P-Solve

Comments on 'A new framework for Technical Actuarial Standards'

Introduction and Background

P-Solve is part of the River & Mercantile Group plc, which was formed by the merger of P-Solve with River & Mercantile Asset Management in 2014. The Punter Southall Group remains a strategic investor in River & Mercantile Group plc.

We offer a wide range of consulting and investment advice services to a broad range of institutional clients, including pension schemes and insurance companies covering a substantial amount of assets. We manage fiduciary mandates to the value of around £7bn.

We manage derivative portfolios for our clients aimed at risk management. These comprise both interest rate and inflation swap portfolios and equity derivatives. In total we manage around £9.6bn of derivatives by exposure.

Our competitors would be drawn from investment consultancies and investment managers and increasingly investment banks will undertake some of the same pension scheme risk modelling work that we do (e.g. liability management of defined benefit pension schemes).

We are regulated by the Financial Conduct Authority (FCA) and we employ a range of professionals, any of which may be involved in providing advice. Our modelling and risk advice may be undertaken by actuaries or non-actuaries.

Our view

We are supportive of a joint approach to regulation and risk management in the areas discussed by the Joint Forum for Actuarial Regulation.

However, it should also be the case that whilst risks can be mitigated in financial systems through certain actuarial skills, a regulatory regime which differentiates between work produced by an actuary and by a bank analyst has unintended consequences. In particular, for employers of actuaries (and the actuaries themselves) it can be a challenge to respond to regulation from a number of different areas (e.g. from the FCA, through the Financial Reporting Council and from the Institute and Faculty of Actuaries through its professional regulatory role). Encouraging firms to employ non-actuaries to undertake modelling work (i.e. the non-actuaries are not required to apply Technical Actuarial Standards to their work) which is used to make key decisions in relation to investment strategies cannot be beneficial to the end-users or to the mitigation of risk.

It is our view that where certain modelling/risk analysis/funding projections and asset/liability modelling is undertaken and presented to the key stakeholders of systemically important institutional investors (for example the trustees of defined benefit pension schemes), the quality of work should be governed in a consistent manner across the different types of provider.

To this end, we would (for example) propose that the principals of the Technical Actuarial Standards currently being consulted on by the FRC ought to apply not only to actuaries, but to anyone who provides such analysis to such investors. In the case of defined benefit schemes, we believe that this could be achieved by such advice being regulated by (either or both of) the FCA and the Pensions Regulator. Making use of the FCA in this role would ensure that the wide definition of actuarial work is identified to those currently undertaking such work but unaware of actuarial regulation, such as for example within investment management organisations or investment banks.

Spectrum of work that we undertake

We have considered some of the work that we undertake for our clients in the areas of risk management and where we would consider that actuarial skills are important in ensuring that a wide breadth of issues are considered properly.

We understand that the FRC does not wish to restrict the application of TASs through a narrow definition, but equally the very broad proposal could lead to some aspects of work undertaken very routinely, such as valuation of interest rate swaps falling within the scope, which we would argue is not the intention since the public interest risk arising from such work is more limited.

Some of the items of work below are currently undertaken (unregulated) by non-actuaries, and we would consider should be subject to some supervision to ensure that the public interest is maintained. We would appreciate clarity on where along this spectrum the FRC intend that the line between actuarial and non-actuarial work would be drawn.

- Projecting forward the value of a fixed interest gilt given market conditions implied by the current forward curve and for changes in interest rates;
- Calculating the impact of a change in interest rates/inflation on the value of a set of pre-determined real and fixed cashflows. This includes making a set of judgements and assumptions about them, where incorrect assumptions could lead to unsuitable decisions being taken to the detriment of pension scheme member security;
- Rolling forward a set of pre-determined real and fixed cashflows (at a previous date) in line with changes in interest rate and inflation to a more recent date;
- Projecting forward an asset value and a set of pre-determined real and fixed cashflows to a future date to ascertain what growth in the assets is needed to bring the value of both the assets and the then-present value of the real and fixed cashflows into line; (for the purposes of deciding on how to invest the assets) – This is good example of the ambiguity between actuarial and non-actuarial work as judgement is required but this is not something that is generally considered as predominantly actuarial.
- Projecting forward an asset value and a set of pre-determined real and fixed cashflows to a future date to ascertain what combination of (1) growth in the assets, and (2) additional annual cash addition to the assets, is needed to bring the value of both the assets and the then-present value of the real and fixed cashflows into line (for the purposes of deciding on how to invest the assets)
- Analysing shocks and risks inherent in the above types of analyses in order to present a range of economic scenario outcomes.
- Projecting forward the value of a set of assets and a series of sets of cashflows which increase in line with different and various indexation to a future date to ascertain what growth in the assets is needed to bring the value of the assets and the then-present value of the real and fixed cashflows into line; (for the purposes of deciding on how to invest the assets)

- Projecting forward the value of a set of assets and the present value of a set of contingent payments where the contingent payment is paid based on different and various indexation but only until a demographic event occurs, for different assumptions of the demographic events.

Compliance Statement

We agree that a compliance statement would be helpful for public understanding, but in order for its scope to be understood, it may need to be quite substantial. We would seek clarity on whether a full description on, say, a website, would be suitable to which users of actuarial work could be directed.

Cost

We do not agree that the increased scope of TAS could be implemented without significant cost, since we fear that the scope as currently specified could be applied to some 'back office' tasks, undertaken by non-actuaries, who may need to significantly change the way in which they perform, review and record calculations. Clearly however we would hope that the increase in standards across the board would be of benefit to the public, provided the line between actuarial and non-actuarial work is drawn appropriately.

P-Solve
March 2015

Contacts:

Helen Davies FIA (helen.davies@psolve.com)

Ross Leach FIA