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Subject: A new framework for Technical Actuarial Standards

Dear Sir or Madam

Thank you for the opportunity to comment on the consultation document 'A new framework for Technical Actuarial Standards'. We welcome the proposal to simplify the structure of the technical actuarial standards (TASs) and support the purpose behind extending scope to a wider range of actuarial work (than is currently subject to the TASs. However, we have concerns about some aspects of the proposals.

Our questions to the specific questions asked are in an appendix at the end of this letter, but we would like to raise a few general concerns as well:

- Our main concern is in relation to the definition of actuarial work, which appears to includes work that might have no 'output' or not involve a third party. It is possible the FRC considers that, in that case, none of the principles are 'material' and so, whilst technically 'in scope', the TASs will not apply. However, this does not seem to us to be a good outcome and a different approach appears to have been taken in the JFAR's Risk Perspective discussion paper. Our view is that it would be preferable if the scope was limited to work that (for example) gives rise to outputs expected to influence someone's decisions: we explain this further in the appendix.

  Also, the FRC's definition of actuarial work is different from the IFoA's. It would be preferable, both for members of the IFoA and, we expect, for users, if the definitions could be consistent (or the reasons for differences explained).

- Our impression is that the TAS is written assuming that the person responsible for the output from the actuarial work will also be responsible for all of the inputs to the actuarial work. In practice, this is not the case: frequently work done will use inputs from third parties, sometimes models, sometimes data and sometimes assumptions. The person's 'communication' to the entity that has commissioned the work will make clear which parts of the work he or she is taking responsibility for, and which parts he or she will not take responsibility for, because the

commissioning entity has not included that responsibility in the scope of work being done. An example is given in the appendix. In particular, the communication will say that, where the third party inputs are incorrect, then the person no longer takes responsibility for the output.

Clearly, in this case, the person (if a member of the IFoA) has a professional responsibility to determine that the inputs are 'appropriate' and to disclose to the commissioning entity if they are not, but the inputs will not be checked to the same degree as they would be if the person were taking responsibility for them. It seems important to us, particularly with the widening of scope, that these practicalities of how work is being done are reflected in the language used in the TAS.

We also have two practical suggestions:

- We are uncertain of the status of ISAP 1, particularly in the context of the proposed APS X1. It would be helpful if the IFoA and the FRC could confirm to members of the IFoA that it is enough that the IFoA and the FRC consider standards to be consistent with ISAP 1. If members of the IFoA are complying with IFoA and FRC standards (for work within their scope), then they should not have to consider International Standards.

- We would also prefer it if the transition period did not result in 'parallel running' of TAS 100 and the generic TASs.

Finally, we should make clear that we are only commenting from the perspective of members of the IFoA. We make no comment about the application of the TASs to people who are not members of the IFoA, although, should this become an issue for us we reserve the right to do so.

We would be happy to discuss our views with you and would welcome the opportunity for further feedback based on the points we raise below.

Yours sincerely,

Deborah Cooper

Appendix – Mercer's response to the specific questions asked in "A new framework for Technical Actuarial Standards"

Q3.1 Do you have any comments on the draft Framework for FRC Actuarial Standards (paragraphs 3.5 to 3.8 and Appendix A)?

We agree that there is some logic in applying the new framework to all 'actuarial work'. However, if this is to be done, 'actuarial work' needs to be more carefully defined (we consider this further in our responses to the TAS 100 questions). Under the current regime, the definitions in the existing Scope and Authority of Technical Actuarial Standards document (*Required*, *Reserved* and 'all other' work brought into scope by the person doing the work or by a specific TAS) makes it relatively simple to know what is in scope. The proposed definition does not: it is not even clear that it only applies to work done for another party, or for a 'user' who might rely on it for decision making.

It is possible that the FRC considers that a piece of work that is not relied on by a user implicitly falls out of scope since none of the principles will be material to decisions made by users. However, this does not seem fit for purpose. The success of the new regime will depend on the definition of actuarial work being commonly understood and accepted, by users and by members of the IFoA (hereafter, in this document, referred to as 'actuaries'), and on the concepts of 'materiality' and 'proportionality' being applied appropriately. Otherwise there is a risk that the new regime is not respected, for example because it is deemed to impose an undue regulatory burden on actuaries, which, in view of the documents underpinning the FRC's regulatory strategy (for example, the *Principles for the Development of Codes, Standards and Guidance*), we do not expect is the intention.

It would also be helpful if the Framework was clear about the effect of an actuary deciding not to comply with a principle, even though it would be material to the user, and disclosing that fact (as envisaged under paragraph 4.7 in the draft Framework). Since that possibility is envisaged without prescribing the circumstances or implying any consequences, our view is that, provided an actuary has reasonable grounds for following this route, it is always legitimate and should not be viewed as non-compliance with the TAS should any disciplinary proceedings ensue (although the member could be required to defend his or her decision). This situation was also permitted under the Scope and Authority, but because of the narrower scope we do not expect it was often used, but since TAS 100 will apply to all actuarial work, there will be many more situations where we consider it likely to be reasonable to adopt this approach, so the extra comfort would be helpful.

Q3.2 Do you have any comments on our proposal to withdraw and archive the existing Scope & Authority (paragraphs 3.26 to 3.29)?

We agree the Scope & Authority document should be archived.

Q3.3 Do you have any comments on our proposed approach to the Significant Considerations documents (paragraphs 3.30 to 3.31)?

We agree the Significant Considerations documents should be archived. Although they provided some background to decisions made by the FRC, their status was never clear. Our view is that the TAS's principles and the supporting paragraphs should be sufficiently clear that further documentation is not necessary.

We note the suggestion that, from time to time, the FRC might deem it necessary to produce non-mandatory 'guidance'. We urge the FRC to be parsimonious about this and to publish the process it would go through (including consultation) before determining there is a need, and before publishing guidance. We also suggest that in section 9 of the Framework a reference to following the FRC's *Principles for the Development of Codes, Standards and Guidance* is made,

Q4.1 Do you agree that the extension of the scope of application of TAS 100 to all actuarial work would be of benefit to users of actuarial work? If you disagree, please explain why.

In principle yes, by making it clear to the public those factors actuaries generally take into account when they deliver actuarial work to users. We do not expect it will result in a sudden change in the quality of the work delivered since, provided they can be applied proportionately, the principles proposed for TAS 100 seem sensible. Our main concerns relate to the definition of actuarial work and to the apparent requirement in paragraph 3.6 of the draft TAS to duplicate work that might have been done by another member of the IFoA, which we cover in our answers to 4.2 and the questions from section 5 of the consultation paper.

Q4.2 Do you agree with the proposed definition of actuarial work? If not please provide reasons and suggest an alternative approach (paragraph 4.11).

We understand the difficulty in finding a definition for 'actuarial work' and expect there might be considerable comment on the words chosen. However, in our view they seem satisfactory and we expect most actuaries will be able to interpret them. Although there could be some inconsistency at the margins, we do not consider this to be unduly problematic. However, we have three concerns:

- The definition is in the context of 'work' rather than a service provided to a client or employer, which the client or employer is entitled to rely on for making a decision. We think it is important to include some reference to how the work will be delivered and used, since otherwise the scope is extended to any work done, even if it is not intended to inform a decision, or if it is not even completed. For example, although we think the principles might be taken into account by someone writing an article for the Actuary magazine, we do not think the article needs to be TAS compliant.
- The definition is different from the definition used by the IFoA (for example, in APS X2). We would prefer a consistent definition and expect that the JFAR might be a forum for achieving this. If there are reasons for the differences then these should be explained, so that differences in the scope of each entities' (the IFoA's and the FRC's) standards is understood.
- An area of uncertainty in relation to all principles based regulation is how, in the event of a complaint, it will be interpreted by the regulatory 'enforcer' (for example, an IFoA disciplinary panel). For example, Mercer might be viewed as an 'actuarial' firm, because a large proportion of its business involves work done by actuaries. Nonetheless, we do not believe this means our clients should be 'entitled to treat' all the work we do as actuarial work 'by implication'. We expect a reasonable person would agree with us, but would be more comfortable if 'implication' were qualified, perhaps by saying 'strong implication'.

Q4.3 Do you agree with the analysis of different areas of work in Appendix E?

The analysis seems reasonable although, as mentioned above, we expect that different people might judge where the line between actuarial and non-actuarial work should be drawn differently, for example in the cases of the CRO, modelling work and wider fields.

Q5.1 Do you agree with the proposed high-level principles (paragraph 5.3)?

It seems possible to interpret the proposed new principles as being stronger than those in the generic TASs. For example, the Data principle is that "Data … shall be sufficient and reliable ... so that users can rely on the resulting actuarial information". The equivalent principle in TAS D is "…overall, the data is sufficiently accurate, relevant and complete for users to rely on the resulting actuarial information". The latter seems better able to accommodate situations where data has not been comprehensively checked, although it is deemed to be 'accurate enough' to be used to provide the relevant work to a user.

As TAS 100's scope is so wide, it needs to encompass situations where actuaries are given data and other information from third parties, and expected to produce their advice without performing comprehensive checks on what has been provided. Often, the advice presented will note that only high level 'reasonableness' checks have been carried out and that, if the advice is incorrect as a

result of weaknesses in the information provided, the actuary will not be held (contractually) responsible. If the FRC's intention is to prevent actuaries from presenting their work in this way, this should be made clear but, in any case, does not very realistic to us.

This begs the question of what the FRC means by 'rely on', particularly in the context of the data, assumptions and modelling principles. Clearly, users need to be able to take decisions using the information provided to them, but they need to understand the degree to which the person providing that information (or that person's employer) stands behind it. If a user already has access to certain information and is not prepared to pay for an IFoA regulated person to reproduce that information, or carry out due diligence on the user's information, then it seems reasonable for the actuary to agree to provide the work subject to disclosing its limitations. This seems possible under the current regime, partly because of its limited scope, but also because its principles seem less demanding. For example, TAS R includes the principle: "C.3.1: An aggregate report shall include sufficient information to enable its users to judge its relevance to the decisions for which they use it". This appears to us to encompass the possibility that an actuary will use information provided by a third party, disclose to the entity that has commissioned the work the information's provenance and the extent to which the actuary has carried out checks on it, and deny responsibility in the event that the information proves faulty. (For the avoidance of doubt, the actuary could not deny responsibility if the information was not 'relevant', but could if it was relevant but incorrect.)

Actuarial work in the pensions world is increasingly reliant on information provided by third parties; actuaries might not have the competence to provide sufficient scrutiny for some of this to enable the user to 'rely' entirely on the actuary's work without any caveat about the source of the information. Consequently, to be of practical use, we believe the high level principles should be amended (for example, the Data principle could be amended to say: "Data used in actuarial work shall be sufficient and reliable for the purpose of that work and subject to sufficient scrutiny and checking to ensure users understand any limitations when they rely on the resulting actuarial information") to address the extent to which users can, in practice and contractually, rely on the information being provided.

Q5.2 Do you agree with the proposed provisions in TAS 100 on data (Appendix B)?

Although we think the provisions are largely sensible, we have some concerns:

Paragraph 5.20 of the consultation document explains why paragraph 2.1 of the draft TAS says 'relevant to the entity'. However, this can be interpreted narrowly (for example, an assumption for future salary increases should be based on the employer's future plans for remunerating its employees) rather than as relevant to the exercise being carried out (for example, sources of data

for determining an inflation assumption for accounting purposes are likely to be more generic). Our view is that saying 'relevant' should be sufficient, since if it is not relevant to the entity or to the task then it has little purpose: alternatively, we suggest "Data shall be relevant to the work and to the entity".

Paragraph 2.2 seems to assume that data can be "improved" by adjusting it: TAS D only required "an assessment [to] be made to determine whether the reliability of the data can be improved". We prefer the formulation in TAS D. In particular, although gaps in data can be filled using some form of algorithm, it is impossible to know whether this has 'improved' the data or not.

We are concerned that the explanation given in paragraph 5.9 of the consultation document could be interpreted as imposing disproportionate obligations (under paragraphs 2.4 and 2.5) on actuaries when they are asked to do work using data from a third party. In that case, checks for reasonableness are carried out, depending on the data and the purpose, but it might be disproportionate to verify that the data provided is 'reliable'. For example, actuaries who advise companies in relation to their pension scheme will often refer to data and valuation results prepared by the scheme actuary. In such cases, it should be sufficient for actuaries responsible for a company's actuarial work, having exercised their professional judgement, to be clear in their communications about the extent of any reasonableness checks steps taken, to avoid possible duplication of effort.

Q5.3 Do you agree with the proposed provisions in TAS 100 on assumptions (Appendix B)?

Although we think the provisions are largely sensible, we have some concerns:

Improving the definition of actuarial work, so that it means a particular exercise being carried out for a user to rely on, should also improve paragraph 3.2 in the draft TAS: as it stands, it implies that all assumptions used in all actuarial work, regardless of how they are being used, should be consistent with one another.

Paragraph 5.21 of the consultation document explains why paragraph 3.6 has been included in the draft TAS (although we point out that the proposal is not more 'detailed' than applied previously, it is different, since it no longer seems possible just to make a statement). However, ISAP 1 only requires checks to be carried out "where practicable". Although we would expect actuaries always to consider whether assumptions look reasonable, there will be cases where not only will it not be practicable to carry out the work required to determine this for sure, but it will have no effect on the eventual decision (for example, where a scheme actuary is asked to carry out accounting calculations using assumptions provided by the company adviser, particularly

where the scheme is small relative to the company's accounts). In this case, we expect it will be appropriate for the scheme actuary to decide it is not proportionate to carry out the suggested work, but the ISAP has a similar concept of 'proportionality' and still includes the 'where practicable', so we are not sure of the intent.

Our concerns about third party reliance, mentioned above in response to Q5.1, also apply here.

Q5.4 Do you agree with the proposed provisions in TAS 100 on modelling (Appendix B)?

Subject to the third party reliance aspect mentioned in response to Q5.1, we agree that the provisions are appropriate, noting that those that appear onerous can be 'ignored' if their effect is not material or if the information would be disproportionate given the user's purpose.

Q5.5 Do you agree with the proposed provisions in TAS 100 on communications (Appendix B)?

The consultation document explains why the reference to 'sensitivity … to variations in key assumptions' has been included, but we prefer the TAS R requirement: giving "an indication of uncertainty". One way of doing this would be to indicate sensitivity to assumptions, so we would view it as being 'substantially consistent' with the ISAP, but it leaves the opportunity to provide different information if that is deemed more helpful to the user. For example, scenario analysis will often be more meaningful than an indication of how results change if an assumption is increased by 1%.

Similarly, proposed paragraph 5.6 in draft TAS 100 is addressed by the requirement in proposed paragraph 3.5 ("describe the relationship of any assumptions which are not neutral to neutral assumptions"): if an assumption is chosen to have a margin for adverse deviations, then it is not neutral.

Q5.6 Do you have any comments on the application of TAS 100 (paragraphs 5.25 to 5.29)?

Apart from observing that these are presumably supposed to apply more widely than just to TAS 100, no.

Q5.7 Do you agree that a compliance statement should be required (paragraph 5.30)?

We agree that a brief compliance statement should be included.

Q5.8 Do you agree with the proposed approach on guidance material (paragraphs 5.32 to 5.34)?

We agree that TAS100 should be self-standing and consider that further guidance should not be necessary.

Q5.9 Do you agree with the proposal to include defined terms in a separate glossary (paragraph 5.35)?

We understand that the FRC has decided to include the scope of each TAS in the TAS itself, since users did not like having to refer to the Scope and Authority document. Provided users do not feel similarly about having to refer to a separate glossary, we have no objection.

Q5.10 Do you consider the definitions of the terms in the glossary are clear (paragraph 5.35)?

We have commented on the definition of actuarial work above.

The phrase 'to document' is not used in the TAS and in any case a definition seems unnecessary, since the FRC is not imposing a special meaning.

Would it be clearer to define 'entity' as the person or body that commissions the work (assuming that is the intention)? As it stands, we do not understand the definition: for example, the subject of actuarial work relating to accounting disclosures under IAS 19 could be considered to be the pension scheme, but we expect the FRC would view this as the company.

In previous consultation responses to the FRC (or the BAS), we have suggested that the definition of 'user' would be improved, if the second sentence was dropped. This continues to be our view.

Q5.11 Do you have any other comments on the exposure draft of TAS 100?

No

Q6.1 What areas of work specified in scope of the current Specific TASs do you consider should not be subject to more detailed actuarial standards (paragraph 6.8)?

We are only commenting on the scope of the Pensions and Transformation TASs as these cover are our areas of expertise.

Pensions TAS

To some extent the requirements of TAS 100 duplicate those of the pensions TAS, so it might be possible to reduce the scope of the Pensions TAS, although we would have no problem with continuing with the status quo. However, some of its content does require review. In particular, the section (E.3.1 to E.3.12) that requires additional content to be added to actuarial reports required by section 224 of the Pensions Act 2004 seems out of place.

Transformations TAS (TAS T)

As proposed in the consultation document, all the work that meets the definition of a Pensions Transformation should fall with the scope of the new specialist Pensions TAS.

Q6.2 What work which is not currently in the scope of the Specific TASs do you consider should be subject to the more detailed standards (paragraph 6.8)?

We believe that, in most cases of work newly in scope, the requirements of TAS 100, together with the professional/ethical standards imposed via the Actuaries Code and Actuarial Profession Standards, should be sufficient. Although other areas of work relevant to pension schemes will newly be in scope of the TASs, in the interests of proportionality we do not think it necessary to impose additional requirements. We think that any 'Public interest' risk is likely to be served via TAS 100 and that additional requirements could pose a barrier to entities using actuaries to provide advice.

Q6.3 Do you agree with the proposed structure of the TASs (paragraphs 6.9 to 6.12)?

We are happy with the proposed structure.

Q6.4 Do you have any other comments on the proposals for technical actuarial standards in section 6?

No.

Q7.1 Do you have any comments on the proposed implementation of the new framework in Section 7?

We think that it should not be necessary, and could be onerous for actuaries and confusing for users, to have parallel running of TAS 100 and the generic TASs. It would be preferable to simply

replace the generic TASs with TAS 100, but to permit actuaries to continue to comply with the generic TASs if they prefer, during the transitional period.

Q7.2 Are the proposed interim arrangements clear (paragraphs 7.7 to 7.9)?

Yes it is clear, although as stated above we do not agree with them.

Q8.1 Do you agree that TAS 100 could be applied to a wide range of actuarial work without disproportionate costs?

We agree that, for work currently in scope of the TASs, as a replacement for the three generic TASs no material new costs will be imposed.

However, for work newly in scope, because of the issues identified in our response, we think there will be some additional costs that could be disproportionate to the benefit to users, depending on the final version.

Q8.2 Do you have any comments on our analysis of the impact of the changes set out in section 8?

Whilst we recognise the rationale set out in 8.2 to 8.7, and support the aims listed in 8.8, we do have some concerns that improving the reliability of actuarial advice will not, in isolation, produce the intended benefits to the public interest. This will only happen if there are some corresponding behavioural changes amongst the users of this information, and perhaps some incentive or compulsion for them to commission work from actuaries and then to pay attention to the less palatable conclusions that work may suggest. The Risk Perspective document, which will inform future regulation, does not discriminate the risks it considers according to the different regulatory regimes that apply to the parties that might be associated with those risks. In determining how to extend its regulatory remit, the FRC needs to take into account: first, the risks to entities of not commissioning work from actuaries, for example because the regulatory burden is deemed to impose unnecessary cost; and secondly, the way the FRC directs its regulatory powers to the different parties it regulates.