

November 2012

Pensions Scheme Incentive Exercises

Analysis of responses to the June 2012 consultation

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Part I

Pension Scheme Incentive Exercises Analysis of responses to the June 2012 consultation

1 Introduction

Consultation and responses

- 1.1 The Financial Reporting Council (FRC) is responsible for setting technical actuarial standards in the UK. These include three Generic TASs, applying across the range of actuarial work, on Data, Modelling and Reporting Actuarial Information, and four Specific TASs applying to specific areas of actuarial work in Pensions, Insurance, Transformations and Funeral Plans.
- 1.2 In June 2012, the FRC, through the Board for Actuarial Standards (BAS), published a consultation paper on pension scheme incentive exercises. This consultation proposed that actuarial work concerning incentive exercises be brought into the scope of the *Pensions* TAS. It also proposed new principles to be included in the *Pensions* TAS to cover work on incentive exercises and considered whether further principles might be included at a later stage. Since the consultation paper was published the functions of the BAS have been transferred to the FRC.
- 1.3 The consultation period ended on 7 September 2012. A total of 12 public responses¹ were received (see Appendix A). Seven of these were from firms of actuaries and four were from professional bodies.
- 1.4 The FRC's Actuarial Council² and the FRC's Actuarial User Group³ provided input to the consultation. We thank all those who contributed.

Summary

- 1.5 All respondents to the consultation supported our proposal to bring actuarial work concerning incentive exercise into the scope of the *Pensions* TAS. However, there were several comments on the proposed wording.
- 1.6 The majority of respondents did not support the introduction of the proposed new principles into the *Pensions* TAS; they considered that the existing provisions of the Generic TASs and the *Pensions* TAS were sufficient.
- 1.7 Having considered the responses to the consultation we have decided to:
 - bring actuarial work concerning incentive exercise into the scope of the *Pensions* TAS but with modified wording from the exposure draft; and
 - not to introduce new principles into the *Pensions* TAS at this stage but to review the position at the first full review of the TASs (see paragraph 1.13).

¹ The responses are available at <http://frc.org.uk/Our-Work/Publications/BAS/Pension-Scheme-Incentive-Exercises-Consultation-Pa/Responses-to-Consultation-Paper-Pension-Scheme-Inc.aspx>

² <http://www.frc.org.uk/About-the-FRC/FRC-structure/Actuarial-Council.aspx>

³ <http://www.frc.org.uk/About-the-FRC/FRC-structure/Actuarial-Council/Actuarial-User-Group.aspx>

- 1.8 Section 2 covers the feedback we received and our reaction. Section 3 explains the changes that we have made to the *Pensions* TAS.
- 1.9 Part II contains the amended version of the *Pensions* TAS (version 2), marked up to show changes from version 1 of the *Pensions* TAS.

Impact assessment

- 1.10 Section 5 of the consultation paper presented our assessment of the costs and benefits associated with the proposed changes to the *Pensions* TAS. We expected that in many cases comprehensive actuarial information is already provided to sponsors and trustees and therefore we considered that the cost of complying with the relevant TASs is likely to be modest. Respondents agreed with our assessment noting that the industry Code of Practice is likely to have a more significant impact on the way incentive exercises are carried out than our proposals.

Effective date of changes

- 1.11 The changes to the *Pensions* TAS will be effective for work performed for aggregate reports completed on or after 1 January 2013.

Significant considerations

- 1.12 We have amended the document *Pensions TAS: Significant Considerations* to include the background to the changes for incentive exercises (chapter 9). This includes advice from the FRC's Actuarial Council to the FRC Board. We have also amended this document to reflect the transfer of responsibilities from the BAS to the FRC and to remove paragraph 5.38 (defined contribution pension schemes) which might have been misleading.

Monitoring

- 1.13 We recognise that our TASs may need amendment from time to time. We regularly obtain feedback from practitioners and users of actuarial information on the impact of the TASs. Going forward this feedback will cover the impact of the changes to the *Pensions* TAS for incentive exercises. We will conduct a formal review of each TAS at least every four years. At least every two years we will consider whether immediate changes are required.

2 Responses to the exposure draft

Introduction

2.1 In this section, we summarise the comments we received in answer to the specific questions that were posed in the consultation paper together with our reactions. The questions in the consultation are set out in boxes with the same numbering as on page 18 of the consultation paper. In brief:

- Actuarial work concerning incentive exercises will be brought into the scope of the *Pensions* TAS.
- No additional principles will be added to the *Pensions* TAS at this stage although we will reconsider the position at our first full review of the TASs.
- The changes will apply to aggregate reports completed on or after 1 January 2013.

Extending the scope of the Pensions TAS

1	Do respondents agree that actuarial work concerning incentive exercises should be brought into the scope of the <i>Pensions</i> TAS?
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2.2 All respondents agreed with our proposal to bring actuarial work concerning incentive exercises into the scope of the *Pensions* TAS. Some respondents suggested that the existing scope of the *Pensions* TAS could be interpreted as already including some actuarial work concerning incentive exercises but respondents considered that removing any doubt about this would be beneficial.

2.3 We have decided to bring actuarial work concerning incentive exercises into the scope of the *Pensions* TAS.

Purpose of the Pensions TAS

2	Do respondents agree that bringing actuarial work on incentive exercises into the scope of the <i>Pensions</i> TAS is consistent with the existing purpose of the <i>Pensions</i> TAS?
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2.4 All respondents agreed that bringing actuarial work on incentive exercises into the scope of the *Pensions* TAS is consistent with one element of the existing purpose of the *Pensions* TAS which is that “actuarial information provided to pension scheme governing bodies, sponsors and other users is relevant, comprehensible and sufficient to support decisions which affect the benefits payable to members of the pension scheme, and includes information on risk and uncertainty”.

2.5 Several respondents noted that including actuarial work on incentives exercises in the scope of the *Pensions* TAS is consistent with another element of the purpose which is that “calculations are performed correctly using measures, methods and assumptions that are fit for purpose”.

2.6 We consider that bringing actuarial work in respect of incentive exercises into the scope of the *Pensions* TAS is consistent with the existing purpose of the TAS.

Definition of incentive exercise

3 Do respondents agree that the definition of an incentive exercise should be consistent with the definition in the industry *Code of Practice*?

2.7 The majority of respondents agreed that the definition of an incentive exercise used in the *Pensions TAS* should be consistent with the definition in the industry *Code of Practice for Incentive Exercises*⁴. Some respondents noted that having the same definition might result in the *Pensions TAS* not applying to new innovative areas of work. We accept this and will continue to monitor regularly the scope of the *Pensions TAS*.

2.8 We consider that consistency with the Industry Code will avoid confusion and is therefore beneficial to practitioners and other stakeholders. We have therefore decided to adopt the definition in the industry code in the *Pensions TAS*.

Effective date

4 Do respondents agree that the changes to the *Pensions TAS* should be effective for work performed for aggregate reports completed on or after 1 December 2012?

2.9 Almost all respondents agreed that the changes should be brought in quickly and were content that the proposal in question 4 was achievable.

2.10 There were some concerns about the implications of the effective date of the revised version for work-in-progress. However, we consider that any additional work required for work-in-progress is unlikely to be significant. In the consultation we proposed that the changes to the *Pensions TAS* would be effective for work performed for aggregate reports completed on or after 1 December 2012. This was based on the revised *Pensions TAS* being published in October 2012. As the revised *Pensions TAS* is to be published in November rather than October we have decided that the changes will be effective for work performed for aggregate reports completed on or after 1 January 2013.

Proposed text

Scope

5 Do respondents agree the proposed text in paragraphs C.1.29 to C.1.31 which bring actuarial work concerning incentive exercises into the scope of the *Pensions TAS*?

2.11 There were several comments on the proposed wording which set out the following examples of actuarial work on incentive exercises:

- carrying out a feasibility study concerning an incentive exercise;
- assisting an entity considering an incentive exercise to set the terms of the offer;
- calculating any enhancement or alternative form of benefit;

⁴ <http://www.incentiveexercises.org.uk/>

- providing actuarial information to a governing body concerning an incentive exercise;
 - drafting and reviewing communication material to be provided to members; and
 - supporting the provision of advice concerning an incentive exercise to members of the pension scheme.
- 2.12 Several respondents suggested that feasibility studies should not be included in the list as they can be exploratory exercises which do not result in any decisions to change benefits. It was also suggested that calculations should not be included by themselves as they are a mechanistic exercise often carried out after decisions are taken and often carried out by administrators.
- 2.13 There were several comments on the inclusion of “drafting and reviewing of communication material to be provided to members”. While it was accepted that this is a very important area, it was noted that this work is covered by the industry *Code of Practice for Incentive Exercises*. It was also noted by respondents that actuaries involved in this communications work will need to follow the Actuaries’ Code and, in particular, actuaries can play an important part in making sure that communications are clear and not misleading.
- 2.14 Some respondents did not agree that “supporting the provision of advice concerning an incentive exercise to members” should be included. It was also suggested that this be changed to cover the provision of actuarial information to those providing advice on the exercise.
- 2.15 Taking account of the comments made by respondents, we have shortened and clarified the list of examples of work. The revised list of examples of work is:
- assisting an entity considering an incentive exercise to set the terms of the offer;
 - providing actuarial information to a governing body to assess the terms of an incentive exercise; and
 - providing actuarial information to another party advising on an incentive exercise.
- 2.16 As in other parts of the *Pensions* TAS, the list of examples of work is not intended to be exhaustive. It is possible that feasibility studies, although not currently listed in the examples in paragraph C.1.30, might on occasions be considered to contain elements of actuarial work which would be in the scope of the *Pensions* TAS, particularly if that work is used to set the level of incentives. What constitutes actuarial work is a matter of perception and common sense, based on the nature of the work, the way it is presented and the expectations of users; it will require judgement to be applied. A key test is whether it is reasonable for any of the intended users to expect the work to involve the application of actuarial techniques.

Principles

6	Do respondents agree that the proposed principles should be included in the <i>Pensions</i> TAS? (paragraphs 4.3 to 4.10)
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2.17 Most respondents considered that the proposed principles should not be included. The points raised included:

- the principles in the Generic TASs and the *Pensions* TAS are considered by practitioners to be sufficient for this work;
- the proposed principles addressed material risks and uncertainty which are covered (albeit in less detail) in paragraphs C.5.5 (providing information on material risks) and C.5.10 (providing information on cash flows) of TAS R and in some cases in paragraphs D.4.4 and D.4.5 (providing information for setting actuarial factors) of the *Pensions* TAS;
- the industry *Code of Practice for Incentive Exercises* sets out, in considerable detail, the information which should be provided to members who are offered incentives and sets out good practice for the operation of these exercises;
- as there are various safeguards (including the Code of Practice, the monitoring of that Code by a Monitoring Board comprised of representatives of industry bodies and the existing TAS provisions) the additional principles would be unlikely to affect outcomes for members;
- the proposed principles are detailed and appear more like rules rather than principles and could encourage a tick-box approach; and
- the FRC should not add new principles whenever the scope of a TAS is extended; doing so could result in the TASs becoming unnecessarily long.

2.18 Having considered each of these points we have decided not to include any new principles at this stage. However, we will reconsider whether new principles should be included at the first major review of the TASs. That review will take account of the feedback we receive from stakeholders about the impact of the TASs on the quality of actuarial work.

Further Principles

7	Are there any further principles which would support trustees, sponsors and members in their decisions that we should consider including in future revisions of the <i>Pensions</i> TAS? (paragraphs 4.11 to 4.15)
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2.19 The majority of respondents considered that no further principles are needed. They noted that the industry *Code of Practice for Incentive Exercises* includes the information that should be provided to trustees, sponsors and members.

2.20 Two respondents suggested additional principles and we will consider these as part of the review outlined in paragraph 2.18.

Impact assessment

8	Do respondents agree with the assessment of the impact of the proposals in section 5?
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2.21 Respondents broadly agreed with our analysis of the impact of the proposals. The general view of respondents was that there would not be significant costs arising from the changes to the *Pensions* TAS, as compliance with the TASs would be unlikely to require significant additional work.

9	What costs and benefits do respondents consider would arise from the proposed amendments to the <i>Pensions</i> TAS?
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2.22 Respondents considered that the industry *Code of Practice for Incentive Exercises* will set the standards for incentive exercises and that the proposed changes to the *Pensions* TAS would, by themselves, have little impact on incentive exercises.

3 Changes to the Pensions TAS

Introduction

3.1 In this section, we describe the changes we have made to the *Pensions TAS*.

References to the BAS

3.2 Following changes to the structure of the Financial Reporting Council, references to the Board for Actuarial Standards (BAS) in the introductory rubric have been changed to the Financial Reporting Council (FRC).

Commencement

3.3 We have changed the sub-heading “Commencement” in the introductory rubric to “Application”.

3.4 We have amended the existing text to state that:

- version 1 of the Pensions TAS applies to Reserved Work completed on or after, and work performed for aggregate reports completed on or after, 1 April 2011 and before 1 January 2013; and
- the revised version of the Pensions TAS, version 2, applies to Reserved Work completed on or after, and to work performed for aggregate reports completed on or after, 1 January 2013.

Definitions

3.5 We have inserted a definition of an incentive exercise in B.2.1. It is the same definition as the industry *Code of Practice for Incentive Exercises*⁵. This definition is:

“An invitation or inducement provided to a member to change the form of their accrued defined benefit rights in a UK registered pension scheme, which meets both of the following tests:

- one objective of providing the invitation or inducement is to reduce risk or cost for the pension scheme or sponsor(s); and
- the invitation or inducement is not ordinarily available to members of the pension scheme.”

Scope

3.6 We have included a new paragraph in the *Pensions TAS* (C.1.29) to bring the actuarial work concerning incentive exercises into the scope of the *Pensions TAS*. A new paragraph C.1.30 gives examples of actuarial work which is likely to be in scope. A new paragraph C.1.31 gives an example of work in this area which we consider not to be actuarial work.

⁵ <http://www.incentiveexercises.org.uk/>

A List of respondents to the June 2012 consultation

Professional and trade bodies

Association of Consulting Actuaries
Institute and Faculty of Actuaries

Pensions Management Institute
Society of Pension Consultants

Insurers, consultants and actuaries

Allan Martin
Aon Hewitt
JLT
KMPG

Mercer
Punter Southall
Towers Watson

Others

The Pension Protection Fund

Part II

Tracked changes from version 1.0 of the Pensions Technical Actuarial Standard

PENSIONS TECHNICAL ACTUARIAL STANDARD

PENSIONS TAS

Status

This standard (the Pensions TAS) is a Specific Technical Actuarial Standard (Specific TAS), as defined in the *Scope & Authority of Technical Standards (Scope & Authority)* of the ~~Board for Actuarial Standards (BAS)~~[Financial Reporting Council \(FRC\)](#).

This standard should be read in the context of the *Scope & Authority*.

The *Scope & Authority* sets out circumstances in which material departures from this standard are permitted or required and the disclosures which are required in respect of them.

A separate document, *Pensions TAS: Significant Considerations*, issued at the same time as this standard, reviews the considerations and arguments that were thought significant by the FRC in developing this standard.

Scope

This standard applies to the work specified in Part C of the standard.

Wider adoption is encouraged.

Commencement

This Application

Version 1 of this standard applies to Reserved Work completed on or after, and work performed for aggregate reports completed on or after, 1 April 2011 and before 1 January 2013.

~~Earlier adoption is encouraged.~~

Version 2 of this standard applies to Reserved Work completed on or after, and work performed for aggregate reports completed on or after, 1 January 2013.

Relationship with other TASs and with Guidance Notes

This standard sets out principles to be adopted across the range of work to which it applies, as described above. The Generic TASs apply and other Specific TASs may apply to work that is within the scope of this standard, setting out additional principles that should be adopted.

In the event of a conflict between this standard and a Guidance Note adopted by the [BASFRFC](#) (as described in the *Scope & Authority*), this standard shall prevail.

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A PURPOSE OF THE PENSIONS TAS

A.1 PURPOSE

A.1.1 The [BAS's FRC's](#) Reliability Objective is that the **users**¹ for whom a piece of actuarial information was created 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.

A.1.2 The purpose of this standard is to assist the achievement of the Reliability Objective by ensuring that in the performance of work within its scope:

- actuarial information provided to **pension scheme governing bodies**, sponsors and other **users** is relevant, comprehensible and sufficient to support decisions about the financing of the **pension scheme** and decisions which affect the benefits payable to members of the **pension scheme**, and includes information on risk and uncertainty;
- sufficient actuarial information is provided to enable **pension scheme governing bodies**, sponsors and other **users** of actuarial information to carry out their regulatory responsibilities in relation to the **pension scheme**; and
- actuarial calculations which result in payments to or from **pension schemes** are performed correctly and are carried out using **measures, methods** and assumptions which are fit for purpose.

¹ Terms appearing in **bold** in the text are explained in the Definitions set out in Part B.

B INTERPRETATION

B.1 INTERPRETATION OF THE TEXT

- B.1.1 All text in this standard has equal status unless stated otherwise. Paragraphs setting out explicit principles are emphasised with boxes for convenience.
- B.1.2 The **Scope & Authority**² states that a failure to follow the principles in this standard need not be considered a departure if it does not have a **material** effect. The contents of this standard should be read in that context, even where the term **material** is not explicitly used or where the word “shall” is used.
- B.1.3 Nothing in this standard should be interpreted as requiring work to be performed that is not proportionate to the scope of the decision or assignment to which it relates and the benefit that **users** would be expected to obtain from the work. What work is proportionate is a matter for judgement and might depend on factors such as the expertise of **users** in the matters being reported on and their needs.
- B.1.4 Part C of this standard includes references to actuarial work. What constitutes actuarial work depends on matters such as whether **users** would reasonably expect the work to be performed using actuarial techniques, and whether the work involves risk, uncertainty or modelling. Actuarial work often involves the exercise of judgement. Some work performed by actuaries might not be actuarial work.
- B.1.5 The form that is taken by any explanations, rationales, descriptions, indications or other analyses required by this standard will need to depend on the scope of the work performed and the benefit to **users**. The level of detail required is a matter for judgement. Unless stated otherwise, analyses may be quantitative or qualitative.
- B.1.6 Lists are not intended to be exhaustive.
- B.1.7 This standard should be interpreted in the light of the purpose set out in Part A.

B.2 DEFINITIONS

- B.2.1 Terms appearing in **bold** in the text are used with the meanings set out below. Some of the definitions are taken from the **Scope & Authority**. The definitions are used consistently in the **Scope & Authority** and other FRC standards.

actuarial factor A number calculated using actuarial techniques and used to place a value on a benefit or to convert a benefit from one form to another.

² Paragraph 23 of the **Scope & Authority**.

aggregate report	The set of all component reports relating to a piece of work within the scope of this standard. The aggregate report for a decision taken by a user in connection with work within the scope of this standard is the set of all component reports containing information material to that decision.
client	The body which has commissioned a piece of work. Examples include the governing body and employers participating in pension schemes .
component report	A document given to a user in permanent form containing material information which relates to work within the scope of this standard. A component report may be given to the user in hard copy or electronically. Formal written reports, draft reports, emails and presentations are examples of component reports . Possible contents of component reports include tables, charts and other diagrammatic presentations as well as or instead of text. A component report may form part of one or more aggregate reports .
data	Facts or information usually collected from records or from experience or observation. Examples include membership or policyholder data, claims data, asset and investment data, operating data (such as administrative or running costs), benefit definitions and policy terms and conditions.
to document	To record in documentation .
documentation	Records of facts, opinions, explanations of judgements and other matters. Documentation may be paper or electronic based. It is not necessarily provided to users . Documentation is material if it concerns a material matter.
entity	The pension scheme , insurance company, fund or other body that is the subject of the work being performed.
to fund	To accumulate funds in order to pay identified future outgoings.
funding assessment	A funding assessment is an exercise which involves comparing values of the liabilities and assets or determining contribution requirements.
funding level	The ratio of the value of assets to the value of liabilities.
Generic TAS	A Technical Actuarial Standard which applies to all work specified in the Schedule to the Scope & Authority .
governing body	The trustees of an occupational pension scheme or the administering authority of a section of the Local Government Pension Scheme.

implementation	<p>The formulae and algorithms of a model in a form that will perform the calculations required by the specification.</p> <p>In many cases an implementation is a computer program, but other types of implementation are possible – for instance, manual calculations are often used for simple models.</p>
<u>incentive exercise</u>	<p><u>An invitation or inducement provided to a member to change the form of their accrued defined benefit rights in a UK registered pension scheme, which meets both of the following tests:</u></p> <ul style="list-style-type: none"> • <u>one objective of providing the invitation or inducement is to reduce risk or cost for the pension scheme or sponsor(s); and</u> • <u>the invitation or inducement is not ordinarily available to members of the pension scheme.</u>
informed reader	<p>Someone who understands, or is capable of understanding with readily available advice, the financial issues involved in a particular pension scheme. An informed reader is not necessarily a user.</p>
material	<p>Matters are material if they could, individually or collectively, influence the decisions to be taken by users of the related actuarial information. Assessing materiality is a matter of reasonable judgement which requires consideration of the users and the context in which the work is performed and reported.</p> <p>The information listed in section E.3 for inclusion in the Scheme Funding report or in analogous reports under Part F is material.</p>
measure	<p>The approach that is used to define how an (uncertain) asset or liability amount is quantified. Two different measures of the same asset or liability may produce different results.</p>
method	<p>The mechanism that is used to quantify an (uncertain) asset or liability amount. Two different methods of calculating the same asset or liability measure should produce similar results.</p>
model	<p>A representation of some aspect of the world which is based on simplifying assumptions.</p> <p>A model is defined by a specification that describes the matters that should be represented and the inputs and the relationships between them, implemented through a set of mathematical formulae and algorithms, and realised by using an implementation to produce a set of outputs from inputs in the form of data and parameters.</p>

neutral	A neutral measure , assumption or judgement is one that is not deliberately either optimistic or pessimistic and does not incorporate adjustments to reflect the desired outcome. A neutral estimate is one that is derived using neutral measures , assumptions and judgements. There may be a range of neutral estimates, reflecting inherent uncertainty.
report	An aggregate report or a component report .
pension scheme	An occupational or personal pension scheme established under UK legislation.
required funding assessment	A funding assessment which is carried out to comply with legal requirements. Legal requirements include those in a pension scheme's governing documents.
Scheme Funding assessment	A funding assessment carried out in accordance with Part 3 of the <i>Pensions Act 2004</i> for an "actuarial valuation" (but not for an "actuarial report") as defined in section 224 (2) of the <i>Pensions Act 2004</i> .
Scheme Funding report	The report required by section 224 (1) and defined as an "actuarial valuation" in section 224 (2) of the <i>Pensions Act 2004</i> .
Scope & Authority	The FRC's <i>Scope & Authority of Technical Actuarial Standards</i> .
solvency basis	The assumptions used to determine the solvency position .
solvency position	The actuary's estimate of the solvency of the pension scheme as defined in Regulation 7 (6) of the <i>Occupational Pension Schemes (Scheme Funding) Regulations 2005</i> .
Specific TAS	A Technical Actuarial Standard that is not designated by the FRC as a Generic TAS . A Specific TAS is limited to a specific, defined context.
specification	A description of a model that describes the matters to be represented, the inputs and their interactions with each other, and the outputs to be produced.
technical provisions	As defined in section 222 (2) of the <i>Pensions Act 2004</i> .
users	Those people whose decisions a report is intended (at the time of writing) to assist. Those to whom the report is addressed, regulators and third parties for whose benefit a report is written are examples of possible users .

C SCOPE

C.1 WORK WITHIN THE SCOPE OF THIS STANDARD

C.1.1 Work that is within the scope of this standard may also be within the scope of other FRC standards. In particular, the **Generic TASs** on *Reporting Actuarial Information, Data and Modelling* apply to all such work.

C.1.2 This standard shall apply to all Reserved Work concerning **pension schemes**.

C.1.3 Reserved Work is defined in the **Scope & Authority**.

C.1.4 This standard also applies to some work that is not Reserved Work.

C.1.5 This standard shall apply to actuarial work performed for a **governing body** of a **funded pension scheme** to support decisions on contribution requirements or benefit levels.

C.1.6 The work described in paragraph C.1.5 includes:

- providing information to support the selection of assumptions;
- calculating the value of liabilities;
- calculating contributions required to meet the cost of a benefit enhancement for a member; and
- providing the results of calculations and other information to support proposals for contribution requirements.

C.1.7 This standard shall apply to actuarial work for a **governing body** of a **funded pension scheme** that concerns any amendments, proposed or agreed, to the **pension scheme's** governing documents which might affect members' benefits or the security of their benefits.

C.1.8 The work described in paragraph C.1.7 includes:

- assessing the **funding** implications of an amendment to benefits;
- comparing **funding levels** before and after an amendment to benefits;
- assessing the financial implications of changes to the **pension scheme** rules; and
- comparing the values of benefits or member options before and after an amendment to benefits.

C.1.9 This standard shall apply to actuarial work for employers or **pension scheme** sponsors on any matter for a **Scheme Funding assessment** for which there is a statutory or contractual requirement for the **governing body** to reach agreement or consult on the matter with the employer or sponsor.

C.1.10 The work described in paragraph C.1.9 includes:

- providing information to support the agreement of assumptions to be used for a **Scheme Funding assessment**; and
- providing information to support the agreement of the level of contributions to be paid to a **pension scheme**.

C.1.11 This standard shall apply to actuarial work for a **governing body** in connection with a bulk transfer of assets and liabilities from one **pension scheme** to another.

C.1.12 Paragraph C.1.11 applies to actuarial work for the **governing body** of the transferring or receiving **pension scheme** concerning transfers with or without members' consents.

C.1.13 The work described in paragraph C.1.11 includes:

- comparing the values of benefits before and after the transfer;
- comparing the values of member options before and after the transfer;
- comparing **funding levels** before and after the transfer; and
- calculating the transfer value.

C.1.14 The work described in paragraph C.1.11 does not include arranging the transfer of assets and liabilities.

C.1.15 This standard shall apply to actuarial work for a **governing body** of a **pension scheme** in wind up or contemplating wind up that concerns the transfer of liabilities to an insurer.

C.1.16 The work described in paragraph C.1.15 includes:

- comparing the values of benefits before and after the transfer;
- comparing the value of member options before and after the transfer; and
- estimating the cost of buying out benefits with an insurer.

C.1.17 The work described in paragraph C.1.15 does not include arranging the transfer of assets and liabilities.

C.1.18 This standard shall apply to actuarial work that concerns actuarial calculations in respect of individual members of a **pension scheme** and which have a direct effect on payments to members or the financial position of the **pension scheme**.

C.1.19 For the purpose of paragraph C.1.18 actuarial calculations are calculations which involve **actuarial factors**.

C.1.20 The work described in paragraph C.1.18 includes:

- recommending and setting **actuarial factors**; and
- providing instructions to other parties on the calculations of benefits which use **actuarial factors**.

C.1.21 The work described in paragraph C.1.18 does not include:

- arithmetical calculations using previously calculated **actuarial factors** (except if the work is Reserved Work); or
- checking other parties' systems and calculations.

C.1.22 This standard shall apply to actuarial work concerning projections of benefits from defined contribution elements of **pension schemes** which have been performed using assumptions other than those specified in legislation or other rules.

C.1.23 The work described in paragraph C.1.22 includes:

- recommending and setting **actuarial factors** for projecting expected pensions;
- recommending and setting **actuarial factors** for use in the design of contribution scales; and
- calculating contributions required to meet a targeted level of benefit.

C.1.24 This standard shall apply to actuarial work concerning **pension schemes** which is provided in connection with financial statements that are intended to give a true and fair view of a reporting entity's financial position and profit or loss (or income and expenditure).

C.1.25 The work described in paragraph C.1.24 includes preparing information for the purpose of compliance with *International Accounting Standard 19*, *International Accounting Standard 26*, *Financial Reporting Standard 17* and *Financial Reports of Pension Schemes: Statement of Recommended Practice*.

C.1.26 The work described in paragraph C.1.24 includes:

- providing information to preparers of financial statements to support the selection of assumptions;
- providing actuarial support to auditors of financial statements;
- providing an opinion on the suitability of assumptions; and
- providing information which is used in preparing financial statements.

C.1.27 This standard shall apply to actuarial work performed to support information on directors' pension arrangements which is disclosed in annual reports and in financial statements that are intended to give a true and fair view of a reporting entity's financial position and profit or loss (or income and expenditure).

C.1.28 The work described in paragraph C.1.27 includes valuing directors' pensions.

C.1.29 This standard shall apply to actuarial work concerning an **incentive exercise**.

C.1.30 The work described in paragraph C.1.29 includes:

- assisting an entity considering an **incentive exercise** to set the terms of the offer;
- providing actuarial information to a **governing body** to assess the terms of an **incentive exercise**; and
- providing actuarial information to another party advising on an **incentive exercise**.

C.1.31 The work described in paragraph C.1.29 does not include arranging the transfer of assets and liabilities and other administrative work to implement any changes to members' and dependants' benefits.

D GENERAL PRINCIPLES

D.1 INTRODUCTION

D.1.1 This Part contains general principles concerning actuarial work in pensions that support the purpose of this standard set out in Part A. It should be interpreted as described in Part B. It applies to the work specified in Part C.

Judgement

D.1.2 Judgements concerning the application of this standard shall be exercised in a reasoned and justifiable manner.

D.1.3 Judgement might be needed on matters such as:

- whether the work is actuarial work;
- the derivation of assumptions; and
- the selection of **models**.

D.1.4 This standard does not require the **documentation** or disclosure of judgements concerning its application unless stated otherwise.

D.2 ASSUMPTIONS

General considerations

D.2.1 Paragraphs D.2.2, D.2.3 and D.2.9 do not apply to assumptions used in **models** if the assumptions are specified in regulations or in some other legal document governing the work, or have been determined by the **client** or **user**.

D.2.2 Assumptions used in, or proposed for use in, models shall be appropriate for the purpose of the calculations for which they are used.
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D.2.3 Assumptions used in, or proposed for use in, models shall be derived from as much relevant information as is sufficient or, if there is insufficient relevant information, as is available.
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D.2.4 What information is relevant is a matter for judgement and might depend on matters such as the effective date of the calculations, and the purpose and the nature of the calculations for which the assumptions will be used. Information that might be relevant includes matters such as:

- financial and economic outlooks;
- mortality and other demographic projections; and
- recent experience of the **pension scheme** if it is statistically useful.

D.2.5 If there is substantial relevant information from which assumptions for use in **models** might be derived, what relevant information is sufficient is a matter for judgement and might depend on matters such as the cost of obtaining additional relevant information, the benefit that **users** receive from the use of additional relevant information and the degree of uncertainty that **users** are prepared to accept.

D.2.6 If there is limited relevant information from which assumptions for use in **models** might be derived, what relevant information is available is a matter for judgement and might depend on matters such as the cost of obtaining additional relevant information and the time it takes to collect. The limited relevant information that is available might need to be supplemented by other information which serves as a proxy, and by judgement.

D.2.7 Any opinion in a **report** on an assumption or a set of assumptions to be used for an exercise shall include a statement about the appropriateness of the assumption or set of assumptions for the purpose of the calculations for which they will be used.

D.2.8 The selection of assumptions might take account of any **material** events which are known to have occurred after the effective date of the calculations. The **Generic TAS** on *Reporting Actuarial Information* requires that the **aggregate report** shall indicate any **material** changes or events that are known by any person responsible for the **aggregate report** to have occurred since the effective date of the **data** and other information on which it is based.

D.2.9 No adjustment shall be made to any assumption used in, or proposed for use in, a **model** to compensate for a shortcoming in another unrelated assumption.

D.2.10 For example, assumptions about discount rates and future changes in mortality rates are unrelated.

Changes to assumptions

D.2.11 **Aggregate reports** shall explain any change in the rationale underlying the assumptions between two similar and related exercises.

D.2.12 The two exercises might be, but need not necessarily be, consecutive exercises such as two triennial **Scheme Funding assessments**. For example, the work carried out for the “actuarial valuation” and the work carried out for the “actuarial report” (both as defined in section 224 (2) of the *Pensions Act 2004*) are two exercises which are similar and related.

Discount rates

D.2.13 For any discount rates used in, or proposed for use in, an exercise, **aggregate reports** shall explain:

- a) the derivation of the discount rates;
- b) the implications of adopting the discount rates; and
- c) the cash flows that are being discounted.

D.2.14 An explanation of the derivation of discount rates might need to include matters such as:

- a comparison with low credit risk rates, such as rates based on nominal gilts or swaps yield curves published by the Bank of England;
- the return expected from the **pension scheme's** assets;
- a description of any **model** used to assist the setting of discount rates, including the assumptions underlying it and its limitations; and
- a range of reasonable alternative discount rates.

D.2.15 An explanation of the implications of adopting particular discount rates might need to include matters such as:

- the possible effects on the **pension scheme's** future **funding level** (on a **solvency basis** or **technical provisions** basis); and
- the **funding** implications of members exercising options (such as exchanging pension for cash on retirement) if the discount rate used to set the option terms differs from the discount rate used for **funding assessments**.

D.2.16 **Aggregate reports** shall explain how the discount rates used in, or proposed for use in, an exercise concerning a **funded pension scheme** compare with the return on assets that can be expected from assets invested according to any stated investment strategy, including any anticipated changes in that strategy.

Mortality

D.2.17 If mortality assumptions are used in, or proposed for use in, an exercise there shall be separate assumptions for base rates of mortality and subsequent changes to mortality rates.

D.2.18 Assumptions for base rates of mortality used in, or proposed for use in, an exercise shall reflect the current and anticipated membership of the **pension scheme** in question.

D.2.19 Assumptions for base rates of mortality will need to be based on the **pension scheme's** own experience if it is statistically useful. Otherwise, assumptions will need to be based on statistics derived from a wider base such as publicly published mortality tables. Matters which might need to be taken into account when using publicly available statistics include the average amounts of pensions and salaries and the socio-economic groups, location and occupations of members.

Discretionary practices

D.2.20 The **data** sought for any exercise shall include information about any relevant practice concerning discretionary benefits.

D.2.21 Relevant practices include:

- previous grants of discretionary benefits; and
- any existing policy regarding the exercise of discretion.

D.2.22 **Aggregate reports** shall state the extent to which assumptions take account of past experience of discretionary practices and information about the exercise of discretion in the future.

D.2.23 Information about the exercise of discretion in the future includes the views of the body which has the power to determine whether such benefits are awarded.

D.3 INFORMATION

Parties with influence or control

D.3.1 If any party associated with a **pension scheme** has influence or control over matters affecting benefits payable to members, the **data** sought for an exercise shall include information from that party about those matters.

D.3.2 Parties that might have influence or control over matters affecting benefits payable to members include:

- the **governing body** of a **pension scheme**;
- the principal employer of a **pension scheme**;
- participating employers in a **pension scheme**; and
- parent companies of participating employers in a **pension scheme**.

D.3.3 Neither an individual in their capacity as a **pension scheme** member, the UK Government nor any regulatory body is a party for the purpose of paragraph D.3.1.

D.3.4 Matters over which a party might have influence or control include:

- benefit increases;
- levels of salary increase; and
- rates of membership turnover.

D.3.5 It might be necessary to seek the information through the **client** rather than directly from the party concerned. The extent of the information to be sought is a matter for judgement, for example it might not be necessary to seek information from all participating employers in a multi-employer **pension scheme**.

Legislative uncertainty

D.3.6 If there is any uncertainty about the impact of legislation on the calculation of benefits, the **data** sought for any exercise shall include any known relevant legal opinions in the possession of the **client** in relation to the **pension scheme** in question.

D.3.7 **Aggregate reports** shall include an explanation of any known uncertainty in benefit definitions due to legislation.

D.3.8 The explanation might need to include matters such as:

- an indication of the maximum liability; and
- the liability under different scenarios.

D.4 CALCULATIONS OF PAYMENTS TO MEMBERS

Instructions for other parties

D.4.1 Instructions provided to another party for the calculation of benefits or other payments related to individual members shall be sufficiently clear to enable that party to carry out the calculations correctly.

D.4.2 The instructions that are provided might need to include:

- clear descriptions of the circumstances in which the instructions do and do not apply;
- sufficient information to enable the calculations to be performed correctly;
- procedures for checking specimen calculations upon initial receipt of the instructions and thereafter; and
- comments on the circumstances in which the instructions should be reviewed, including the frequency of reviews.

D.4.3 Paragraphs D.4.1 and D.4.2 apply to the provision of instructions to another party for the calculation of benefits or other payments. Other principles in this standard and the principles in the **Generic TAs** do not apply to such instructions.

Information for setting actuarial factors

D.4.4 Information that is provided to enable a **governing body** or other body to set **actuarial factors** for calculations concerning individual members shall be sufficient for that body to understand the financial implications of choosing the **actuarial factors**.

D.4.5 The information that is provided might need to include matters such as:

- an indication of the financial impact of choosing different **actuarial factors** on the **funding** of the **pension scheme** and the members exercising options;
- the implications of changes in market conditions; and
- the circumstances in which the **actuarial factors** should be reviewed.

Transfer values

D.4.6 Paragraphs D.4.7 to D.4.8 apply to information provided under Regulation 7B (2) of the *Occupational Pension Schemes (Transfer Values) Regulations 1996* or under Regulation 2B(2) of the *Occupational Pension Schemes (Early Leavers: Cash Transfer Sums and Contribution Refunds) Regulations 2006*.

D.4.7 Information that is provided to enable a **governing body** to set assumptions for cash equivalent transfer values shall include a comparison of any proposed assumptions with those used for a **Scheme Funding assessment**.

D.4.8 The comparison will need to include an explanation of the differences between the two sets of assumptions which might include a comparison of transfer values on both sets of assumptions for sample members.

D.5 FINANCIAL STATEMENTS

D.5.1 Paragraphs D.5.2 to D.5.3 apply to actuarial work supporting information provided to preparers and auditors of financial statements.

D.5.2 Information shall be sought regarding materiality levels for accounting purposes that apply to the piece of work.

D.5.3 If approximate **methods** have been used to provide actuarial information the **aggregate report** shall state any circumstances under which the information might, as a result of the use of approximate **methods**, be materially inaccurate for accounting purposes.

E PENSION SCHEMES SUBJECT TO PART 3 OF THE PENSIONS ACT 2004

E.1 INTRODUCTION

E.1.1 This Part applies to **pension schemes** which are subject to Part 3 of the *Pensions Act 2004* (Scheme Funding). It should be interpreted as described in Part B.

E.2 SCHEME FUNDING ASSESSMENTS

E.2.1 Paragraphs E.2.2 to E.2.12 apply to actuarial work supporting **Scheme Funding assessments** for **governing bodies** under section 230 of the *Pensions Act 2004*.

Risk and uncertainty

E.2.2 The **Generic TAS** on *Reporting Actuarial Information* requires that for each **material** risk or uncertainty faced by the **entity** in relation to the work being reported on, an **aggregate report** shall state the nature and significance of the risk and the approach taken to the risk.

E.2.3 The risks faced by a **pension scheme** in relation to its **funding** might include:

- the risk that the **pension scheme** sponsor will not be able to pay contributions or make good deficits in the future;
- the risk that the future investment return on assets will be insufficient to meet the **governing body's funding** objectives;
- the risk that returns on the investment of future income will differ from the returns available at the effective date of the calculations;
- the risk that inflation will differ from that assumed resulting in higher liabilities;
- the risk that falls in asset values will not be matched by similar falls in the values of liabilities;
- the risk that unanticipated future changes in mortality will increase the cost of the benefits; and
- the risk associated with the potential exercise of options under the **pension scheme** (by members or others).

E.2.4 There are many ways of indicating the extent of uncertainty and risks, such as:

- giving a range, confidence level or other statistical calculation;
- presenting the outcomes of scenarios, possibly including extreme scenarios; and
- a narrative describing the risks.

Measures

E.2.5 **Aggregate reports** shall describe and explain the implications of adopting different **funding measures**.

E.2.6 Explanations and descriptions might need to include matters such as:

- the treatment of new members;
- the treatment of future increases to salaries; and
- how the **measures** might be expected to affect future contributions over the lifetime of the **pension scheme**.

Statutory duties

E.2.7 **Aggregate reports** shall contain sufficient actuarial information to support the **governing body** in fulfilling its statutory duties in relation to setting assumptions and the **funding** strategy.

E.2.8 Other information which supports the **governing body** in fulfilling its statutory duties might be provided by other advisors.

E.2.9 The information that is provided might need to include:

- a range of options for each **material** assumption;
- relevant financial and economic information;
- the sensitivity of calculations to each **material** assumption;
- the effect that changes in financial conditions might have on the **technical provisions** and the **solvency position**; and
- relevant information about trends in mortality.

Technical provisions

E.2.10 **Aggregate reports** which include an assessment of the **technical provisions** of a **pension scheme** shall include:

- a) an approximate estimate of the value of the liabilities represented by the **technical provisions** calculated using the same assumptions that are used for the **technical provisions** but with any margins for prudence removed;
- b) an explanation of the relationship between the **technical provisions** and the approximate estimate; and
- c) an explanation of any change to the relationship between the **technical provisions** and the approximate estimate from the previous exercise of the same type, if any.

E.2.11 The approximate estimate described in paragraph E.2.10 is a **neutral** estimate for the purpose of paragraph C.5.4 of the **Generic TAS on Modelling**. The level of detail and precision in the estimate is a matter for judgement.

E.2.12 The information in paragraph E.2.10 might need to be supplemented by further explanations of the level of prudence in the **technical provisions**.

E.3 SCHEME FUNDING REPORT

E.3.1 Paragraphs E.3.3 to E.3.12 apply to the **Scheme Funding report**.

E.3.2 A **Scheme Funding report** cannot be part of an **aggregate report** for any earlier decisions made during a **Scheme Funding assessment**. It might form part of an **aggregate report** for further decisions made by a **governing body** or by others.

Contents

E.3.3 The **Scheme Funding report** shall be written so that an **informed reader** can understand the financial position of the **pension scheme**, including its development since the previous **Scheme Funding assessment** and how it might change in the future. The **Scheme Funding report** shall include:

- a) information required by statute;
- b) the **governing body's funding** objectives;
- c) a description of the effect on members' benefits had the **pension scheme** been wound up at the effective date of the **Scheme Funding assessment**;
- d) an explanation of any difference between the **technical provisions** and the value of the liabilities calculated on the **solvency basis**; and
- e) the current **funding level** and projections of the **funding level** at the expected effective date of the next **Scheme Funding assessment** on the **solvency basis** and on the **technical provisions** basis.

- E.3.4 Information about complex matters should not be excluded on the grounds that it might be too difficult for some readers to understand.
- E.3.5 The projections required by paragraph E.3.3E.3.3(e) might be approximate.
- E.3.6 The **Scheme Funding report** will need to include the information in paragraphs E.3.7 to E.3.12. This information is **material**. The level of detail is a matter for judgement.
- E.3.7 The **Scheme Funding report** will need to include the following information on **data** and information:
- summary membership **data** including average ages;
 - a summary of the benefit provisions or a reference to a summary of benefit provisions which has already been provided to members;
 - a statement of assets;
 - a summary of any stated investment strategy of the **governing body**;
 - a summary of experience since the previous **Scheme Funding assessment** including membership changes, contributions paid and investment returns; and
 - a summary of significant events, including changes to benefits, that have taken place since the previous **Scheme Funding assessment**.
- E.3.8 The **Scheme Funding report** will need to include the following information on methodology and assumptions:
- a description of **measures** used; and
 - a summary of the key assumptions including a comparison with those used in the previous **Scheme Funding assessment**.
- E.3.9 The **Scheme Funding report** will need to include the following information on the **pension scheme's** experience:
- an explanation of the reasons for changes in the **funding level** from the previous **Scheme Funding assessment**; and
 - quantification of any significant change in the **funding level** analysed by causes including changes in assumptions and the experience of the **pension scheme**.
- E.3.10 The **Scheme Funding report** will need to include the following information on cash flows:
- a description of the nature of future cash flows, which might need to include a description of how benefit amounts vary for different categories of the membership (such as pensioners, former members and active members).

E.3.11 The **Scheme Funding report** will need to include the following information on results and decisions:

- a summary of the results of the calculations; and
- if it is available, the contribution plan agreed as a result of the **Scheme Funding assessment**.

E.3.12 The **Scheme Funding report** will need to include the following information on risk and uncertainty:

- a description of the risks to the financial position of the **pension scheme** and any actions taken to mitigate them;
- an analysis of the sensitivity of the results of the calculations to changes in key assumptions.

F FUNDED PENSION SCHEMES NOT SUBJECT TO PART 3 OF THE PENSIONS ACT 2004

F.1 INTRODUCTION

F.1.1 This Part applies to **funded pension schemes** which are not subject to Part 3 of the *Pensions Act 2004* (Scheme Funding). It should be interpreted as described in Part B. This Part requires that the relevant principles in Part E apply in the context of such **pension schemes'** governing documents and statutory requirements.

F.2 REQUIRED FUNDING ASSESSMENTS

F.2.1 Paragraphs E.2.2 to E.2.9 and E.3.3 to E.3.12 shall apply to **required funding assessments**.

F.2.2 References in Part E to the **Scheme Funding report** will need to be treated as applying to the **report** produced on completion of the **required funding assessment**. References to a **Scheme Funding assessment** will need to be treated as applying to a **required funding assessment**.

F.2.3 References in Part E to **technical provisions** will need to be treated as applying to a value of liabilities which is used to determine contributions under the governing documents and statutory requirements for the **pension scheme**.

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