LCP's response to the FRC's consultation on introducing a new TAS 310

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This document sets out LCP's response to that part of the Financial Reporting Council's consultation relating to TAS 310 published on 9 May 2023 (the "Consultation"). We are responding separately to that part of the same consultation on TAS 300.

Who we are

LCP is a firm of financial, actuarial, and business consultants, specialising in pensions, investment, insurance, energy, health and business analytics. We have around 1,000 people in the UK, including 160 partners and over 300 qualified actuaries.

The provision of actuarial, investment, covenant, governance, pensions administration, benefits advice, and directly related services, is our core business. About 80% of our work is advising trustees and employers on all aspects of their pension arrangements, including investment strategy. The remaining 20% relates to insurance consulting, energy, health and business analytics. LCP is authorised and regulated by the Financial Conduct Authority and is licensed by the Institute and Faculty of Actuaries in respect of a range of investment business activities.

Our overall thoughts

We have set out below our answers to the specific questions posed in the consultation.

In summary, the draft TAS 310 proposals set a very high standard for those advising on CDC schemes. Whilst we agree that this aspiration is appropriate, in several places the proposals introduce what we believe to be disproportionately onerous requirements on practitioners. If implemented, we believe these will significantly increase ongoing implementation costs with little benefit to member outcomes.

In particular:

- The requirements for modelling and assumptions, to consider and report on 'credible alternatives', lack clarity on whether the 'credible alternative' requirements would introduce an obligation to consider a full range of credible alternatives or simply two or three possible alternatives.
- The focus on downside over upside scenarios could introduce inappropriate bias into the decision-making process.
- The proposed requirements for post valuation experience appears onerous.
- The requirement to model the probability that the live running tests might be failed at some future date using stochastic modelling appears particularly onerous.

As TAS 310 is currently drafted, we believe its implementation would add material costs, over and above those arising solely from the legislation and regulation of CDC.

We are happy for LCP to be named as a respondent to the Consultation and happy for our response to be in the public domain. We are happy for you to reference our comments in any response and would be happy to work with FRC on any revisions to TAS 310.

We look forward to seeing the final version of TAS 310 in due course and trust that our comments are helpful. We are responding separately to your proposals on TAS 300.

Helen Draper, FIA
Partner

1. TAS 310: CMP pensions

10. Do you have any comments on our intention to have an effective date for TAS 310 of within one year of the first CMP scheme being in operation? Is there an alternative timing that would be more appropriate? Please provide any supporting evidence for alternative timings.

The nature of CDC schemes means the design of the scheme is key and many aspects are already 'set in stone' once the design is formalised in the scheme rules. At this point delivery of a successful scheme is arguably predominantly an investment challenge and subsequent valuations must follow the design set out in the scheme rules. Therefore, TAS 310 would ideally have been in place well before advice was given on the first CDC designs to be put forward for authorisation. However, we do not envisage that retrospective application is appropriate.

Moving forward, it is helpful for the TAS to be brought into effect as soon as possible to aid planning prior to entering the authorisation process. However, it is also important for the TAS to be well drafted and, we believe there are currently several significant potential concerns relating to the draft put forward for consultation. It is important that TAS 310 is not "rushed through" and these issues are fully considered before TAS 310 is finalised.

2. Assumptions

11. Do the proposed provisions provide sufficient clarity of requirements for practitioners to set central estimate assumptions? Please set out any areas of setting CE assumptions you believe require further provisions, including reasons for these.

The provisions seem reasonable and consistent with the approach we would expect to be adopted.

We agree that it is appropriate to focus on the central estimate. We note that this allows considerable subjectivity, and so it is entirely reasonable that different actuaries could form different views on the same assumptions in the same circumstances. We believe this to be appropriate.

We note that in practice the scheme actuary will be more likely to be advising on the assumptions with the decisions on the central assumptions to be used taken by the trustees, as is the case under the regulations for ongoing valuations. This is not necessarily reflected in the wording as drafted and we recommend it is amended.

As a minor point, we note that term "central estimate" is already defined in legislation – as "an estimate that is not deliberately either optimistic or pessimistic, does not include any margin for prudence and does not incorporate adjustments to reflect the desired outcome" (Regulation 2 of the Occupational Pension Schemes (Collective Money Purchase Schemes) Regulations 2022). Rather than introducing a new definition with very similar meaning the glossary should simply reference the existing definition.

3. Modelling

12. What are your views on the proposed provisions in relation to CMP modelling? Do you expect the proposed requirements on communication to support intended users in making relevant decisions based on modelling? Do you believe there are further items where additional requirements would be appropriate?

We have several concerns over P3.2:

- The proposed stochastic assessment of the probability of the live running tests being failed at some point in the future is expected to be extremely onerous and we believe it to be disproportionate. It would add significant cost, and it is not clear how it would influence trustees' decision making once the Scheme is established.
- It is suggested that models should be able to "identify scenarios (including probabilities)" relating to certain events happening. We suggest there is clearer separation between scenario planning and stochastic modelling, for example replace this with wording such as "identify scenarios in which and estimate the probability that:"
- P3.2 focuses on downside scenarios in isolation – in practice upside scenarios should be equally likely and also present challenges for the management of CDC schemes. A focus on downside outcomes might also bias decision making towards making central estimates which err towards prudence. For example, there is no problem with a CDC scheme providing "negative real increases", which are a design feature and for example, in times of high inflation, could still be extremely high increases compared to

more traditional pension schemes. The TAS should require the actuary to discuss both upside and downside scenarios, to put the central estimate advice (and risks of intergenerational unfairness which may be introduced by erring on the side of caution) in a rounded context.

It is unclear what P3.4 is trying to achieve. Clearly changing the underlying model could result in significantly different modelling results but simply confirming that this is the case (which would appear to satisfy this requirement) would not be of particular benefit. We are concerned that any change to the wording of this requirement could easily introduce a very onerous requirement, without adding any benefit.

On P3.5, it is not clear whether this is a requirement to comment on one or two credible alternatives, or the possible range of credible alternatives. The latter seems virtually impossible to satisfy as there would be a huge range of "credible alternative modelling". Even considering one or two alternative models could be disproportionate, given the complex nature of the exercise. This is therefore potentially an extremely onerous requirement, particularly if a quantitative evaluation is required. Our preference is to remove the requirement completely, or to simply require communication of the fact that different models could produce different outcomes.

Requiring consideration of alternative modelling could potentially lead to pressure on the actuary to adopt more optimistic approaches, and in turn this could lead to contentious benefit reductions being deferred and unsustainable expectations being set. Conversely it could worry trustees into pushing the actuary towards the more pessimistic scenarios. Either way, this requirement could lead to bias in decision making and therefore intergenerational unfairness.

We have similar concerns on P3.10 as for P3.2 above.

4. Scheme design

13. What are your views on the proposed provisions in relation to Scheme design? Do you envisage any difficulties in meeting the requirements of these provisions. Please provide details to accompany your response.

The requirement to use data which is "as comprehensive as possible" seems unnecessarily onerous, particularly given it could be applied to very early preliminary and therefore approximate assessments of a possible CDC arrangement. We would suggest a more proportionate approach, for example allowing use of data that is "appropriate to the advice being given, to the extent that this is available".

5. Viability assessments

14. What are your views on the proposed provisions on completing assessments of scheme viability and certifying soundness? Do you consider it is appropriate to require practitioners to consider areas beyond those outlined in legislation when certifying soundness? Please give reasons for your response.

We agree that it would not be appropriate to define soundness within the TASs, given how this term is framed in legislation. In particular, we believe the TAS should not add specific additional requirements to the legislative provisions in this area.

- We are comfortable with the current drafting of P5.1, which notes the actuary could go beyond the legislative provisions where they consider there to be additional 'relevant matters', and then lists some matters which might (or might not) be considered relevant by the actuary. We do not believe the items listed in a to c of P5.1 would necessarily suggest a scheme is no longer sound, and our preference would be to remove this list (in particular "intergenerational fairness" is not defined and is open to interpretation). However, we do not have strong objections to other items, given the actuary can decide which are considered to be relevant.
- P5.2a can be interpreted as simply requiring the actuary to review the communication they consider relevant. For the avoidance of doubt, it would be helpful if the reference to "all member communications" was amended to "the member communications".
- P5.4d refers to "any running or gateway tests". This should presumably say "any live running or gateway tests".
- P5.4e requires "a description of the scenarios". Given there are many scenarios which could potentially occur, including many that are very unlikely, we suggest that this be amended to read "an overview of the main credible scenarios".
- P5.4f requires amendment to cover both downside and upside scenarios which could lead to a scheme become unsound (e.g. scenarios in which very

high future pension increases might be required, making the design inappropriate and hence potentially unsound / unviable). P5.4f should also be amended to reflect the fact that some material risks may not be quantifiable (e.g. legislative changes that override the scheme rules on benefit determination) so the requirement to determine the "likelihood" may not be achievable.

- It is also unclear in P5.4f what the reference to negative "real" increases is intended to achieve with respect to risks around future soundness. For example, a well-run scheme designed and operating using best estimate assumptions might reasonably expect to provide negative real increases in 50% of cases. This is a design feature and has no more relevance to soundness than the other 50% of circumstances in which the scheme might expect to provide positive real increases. We would suggest the focus here is on risks around the ability to provide "nominal" increases.

15. Do you agree that the considerations for a practitioner certifying scheme soundness via a viability certificate are the same as those a practitioner should communicate to trustees in their own consideration as to whether the design of the scheme is sound for their viability report?

Not necessarily.

The practitioner's certification should be based on actuarial matters only.

However, the trustee's considerations would be expected to be much broader, and as part of the trustee's considerations of viability they might ask for the actuary to share views on these wider matters as part of a discussion among a wider adviser group (e.g including the trustee's lawyers and investment adviser).

16. Are there any other areas in relation to soundness (including practitioners' communications of their work on soundness) which require further standards? Please provide as much detail as possible.

No.

6. Actuarial valuations

17. What are your views on the proposed provisions on actuarial valuations for CMP schemes? Are there other key areas of judgement beyond the central estimate assumptions? Are there further areas you would expect to be included? Please give reasons for your response.

We see no reason for the requirement in P6.1a – ie to compare all assumptions with those used in the first gateway test. These will become less relevant as time progresses – and this could happen quickly if there are significant financial changes after the scheme commences. In any case, it is not clear why consistency with a historic test should be required and what benefit this provides, to justify the additional costs of this analysis. A comparison with the assumptions adopted for the most recent previous valuation might be more reasonable.

The exception to this is the comparison with the original aspiration for indexation, where we would anticipate a comparison to continue to be appropriate.

On P6.1b, (and as for P3.5 above), it is not clear whether this is a requirement to consider one or two credible alternative sets of assumptions, or the possible range of credible alternatives for each assumption. The same comments apply as for P3.5. We suggest that these requirements be redrafted as a requirement to show the sensitivity of the results to changes in the most material assumptions.

The requirements for consideration of post valuation experience (PVE) are disproportionate given that CDC valuations are carried out every 12 months. If the actuary allows for all PVE (a constantly moving target) in setting the benefit adjustment this creates challenges in finalising the valuation. We accept that there might be circumstances (for example following a significant market crash shortly after the effective date) where ignoring allowance for PVE would be inappropriate. Allowance for PVE is a trustee decision – which we might expect to be applied in extreme circumstances – and in normal circumstances PVE should be ignored. This is an example where TAS310 as drafted appears to introduce requirements beyond those set out in the CDC legislation, and where compliance with TAS 310 would add material cost if it is implemented in its current form.

P6.2a again raises the problems associated with "credible alternatives" – see our comments on P3.5 and P6.1b above. Paragraph 3.38 of the consultation document explains that the FRC "considers it necessary" without confirming

exactly what it has in mind (in terms of the potential range or one or two alternative suggestions) or why this might be necessary – or even beneficial, given the additional costs involved and the potential for the actuary to be encouraged to move towards one end of a given range of alternatives, potentially introducing bias, as a result of requiring these additional disclosures.

We suggest the P6.2b requirement to consider a 'credible alternative' to the approach adopted for PVE is removed. We set out above in our comments on P6.1c, why PVE should only be allowed for in extreme circumstances and should generally be ignored. Given this, incurring the costs associated with the additional calculations appears disproportionate.

18. Do you agree the required content of the valuation report set out in Appendix A is reasonable for CMP schemes? Is there further content which should be included?

We suggest that:

- Paragraph f could be expanded to provide a quantification of the factors leading to the benefit adjustment being different to last year's – the actuary and trustees should review and understand this as part of their work on the valuation.
- Paragraph h should be restricted to material risks.

Having said this, as with our comment on the TAS 300 proposals, we think that such disclosures should be a matter for regulation, rather than be in a Technical Actuarial Standard. Regulation 19 of the Occupational Pension Schemes (Collective Money Purchase Schemes) Regulations 2022 sets out a long list of the required contents of the valuation report. We suggest that the contents of Appendix A be added to this regulation. In passing, we note that paragraph d covers similar ground to Regulation 19(4)(i).

If the proposed Appendix A is to be retained within TAS 310 we think you should clarify whether these requirements are subject to the guidance on proportionality. Our presumption is that they are not.

7. Member option factors

19. What are your views on the proposed provisions in relation to factors for CMP schemes? Do you envisage any issues complying with provision P7.4 regarding selection risk? Are there certain groups of members you believe this may disadvantage? Please provide reasons for your response.

We suggest that it is the "principles of cost-neutrality" that should be followed rather than factors being required to be cost-neutral in every possible aspect.

The statement in P7.2 that factors "should be cost neutral on a central estimate basis" should be qualified by a reference to the scheme rules.

8. Impact assessment

20. Do you agree with our impact assessment? Please give reasons for your response.

As noted above, we have significant concerns over the current draft of TAS 310, which we believe would add a large amount of additional cost to the requirements of legislation. Examples include the proposed additional requirements to consider and report on 'credible alternatives' in several areas and considerations and reporting in relation to post valuation experience. It is therefore not correct to suggest, as set out in paragraph 4.8 of the consultation document, that any costs arise solely from the legislation and regulation of CDC.

We hope that these issues will be addressed as a result of this consultation, so that the final version of TAS 310 does not introduce significant additional costs.