



BOARD FOR ACTUARIAL STANDARDS

**TRANSFORMATIONS TECHNICAL ACTUARIAL STANDARD
SIGNIFICANT CONSIDERATIONS**

DECEMBER 2010

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1 INTRODUCTION

PURPOSE

- 1.1 The Board for Actuarial Standards (BAS) is responsible for setting technical actuarial standards in the UK: it is an operating body of the Financial Reporting Council (the FRC)¹.
- 1.2 In December 2010, after a process of consultation, the BAS published its Specific Technical Actuarial Standard (Specific TAS) on Transformations (the Transformations TAS). Transformations include transactions such as bulk transfers between pension schemes and transfers of insurance portfolios which affect individual pension scheme members and insurance policyholders without requiring their consent.
- 1.3 This document reviews the considerations and arguments that were thought significant by the BAS in developing the Transformations TAS.

BACKGROUND

- 1.4 In our consultation paper *Towards a Conceptual Framework*, which was published in November 2007², we proposed that our standards would be of two types: generic, applying to a wide range of actuarial work, and specific, limited to a defined context. Generic standards would help to provide coherence and consistency across the range of actuarial work.
- 1.5 That document also set out our proposals that standards be principles-based rather than rules-based, and that they address outputs and responsibilities, with output-based standards focusing on the users of actuarial services and their needs as decision makers.
- 1.6 In April 2008 we published a consultation paper on the *Structure of the new BAS Standards*, in which we set out our proposals to develop a suite of TASs of which three would be Generic TASs on *Data*, *Modelling* and *Reporting Actuarial Information*. There would also be a number of Specific TASs, applying to work in particular areas such as insurance and pensions.
- 1.7 Following consultations, we published our Generic TAS on *Reporting Actuarial Information* (TAS R) in September 2009, our Generic TAS on *Data* (TAS D) in December 2009, and the Generic TAS on *Modelling* (TAS M) in April 2010. We published our Specific TAS on *Pensions* (the Pensions TAS) in October 2010, and our Specific TAS on *Insurance* (the Insurance TAS) in November 2010.
- 1.8 In December 2009 we published a consultation paper on *Transformations* followed by an exposure draft of the Transformations TAS in June 2010.

¹ The Financial Reporting Council is the UK's independent regulator responsible for promoting high quality corporate governance and reporting to foster investment.

² All BAS publications are available from <http://www.frc.org.uk/bas/publications/>.

- 1.9 We consulted informally on a proposed Specific TAS on *Funeral Plans* in the second quarter of 2010 and issued an exposure draft in August 2010. We also consulted on a possible Specific TAS on *Actuarial information used for accounts and other financial documents*. Following that consultation we decided to cover the work in the Insurance and Pensions TASs rather than in a separate TAS.
- 1.10 We aim to ensure that our standards are consistent with the wider strategic aims established by the FRC including its *Actuarial Quality Framework*, which was issued in January 2009 and updated in June 2010.

TRANSFORMATIONS TAS

- 1.11 In developing the Transformations TAS, we considered the responses to the consultations mentioned above. We also held discussions with a number of bodies including the FRC's Actuarial User Committee.
- 1.12 The Transformations TAS is the third Specific TAS to be developed by the BAS. The structure and style used for the Transformations TAS are reviewed in section 2. Sections 3 to 6 review the development of the content.
- 1.13 The Transformations TAS addresses circumstances in which users of actuarial work have a responsibility towards individual beneficiaries. We consider that although the principles in the TAS are limited in number they meet an important need for users and beneficiaries.
- 1.14 We consulted on whether the principles should be included in the Pensions and Insurance TASs, or whether they should be in a separate TAS. It was argued that pensions and insurance transformations are too different for common principles to be applicable. However, we concluded that the duties of care to pension scheme members and insurance policyholders have much in common, while recognising that there are some differences – in particular in the scope of actuarial opinions required. We are also mindful of the Morris Report comment that previous standards have lacked consistency across practice areas. It was also argued that it would be simpler for practitioners if all the principles concerning pensions were in the Pensions TAS, and all those concerning insurance in the Insurance TAS. One of the key considerations in our decision to develop a separate TAS was that it facilitated the earlier issue of the Pensions and Insurance TASs, and enabled us to issue all three Specific TASs (on Pensions, Insurance and Transformations) by the end of 2010.
- 1.15 We intend to review the interrelationship of the TASs once the full initial set of TASs has been issued.

2 STRUCTURE AND STYLE

INTRODUCTION

- 2.1 The structure and style of the Transformations TAS (and our other TASs) reflect the objectives and characteristics of our standards that are set out in our *Conceptual Framework*³. In particular, our TASs are written in a way which favours principles over prescriptive rules, and each TAS has its own specific objectives.

STRUCTURE

- 2.2 Information including the status of the TAS and its relationship with other TASs and with Guidance Notes is included in a rubric that precedes the content of the TAS.
- 2.3 Part A of the TAS covers its purpose and Part B covers how it should be interpreted. Part C sets out its scope. Part D contains general principles applicable to all work within its scope.

STYLE

- 2.4 In drafting the Transformations TAS, we have tried to tread the fine line between being clear about the requirements of the TAS and being unnecessarily prescriptive. We consider that, for writing standards, clarity of expression and the substance of the text are more important than the tone in which the text is written. We therefore use the word “shall” to express requirements, and “will need to” to describe the implications of those requirements, in order to provide clarity about what the Transformations TAS requires. The use of these words is consistent with the Transformations TAS’s mandatory nature.
- 2.5 Some of the requirements in the Transformations TAS are for indications or explanations. These terms were chosen because they can be interpreted quite broadly, and therefore the level of detail that they require is a matter for judgement.
- 2.6 The whole of the Transformations TAS is subject to the provision in the *Scope & Authority* that it is only material departures that need be disclosed. There is an explicit statement to this effect in Part B, and the word “material” is therefore used sparingly in the TAS. Similarly, Part B states that the requirements should be interpreted proportionately, and the word “proportionate” is not used in the remainder of the text.

³ The *Conceptual Framework for Technical Actuarial Standards*, published in July 2008.

3 PURPOSE OF THE TRANSFORMATIONS TAS

PURPOSE

- 3.1 All our standards serve the overall purpose set out in our Reliability Objective, 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.⁴
- 3.2 Our standards are intended to ensure the quality of actuarial information that the users receive, whoever performs the work. Actuaries performing work that is not designated as being within the scope of our standards may choose to comply with them, and people doing actuarial work who are not actuaries may well be required by others to meet the same standards. The purpose of TASs is to set out requirements that must be met in order to comply with them, not to explain best practice or recommend good practice.
- 3.3 Transformations require users to make decisions which affect the benefits of individual pension scheme members and insurance policyholders. In order for users to understand the implications of their decisions, it is essential that the underlying actuarial work is of high quality. There are two broad categories of actuarial work in transformations which we considered should be covered by the Transformations TAS. The two categories are:
- actuarial work carried out to assist decisions on transfers of assets and liabilities from one pension scheme to another scheme or to an insurer, or from one insurer to another insurer or other entity; and
 - actuarial work carried out to support decisions about the modification of the benefits of pension scheme members or policyholders' entitlements.
- 3.4 The purpose of the Transformations TAS reflects these two categories, and the role of actuarial work in supporting decisions and analysing the effects of transformations on individuals (paragraph A.1.2).
- 3.5 Actuarial work alone is often not sufficient to enable users to make appropriate decisions: for example, legal advice is often required to clarify the interests of different parties, and, in pensions work, assessment of the covenant strength of scheme sponsors may require specific expert input. The TAS applies only to actuarial work (see also paragraphs 4.8 to 4.11).
- 3.6 As stated in paragraph B.1.7, the interpretation of the Transformations TAS is governed by its purpose. If it appears that any provision in the Transformations TAS conflicts with its purpose, then that provision is being misinterpreted.
- 3.7 The purpose does not in itself impose any explicit requirements. The explicit requirements are in part D of the TAS and in the Generic TASs. They should be interpreted in the light of the purpose (paragraph B.1.7).

⁴ *Scope & Authority*, paragraph 8.

- 3.8 The references to fairness and security in paragraph A.1.2 are central to the purpose of the Transformations TAS. Although there is by no means always a requirement for practitioners to opine on fairness, the actuarial information provided is likely to support or inform decisions by other parties who have to do so. Considerations of fairness and security therefore provide the context for actuarial work within scope of the Transformations TAS.

4 INTERPRETATION OF THE TRANSFORMATIONS TAS

INTRODUCTION

- 4.1 Part B of the Transformations TAS consists of two sections. The first describes how the TAS should be interpreted and the second defines a number of terms that are used in the remainder of the TAS.

INTERPRETATION

- 4.2 The text in section B.1 of the Transformations TAS is intended to assist practitioners to make judgements about how to comply with the standard. All our TASs are principles-based: they are not intended to foster a tick-box mentality. Awareness of the objectives and spirit of the standard should help practitioners make judgements about compliance.

Materiality and proportionality

- 4.3 Many of the responses to our consultations and the discussions we have had with practitioners indicate that there can be a tendency to interpret our standards as requiring more work and more detailed work than is our intention. In section B.1 we have therefore emphasised:
- the provision in the *Scope & Authority* for immaterial departures;
 - that the standard should not be interpreted disproportionately; and
 - the scope for interpretation in the details of the principles.
- 4.4 We do not consider that it would improve the clarity of the Transformations TAS to repeat the word “material” in every principle. We have therefore explicitly reminded its readers that the standard should be read in the context of paragraph 23 of the *Scope & Authority*, which permits immaterial departures (paragraph B.1.2).
- 4.5 For example, when deciding how to indicate the impact on the actuarial information of adopting alternative plausible assumptions (paragraph D.4.7), alternative discount rates are likely to make a material difference to the impact of a pension scheme modification, but changes to the proportion married might have little effect. In this circumstance, it would not be a material departure from the TAS if the aggregate report did not comment on the impact of alternative assumptions for the proportion married.
- 4.6 We consider that actuaries (and others complying with our standards) should not act disproportionately, and in particular should not use BAS standards as an excuse for doing so. We have taken care to ensure that it is not necessary to perform work that is disproportionate to the needs of the users in order to comply with the Transformations TAS, and have explicitly reminded readers of the standard that it should not be interpreted disproportionately (paragraph B.1.3). Proportionality applies to documentation, including work carried out to document compliance with our standards, as well as to information in reports and the work on which the information is based.

- 4.7 There is an important distinction to be made between materiality and proportionality. If a piece of actuarial information is not material, there is no requirement to follow the principles set out in the standard. In this context a piece of actuarial information might be either the result of substantive work performed or information required to be in an aggregate report by our standards. If actuarial information is material, the principles must be complied with proportionately. For example, in some cases a required explanation might be comparatively brief, or an indication might consist of a short description, while in other cases a detailed explanation or full quantitative analysis might be appropriate.

Actuarial work

- 4.8 The term “actuarial work” is used throughout Part C. There is no universally accepted definition of “actuarial work” and we consider that it is not possible to provide a precise definition, especially as the actuarial profession evolves and the range of work that it performs changes. We also consider that what constitutes actuarial work is a matter of perception and common sense, based on the nature of the work, the way it is presented and the expectations of users. The key test is whether it is reasonable for any of the intended users to expect the work to involve the application of actuarial techniques (paragraph B.1.4).
- 4.9 We consider that the following criteria might be useful in judging whether work is actuarial:
- If users are relying on the fact that the work requires actuarial skills – for example modelling work which involves mortality or discounting, or aspects of a role which is reserved to actuaries – and the work is therefore commonly performed by actuaries (see paragraph 11 of the *Scope & Authority*), it is actuarial work.
 - If the work is presented (for example in a report) as actuarial, or as involving the use of actuarial techniques, other than through an incidental reference, it is actuarial work whether or not is performed by an actuary.
 - If users understand that work has been done by an actuary acting in a professional actuarial capacity, it is actuarial work. However, in other cases, it may be clear that the actuary’s qualification is only incidental to the work.
- 4.10 Inevitably there will be some pieces of work which do not precisely fit these criteria and about which judgement or additional clarification will be required. Although a disclaimer may be used to resolve borderline cases, it will not be effective for work which is clearly actuarial, or if it has not been adequately communicated to all users. In many such cases, little additional work is required to comply with the TASs in any event, and the benefits of compliance to users are significant.
- 4.11 Often actuarial work forms part of a wider exercise such as the wind-up of a pension scheme. In such cases it is only the actuarial work that is within the scope of the Transformations TAS. For example, work such as estimating the cost of buying out benefits or comparing the value of benefits before and after buy out is actuarial work and is within the scope of the TAS, whereas cleaning up data problems is not.

Explanations, descriptions and indications

- 4.12 Throughout the Transformations TAS we have used words such as “indicate” and “explain” in order to avoid being prescriptive about the type of analysis or level of detail that is required. In paragraph B.1.5 we have emphasised that the level of detail is a matter for judgement. Where possible, we have illustrated the principles in the Transformations TAS with examples, in order to better convey the intention behind the principle.

DEFINITIONS

- 4.13 Section B.2 defines a number of terms used within the text of the standard. Many of the definitions appear in the Generic TASs and in other Specific TASs.

Data

- 4.14 The definition of data is the same as in the other TASs and includes examples. Other items of data in transformations work might include legal opinions and information from earlier reports which have been prepared for the user.

Governing body

- 4.15 The definition of the term “governing body” is taken directly from the Pensions TAS for consistency. Since this term relates exclusively to pension schemes, we considered extending the definition to include insurers, but considered it would be confusing if the definition differed between TASs.

Insurance transformation

- 4.16 The definition of the term “insurance transformation” is the same as that used in the Insurance TAS. It includes Schemes of Arrangement in which the consent of all policyholders is not obtained: this occurs in most cases because a majority of member consents is sufficient. The transformation may therefore proceed, subject to approval by the courts, without the consent of some policyholders. The principles of the Transformations TAS apply to ensure that their interests are taken into account. If all consents are obtained, the concerns which the Transformations TAS addresses do not apply, and the Scheme of Arrangement is outside the scope of the TAS.

Materiality

- 4.17 We have adopted the same definition of materiality in all our TASs and in our *Scope & Authority*.
- 4.18 Our definition makes it clear that the judgement of materiality must take place within the context in which the work is performed and reported. The context includes the time at which the activities take place, so that there is no element of hindsight, but does not limit it to either the time at which the work is performed or the time at which it is reported (which are not always the same). The definition also introduces an element of reasonableness into the judgement.

Pension transformation

- 4.19 “Pension transformation” has the same definition as in the Pensions TAS. In most actuarial work performed in support of pension transformations the primary concern is whether the benefits accrued to date are adversely affected. The definition of a pension transformation is therefore limited to cases in which the accrued benefits of pension scheme members are affected, and does not include cases in which only future accruals are affected. We consider that there are other safeguards such as requirements to maintain future pension expectations or to meet minimum standards for such future provision.

Users

- 4.20 In many cases the use of and reliance on actuarial information are not confined to those paying for its preparation. We consider that all the intended users, regardless of their commercial relationship with those responsible for preparing the report, should be able to rely on the information.
- 4.21 The definition of “users” deliberately refers to those who are intended to be assisted by the actuarial information. Those who may have access to the information are not necessarily users. For example some reports are addressed to and intended for a limited group of people, such as pension scheme trustees, but are available to (but not addressed to) a wider group of stakeholders, such as scheme members. It is only those for whom the report is specifically intended who are users of the information it contains for the purposes of compliance with our standards.
- 4.22 When actuarial information provided to users is subsequently forwarded by users to other recipients, such as beneficiaries, practitioners responsible for the work might not have control over any changes introduced by users. It is the original actuarial work prepared for users that falls within the scope of TAS, not the onward communication to the affected beneficiaries. Paragraph C.3.3 of TAS R requires reports to include a statement of the purpose and the users of actuarial work, and who commissioned that work. Practitioners might include in this statement any specific concerns about the use of the information for purposes and by users other than those stated.

5 SCOPE OF THE TRANSFORMATIONS TAS

INTRODUCTION

- 5.1 Part C sets out the scope of the Transformations TAS. The scope includes actuarial work that supports the purpose set out in paragraph A.1.2.

GENERAL COMMENTS

- 5.2 All actuarial work which is within scope of the Transformation TAS is also covered by the Insurance TAS or the Pensions TAS. The Transformations TAS is particularly concerned with actuarial work for users who have the authority to decide whether or not a transformation should proceed, or who must take account of the effects of the transformation on many different parties. Actuarial information that is prepared for the party proposing the transformation is often restricted to the impact on that party and the practicalities of effecting the transformation; information provided specifically to promote the interests of beneficiaries may ignore the valid interests of other parties. In both instances, such “one-sided” actuarial information is covered by the Pensions and Insurance TASs.
- 5.3 The scope of the Transformations TAS is therefore limited to actuarial work which concerns or may be used in an assessment of fairness of the transformation. In an insurance transformation this includes information provided to the courts. In the case of pension schemes, it includes advice to the trustees of the scheme whose members are directly affected, who have a responsibility to look after their interests.
- 5.4 Some work might be within the scope of the Transformations TAS by virtue of more than one paragraph. For example, work concerning the modification of pension scheme benefits in order to facilitate a buy-out with an insurance company might be covered by both paragraph C.1.6 (modifications) and paragraph C.1.7 (transfer to an insurer).
- 5.5 The scope of the Generic TASs is set out in the Schedule to our *Scope & Authority*. The Generic TASs apply to all work that is within the scope of any Specific TAS, and so they apply to the work that is within the scope of the Transformations TAS (paragraph C.1.1).
- 5.6 Some of the areas of actuarial work described in Part C, such as bulk transfers and wind-ups, are very broad. In many cases the TAS includes some examples of work that is within its scope, and in some cases examples of work that is not. The examples are not exhaustive.
- 5.7 The nature of actuarial work within scope of the Transformations TAS might vary substantially from case to case. It is not our intention to require actuarial work to go beyond the scope agreed with the user. While the scope set out in Part C is broadly defined, many of the principles in Part D specifically exclude analysis of the impact of the transformation on beneficiaries or parties that are not within the scope of the work requested.

WORK NOT WITHIN THE SCOPE OF THE TRANSFORMATIONS TAS

- 5.8 As stated in paragraph 5.3, the Transformations TAS focuses on the impact of transformations on pension scheme members and policyholders. Actuarial work which is unrelated to considerations of fairness or to assessment of the impact on beneficiaries is not therefore within the scope of this standard.
- 5.9 Actuarial work for the sponsor of a pension scheme concerning a possible modification of benefits or bulk transfer without consent is not within the scope of the TAS because it need not address the impact on individual members. Such work is within the scope of the Pensions TAS. The impact on individual members is usually addressed by work for the trustees of the pension scheme(s) affected, and such work is within the scope of the TAS.
- 5.10 Other work that we considered for inclusion within the scope of the TAS, but rejected, included:
- merger and acquisition pensions work for employers;
 - advice and guidance on pension scheme buy-ins (ie when trustees purchase insurance contracts to meet pensions obligations); and
 - reinsurance and securitisation transactions by which insurers seek to manage their risks.
- 5.11 Actuarial work in pensions for employers concerning transformations is excluded because for any pension transformation to proceed, actuarial information must also be produced for the trustees. The Transformations TAS applies to the work performed for the trustees. Pension scheme buy-ins are excluded because they are effectively investment decisions and do not change obligations to the scheme members.
- 5.12 Transactions, such as some reinsurance and securitisation arrangements, which do not involve changes to liabilities are not transformations. They change neither policyholders' expectations nor where they look for those expectations to be met, and there is no user whose role is to consider the impact on beneficiaries. Some actuarial work concerning reinsurance may be within the scope of the Insurance TAS.
- 5.13 Reserved Work on the topics covered in paragraphs 5.8 to 5.12 is within the scope of the TAS (paragraph C.1.2).

WORK WITHIN THE SCOPE OF THE TRANSFORMATIONS TAS**Required Work and Reserved Work**

- 5.14 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). 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) from the Institute and Faculty of Actuaries.

- 5.15 Although actuarial work concerning pension transformations rarely requires an explicit opinion on the fairness of the proposed transformation, it is carried out to assist the user in deciding if the impact on individuals is acceptable and is therefore within scope; consideration of fairness is a core element in insurance transformations.
- 5.16 The Transformations TAS applies to Reserved Work that concerns pension transformations (paragraph C.1.2). Such work includes the provision of a certificate from an actuary to the transferring scheme trustees that the benefits provided in the receiving scheme are “broadly no less favourable” than those in the transferring scheme as required by legislation⁵. Reserved Work is already within the scope of the Generic TASs⁶.
- 5.17 Some work related to the provision of the certificate referred to in paragraph 5.16 may not be Reserved Work. It may, however, be within the scope of the TAS by virtue of other paragraphs in Part C. For example, analysis of the impact of the transformation on the contribution levels required in the ceding scheme may be carried out as part of the related work; this is not Reserved Work, but may be within scope by virtue of paragraph C.1.9.
- 5.18 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 a qualified actuary.
- 5.19 The Transformations TAS also applies to Reserved Work that concerns insurance transformations (paragraph C.1.2). In the text accompanying the exposure draft of the Transformations TAS we indicated that actuarial work for a single party would be outside the scope of the Transformations TAS, because the work need not consider the fairness to or even the interests of the policyholders affected. Such work is more likely to be concerned with identifying the financial attraction of such work, and assessing the practicalities of ensuring the transformation takes place.
- 5.20 However, there may be cases in which Reserved Work is initially performed in order to support the insurer considering the transformation, but the results of the work are provided to the courts after it has been decided to proceed with the transformation. If the work that was performed initially for the insurer was not within the scope of the TAS, it would be brought within the scope after it was performed, with no opportunity for the practitioner to reconsider whether or not it complies with the TAS. Reserved Work performed solely for one party has therefore been brought within the scope of the TAS. In most cases such Reserved Work addresses issues of policyholder protection anyway.

⁵ Occupational Pension Schemes (Preservation of Benefits) Regulations 1991 as amended.

⁶ See the Schedule to the *Scope & Authority*.

Pension transformations

- 5.21 Bulk transfers between pension schemes can affect members' benefits and their security, and so actuarial work for governing bodies in this area is within the scope of the TAS (paragraph C.1.5). If the transfer involves no changes to members' benefits it might be appropriate to depart from many of the principles of the TAS on grounds of materiality. However, the security of their benefits will almost certainly change, and the actuarial information should assess this, or at least alert users to the need to obtain specialist advice on this issue.
- 5.22 In addition to the provision of a certificate confirming that the benefits in the receiving scheme are "broadly no less favourable", governing bodies may want additional reassurance that other qualitative targets are met - for example that the options available to members are similar, or that death benefits are suitable. The Transformations TAS does not specifically require additional work of this nature to be performed, but if it is performed it is within the scope of the TAS (paragraph C.1.5). Arranging the transfer of liabilities is, however, outside the scope.
- 5.23 In addition, the trustees of the receiving scheme may seek actuarial advice on the impact of the transfer on their existing members. The increase in size of the receiving scheme might change the order of priority of benefits for members, or influence the rate at which any deficit is to be made good. Actuarial work for the receiving scheme is therefore within the scope of the TAS (C.1.8).
- 5.24 Changes to scheme rules which affect the level of benefits or the underlying security of the benefits are within the scope of the TAS (paragraph C.1.6). Some pension scheme changes are exempted from legislative requirements affecting members' benefits⁷ - for example, changes in pension indexation from RPI to CPI - but are within the scope of the TAS.
- 5.25 Sometimes regular maintenance of a pension scheme leads to changes in the terms of options available to members, such as the commutation factors applied when pension is surrendered in return for a lump sum. Such work is a modification of benefits as described in paragraph C.1.6, and is within the scope of the TAS.
- 5.26 The wind-up of a pension scheme involves many tasks before the effecting of insurance contracts and the closure of the trust. Although many of these tasks may be actuarial work, it is only work concerning the transfer of members' benefits which is within the scope of the Transformations TAS. The transfer might well involve the modification of benefits to better fit the terms which the insurer can offer. In some cases, members' benefits are reduced or member options such as terms for taking a cash sum on retirement are changed. Actuarial work concerning the transfer of liabilities to an insurer is therefore within the scope of the Transformations TAS when the work is provided for the governing body of a scheme in wind-up or contemplating wind-up (paragraph C.1.7).

⁷ Pensions Act 1995 Section 67 as amended.

- 5.27 A wide variety of work is performed in connection with the transfer of liabilities to an insurer, not all of which is actuarial work and hence within the scope of the Transformations TAS. For example, we consider that using actuarial models to estimate the cost of buying out the benefits on wind-up is actuarial work but that simply obtaining quotations and passing them to a client is not. Likewise, we consider that reconciling contracting out earnings data with HMRC is not actuarial work. Comparing members' benefits before and after the proposed transfer is actuarial work, but arranging the transfer is not.
- 5.28 In recent years many governing bodies have purchased annuities in order to control the risks faced by pension schemes. In these cases the annuity policies are held by the trustees who remain responsible for the provision of benefits to the pension scheme members, rather than being assigned directly to the members in question. Transactions of this type are commonly known as "buy-ins". Actuarial work in connection with buy-ins is not covered by paragraph C.1.7. We consider that buy-ins are essentially investment decisions taken by the trustees and are therefore not within the scope of the TAS (see paragraph 5.11).
- 5.29 In order to maintain consistency with the Pensions TAS, the definition of pension scheme in Part B includes personal pensions. There is very little actuarial work associated with changes of provider of personal pensions, and it is not within the scope of the TAS (paragraph C.1.10).

Insurance transformations

- 5.30 In the event of a Part VII transfer or a Scheme of Arrangement, a court is required to determine whether the transformation can proceed on the proposed terms. In order to do so, the court must decide whether the transformation is fair to all parties, and usually calls upon an independent expert for advice. In a Scheme of Arrangement the court is also responsible for approving the proposed class structure and voting procedures, and these too may require actuarial information or use independent experts.
- 5.31 Independent experts may be actuaries, or may rely on actuarial work performed by others. In either case, the actuarial work is within the scope of the Transformations TAS (paragraph C.1.11).
- 5.32 For many Part VII transfers that do not involve with-profits business, especially those for general insurers, some of the reporting requirements of the TASs are likely to be immaterial or require very little work for proportionate compliance.
- 5.33 In Part VII transfers, legislation⁸ requires that a summary report is prepared by the court and provided to policyholders affected by the transfer. Although the independent expert may be asked to contribute to the summary report, and the Actuaries' Code requires that actuaries do what they can to ensure the report is accurate and not misleading⁹, it is the court that is ultimately responsible for its scope and content. These summary reports are not within the scope of the TAS (paragraph C.1.12).

⁸ The Financial Services and Markets Act 2000, section 109.

⁹ The Actuaries' Code Paragraph 5.2.

- 5.34 There are two aspects of the management of with-profits business which involve changes in policyholders' expectations. An inherited estate reattribution might change the payments that with-profits policyholders expect to receive, even though there may have been no entitlement to any particular amount. The potential for benefit reductions – even if only at a perceived or expected level, as opposed to full entitlement – means that this work is within the scope of the TAS (paragraph C.1.13)
- 5.35 Changes to the Principles and Practices of Financial Management (PPFM) may change with-profits policyholders' expectations, and so actuarial work performed by the with-profits actuary supporting such changes is within the scope of the Transformations TAS (paragraph C.1.14). All actuarial work on changes to principles in the PPFM is within the scope of the Insurance TAS and hence the Generics TASs, whether it is performed by the with-profits actuary or by others. However, the with-profits actuary has the explicit responsibility under SUP 4.3.16A (4) to consider whether the actual discretion exercised takes account of with-profits policyholders interests in a reasonable and proportionate (“fair”) manner. Any work addressing the policyholders' interests must therefore be effectively signed off by the with-profits actuary.
- 5.36 Work supporting benefit reductions under FSMA 2000 is within the scope of the TAS (paragraph C.1.15). These transformations reduce policyholders' entitlements and the courts will rely on actuarial information to assess the fairness of the proposals.

6 GENERAL PRINCIPLES

INTRODUCTION

- 6.1 Part D of the Transformations TAS contains general principles that apply to all work within the scope of the TAS.

Judgement

- 6.2 Because the Transformations TAS is principles-based and has been written to cover a wide range of work, judgement will be required in order to apply it. Such judgement should be reasoned and justifiable (paragraph D.1.3).
- 6.3 Judgement might be needed on many matters when complying with the Transformations TAS, including whether the work in question is within the scope of the TAS, how the assumptions are derived, and what models to use (paragraph D.1.4). When making such judgements it is important to be guided by the spirit and reasoning behind the principles in the TAS, as well as by how they are drafted (see paragraph 20 of the *Scope & Authority*).
- 6.4 We consider that requiring a justification of all judgements would be unduly onerous, and so require only that it is possible to justify them, rather than requiring justifications to be documented (paragraph D.1.5). We consider that proportionality should apply to the work done in order to demonstrate compliance with the TAS as well as to work done in order to comply. We therefore consider that documentation of compliance should be proportionate to the scope of the work (see paragraph B.1.3).

ASSUMPTIONS

- 6.5 Section D.2 sets out principles concerning the selection of assumptions.
- 6.6 Actuarial work in transformations involves assumptions about many matters, including:
- discount rates;
 - claim rates;
 - future levels of inflation;
 - (for pension schemes) the numbers of members exercising options such as early retirement and exchanging pension for cash on retirement; and
 - running costs.
- 6.7 The parties to a transformation (sponsor, trustees, courts, different classes of beneficiaries, receiving entities and others) have different objectives. It is unlikely that a single set of assumptions will meet all such objectives. Actuarial information for a transformation focuses on the needs of users, but assumptions should be selected with an understanding of the other parties' likely interests. The Transformations TAS requires practitioners to give proper emphasis to the interests of all the relevant parties (paragraph D.2.1). If the actuarial work is explicitly restricted to consider only the interests of the user, the proper emphasis to be placed on the interests of other parties may be none (paragraph D.2.4). The interest of other parties may also be

ignored for the purpose of providing actuarial information which indicates the impact of alternative assumptions (paragraph D.4.7)

- 6.8 In many pension transformations the assumptions to be used are effectively set by legislation. For example, in pension scheme modifications, legislation¹⁰ requires use of assumptions consistent with the cash equivalent basis. Some work concerning asset shares in wind ups must use a buyout basis. Paragraph 24 of the *Scope & Authority* explains that departures from a TAS are permitted in order to meet legal requirements.
- 6.9 The focus on proper emphasis requires judgement to be exercised (paragraph D.2.3). Although users may be particularly interested in the results of using assumptions biased in one direction, further valuable information might be provided by taking some account of the interests of other parties. For example, the use of prudent assumptions may reveal that some pension scheme members are likely to be marginally worse off after the transformation, but it may be more helpful to users to know the impact of using a less extreme set of assumptions (paragraph D.2.1). Reflecting broader interests may be particularly relevant if the scope of the actuarial work includes consideration of the impact on other beneficiaries (for example members remaining in a pension scheme following a proposed partial transfer, or existing policyholders in the receiving insurance company). In other situations users may find it helpful to understand the viewpoints of other parties, which may differ significantly from their own.
- 6.10 Paragraph D.2.4 explains that in some cases, it may be appropriate to give no weight to any interests apart from those of users. In some cases, the information necessary to determine the proper emphasis to place on the interest of one or more parties might not be available within the required timescale. In others, there may be some beneficiaries who are not affected adversely by the transformation. For instance, the new sponsoring employer or insurance company following a transformation may make available additional contingent funding or assets to improve the security for the benefits.
- 6.11 Paragraph D.2.5 provides a non-exhaustive list of the parties whose interest might need to be given proper emphasis.

DATA

- 6.12 Section D.3 explains how the requirements of TAS D apply to transformations.
- 6.13 Because of the potential for individual members to be affected, it is particularly important that individual member data for transformations is as complete as is practical. TAS D requires data checking to be suited to the context. For transformations, this means that extra care is needed to ensure that the sponsor of the transformation should be challenged to ensure that the data provided is as complete as possible, and does not include any deliberate or inadvertent shortcomings.
- 6.14 The definition of data in paragraph B.2.1 does not refer only to membership or policyholder records, but includes assets, benefit specifications and running costs.

¹⁰Pensions Act 1995 section 67 as amended.

REPORTING

- 6.15 Section D.4 contains principles concerning the extent of information to be provided to the users.

Relevance

- 6.16 The impact of a transformation is likely to differ not just between the principal parties, but to subgroups of pension scheme members or insurance policyholders. The reliability of actuarial information is improved when the user has a clear understanding of the scope and limitations of the actuarial work. Paragraph D.4.1(a) therefore requires that the report makes clear which parties and which groups of members or policyholders have been considered in the actuarial information and which have not.
- 6.17 In some transformations, it might be considered that the only real concern is to ensure that members' or policyholders' benefits are not adversely affected, and that any advantageous effects are irrelevant. An explicit statement about the scope of the actuarial work carried out improves the reliability of the actuarial work for users (paragraph D.4.1(b)).
- 6.18 Paragraph D.4.1(b) refers to an assessment of the change in security of benefits following the transformation. As explained in paragraph 3.5 above, this may be best addressed by separate specialist input rather than by actuarial work. The Transformations TAS does not require practitioners to do work for which they are not qualified, and does not require an assessment of security of benefits, although such an assessment is sometimes given as an example of the type of information that might be included. In some cases it might help users to point out that such assessments might be material, and to suggest that they are obtained.

Material risks

- 6.19 Beneficiaries are subject to a number of material risks in terms of likelihood and amount of payment. Many of the risks are not affected by a transformation – for example, mortality risk for a pension scheme member or a life assurance policyholder, or likelihood of having to claim for a general insurance policyholder. Other risks may change as a result of the transformation, in relation to the timing or amount of the payments, the likelihood of payment, or the administrative systems relating to payment. These changes to risks are as important as the changes to benefits, and the TAS requires that an indication of the changes is reported (paragraph D.4.2).
- 6.20 Paragraph D.4.3 notes that one effect of a transformation could be a change in the ability (or willingness) of a pension scheme sponsor or insurer to pay the benefits due to the member or policyholder. This could arise if the scheme sponsor or employer has changed, or if the transformation leads to a change in the financial strength of an insurer. As noted in paragraph 6.18 above, this does not impose a requirement on practitioners to advise on issues beyond their expertise.
- 6.21 The changes introduced by the transformation might also mean that economic circumstances which would have been benign prior to the transformation have an adverse impact on some beneficiaries. For example, if the transformation is a change in the terms of pension indexation, a change in inflation rates might have a different effect on benefit amounts after the transformation.

- 6.22 Although the requirement to comment on material risks is restricted to those classes of beneficiaries who are within the scope of the work, there may be circumstances in which it would be helpful to users to draw attention to the risks affecting other groups of beneficiaries which they might wish to investigate further (paragraph D.4.4).

Range of assumptions

- 6.23 Paragraph D.4.6 explains how the requirements of TAS R apply to the assumptions used for transformations.
- 6.24 The final selection of assumptions might well be the result of negotiation between different parties, and there is often a range of assumptions which might be considered plausible. Users therefore need to know where any particular set of assumptions lies within this range (paragraph D.4.6).
- 6.25 Because a transformation may affect individual pension scheme members and insurance policyholders quite differently, it is unlikely that the users of actuarial information in a transformation can appreciate the uncertainty around outcomes without seeing the results on more than one set of assumptions about future outcomes. This is perhaps more true of transformations than of areas of actuarial work in which decisions are taken at the level of the pension scheme or insurance company as a whole. The TAS therefore requires an indication of the effect of adopting one or more alternative sets of plausible assumptions (paragraph D.4.7).
- 6.26 The nature of the indication and the number of alternative sets of assumptions to be considered are matters for judgement (paragraph D.4.8), and might depend on the urgency of the work, the terms of reference, and the scale of the transformation. For example, if the impact of the transformation is modest, a brief statement to this effect may be sufficient. For a significant change, which is potentially controversial, it might be necessary to produce detailed analyses of the changes to beneficiaries' entitlements.
- 6.27 Paragraph 2.5 above explains that the level of detail required for an indication is a matter for judgement. An indication does not have to involve detailed calculation and, in particular, an indication of the impact on an insurance transformation of adopting alternative assumptions need not involve quantifying the absolute level of security before and after the transformation. The concern for users is the extent to which the level of security for benefits changes as a result of the transformation, and actuarial work which supports a statement that the level of security is not significantly worse following the transformation might be sufficient.
- 6.28 In any event, if the transformation is the subject of an actuarial certificate, users will need to know whether the certificate could have been given had any set of reasonable assumptions been used, or whether the use of slightly different assumptions would have prevented the provision of the certificate (paragraph D.4.9).

Assessment of impact

- 6.29 The impact of a transformation is unlikely to be the same for all beneficiaries. Users need to understand the impact of the transformation on different groups of beneficiaries in order to decide whether the transformation can proceed (paragraphs D.4.10 to D.4.12).

- 6.30 Throughout the TASs we focus on the impact of any action on cash flows, since they are the most relevant aspects of the insurance or pension arrangements for many users. They are also highly relevant for many insurance policyholders and pension scheme members.
- 6.31 For example, changes to the timing of prospective payments may be more important to pension scheme members than the total amount of benefits – different pension increase rates might produce the same discounted value for two sets of payments with quite different payment patterns, even though the two sets are of very different utility to members. Changes to the timing or payment terms of with-profit bonuses might affect life insurance policyholders. Changes to claims settlement procedures might affect all insurance policyholders if, for example, they delay the payment of claims.
- 6.32 The Transformations TAS therefore requires that any material impact on cash flows is reported (paragraph D.4.12).
- 6.33 For any transformation there is at least one party proposing that it should proceed. Users need to know the rationale of such parties (paragraph D.4.13), particularly if the transformation might lead to some beneficiaries being adversely affected, or if the transformation involves across the board reductions in benefit expectations.

Reports including opinions

- 6.34 In some circumstances, particularly for insurance transformations, the actuarial information includes an opinion – formal or informal – on the suitability of the transformation. If this is the case paragraph D.4.14 requires that the opinion is accompanied by an explanation of how it has been reached, including what information has been considered (and what information was not considered or not available). It also requires that the information explains which principles have been applied. In some cases the scope of the work might render some of the principles in the TAS immaterial – for example indications of changes to cash flows and the rationale of the proposer of the transformation. In this case, users need to know which principles have been applied, and which have been departed from.

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