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Paul Kennedy
Director of Actuarial Policy
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Dear Paul

PENSION SCHEME INCENTIVE EXERCISES – PENSIONS TAS EXTENSION

I am writing on behalf of the Association of Consulting Actuaries in response to the consultation paper issued in June 2012 containing a proposed extension to the Pensions TAS.

Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes. Members of the Association are all qualified actuaries and are subject to the Actuaries' Code of the Institute and Faculty of Actuaries. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the majority of members of defined benefit pension schemes.

The ACA is the representative body for consulting actuaries, whilst the Institute and Faculty of Actuaries is the professional body.

We are generally supportive of the proposals set out in the consultation paper, but wish to raise some concerns. Our responses to the questions are set out in the appendix to this letter.

We hope that you find our comments of assistance and would be happy to discuss them further if that is helpful. You can contact me on 020 7432 6635 (david.everett@lcp.uk.com) or either of my colleagues Andrew Blain on 020 7227 2914 (andrew.blain@towerswatson.com) and Chris Fletcher on 0113 284 8066 (chris.fletcher@xafinityconsulting.com).

Yours sincerely

David Everett
Deputy Chairman
ACA Pension Schemes Committee

APPENDIX: ACA RESPONSES TO SPECIFIC QUESTIONS

We have answered the questions as posed in Section 6 of the Consultation Paper which we note is in a slightly different order and whose questions are occasionally slightly differently expressed to where the questions are first posed in the main sections of the Consultation Paper.

***Question 1**: Do respondents agree that actuarial work concerning incentive exercises should be brought into the scope of the Pensions TAS?*

Yes and the proposals are a necessary first step, but consideration does need to be given to setting some technical standards in relation to member communications if the objective set out in the last sentence of 3.2 of the Consultation Paper is to be met – we note that this may be tackled at a future point.

We would have liked the Consultation Paper to have explored whether there are any issues in turning on, for incentive exercises, all the principles within the generic TASs as well as the General Principles set out in D.1 to D.3. of the Pensions TAS and potentially some of D.4. We cannot immediately see that there should be any, but it would have been good to have seen your thinking.

***Question 2**: Do respondents agree that bringing actuarial work on incentive exercises into the scope of the Pensions TAS is consistent with the existing purpose of the Pensions TAS?*

It is consistent, but only insofar as pension scheme governing bodies and sponsors are concerned. The first bullet of A.1.2 of the Pensions TAS says:

> "actuarial information provided to pension scheme governing bodies, sponsors and other users is relevant, comprehensible and sufficient to support decisions about the financing of the pension scheme and decisions which affect the benefits payable to members of the pension scheme, and includes information on risk and uncertainty"

If and when the objective, set out in 3.2 of the Consultation Paper is addressed (ie of ensuring that members are provided with clear and sufficient information so that they can take informed decisions), we believe that section A.1.2 will need to be refined.

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

Yes. It is important that there is a consistency of approach between the scoping of the Pensions TAS and that of the Code of Practice.

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

Yes, if the Standard is settled in more or less its proposed form and by October at the latest, given the limited impact that the proposals are likely to have on existing best practice advisory processes which have already developed in this area as a result of the influence of the Technical Actuarial Standards. The statement issued by the Pensions Regulator in July and the industry's Code of Practice issued in June will also have influenced behaviour.

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

Paragraph C.1.29 seems to be too wide as it can be read as including actuarial work carried out to assist scheme members in their decision-making. We understand from the foreword to the Consultation Paper that the intention is to assist just trustees and employers in their decision-making. Certainly that appears to be the intention insofar as the additional principles are concerned.

Given this we are not sure whether the last two bullets of paragraph C.1.30 should be included. If they are, then we suggest that the drafting is tightened by explicitly restricting consideration to the drafting and reviewing of **actuarial information** within communication material, and supporting the provision of **actuarial** information and advice to members of the pension scheme respectively. In relation to these aspects of actuarial work it would seem that the principles set out in D.6 are not applicable.

We believe that the fourth bullet of C.1.30 should refer specifically to illustrating the impact of exercises on pension schemes as this is the area that we believe would most benefit from the introduction of the TAS principles.

The first bullet of C.1.30 is potentially troublesome in its interpretation. If a company asks for a quick "is this going to be worthwhile", is it the expectation that the actuary needs to ensure full compliance with Technical Actuarial Standards in replying, or is it the intention that only a more formal "feasibility study" is subject to the new requirements? We suggest that you add the word "formal" into the first bullet, or make an equivalent adjustment to the wording given that if the conclusion of an informal review is that it has merit, a more formal feasibility study is likely to then proceed, which would be subject to the Technical Actuarial Standards.

We suggest that "providing actuarial advice and information to an independent financial adviser concerning an incentive exercise" is added to paragraph C.1.30, in order to make clear that this advice is covered by the requirements. We are thinking in particular of where actuaries employed by IFAs help in determining critical yields for IFA's green light recommendations.

***Question 6**: Do respondents agree that the proposed principles should be included in the Pensions TAS? (paragraphs 4.3 to 4.10)?*

We are disappointed that the Consultation Paper fails to explore the need for these principles. It seems that a "bolt-on" approach has been taken, drawing principles from the Transformations TAS. We ask that you consider whether, in fact, what is needed at this stage, can be surmised from the existing content of the Pensions TAS and TAS R, and whether the new section of the Pensions TAS results in unnecessary (and potentially confusing) duplication. For example, the two principles set out in D.6.2 and D.6.6 address 'material risks' and 'impact, but:

- requiring advice to include information on the financial implications of any decisions is similar to D.4.5 of the Pensions TAS – although this is in the context of factors, we can't see that it wouldn't apply here, since factors are being applied);
- ensuring clients understand the material risks associated with the information they are provided with is in C.5.5 of TAS R;
- understanding the financial consequences, to themselves and other relevant parties, of any decisions taken as a result is in D.4.4 of the Pensions TAS; and
- C.5.10 of TAS R requires information on cash flows.

The rest of our comments in this section are based on the assumption that you do wish to copy and paste principles set out in the Transformations TAS.

We do not see the need for D.6.5 as it is a natural interpretation of the phrase "representative members and dependants". But if you feel that this interpretation should be present we suggest that it is reworked as a definition and placed in section B.2. On a drafting point "will need" seems too strong for a principles-based Standard.

The principle at D.6.6 appears to have been drawn from part of D.4.10 of the Transformations TAS, but if the FRC considers that the existing principles are not adequate we question why more of this principle has not been carried across. There would seem to be some sense in requiring aggregate reports to also indicate:

- the extent of any potential reduction in the amount of the benefits;
- the potential for any change in the likelihood of receipt of payments; and
- the quantifiable advantages which might be gained.

On a drafting point "of representative members and dependants" should be removed from paragraph D.6.6 c).

We are not sure whether paragraph D.6.7 adds anything particularly meaningful to the principle stated in paragraph D.6.6, and in one place it seems to modify the principle. If you wish to retain it, the following drafting points should be addressed:

- in the first bullet it should be “a plausible range of potential gains or losses **in the value of benefits** to representative members and dependants”; and
- there is a missing “the” in the second bullet.

The third bullet has been written out of context to paragraph D.6.7 and appears to modify the principle stated in paragraph D.6.6 c). We suggest that you modify the principle in D.6.6 c) because, for example, it is useful for reports to include comments on how the impact of exercises may vary with time – in particular because transfer value assumptions may be derived differently from those assumptions on which the impact is being measured.

Looking at the material risks paragraphs and the assessment of impact paragraphs in the round, it would seem more natural to reverse the ordering so that the assessment of impact is dealt with before the material risks section. However, we note that the proposed ordering is consistent with the Transformations TAS.

We do not see the need for D.6.9 as it is identical to D.6.5 and as such is a natural interpretation of the phrase “representative members and dependants”. As per our comment above, if you feel that this interpretation should be present we suggest that it is reworked as a definition and placed in section B.2.

With the introduction of D.6 there are now 4 pages (from D.4 onwards) under the heading of “General Principles” which are in fact principles that only apply in specific situations. We think that the time has come to arrange all this material in a new section.

Returning to our theme of copying and pasting, we do have some concerns with the look and feel of the proposed extended Pensions TAS. Limiting the application of principles to particular exercises is likely to result in a tick box mentality, which the FRC said originally (in the Conceptual Framework) it wanted to avoid. There is a danger that if, at each scope extension, new principles are introduced that are specific to that extension, in due course the universality of the TAS across pensions work is lost and we return to something not far from the Guidance Notes regime.

Question 7*: Are there any further principles which would support trustees, sponsors and members in their decisions that we should consider including in future revisions of the Pensions TAS? (paragraphs 4.11 to 4.16)?*

Providing appropriate actuarial information to assist scheme members in their decisions is not directly covered in this proposed revision to the Pensions TAS. We believe that you should give consideration to this separately and start the process by means of a discussion paper to be issued by the end of this year, rather than waiting until the first major review of the TASs “in around two years”.

There are potentially a number of pieces of actuarial information that can be given, but they will depend on the exercise type and its precise nature. The actuarial information also has to be given in a manner in which it can be readily understood and hence be effective in contributing to the member’s decision. This area is fraught with difficulty as Technical Actuarial Standards are not normally written with scheme members as “users” in mind. You may wish to explore in the discussion paper whether setting minimum member disclosures, to assist them as an "informed reader" is a more effective approach.

A further issue is that you do not regulate sponsors or governing bodies. There is no point in your requiring the actuary to provide information which may assist the scheme member in reaching his or her decision if the entity to whom it has been supplied is not required to pass it on.

***Question 8**: Do respondents agree with the assessment of the impact of the proposals in section 5?*

Whilst we agree that bringing actuarial work concerning incentive exercises into the scope of the Pensions TAS could be beneficial to members (5.3), we disagree with your contention at paragraph 5.4 that members will shortly receive "sufficient information so they can make informed decisions." If this were the case there would be no need for you to consider developing any further member-centric principles, or for you to have made the statements in paragraph 4.11.

We agree that the proposed measures will lead to an improvement in the quality of information provided to some sponsors and trustees, particularly in smaller exercises. However, we believe that for the majority of exercises where best practices are already followed the difference will be less marked.

***Question 9**: What costs and benefits do respondents consider would arise from the proposed amendments to the Pensions TAS?*

We suspect that the additional cost of complying with the TASs will be modest, particularly by those who have embraced the TASs informally in all their actuarial advisory processes.

Response by:

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