



**BOARD FOR ACTUARIAL STANDARDS**

**TRANSFORMATIONS:  
CONSULTATION PAPER**

**DECEMBER 2009**

## FOREWORD BY THE CHAIRMAN

The BAS has now published two of its proposed three Generic TASs on Reporting and Data with the final one on modelling at Exposure Draft stage. It is pressing ahead with work on its proposed Specific TASs and this is the fourth consultation following on from papers on pensions, insurance and actuarial information used for accounts issued earlier this year.

The BAS Board concluded from its consultations some time ago that it was appropriate to dedicate a Specific TAS to actuarial work used in transformations of pensions and insurance obligations. The word “transformations” is intended to cover a range of different issues, with the common thread that a change is occurring which will alter, and often crystallise, payments made to beneficiaries, be they policyholders of an insurance company or pensioners. As a result, fairness issues arise frequently, and actuaries are often asked to be the arbiters of fairness. Fairness is always emotive and often subjective, and this places an extra burden on the quality of actuarial work. It is vital then that users, those affected by the transformation and regulators can have confidence in the objectivity of the information.

Although the work arises from a wide variety of sources, a single TAS will have the advantage of enabling actuaries and users alike to dispense with some duplication of jargon and differences in approach, in support of the BAS’s general goal of more reliable actuarial work.

As our TAS programme advances, the interdependence of the TASs becomes ever greater. Appropriate data, reporting and modelling all form the basis for transformation work, and we are keen to hear how actuaries and users see this emerging in practice.

We seek the views, particularly, of pension fund trustees, governing bodies of insurers and those who have been affected by transformations as well as actuaries. All your views are important, and the Board looks forward to receiving them.

This consultation, as with all our consultations, is important. The BAS needs input to produce workable and effective standards. We appreciate that in this era there are always a large number of people asking practitioners and other busy people to spend time away from their regular activities.

The Board has particularly been assisted in its work by the members of the Working Group. Our thanks are due to them all.

Jim Sutcliffe  
December 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* of which *TAS R: Reporting Actuarial Information* and *TAS D: Data* were issued in September and November 2009 respectively. There will also be a number of Specific TASs, applying to work in particular areas such as insurance, pensions and accounting. Consultation papers on *Pensions*, *Insurance* and *Actuarial information used for accounts and other financial documents* setting out our proposals for Specific TASs in these three areas were published in June, September and October 2009 respectively. This document sets out proposals for a Specific TAS applying to actuarial work related to transformations of pension and insurance obligations.
- 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 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 is considering publishing on transformations. The intended audience includes actuaries, pension scheme trustees and other governing bodies, pension scheme sponsors, pension scheme beneficiaries, directors and managers of insurers, policyholders and their advisers, regulators and other stakeholders.
- 1.5 The primary purpose of the proposed TAS is to ensure that actuarial information provided in respect of a transformation of pensions or insurance obligations gives the best possible support to those who use the information.
- 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 This document proposes a number of principles for inclusion in the BAS's transformations 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.
- 1.8 We would welcome views on the matters addressed in this document, and in particular on the questions listed at the end of each section and collated in section 10. The responses that are received will inform our thinking as we develop an exposure draft leading to a Specific TAS.

## **ACTUARIAL WORK IN TRANSFORMATIONS**

- 1.9 Actuarial work is performed in a number of areas in relation to transformations of pensions and insurance obligations. In many of these areas actuaries act as experts providing a determination or an opinion, while in other circumstances they act as advisers to the various parties involved in or affected by the transformation.

### **Pension scheme transformations**

- 1.10 If pension scheme assets and liabilities are transferred to another scheme without the consent of members, legislation<sup>3</sup> requires an actuary to certify to the trustees of the transferring scheme that the benefits provided in the receiving scheme are "broadly no less favourable" than those in the transferring scheme. Here the actuary is acting as expert providing an opinion. The trustees of both the transferring scheme and the receiving scheme may also take actuarial advice on other aspects of the transfer such as the relative funding level of the two schemes, any change to the security of members' benefits resulting from the transfer and the recovery plan if there is a deficit.
- 1.11 A modification of pension scheme benefits may be made either with the informed consent of each affected member or by the trustees ensuring that the actuarial equivalence requirements are satisfied in the case of each affected member. In the former case, an actuary may be required to give advice to the trustees and members concerned. In the latter case an actuary (not necessarily the Scheme Actuary) is required to certify that, at the time the proposed modification took effect, the actuarial value of each affected member's rights immediately after the change was no less than the actuarial value of that member's rights immediately before the change. In this case the actuary is acting as an expert providing a determination.
- 1.12 When staff are transferred with their role within the public sector, or from the public service to the private sector, Government requires<sup>4</sup> that an assessment be made of the "broad comparability" of the pension arrangements offered by the new employer in respect of future service pension rights to those provided by their existing employer. Assessments may also be requested by a private sector employer with a view to obtaining a "passport" for employees

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<sup>3</sup> Occupational Pension Schemes (Preservation of Benefit) Regulations 1991 as amended.

<sup>4</sup> *Staff Transfers from Central Government: A Fair Deal for Staff Pensions* HM Treasury Statement of Practice June 1999.

who may transfer from a particular public sector scheme over a period of time. This assessment must be performed by an actuary who is acting as an expert. Currently the work is carried out in the Government Actuary's Department.

- 1.13 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 are likely to 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 and the security provided by the insurance company taking on the liabilities. In this case the actuary is acting as adviser.
- 1.14 The Pensions Act 2007 has brought in legislation which allows trustees to convert Guaranteed Minimum Pensions into a pension of another form. This is intended to enable trustees to simplify scheme benefits. The trustees determine actuarial equivalence and the assumptions to be used for determining actuarial equivalence. In doing so, they must take advice from the Scheme Actuary.

### **Insurance transformations**

- 1.15 Insurers with portfolios in run-off may wish to reach finality by providing a mechanism to estimate and settle future contingent liabilities with policyholders. This can be achieved by a scheme of arrangement. A scheme of arrangement is a court-sanctioned compromise under part 26 of the Companies Act 2006 between a company and its creditors to discharge the liabilities to those creditors in a designated manner. Actuaries may play a number of roles in schemes of arrangement, from providing actuarial information on the terms to the various parties involved to acting as independent experts determining the value of claims.
- 1.16 For example, a scheme of arrangement was used to vary the benefits of different classes of Equitable Life policyholders as part of the resolution of the guaranteed annuity option problem faced by that company. An independent actuary provided an expert opinion that the terms of the scheme had been determined in a fair and reasonable manner from an actuarial point of view.
- 1.17 An insurance business reorganisation, perhaps following a business acquisition, demutualisation or reattribution of an inherited estate, may result in portfolios of insurance policies being transferred between legal entities. These transfers, known as Part VII transfers because they are governed by the Financial Services and Markets Act 2000 (FSMA) Part VII, require court approval. The application made to the court for an order sanctioning the transfer must be accompanied by a report from an independent expert on the terms of the scheme. The independent expert is usually (though not always) an actuary, and the expert's report considers matters such as the effect of the transfer on the policyholders (and others) including any change in the security of their benefits. In addition, it would be usual in the case of a Part VII transfer of long-term insurance business for the actuarial function holders of the insurers involved to report on the implications of the scheme for their respective governing bodies. Where with-profits business is transferred, the governing bodies are required to obtain the advice of their with-profits

actuaries on how the rights and reasonable expectations of the with-profits policyholders are affected by the transfer.

- 1.18 A Part VII transfer may provide for a reduction in policyholder benefits – perhaps where the insurer from whom the business is being transferred is in financial difficulties. Regulation<sup>5</sup> provides for an actuary to be appointed to give an opinion on the reduction in benefits that ought to be made.
- 1.19 Where a long-term insurer is in liquidation, regulation<sup>6</sup> provides that an independent actuary may be appointed to report on the desirability of continuing the business and on any reduction in benefits that may be required to ensure that it may be continued successfully. The continuation is likely to be effected by a Part VII transfer.
- 1.20 Long-term insurers with with-profits business are required by regulation<sup>7</sup> to have and maintain Principles and Practices of Financial Management (PPFM) for their with-profits business. The principles are enduring statements which describe the business model the insurer adopts to meet its obligations to its with-profits policyholders and to respond to longer-term changes in the business and economic environment. The practices describe how the insurer manages its with-profits business and responds to shorter-term changes in the business and economic environment. Changes to the PPFM may affect the benefits that with-profits policyholders receive. Insurers are required to have appropriate governance structures in place to ensure compliance with and maintenance of their PPFMs which should include some independent judgement over potential conflicts of interest between classes of policyholders and, where relevant, shareholders. Insurers are also required to take advice from their With-Profits Actuary on the impact of any changes to their business plans or practices which would have an impact on their with-profits policyholders. This will include any change to the PPFM.
- 1.21 The same regulation requires that a long-term insurer with with-profits business that wishes to perform a reattribution of its inherited estate appoint a policyholder advocate to negotiate on behalf of the with-profits policyholders the terms of the reattribution. The policyholder advocate is likely to use actuarial information to support their negotiations. The governing body of the insurer is also required to seek the advice of its with-profits actuary on the reattribution, given that it is a material change in its practices. As well as a policyholder advocate, there may also be a need for an independent expert to provide an objective assessment of the reattribution proposal – the reattribution expert. It is likely that the reattribution expert will be an actuary or, if not, will use actuarial information to support the assessment.

### **Other independent expert roles**

- 1.22 Contract terms may provide for the appointment of an independent expert or an arbitrator. For example, an expert may be used to determine claim amounts under personal injury insurance contracts, or to determine amounts

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<sup>5</sup> FSMA s.113.

<sup>6</sup> FSMA s.376.

<sup>7</sup> FSA Handbook COBS s.20.

due in a dispute over the fair treatment of policyholders under insurance contracts or in the determination of the amounts payable in a transfer of pensions obligations. The independent expert or arbitrator may be an actuary or, if not, may use actuarial information in making the determination.

- 1.23 Regulation<sup>8</sup> allows for a Skilled Person to be appointed to investigate matters that are of concern to the relevant regulator. Depending on the nature of the matter, the Skilled Person may be an actuary. For example, if the FSA is concerned about the estimation of liabilities, it may require an actuary to report on them. While not necessarily leading to a transformation of pensions and insurance obligations, the work may lead to a change in the way the pension scheme or the insurer is managed.

## **RATIONALE FOR A TRANSFORMATIONS TAS**

- 1.24 We consider that a TAS for actuarial information used in transformations of pensions and insurance obligations is required because:
- a) it would allow for a particular focus on the impact on beneficiaries where the same issues arise for users to consider in both pensions and insurance transformations;
  - b) it would probably be more helpful to users making decisions about complex transformations which might include a number of individual transformations;
  - c) it would help to ensure that issues relating to actuarial information for transformations are addressed consistently across pensions and insurance;
  - d) it would reduce the sometimes artificial distinctions that are made between the different actuarial fields; and
  - e) it would be helpful for experts who are not actuaries who provide information on transformations.
- 1.25 On the other hand, it might be helpful for practitioners for the work to be within the scope of the pensions, insurance and other TASs, thus reducing the number of different TASs with which they have to be familiar.
- 1.26 We would welcome views on whether respondents agree that the benefits of a separate transformations TAS outweigh the benefits of having one fewer Specific TASs.

## **CONTENTS AND STRUCTURE OF THIS CONSULTATION PAPER**

- 1.27 The Generic TASs on *Data* (TAS D) and *Reporting Actuarial Information* (TAS R) set out principles which will apply to all the principal areas of actuarial work. The Generic TAS on *Modelling* (TAS M) will also follow this pattern. The Specific TASs will build on the foundation laid by the Generic TASs. The Specific TAS on transformations will set out the work to which it will apply and will contain principles covering how that work should be performed. By virtue of the BAS's *Scope & Authority*, work which must comply with a Specific TAS will also have to comply with the Generic TASs.

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<sup>8</sup> FSMA s.166 and Pensions Act 2004 s.71.

- 1.28 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.
- 1.29 Sections 5 to 8 consider possible principles that the TAS might contain together with their underlying rationale.
- 1.30 Section 9 considers the transition from the adopted Guidance Notes to the new TASs.

### **RESPONSES TO THIS CONSULTATION PAPER**

- 1.31 Details of how to respond to this paper are set out in Section 10. Comments should reach the BAS by 1 March 2010.

In paragraphs 1.24 to 1.26 we consider whether there should be a separate TAS for actuarial information used in transformations of pensions and insurance obligations or whether the work of preparing such information should be within the scope of the pensions, insurance and other TASs.

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

- 1. Do respondents agree that the benefits of a separate transformations TAS outlined in paragraph 1.24 outweigh the benefit of one fewer Specific TASs?**

## 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 transformations TAS and discuss the TAS's application. We also discuss the departures that will be permitted by our *Scope & Authority*.

### PURPOSE OF THE TRANSFORMATIONS 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 The users of actuarial information related to transformations are diverse and might be drawn from pension scheme members, insurance policyholders and their representatives and advisers, pension scheme trustees and sponsors, managers and governing bodies of insurers, regulators and the courts. As with the other TASs we consider that the transformation TAS should not only require accurate calculation but also encourage good communication of actuarial information.

2.4 The actuarial information we consider most important in transformations is information about the impact on the pension scheme member if the transformation involves a pension scheme or the policyholder if the transformation involves insurance business. The impact will include any change to the risk and uncertainty attached to the receipt of the benefit as well as any change in its nature, timing and amount.

2.5 We are therefore proposing that the purpose of the transformations TAS is to facilitate the achievement of the Reliability Objective by ensuring that in relation to the performance of work within its scope:

- a) users of actuarial information who make decisions on the transfer of assets and liabilities or the modification of liabilities are provided with sufficient information, including information on cash flows, risk and uncertainty, to enable them to make an informed decision and to assess the impact, including fairness, security and level of benefits, on those affected by the transfer or modification; and
- b) in those cases where the actuarial information is a determination made by an actuary performing an expert role, the users of the determination are provided with sufficient information to see that it has been made with the greatest practicable degree of fairness between the interested parties, subject to the constraints of any applicable regulation, and to understand its limitations.

## APPLICATION

- 2.6 The transformations TAS will apply to both work carried out in relation to actuarial information used in transformations of pensions or insurance obligations, and determinations by an actuary performing an expert role.

## DEPARTURES

- 2.7 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*.
- 2.8 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 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. Assessing materiality is a matter of reasonable judgement which requires consideration of the users and the context in which the work is performed and reported.
- 2.9 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).
- 2.10 The *Scope & Authority* sets out the disclosures that are required in the event of any departure.

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

- 2. Will the proposed purpose of the transformations TAS that is set out in paragraph 2.5 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>9</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 transformations TAS as has been used in TAS D and TAS R:

Matters are material if they could, individually or collectively, influence the decisions to be taken by users of the related actuarial information. Assessing materiality is a matter of reasonable judgement which requires consideration of the users and the context in which the work is performed and reported.

### 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.

### APPLICATION OF JUDGEMENT

- 3.4 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.

- 3.5 We intend to include the following principle in the transformations TAS:

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

- 3.6 Our other TASs will include the same principle. In due course we may choose to amend our *Scope & Authority* to cover this.

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<sup>9</sup> Paragraph 23 of the *Scope & Authority of Technical Standards*.

## 4 SCOPE

### INTRODUCTION

- 4.1 TAS R, TAS D and the exposure draft of TAS M contain requirements which apply to all actuarial work within their scope, which includes all work within the scope of the transformations TAS. In this section we discuss what work should fall within the scope of the transformations TAS.
- 4.2 The rationale for bringing work within the scope of our TASs is described in paragraphs 4.3 to 4.8. Paragraphs 4.9 to 4.54 discuss areas of work related to transformations which might be included within scope. Paragraphs 4.55 to 4.58 summarise our proposals.

### RATIONALE

- 4.3 Our overriding concern when considering the scope of our standards is our Reliability Objective, which is that users of actuarial information can place a high degree of reliance on its relevance, transparency of assumptions, completeness and comprehensibility, including the communication of any uncertainty inherent in the information. In looking at work in the area of transformations, we consider particularly the degree of reliance that those making decisions about a potential transformation or those affected by the transformation might wish to place on the information resulting from the work. We also consider whether there are areas in which the decisions that these potential users could make need not be based on actuarial information.
- 4.4 A number of factors influence our decision.
- 4.5 We are more likely to include work within the scope of our standards if the users of the work are relying on the fact that it has been performed by an actuary (rather than by someone who is not an actuary). Compliance with our standards will, we consider, enable users to place a high degree of reliance on the work. This means that, for example, work that is required to be performed by actuaries is, other things being equal, likely to be within scope.
- 4.6 Reserved Work and Required Work are defined in paragraphs 15 to 19 of the *Scope & Authority*. Required Work is work that is required to be performed in order that the entity commissioning it fulfils a legal obligation, which will usually be a regulatory obligation, and Reserved Work is Required Work that must be performed by an actuary. We have proposed that all Reserved Work should be within scope of our Generic TASs.
- 4.7 There are many types of work that are performed by actuaries but do not have to be. In some cases the work is nearly always performed by actuaries; in others, only rarely. We are more likely to include the former type of work within the scope of our standards because users are more likely to rely on the fact that it has been performed by an actuary.
- 4.8 When considering whether work should be within the scope of our standards, we take into account the importance that the actuarial information has for the decisions made by users. The more important it is the more likely it is to be within scope. In this regard, where transformations affect the

amount or security of benefits of pension scheme members or insurance policyholders we consider that the actuarial information is very important.

## **WORK WITHIN SCOPE**

- 4.9 In the remainder of this section we discuss areas of work that might be included within the initial scope of the transformations TAS, taking the above factors into account. The scope of the TAS will be reviewed periodically following publication.

### **Transfers of pension scheme liabilities without members' consents**

- 4.10 In certain circumstances, regulation<sup>10</sup> allows pension schemes to provide for members' accrued rights to be transferred to another pension scheme without the members' consents. In this case, the transformation is a transfer of the obligation to pay pension benefits from one scheme to another. In addition, in order to simplify administration, the transfer may also, but not always, include a change in benefits. One condition for the transfer is that the trustees of the transferring scheme must obtain actuarial certification that the benefits provided by the receiving scheme are "broadly no less favourable" than the benefits provided by the transferring scheme. Provision of this certificate is Reserved Work and is, therefore, expected to be within the scope of the pensions TAS.
- 4.11 However, this Reserved Work is limited in scope. Additional matters that the trustees of the transferring plan may wish to consider and for which they may require actuarial information in order to make a fully informed decision include the impact of the transfer on the security of transferring members' benefits, the funding level of the receiving scheme relative to the transferring scheme and the implications for the recovery plan to eliminate any funding deficit where relevant. 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.
- 4.12 As bulk transfers without members' consents can result in changes both to members' benefits and to their security, we propose that actuarial work in connection with them is within the scope of the transformations TAS.

### **Transfers of public sector employees' future pensions rights**

- 4.13 One condition for a private sector business taking on work performed by the public sector is that it must provide "broadly comparable" pensions benefits in respect of transferring employees' future service. In addition, there needs to be a bulk transfer agreement in place in respect of past service rights although employees may choose whether to transfer or to leave their accrued benefits in their public service scheme.
- 4.14 To satisfy the criteria for broad comparability an actuary must perform a rigorous scrutiny of the alternative pension arrangements, comparing the alternative scheme with the public service scheme in detail. A broadly comparable scheme is one which, in the actuary's opinion, satisfies the condition that there are no identifiable employees who will suffer material

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<sup>10</sup> Occupational Pension Schemes (Preservation of Benefit) Regulations 1991 as amended.

detriment overall in terms of their future accrual of pension benefits under the alternative scheme. The Government Actuary's Department provides the certificate of broad comparability for transfers of staff from Government Departments and Agencies.

- 4.15 As this is Reserved Work and transferring employees and their representatives rely on the certificate in evaluating the new pension arrangement, we propose that the work related to assessing broad comparability is within the scope of the transformations TAS.

#### **Modification of pension scheme benefits**

- 4.16 Pension scheme benefits may be modified either with the informed consent of each affected member or by the trustees ensuring that the actuarial equivalence requirements are satisfied in the case of each affected member. In order to demonstrate actuarial equivalence, the trustees must obtain a certification from an actuary (not necessarily the Scheme Actuary) that, at the time the modification took effect, the actuarial value of each affected member's rights immediately after the change was no less than the actuarial value of that member's rights immediately before the change. This certification is Reserved Work and is therefore expected to be covered by the pensions TAS.
- 4.17 The Pensions Act 2007 allows a pension scheme's trustees to convert Guaranteed Minimum Pensions into a pension of another form. This is intended to enable the trustees to simplify scheme benefits. The trustees 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 actuarial information provided by the Scheme Actuary is Reserved Work and is therefore expected to be covered by the pensions TAS.
- 4.18 However, the Reserved Work required when pension benefits are modified without members' consents is limited in scope, and does not cover matters such as the provision of benefit comparisons or any changes in the terms on which member options, such as early retirement, cash commutations or transfer values, might be available before and after the proposed modification.
- 4.19 As the trustees and members rely on actuarial work when evaluating a modification of pension scheme benefits without members' consents, we propose that this work is within the scope of the transformations TAS.

#### **Pension scheme buyouts**

- 4.20 Pension scheme liabilities may be transferred to an insurer through a full or partial scheme buyout. In this case the transformation is a transfer of the obligation to pay pension benefits from a pension scheme to an insurer. The buyout process may also trigger a modification of members' benefits to fit what the insurer is prepared to offer. In particular, where the scheme sponsor is insolvent, the buyout is likely to require a reduction in benefits.
- 4.21 While there is no statutory requirement for trustees to obtain actuarial information relevant to a buyout decision, it is usual for them to look to the Scheme Actuary for advice on at least some aspects of the buyout.

- 4.22 As pension scheme buyouts may affect the security and amount of members' benefits, we propose that actuarial work in connection with them is within the scope of the transformations TAS.

### Schemes of arrangement

- 4.23 Schemes of arrangement<sup>11</sup> are sometimes used in insurance to change the terms of contracts without the consent of individual policyholders (although they do require a vote of affected policyholders). The most frequent use of such a scheme in insurance is to give finality to a run-off portfolio. Actuaries may perform a number of different roles within schemes of arrangement which may be categorised in two broad groups.
- 4.24 The first group of roles involves working for one of the parties to the scheme, for example providing information:
- a) to the insurer on the estimation guidelines including business classification, estimation methodologies and their application; or
  - b) to an individual creditor (policyholder) on the value of their claim.
- 4.25 The second group of roles involves working as an independent expert or performing work for the use of an independent expert, for example acting as or performing work for:
- a) a policyholder advocate where the scheme of arrangement covers individual policyholders;
  - b) the vote valuer or vote adjudicator in the assessment of the quantum of policyholders' claims;
  - c) a scheme adjudicator in the resolution of disputes over claim values; or
  - d) in an insolvent scheme, the scheme actuary or the person responsible for ensuring equity and fairness across the whole population of creditors.
- 4.26 In both groups of roles, the user is likely to be relying on the work because it has been performed by an actuary.
- 4.27 In the consultation paper on the insurance TAS that we issued in September 2009 we sought views on whether work performed for one of the parties involved in a business transaction which included commutations of insurance policies should be within the scope of the insurance TAS. This could be extended to include performing work for one of the parties involved in a scheme of arrangement and we would welcome views on this.
- 4.28 As a scheme of arrangement affects the benefits to be received by policyholders of the insurance policies affected and users, who will include the courts and the regulator, will rely on the work of an independent expert in making their decisions about the scheme, we propose that work performed as or in support of an independent expert involved in a scheme of arrangement is within the scope of the transformations TAS.

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<sup>11</sup> Companies Act 2006 Part 26.

## Part VII transfers

- 4.29 Part VII of the Financial Services and Markets Act 2000 provides for the transfer of insurance business between legal entities. These transfers, known as Part VII transfers, require court approval. The application made to the court for an order sanctioning the transfer must be accompanied by a report from an independent expert on the terms of the scheme effecting the transfer. The independent expert is usually (though not always) an actuary, and the expert's report considers such matters as the likely effects of the scheme on the policyholders (and others) being transferred and on any policyholders in the receiving entity.
- 4.30 The purpose of the expert's report is to inform the court, although policyholders, others affected by the transfer and the FSA will also place reliance on it. We therefore propose that work performed as or in support of an independent expert in a Part VII transfer is within the scope of the transformations TAS.
- 4.31 Where the transfer involves long-term insurance, as well as the report on the scheme prepared by the independent expert, the court would expect to see reports on the scheme by the actuarial function holders of the transferring and the receiving insurers. These reports to the insurers' managements should cover the implications of the transfer on the insurers' ability to meet their obligations to policyholders and on the regulatory capital required to support their businesses. This is Reserved Work and so will be within the scope of the Generic TASs. In our recent consultation paper on the insurance TAS we proposed including the assessment of regulatory capital within its scope. We consider that this should cover the preparation of the actuarial function holders' reports on the implications of a Part VII transfer and so we propose not to include this work within the scope of the transformations TAS.
- 4.32 We would be interested in the views of respondents whether they agree with our proposal or whether actuarial function holders' work on Part VII transfers should be considered separately and included within the scope of the transformations TAS.
- 4.33 Where a transfer of long-term business includes with-profits business the court would expect to see reports on the scheme by the with-profits actuaries of the transferring and receiving insurers. These reports to the insurers' governing bodies would cover the implications of the scheme for the fair treatment of the with-profits policyholders affected by the transfer including their reasonable benefit expectations. This is Reserved Work and so will be within the scope of the generic TASs. In our recent consultation paper on the insurance TAS we proposed that actuarial information supporting the exercise of discretion by insurers should be covered by the insurance TAS.
- 4.34 We would be interested in respondents' views whether this sufficiently covers the work of with-profits actuaries in preparing their reports to management on Part VII transfers or whether, because of the potential impact on policyholders' benefits, this work should be brought within the scope of the transformations TAS.

## Reattribution of inherited estates

- 4.35 For a long-term insurer carrying on with-profits business, the inherited estate of a with-profits fund is the excess of the fair market value of the with-profits assets over the realistic liabilities of that fund. An insurer may wish to go through a process of redefining the rights and expectations that with-profits policyholders have over the inherited estate. This process is called a reattribution of the inherited estate. Such a reattribution was recently completed by Aviva with respect to a number of its UK life funds. In order to carry out a reattribution the insurer must appoint a Policyholder Advocate and an independent expert. The role of the independent expert is to objectively assess the scheme. Where the scheme is implemented through a Part VII transfer, the independent expert required by this transfer mechanism fulfils this role. Otherwise a reattribution expert must be appointed. The reattribution expert is likely to be an actuary.
- 4.36 The role of the Policyholder Advocate is
- a) negotiating on behalf of the with-profits policyholders the terms of the reattribution;
  - b) commenting to with-profits policyholders on the terms of any proposal and the views expressed by the with-profits actuary and the independent expert ; and
  - c) making a recommendation to with-profits policyholders.
- 4.37 The Policyholder Advocate is not usually an actuary but relies heavily on actuarial information.
- 4.38 Given the significant impact on with-profits policyholders of a reattribution, we propose that work performed for the Policyholder Advocate and the work performed as or in support of the independent expert in a reattribution of an inherited estate is within the scope of the transformations TAS.
- 4.39 The insurer's governing body is required to take advice from the with-profits actuary on any proposed reattribution as it represents a key decision on the exercise of discretion. The work will consider the allocation of benefits between with-profits policyholders and the implications of the reattribution for the fair treatment of the with-profits policyholders including their reasonable benefit expectations.
- 4.40 As well as providing information to the insurer, the with-profits actuary reports annually to with-profits policyholders on whether their interests have been taken account of in a reasonable and proportionate manner although there is no requirement to report prior to a reattribution.
- 4.41 This actuarial information prepared by the with-profits actuary is Reserved Work and so will be within the scope of the Generic TASs. In our recent consultation paper on the insurance TAS we proposed that actuarial information provided to the insurer and policyholders about the exercise of discretion should be covered by the insurance TAS.
- 4.42 We would be interested in respondents' views whether this sufficiently covers the work of the with-profits actuary in reporting to the insurer and to with-profits policyholders on a reattribution of an inherited estate or

whether, because of the potential impact on policyholders' benefits, this work should also be brought within the scope of the transformations TAS.

### **Modification of the Principles and Practices of Financial Management**

- 4.43 A reattribution of an inherited estate can be seen as a particular example of a modification to the Principles and Practices of Financial Management (PPFM) of a long-term insurer that conducts with-profits business. More generally, changes in the business environment may lead to a need to change the PPFM which may have a material impact on the benefits ultimately received by with-profits policyholders. The insurer is required to take advice from the with-profits actuary on such changes.
- 4.44 As well as providing information to the insurer, the with-profits actuary reports annually to with-profits policyholders on whether their interests have been taken account of in a reasonable and proportionate manner.
- 4.45 The work in paragraphs 4.43 and 4.44 is Reserved Work. In our recent consultation paper on the insurance TAS we proposed that this work should be covered by the insurance TAS.
- 4.46 In reporting on the exercise of discretion including any change in the PPFM, the with-profits actuary should consider its implications for the fair treatment of with-profits policyholders. With-profits policyholders can be expected to draw comfort from this information. We therefore propose to bring the work of the with-profits actuary in providing information on the impact of changes to the PPFM within the scope of the transformations TAS.

### **Reductions in benefits under insurance policies**

- 4.47 In certain circumstances, regulation<sup>12</sup> allows for an actuary to be appointed to report on a reduction in benefits under insurance policies that may be required to ensure that an insurer in financial difficulties may be run off successfully. This work is Reserved Work and so will be within the scope of the Generic TASs.
- 4.48 As benefits are to be reduced we propose that this work is also brought within the scope of the transformations TAS.

### **Skilled Persons' reports**

- 4.49 Both the pensions and the insurance regulators may require<sup>13</sup> a Skilled Person to report to them on matters on which they have concern. The Skilled Person should have the skills necessary to report on the matters. Depending on the matters of concern, it might be appropriate for the Skilled Person to be an actuary. For example, if the insurance regulator had concerns about insurance liabilities or the pensions regulator had concerns about a recovery plan then an actuary may be used to produce a report.
- 4.50 The report may not be concerned with a transformation of obligations although there are parallels with the independent expert report required to

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<sup>12</sup> FSMA s.113 and s.376.

<sup>13</sup> Pensions Act 2004 s.71 and FSMA s.166.

implement a Part VII transfer – objectivity and relevant expertise. The result of the report is likely to be a change in the way the pension scheme or insurer is managed which may have an impact on the benefits received by pension scheme members or insurance policyholders.

- 4.51 We propose that actuarial work required by a regulator to be performed by a Skilled Person is within the scope of the transformations TAS although we would be interested in respondents' views on whether it would be more appropriate to include it within the scope of the pensions or insurance TASs.

### **Claim determination and dispute resolution**

- 4.52 Contract terms may provide for the appointment of an independent expert or an arbitrator. For example, an expert may be used to determine amounts due under personal injury insurance contracts, or the amounts payable in a transfer of pensions obligations. The independent expert may be an actuary or use actuarial information in making the determination. In some cases the contract may require the expert to be an actuary, which would make it Reserved Work.
- 4.53 In the consultation paper on the insurance TAS published in September 2009 we sought views on whether Reserved Work arising from other than regulatory or legislative obligations should be within the scope of the insurance TAS. This would include claim amount assessment and contractual dispute resolution clauses in insurance contracts requiring a determination by an actuary. Such terms may also apply in transactions concerning the transfer of pensions obligations.
- 4.54 Given the possible impact on benefits, we propose that work as an expert or arbitrator or supporting an expert or arbitrator in the determination of claim amounts under insurance contracts or in resolution of a dispute about the appropriate treatment of beneficiaries of pension schemes or insurance policyholders is within the scope of the transformations TAS.

### **SUMMARY**

- 4.55 In considering the scope of the proposals below, it should be noted that some types of work may be within the scope of more than one Specific TAS.
- 4.56 We are proposing that the following actuarial work is within the scope of the transformations TAS:
- a) work in connection with the bulk transfer of pension scheme members' benefits without their consents (paragraphs 4.10 to 4.12);
  - b) work assessing broad comparability in respect of the transfer of public sector employees' future service pensions rights (paragraphs 4.13 to 4.15);
  - c) work in connection with the modification of pension scheme benefits without members' consents (paragraphs 4.16 to 4.19);
  - d) work in connection with pension scheme buyouts (paragraphs 4.20 to 4.22);

- e) work acting as or in support of an independent expert or policyholder advocate required by a scheme of arrangement (paragraphs 4.23 to 4.26 and 4.28);
  - f) work acting as or in support of the independent expert required by a Part VII transfer (paragraphs 4.29 to 4.30);
  - g) work acting as or in support of the independent expert or the policyholder advocate required in the reattribution of an inherited estate (paragraphs 4.35 to 4.38);
  - h) information provided by the with-profits actuary relating to changes to the PPFM (paragraphs 4.43 4.46);
  - i) reporting on policyholder benefit reductions under FSMA s.113 or s.376(10) (paragraphs 4.47 to 4.48);
  - j) work performed by or in support of a Skilled Person under FSMA s.166 or Pensions Act 2004 s.71 (paragraphs 4.49 to 4.51); and
  - k) work acting as or in support of an expert or arbitrator making a determination of claim amounts under insurance contracts or in any dispute about the appropriate treatment of beneficiaries of a pension scheme or insurance policyholders (paragraphs 4.52 to 4.54).
- 4.57 We are asking for views on whether the following work should be within the scope of the transformations TAS:
- a) information provided by the with-profits actuaries relating to a Part VII transfer (paragraphs 4.33 to 4.34); and
  - b) information provided by the with-profits actuary relating to a reattribution of an inherited estate (paragraphs 4.39 to 4.42).
- 4.58 We are proposing the following work should not be within scope of the transformations TAS:
- a) information provided for one party to a scheme of arrangement (paragraph 4.27); and
  - b) information provided by the actuarial function holders to the insurers relating to a Part VII transfer (paragraphs 4.31 to 4.32).

Section 4 discusses the possible scope of the transformations TAS.

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

- 3. Do respondents agree that the areas of work listed in paragraph 4.56 should be within the scope of the transformations TAS?**
- 4. Should the areas of work listed in paragraph 4.57 be within the scope of the transformations TAS?**
- 5. Do respondents agree that the areas of work listed in paragraph 4.58 should not be within the scope of the transformations TAS?**
- 6. Do respondents agree that information provided for one party to a scheme of arrangement should be within the scope of the insurance TAS? (paragraph 4.27)**
- 7. Is there any other work which is not mentioned that should be within the scope of the transformations TAS?**

## 5 DATA

### INTRODUCTION

- 5.1 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 transformations TAS. The principles contained in TAS D cover the collection of data, its checking and the actions which should be taken when data is incomplete or inaccurate.
- 5.2 TAS R contains principles relating to the reporting of data including the data used, shortcomings in that data and how any such shortcomings were dealt with.

### DATA USED FOR TRANSFORMATIONS

- 5.3 We consider it essential that appropriate data checks are carried out and action taken to deal with incomplete, inaccurate or out of date data in order that users can rely on the resulting actuarial information.
- 5.4 In the context of transformations we consider it important that, as well as carrying out appropriate checks on data, actuaries should be sceptical about data supplied and subject it to challenge in order that users can rely on the neutrality of the resulting actuarial information. Neutrality in this context means that the information does not favour one group of stakeholders at the expense of another. We therefore propose that the transformations TAS includes the following principles:

Data received should be challenged in order to determine the extent to which the data is sufficiently accurate, relevant and complete for users to rely on the neutrality of the resulting actuarial information.

The challenges that have been made and the responses received should be documented.

Section 5 considers data requirements for actuarial work relating to transformations.

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

8. Do respondents have any comments on the proposal concerning data that is presented in paragraph 5.4?
9. Are there any other data issues which respondents consider should be covered by principles in the transformations TAS?

## 6 ASSUMPTIONS

### INTRODUCTION

- 6.1 In this section we consider assumption setting in actuarial work in relation to transformations. Paragraphs 6.5 to 6.19 consider general principles which might apply to all actuarial information being provided for transformations. In paragraphs 6.5 to 6.14 we propose principles which we have also proposed in the pensions and insurance consultation papers. In paragraphs 6.15 to 6.19 we consider a principle specific to transformations.

### BACKGROUND

- 6.2 The choice of assumptions can have a significant impact on the results of calculations and consequently on any assessment of benefits before and after a transformation. It is therefore important that those responsible for selecting assumptions understand the rationale for them and how that selection might influence decisions.
- 6.3 In some circumstances it is users of actuarial information, such as governing bodies of insurers or trustees of pension schemes, who are responsible for setting actuarial assumptions. In other circumstances the assumptions are set by the practitioners producing the actuarial information. 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, regardless of who has the formal responsibility for choosing the assumptions.
- 6.4 The exposure draft of TAS M requires that assumptions used in models are documented and are consistent.

### GENERAL PRINCIPLES

#### Purpose

- 6.5 When selecting assumptions, consideration should be given to the nature and purpose of any calculations for which they will be used. We therefore propose that the transformations TAS includes the following principle, which is consistent with principles proposed for the insurance and pensions TASs:

Assumptions used in, or proposed for use in, models should be appropriate for the purpose of the calculations for which they are used.

#### Regulation

- 6.6 Legislation or other legal requirements sometimes specify the actuarial assumptions to be used in producing actuarial information relevant to a transformation or the methodology to be used to derive some or all of the assumptions. For example, in providing an actuarial equivalence statement after a modification of pension benefits, regulations require that the assumptions used are the same as those used by the trustees to determine cash equivalent transfer values. If a principle, or proposed principle, conflicts with the requirements of legislation, the BAS will alert the relevant regulator

to the conflict. The requirements of legislation and other legal requirements should be applied but the conflict should usually be disclosed to the user.

### **Evidence base**

- 6.7 For users to have confidence in actuarial information, any assumptions used should be based on evidence. The evidence should include both past experience and any available insight into trends that might cause experience to be different in the future. We therefore propose that the transformations TAS includes the following principle:

Assumptions used in, or proposed for use in, models should be derived from all available and relevant historical information and analysis of whether the future might differ from the past.

### **Consistency**

- 6.8 It is important that assumptions are consistent as a whole and each assumption should be justifiable individually. The exposure draft of TAS M requires that assumptions used in models are consistent.
- 6.9 Sometimes one assumption is modified in order to reflect a shortcoming in another. For example, sometimes the discount rate used to value liabilities is reduced to allow for future improvements in mortality rates instead of an explicit assumption being incorporated. We consider that this approach makes information less transparent to users, and is inconsistent with the achievement of our Reliability Objective.
- 6.10 We therefore propose that the transformations TAS includes the following principle:

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

### **Mortality**

- 6.11 We issued a discussion paper on *Mortality* in March 2008. Having considered responses to that paper we decided that we would not produce a Generic TAS on mortality but would cover the selection of mortality assumptions in Specific TASs.
- 6.12 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 paper on *Mortality*, we consider that these two factors are very different in nature: in principle it is often possible to obtain reliable data on current 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 current mortality on an entity specific basis, whereas it is debatable whether that can be done for future changes.

- 6.13 We therefore propose that the transformations TAS includes the following principle, which is consistent with principles proposed for the pensions and insurance TASs:

Mortality assumptions used in, or proposed for use in, an exercise should distinguish between current rates of mortality and future changes to mortality rates. Assumptions concerning current rates of mortality used in, or proposed for use in, an exercise shall reflect the entity in question.

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

### **Neutrality**

- 6.15 Regulation sometimes requires that actuarial information is based on a comparison of benefits promised before and after the transformation. In other cases, users will require such a comparison before making their decisions. This comparison may require assumptions to be made about how these benefits may develop over time. For example, in a pension scheme bulk transfer, assumptions may need to be made in order to compare changes in the benefit structure or, in a scheme of arrangement affecting general insurance policies, assumptions may be required for the development and timing of claim payouts.
- 6.16 The interests of the sponsors of the transformation and the beneficiaries affected by it may not always coincide. The sponsors of the transformation are likely to expect some gain from it. This gain might be a reduction in administrative costs or more effective capital management.
- 6.17 In some transformations beneficiaries are likely to be especially concerned about the level and security of their benefits. Different classes of beneficiary may have different interests. Beneficiaries may be less able to tolerate an adverse outcome should actual experience be worse than that assumed than to appreciate a positive outcome should the experience be better. However, it is possible that they expect some risk to be taken in the expectation of a greater return. For example, in long-term insurance, with-profits policyholders expect the insurer to take on and manage market and credit risk to enhance the return on their with-profits policies.
- 6.18 In most cases, assumptions may be selected from a plausible range. We consider it important that the selection should be neutral between the sponsors of the transformation and the beneficiaries affected. By neutral we mean that the selection of the assumptions should be unaffected by subjective adjustments to reflect matters such as desired outcomes.
- 6.19 We therefore propose that the transformations TAS includes the following principle:

The selection of assumptions should place proper emphasis on the interests of all parties affected by the transformation.

Section 6 discusses considerations that apply to the selection of assumptions for calculations relating to actuarial information provided for transformations.

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

- 10. Do respondents have any comments on the proposals concerning assumptions that are presented in section 6, and in particular on the principles proposed in paragraphs 6.5, 6.7, 6.10, 6.13 and 6.19?**
- 11. Are there any other principles on the selection of assumptions which respondents believe should be in the transformations TAS?**

## 7 MODELLING

### INTRODUCTION

- 7.1 TAS M will set out principles for actuarial models. It is expected to cover the use, including their fitness for purpose, and documentation of models as well as the communication of the outputs of models to users.
- 7.2 The exposure draft of TAS M to be published later this month contains requirements concerning modelling which will apply to all actuarial work within its scope, which includes all work within the scope of the transformations TAS. The principles contained in the exposure draft of TAS M cover the construction of models, checking and documentation.

### PRINCIPLES

- 7.3 We consider that the proposed principles in the exposure draft of TAS M together with the reporting requirements of TAS R are sufficient for the work carried out in providing actuarial information for transformations. We therefore propose to include no further principles on modelling and calculations in the transformations TAS. We would welcome respondents' views on this proposal.

Section 7 considers modelling and calculations relating to actuarial information provided for transformations.

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

12. **Are there any specific issues relating to modelling and calculation work for actuarial information provided for transformations which respondents believe should be covered by principles in the transformations TAS?**

## 8 REPORTING

### INTRODUCTION

- 8.1 TAS R sets out principles for reporting which apply across a wide range of actuarial work. In this section we address areas in which further principles may be required in respect of actuarial information provided for transformations.
- 8.2 TAS R includes requirements for a statement of material assumptions and the rationale for their selection. Similarly, TAS R includes requirements for the rationale of methods and measures used for material calculations. These principles will ensure that the user is given sufficient information to understand the rationale for different assumptions that contribute to their decision making.
- 8.3 In this section we address areas in which further principles on reporting may be required in respect of actuarial information provided for transformations.

### PRINCIPLES

- 8.4 We consider it essential that users are provided with sufficient information to enable them to understand the impact of any transformation on beneficiaries. In some areas within the proposed scope regulatory requirements exist but are limited. For example in bulk transfers, the trustees are required to obtain a certificate that the rights given in the new scheme are broadly no less favourable than the rights being given up. The certificate does not explicitly cover the risk that those rights may not in fact materialise in practice. In Part VII transfers, the independent expert's report is focused on the maintenance of the security of benefits after the transformation.
- 8.5 TAS R requires that reports indicate the nature, including timing, of any cash flows being quantified. In making decisions about a proposed transformation we consider it important that users are aware of the changes to the nature of cash flows due to beneficiaries resulting from the transformation. In the context of transformations, the nature of cash flows would include the counterparty making the payment, the quantum of the payment and the trigger for the benefit payment. These changes may vary between different classes or types of beneficiary. We therefore propose that the transformations TAS includes the following principle:
- Reports on transformations should indicate any material changes to the nature of cash flows to the pension scheme members or insurance policyholders affected directly by the transformation.
- 8.6 TAS R requires that reports state the nature and extent of the material risks being faced by the entity in relation to the work being reported on. In making decisions about a proposed transformation we consider it important that users are aware of the material risks to benefits faced by beneficiaries and of any change in these risks as a result of the proposed transformation. In the context of a transformation, the class of beneficiaries is wider than those who are directly affected by the proposed transformation. For example, in the context of a bulk transfer of a subgroup of pension scheme members, the

risks to the benefits of those members whose benefits are not being transferred may also change or, in the case of a Part VII transfer, the risks to the benefits of any other policyholders in the receiving insurer may change even though there is no change to their benefit entitlements. We therefore propose that the transformations TAS includes the following principles:

Reports on transformations should state the nature and extent of the material risks to their benefits being faced by the different classes of beneficiaries affected either directly or indirectly by the transformation.

Reports should indicate how these material risks are affected by the proposed transformation.

- 8.7 In paragraphs 6.15 to 6.19 we discuss the concept of neutrality with regard to the selection of assumptions. By this we mean that the selection of the assumptions should be unaffected by subjective adjustments to reflect matters such as desired outcomes. In order to demonstrate neutrality, we propose that the transformations TAS includes the following principle:

Reports should include the range of plausible material assumptions as well as the rationale for the assumptions actually selected.

- 8.8 In some transformations, beneficiaries are protected by an advocate explicitly appointed to protect their interests and negotiate the best possible terms for the transformation on their behalf. In some transformations, the actuarial information takes the form of an adjudication which by implication is fair between the parties. In other transformations, beneficiaries are protected by a requirement for an actuary to provide an expert opinion on whether certain specified minimum criteria have been met. For example, in pensions, a modification of benefits may require an actuary to certify that the value of benefits after the modification is no less than the value before. It has been suggested to us that users would find it useful if the actuarial information they received on a transformation included an indication of its fairness to the beneficiaries affected by it. For example, where benefits are obtained by the sponsors of a transformation, the report might include a description of how these benefits are balanced by improvements in the terms given to the pension scheme members or insurance policyholders affected.

- 8.9 We would be interested in respondents' views on whether we should include a principle requiring reports to include an opinion on the fairness of a proposed transformation together with a rationale for that opinion.

Section 8 considers the reporting of actuarial information for transformations.

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

13. Do respondents have any comments on the proposed principles on reporting in paragraphs 8.5, 8.6 and 8.7?
14. Do respondents believe that reports should include an opinion on the fairness of a transformation together with a rationale for that opinion? (paragraphs 8.8 to 8.9)
15. Are there any other principles on reporting which respondents believe should be in the transformations TAS?

## 9 TRANSITION FROM ADOPTED GUIDANCE NOTES

### INTRODUCTION

9.1 The BAS has responsibility for the Guidance Notes that it adopted from the Actuarial Profession (the adopted GNs). The only adopted GN that explicitly covers transformations is GN16 (pensions). GNs 40 and 41 (long-term insurance), which cover the roles of the actuarial function holder and with-profits actuary respectively, include work related to transformations. We intend to withdraw these GNs after the applicable specific TASs come into effect, as we discussed in the pensions and insurance consultation papers.

### GN16

9.2 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.

9.3 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 considerable difficulty. In 2005 the Faculty and Institute of Actuaries obtained an 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".

9.4 As discussed in the pensions consultation paper we do not intend to refer to the opinion obtained from Counsel by the Faculty and Institute of Actuaries in 2005. The purpose of BAS standards is not to provide guidance to practitioners on the interpretation of legislation but rather to ensure that actuarial information provided gives the best possible support to those who use the information.

9.5 GN16 also contains the form of the certificate which actuaries must sign to confirm that benefits are in their opinion "broadly no less favourable". As discussed in our consultation we do not wish to maintain the certificate within our standards. A few respondents to the pensions consultation paper suggested that a standard wording be retained. We do not consider it appropriate to include a standard wording for the required opinion in our standards but we are considering whether the form of the certificate should be contained elsewhere. We note that there is no standard certificate where pension benefits are modified using the actuarial equivalence route.

**GN40**

- 9.6 GN40 (*The Role of the Actuarial Function Holder*) sets out the duties of the Actuarial Function Holder (AFH) as defined in the *FSA Handbook*<sup>14</sup> and gives guidance on how to fulfil them. Section 2 of GN40 quotes from the *FSA Handbook* and Financial Services and Markets Act 2000 on matters that are relevant to the AFH role, section 3 summarises the requirements for the appointment as AFH, and the remainder of the text consists of guidance on how to comply with the requirements in the *FSA Handbook*.
- 9.7 Core principles of GN40 in relation to the requirements for the work done by the AFH will be covered by our TASs. We therefore intend to withdraw GN40 when the insurance TAS becomes effective.
- 9.8 We are proposing not to include those duties of the AFH which apply to insurance transformations within the scope of the transformations TAS.

**GN41**

- 9.9 The *FSA Handbook* requires insurers with with-profits insurance liabilities to appoint a With-Profits Actuary (WPA). It also provides rules and guidance on the duties of the WPA and the insurer. GN41 (*The Role of the With-Profits Actuary*) gives guidance to the WPA.
- 9.10 GN41 summarises the requirements in the *FSA Handbook* for appointment as WPA and provides guidance on how to comply with these requirements.
- 9.11 GN41 also covers what the WPA should do to achieve fairness for policyholders.
- 9.12 Core principles of GN41 in relation to the work performed by the WPA will be covered by either the insurance or transformations TASs. In our consultation on the insurance TAS we said that we intended to withdraw GN41 when the insurance TAS becomes effective although we now note that there may be a need for a transitional arrangement to cover the fairness of changes to the PPFM.

Section 9 considers the transition from the adopted GNs applying to transformations to BAS standards.

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

- 16. Do respondents have any comments on the proposed transitional arrangements from the adopted GNs to TASs described in section 9?**

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<sup>14</sup> The *FSA Handbook* of Rules and Guidance.

## 10 INVITATION TO COMMENT

### QUESTIONS

- 10.1 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 Do respondents agree that the benefits of a separate transformations TAS outlined in 1.24 outweigh the benefit of one fewer Specific TASs?
  - 2 Will the proposed purpose of the transformations TAS that is set out in paragraph 2.5 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 Do respondents agree that the areas of work listed in paragraph 4.56 should be within the scope of the transformations TAS?
  - 4 Should the areas of work listed in paragraph 4.57 be within the scope of the transformations TAS?
  - 5 Do respondents agree that the areas of work listed in paragraph 4.58 should not be within the scope of the transformations TAS?
  - 6 Do respondents agree that information provided for one party to a scheme of arrangement should be within the scope of the insurance TAS? (paragraph 4.27)
  - 7 Is there any other work which is not mentioned that should be within the scope of the transformations TAS? (section 4)
  - 8 Do respondents have any comments on the proposal concerning data that is presented in paragraph 5.4?
  - 9 Are there any other data issues which respondents consider should be covered by principles in the transformations TAS? (section 5)
  - 10 Do respondents have any comments on the proposals concerning assumptions that are presented in section 6, and in particular on the principles proposed in paragraphs 6.5, 6.7, 6.10, 6.13 and 6.19?
  - 11 Are there any other principles on the selection of assumptions which respondents believe should be in the transformations TAS? (section 6)
  - 12 Are there any specific issues relating to modelling and calculation work for actuarial information provided for transformations which respondents believe should be covered by principles in the transformations TAS? (section 7)
  - 13 Do respondents have any comments on the proposed principles on reporting in paragraphs 8.5, 8.6 and 8.7?

- 14 Do respondents believe that reports should include an opinion on the fairness of a transformation together with a rationale for that opinion? (paragraphs 8.8 to 8.9)
- 15 Are there any other principles on reporting which respondents believe should be in the transformations TAS? (section 8)
- 16 Do respondents have any comments on the proposed transitional arrangements from the adopted GNs to TASs described in section 9?
- 10.2 In addition to the specific questions listed above, we would welcome respondents' views on any other aspects of the proposed transformations TAS.

## RESPONSES

- 10.3 For ease of handling, we prefer comments to be sent electronically to [bastransformations@frc.org.uk](mailto:bastransformations@frc.org.uk). Comments may also be sent in hard copy form to:

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

- 10.4 Comments should reach the BAS by 1 March 2010.
- 10.5 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.
- 10.6 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 LIST OF DEFINITIONS AND PRINCIPLES

- A.1 This appendix lists the principles that the BAS is proposing to include in its transformations 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 may be used.

### PURPOSE OF THE TAS

- A.2 The purpose of the transformations TAS is to facilitate the achievement of the Reliability Objective by ensuring that in the performance of work within its scope: (paragraph 2.5)
- a) users of actuarial information who make decisions on the transfer of assets and liabilities or the modification of liabilities are provided with sufficient information, including information on cash flows, risk and uncertainty, to enable them to make an informed decision and to assess the impact including fairness, security and level of benefits, on those affected by the transfer or modification; and
  - b) in those cases where the actuarial information is a determination made by an actuary performing an expert role, the users of the determination are provided with sufficient information to see it has been made with the greatest practicable degree of fairness between the interested parties, subject to the constraints of any applicable regulation, and to understand its limitations.

### GENERAL CONCEPTS AND PRINCIPLES

- A.3 (Definition) Matters are material if they could, individually or collectively, influence the decisions to be taken by users of the related actuarial information. Assessing materiality is a matter of reasonable judgement which requires consideration of the users and the context in which the work is performed and reported (paragraph 3.2).
- A.4 Judgements concerning the application of this standard should be exercised in a reasoned and justifiable manner (paragraph 3.5).

### SCOPE

- A.5 We are proposing the following work should be within the scope of the transformations TAS:
- a) work in connection with the bulk transfer of pension scheme members' benefits without their consents (paragraphs 4.10 to 4.12);
  - b) work assessing broad comparability in respect of the transfer of public service employees' future service pension rights (paragraphs 4.13 to 4.15);

- c) work in connection with the modification of pension scheme benefits without members' consents (paragraphs 4.16 to 4.19);
- d) work in connection with pension scheme buyouts (paragraphs 4.20 to 4.22);
- e) work acting as or in support of the independent expert or the policyholder advocate required by a scheme of arrangement (paragraphs 4.23 to 4.26 and 4.28);
- f) work acting as or in support of the independent expert required by a Part VII transfer (paragraphs 4.29 to 4.30);
- g) work acting as or in support of the independent expert or the policyholder advocate required in the reattribution of an inherited estate (paragraphs 4.35 to 4.38);
- h) information provided by the with-profits actuary relating to changes in the Principles and Practices of Financial Management (paragraphs 4.43 to 4.46);
- i) reporting on policyholder benefit reductions under FSMA s.113 or s.376(10) (paragraphs 4.47 to 4.48);
- j) work performed by or in support of a Skilled Person under FSMA s.166 or Pensions Act 2004 s.71 (paragraphs 4.49 to 4.51); and
- k) work acting as or in support of an expert or arbitrator making a determination about claim amounts under insurance contracts or the appropriate treatment of beneficiaries of a pension scheme or insurance policyholders (paragraphs 4.52 to 4.54).

## **DATA**

- A.6 Data received should be challenged in order to determine the extent to which the data is sufficiently accurate, relevant and complete for users to rely on the neutrality of the resulting information (paragraph 5.4).
- A.7 The challenges that have been made and the responses received should be documented (paragraph 5.4).

## **ASSUMPTIONS**

- A.8 Assumptions used in, or proposed for use in, models should be appropriate for the purpose of the calculations for which they are used (paragraph 6.5).
- A.9 Assumptions used in, or proposed for use in, models should be derived from all available and relevant historical information and analysis of whether the future might differ from the past (paragraph 6.7).
- A.10 No adjustment should be made to any assumption to compensate for a shortcoming in another assumption (paragraph 6.10)
- A.11 Mortality assumptions use in, or proposed for use in, an exercise should distinguish between current rates of mortality and future changes to mortality rates. Assumptions concerning current rates of mortality used in, or

proposed for use in, an exercise shall reflect the entity in question (paragraph 6.13).

- A.12 The selection of assumptions should place proper emphasis on the interests of all parties affected by the transformation (paragraph 6.19).

## **REPORTING**

- A.13 Reports on transformations should indicate any material changes to the nature of cash flows to the pension scheme members or insurance policyholders affected by the transformation (paragraph 8.5).
- A.14 Reports on transformations should state the nature and extent of the material risks to their benefits being faced by the different classes of beneficiaries affected either directly or indirectly by the transformation (paragraph 8.6).
- A.15 Reports should indicate how the material risks are affected by the proposed transformation (paragraph 8.6).
- A.16 Reports should include the range of plausible material assumptions as well as the rationale for the assumptions actually selected (paragraph 8.7).

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