



**BOARD FOR ACTUARIAL STANDARDS**

**PENSIONS:  
CONSULTATION PAPER**

**JUNE 2009**

## FOREWORD BY THE CHAIRMAN

We have recently produced exposure drafts of our three Generic Technical Actuarial Standards (TASs) on Data, Modelling and Reporting Actuarial Information. In this paper we set out our thoughts on the Specific TAS which we are developing for pensions.

The pensions TAS will build on the solid foundation created by the Generic TASs. While the Generic TASs will include principles which will apply to actuarial work in any field, the principles in the pensions TAS will focus on aspects of actuarial work in pensions.

There are some important issues in the paper which I would like to highlight.

The first is how discount rates used to value liabilities are selected. We believe that it is important that users of actuarial information understand the rationale for using a particular discount rate. In particular we believe users would benefit from understanding how the discount rate compares with the yields on low risk assets such as gilts or swaps. We envisage that discount rates will be the subject of much debate in the coming years in both pensions and insurance and we hope that our proposals will stimulate thinking in this area.

The second issue is the assessment of the degree of prudence in Scheme Funding. Users may benefit from being able to compare prudent estimates of pension liabilities with best estimates so that they can quantify the amount of prudence. We are seeking views on whether this should be made a requirement under the Pensions TAS.

The third issue is the content of the actuarial report which is produced for Scheme Funding exercises. These documents are available to members of pension schemes. We are interested in views, particularly from users of actuarial information, on what these reports should contain.

The Board has been greatly assisted in its work by the members of the Working Group, the FRC's Stakeholder Interest Working Group and other users, practitioners and stakeholders. Our thanks are due to them all.

The proposals in this paper are likely to affect actuarial work and the resulting information for some years to come. Your views are important, and the Board looks forward to receiving them.

Paul Seymour  
June 2009

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# 1 INTRODUCTION

## BACKGROUND

- 1.1 The Board for Actuarial Standards (the BAS) is responsible for setting technical actuarial standards in the UK. It is an operating body of the Financial Reporting Council (the FRC).<sup>1</sup>
- 1.2 The BAS is developing a new set of Technical Actuarial Standards (TASs), as it proposed in its consultation paper on the *Structure of new BAS standards*.<sup>2</sup> There will be three Generic TASs, applying across the range of actuarial work, on *Data, Modelling and Reporting Actuarial Information*. There will also be a number of Specific TASs, applying to work in particular areas such as long term insurance business, general insurance, pensions and business rearrangements. This document sets out proposals for the Specific TAS on pensions.
- 1.3 The BAS has published its *Conceptual Framework for Technical Actuarial Standards* and *Scope & Authority of Technical Standards (Conceptual Framework and Scope & Authority)*. Its standards will be outcome-focused and principles-based, and will be developed through a fully consultative process. This document, a consultation paper, will be followed by an exposure draft of the Specific TAS on pensions which will also be subject to public consultation.

## AUDIENCE AND AIMS OF THIS DOCUMENT

- 1.4 This document has been written for anyone who is likely to be affected by the standard that the BAS intends to publish on pensions. The intended audience includes actuaries, pension scheme trustees and other governing bodies, scheme sponsors, regulators and pension scheme beneficiaries.
- 1.5 The primary purpose of the proposed TAS is to ensure that actuarial information gives the best possible support to those who use the information to make decisions based on it. We intend the TAS to be durable: it will therefore contain few references to legislation and regulations (which may change over time). This means that the proposed TAS will have a very different look and feel from the Guidance Notes (GNs) which we adopted from the Actuarial Profession. The transition from the GNs to the new TAS is considered in section 10.
- 1.6 This document does not revisit matters that have already been covered in the consultation papers and exposure drafts of the Generic TASs, which affect all areas of actuarial work.

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<sup>1</sup> The Financial Reporting Council is the UK's independent regulator responsible for promoting confidence in corporate reporting and governance.

<sup>2</sup> All the BAS's publications are available from its website at <http://www.frc.org.uk/bas/publications>.

- 1.7 Some pension arrangements are provided by insurance companies. We do not intend that actuarial work carried out for insurance companies in respect of such arrangements should be covered by the pensions TAS. This work may be covered by the Specific TAS on insurance which we intend to consult on later this year.
- 1.8 This document proposes a number of principles for inclusion in the BAS's pensions TAS. However, it is by no means an exposure draft of the proposed TAS, and the proposals are intended to convey more the general sense of the requirements that may appear in the TAS than the precise words that are likely to be used, or the precise structure that the standard is likely to take.
- 1.9 We would welcome views on the matters addressed in this document, and in particular on the questions listed in section 11. The responses that are received will inform our thinking as we develop an exposure draft leading to a Specific TAS on pensions.

### **ACTUARIAL WORK IN PENSIONS**

- 1.10 Pensions are one of the main sources of income for people who are no longer economically active. Pensions in the UK are traditionally associated with employment and many employees are provided with an occupational pension as part of their remuneration.
- 1.11 There are two main types of pension scheme: defined benefit (DB) and defined contribution (DC). DB schemes typically pay a pension defined in terms of the salary paid to the scheme member, either in the final years of employment or, less frequently, averaged over the whole period of employment. Most DB schemes are established under trust and managed by appointed trustees. Typically the financing is on a balance of cost basis with the members paying a fixed contribution and the sponsoring employer paying the balance. Because of the long period of projection, there is considerable uncertainty about the future development of both the assets and the liabilities of DB schemes.
- 1.12 In DC schemes contributions (by the member, the employer or both, usually as a fixed proportion of salary) accumulate with investment returns. The accumulated funds are then used to provide a pension at retirement, often through the purchase of an annuity. Typically financing is on a defined cost basis with the rate of contribution from the sponsoring employer being specified in advance.
- 1.13 The pension scheme actuary's main statutory role in respect of DB schemes is to investigate and advise the trustees on the funding position, with a view to enabling them to meet their obligations under the trust deed, trust law and pensions legislation. However, actuaries and actuarial firms typically provide a wider range of services and information or advice to trustees.
- 1.14 The main actuarial input to DC schemes is to advise on scheme design and provide illustrations for individual benefits for members.
- 1.15 Actuaries also provide information on pension arrangements to employers in a number of areas, including in connection with the funding of DB schemes, scheme design, statements of pension liabilities in financial statements, mergers and acquisitions and corporate restructuring.

## CONTENTS AND STRUCTURE OF THIS CONSULTATION PAPER

- 1.16 The Generic TASs on *Data, Modelling and Reporting Actuarial Information* (TAS D, TAS M and TAS R) will set out principles which can apply to all the principal areas of actuarial work. The Specific TASs will build on the foundation laid by the Generic TASs. They will set out the work to which they will apply and will contain principles covering how that work should be performed. By virtue of the BAS's *Scope & Authority* that work will also have to comply with the Generic TASs.
- 1.17 We consider the purpose of the proposed TAS in section 2. Section 3 discusses some general concepts and section 4 covers the scope of the proposed TAS.
- 1.18 Sections 5 to 8 consider possible principles that the TAS might contain together with their underlying rationale. The sections cover principles concerning data, assumptions, modelling and reporting respectively. Where possible we have identified principles which would apply across all areas of actuarial work in pensions, at the start of the relevant section. Each section then goes on to consider specific areas of pensions work that the TAS may also need to address. For some areas of pensions work, the proposed TAS may add little or nothing to the Generic TASs.
- 1.19 Section 9 considers some areas of pensions work that may be covered either in our proposed Specific TAS on business rearrangements or in the TAS on pensions. The areas considered are those that involve actuarial comparisons of benefits that may be paid to scheme members or others under various arrangements.
- 1.20 Section 10 considers the transition from the pensions-related adopted Guidance Notes to the new TASs.

## RESPONSES TO THIS CONSULTATION PAPER

- 1.21 Details of how to respond to this paper are set out in Section 11. Comments should reach the BAS by 18 September 2009.

## 2 PURPOSE

### INTRODUCTION

- 2.1 Our *Conceptual Framework* states that each TAS will set out its purpose. In this section we propose a purpose for the pensions TAS and discuss the TAS's application. We also discuss the departures that will be permitted by virtue of our *Scope & Authority*.

### PURPOSE OF THE PENSIONS TAS

- 2.2 The overall purpose of all BAS standards is that the users 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. This is the BAS's Reliability Objective, and is set out in the *Scope & Authority*.
- 2.3 We believe that the purpose of the pensions TAS should be to assist the achievement of the Reliability Objective by ensuring that in the performance of work within its scope:
- a) trustees, other members of pension scheme governing bodies, sponsors and other users of actuarial information are provided with sufficient information, including information on risk and uncertainty, to enable them to make decisions which relate to the financing of the pension scheme or affect the benefits payable to members of the pension scheme; and
  - b) calculations which result in payments to or from pension schemes are accurate and are carried out using methods which are fit for purpose.
- 2.4 Decisions relating to the financing of the pension scheme include decisions about the assumptions to be used in Scheme Funding. Similarly, decisions affecting the benefits payable to members include decisions about the basis on which the payments should be calculated.
- 2.5 Members of schemes may themselves make decisions affecting the benefits that are payable to them, by choosing whether to exercise options such as taking a transfer value or retiring early.

### APPLICATION

- 2.6 The pensions TAS will apply to work carried out in relation to occupational pension schemes. It will apply mainly to work in relation to defined benefit schemes but possibly also to some work in relation to defined contribution schemes.
- 2.7 We intend the TAS to apply to work within its scope carried out for pension schemes of all sizes. We believe that it is important that actuarial information is of a high quality regardless of the size of the arrangements in question.

- 2.8 Most pension schemes are established under trust. However, there are some that are not, including a number of unfunded public sector schemes and the Local Government Pension Scheme. Throughout this paper references to trustees and Scheme Actuaries should be read as applying to the relevant governing body and actuary advising that body respectively.

## DEPARTURES

- 2.9 The permitted or required departures from compliance with TASs are set out in full in paragraphs 20 to 24 of the BAS's *Scope & Authority*.
- 2.10 Paragraphs 22 and 23 of the *Scope & Authority* explain that departures that have an immaterial effect on the work being performed are permitted. A departure should be considered material if, at the time the work is performed, the effect of the departure (or the combined effect if there is more than one departure) could influence the decisions to be taken by the intended recipients of the work product.
- 2.11 Paragraph 24 of the *Scope & Authority* explains other possible departures, of which the most important is that departure is required in the extremely rare circumstances that compliance would conflict with the Reliability Objective (see paragraph 2.2).
- 2.12 The *Scope & Authority* sets out the disclosures that are required in the event of any departure.

In paragraph 2.3 it is proposed that the purpose of the pensions TAS will be that:

- a) trustees, other members of pension scheme governing bodies, sponsors and other users of actuarial information are provided with sufficient information, including information on risk and uncertainty, to enable them to make decisions which relate to the financing or affect the benefits payable to members of the pension scheme; and
- b) calculations which result in payments to or from pension schemes are accurate and are carried out using methods which are fit for purpose.

**The BAS would welcome responses to the following question:**

1. **Will the proposed purpose of the pensions TAS that is set out in paragraph 2.3 help to ensure that users of actuarial information can place a high degree of reliance on its relevance, transparency of assumptions, completeness and comprehensibility?**

## 3 GENERAL CONCEPTS

### INTRODUCTION

- 3.1 In this section we consider several issues which are fundamental to all areas of actuarial work. These have been covered in more detail in the previous consultations on the Generic TASs and in our *Scope & Authority*.

### MATERIALITY

- 3.2 Materiality is a vital concept in the context of TASs. The *Scope & Authority* states that a failure to follow the principles in a standard need not be considered a departure if it does not have a material effect.<sup>3</sup> In the consultations on the Generic TASs we covered materiality in depth and we do not intend to cover the same ground in this paper. We intend to use the same definition in the pensions and other TASs as was proposed in the exposure drafts of TAS D and TAS M:

A matter is material if, at the time the work is performed, it (or information resulting from it) could influence the decisions to be taken by users. A matter that is immaterial when considered in isolation may be material when considered in conjunction with others.

### PROPORTIONALITY

- 3.3 We are committed to proportionate regulation, and have borne in mind the cost of applying our standards in drafting the proposals in this paper. We also recognise that our standards should not encourage those seeking to comply with them to perform work that does not provide commensurate benefit to the users of the resulting actuarial information. Our standards are drafted so that compliance will not require disproportionate work.
- 3.4 Some respondents to consultations on the Generic TASs have suggested that, for smaller assignments in pensions, compliance with our TASs may lead to substantial additional work without commensurate benefits to users. In particular it has been argued that in order to comply with TAS R practitioners will prepare longer reports resulting in extra fees being charged to clients. This is not our intention. Indeed we believe that in many cases long reports may not comply with TAS R as they may contain unnecessary details which would obscure the material information.
- 3.5 We expect those complying with our standards to exercise their judgement in determining what a report should contain and then to document their rationale. We believe that the process of considering what should be in a report, and what should be omitted, will result in improved information for users.

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<sup>3</sup> Paragraph 23 of the *Scope & Authority of Technical Standards*.

## **APPLICATION OF JUDGEMENT**

- 3.6 The way in which the principles set out in a TAS are applied is a matter of judgement by those responsible for preparing actuarial information. In particular, it will often be necessary to make judgements about what is, or is not, material or proportionate.
- 3.7 We intend to include the following principle in the pensions TAS:
- Judgements concerning the application of this standard shall be exercised in a reasoned and justifiable manner.
- 3.8 Our other TASs will include the same principle. In due course we may choose to amend our Scope & Authority to cover this.

## 4 SCOPE

### INTRODUCTION

4.1 In this section we consider what work will fall within the scope of the pensions TAS. The nature of Reserved Work is discussed in paragraphs 4.2 to 4.7. Paragraphs 4.8 to 4.28 look at the areas of non-Reserved Work which we are proposing to bring within the scope of the TAS. Other areas of non-Reserved Work are considered in paragraphs 4.29 to 4.44.

### RESERVED WORK

4.2 Our Scope & Authority defines Required Work as work carried out in order that the entity commissioning the work complies with regulations, or with some other legal obligation, that require the entity to have the work carried out (or make certain outcomes conditional on the work having been carried out).

4.3 Reserved Work is defined as Required Work for which the regulations or other legal obligation require the entity in question to commission the work from an individual who holds a prescribed actuarial qualification (usually Fellowship).

4.4 We intend that the pensions TAS will apply to all Reserved Work that concerns occupational pension schemes.

4.5 Many areas of Reserved Work in pensions must be carried out by a Scheme Actuary appointed under section 47 of the Pensions Act 1995. These areas of work include advice on Scheme Funding and the calculation of technical provisions under the Pensions Act 2004. Certain pension schemes are exempt from the Scheme Funding provisions of that Act but are subject to other funding requirements. For example, a Fund Actuary is required to carry out certain duties in connection with the Local Government Pension Scheme which is subject to other legislation including the Local Government Pension Scheme Regulations as amended. Appendix A describes some of the Reserved Work in pensions created by legislation.

4.6 Reserved Work may be created for individual pension schemes through provisions in their governing documents. For example, a scheme's Trust Deed and Rules may require that actuarial input is used in:

- setting terms for converting pension to cash at retirement;
- setting factors for calculating reduced pensions on early retirement;
- calculating transfer values; or
- calculating additional payments required to meet the cost of benefit improvements.

4.7 Reserved Work may also arise as a result of terms in contractual arrangements. For example, a sale agreement may require an assessment of any shortfall in the funding of a scheme to be calculated by an actuary.

**NON-RESERVED WORK IN SCOPE**

- 4.8 One suggestion that has been made is that all work carried out by pension actuaries, including all actuarial work for scheme sponsors, should be subject to the BAS's standards.
- 4.9 On the other hand, it has also been suggested that our standards should apply only to Reserved Work. An argument supporting this suggestion is that, if a TAS affects the output from work done by actuaries, but not the equivalent work done by others, entities may, on occasion, be deterred from choosing an actuary for the work.
- 4.10 We have no brief to encourage entities to use actuaries in preference to others, but there might be risks to beneficiaries and others if those who commission work were deterred from using actuaries when the skills of the actuary and the ethical code of the profession were most needed.
- 4.11 We are proposing that the pensions TAS will apply to work in connection with occupational pension schemes which is almost always carried out by an actuary and which is used to make important decisions related to the financing of pension schemes or which might affect the level of benefits payable to members. This supports the purpose of the pensions TAS proposed in paragraph 2.3. Significant areas of non-Reserved Work that we propose to include within the scope of the pensions TAS are considered in more detail in the following paragraphs.

**Funding updates**

- 4.12 Actuaries are often asked to provide updated funding information which is not required by legislation and which is therefore not Reserved Work. For example, trustees may use actuarial information about the funding of a pension scheme when they take decisions on matters such as investment strategy or sponsor proposals to modify benefits.
- 4.13 We believe that compliance with the pensions TAS for this work will not be onerous. In most cases the work is likely to be based on the previous formal review, which will itself have had to comply. We also believe that it is important that information regarding the funding of pension schemes is of high quality, so that the resulting decisions are soundly based.

**Scheme funding – scheme sponsors**

- 4.14 Work for scheme sponsors in relation to Scheme Funding is almost always carried out by actuaries. Scheme Funding decisions are financially very significant for both schemes and sponsors. We therefore propose that any work carried out for a scheme sponsor in relation to a matter for which legislation requires agreement of the employer is within the scope of the pensions TAS. Such work includes work on Scheme Funding assumptions, the Statement of Funding Principles and setting contribution levels.

**Scheme amendments**

- 4.15 From time to time pension schemes are amended in order to change the benefits that are payable to members, or other changes are made that might affect members' interests in terms of either the amount of benefit or the level of security of the benefits. When considering scheme amendments trustees usually use actuarial information. We believe that the work of providing such information should be within the scope of the pensions TAS because of the effects on the benefits payable to members.

**Bulk transfers**

- 4.16 If pension scheme assets and liabilities are transferred to another scheme without the consent of members, legislation requires the actuary to certify to the trustees that the benefits provided in the receiving scheme are "broadly no less favourable" than those in the transferring scheme. This is Reserved Work.
- 4.17 The work required by legislation is limited in scope, and does not cover, for example, the impact of the transfer on the security of members' benefits, the funding level and the recovery plan to eliminate any deficit. These are all matters that the trustees may wish to consider and for which they may require actuarial information. In addition, the trustees of the scheme receiving the bulk transfer may well wish to consider these and related matters when deciding whether to accept the transfer.
- 4.18 As bulk transfers can result in changes to the level and security of members' benefits, we believe that work in connection with them should be covered by our TASs. However, we have not yet decided whether it should be covered by the pensions TAS, or the TAS we are proposing to prepare that will cover matters such as business rearrangements (see section 9).

**Pension scheme wind ups**

- 4.19 Winding up a pension scheme is a process during which it is essential that trustees have high quality information on which to base their decisions. Much will depend on the funding level, whether the sponsor is able to make any further payments and whether the scheme will qualify for entry into the Pension Protection Fund. If benefits are bought out with an insurance company or other organisation, trustees will wish to consider the terms for the transfer and the impact on members. Trustees usually make extensive use of actuarial information when making their decisions in this area.
- 4.20 Because the level and security of members' benefits are affected by the decisions that are made, we are proposing that work in connection with pension scheme wind ups is within the scope of the pensions TAS.

**Individual calculations and factors**

- 4.21 Most pension schemes use actuarial factors for various calculations concerning the payment of benefits to members. For example, "early retirement factors" are used to convert a pension at a member's normal retirement date into a lower pension payable from an earlier date, and "commutation factors" are used to convert some of a member's pension into a cash sum on retirement.

- 4.22 In 2006 the Actuarial Profession carried out a review of the issues arising from actuarial advice in connection with setting terms for cash commutation and other member options. We will take account of the issues that were identified as we develop the pensions TAS.
- 4.23 Actuarial factors affect the level of benefits that members receive and it is important that trustees receive high quality information on them. It is also important that the information is reviewed regularly to take account of changing conditions. We therefore propose that work concerning actuarial factors used in the calculation of benefits paid to members is within the scope of the pensions TAS.
- 4.24 Whether or not actuarial factors are used, actuaries are often involved in calculations concerning the benefits paid to members of pension schemes. As the calculations affect the levels of the benefits that are paid, we are proposing that, when these calculations rely on actuarial factors, this work is within the scope of the pensions TAS.
- 4.25 Even if actuaries do not themselves perform such calculations, they may supply administrators with instructions for performing them. It is important that instructions are clear and are not misunderstood, and that the calculations that follow them are performed only when the instructions are applicable. We are therefore proposing that such instructions are within the scope of the pensions TAS.

### Summary

- 4.26 To summarise, we propose that the following non-Reserved Work is within the scope of the pensions TAS:
- a) updates to scheme funding information used to make or support financial decisions by governing bodies on contribution requirements, investment strategy and rule changes (paragraphs 4.12 and 4.13);
  - b) actuarial information provided to employers or scheme sponsors on any matter related to Scheme Funding where there is a statutory or contractual requirement for the governing body to reach agreement with or consult on the matter with the employer or sponsor, or vice versa (paragraph 4.14);
  - c) actuarial information provided to a governing body relating to amendments to scheme rules which might affect members' benefits or their security (paragraph 4.15);
  - d) actuarial information provided to a governing body relating to financial matters in connection with a bulk transfer of assets and liabilities from one pension scheme to another (paragraphs 4.16 to 4.18);
  - e) if not covered by a TAS covering business rearrangements, actuarial information provided to governing bodies for pension schemes in wind up, including advice in connection with a transfer of liabilities on buy out (paragraphs 4.19 and 4.20); and
  - f) actuarial information for a governing body relating to individual calculations and factors which is not Reserved Work (paragraphs 4.21 to 4.25).

- 4.27 As a result of being within the scope of the pensions TAS, all this work will also be within the scope of the Generic TASs.
- 4.28 It should be noted that the wording above is indicative only, and does not reflect the final wording in the pensions TAS.

#### **NON-RESERVED WORK OUT OF SCOPE**

- 4.29 There are a number of areas of non-Reserved Work which we do not intend to bring into the scope of the first version of the pensions TAS. We will review the scope of the TAS periodically, and these areas may be brought into scope at a later date. Some of these areas of work are considered in the following paragraphs.

#### **Accounting for pension costs**

- 4.30 There are two accounting standards which apply to UK organisations accounting for pension costs in financial statements – FRS17 and IAS19. There are also various overseas accounting standards, including those published by the US organisation FASB, under which UK pension schemes report. Work in connection with overseas accounting standards is not within the BAS's scope, as our standards are limited to work performed in relation to the UK operations of entities and any overseas operations which report into the UK within the context of UK legislation or regulation, as described in paragraph 13 of our *Scope & Authority*.
- 4.31 We believe that some work concerned with accounting for pension costs should be within the scope of our TASs. However, although many of the principles in the pensions TAS may be applicable to such work, we have concluded that it should instead be covered in our proposed Specific TAS on information for financial reporting. As well as covering accounting for pension costs, this TAS is also expected to cover accounting for post-retirement medical plans, life insurance and general insurance.

#### **Investment**

- 4.32 Many actuaries provide investment-related work for trustees of pension schemes. The work is wide ranging, including investment manager selection and asset liability modelling. However, by no means all or even most investment work is carried out by actuaries and it is not always clear what work is actuarial and what is not.
- 4.33 We are therefore currently not inclined to include investment work in the first version of the pensions TAS. However, we believe that the principles contained in the Generic TASs would be appropriate for asset liability modelling work, in which complex models are often used. We would therefore strongly encourage compliance with the Generic TASs for all asset liability modelling work.

#### **NON-RESERVED WORK – VIEWS SOUGHT**

- 4.34 There are some areas of non-Reserved Work for which we have yet to reach a view on whether they should be within the scope of the pensions TAS. We would welcome views on whether the areas of work described in the following paragraphs should be subject to our standards, and in particular whether they should be within the scope of the pensions TAS.

**Defined contribution schemes**

- 4.35 Actuarial information may be provided on a number of aspects of defined contribution schemes. This work is usually not Reserved Work.
- 4.36 When a defined contribution pension scheme is established the sponsor will determine the level of contributions and the level of death benefits. In setting the level of contributions various factors may be taken into account, including the amount of pension which might be provided from different levels of contribution. Similarly in setting the level of death benefits to be provided the sponsor may consider the amount of a dependant's pension which might be provided by a lump sum payment. Sponsors may use actuarial information in making their decisions. Because these decisions will affect the benefits members ultimately receive, we are considering bringing this work into the scope of the pensions TAS.
- 4.37 Another area of work where actuarial information is used is benefit projections for members. Although such projections do not directly affect the benefits members receive, they may affect their decisions. We would be interested in views on whether this, and other areas of work in relation to defined contribution pension schemes, should be brought into the scope of the pensions TAS.

**Mergers and acquisitions**

- 4.38 Actuarial information is often used in due diligence exercises for company mergers and acquisitions. Pension scheme finances can be significant in the context of a commercial transaction, and actuarial information is often used in determining the financial terms of a transaction. In many cases work is carried out within very short timescales without access to complete data.
- 4.39 It has been suggested that it would be difficult for such work to comply with our standards, because of the intense time constraints under which information is provided. However, we believe that compliance with our standards would indeed be possible. In most cases, the requirements in our TASs are deliberately flexible, allowing either qualitative or quantitative analyses.
- 4.40 We believe that it is important that decision makers are fully aware of the shortcomings of the information that they use, and our TASs require full explanations of risk and uncertainty, and of any limitations in the data that has been used or the calculations that have been performed.

**Inducements to transfer**

- 4.41 The Pensions Regulator (tPR) has issued guidance on inducements provided to members who transfer out of defined benefit pension schemes. tPR takes particular interest in this area as one of its main statutory objectives is to protect members' benefits. Actuaries are often involved in providing information to employers who offer inducements to transfer, particularly in determining the level of any inducements.

- 4.42 It is possible that members may make decisions which are not in their best financial interests if they are not provided with full information or do not understand the information given to them. There is therefore an argument that information provided to employers in relation to such exercises should be subject to our standards. We would therefore welcome views on whether this work should be within the scope of the pensions TAS.

#### **Other work carried out for scheme sponsors**

- 4.43 As well as work for scheme sponsors in connection with Scheme Funding (see paragraph 4.14), actuaries are increasingly involved in other work for scheme sponsors, such as so-called risk reduction exercises involving consideration of matters such as annuity purchase, benefit design and investment strategy.
- 4.44 Since any changes directly affecting the benefits of members must be approved by the trustees, and we are proposing that the relevant work will be within the scope of the pensions TAS (see paragraph 4.15), we are not currently inclined to bring all work for sponsors into the scope of the TAS. However, we would welcome the views of respondents.

Section 4 discusses the possible scope of the pensions TAS. Paragraphs 4.2 to 4.7 discuss our proposal that all Reserved Work concerning occupational pension schemes should be in scope. Paragraphs 4.8 to 4.28 discuss the non-Reserved Work that we believe should be in scope, paragraphs 4.29 to 4.33 cover the work that we do not currently propose to be in scope, and paragraphs 4.34 to 4.44 cover work about which we are undecided.

#### **The BAS would welcome responses to the following questions:**

2. Do respondents agree that all Reserved Work concerning occupational pension schemes should be within the scope of the pensions TAS? (paragraphs 4.2 to 4.7)
3. Do respondents agree with our intention that the pensions TAS should apply to work in connection with occupational pension schemes which is almost always carried out by an actuary and which is used to make important financial decisions or which might affect the level of benefits payable to members? (paragraph 4.11)
4. Should the pensions TAS cover the non-Reserved Work listed in paragraph 4.26 ?
5. Do respondents agree that the areas of work described in paragraphs 4.29 to 4.33 should not be within the scope of the pensions TAS?

- 6. Should the following areas of actuarial work performed in connection with defined contribution schemes be within the scope of the pensions TAS:
  - a) scheme design; (paragraph 4.35)**
  - b) benefit projections; (paragraph 4.36)**
  - c) any other work? (paragraph 4.37)****
- 7. Should work performed in connection with mergers and acquisitions be within the scope of the pensions TAS? (paragraphs 4.38 to 4.40)**
- 8. Should work for scheme sponsors on inducements to transfer be within the scope of the pensions TAS? (paragraphs 4.41 to 4.42)**
- 9. Is there any work for scheme sponsors, other than work on Scheme Funding where agreement is required and inducements to transfer, that should be within the scope of the pensions TAS? (paragraphs 4.43 to 4.44)**
- 10. Is there any other work which is not mentioned above that should be within the scope of the pensions TAS?**

## 5 DATA

### INTRODUCTION

- 5.1 The exposure draft of TAS D contains requirements concerning data which will apply to all actuarial work within its scope, which includes all work within the scope of the pensions TAS. The principles contained in the exposure draft of TAS D cover the collection of data, its checking and the actions which should be taken when data is incomplete or inaccurate.
- 5.2 In this section we consider areas of data specific to pensions, including benefit definitions (paragraphs 5.4 to 5.5), information from scheme sponsors (paragraphs 5.6 to 5.7), overriding legislation (paragraphs 5.8 to 5.10) and discretionary benefits (paragraphs 5.11 to 5.12).
- 5.3 This section includes principles on specific data which should be sought. Where such data is sought but not provided then this should be reported to the user.

### BENEFIT DEFINITIONS

- 5.4 The benefits that are payable to scheme members are usually defined in a scheme's trust deed and rules (or other governing documents). However, these definitions may be overridden by, for example, trustees' resolutions or announcements, subsequent amendments to the scheme documents or changes to legislation. Considerable care needs to be taken to ensure that the correct benefit definitions are used in actuarial work.
- 5.5 Benefit definitions are included in the definition of data in TAS D, and the requirements in TAS D for gathering data, checking it and dealing with uncertainty and incompleteness in it therefore apply to them. We do not believe that any additional requirements are necessary.

### SPONSOR INFORMATION

- 5.6 Scheme sponsors often influence or control some of the matters about which actuarial assumptions are made. These matters include, for example, the level of salary increases and the numbers of members retiring early. Information about these matters is therefore needed in order to make decisions about the assumptions that should be used.
- 5.7 We therefore propose to include the following principle in the pensions TAS:
- The data sought should include information from the scheme sponsor about matters affecting benefits payable to members over which it has influence or control.

## OVERRIDING LEGISLATIVE REQUIREMENTS

- 5.8 UK or European law may override scheme rules in some areas. On occasions there may be uncertainty how scheme rules are affected by such changes – the requirement to equalise benefits for men and women in pension schemes following the Barber judgement is a well known example. When checking benefit definitions, care needs to be taken to ensure that they reflect any overriding legislation.
- 5.9 If there is uncertainty about how benefits are affected, a decision must be made about the allowance that should be made in calculations for that uncertainty. If the uncertainty is material the exposure draft of TAS R requires that a description of the uncertainty is reported to the user.
- 5.10 TAS R is likely to require that any material uncertainty relating to data and its treatment is reported to users. Relevant information for this purpose includes any legal opinions. We therefore propose to include the following principle in the pensions TAS:

Where there is uncertainty about the impact of overriding legislation on the calculation of benefits, the data sought should include any relevant legal opinions.

## DISCRETIONARY PRACTICES

- 5.11 Trustees may award discretionary benefits to members, such as pension increases above the rates guaranteed by the scheme or enhanced early retirement terms. Data collection should include a history of any such discretionary practices and information about the basis on which discretion is exercised. For example, there may be a policy that discretionary increases to pensions in payment are awarded if the funding level exceeds a specified level.
- 5.12 We propose to include the following principle in the pensions TAS:

The data sought should include information about any practice of granting discretionary benefits, its history and any policy regarding the exercise of discretion.

Section 5 considers data requirements for pensions work.

**The BAS would welcome responses to the following questions:**

- 11. Do respondents have any comments on the proposals concerning data that are presented in section 5, especially those in paragraphs 5.7, 5.10 and 5.12?**
- 12. Are there any other data issues which respondents believe should be covered by principles in the pensions TAS?**

## 6 ASSUMPTIONS

### INTRODUCTION

6.1 In this section we consider actuarial assumption setting in pensions work. Paragraphs 6.7 to 6.19 discuss general considerations which apply when setting assumptions. Paragraphs 6.20 to 6.53 consider specific assumptions which apply across all areas of pensions work. Paragraphs 6.54 to 6.65 discuss assumptions for specific areas of work including Scheme Funding and cash equivalent transfer values.

### BACKGROUND

6.2 The choice of assumptions can have a significant impact on the results of calculations and on the decisions taken by users of actuarial information. It is therefore important that those responsible for choosing assumptions understand the rationale for them and how the choice of different assumptions might affect any decisions which will be made.

6.3 It has been suggested to us by users in particular that we should set benchmarks for assumptions used for certain tasks such as Scheme Funding. It is argued that this would improve consistency and help trustees of pension schemes. However, we believe that actuaries and trustees should use their judgement to select assumptions which are appropriate for the particular circumstances. No benchmarks can be universally applicable and we are therefore not currently inclined to set benchmarks.

6.4 There are (at least) two different contexts in which actuarial work may involve assumptions. First, there are many tasks (such as Scheme Funding) in which the trustees (or others) are responsible for setting the assumptions and use actuarial information for this purpose. Second, there are other tasks in which actuaries themselves set the assumptions.

6.5 In the first context, the actuarial information that is used by trustees may include recommended assumptions, or may contain a number of options from which the trustees choose. In the remainder of this section we use the term “selecting assumptions” to refer to the process of determining the assumptions to be used, recommended or presented in actuarial information. We believe that the same principles should apply in all these situations.

6.6 TAS M will probably include a number of requirements concerning assumptions that are used in models. However, some actuarial work in the pensions field covers assumptions but does not involve models. In some cases, for example, actuaries are asked to recommend sets of assumptions to be used for various purposes, but perform no modelling. We believe that the requirements in TAS M that concern assumptions should apply in these situations and will draft the pensions TAS accordingly.

### GENERAL PRINCIPLES

6.7 In the following paragraphs we consider principles which might apply to the selection of assumptions in all areas of pensions work.

**Purpose**

- 6.8 When selecting assumptions consideration must be given to the nature and purpose of any calculations for which they will be used. Examples of different purposes are given in paragraphs 6.23 to 6.26. To reflect this we propose to include the following principle in the pensions TAS:

The selection of assumptions should take account of the purpose of the calculations for which they will be used.

**Legislation**

- 6.9 Legislation or other regulations sometimes specify the actuarial assumptions to be used for an exercise or the methodology to be used to derive some or all of the assumptions. In the event of a conflict with the requirements of legislation or regulations from other bodies, the BAS will alert that body to the conflict. The requirements of legislation or other regulations should be applied but the conflict should usually be disclosed to the user.

**Evidence base**

- 6.10 Assumptions should not be plucked out of thin air, but should be based on evidence and should be consistent. In many cases, assumptions should reflect the state of the world at the effective date of the calculations in which they will be used. For example, if limited information is available about asset values at the effective date and therefore assumptions are needed in order to estimate them, those assumptions should be based on market conditions at the effective date rather than at the date at which the calculations are performed (or at some other date).
- 6.11 For some exercises, such as Scheme Funding, the calculations may be performed and decisions may be taken some time after the effective date of the calculations. Material events after the effective date may affect the decisions to be made. Examples of such events include falls or rises in asset values, changes to the scheme sponsor and changes to the membership. In some of these cases it may be necessary to base some assumptions on the more recent information.
- 6.12 We therefore propose to include the following principle in the pensions TAS:
- The selection of assumptions should take account of information available at the effective date of the calculations for which they will be used. The selection of assumptions should also take account of any material events which are known to have occurred after the effective date of the calculations.
- 6.13 In selecting demographic and salary increase assumptions the recent experience of the pension scheme in question should be analysed. This is especially important for assumptions concerning matters such as mortality rates for which the experience of a particular pension scheme may differ from that of the general population. External data such as information from the Continuous Mortality Investigation may also be relevant.

- 6.14 We therefore propose to include the following principle in the pensions TAS:

Recent experience of the pension scheme should be analysed and compared with the selected demographic and salary increase assumptions.

- 6.15 The analysis may be qualitative or quantitative. In some cases, especially for small schemes, any analysis of past experience would be immaterial.

### **Sponsor information**

- 6.16 As discussed in paragraphs 5.6 to 5.7, the scheme sponsor often influences or controls some of the matters about which assumptions are made. Examples include the level of salary increases and the numbers of members retiring early. Information about such matters from the sponsor should inform the selection of assumptions. We therefore propose to include the following principle in the pensions TAS:

The selection of assumptions should take account of information from the sponsor on matters over which it has influence or control.

### **Consistency**

- 6.17 It is important that the assumptions are consistent as a whole, as well as that each assumption should be justifiable individually. The exposure draft of TAS M requires that assumptions used in models are consistent.

- 6.18 In some cases, current practice is to modify one assumption in order to reflect a shortcoming in another. For example, the discount rate used to value liabilities is sometimes decreased to allow for future reductions in mortality rates, instead of incorporating an explicit assumption about mortality improvements. We believe that this approach makes information less transparent to users, and is inconsistent with the achievement of our Reliability Objective.

- 6.19 We therefore propose to include the following principle in the pensions TAS:

No adjustment should be made to any assumption to compensate for a shortcoming in another assumption.

## **SPECIFIC ASSUMPTIONS**

### **Discount rates**

- 6.20 Discounting is widely used in actuarial work to assign a single value to a series of payments that take place over a period of time. It is used to assign a present value to payments that will occur in the future; for example, determining the current value of the liabilities of a pension scheme, where the liabilities primarily consist of the benefits that will be paid to members.

- 6.21 The significant assumptions are the amount of the payment, when it will be paid and the discount rate. In the following paragraphs we discuss the discount rate.

- 6.22 Like any other assumption, the discount rate used for calculations should depend on the purpose of those calculations. The question of discounting was examined by the value working group of the BAS, which reported in 2007<sup>4</sup>. The group's report identified a number of different purposes for which calculations might be required for a defined benefits pension scheme. These are considered in the following paragraphs.
- 6.23 *Scheme Funding* – legislation requires trustees to have funding objectives setting out how the trustees intend to pay future benefits from a combination of existing assets and future contributions. The purpose of a Scheme Funding exercise is to check whether the funding objectives are being met and to enable the trustees to make decisions about future contributions. Discounting in the context of a Scheme Funding exercise should therefore take account of the likely future returns from the scheme's assets, which depend on the trustees' investment strategy.
- 6.24 *Forecasting* – sponsors and trustees may sometimes require a best estimate of the funding level and contribution requirements of their scheme. This is calculated using best estimate assumptions of investment returns, real interest rates and longevity.
- 6.25 *Accounting for pension costs* – accounting standards require that financial statements give a true and fair view of the state of affairs of the entity. The accounting standards FRS17 and IAS19 require pension fund liabilities to be disclosed and the surplus or deficit to be shown on the balance sheet. Both standards require the discount rate used to be consistent with appropriate high quality corporate bonds.
- 6.26 *Pension Protection Fund (PPF) levy calculations* – the PPF was created to provide compensation to members of pension schemes where the sponsor has failed. A valuation of scheme liabilities must be carried out on a basis set by the PPF in order that the PPF levy can be calculated. The levy is partly based on the risk of the scheme sponsor failing. If a sponsor fails, an underfunded scheme may be eligible for entry into the PPF. The valuation, and hence the discount rate, are therefore broadly based on the PPF's assessment of the cost of meeting the liabilities, which has some similarities to the cost of buying out the liabilities with an insurance company.
- 6.27 The list above is by no means exhaustive: among other things, it omits the discount rates used for individual calculations and for setting actuarial factors. It shows that there are different purposes for which a discount rate may be chosen, and illustrates how the rate chosen may be different for different purposes. The principle proposed in paragraph 6.8 is thus especially important when selecting discount rates.
- 6.28 Given the many different purposes of calculations it is useful for users to understand how the discount rate chosen for a particular purpose compares with other possible rates. One way of doing this is to compare the rate with a standard comparator rate. The discount rates chosen for different purposes will have different relationships with the comparator.

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<sup>4</sup> <http://www.frc.org.uk/images/uploaded/documents/Value%20Working%20Group%20Report2.pdf>

- 6.29 It has been suggested that a suitable comparator rate would be the yield on low risk assets such as government bonds or swaps based on government bonds.
- 6.30 There is however a danger that the use of a comparator rate, especially if an explanation of any difference from it is required, will encourage the comparator to be used to derive the discount rate, for example by adding an amount to the low risk return to allow for equity outperformance. This would in our view be undesirable as there are other methods for deriving discount rates which may be more appropriate for the purpose.
- 6.31 Nevertheless, we are considering requiring the use of a comparator rate through the inclusion of a principle such as the following:
- The relationship between the selected discount rate and a low risk rate should be explained to the user.
- 6.32 We would be interested in respondents' views on the proposal to have a comparator and if so whether the comparator should be based on low risk assets.
- 6.33 For some purposes, including Scheme Funding, the discount rate might take account of the likely future returns from the scheme assets. These will depend on the trustees' investment strategy. The strategy itself is likely to change over time as the composition of the membership and the proportion of pensions in payment change. This is especially true for schemes closed to new members. We therefore propose to include the following principle:
- If a discount rate is related to the future returns on scheme assets its selection should take into account the trustees' investment strategy and anticipated changes in that strategy.
- 6.34 In addition to estimating the expected return on assets currently held by trustees, there is a need to make an assumption about the return from investments to be made from future income, which can be subject to much greater uncertainty. Future income can include investment income, contributions for future accrual of benefits and contributions to eliminate deficits. This difficulty is especially significant if future contributions are expected to be large.
- 6.35 This investment risk may be allowed for in setting the discount rate and we propose the following principle:
- If a discount rate is related to the future returns on scheme assets its selection should take account of the risk that yields on the investment of future income will be lower than the yields currently available.

## Inflation

- 6.36 Assumptions about future rates of inflation may affect a number of matters, including, for example, salary increases, increases to pensions in payment, the revaluation of deferred pensions and running costs. They should take account of any indicators available, such as the yield available on index linked gilts and published forecasts from the Bank of England and other economic commentators. We therefore propose the following principle for inclusion in the pensions TAS:

Assumptions about future rates of inflation should take account of financial indicators and publicly available forecasts.

## Other financial assumptions

- 6.37 There are a number of other financial matters for which assumptions are often needed, such as levels of pension increases, revaluation of deferred pensions and salary increases. These may directly or indirectly depend on inflation or other financial indicators. Often increases in pensions are subject to an upper or lower limit – for example, pension increases may be linked to inflation but with an annual cap of 5% pa. In such cases careful consideration needs to be given to the relationship between the assumptions being selected and the assumed rates of inflation. Sometimes models are used to determine these assumptions.
- 6.38 We do not propose to have any specific principles in our pensions TAS for the selection of such assumptions. However TAS R is likely to require that the report to the user includes the rationale for the selection of these assumptions.

## Mortality

- 6.39 We issued a consultation paper on *Mortality* in March 2008. Having considered responses to that paper we decided that we would not produce a Generic TAS on mortality. We are, however, proposing to cover the selection of mortality assumptions in Specific TASs.
- 6.40 Mortality assumptions are not always presented in a way that is easy for the users of actuarial information to understand. For example, the name of a mortality table may mean little to non actuaries.
- 6.41 Future rates of mortality depend on both current rates of mortality and the way in which those rates are expected to change in the future. As we discussed in the consultation paper on *Mortality*, we believe that these two factors are very different in nature: in principle it is often possible to obtain reliable information about current rates of mortality, whereas it is impossible to know what the future holds in terms of changes to mortality rates. In addition, it is often possible to select assumptions about mortality on a scheme specific basis, whereas it is debatable whether that can be done for future changes.

- 6.42 We propose to include the following principle on the selection of mortality assumptions in our pensions TAS:

Separate assumptions should be selected for current rates of mortality and for future changes to mortality rates. Assumptions concerning current rates of mortality should reflect the estimated current mortality rates applicable to the pension scheme in question.

- 6.43 The information that should be taken into account when selecting assumptions for current mortality rates includes, for example, variations arising from pension amount, occupation and regional factors. The CMI and other organisations publish many useful analyses of both current mortality rates and rates of change in mortality.

#### **Other demographic assumptions**

- 6.44 There are a number of other demographic assumptions that may be made. They include, for example, the proportions of members retiring or leaving employment at each age, and the proportions of members that are married or have other dependants. We believe that the general considerations for setting assumptions are sufficient for these assumptions.

#### **Discretionary benefits**

- 6.45 Trustees may award discretionary benefits such as pension increases above the rates guaranteed by the pension scheme documents, or enhanced terms for early retirements. Data requirements for discretionary benefits were discussed in paragraphs 5.11 to 5.12. Information concerning discretionary benefits should be taken into account when selecting assumptions.

- 6.46 We propose the following principle for inclusion in the pensions TAS:

Assumptions about the award of discretionary benefits should take account of past experience and information about the sponsor's or trustees' intentions which might affect the practice in the future.

- 6.47 The absence of any allowance for discretionary benefits is itself an assumption.

#### **Running costs**

- 6.48 The costs of running a pension scheme including those for administration, professional advice and investment management are usually referred to as expenses. The running costs are sometimes met by the sponsor and sometimes paid from the scheme assets. Assumptions about the level of running costs may be particularly important in Scheme Funding calculations but are also relevant in other calculations.

- 6.49 An assumption that is often made in Scheme Funding exercises is that running costs are a simple percentage of payroll – this amount is then added to the contribution rate to allow for future running costs. This approach may be satisfactory in some cases, but has obvious disadvantages for schemes with a decreasing percentage of active members (and hence a decreasing payroll). In practice, running costs are incurred in respect of benefits that are paid as well as contributions that are received, and indeed the former are generally more significant.

- 6.50 We therefore believe that transparency is increased if the relationship between running costs and benefits is clear. In particular, given that liabilities in respect of benefits that have already accrued are usually treated separately from liabilities in respect of the future accrual of benefits, we believe that running costs should be similarly treated.
- 6.51 As a scheme matures and becomes closer to potential wind up running costs increase in significance. An assessment of the level of future running costs is no easy task, but is vital if running costs are not to be underestimated. This is the case even when the sponsor pays the running costs as there may be a risk that the sponsor will not always be able to continue to pay them.
- 6.52 Assumptions concerning future running costs should, like all other assumptions, take account of recent relevant information, such as the recent experience of the scheme and the level of costs that are expected to be incurred in the future.
- 6.53 We propose to include the following principle in the pensions TAS:
- Separate assumptions should be selected for running costs paid by trustees in respect of liabilities relating to accrued benefits and future accruals of benefits.

#### **SPECIFIC AREAS OF WORK**

- 6.54 In the following paragraphs we consider principles which might apply to the selection of assumptions in specific areas of pensions work.

#### **Scheme Funding - trustees**

- 6.55 In Scheme Funding exercises the trustees are responsible for setting assumptions having taken advice from the Scheme Actuary. TPR's code of practice on funding defined benefits sets out matters relating to the assumptions which should be covered by actuarial advice.
- 6.56 The Pensions Act 2004 requires that:
- the economic and actuarial assumptions must be chosen prudently;
  - the rates of interest for discounting must be chosen prudently; and
  - the mortality tables and demographic assumptions must be based on prudent principles.
- 6.57 TPR's guidance to trustees on Scheme Funding adds that:
- trustees should choose individual assumptions with a level of prudence consistent with the overall confidence they want to have that the resulting technical provisions will prove adequate;
  - trustees must consider whether account should be taken of a margin for adverse deviation when choosing prudent economic and actuarial assumptions; and
  - to inform this choice trustees should discuss with the actuary the range of potential values so as to determine the appropriate margin (if any) over best estimate values.

- 6.58 It can be difficult to determine what prudence means in the context of a pension scheme. There is a view that prudence should depend, in part, on the covenant of the scheme sponsor – an approach that is prudent for a scheme whose employer has a strong covenant may not be prudent for a scheme whose sponsor has a weaker covenant. At this stage we do not intend to define prudence or to give guidance on how prudence should be determined. Instead we believe this should be a matter for the judgement of trustees and those advising them.
- 6.59 The exposure draft of TAS R requires that the meaning of terms such as prudence should be explained to the user of actuarial information. The exposure draft of TAS M requires that the user is given an indication of the extent to which estimates have been influenced by the purpose of a model. This means that estimates described as prudent should be accompanied by an indication of the level of prudence involved. We believe that it is important that the trustees have good information on which to base their decisions about the prudence or otherwise of the assumptions that they choose.

### **Scheme Funding - solvency**

- 6.60 The Pensions Act 2004 requires that the solvency position (by which it means the funding level were the pension scheme to be discontinued) of a pension scheme is shown. The adopted GN covering Scheme Funding (GN9) includes a set of assumptions which may be used for calculating the solvency position. We do not intend to include such a set of assumptions in the pensions TAS. Conditions change over time and we believe that assumptions should be selected based on information that is available at the time of the calculations.
- 6.61 We therefore propose the following principle for inclusion in our pensions TAS:

The assumptions selected for any calculations relating to the position if a scheme had been discontinued or wound up should be determined taking account of possible annuity rates available from providers, the nature of the pension scheme liabilities and the level of relevant bond yields.

### **Transfer values – private sector schemes**

- 6.62 Since 1 October 2008 trustees have been responsible for setting assumptions for cash equivalent transfer values. Legislation requires the trustees to use a best estimate basis for calculating minimum cash equivalent transfer values and to take actuarial advice before setting the assumptions. In addition, tPR has issued guidance to trustees on transfer values.
- 6.63 The requirement to use best estimate assumptions differs from the requirement for prudence in the selection of assumptions for Scheme Funding exercises. We believe trustees would benefit from understanding the relationship between the two sets of assumptions and therefore propose the following principle for inclusion in the pensions TAS:

The assumptions selected for cash equivalent transfer values should be justifiable in relation to the assumptions used for Scheme Funding.

**Transfer values – public sector schemes**

- 6.64 Cash equivalent transfers from public sector schemes are usually calculated using assumptions which are consistent with the legislation applying to private sector schemes. Although different legislation governs private sector schemes and public sector schemes, and some public sector schemes are unfunded, we believe that the principles for setting assumptions generally are sufficient for this task.

**Debt on employer calculations**

- 6.65 Section 75 of the Pensions Act 1995 (the debt on the employer legislation) provides for the calculation of a debt when a pension scheme winds up and when an employer ceases to participate in a multi-employer pension scheme. This calculation will often lead to a financial transaction. In such cases the calculations to determine the level of the debt to be paid would normally be expected to use best estimate assumptions.
- 6.66 Some concern has been expressed that there is no guidance from the BAS on this matter. However we believe that the legislation is sufficiently clear to enable actuaries to determine the correct approach.

Section 6 discusses assumptions. Paragraphs 6.7 to 6.19 discuss considerations that apply to the selection of assumptions in all areas of pensions work.

Paragraphs 6.20 to 6.53 discuss considerations applying to some specific assumptions, including discount rates, inflation, other financial assumptions, mortality, other demographic assumptions, discretionary benefits and running costs.

Paragraphs 6.54 to 6.66 discuss considerations applying to assumptions in some particular areas of work, including Scheme Funding, transfer values and debt on employer calculations.

**The BAS would welcome responses to the following questions:**

13. **Do respondents have any comments on the proposals concerning assumptions that are presented in section 6, especially those in paragraphs 6.3, 6.8, 6.12, 6.14, 6.16, 6.19, 6.33, 6.35, 6.36, 6.42, 6.46, 6.53, 6.61 and 6.63?**
14. **Respondents are asked for their views on whether a standard comparator rate for discount rates would assist users' understanding, and if so whether a low risk rate should be used? (paragraphs 6.28 to 6.31)**
15. **Are there any other principles on the selection of assumptions which respondents believe should be in the pensions TAS?**

## 7 MODELLING AND CALCULATIONS

### INTRODUCTION

- 7.1 TAS M will set out principles for actuarial models. It is expected to cover the use and documentation of models as well as the communication of the outputs of models to users. TAS M will apply to a wide range of work, from complex stochastic models to calculations for individual pension scheme members.
- 7.2 In this section we consider methods and measures used in actuarial work in pensions (paragraphs 7.3 to 7.4). Paragraphs 7.5 to 7.6 consider models in the context of Scheme Funding. In paragraphs 7.7 to 7.10 we consider issues relating to individual member calculations including cases where the actuary provides instructions for calculations to an administrator. Roll forward calculations are considered in paragraphs 7.11 to 7.14.

### METHODS AND MEASURES

- 7.3 For some exercises there is a range of approaches which can be used. For example, when assessing contribution rates for a pension scheme the possible approaches include the “projected unit method” which takes into account prospective future salary increases and the “current unit method” which does not.
- 7.4 The exposure draft of TAS M requires documentation of the mathematical formulae and algorithms underlying different methods and measures. The exposure draft of TAS R requires explanations of methods and measures used in calculations to be reported to users. We believe that these principles adequately cover methods and measures in relation to pensions and therefore do not propose to have any further principles in the pensions TAS.

### SCHEME FUNDING

- 7.5 Trustees are required to choose a funding method for Scheme Funding and document it in their Statement of Funding Principles. They are required to obtain actuarial advice before choosing a funding method. In order to make sound decisions, the trustees should understand the implications of choosing a particular method, including points such as the way in which new entrants are accounted for and the effect on future contributions. They should also be aware of what different methods assume about future salary increases particularly as trustees’ legal obligations are usually limited to benefits based on current rather than future salaries.
- 7.6 We therefore propose to include the following principle in the pensions TAS:
- The funding method employed in Scheme Funding exercises should be explained to trustees. This explanation should include the way future entrants and future increases to benefits have been taken into account.

**INDIVIDUAL MEMBER CALCULATIONS**

- 7.7 The principles in TAS M will apply to all calculations relating to individual members carried out by actuaries and we do not propose to add any further principles within the pensions TAS.

**INDIVIDUAL MEMBER CALCULATIONS – INSTRUCTIONS FOR ADMINISTRATORS**

- 7.8 Often a pension scheme's actuary will provide the scheme's administrators with instructions and factors so they can carry out the calculations relating to individual members. In such cases it is particularly important that the instructions provided are clear, as misunderstandings can lead to incorrect benefit calculations.
- 7.9 The instructions should make it clear to which calculation the instructions apply, how the calculations should be carried out and when cases should be referred to the actuary for checking. They should also make clear when they should not be used – for example, the instructions may have been designed for members with normal scheme benefits and should not be used for members with special benefit arrangements. The instructions should also comment on when any factors used should be reviewed – for example, after a period of time or when market conditions vary by a certain amount.
- 7.10 We propose to include the following principle in our pensions TAS:
- Instructions provided to another party for the calculation of benefits or other payments related to individual members should include:
- clear descriptions of the circumstances in which the instructions apply;
  - sufficient information to enable the calculations to be performed correctly;
  - procedures for checking the calculations; and
  - comments on when the instructions should be reviewed.

**ROLL FORWARD CALCULATIONS**

- 7.11 The results of past calculations may be rolled forward for various purposes, including the provision of information for financial statements (for example in compliance with FRS17 or IAS19), the calculation of the PPF levy and annual Scheme Funding updates.
- 7.12 Roll forwards typically take assets and liabilities at one date and project them to a later date taking account of changing financial conditions and some but not all changes to the data. Roll forward calculations enable updated numbers to be produced more quickly and at a lower cost than carrying out full calculations using data at a later date.

- 7.13 Roll forward calculations have limitations. The longer the period from the date of the original calculation the less reliable the projection becomes. The reliability of roll forward calculations may also decrease when there are changes in financial conditions which affect the assumptions used in the roll forwards. It is important that users of actuarial information understand the limitations of roll forwards.
- 7.14 TAS M is likely to contain principles on reporting the limitations of models to users. These principles will be of particular importance for roll forward calculations and will ensure that users are given an explanation of any uncertainty created by the roll forward methodology and can decide whether more accurate calculations should be commissioned.

### **OTHER CALCULATIONS**

- 7.15 The principles in TAS M will apply to other calculations, including those for Scheme Funding, and at this stage we do not propose to add any further principles within the pensions TAS.

Section 7 considers modelling and calculations in pensions, including those used in Scheme Funding, individual member calculations and roll forward calculations.

**The BAS would welcome responses to the following questions:**

16. Do respondents have any comments on the proposals concerning modelling and calculations that are presented in section 7, especially those in paragraphs 7.6 and 7.10?
17. Are there any other principles relating to models and calculations which respondents believe should be in the pensions TAS?

## 8 REPORTING

### INTRODUCTION

- 8.1 TAS R will set out principles for reporting which will apply across a wide range of actuarial work. However, there are some reporting issues that apply only in the pensions area, and we consider them in this section. Paragraphs 8.2 to 8.9 discuss proposed principles covering reporting the rationale for actuarial assumptions. Paragraphs 8.10 to 8.32 cover reporting in the context of Scheme Funding, including whether best estimates should be shown alongside prudent estimates and the content of the report produced at the end of the Scheme Funding process. Paragraphs 8.33 to 8.40 cover reporting in other areas of pensions work.

### RATIONALE FOR ASSUMPTIONS

- 8.2 The exposure draft of TAS R requires a statement of the material assumptions, the rationale for their selection and a comparison with the assumptions used for a previous exercise with a similar purpose. These principles will ensure that the user is given sufficient information to understand, for example, how the discount rate is derived and the rationale for allocating running costs between accrued liabilities and future accruals. They should also ensure that users understand the rationale for assumptions about member options including the amount of pension which members convert into a cash sum on their retirement, which can have a significant impact on the results of calculations.
- 8.3 In some cases the rationale for selecting assumptions may change over time, so that the rationale used for a Scheme Funding exercise, say, may differ from the rationale underlying the assumptions used the previous time the exercise was carried out. The exposure draft of TAS R requires the results of the two exercises to be compared. We believe that it is also important that trustees understand the reasons for any change in the rationale underlying the assumptions as this may have a material impact on the contributions which are paid to the scheme.
- 8.4 We therefore propose the following principle for inclusion in the pensions TAS:

The reasons for any change in the rationale underlying the selection of assumptions between two similar exercises should be explained to the users.

### ASSUMPTIONS

- 8.5 Assumptions regarding future mortality rates are particularly significant in some areas of pensions work. It is often difficult for the users to understand the implications of the assumptions, especially if the assumptions are presented simply as the names of the mortality tables that are used. We believe that illustrations of the effects of mortality assumptions can be of great assistance to users.

- 8.6 Illustrations may use life expectancies: if so, the meaning of the statistics presented should be explained carefully. Terms such as period and cohort life expectancy are generally not well understood by non actuaries. Illustrations could, for example, show the life expectancy at normal retirement age for a current pensioner and a younger member, showing the effect of future changes in mortality rates.
- 8.7 Another form of illustration is the proportion of members assumed to reach older ages. This can be particularly useful for showing the effects of the assumed maximum age to which it is possible for people to live – this is sometimes known as the terminal age.
- 8.8 In many calculations, including Scheme Funding, an assumption must be made about the level of pension which members give up for cash on retirement. As the HMRC tax rules currently allow up to 25% of the value of a member's pension to be exchanged this can be a highly material assumption particularly as the basis for conversion can be quite different from the basis used for calculating Scheme Funding liabilities. It is therefore important that users appreciate the implications of this assumption.
- 8.9 The exposure draft of TAS R requires that aggregate reports contain the rationale for all material assumptions. The exposure draft of TAS M requires that material limitations of models, such as their sensitivity to key assumptions, are explained to users.

#### **SCHEME FUNDING – BEST ESTIMATES**

- 8.10 In our consultation paper on *Modelling* we considered whether the equivalent best estimate should be presented alongside every prudent estimate. The feedback we received was that it was impractical to do so in every case, and so the principle will not be part of TAS M.
- 8.11 Legislation requires assumptions to be set prudently for Scheme Funding. We believe that trustees should understand how prudent they are being when choosing assumptions and setting contribution rates. It has been suggested that one way to assist them is to ensure that they are given best estimates to compare with prudent assumptions and estimates. As legislation requires that best estimates be used for determining cash equivalent transfer values (see paragraphs 6.62 to 6.63), a requirement to present best estimates in the course of Scheme Funding exercises may not be too onerous.
- 8.12 Presenting best estimates in the course of Scheme Funding exercises would also assist trustees to assess how, if at all, the level of prudence had changed between successive Scheme Funding exercises.
- 8.13 There may be some cases in which it is difficult to produce a single best estimate. Indeed, it has been argued that prudent estimates have often been used in actuarial work precisely because it is difficult to determine a best estimate basis. However, we do not believe that these difficulties are insuperable, especially in the light of the requirements to use best estimates for cash equivalent transfer values. We also believe that there would be significant benefit to users if best estimates were presented in the course of Scheme Funding exercises.

8.14 We therefore propose to include the following principle in the pensions TAS:

In Scheme Funding exercises, any prudent estimate of scheme liabilities that is presented should be accompanied by a best estimate. The change in the level of prudence from that in the previous Scheme Funding exercise should be explained to users.

8.15 If the scheme liabilities are broken down into, for example, those relating to accrued benefits and those relating to future accruals, the best estimates should be similarly broken down.

### **SCHEME FUNDING – INFORMATION FOR TRUSTEES**

8.16 The primary objective of our TASs is to ensure that users of actuarial information can rely on that information for the decisions that they make. Trustees make a number of important decisions in connection with Scheme Funding exercises, and need the relevant information before they take those decisions. Our TASs also place much emphasis on ensuring that the users of actuarial information are aware of the uncertainty inherent in it, and of the relevant risks.

8.17 We therefore propose to include the following principle in the pensions TAS:

The actuarial information given to trustees in the course of Scheme Funding exercises before they make decisions should include an explanation of how the funding objectives adopted by the trustees have been taken into account. It should also include comments on the following risks:

- the risk that the scheme sponsor may not be able to continue 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 funding objective;
- the risk that falls in asset values will not be matched by similar falls in the values of liabilities, thereby reducing the funding and/or solvency levels of the scheme;
- the risk that unanticipated future changes in mortality will increase the cost of the benefits;
- the risk associated with the potential exercise (by members or others) of options against the scheme; and
- any other material risks.

- 8.18 In some cases there may be uncertainty surrounding the definitions of benefits to be paid, for example arising from legislative requirements to equalise benefits for men and women (see paragraph 5.8). We believe that the financial effect of any legislative uncertainty should be described and that an upper estimate of the additional liabilities would assist the trustees in understanding the amount of any uncertainty. However, in some cases such an estimate would be difficult or even impossible to calculate. We therefore propose the following principle for inclusion in the pensions TAS:

The treatment of any uncertainty in benefit definitions due to overriding legislation should be explained to trustees in the course of Scheme Funding exercises. The explanation should include an indication of the maximum liability.

- 8.19 The exposure draft of TAS R requires reports to include an indication of uncertainty inherent in the information. In Scheme Funding exercises, this requirement will apply to estimates of both accrued liabilities and future contribution levels.

### **SCHEME FUNDING – REPORTS**

- 8.20 Legislation requires that Scheme Actuaries provide a report (referred to as an “actuarial valuation” in legislation) to the trustees on completion of Scheme Funding exercises. This report must contain details of the Technical Provisions and of the solvency funding position, and is required to be available to scheme members on request. As part of its deregulatory review of pensions, the DWP has recently consulted on the disclosure requirements, so that it is possible that they may change in the future. However, we understand that it is unlikely that the report will cease to be available to members.
- 8.21 It is likely that TAS R will alter the format and timing of the reporting of Scheme Funding information to trustees, as its emphasis will be on the information that is provided before the funding decisions are made, rather than on the information that is provided after the exercise is complete.
- 8.22 We have been considering what information in addition to the statutory minimum should be required in the report and have sought views from interested parties. As a result, we have identified four possible approaches.
- 8.23 Whichever approach is adopted, we believe that the report should contain a description of the impact on members’ benefits had the scheme had been wound up at the effective date. This information is likely to be useful to members who have concerns about the financial position of the scheme sponsor.
- 8.24 The first approach is for the BAS to set no requirements additional to those in legislation. We do not believe that this approach would assist in the achievement of our Reliability Objective, as the report would be of little use to scheme members.

- 8.25 The second approach is for the report to contain most of the information which had been provided to the trustees during the funding process. It is argued that this is necessary in certain circumstances to help members make informed decisions – particularly where there is some uncertainty about the future of the pension scheme. However, much of the information provided to trustees during the Scheme Funding process, for example information to assist them in deciding on the assumptions to be used, might be irrelevant to scheme members, making it difficult for them to judge which parts of the report contain information that is material for their circumstances.
- 8.26 The third approach is for the report to include enough information for an informed reader to gain a reasonable appreciation of the financial position of the pension scheme, and for the BAS to define what that information should be. As well as the results of calculations and the agreed level of contributions the information would, for example, include details of the most important assumptions, a summary of the data that had been used, and some analysis of key factors which had affected the pension scheme since the previous Scheme Funding exercise.
- 8.27 The fourth approach is for the report to include sufficient information for an informed reader to understand the financial position of the pension scheme including its development since the previous Scheme Funding exercise, but to leave the precise information that should be included up to the judgement of the Scheme Actuary and the trustees.
- 8.28 We believe that both the third and fourth approaches have merit. Given the availability of the report to scheme members, we believe that their needs should be taken into account in its preparation. We believe that, with a few exceptions, the information that is relevant to the members is also relevant to the decisions the trustees make during the Scheme Funding process, so that there would be little extra work. We would welcome views on whether this is so.
- 8.29 It is our general view that lists of specific requirements are counterproductive and may lead to the omission of important information. We think that the requirements in TAS R and TAS M, together with the other principles in the pensions TAS, will go a long way to ensuring that sufficient information is included, as long as an appropriate definition of the intended user of the report is used together with a specification of the types of decisions the report should be assumed to support. For this to work, the intended users of the report should include scheme members, and the reports should be assumed to support decisions that depend on the financial position of the scheme.

8.30 We therefore propose the following principle for inclusion in the pensions TAS:

The intended users of the Scheme Funding report should include scheme members, who should be assumed to be informed readers who will make decisions based on the financial position of the pension scheme, including its development since the last Scheme Funding exercise. The report should include:

- the information required by Statute;
- the trustees' funding objectives;
- a description of the impact on members' benefits had the scheme been wound up at the effective date; and
- other material information.

8.31 The judgement about materiality should be made in the context that information that could affect decisions made by scheme members based on the financial position of the scheme is material. The requirements in TAS R and the reporting requirements in TAS M will apply to this report.

8.32 It has been suggested to us that we should provide one or more specimen Scheme Funding reports. This might help to ensure a consistent approach to the preparation of the report and provide an indication of the possible form and content of a Scheme Funding report. We would be interested to know whether this would be of assistance to users of these reports.

### **PPF LEVY CALCULATIONS**

8.33 Section 179 of the Pensions Act 2004 requires the Scheme Actuary to calculate the liabilities of the scheme using assumptions specified by the PPF. The calculations may be based on the results of previous calculations with results rolled forward (see paragraphs 7.11 to 7.14).

8.34 Where there is any uncertainty about data and adjustments are made to that data, the PPF allows the actuary to make prudent approximations. TAS R is likely to require that the approach that has been adopted is reported to the user.

8.35 The formal report containing the results of the calculations is commissioned by the trustees, and made available by them to the PPF. The trustees do not usually rely on the formal report for any decisions that they make (although decisions may depend on work that was performed for the purpose of the report). We do not wish the preparation of this report to be disproportionate, and therefore propose to include the following principle in the pensions TAS:

It should be assumed that the intended user of the formal report giving the results of the PPF levy calculations is the PPF, and that the decisions that will be based on the report will concern the compliance of the calculations with the specified assumptions.

8.36 We believe that this will mean that a number of the principles in the Generic TASs and in the pensions TAS will be immaterial for this report.

**ACTUARIAL FACTORS**

8.37 Actuarial factors are used in the calculation of payments to or on behalf of individual scheme members under various circumstances such as early retirement. For example, actuarial factors are used to convert part of a member's pension into a cash lump sum at retirement. It is important that the factors that are used are reviewed in the light of changing circumstances. Some scheme rules require the actuary to certify that the factors used for cash lump sums are reasonable, yet in some cases we believe that the same factors have been used for many years despite changing market conditions and improving life expectancy. The use of outdated actuarial factors may well be to the detriment of scheme members.

8.38 We therefore propose that the pensions TAS includes the following principle:

When information is provided to enable trustees to set factors for calculations concerning individual members it should include an indication of how robust the factors are and when they should be reviewed.

8.39 It is important that when trustees select factors they understand the options that are available to them and the financial effects on the funding of the scheme, the members exercising options and the sponsor of the scheme. We believe that the inclusion of the following principle in the pensions TAS will assist this understanding:

When information is provided to enable trustees to set factors for calculations concerning individual members it should include an indication of the financial impact of choosing different factors on the funding of the scheme, the members exercising options and the sponsor of the scheme.

**TRANSFER VALUES**

8.40 Cash equivalent transfer values (CETVs) were discussed in paragraphs 6.62 to 6.63. We propose to include the following principle in the pensions TAS:

The information provided to trustees for setting assumptions for cash equivalent transfer values should include a comparison of the assumptions with those used for Scheme Funding with an explanation of the differences.

Section 8 considers the reporting of actuarial information for pensions. It discusses possible requirements concerning assumptions, Scheme Funding, PPF levy calculations, actuarial factors and transfer values.

**The BAS would welcome responses to the following questions:**

- 18. Do respondents have any comments on the proposals concerning reporting that are presented in section 8, especially those in paragraphs 8.4, 8.17, 8.18, 8.35, 8.38, 8.39 and 8.40?**
- 19. Do respondents agree that in Scheme Funding exercises any prudent estimate of scheme liabilities should be accompanied by a best estimate? (paragraphs 8.10 to 8.15?)**
- 20. Do respondents agree with our conclusion that the final Scheme Funding report should include sufficient information for an informed reader to understand the financial position of the scheme, and that this is best accomplished by defining the intended users and decisions accordingly? Do respondents agree with our conclusion that this would require little extra work? (paragraphs 8.20 to 8.31)**
- 21. Would the provision of specimen Scheme Funding reports be of value to users? (paragraph 8.32)**
- 22. Are there any other principles on reporting which respondents believe should be in the pensions TAS?**

## 9 ACTUARIAL COMPARISONS

### INTRODUCTION

- 9.1 There are a number of situations in which the benefits of members must be compared under different circumstances. Examples include comparisons of benefits before and after the modification of subsisting rights, changes to scheme rules and bulk transfers without the consent of members. Many of these tests are required by legislation.
- 9.2 It is possible that these comparisons will be covered by a Specific TAS on business rearrangements which would also cover comparisons in other areas of actuarial work. We are likely to consult on proposals for that TAS around the end of 2009 or the beginning of 2010. As we have yet to make a decision on its content this paper includes our preliminary thoughts in the area of actuarial comparisons in pensions.
- 9.3 Actuarial comparisons that are within the scope of a specific TAS will have to comply with our Generic TASs. Many of the important aspects of actuarial comparisons are covered by the requirements for disclosure of assumptions and explanations of risk and uncertainty.
- 9.4 There are a number of matters that we will consider for inclusion as principles in a Specific TAS.
- 9.5 When comparisons are made, it is important that the users understand the purpose of the comparison and the factors that have been considered. For instance, there may be a wide range of assumptions that could be used, some of which might be particularly significant. There may be a choice of methodologies for performing the comparison. And there may be a wide range of options that could be compared.
- 9.6 Depending on the potential event that triggers the comparison, there may be significant effects on the financial position of the scheme. For example, it might be necessary to compare by how much members' benefits would be reduced in the event of winding up, or to consider any changes in the contribution rates.

### WIND UPS

- 9.7 When a pension scheme is wound up and the benefits bought out with an insurance company, comparisons of the benefits before and after the buyout are usually made. Such comparisons should incorporate any reductions in benefits due to underfunding. They should also incorporate matters such as the terms on which member options, such as early retirement, cash commutations or transfer values, will be available.

**BULK TRANSFERS WITHOUT THE CONSENT OF MEMBERS**

- 9.8 Where members are transferred from one pension scheme to another without the consent of individual members, legislation requires the trustees to obtain actuarial certification that the benefits after the transfer are “broadly no less favourable” than the benefits before. GN16 (which is one of the adopted GNs) contains wording for the certification and requires the transfer to be completed within three months for the certification to be valid. Instead of specifying a fixed period we intend to require the actuary signing the certificate to state the period for, or circumstances under which, the certificate will be valid.
- 9.9 The trustees of the schemes making and receiving a bulk transfer may choose to use actuarial information about the implications of the transfer on their schemes in making their decisions. We will propose that either the pensions TAS or the business rearrangements TAS will include principles for the information that is provided to trustees. These are likely to cover comparisons of funding levels, members’ benefits on wind up, and contribution rates before and after the transfer.

Section 9 considers actuarial comparisons, and describes some principles that will be considered for inclusion in a Specific TAS.

**The BAS would welcome responses to the following question:**

- 23. Do respondents think that actuarial comparisons in pensions should be covered in the pensions TAS or in a Specific TAS covering similar matters across all areas of actuarial work?**

## 10 TRANSITION FROM ADOPTED GUIDANCE NOTES

### INTRODUCTION

- 10.1 The BAS has responsibility for the adopted GNs – those covering pensions matters are GN9, GN16, GN19, GN26, GN28, GN34, GN36 and GN49. We intend to withdraw these GNs after the pensions TAS comes into effect. The transition from these GNs to the new TAS is considered below. In some cases the transition may involve the retention of some of the material for a limited period.
- 10.2 Our standards cover technical areas. The Actuarial Profession is responsible for ethical and conduct standards. There are, however, some areas covered by GNs that could be construed as either technical or ethical. An example is the requirement to draw the attention of trustees to matters such as guidance from tPR.
- 10.3 It has been suggested to us that, rather than analysing in detail the difference between technical requirements on the one hand and ethical and conduct matters on the other, a pragmatic approach would be for our pensions TAS to cover the areas which could be construed either way. In the discussion of the adopted GNs below, we identify some of the principal matters which we think fall into this category. We invite respondents to comment on whether we should cover matters such as these, and if so which ones, in the pensions TAS. We are especially interested in whether users of actuarial information believe that covering such matters in the pensions TAS would increase the reliance they could place on the information.

### GN9

- 10.4 Many of the requirements of GN9 (*Funding Defined Benefits – Presentation of Actuarial Advice*) will be covered by the pensions TAS and TAS R, although they will be expressed differently.
- 10.5 The matters covered in GN9 that could be construed as either technical or ethical (see paragraphs 10.2 to 10.3) include:
- the requirement for the actuary to encourage trustees to seek advice on funding principles sufficiently early in the process; and
  - the requirement for a Scheme Funding report to name the actuary who carried out the previous exercise.
- 10.6 GN9 sets out an actuarial basis which the actuary may adopt for determining the funding level if the scheme were to be discontinued. This default basis was intended to be a broad proxy for the basis which an insurer may use for buying out benefits on wind up. We do not propose to specify a default basis as we believe that it is for actuaries to use their judgement to determine a suitable basis (see paragraphs 6.60 to 6.61).

- 10.7 GN9 sets out detailed disclosure requirements relating to the impact of the scheme being discontinued. For example it requires that when a scheme is less than fully funded on a buy out basis the actuary must quantify the impact on members' benefits had the scheme been wound up. It also requires the actuary to comment on the effect that future contributions will have on the level of coverage of members' benefits.
- 10.8 We believe it is important that the trustees understand how members' benefits might be affected if their scheme was to be wound up. In paragraph 8.30 we are proposing that the trustees are given an indication of how members' benefits might be affected on a subsequent wind up – this could include a quantification of the reduction in benefits.

## **GN16**

- 10.9 GN16 (*Retirement Benefit Schemes - Transfers Without Consent*) was first published in 1991. It provides guidance to actuaries who provide certification in respect of bulk transfers made without members' consents (see paragraphs 9.8 to 9.9).
- 10.10 The Preservation Regulations require the actuary to certify that members' benefits will be "broadly no less favourable" after the bulk transfer. The interpretation of this term has caused some considerable difficulty. In 2005 the Faculty and Institute of Actuaries obtained a 30 page opinion from Counsel on several aspects of the legislation relating to the actuarial certification. As a result GN16 was amended in a number of areas and now directs actuaries to the opinion while pointing out that the opinion must not be relied upon as being legal advice to individual actuaries or their firms. GN16 then states that each actuary "must consider the extent to which it may be necessary to take his or her own legal advice on the meaning of the Regulations".
- 10.11 We have discussed the difficulties caused by the term "broadly no less favourable" with the DWP. We do not intend to refer to the opinion obtained from Counsel by the Faculty and Institute of Actuaries in 2005.
- 10.12 GN16 also contains the form of the certificate which actuaries must sign to confirm that benefits are in their opinion "broadly no less favourable". We do not wish to maintain the certificate within our standards and are considering whether the form of the certificate should be contained elsewhere. Another approach would be for the individual actuary to determine the form of wording for their certificate although this might lead to the form of the certificate varying from case to case.
- 10.13 The matters covered in GN16 that could be construed as either technical or ethical (see paragraphs 10.2 to 10.3) include:
- the requirement for the actuary to draw to the attention of trustees certain matters which may be relevant to the trustees' decisions such as the benefits and options provided by the transferring scheme;
  - taking instructions from the trustees on matters such as the categories of members to be included in the certificate;
  - the requirement to explain various matters regarding the certification to the trustees; and

- the requirement to draw the attention of the trustees to events including those which would mean that the certification would no longer be valid.

## **GN19**

- 10.14 All substantive technical content has been removed from GN19 (*Retirement Benefit Schemes - Winding-up and Scheme Asset Deficiency*) following changes to legislation. There remain references to GN19 in legislation which will need to be retained whilst transitional cases are considered. We will be discussing this with the DWP.

## **GN26**

- 10.15 GN26 (*Pension Fund Terminology*) does not sit logically within the pensions TAS. There is merit in having a glossary of actuarial terms as it may be of benefit to users and will help ensure that consistent language is used in actuarial work. The glossary could be extended from the definitions within GN26 to cover, for example, terminology used to describe life expectancy.
- 10.16 We would welcome views on whether it would be of value to users of actuarial information to have such a glossary, and if so what it should contain.
- 10.17 We intend to withdraw GN26 when the pensions TAS becomes effective.

## **GN28**

- 10.18 Pension schemes which are contracted-out of the second part of the State pension scheme must provide benefits which are at least equivalent in value to a Reference Scheme. When a Scheme becomes contracted-out the Scheme Actuary must provide certification that the benefits satisfy the test. Trustees must also ensure that if benefits of a contracted-out scheme are reduced they still meet the Reference Scheme test. GN28 (*Retirement Benefit Schemes - Adequacy of Benefits for Contracting-out*) gives guidance to actuaries determining whether a scheme passes the Reference Scheme test. It also supplements the legislation as it provides details of what schemes must do to meet the test which are not contained in the legislation – for example on the treatment of spouses' pensions.
- 10.19 Although some aspects of GN28 are likely to be covered by TASs, the content which supplements legislation does not fit into principles-based standards. This has been highlighted to the DWP. We are considering how we might maintain those parts of GN28 which supplement legislation outside our TASs.
- 10.20 The matters covered in GN28 that could be construed as either technical or ethical (see paragraphs 10.2 to 10.3) include:
- the process for taking instructions to determine whether a scheme satisfies the reference scheme test.

## **GN34**

- 10.21 GN34 (*Illustration of Defined Contribution Pension Scheme Benefits*) sets out considerations for actuaries providing illustrations of benefits from defined contribution schemes. Unlike many other GNs, GN34 is not mandatory. We intend to withdraw GN34 when the pensions TAS becomes effective. We may at a later stage consider whether we should set standards for the provision of defined contribution illustrations.

**GN36**

- 10.22 The provisions of GN36 (*Accounting for Retirement Benefits under FRS17*) will be considered in the consultation on the Specific TAS on information for financial reporting.

**GN49**

- 10.23 GN49 (*Occupational Pension Schemes – Scheme funding matters on which advice of actuary must be obtained*) covers some aspects of Scheme Funding advice to trustees. Part of GN49 repeats legislation, part includes guidance which we believe to be professional and there are other parts covering information to be given to trustees which we intend to be covered by TAS R and the pensions TAS. GN49 will therefore be withdrawn when the pensions TAS comes into force.
- 10.24 The matters covered in GN49 that could be construed as either technical or ethical (see paragraphs 10.2 to 10.3) include:
- bringing the attention of trustees to matters listed in sections 75, 79 or 102 of tPR's code of practice for funding defined benefits on which the actuary has not given advice; and
  - bringing to the attention of trustees that prior to obtaining advice they must provide sufficient and up to date information.
- 10.25 GN49 specifies the action to be taken if an actuary believes that the trustees are not complying with their obligation to provide adequate information. We believe that this is an ethical matter and do not propose to carry this forward to the pensions TAS.
- 10.26 Section 230(1) of the Pensions Act 2004 requires the trustees to obtain the advice of the actuary before modifying the basis of future accrual of benefits when they have not been able to agree certain funding matters with the employer. This rarely happens in practice. Paragraph 2.4 of GN49 states that the actuary's obligation in this context is limited to the implications for the statement of funding principles, the recovery plan and the schedule of contributions. However the legislation is not this specific and the withdrawal of GN49 will remove this limitation of the actuary's obligation.

Section 10 considers the transition from the adopted GNs to the new BAS standards. It describes each adopted GN in the pensions area, including any significant requirements that will not be covered in the Generic or Specific TASs.

**The BAS would welcome responses to the following questions:**

24. Do respondents have any views on whether it would be of value to users of actuarial information for the BAS to maintain a glossary of actuarial terminology and if so, what it should contain? (paragraphs 10.15 to 10.17 )
25. Do respondents have any comments on the proposed transitional arrangements from the adopted GNs to TASs described in section 10?
26. Do respondents have any views on whether matters which could be construed as technical or ethical such as those mentioned in paragraphs 10.5, 10.13, 10.20 and 10.24 should be included in the pensions TAS?

# 11 INVITATION TO COMMENT

## QUESTIONS

- 11.1 We invite the views of those stakeholders and other parties interested in actuarial information who wish to comment on the content of this document. In particular we would welcome views on the following issues:
- 1 Will the proposed purpose of the pensions TAS that is set out in paragraph 2.3 help to ensure that users of actuarial information can place a high degree of reliance on its relevance, transparency of assumptions, completeness and comprehensibility?
  - 2 Do respondents agree that all Reserved Work concerning occupational pension schemes should be within the scope of the pensions TAS? (paragraphs 4.2 to 4.7)
  - 3 Do respondents agree with our intention that the pensions TAS should apply to work in connection with occupational pension schemes which is almost always carried out by an actuary and which is used to make important financial decisions or which might affect the level of benefits payable to members? (paragraph 4.11)
  - 4 Should the pensions TAS cover the non-Reserved Work listed in paragraph 4.26?
  - 5 Do respondents agree that the areas of work described in paragraphs 4.29 to 4.33 should not be in the scope of the pensions TAS?
  - 6 Should the following areas of work performed in connection with defined contribution schemes be within the scope of the pensions TAS:
    - a) scheme design; (paragraph 4.35)
    - b) benefit projections; (paragraph 4.36)
    - c) any other work? (paragraph 4.37)
  - 7 Should work performed in connection with mergers and acquisitions be in the scope of the pensions TAS? (paragraphs 4.38 to 4.40)
  - 8 Should work for scheme sponsors on inducements to transfer be in the scope of the pensions TAS? (paragraphs 4.41 to 4.42)
  - 9 Is there any work for scheme sponsors other than work on Scheme Funding where agreement is required and inducements to transfer, that should be in the scope of the pensions TAS? (paragraphs 4.43 to 4.44)
  - 10 Is there any other work which is not mentioned above that should be within the scope of pensions TAS? (section 4)
  - 11 Do respondents have any comments on the proposals concerning data that are presented in section 5, especially those in paragraphs 5.7, 5.10 and 5.12?
  - 12 Are there any other data issues which respondents believe should be covered by principles in the pensions TAS? (section 5)

- 13 Do respondents have any comments on the proposals concerning assumptions that are presented in section 6, especially those in paragraphs 6.3, 6.8, 6.12, 6.14, 6.16, 6.19, 6.33, 6.35, 6.36, 6.42, 6.46, 6.53, 6.61 and 6.63?
  - 14 Respondents are asked for their views on whether a standard comparator rate for discount rates would assist users' understanding, and if so whether a low risk rate should be used? (paragraphs 6.28 to 6.31)
  - 15 Are there any other principles on the selection of assumptions which respondents believe should be in the pensions TAS? (section 6)
  - 16 Do respondents have any comments on the proposals concerning modelling and calculations that are presented in section 7, especially those in paragraphs 7.6 and 7.10?
  - 17 Are there any other principles relating to models and calculations which respondents believe should be in the pensions TAS? (section 7)
  - 18 Do respondents have any comments on the proposals concerning reporting that are presented in section 8, especially those in paragraphs 8.4, 8.17, 8.18, 8.35, 8.38, 8.39 and 8.40?
  - 19 Do respondents agree that in Scheme Funding exercises any prudent estimate of scheme liabilities should be accompanied by a best estimate? (paragraphs 8.10 to 8.15)
  - 20 Do respondents agree with our conclusion that the final Scheme Funding report should include sufficient information for an informed reader to understand the financial position of the scheme, and that this is best accomplished by defining the intended users and decisions accordingly? Do respondents agree with our conclusion that this would result in little extra work? (paragraphs 8.20 to 8.31)
  - 21 Would the provision of specimen Scheme Funding reports be of value to users? (paragraph 8.32)
  - 22 Are there any other principles on reporting which respondents believe should be in the pensions TAS? (section 8)
  - 23 Do respondents think that actuarial comparisons in pensions should be covered in the pensions TAS or in a Specific TAS covering similar matters across all areas of actuarial work? (section 9)
  - 24 Do respondents have any views on whether it would be of value to users of actuarial information for the BAS to maintain a glossary of actuarial terminology and if so, what it should contain? (paragraphs 10.15 to 10.17)
  - 25 Do respondents have any comments on the proposed transitional arrangements from the adopted GNs to TASs described in section 10?
  - 26 Do respondents have any views on whether matters which could be construed as technical or ethical such as those mentioned in paragraphs 10.5, 10.13, 10.20 and 10.24 should be included in the pensions TAS?
- 11.2 In addition to the specific questions listed above, we would welcome respondents' views on any other aspects of the proposed pensions TAS.

## RESPONSES

- 11.3 For ease of handling, we prefer comments to be sent electronically to **basensions@frc.org.uk**.

Comments may also be sent in hard copy form to:

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

- 11.4 Comments should reach the BAS by 18 September 2009.
- 11.5 All responses will be regarded as being on the public record unless confidentiality is expressly requested by the respondent. A standard confidentiality statement in an e-mail message will not be regarded as a request for non-disclosure. We do not edit personal information (such as telephone numbers or email addresses) from submissions; therefore only information that you wish to publish should be submitted. If you are sending a confidential response by e-mail, please include the word "confidential" in the subject line of your e-mail.
- 11.6 We aim to publish non-confidential responses on our web site within ten working days of receipt. We will publish a summary of the consultation responses, either as a separate document or as part of, or alongside, any decision.

## A RESERVED AND NON RESERVED WORK

### RESERVED AND RELATED WORK IN PENSIONS

- A.1 Some of the areas of Reserved Work for pensions actuaries are described below. The list also contains some non-Reserved Work.

### SCHEME ACTUARY APPOINTMENT

- A.2 Section 47 (1) (b) of the *Pensions Act 1995* requires the trustees of occupational pension schemes to appoint a Scheme Actuary.
- A.3 *The Occupational Pension Schemes (Scheme Administration) Regulations 1996 – SI 1996/1715* requires that the provision of advice on financial questions relating to the funding of, and assets of, the scheme and on questions in respect of probabilities relating to mortality and other contingencies, and any other matter relating to the actuarial affairs of the scheme be given by a Scheme Actuary.

### SCHEME FUNDING

- A.4 The Scheme Funding legislation is contained in *Part 3 of the Pensions Act 2004* and *The Occupational Pension Schemes (Scheme Funding) Regulations 2005 (SI 2005/3377)*. *TPR's Code of Practice – Funding defined benefit schemes* provides guidance to trustees on the discharge of their responsibilities under this legislation.
- A.5 The legislation applies to all funded defined benefit pension schemes unless exempted. Exempt schemes include:
- those established by an Act and those guaranteed by a public authority (for example, the Local Government Pension Scheme);
  - the Parliamentary Contributory Pension Fund;
  - small schemes – i.e. schemes with 12 or fewer members who are directors;
  - schemes which are not tax approved; and
  - schemes with fewer than two members.
- A.6 The trustees are responsible for setting assumptions, drawing up a statement of funding principles, drawing up a recovery plan and producing a schedule of contributions. In each case, the trustees must take advice from the Scheme Actuary and have employer agreement. Some trust deeds require the actuary (ie the actuary as defined in the deed) to set the contribution rate. This advice is Reserved Work.
- A.7 In some circumstances, trustees may modify future benefits and, if they do so, must take advice from the Scheme Actuary. This advice is Reserved Work.

- A.8 The Scheme Actuary must provide an “actuarial valuation” which is a written report valuing the scheme’s assets and calculating its technical provisions. This must be provided at intervals of no more than three years. The Scheme Actuary must certify the schedule of contributions. The provision of the “actuarial valuation” and the certificate is Reserved Work.
- A.9 Scheme specific funding valuations must include a solvency valuation provided by the Scheme Actuary – assumptions for this valuation are set by the Scheme Actuary. This is Reserved Work.
- A.10 The Scheme Actuary must certify the technical provisions - this is Reserved Work.
- A.11 In years between “actuarial valuations” the Scheme Actuary must provide an “actuarial report” which is a report on developments affecting the scheme’s technical provisions since the last actuarial valuation was prepared. This may be based on approximate calculations. The production of this report is Reserved Work. Where trustees normally obtain triennial valuations, tPR’s code of practice states they should consider obtaining one for an intervening year instead of an actuarial report when, after taking advice from their Scheme Actuary, it seems to them that events have made it unsafe to continue to rely on the results of the previous valuation as the basis for the current level of contributions.
- A.12 Schemes which begin to wind up on or after 30 December 2005 are subject to a limited requirement under the legislation. Under regulation 18 of the Scheme Funding regulations, the trustees must obtain an annual estimate from the Scheme Actuary of the solvency position of the scheme. This is Reserved Work.
- A.13 *Section 156 of the Pensions Act 2004* sets out the requirements for actuarial valuations of “closed schemes”. These are schemes where the employer is insolvent and the assets are more than sufficient to provide PPF benefits but where the trustees have not had the benefits bought out from an insurer. The provision of these valuations is Reserved Work.

## **SUMMARY FUNDING STATEMENTS**

- A.14 *Part 3 of the Pensions Act 2004 (Scheme Funding) and The Occupational Pension Schemes (Scheme Funding) Regulations 2005 (SI 2005/3377)* require that trustees issue an annual statement to members summarising the scheme’s funding position – this will include information provided by the Scheme Actuary. However, this is not Reserved Work as there is no requirement for actuarial involvement.

## **TRANSFER VALUES**

- A.15 The relevant legislation is *The Occupational Pension Schemes (Transfer Values) Regulations 1996 (SI 1996/1847)* as amended by legislation including *The Occupational Pension Schemes (Transfer Values) (Amendment) Regulations 2008 (SI 2008/1050)*. Trustees determine the assumptions for the calculation of cash equivalents having taken advice from the Scheme Actuary or other actuary if Section 47 of the Pensions Act 1995 does not apply. In determining the assumptions, the trustees must have regard to the main characteristics of the membership of the scheme and the scheme’s investment strategy.

- A.16 The trustees may request an insufficiency report from the Scheme Actuary under *regulation 7D(2) or 7E(4) of the 1996 Transfer Value Regulations*. This must compare assets and liabilities. There must be a deduction for winding up expenses determined by the actuary.
- A.17 Providing advice on the actuarial assumptions and providing the insufficiency report are areas of Reserved Work.

### **PENSION SHARING ON DIVORCE**

- A.18 The relevant legislation is *The Pension Sharing (Valuation) Regulations 2000 (SI 2000/1052)* as amended by legislation including *The Occupational Pension Schemes (Transfer Values) (Amendment) Regulations 2008 (SI 2008/1050)*. Pension shares may be reduced when the actuary has provided an insufficiency report. This is not Reserved Work.

### **INDIVIDUAL CALCULATIONS AND FACTORS**

- A.19 Individual calculations can include transfer values, early and late retirement calculation, cash commutation, AVC conversion and benefit augmentations. There are many variations in the provisions of individual trust deeds and rules relating to such calculations, with some requiring the trustees to take advice from the actuary and some giving the actuary various powers. Whether this work is Reserved Work will depend on the terms of an individual scheme's trust deed and rules.

### **MODIFICATION OF SUBSISTING RIGHTS**

- A.20 *Section 67 of the Pensions Act 1995 and Regulation 5 of The Occupational Pension Schemes (Modification of Schemes) Regulations 2006* set out the requirements to be satisfied when there is a modification of subsisting rights or changes to members' accrued benefits in a pension scheme.
- A.21 Accrued benefits may be modified either with the informed consent of each affected member or by the trustees ensuring the actuarial equivalence requirements are satisfied in the case of each affected member. This is achieved by an actuary (not necessarily the Scheme Actuary) certifying that, at the time the proposed modification took effect, the actuarial value of each affected member's subsisting rights immediately after the change is no less than the actuarial value of that member's subsisting rights immediately before the change. The actuary must use methods and assumptions which are consistent with methods and assumptions used by the trustees to calculate cash equivalent transfer values.

- A.22 The certification is Reserved Work.

### **BULK TRANSFERS WITHOUT MEMBER CONSENT (GN16)**

- A.23 Where a bulk transfer is paid without members' consent, the trustees must obtain actuarial certification that the benefits after the transfer are "broadly no less favourable than" the benefits before. In doing so, the actuary must take account of discretionary practices. The relevant legislation is the *Pensions Act 1995 and The Occupational Pension Schemes (Preservation of Benefit) Regulations 1991 (SI 1991/167)*.
- A.24 The actuarial certification is Reserved Work.

**DEBT ON EMPLOYER CALCULATIONS**

- A.25 When a pension scheme is wound up, or when a participating employer ceases to participate in a multi-employer pension schemes, the Scheme Actuary must carry out calculations and provide certification in accordance with legislation - *The Occupational Pension Schemes (Employer Debt) Regulations 2005 (SI 2005/678)* as amended by *The Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2008 (SI 2008/731)*. The calculations are used to determine the level of any shortfall to be met by the relevant employer. This is Reserved Work.

**WIND UPS**

- A.26 When a pension scheme is wound up and in deficit, the Scheme Actuary must carry out calculations of the liabilities of different categories of member to determine how benefits should be reduced. The relevant legislation is *Section 73 of the Pensions Act 1995* and *The Occupational Pension Schemes (Winding up etc.) Regulations 2005 (SI 2005/706)*. This is Reserved Work.

**REFERENCE SCHEME TEST (GN28)**

- A.27 Pension schemes which are contracted-out of the second part of the State Pension Scheme must provide benefits which are at least equivalent in value to a Reference Scheme. The relevant legislation is *Section 12A of the Pension Schemes Act 1993* and *The Occupational Pension Schemes (Contracting-out) Regulations 1996 (SI 1996/1172)*, as amended.
- A.28 The legislation requires that the Scheme Actuary certifies broad equivalence of a pension scheme's benefit to those of a Reference Scheme. Certification is provided when a scheme is contracted-out for the first time and when benefits are modified. The certification is Reserved Work.

**PPF LEVY CALCULATIONS**

- A.29 *Section 179 of the Pensions Act 2004* sets out the requirements for the calculation of liabilities, with the guidance from the PPF setting out the assumptions to be used and the form of certification. The assumptions are similar but not identical to those used in Section 143 calculation for schemes entering the PPF.
- A.30 The Scheme Actuary may provide a certificate of deficit reduction contributions. These are defined as the total contributions (with no adjustment being made for investment returns) less the cost of accrual of scheme benefits, subject to various adjustments. PPF guidance contains the form of certification.
- A.31 The areas above are Reserved Work.

**PPF ASSESSMENT CALCULATIONS**

- A.32 *Section 143 of the Pensions Act 2004* sets out the requirements for the calculation of liabilities with the guidance from the PPF setting out the assumptions to be used. The assumptions are similar but not identical to those used in the Section 179 calculation for the PPF levy.

A.33 The Scheme Actuary must certify that the calculations have been performed in accordance with legislation. The Scheme Actuary must also certify whether, in their opinion, appropriate action/insufficient action has been taken to ensure that, as far as practical, all potential scheme beneficiaries have been identified and data uncertainties resolved.

A.34 The areas above are Reserved Work.

### **GMP CONVERSION**

A.35 The *Pensions Act 2007* and *The Occupational Pension Schemes (Contracting-out) (Amendment) Regulations 2009 (SI 2009/846)* will allow trustees to convert Guaranteed Minimum Pensions (GMPs) into a pension of another form. This is intended to enable trustees to simplify scheme benefits. The trustees will determine actuarial equivalence and the assumptions to be used for determining actuarial equivalence. In doing so, they must take advice from the Scheme Actuary. The Scheme Actuary must calculate the post conversion benefits and provide a certificate confirming actuarial equivalence. The advice and certification are Reserved Work.

### **ACCOUNTING FOR PENSION COSTS**

A.36 Pension costs for company accounts are determined in accordance with financial reporting standards. The key standards which UK companies must comply with are FRS17 and IAS19. Under FRS17 and IAS 19, the actuarial assumptions used are set by the employer. FRS 17 states that assumptions should be set upon advice given by an actuary. IAS 19 comments that assumptions are usually set having taken actuarial advice and so this is not Reserved Work.

A.37 Neither standard requires calculations to be carried out by an actuary although they usually are. The calculation work is not Reserved Work.

### **LOCAL GOVERNMENT PENSION SCHEME (LGPS)**

A.38 The relevant legislation for LGPS is *The Local Government Pension Scheme Regulations 1997* and the provisions of various Pensions Acts and regulations.

A.39 LGPS is a statutory pension scheme subject to a different funding regime to most Defined Benefit schemes. It has around 100 Funds each administered by an Administering Authority and each has an appointed Fund Actuary.

A.40 The Administering Authority must produce a Funding Strategy Statement in collaboration with the Fund's Actuary. The actuary's role in this work is Reserved.

A.41 The Fund Actuary is required to carry out a triennial actuarial valuation, to provide a report and to provide a rates and adjustments certificate. This is Reserved Work.

A.42 The Fund Actuary has a number of other reserved roles including determining contributions for admitted bodies - these are often private sector outsourcing firms who participate in LGPS during the period of a contract.

**PUBLIC SECTOR PENSION SCHEMES**

A.43 There are several public sector schemes which were established by their own legislation. These schemes are typically unfunded arrangements. The main schemes are shown below with the relevant legislation:

- the Principal Civil Service Pension Scheme (PCSPS) – *Superannuation Act 1972*;
- the Teachers’ Pensions Scheme and the Scottish Teachers’ Pensions Scheme – *Teachers’ Pensions Regulations 1997* and the Scottish equivalent legislation;
- the National Health Service Pension Scheme – *National Health Service Pension Scheme Regulations 1995*;
- Police Pension Schemes (1987 and 2006) – *Police Pensions Regulations 1987* and other legislation relating to the 2006 Scheme;
- Armed Forces Pension Schemes (1975 and 2005) – *Armed Forces (Pensions and Compensation) Act 2004* and other legislation relating to the 1975 Scheme; and
- New Firefighters’ Pension Scheme – *Fire and Rescue Services Act 2004* and other legislation relating to the Firefighters’ Pension Scheme

A.44 There are various areas of Reserved Work for the relevant actuary in relation to these schemes.

**THE PENSION PROTECTION FUND (PPF)**

A.45 The PPF was established by the *Pensions Act 2004* and in a number of areas is advised by its own actuary.

**FUTURE RESERVED ROLES**

A.46 The Government is currently consulting on new legislation for pension schemes which qualify for the Financial Assistance Scheme (FAS). Under the Government’s proposals, an actuary would be appointed by the FAS Scheme Manager (currently this is the DWP but it is proposed that the PPF will take over this role). The Scheme Actuary will be required to carry out a valuation of the Scheme’s liabilities. This would be Reserved Work.

A.47 The Government is introducing new legislation which will exempt employers with “good quality” pension schemes from the requirements to enrol members in the new Personal Accounts DC state pension scheme. Actuarial certification may be required in some cases to determine if the pension scheme offers benefits of “good quality”. The DWP is currently considering the nature of any actuarial equivalence test.

A.48 The PPF is consulting on bringing an investment component into their levy calculation, which might include the use of models to assess investment risk. It is possible that these might require some form of actuarial certification.

## B LIST OF DEFINITIONS AND PRINCIPLES

- B.1 This appendix lists the principles that the BAS is proposing to include in its pensions TAS together with the associated definitions. This list is for convenience only. Readers should note that the principles cannot be seen in isolation, but should be read in the context of the discussion that explains them. Moreover, the proposals are intended to convey the general sense of the requirements that may appear in the TAS rather than the precise words that are likely to be used.

### PURPOSE OF THE TAS

- B.2 In the performance of work within the scope of the pensions TAS:
- a) trustees, other members of pension scheme governing bodies, sponsors and other users of actuarial information are provided with sufficient information, including information on risk and uncertainty, to enable them to make decisions which relate to the financing of the pension scheme or affect the benefits payable to members of the pension; and
  - b) calculations which result in payments to or from pension schemes are accurate and are carried out using methods which are fit for purpose (paragraph 2.3).

### GENERAL CONCEPTS AND PRINCIPLES

- B.3 (Definition) A matter is **material** if, at the time the work is performed, it (or information resulting from it) could influence the decisions to be taken by **users**. A matter that is **immaterial** when considered in isolation may be **material** when considered in conjunction with others (paragraph 3.2).
- B.4 Judgements concerning the application of this standard shall be exercised in a reasoned and justifiable manner (paragraph 3.7).

### SCOPE

- B.5 All Reserved Work concerning occupational pension schemes (paragraph 4.4).
- B.6 Non Reserved Work concerning occupational pension schemes in any of the following areas (paragraph 4.26):
- a) update to scheme funding information used to make or support financial decisions by governing bodies on contribution requirements, investment strategy and rule changes;
  - b) actuarial information provided to employers or scheme sponsors on any matter related to scheme funding where there is a statutory or contractual requirement for the governing body to reach agreement with or consult on the matter with the employer or sponsor, or vice versa;
  - c) actuarial information to a governing body relating to amendments to scheme rules which might affect members' benefits or their security;

- d) actuarial information provided to a governing body relating to financial matters in connection with a bulk transfer of assets and liabilities from one pension scheme to another;
- e) (if not covered by a TAS covering business rearrangements) actuarial information provided to governing bodies for pension schemes in wind up including advice in connection with transfer of liabilities on buy out; and
- f) actuarial information for a governing body relating to individual calculations and factors which is not Reserved Work.

## **DATA**

- B.7 The data sought should include information from the scheme sponsor about matters affecting benefits payable to members over which it has influence or control (paragraph 5.7).
- B.8 Where there is uncertainty about the impact of overriding legislation on the calculation of benefits, the data sought should include any relevant legal opinions (paragraph 5.10).
- B.9 The data sought should include information about any practice of granting discretionary benefits, its history, and any policy regarding the exercise of discretion (paragraph 5.12).

## **ASSUMPTIONS**

### **General principles**

- B.10 The selection of assumptions should take account of the purpose of the calculations for which they will be used (paragraph 6.8).
- B.11 The selection of assumptions should take account of information available at the effective date of the calculations for which they will be used. The selection of assumptions should also take account of any material events which are known to have occurred after the effective date of the calculations (paragraph 6.12).
- B.12 Recent experience of the pension scheme should be analysed and compared with the selected demographic and salary increase assumptions (paragraph 6.14).
- B.13 The selection of assumptions should take account of any information from the sponsor on matters over which it has influence or control (paragraph 6.16).
- B.14 No adjustment should be made to any assumption to compensate for a shortcoming in another assumption (paragraph 6.19).

### **Specific assumptions**

- B.15 The relationship between the selected discount rate and a low risk rate should be explained to the user (paragraph 6.31).

- B.16 If a discount rate is related to the future returns on scheme assets its selection should take into account the trustees' investment strategy and anticipated changes in that strategy (paragraph 6.33).
- B.17 If a discount rate is related to the future returns on scheme assets its selection should take account of the risk that yields on the investment of future income will be lower than the yields currently available (paragraph 6.35).
- B.18 Assumptions about future rates of inflation should take account of financial indicators and publicly available forecasts (paragraph 6.36).
- B.19 Separate assumptions should be selected for current rates of mortality and for future changes to mortality rates. Assumptions concerning current rates of mortality should reflect the estimated current mortality rates applicable to the pension scheme in question (paragraph 6.42).
- B.20 Assumptions about the award of discretionary benefits should take account of past experience and information about the sponsor's or trustees' intentions which might affect the practice in the future (paragraph 6.46).
- B.21 Separate assumptions should be selected for running costs paid by trustees in respect of liabilities relating to accrued benefits and future accruals of benefits (paragraph 6.53).

### **Specific areas of work**

- B.22 The assumptions selected for any calculations relating to the position if a scheme had been discontinued or wound up should be determined taking account of possible annuity rates available from providers, the nature of the pension scheme liabilities and the level of relevant bond yields (paragraph 6.61).
- B.23 The assumptions selected for cash equivalent transfer values should be justifiable in relation to the assumptions used for Scheme Funding (paragraph 6.63).

## **MODELLING AND CALCULATIONS**

### **Scheme Funding**

- B.24 The funding method employed in Scheme Funding exercises, including whether and in what way future entrants have been taken into account, should be explained to trustees. This should include the way future entrants and future increases to benefits have been taken into account (paragraph 7.6).

### **Individual member calculations**

- B.25 Instructions provided to another party for the calculation of benefits or other payments related to individual members should include:
- clear descriptions of the circumstances in which the instructions apply;
  - sufficient information to enable the calculation to be performed correctly;
  - procedures for checking the calculations; and
  - comments on when the instructions should be reviewed (paragraph 7.10).

## REPORTING

### Rationale for assumptions

B.26 The reasons for any change in the rationale underlying the selection of assumptions between two similar exercises should be explained to the users (paragraph 8.4).

### Scheme Funding

B.27 In Scheme Funding exercises, any prudent estimate of scheme liabilities that is presented should be accompanied by a best estimate. The change in the level of prudence from that in the previous Scheme Funding exercise should be explained to users (paragraph 8.14).

B.28 The actuarial information given to trustees in the course of Scheme Funding exercises before they make decisions should include an explanation of how the funding objectives adopted by the trustees have been taken into account. It should also include comments on the following risks:

- the risk that the scheme sponsor may not be able to continue 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 funding objective;
- the risk that falls in asset values will not be matched by similar falls in the values of liabilities, thereby reducing the funding and/or solvency levels of the scheme;
- the risk that unanticipated future changes in mortality will increase the cost of the benefits;
- the risk associated with the potential exercise (by members or others) of options against the scheme; and
- any other material risks (paragraph 8.17).

B.29 The treatment of any uncertainty in benefit definitions due to overriding legislation should be explained to trustees in the course of Scheme Funding exercises. The explanation should include an indication of the maximum liability (paragraph 8.18).

B.30 The intended users of the Scheme Funding report should include scheme members, who should be assumed to be informed readers who will make decisions based on the financial position of the pension scheme, including its development since the last Scheme Funding exercise. The report should include the following information:

- the information required by Statute;
- the trustees' funding objectives;
- a description of the impact on members' benefits had the scheme had been wound up at the effective date; and
- other material information (paragraph 8.30).

### **PPF levy calculations**

- B.31 It should be assumed that the intended user of the formal report giving the results of the PPF levy calculations is the PPF, and that the decisions that will be based on the report will concern the compliance of the calculations with the specified assumptions (paragraph 8.35).

### **Actuarial factors**

- B.32 When information is provided to enable trustees to set factors for calculations concerning individual members it should include an indication of how robust the factors are and when they should be reviewed (paragraph 8.38).
- B.33 When information is provided to enable trustees to set factors for calculations concerning individual members it should include an indication of the financial impact of choosing different factors on the funding of the scheme, the members exercising options and the sponsor of the scheme (paragraph 8.39).

### **Transfer values**

- B.34 The information provided to trustees for setting assumptions for cash equivalent transfer values should include a comparison of assumptions with those used for Scheme Funding with an explanation of the differences (paragraph 8.40).

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