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PENSIONS TECHNICAL ACTUARIAL STANDARD

APPENDIX

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

We agree with the underlying principles, but have two comments:

- The term 'actuarial information' is not defined in the consultation paper nor, as far as we can see, in the BAS Scope and Authority. Obviously this causes little difficulty when talking about Reserved Work, but may cause significant problems in relation to non-Reserved Work.
- The definition of 'other users' is written too widely in our opinion. It may, for example, require significant extra work to be undertaken for the benefit of people who did not commission or pay for the actuarial advice. We comment in more detail on this in relation to pension scheme members in our answer to Question 20.

Paragraph 'b' of Section 2.3 should refer to 'calculations involving actuarial factors'. As written, the wording requires **all** individual benefit payments from the scheme to be covered by the TAS, instead of just those with an actuarial component.

2. Do respondents agree that all Reserved Work concerning occupational pension schemes should be within the scope of the pensions TAS? (paragraphs 4.2 to 4.7)

In answer to Question 2 we agree that all Reserved Work required under regulations or similar statutory requirements should be covered by the TAS. There is extensive experience in terms of complying with professional guidance under these kinds of pieces of work.

We are more hesitant about Reserved Work which derives from 'other legal obligations'. While it may be ultimately appropriate to include this kind of work, we believe that the BAS ought to undertake a cost-benefit analysis in relation to those pieces of work that would typically be required. Either this needs to be undertaken prior to the TAS coming into force, or else this kind of work should be excluded from the scope of the TAS for the time being.

3. Do respondents agree with our intention that the pensions TAS should apply to work in connection with occupational pension schemes which is almost always carried out by an actuary and which is used to make important financial decisions or which might affect the level of benefits payable to members? (paragraph 4.11)

We agree with the underlying principle of paragraph 4.11, but would recommend that the wording is extended so that the TAS will apply to pieces of work that satisfy this principle, and that the BAS has specifically identified as appropriate to be covered by the TAS, having undertaken a cost-benefit analysis of the extra work that would be required.

4. Should the pensions TAS cover the non-Reserved Work listed in paragraph 4.26?

We believe that by and large it may well be appropriate to include the work listed in paragraph 4.26 within the scope of the pensions TAS, but not until a cost benefit analysis has been undertaken to establish the amount of extra work that would be required in relation to each item.

Funding updates mentioned in paragraph 4.26 (a), are regularly obtained by pension scheme trustees, to obtain an understanding of how these scheme's funding may have moved since the previous formal valuation. For clarity, we recommend that such updates should only be within the scope of pensions TAS if they are used to support decisions to change contribution requirements, investment strategy or rules. In the normal circumstances, where no change is made by the governing bodies as a result of receiving the funding information, the work should be outside the scope of the TAS.

Once again, this section suffers from the lack of a definition of 'actuarial information'. The definition should clearly not be as broad as to cover any information that happens to be provided by an actuary.

At a recent meeting of 190 of our members, we took a vote on whether advice to employers on scheme funding should be within scope of the TAS. The vast majority of those present voted against having this in scope. The view was expressed that generally employers are capable of deciding on the scope of advice on funding, and need not necessarily receive all the background information included in the TAS. Apart from anything else, the employer will often have sight of the advice received by the trustees, so will have the background information.

We therefore recommend deleting paragraph 4.26 (b) from the scope of the TAS. We note that in any case, as the work is not required on Reserved Work, it is open to the employer to instruct the actuary to depart from the TAS (Scope & Authority, paragraph 24(b)(iii)), although this can only be done with full disclosure of the departures. We think that it would be more orderly simply to reduce the scope of the pension TAS.

5. Do respondents agree that the areas of work described in paragraphs 4.29 to 4.33 should not be in the scope of the pensions TAS?

We note that the scale of work for accounting for pension costs may typically be very much more restricted than the scope for accounting for insurance business, for example.

Different measures of materiality will apply to each and we wonder therefore whether there will be significant differences between the financial reporting in the two areas, and hence whether there is much benefit in keeping the different types of reporting in a single statement. On balance we suspect that this work would fit better in the pensions TAS. Nonetheless we have no difficulty with the principle of pulling this work out of scope of the pensions TAS if it is covered elsewhere.

6. *Should the following areas of work performed in connection with defined contribution schemes be within the scope of the pensions TAS:*

- a) *Scheme design; (paragraph 4.35)***
- b) *Benefit projections; (paragraph 4.36)***
- c) *Any other work? (paragraph 4.37)***

The work listed here may be done by actuaries or non-actuaries, with the latter perhaps relying on calculations which were originally done by an actuary, although not necessarily specifically for the client concerned. On this basis, we do not believe that it is appropriate to include this work within the pensions TAS.

7. *Should work performed in connection with mergers and acquisitions be in the scope of the pensions TAS? (paragraphs 4.38 to 4.40)*

We are somewhat uncomfortable with inclusion of mergers and acquisitions. Some work on mergers and acquisitions is done at a relaxed pace, with time to produce a crafted report with full disclosure of all the matters required by the pensions TAS. Much of the time this is not the case, in some cases involving urgent work undertaken in the early hours of the morning with minimal data and no access to systems, to support a M&A negotiation. In the latter circumstances, compliance with the TAS is impractical, even to the extent of including boiler plate risk wording.

In these circumstances, we believe that the TAS must explicitly permit flexibility. We suggest that the actuary should be required to disclose where there are risks, including risks relating to incomplete data and approximate calculations. If the BAS believes that non-compliance with the full TAS will usually be acceptable on proportionality grounds, the BAS should go on to state what degree of compliance would normally be accepted.

We also think it would be unhelpful if including this work in the scope of the pensions TAS simply results in the addition of lengthy boiler plate wording in actuarial papers, in relation to such matters as risk and the implications of not complying with the detailed TAS.

If merger and acquisition work is to be included in the coverage of the TAS, we suggest that pensions work in relation to public sector outsourcing is also included.

8. *Should work for scheme sponsors on inducements to transfer be in the scope of the pensions TAS? (paragraphs 4.41 to 4.42)*

We believe that guidance relating to inducements to transfer will be, for the most part, ethical in nature, or perhaps something to be covered by future regulations. On these

grounds, we believe that any guidance should be provided by the actuarial profession, or, if appropriate, the Pensions Regulator.

9. *Is there any work for scheme sponsors other than work on Scheme Funding where agreement is required and inducements to transfer, that should be in the scope of the pensions TAS? (paragraphs 4.43 to 4.44)*

No.

10. *Is there any work which is not mentioned above that should be within the scope of pensions TAS? (section 4)*

Not currently, but the BAS will need to keep this under review from time to time so that standards can be established for new areas of actuarial practice where these arise.

11. *Do respondents have any comments on the proposals concerning data that are presented in section 5, especially those in paragraphs 5.7, 5.10 and 5.12?*

We agree with the proposals in paragraph 5.7 and 5.12.

Paragraph 5.10 is, presumably, partly intended to deal with Guaranteed Minimum Pensions (GMPs) which are sex-discriminatory, as was required by the relevant state pension legislation. The TAS wording appears to imply that the actuary should be seeking a legal opinion if one does not exist already. The standard should instead say that the actuary should ask for any legal opinions which the trustees have taken. We comment on this further in our response to Question 18.

12. *Are there any other data issues which respondents believe should be covered by principles in the pensions TAS? (section 5)*

No.

13. *Do respondents have any comments on the proposals concerning assumptions that are presented in section 6, especially those in paragraphs 6.3, 6.8, 6.12, 6.14, 6.16, 6.19, 6.33, 6.35, 6.36, 6.42, 6.46, 6.61 and 6.63?*

6.3. Agreed

6.8. Agreed

6.12. In these circumstances, the assets of the scheme are required, under pensions legislation, to be taken at market value on the effective date of the valuation, without adjustment to take account of subsequent events. In our view the same principle should apply to pension liabilities. Two different valuations undertaken at the same effective date but reported on a different date should not contain different results simply because of an event that happened between the two reporting dates. The actuary, however, should be required to mention the material event and to comment on the impact.

6.14. The wording 'if this is material' should be added to the end of the paragraph. This principle will give no useful statistical information for the large number of relatively small schemes. While the concept of materiality is implicit throughout the pensions TAS, we

believe that it is important to mention it in cases where the guidance is likely to be inappropriate more often than not.

6.16. Agreed, although this will be difficult to achieve in multi-employer schemes.

6.19. Agreed in principle. However we note that it is not unusual to include a higher margin for prudence in one assumption (for example, the discount rate) where another assumption is difficult to determine (for example, the extent to which life expectancy will improve in future), and we recommend that this continues to be permitted.

6.33. Agreed – we assume that the phrase “take account of”, here and elsewhere, has its normal meaning here, ie “consider” or “bear in mind”, rather than “give substantial weight to”. If this is not the case, we recommend clarifying the wording.

6.35. Agreed in principle, although this will typically be done anyway in the selection of a prudent set of assumptions.

6.42. Agreed.

6.46. Agreed.

6.53. We believe this is impractical. There is no natural division of running costs between accrued benefits and future accrual in benefits. We suggest instead that the Standard points out that, with a diminishing active workforce, it may be more appropriate over time to transfer the allowance for running costs from the future accrual component of liability to the accrued benefit component. In particular this would become very relevant if there is an expectation that the scheme will be wound up in the not too distant future.

6.61. Essentially agreed, although we would suggest that the reference is to ‘annuity rates and / or bond yields’.

6.63. Agreed.

14. Respondents are asked for their views on whether a standard comparator rate for discount rates would assist users’ understanding, and if so whether a low risk rate should be used? (paragraphs 6.28 to 6.31).

The analysis may be of some help, provided that the information required does not include calculation of the value of liabilities on the low risk rate. We also point out that the concept of a low risk rate is not itself uniquely defined, with some differences between, for example, bond indices of different durations, yield curves and swaps.

15. Are there any other principles on the selection of assumptions which respondents believe should be in the pensions TAS? (section 6)

No.

16. Do respondents have any comments on the proposals concerning modelling and calculations that are presented in section 7, especially those in paragraph 7.6 and 7.10?

7.6. Agreed.

7.10. Pension administration calculations are typically done by qualified pensions administrators, or programmed into automated calculation routines. In our view, it is inappropriate for the actuary to try to oversee the work of these individuals or systems. The comment about checking calculations therefore needs to be reduced in scope. It could be appropriate if it referred to the actuary checking specimen calculations on the first receipt of the actuarial instructions, to check that the administrator has correctly understood the actuary's instructions, but beyond this it is not appropriate for the actuary to get involved.

17. Are there any principles relating to models and calculations which respondents believe should be in the pensions TAS (section 7)?

No.

18. Do respondents have any comments on the proposals concerning reporting that are presented in section 8, especially those in paragraphs 8.4, 8.17, 8.18, 8.35, 8.38, 8.39 and 8.40?

8.4 . Agreed.

8.7. In our view, the focus on the terminal age is very odd. To a large extent, the terminal age of the life table is set as a matter of convention – typically it has been 120 for some years. We do not think this paragraph provides any useful information, and suggest that it is not included in the final TAS.

8.17. The wording here is very similar to that required under existing actuarial guidance on valuation reports, and we agree that it is appropriate.

8.18. Equalising GMPs, which are the principal liabilities that are likely to be covered under this paragraph, is extremely complex.

The existence of these issues is one of the reasons for the winding up of pension schemes sometimes to drag on for a very long time. They are not issues that can easily be quantified, particularly when there is a theoretical possibility of having to recalculate pension payments in the past and make retrospective payments to members.

The introduction in paragraph 8.18 acknowledges that an estimate may be difficult or impossible to calculate, but this is not taken into account in the wording of the proposed section of the TAS. We suggest that actuaries should not be required to provide an indication of the maximum liability as a matter of course. Actuaries should however be required to indicate where they believe that such potential liabilities exist.

Alternatively, the requirement could be changed to require disclosure of an estimate of the financial effect of the issue, “where practicable”; this borrows the wording of the Accounting Standards Board’s financial reporting standard, FRS12, in relation to contingent liabilities, an issue which seems to us to be similar to the matters discussed in paragraph 8.18.

8.35. The report on PPF liabilities is not itself supplied to the PPF, although figures taken from the report will be used in a submission to the PPF. However we agree with BAS that

a condensed form of reporting is more appropriate than for a scheme funding report. We suggest changing the proposed TAS wording to the following:

“The formal report giving the results of calculations of PPF liabilities is used to calculate the PPF levy. The content of the report should be written on the basis that the decisions that will be based on the report will concern the compliance of the calculations with the specified assumptions. It is not a requirement of this TAS for the report to cover the issues required for a Scheme Funding report.”

8.38 . Agreed.

8.39 . Agreed.

8.40. Agreed.

19. Do respondents agree that in Scheme Funding exercises any prudent estimate of scheme liabilities should be accompanied by a best estimate? (paragraphs 8.10 to 8.15)

We understand the potential attraction of trying to obtain a comparison between a prudent liability estimate and a best estimate. Unfortunately the simplistic approach of requiring actuaries to provide a best estimate figure alongside every prudent figure is flawed. The approach would double the number of liability calculations required for valuing the scheme on an ongoing basis, which would add significantly to cost. If the information was useful, this might be acceptable. Unfortunately, we believe that this will not be the case:

- The best estimate figure relies on individual actuarial judgement. Different actuaries, will, quite acceptably, have different views on what a best estimate view of the future involves. It is quite possible that a liability which is regarded by one Actuary as being 110% of the best estimate figure will be regarded by another as 120% or more.
- Without significant detail, recipients of actuarial advice may take inappropriate comfort from the size of a margin. For example, where a best estimate of a liability might be regarded as the amount of money required for there to be a 50:50 chance of assets being sufficient to meet liabilities, a typical “prudent” basis may only increase this 50% figure to, say, 65%.
- There will be a temptation for users to compare margins for prudence and to draw inaccurate conclusions. For example, it may seem to a typical recipient of funding advice that holding a margin of 15% relative to best estimate is a better position than holding a margin of 5%; however the latter may in fact be the less risky approach if that scheme’s assets are invested in a closely matched liability driven investment strategy, while the scheme with the 15% margin is heavily invested in equities.

We believe that it is appropriate for the actuary to justify the choice of prudent funding assumptions by explaining the way in which the assumptions are prudent, and we suggest incorporating a requirement to do this in the TAS. We do not believe that it is an appropriate requirement for the Actuary to accompany every single figure calculated on a

prudent basis with a best estimate calculation, as we do not believe that the resulting extra cost is an appropriate use of pension scheme money.

At the meeting of 190 of our members, a vote on the subject was held, with the vast majority of those present voting against including a requirement to calculate and disclose best estimate figures in funding reports. We therefore recommend restricting disclosures in relation to prudence and risk to those required by paragraph 8.17.

20. *Do respondents agree with our conclusion that the final Scheme Funding report should include sufficient information for an informed reader to understand the financial position of the scheme, and that this is best accomplished by defining the intended users and decisions accordingly? Do respondents agree with our conclusion that this would result in little extra work? (paragraphs 8.20 to 8.31)*

Scheme funding reports are produced at the conclusion of a detailed process of consultation between the actuary, pension trustees and, usually, the sponsoring employer. During the process the actuary will have established the trustees' and employer's objectives in relation to the funding of the scheme.

By contrast, the scheme actuary has no direct relationship with scheme members. It is not possible for the actuary to know the personal objectives and risk tolerances of members, which will in any case differ from member to member.

Our view therefore is that the BAS should not attempt to expand the scope of the scheme funding report beyond its existing scope, namely reporting to the trustees and, sometimes, the employer on the funding of the scheme and required contributions. Experience in the law courts involving financial reports has demonstrated that there can be significant difficulties where a reader of a report uses it for a purpose for which it was not prepared. We expect that the Financial Reporting Council (FRC) will be familiar with these problems, and hope that the FRC and the BAS will accept that the problems apply equally to actuarial reports.

Having said this, we do not have any objection to requiring reports to include the material set out in the wording of the first three bullets in paragraph 8.30. The requirement to include unspecified "other material information" is too wide in the context of a report addressed to trustees.

Finally we would also point out that there is already a document required by UK law which is intended to summarise the funding valuation for members, namely the summary funding statement. If anything, we suggest that the BAS concentrates more attention on liaising with the Department for Work and Pensions over the content of this document than on the valuation report, which in practice is rarely requested by scheme members.

21. *Would the provision of specimen Scheme Funding reports be of value to users?(paragraph 8.32)*

We believe that providing specimen scheme funding reports would be valuable in helping the BAS to understand the extent of changes that they are proposing. We therefore support their provision, and suggest that this is extended to other reports within the scope of the TAS.

22. *Are there any other principles on reporting which respondents believe should be in the pensions TAS? (section 8)*

No.

23. *Do respondents think that actuarial comparisons in pensions should be covered in the pensions TAS or in a specific TAS covering similar matters across all areas of actuarial work? (section 9)*

We cannot see that there will be a significant amount of common ground between the actuarial comparisons in relation to pension schemes and actuarial comparisons for other areas of actuarial practice. If they are to go in any BAS document, we suspect that the issue should be covered by the pensions TAS.

However a number of the issues seem to involve an ethical component – for example comparisons of benefit value may involve issues such as deciding whether benefits for one person (e.g. the member) can be replaced with benefits for another (e.g. the member's spouse). We suggest that the BAS reaches agreement with the actuarial profession on the extent to which they will each provide guidance before proceeding in this area.

24. *Do respondents have any views on whether it would be of value to users of actuarial information for the BAS to maintain a glossary of actuarial terminology and if so, what it should contain? (paragraphs 10.15 to 10.17)*

We believe that it would be of value to users of actuarial information for the BAS to maintain the glossary of actuarial terminology. As a start, the content of GN26 would be useful.

25. *Do respondents have any comments on the proposed transitional arrangements from the adopted GNs to TASs described in section 10?*

We believe that it is desirable for a standard certificate for circumstances currently covered by GN16. If the BAS does not wish to keep this, it should liaise with the Department for Work and Pensions to agree a suitable new home. Otherwise we have no comments.

26. *Do respondents have any views on whether matters which could be construed as technical or ethical such as those mentioned in paragraphs 10.5, 10.13, 10.20 and 10.24 should be included in the pensions TAS?*

We agree that the matters listed could be construed either as technical or ethical. We believe that a decision should be taken on a pragmatic basis by agreement between the BAS and the actuarial profession.

If you have any queries or comments, please do not hesitate to contact Charles Young, Chairman, ACA Pension Schemes Committee (charles.young@hymans.co.uk).

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