profession, which the FRC carries out through a separate operating body, the Professional Oversight Board. This document relates only to pronouncements of the BAS.

⁹ The Actuarial Profession is the name by which the Institute of Actuaries and the Faculty of Actuaries are known when working together. At the time of writing this document, the Councils of the Institute and of the Faculty have indicated their intention to recommend to their members a merger of the two bodies, but no decision has yet been taken. Pending any revisions to this document to reflect such a merger, references in this document to "The Actuarial Profession" and to an "Actuarial Professional Body" include any successor body.

becomes a requirement. The Compliance section of this document addresses the status and enforceability of TASs and of GNs adopted by the BAS.

- 7 The BAS may make pronouncements other than TASs or legacy GNs, for example Statutory Money Purchase Illustrations (known as TM1) and, potentially, bulletins on emerging issues. This *Scope & Authority* applies only to TASs and GNs. The authority, scope and application of any other BAS pronouncements is, or will be, identified in those documents themselves (as it is in TM1).

INTERPRETATION

- 8 The following terms have a particular meaning in this document, regardless of their meaning in other documents or in ordinary English usage.

Actuarial Professional Body means either or both of the Institute of Actuaries and the Faculty of Actuaries in Scotland and any successor body in the event of a merger (see footnote [9] on page [37]).

Actuary means any individual who is subject to one or more of the disciplinary schemes of an Actuarial Professional Body.

Specific Technical Actuarial Standard (and **Specific TAS**) means any TAS which is not designated by the BAS as a Generic TAS.

Some TASs are designated as a **Generic Technical Actuarial Standard** (or **Generic TAS**). This designation indicates that the standard applies to work specified in the Schedule to this *Scope & Authority*.

Reliability Objective means the objective that users of actuarial information should be able to place a high degree of reliance on the information's relevance, transparency of assumptions, completeness and comprehensibility, including the communication of any uncertainty inherent in the information.

Required Work has the meaning ascribed to it in paragraph 15 below

Reserved Work has the meaning ascribed to it in paragraph 17 below.

Required But Not Reserved refers to work which falls within the class of Required Work, but is not Reserved Work.

- 9 These terms are used in this document with the initial letters capitalised. Italics are used for emphasis or, as will be clear in the context, to refer to the names of documents. In this document, italics do not denote defined terms. This is a departure from the practice adopted by the Actuarial Profession in its Guidance Notes, including those GNs adopted by the BAS.

AUTHORITY OF BAS PRONOUNCEMENTS

- 10 The authority for BAS standards derives from the powers of those bodies which decide to recognise BAS standards and adopt any or all of them as a requirement imposed on individuals or entities which the body in question has power over. Specifically:

- The disciplinary schemes of the Actuarial Professional Bodies and the Accountancy & Actuarial Discipline Board recognise the authority of BAS standards by providing that any departure from a BAS standard may amount to misconduct, rendering the actuary liable to disciplinary action.

- The regulatory regimes for pensions and for insurance have recognised certain BAS standards for the purposes of requirements imposed on the entities they regulate.
- Compliance with BAS standards is likely to be taken into account when the adequacy of the work of actuaries is being considered in a court of law or in other contested situations.

SCOPE AND APPLICATION OF TECHNICAL ACTUARIAL STANDARDS

- 11 Any TAS developed by the BAS will be targeted at work (or a class of work) that is commonly (but not necessarily exclusively) performed by Actuaries. The relevant area of work will be identified within the TAS.
- 12 Even though an entity, a firm or an individual who is not an actuary may not be obliged to apply BAS standards, the BAS recognises that:
- employers or clients of Actuaries may agree to make it a contractual condition that a particular piece of work be carried out in compliance with one or more stated TASs (which may be either Generic TASs or Specific TASs), so long as the standard is relevant to the work;
 - other regulators may make it a requirement of their regulatory regime that an entity or an individual adopts one or more stated TASs (which may be either Generic TASs or Specific TASs), so long as the standard(s) are relevant to the work; and/or
 - entities or individuals who are not Actuaries may apply TASs voluntarily and, if they do so, may assert that the information they have produced complies with TASs published by the BAS.
- 13 The BAS develops TASs in the context of UK legislation and regulation. The geographic scope of TASs is, therefore, limited to work done in relation to the UK operations of entities and any overseas operations which report into the UK within the context of UK legislation or regulation. This definition of scope applies regardless of the location or domicile of the person carrying out the work.
- 14 If a TAS is applied in relation to work which falls outside the geographic scope described in paragraph 13, those making the decision to apply the TAS must take responsibility for ensuring that the TAS is appropriate in the local conditions.

REQUIRED WORK

- 15 Some work carried out by Actuaries is undertaken in order that the entity commissioning the work might comply with regulations, or with a legal obligation, that requires the entity to have the work carried out (or makes certain outcomes conditional on the work having been carried out). Such work is referred to in this *Scope & Authority* as Required Work.
- 16 For the purposes of this definition of Required Work:
- a) The term *regulation* is used with its ordinary English meaning of a rule or order issued by an appropriate authority. This definition embraces primary and secondary legislation (Acts of Parliament and Statutory

Instruments) and also pronouncements by those with executive authority to make binding statements.¹⁰

- b) The *legal obligation* referred to above is the obligation on the entity to commission the work, as found for example in a pension scheme trust deed or an insurance policy contract. It is not the obligation on the individual(s) who carry out the work. The creation of a contract between an entity and one or more individuals to carry out the work does not make the work “required”.

RESERVED WORK

- 17 In some cases of Required Work, the regulations or other legal obligation require the entity in question to commission the work from an individual who holds a prescribed qualification (usually Fellowship) from an Actuarial Professional Body. Such work is referred to in this *Scope & Authority* as Reserved Work.
- 18 For the purposes of this definition, Reserved Work does not include:
- a) work assigned by regulations to the holder of a unique post;¹¹ or
- b) monitoring the work of another Actuary.
- 19 There may, however, be circumstances where an entity is required to commission some Reserved Work and elects to commission a unique post-holder to carry out that work. That work remains Reserved Work and TASs apply to that work exactly as if the entity had elected to commission any other Actuary.

COMPLIANCE WITH TECHNICAL ACTUARIAL STANDARDS

- 20 TASs are intended to assist in the achievement of the Reliability Objective. In applying TASs, it is important to be guided by the spirit and reasoning behind them, as well as following any detailed rules. The spirit and reasoning (as well as any rules) are set out in the individual TASs.
- 21 Compliance with all relevant TASs is compulsory for Actuaries, except to the extent of any departures permitted or required by paragraph 23-24 below.
- 22 Particulars of any material departure from a TAS should be identified in the document which communicates the results of the work to which the TAS applied and the reasons for the departure stated. The document should also state clearly that it is not to be passed on to a third party without all the information relating to the departure being included in the document that is passed on.
- 23 To the extent that departures from a TAS have an *immaterial* affect on the outcome, they need not be considered as departures and they need not be disclosed. Unless defined otherwise in a TAS, a departure should be

¹⁰ This definition *includes*, for example, accounting standards. The definition does *not* include Codes of Practice published by the Pensions Regulator, but these Codes often refer to other documents (eg legislation and statutory instruments) which *are*, of themselves, regulations.

¹¹ A “unique post” is one for which the post mentioned in the regulations exists uniquely, for example the Government Actuary, PPF Actuary or Lloyd’s Actuary. Scheme Actuary and Actuarial Function Holder are not unique posts, because there are many of them, notwithstanding that each pension scheme or insurance company has only one.

considered material if the effect of the departure (or the combined effect if there is more than one departure) could influence the decisions taken by the intended recipients of the work product.

24 Further departures from a TAS are permitted or required as follows:

a) Reserved Work

There may be extremely rare circumstances in which the Actuary responsible for a piece of Reserved Work concludes that compliance with all the requirements of a particular TAS would be so wrong or misleading that it would conflict with the Reliability Objective.

In such cases, the Actuary *should* depart from the requirements, but only to the minimum extent necessary to remove the conflict with the Reliability Objective. Informed and unbiased judgement should be used to devise an appropriate alternative treatment, which should be consistent with the actuarial and commercial characteristics of the circumstances concerned, as well as consistent with the Reliability Objective.

b) Work that is Required But Not Reserved

The departures required in rare circumstances by sub-paragraph (a) above are required also in relation to work that is Required But Not Reserved.

In addition, there may be circumstances in which the Actuary responsible for a piece of work concludes that the objectives for which a piece of work was commissioned would be better met by departing from some of the requirements of a relevant TAS. In such cases, the Actuary *may* depart from the requirements so long as the departure is identified, the reasons for the departure are given and the result is not in conflict with the Reliability Objective.

Where it is feasible to do so, without adding disproportionately to the costs, the document which communicates the results of the work should include a quantification of the effect of the departure or, in the case of qualitative information, the implications of the departure.

c) All other work

The departures required in rare circumstances by (a) above, and permitted by (b) above, apply also to all other work.

In addition, those responsible for commissioning work may instruct the Actuary responsible for carrying it out to depart from specified (or all) requirements of TASs. Notwithstanding that those who commissioned the work instructed the departure(s), the disclosure requirements set out in paragraph 22 above still apply.

ACTUARIES WORKING IN A TEAM

25 As noted in paragraph 10, the authority of BAS standards derives from the powers of those bodies which decide to recognise BAS standards, not from the BAS itself. In some cases, the authority derives from the regulatory regime governing the entity which commissions work from the Actuary and the TAS applies, therefore, to the entity.

26 In other cases, however, for example in relation to disciplinary action taken by an Actuarial Professional Body, the authority is solely over Actuaries, not

over the entity that commissioned the work from the Actuary. Where the authority is over the Actuary, not the entity, and one or more Actuaries work as part of a team alongside non-Actuaries, with the Actuaries contributing only part of the work, the Actuaries are not required to apply the TASs unless one or more of the Actuaries is responsible for that part of the work for which a TAS is relevant.

- 27 For this purpose, an Actuary is defined as being “responsible” for (part of) the work, if he or she has the authority to determine, or to veto, the content of the final work product (whether or not any other individual also has an equivalent authority, or power of veto, over the work). This is a matter of fact which, in the event of an allegation of misconduct or negligence, may have to be determined by the appropriate tribunal.
- 28 For the purposes of the BAS’s definition of “responsible”, being a signatory or a joint signatory of the work would normally be strong prima facie evidence that the individual had the authority to prevent, or to disclose, departures from TASs. But delegating the role of signatory to another person would not, of course, prove that someone other than the Actuary was responsible for the work.

COMPLIANCE WITH LEGACY GUIDANCE NOTES

- 29 The GNs published by the Actuarial Profession were classified as Practice Standard, Recommended Practice or a combination of the two. That same classification has been retained by the BAS unaltered in relation to the GNs adopted by the BAS and the meanings associated with those classifications remains unchanged, as set out below.
- 30 A material breach of a requirement in a GN adopted by the BAS and classified as Practice Standard, is of itself a ground for referral under the disciplinary scheme of an Actuarial Professional Body or the Accountancy & Actuarial Disciplinary Board, as the case may be, and would amount to strong prima facie evidence of misconduct. Such evidence could normally be displaced only if the Actuary could show that any departure from strict compliance with any aspect of the GN had been adequately disclosed and that there was reasonable justification for the course of action in question.
- 31 A failure to comply with a GN (or part of a GN) adopted by the BAS and classified as Recommended Practice is not of itself a ground for referral under the disciplinary schemes. However the determination of a complaint under the disciplinary schemes is likely to take into account any such failure to comply, and whether or not it had been adequately disclosed by the Actuary concerned.

THE DEVELOPMENT OF TECHNICAL ACTUARIAL STANDARDS

- 32 Topics that become the subject of a TAS are identified by the BAS either from its own research or from external sources, including submissions from interested parties. In particular, the BAS liaises regularly with the Actuarial Profession regarding areas of practice for which new standards may be required.
- 33 When a topic is identified by the BAS as potentially requiring the issue of a TAS, the Board commissions its staff to undertake a programme of research and consultation. This programme involves consideration of and consultation on the relevant conceptual issues, existing pronouncements and practice in

the United Kingdom and overseas and the economic, legal and practical implications of the introduction of particular actuarial requirements.

- 34 When the issues have been identified and debated by the BAS, a consultation paper is normally produced and circulated to relevant parties, including those who have registered their interest with the BAS.
- 35 In the case of a new TAS or substantial revisions to an existing TAS, the first consultation document normally identifies the relevant issues, together with one or more policy options and questions on which the BAS would like respondents to express their views. Once the BAS has given due consideration to the submissions received, it develops and publishes an exposure draft of the proposed content of the TAS. Respondents are invited to comment on the content and also to indicate their views on the time needed (if any) to prepare for implementation of the TAS.
- 36 Where exposure drafts would cause changes to be made to other previously issued publications, any such consequential changes will be identified.
- 37 The text of the proposed TAS will be refined in the light of feedback on the exposure draft. If the BAS deems it necessary, there may be a further period of public or selective exposure prior to the issue of the TAS. Once the text has been finalised and approved by the BAS, the TAS will be published including an announcement of the start date. As a practical matter, the start date will be set sufficiently into the future to enable those who will be affected by the standard to prepare for its implementation.
- 38 Representations received in response to public consultations and exposure drafts are given full and proper consideration by the BAS, and will be available for public inspection, unless the respondent requests confidentiality. Although the BAS weighs carefully the views of interested parties, the ultimate content of a TAS must be determined by the Board's own judgement based on research, public consultation and careful deliberation about the benefits and costs of providing the resulting information.
- 39 In the case of minor revisions to an existing TAS, or revisions required to reflect changes in external circumstances which leave no real scope for debate about the required revisions, the BAS may proceed straight to an exposure draft. In rare cases, where the revisions are of such a minor nature that even an exposure draft is unnecessary (for example because the change relates to a legislative cross-reference which has been altered), the BAS may proceed straight to an amended version of the TAS without any public consultation.

UNFORESEEN CIRCUMSTANCES

- 40 It is conceivable that unforeseen circumstances may arise in which it becomes a matter of some urgency that a new standard should be written or an existing standard amended. In the event of such an occurrence, the BAS will issue an "Urgent Issue TAS", adopting an expedited development process commensurate with the urgency of the circumstances (and an early review – see paragraph 47 below).
- 41 Unless stated otherwise in the Urgent Issue TAS, it will have the same scope and authority as set out in this document.

TECHNICAL ACTUARIAL STANDARDS AND THE LEGAL FRAMEWORK

42 In deciding the most appropriate treatment, the BAS must consider the environment in which its standards are to be applied. The legislation which reporting entities must comply with forms an important part of that environment. Accordingly, TASs are drafted in the context of prevailing United Kingdom legislation and European Community Directives with the aim of ensuring consistency between actuarial standards and the law. More specifically, the BAS will take account, where appropriate, of the regulatory requirements of the Financial Services Authority, The Pensions Regulator and any other relevant regulatory body.

EARLY ADOPTION OF TECHNICAL ACTUARIAL STANDARDS

43 Some individuals or entities may wish to comply with a standard in advance of the published start date. In some circumstances this is acceptable and is to be encouraged if the individual or entity concerned does not need the full amount of time allowed to prepare for implementation.

44 There are, however, occasions when early adoption is not appropriate. This would typically be the case when, for example:

- a) compliance with the new standard would put the entity in breach of the existing standard; and/or
- b) a standard is to come into force in parallel with other events, such as a change in legislation, without which the adoption of the standard would be premature.

45 When announcing a new standard, the BAS will normally indicate whether early adoption is appropriate or not.

REVIEWS OF EXISTING TECHNICAL ACTUARIAL STANDARDS

46 TASs are issued against the background of a business environment that evolves over time. Once published, the BAS will keep TASs under review. The BAS will liaise in particular with the Actuarial Profession, the relevant financial regulators and users for their comments on the continuing effectiveness of standards. The BAS welcomes comments from others who may wish to make direct representations.

47 It will normally be appropriate to allow new TASs a period in which to become established before commencing a review. For some standards, a substantial period of time may be needed before their effectiveness can be judged, but there may be reasons why an earlier review is appropriate in some cases, especially so in the case of an Urgent Issue TAS (see paragraphs 40-41 above).

SCHEDULE

48 The Schedule referred to in the definition of “Generic TAS” in paragraph 8 of this *Scope & Authority* is set out on the following page.

[Date]

SCHEDULE

For the purposes of the definition of “Generic TAS” in paragraph 8 of this *Scope & Authority*, the specified work to which a Generic TAS applies is as follows:

Work which falls within the scope of one or more Specific TASs.

[Date of publication of the Schedule]

PART IV

INVITATION TO COMMENT

INVITATION TO COMMENT

ISSUES FOR COMMENT

The BAS invites the views of those stakeholders and other parties interested in actuarial practice who wish to comment on the content of the Exposure Drafts in Parts II and III of this document.

This current consultation is not intended as an opportunity to re-visit those issues that have already been exposed for comment in the previous consultation document. Those wishing to comment at this stage should bear in mind that the BAS has already consulted on the majority of the policy decisions underlying the *Conceptual Framework* and, to some extent, the policies underlying the *Scope & Authority* document.

With this in mind, commentators are asked to comment on the policy decisions only to the extent that they introduce *new* or *changed* policies that were not articulated in the November 2007 Consultation Paper. Specifically, commentators are asked to focus their attention on:

- 1 the proposed addition of “internal consistency” as a precept in Section 3 of the *Conceptual Framework*;
- 2 the proposal that the scope of generic standards should be set out in a Schedule to the *Scope & Authority* which may be revised over time; and
- 3 the text of the two exposure drafts (on the *Conceptual Framework* and the *Scope & Authority*) as means of implementing the policy decisions outlined in Part I of this document.

SUBMISSION OF RESPONSES

For ease of handling, we prefer comments to be sent electronically to basframework@frc.org.uk.

Comments may also be sent in hard copy form to:

The Director
Board for Actuarial Standards
5th Floor, Aldwych House
71-91 Aldwych
London
WC2B 4HN

Comments should reach the BAS by **23 May 2008**.

All responses will be regarded as being on the public record unless confidentiality is expressly requested by the respondent. If you are sending a confidential response by e-mail, please include the word “confidential” in the subject line of your e-mail.

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