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DISCUSSION ON EXPOSURE DRAFTS OF THREE GUIDANCE NOTES ON RETIREMENT BENEFITS: ACCOUNTING FOR PENSION COSTS UNDER SSAP24 (EXD6) BULK TRANSFERS (EXD7) GUARANTEED PENSION INCREASES FROM SURPLUSES (EXD8)

[Discussed at the Faculty on 24 October 1990]

The texts of the drafts as they stood at the time of the meeting are printed after the discussion. There are differences between the wording of these drafts and the texts finally adopted as professional guidance where matters have proceeded to final approval.

Editors Note: The report of this meeting should have been included in Volume 43 Part I.

Note: The exposure drafts were also discussed at the Institute in 22 October 1990.

The President (Mr A. Neill) welcomed members and their guests including Mr Jeremy Row C.B.E., Chairman of the Occupational Pensions Board; Mr Roy Brimblecombe C.B.E., Chairman of the Pensions Joint Committee of the Faculty and the Institute; Mr David Loades, Directing Actuary of the Government Actuary's Department, and Miss Sarah Morrell of the Department of Social Security.

Mr R. E. Brimblecombe F.I.A., introducing the discussion, said:—By way of background, briefly, EXD6 results from a feeling within the actuarial profession that there should be a counterpart to the accountants guidance on Accounting for Pension Costs under SSAP24 (EXD7) results from a specific recommendation in the OPB report on the Rights and Expectations of Pension Scheme Members whilst EXD8 results directly from an agreement in principle earlier this year between the Councils of the Faculty and Institute and the DSS that we would provide guidance for the use of surpluses to provide what is now known as thc Limited Price Indexation (LPI) under the Social Security Act 1990. I would like to stress that I believe very strongly that Guidance Notes have become an integral part of our professional way of life. I believe it to be both a privilege and an opportunity for us as a profession to operate as we do by way of such Guidance Notes, especially where they are used as a surrogate for legislation. I believe that this gives us the opportunity to be far more flexible and to apply our undoubted professional judgement in cases which otherwise might be subject to rigid inflexible legislation.

A general word on the question of timing. On EXD8 dealing with surpluses the DSS have asked that the Guidance Note should be available if possible a year before A-Day, which is the appointed day after which surpluses have to be used to provide LPI. The Government have yet to announce A-Day but it is widely believed that this will be 1 January 1992. On EXD7, draft regulations have already been published for comment and the professions will be responding to the request for comments on those regulations in due course. Further, it is suggested that the regulations will come into force on 28 February 1991. Both points predicate the need for issue of the final versions around the turn of the year. On EXD6, whilst there is less time constraint, there has been pressure on the profession to issue guidance to actuaries on SSAP24 and I would hope we can be in a position to issue the final document without undue delay, hopefully in the early part of 1991. I would however like to emphasise that the three Exposure Drafts we are discussing tonight are as their name implies just that. The Pensions Joint Committee look forward to hearing the discussion on the proposals. Together with comments submitted in writing, all the views expressed here and at the Institute last Monday, will be taken into account by the Committee before it makes recommendations for the final versions of the Guidance Notes to the two Councils later this year which, if approved, will then be published.

Turning back to EXD6 this is the long awaited guidance to Actuaries in relation to SSAP24. As you will be aware the Auditing Practice Committee issued a practice note (number 2) in August of this year which was produced after in-depth discussions with the Pensions Joint Committee and with the blessing of the two professional actuarial councils. However, it is felt that that document is only half the story and hence the draft Guidance Note for discussion tonight is the actuarial counterpart of that accountants practice note. I think the draft Guidance Note is fairly self explanatory but there is however one point I would like to make at the outset.

Concern has been expressed that SSAP24 requires yet another series of actuarial valuations which could only add to the cost of schemes, particularly smaller schemes. However, it is clear from the accountants' document, practice note number 2, that the starting point in relation to SSAP24 is for the Auditor and the Actuary to discuss to what extent the last valuation the Actuary has carried out meets, in the Actuary's professional judgement, the requirements of SSAP24 and if not to what extent that valuation needs to be modified. The draft Guidance Note is designed to help actuaries assess whether their normal valuation method does indeed meet those requirements.

Mr J. R. Gibb said:—I speak as a user of SSAP24. Last week I read the accounts of a stable and substantial long established company which makes profits in the order of £100 million and had adopted the standard – having a June year end. In note 6 to the accounts I found a statement that the pension cost was a credit of £4 million and a reference to note 23 on page 55. On page 55 I did indeed find a statement covering all the items set out in SSAP24 and the figures were that the recurring pension cost was £16 million and there was a credit of £20 million for the existing surplus in the pension scheme spread over the required number of years, and that the account simply incorporated this net credit.

Surely the intention of this standard is that the profit and loss account should include the annual recurring charge and that the credit for the existing surplus ought to be shown as an extraordinary item and taken direct to reserves. Otherwise the profit of the company on any sensible basis is overstated and not insignificantly in this case (about 25%). The importance of pension costs in relation to profits is very considerable and the figure of 25% that I mentioned is not atypical. It is rather beyond me how these accounts were judged to be true and fair but they certainly aren't sensible.

On the other hand, the Chairman of the same company is very sensible because he said: "We have adopted for the first time the accounting standard for pension costs SSAP24, which has allowed us to recognise part of the surplus built up in recent years. The ongoing contribution required if there had been no surplus would have been £16 million but for this year is more than offset by the surplus. At some stage this balance will certainly be reversed." In other words the Chairman of the company felt obliged to qualify his own accounts.

Surely this is exactly what we are trying to avoid and if all the work under SSAP24 is to be relegated to note 23 on page 55 we haven't quite got there yet.

Mr D. Johnson said:—In section 2 the division between the company and trustees may be more apparent than real for small family businesses and therefore conflicts of interest may well arise although they may not be material. In such cases the Actuary and Accountants should ensure compliance with the 'letter' of SSAP24 and not involve wholly disproportionate service costs for the client. In particular it seems to be impracticable to consider separate assumptions. We have experienced some small schemes where a large firm of accountants has asked for an endless stream of figures for SSAP24, without much regard to either the cost or the usefulness of the end product.

A minor detail is in note 4 on the fifth last line. I found somewhat confusing the term 'Members', I think it would be better if we used the term 'Actuary'.

In section 8 it seems to me that for schemes with very few members it is unavoidable that large fluctuations will occur.

In section 10 practical limits must be applied where a scheme is made up of numerous small employers. In particular it would be very difficult to arrive at a realistic split of assets to determine the funding position of each section. Section 29 on the face of it appears a bit of an overkill. This, having spoken to one or two people, could involve our organisation in having to value insured annuities which we would not normally be valuing.

Overall I feel that it is important that both sides have an understanding of some common ground but both the Actuary and the Accountant has his own job to do and should not be influenced by the other in doing that, only assisted.

Mr A. Zegleman said:—I am not convinced that this draft Guidance Note actually does give any practical help to the Actuary in dealing with SSAP24. First there is the question of updating valuations for events which happen in the accounting periods after the first year. It seems to me that under the Guidance Note as drafted, paragraph 4 almost suggests it is going to be necessary to make annual valuations and I do not see how the Actuary can ensure that he is made aware of changes in the benefits, membership and any other relevant factors.

Paragraph 12 equally seems to make little sense to me although I suspect there is perhaps a typing error here in that consistency in the calculation of the remaining service lifetime should be by reference to the way the variation is to be spread rather than with the assumptions used in the calculation of the regular cost.

In any event I wonder whether it is sensible to offer a client a choice of three or more average service working lifetimes depending on the method on which the surplus is going to be amortised. On practical grounds this is going to stretch the credibility gap between Finance Director and Actuary a deal further than it might well be capable of taking. Given the sensitivity of SSAP24 figures to the valuation method and the assumptions underlying I am not convinced that there is any merit in introducing yet another complication.

I think the section immediately following is one of concern as it appears to be an attempt to distil into half a dozen paragraphs the general theory of how to fund a final salary pension scheme. I do think it appropriate that this should appear in a Guidance Note on SSAP24. After all, earlier in the note the reader is reminded that the normal professional guidelines apply to all of us. By definition that means that anyone giving advice on pension funds already possesses a sound knowledge of pension fund financing so I do not think it is necessary to teach part of the fundamentals in this Guidance Note.

Leading on then to one of the more controversial sections, section 20, which requires that any actuarial method not specifically mentioned in the Guidance Note will require the Actuary to refer to the Faculty or Institute. Again there is a practical problem here as the speed at which SSAP24 figures usually have to be produced would make it impossible to refer back to the Faculty or Institute. I think more important however is the principle whether the role of the Faculty or Institute is one to oversee the detailed advice the Actuary gives to his client. Under normal professional standards any Actuary giving advice on pension matters must be competent in the practice of pension funds – why therefore does SSAP24 advice require such special treatment?

Mr C. M. Stewart F.I.A., said:—I thought it a great pity that, no sooner had the Accounting Standards Board of the United States issued FAS87, than Actuaries there were obliged to enter a disclaimer whenever they made calculations for purposes of the accounting standard. How much better it would have been if the two professions had been able to agree on an accounting standard beforehand. We have managed things much better here. We have been able to get as far as paragraph 88(h) of SSAP24 before suggesting that the Actuary might wish to attach a qualification to his figures but I regard even this is a pity.

May I first, contrary to what a previous speaker said, say how much I welcome the section which examines the validity of various actuarial methods. This exposes some of the fallacies and misunderstandings which have clouded our discussions on this subject in the past. I hope this helpful material will be disseminated more widely. It will be useful in a much wider context than the accounting standard for pension costs in company accounts.

I hesitated only on the last few lines of paragraph 19 on control periods where it is implied that some actuaries might be calculating future contribution rates without making full provision for future pay increases. I have never come across such a method and I wondered what provision an actuary might be making, and why he was making it, which was different for making full allowance but not materially different.

The Exposure Draft states that the appropriate value of accrued liabilities for purposes of paragraph 88(h)(iii) is that given by the projected accrued benefits method. I don't know whether this is the Joint Committee's interpretation or whether they have been advised by the Accounting Standards Committee that this was the Committee's intention but it's not what SSAP24 actually says. The definition of level of funding in SSAP24 passes us on the definition of accrued benefits, which in turn says that they may be based either on current earnings or projected final earnings. This appears to give a choice. However, there is not much point in my speculating about what the Accounting Standards Committee intended. If the Joint Committee are mistaken, then the Accounting Standards Committee will presumably say so. If they are right, then it follows that answers under 88(h)(iii) may have to be qualified as the Exposure Draft says. I could live with that. Does it in fact make much difference? In truth not very much. There is a new statutory minimum requirement for benefits based on current earnings to be revalued in line with prices with a 5% limit. This is the 'current funding level' referred to in 88(g). This minimum funding level might be about 10% or 15% lower than by the projected accrued benefit method. However some schemes already promise a higher rate of revaluation on winding up than the statutory minimum and for them there will be hardly any difference.

Recently, a growing number of schemes have been meeting their obligation to equalise pension ages for men and women by introducing flexible retirement for both between ages 60 and 65. Under the projected accrued benefit method an average retirement age somewhere between 60 and 65 will presumably be assumed but wind-up benefits cannot be flexible and will come into payment at the earliest age of 60. The level of funding in 88(g) may now therefore be higher than 88(h) in some cases. Given that the funding level under 88(g) may for very good reasons be lower or higher than under 88(h) but never very much higher or lower, one wonders what is to be gained by trying to specify only the projected accrued benefit method under 88(h) with the consequence that actuaries may feel the need to qualify their answers.

I think we've got into this difficulty because of confusion as to what constitutes an ongoing actuarial valuation. We really must stick to the definition given in SSAP24.

Mr A. N. Walton said:—I am mainly experienced in small insured schemes and generally for those schemes the use of a control period can be a significant factor in producing my 'best estimate' of the cost to the scheme, especially where new entrant and withdrawal assumptions may be completely hypothetical. SSAP24 requires that I produce my best estimate. EXD6 because it specifically states that I cannot use a control period may be such as to mean I cannot provide the best estimate required by the accountants.

Mr G. G. Bannerman said:—I have no problem over EXD6 as it stands and I think that many actuaries share my view that the accountants in their desire to achieve a common standard have rather lost the place. I am glad to see our profession's preferred route in dealing with running off the surplus or a liability is to express the adjustment as a percentage of salaries. I have done this in the past but have found some difficulty in explaining to accountants why such a calculation gives a different cash figure from that obtained by dividing the surplus by the service lifetime term. I think it can be said that there is no accounting for auditors. The notion of projecting salaries and allowing for interest seems to be a concept totally alien to them, I think that is something that people have to watch out for.

Mr A. U. Lyburn, closing the discussion, said:—I was particularly interested to hear Mr Gibb's comment. His message was directed at the accountants and we will have great pleasure in passing it onto Mr Graham Ward, the Chairman of the Working Party which produced SSAP24. I would ask however that if SSAP24 did not exist, would the Chairman of that company have made any comment whatsoever?

In the discussions which some actuaries attended with the Working Party years ago, when SSAP24 was an Exposure Draft, we raised continually with the accountants the problems of small companies as mentioned by Mr Johnson. No matter how much we may feel there is a plea to help them out and save them the costs of all the extra work and so forth there is as I understand it legislative requirements on the auditors which require this kind of reporting.

In answer to the question raised by Mr Zegleman as to whether or not we need this Guidance Note, I would say quite definitely, we do. When I was Chairman of Pension Standards Joint Committee, I received many requests for guidance from members of the Faculty and Institute. It is hoped that this Guidance Note will reduce the burden on whoever has to answer queries in future.

Mr Stewart centred on disclosure and on whether we should be using one particular method or the other. As he said there is some history to classification of methods. Some time ago the two then Presidents of the Faculty and Institute wrote to the Chairman of the Auditing Practices Committee asking for interpretation of SSAP24. The very helpful advice we got back is that the APC was not empowered to give an interpretation. In that case we should be thankful we are members the Faculty or Institute whose committees are prepared to stick their necks out and give an interpretation.

Just before I finish with Mr Stewart's remarks, Paragraph 20 does give you the ability to put your method to the Secretary of the Faculty or the Institute for comment as to whether it is acceptable in their opinion.

Control periods have been mentioned and I think it is fair to say that all SSAP24 requires is a best estimate. If the control period gives a best estimate or where the difference is not material then that is alright. Mr Low's comments on the interaction of EXD6, EXD7 and EXD8 are undoubtedly apt. He is not alone and the principles he advocates and concerns he has expressed will have to be given very full consideration by the Working Party and the Committee in due course.

DISCUSSION

Mr H. W. Brown, introducing the discussion, said:—This draft Guidance Note has been produced at the request of the DSS following the Government's acceptance of an Occupational Pensions Board recommendation in the report on the Rights and Expectations of Pension Scheme Members that bulk transfer values without the consent of members should only be allowed if there is an actuarial certificate to the effect that by and large members will not be adversely affected by that transfer and that there should be guidance given on the certificate by the professional actuarial bodies. It has been suggested to me that the requirements of the Actuary before he can be satisfied are relatively onerous and that this can only lead to there being relatively few bulk transfers without consent.

I make no apology for this, because I believe it is right for individuals to be protected in this way and if as a result there is a reduction in the number of bulk transfers without consents then so be it. The alternative of course is still open of obtaining consent from the members before the transfer takes place.

EXD7 is not concerned with the basis that is used to calculate the amount of the bulk transfer value. It is assumed that this will have been discussed, agreed and documented by the various parties before the request is made to the Actuary for an actuarial certificate. The Guidance Note and the certificate are concerned with the benefits in the transferring and receiving schemes and not on the adequacy or otherwise of the amount of the transferred amount – the transfer value.

Actuaries will need to ensure that the Trustees are aware of the scope of the certificate and make clear that the certificate is only one of many factors they need to take into account before agreeing to the transfer. The responsibility to make that transfer without the members' consent still remains with the Trustees of that occupational pension scheme. The certificate is not their authority to make the transfer, I cannot stress enough paragraph 1.4 in the draft Guidance Note.

It is impractical for the Actuary to carry out his investigations on an individual member by member basis. However, the Actuary must satisfy himself that different categories of members are not disadvantaged. He may however feel that because of the benefits structure or the membership composition of the scheme some categories may consist of only one member. The Actuary must be concerned with the benefits under both schemes on both a on-going and a wind-up situation. Expectations have given some actuaries concern. The Working Party considered expectations carefully and felt expectations to mean the benefits which are not promised under the rules but because of a regular practice that has been adopted in the past, or because of a commitment that has been made, there is every likelihood that they can be expected to be paid in the future.

Mr C. W. F. Low said:—I think it is important to look at the interaction of all the Exposure Drafts. The point which concerns me is the interaction of paragraph 27 and 28 of EXD6, with paragraph 2.1 of EXD8. In essence it is: When is a valuation a valuation?

In many schemes the Actuary's client is the Trustee and it is to the Trustees that his report has been sent. Sensibly SSAP24 has been drafted and envisages, as does EXD6, that figures can be prepared for the company on the basis of that valuation. But, as paragraph 27 and 28 make quite clear, if the valuation for the Trustees has been done on a basis or a method which is not acceptable under SSAP24 then fresh figures have to be prepared for the company. Paragraph 28 goes on to remind us that the degree of disclosure should be to this set of figures (or is it a valuation?) and that GN9 applies to them. It seems to me that in that case, one has provided figures to the company which is a valuation to which GN9 applies.

Switching to EXD8, paragraph 2.1, LPI immediately comes into play. I do not believe that is intended. Can I suggest that the wording which is used in Section 4 of GN13 might be helpful to remove this anomaly.

Mr A. U. Lyburn said:—By way of introduction, when John Martin and I were encouraging our OPB colleagues to recommend the guidance note route I had naively expected to be out of office in time and to be free of the considerable responsibility of being involved in the production of these Guidance Notes. In fact if need be, free to be on the opposition front benches. Well I'm not actually going to go as far as that but I do have one or two comments.

1. Without disclosing too much there was considerable discussion at Staple Inn on Monday night over the use of the word 'expectations' especially as expectations are not referred to in the Draft Regulations. We have an indication that the word 'expectations' will not be in the legislation because of a legal opinion

so that in fact the buck is being passed back on us. The Committee therefore will be very interested to hear what is said tonight about 'rights and expectations'.

2. My second point is technical and has been brought to my attention by another OPB colleague, Harriet Dawes, whom some here will know is an eminent pensions lawyer. The covering memorandum issuing the draft Guidance Note and the draft Guidance Note itself refers to the transfers of not only active members, but also members with deferred pensions and current pensioners. Unfortunately at present, under the Social Security Act 1973, Schedule 16, paragraph 9(2)(a), a scheme can provide for members' accrued rights to be transferred out but, except in cases set out in Regulations, only with the member's consent. These Regulations are in SI 1984/614. Currently a member's accrued rights can only be transferred from one continuing scheme to another without his consent, where his Guaranteed Minimum Pension is transferred. Where a scheme is being wound-up (but not where it continues) deferred pensioners and pensioners may be transferred without their consent. Such transfers, however, cannot take place where the transferring scheme is not being wound-up.

   It is hoped to clarify this point to make sure that deferred pensioners and pensioners may be transferred without their consent in a wider range of circumstances. At this stage I suggest that this point be borne in mind.

3. My third comment is more fundamental and is perhaps a corollary to Mr Brown's comment that the number of bulk transfers without consent may not be very significant. I am actually deeply concerned over bulk transfers whether with or without consent, regardless of how equivalent the benefits in the two schemes are, where the valuation assumptions of the receiving scheme are significantly weaker than those of the transferring scheme. It is not difficult to envisage circumstances where an immediate revaluation on the completion of a transfer under these circumstances could lead to the possibility of a contribution holiday for five if not more years and in the process significantly reduce not only the protection but the rights, expectations and, worse, the ultimate benefits of those transferred. While there may be other solutions, the solution that appeals to me most at present is to require the receiving scheme trustees to maintain an earmarked fund, for a period to be agreed, and to undertake to apply any surpluses solely for the benefit of the cohort of transferees. The valuation bases of the principal and of the earmarked funds would normally have to be the same. Some may regard this as a backward step and I know this raises practical problems but with today's technology they should be easily overcome. I add, that for twenty years I have done just that almost in reverse with a case where the incoming assets were insufficient to match the expectations of the transferring members (i.e. virtually past service parity with the existing members). Over the years surpluses arose in the earmarked fund and they have been used to increase the benefits of this particular cohort and they have now in fact been increased to the parity level.

I look forward to comments on this particular point. Naturally I hope sufficient members of the profession will share my concern and assuming they do, should a requirement along the lines I am advocating be in the Guidance Note or in the Regulations? Perhaps I should add that at the present time I am including such a requirement in recommendations I am giving to the Trustees of a transferring scheme under such circumstances.

Mr P. Randall F.I.A. said:—I am speaking about EXD7 and EXD8 on behalf of my firm, which has many members of both the Faculty and the Institute. I have some general remarks to make about both drafts, which I'll make now, and some detailed comments on each, where I'll stick to EXD7 for the moment.

Neither draft is well received. It is clear that the pressures of time have meant that quite a lot of work remains to be done. Much of the recent DSS and Inland Revenue legislation on pension schemes has been poorly drafted. Actuaries have been the main critics of this, and rightly so: but this means that our contributions, when we are given the opportunity to make them, must be of a higher standard. We do not believe that these drafts yet meet such higher standards.

Both drafts suffer from a lack of clear focus on specific objectives, perhaps because those objectives were never well set out in the first place. This is clearly the case in EXD7, where the central problem is surely to tie down and quantify members' expectations if the original OPB remit is to be met. In EXD8 the lack of focus leads to an ill defined compromise between retaining maximum flexibility and meeting the Government's desire for pension increases to be guaranteed and paid wherever schemes can afford them from current funds.

Turning to EXD7, we think it would not be helpful if the main effect of the guidance was to put an end to bulk transfers without consent, because actuaries felt unable to give the necessary certificates. There will continue to be cases where such a transfer is the only practical course of action.

But this means that the draft must be better focused, and in particular, must give more weight to individual rights and expectations. We are not satisfied that EXD7 achieves the right balance, or indeed a clear and consistent one, on the weight the Actuary has to give to the rights and expectations of the membership as a whole, sub-groups of that membership, or individual members and their dependants. It may be argued that it is for the Trustees to ensure that individual members are not materially disadvantaged, but how are they supposed to do this?

We also note that the legislation does not concern itself with the effects of a bulk transfer on the expectations of either the remaining members of the transferring scheme, or the existing members of the receiving scheme. This is a deficiency of the legislation, but it is not one that the Faculty and Institute should identify and address. These members' positions are affected by the financial strengths of the transferring and receiving schemes before and after the transfer, yet paragraph 3.6 requires the Actuary largely to ignore these.

There are many places where we feel that the drafting could be made more precise and improved substantially. An example is the way in which the 'rights and expectations' of paragraph 2.1 become the rather looser 'benefits' for the rest of the draft. One possible aid to solving the problem for establishing 'expectations' in the receiving scheme might be to rely on statements of benefit policy made to the members by the Trustees and Principal Employer akin to those required under the Inland Revenue surplus regime when discretionary pension increases are to be taken into account.

Another example is the use of 'actuarial reasons' in the wording of the certificate itself, which is not helpful. A better format might be something on the lines of "I have conducted the investigations required by GNx of the Faculty and Institute of Actuaries. In my opinion no grounds were disclosed by those investigations on which the Trustees should refuse a bulk transfer, etc."

This ties in with the earlier point about the relative responsibilities of the Actuary and the Trustees. It is clear to us that in practice Trustees will rely heavily on the fact that a certificate has been issued when deciding whether to approve a bulk transfer proposal. This will be the case despite the two sentences added in draft to paragraph 1.4 and requiring the Actuary to point out that the decision to effect the transfer is the Trustees' responsibility.

For this reason, and as a matter of general prudence, we feel it would be helpful for the Faculty and Institute to have taken legal advice on the liability that could rest with the Actuary if it subsequently became clear that members' rights or reasonable expectations had not been fulfilled following a bulk transfer. We understand that this advice has not yet been sought and we think this should be done as a matter of urgency. Many of us would be unhappy about giving such certificates whilst this point is in doubt.

Many of us also feel that, however limited the Actuary's liability in law, such a case of rights and expectations not being fulfilled would call the value of the certificate into serious question. More importantly, it would undermine public confidence in our profession as a whole. Yet it is very far from clear that EXD7 would prevent this possibility. If it does, it is likely to have been because actuaries felt too exposed to give any certificates at all.

We have several problems with paragraph 3.5. First, it has given rise to different interpretations amongst us of the weight to be placed on the winding up provisions. Second, it appears to place more emphasis on the form of words in the relevant rules than on the likely consequent benefits. Third, it appeared to some of us that even where members' benefit rights were being improved on transfer, a slightly inferior winding up rule would prevent the Actuary from giving the relevant certificate.

We also find it difficult to agree with the thrust of paragraph 3.7. We understand that it is there because the Working Party felt that to include defined contribution schemes would involve the Actuary in giving an opinion on their likely future investment returns. One consequence of this is that we are setting ourselves guidance for certifying the values of ill-defined expectations of discretionary defined benefits, yet will not say that a £1,000 credit in one defined contribution scheme may be broadly the same as a £1,000 credit in another. This is 'Alice in Wonderland' logic and the danger is that the public will see it as such.

Mr R. J. Amy said:—My main concern is a practical one, because I see a very fine line between certificates being given in the context of bulk transfers without members' consent and what tends to happen in practice when you go to a work-force, maybe a pretty well organised work-force, and say to them "are you going to consent to the bulk transfer of these terms?" What do they do? They take advice. As soon as we get into a situation where there is an actuarial certificate that applies to bulk transfers without consent, they are going to look for the same actuarial advice, governed by these same Guidance Notes, to guide them on whether they should accept the terms. If we proceed with as tough a Guidance Note as this, and I am particularly concerned about paragraph 3.5, some very fine differences in how a surplus is dealt with on wind up could prevent the Actuary signing a certificate.

There is a danger that we are going to see some bulk transfers falling back into the default position where no future salary reserves are paid to protect full past service rights; instead members could end up with deferred pensions. This would be a retrograde step; so I would like to see us backing off a bit from such a tight Guidance Note while at the same time I would agree with previous speakers that some of the wording needs to be more precise.

Mr G. G. Bannerman said:—In the past I have found that there was no difficulty in recommending a transfer of employees going from one scheme to another where the benefits promised were equal. Usually we did not worry too much about a possible surplus and its distribution. We then got to the stage of considering the effect of variations. For example when comparing a final year's salary scheme with a three year average scheme we could give a bit more accrual rate for the back service to make the two equal and again I would not see any great problem in that. That was again a question of surplus. In the past I have also been reasonably relaxed about doing some sort of conversion formula for people going for a scheme with or without increases to one where the opposite position arose. We now have a situation, and there is absolutely no mention of this in EXD7, which I would have been happy about a year ago but not now because we are deliberately warned not to take much account of the surplus position of the transferring scheme. But what if you have a scheme with a static benefit when you want employees to transfer to a receiving scheme that has a lower accrual rate and an escalating benefit. In the past we would have recommended an adjustment to the accrual to take account of it but if the transferring scheme already has surplus, if these people are accepting an escalating pension at a lower level they have less prospect of uplift to LPI. This is something that I think again must endanger any certificate in this form and must also endanger the advice that one should give to individual members if we are seeking their consent.

Mr C. W. F. Low said:—I am exceedingly concerned that the profession has fallen into the position of trying to get its members to do the impossible. I can well understand why the DSS has backed away from defining expectations. As a practical pension consultant I am well aware of the urgent need to be able to continue paying bulk transfers, for example in corporate reorganisations or in continuing schemes, for small numbers where former members and aged pensioners cannot be contacted. It was not the Faculty that was responsible for the primary legislation, but we are being asked to be the fall guys. Commercially minded clients will agree to transfers and they are looking for us to sign the certificate and I believe the many of us will find it impossible to sign certificates.

While we have not attempted to define closely members' expectations, if we look at paragraph 4.5 it says "any discretionary benefits that have been awarded as a regular practice which members would reasonably count as an expectation and which it is assumed will continue in future and have been taken account of should be recorded."

We are being asked to certify what members would reasonably count as an expectation. Consider a very common feature of many pension plans – enhanced and generous early retirement factors. Often these enhanced early retirement pensions have been granted for many years. If they have been granted for more than three years, we can pre-fund for them under the surplus regulations. It would be perfectly reasonable under EXD7 to assume that they would continue to be granted. But EXD8 in paragraph 4.3 makes it quite clear that, unless the benefits are guaranteed under the deed, they cannot be counted. That makes it very clear how expectations can be torpedoed at a stroke by legislation.

Would it be reasonable for a male with a pension age of 65 to expect to be receiving that pension at age 60 as a result of the Barber case? It could be, for all I know. I am afraid I would find it impossible to sign any certificate under EXD7 and I think we might be doing our members a greater service if we refused to take up this particular cross at this time. I am aware that it would be politically awkward for the Faculty, and that we in the Actuarial profession would be regarded in a very bad light by politicians, but I think that it might be the wiser course.

Mr P. Hurcombe F.I.A., said:—I am concerned with the lack of protection for individuals in this EXD7. We are specifically instructed not to consider the matter on an individual basis. There is admittedly some protection for categories of members in paragraph 3.4 and Mr Brown referred to the fact that one can consider an individual to be a category of member. I would prefer EXD7 to go further and actually talk about individuals.

I would also agree that the form of the draft certificate is wrong. The reference to actuarial reasons is extremely vague and unhelpful and it would be much better if it repeats what has actually been done. In particular if we are being asked to sign a certificate on the basis that some individuals may be worse off and that even categories of members may be worse off provided they are not materially worse off, then I think it is only right that we should state that in our certificate.

Mr H. W. Brown, closing the discussion, said:—I do find it interesting that there seems to be two quite different sets of opinion. There was Mr Amy who could see it as a very tough Guidance Note. 'Tough' from the employer's point of view in that employers in general will no longer be able to press-gang the Trustees into making bulk transfers without members' consent and maybe to the detriment of those members. Yet on the other side we have Mr Hurcombe who felt that really the Guidance Note did not go far enough. He felt that you cannot really look at groups but should be looking at individual members to ensure that no member is any worse off after the transfer than he is before the transfer.

The Working Party spent a considerable amount of time with this very problem and I think we felt we had come to a practical area of compromise, where if the Actuary could divide the membership into homogeneous groups such that those groups were fairly well reflected in the benefits before and after and he was happy that the group was not in any way losing out then he should be able to give the certificate without going to the next stage of looking at each individual member. What the Working Party thought of here was categorising members by age, because age obviously is something that is material if the benefits structure is changing. Similarly if there was a State offset in the definition of final pensionable salary, groups would probably have to take account of lower as well as higher paid employees to ensure that for the lower paid, because of higher accrual rate in the transferring scheme compared with a lower accrual in the receiving scheme, you were effectively upsetting the balance although on average it appeared to be alright. Hence in my opening comments I anticipated that you might even look at one individual member if that member was so different from the other members of the scheme. I felt that the Guidance Note was specific in those areas and gave enough guidance to the profession so that an individual Actuary would be pointed in the direction of carrying out these various calculations before he could give the certificate.

We also have to go back to the basic principal of why the whole area has been brought out by the OPB in the past. Their concern was a practical concern; that members have been transferred without their consent to another occupational pension scheme and have lost out in the process. This really is an area that both the profession and the pension industry needs to look at. It is a difficult problem but I think we have to grasp that nettle.

Mr Randall made a number of comments and I have taken note of them. One of the areas that I think the Working Party certainly needs to look at is the certificate. I am no longer happy that the certificate really reflects what we originally intended it to and certainly I think that is an area that needs to be re-visited and the wording tightened or modified in some way. Legal liability was another point that he made and I think it is something that as a profession we need to check out. I am not so sure about the defined contribution argument. I find the whole question of defined contribution schemes a difficult one. If one of the two schemes is a defined contribution and the other is a defined benefit, I as an individual Actuary would find it extremely difficult to give a certificate. If there are two defined contribution schemes and if the reorganisation involves the same Investment Manager then I think I might be happy in giving a certificate in those circumstances. But if it is a different Insurance Company, a different Investment Manager, different expenses involved, different discontinuance expenses I am not so happy. Moreover I am not so sure that as a profession we really should be going down that route. Certainly the comments will be taken account of and studied further by the Working Party.

I was a little bit disappointed that no one took up the point that Mr Lyburn made about earmarked funds for transferring members. This certainly is not an area that the Working Party considered and I think it is one that we need to look at further. Perhaps the answer there is to try to form the promise that is made to the individual, if there is some form of money purchase underpin based on the fund but even that has its complications, especially if you are dealing with large groups of people transferring. A money purchase underpin I think only really becomes meaningful if you are dealing with individual members.

I can see all sorts of problems with an earmarked fund as the numbers that have a part of that earmarked fund become fewer and fewer either through retirements, deaths or withdrawals from the company. At the end of the day we could be in a tontine situation with the last member getting everything, if that is not going to exceed Revenue maximum benefits. Certainly it is an area that I wish some people had commented on and the Working Party will certainly look at it again.

Another point that Mr Amy made was about deferred pensions. I think the situation here was that because of the tough Guidance Note no Actuary would give this certificate and therefore because the Actuary wasn't giving the certificate members would not give their consent to transfer and they would end up with deferred pensions. I cannot really believe this would happen because no matter what the final salary promise is going to be in the receiving scheme, more often than not I am sure it would be considerably better than the deferred pension. Even if bulk transfers without consent were vetoed completely there would need to be some further requirement that the other scheme had to provide better or equivalent benefits than the transferring scheme, unless there was further legislation to say that discontinuance benefits had to be the same as the ongoing final salary benefits.

I have tried to cover some of the points that were made tonight, but I am sure that we still have a little bit to go along the road before we get the final guidance.

Mr H. W. Brown, introducing the discussion, said:—Changes in what is now the Social Security Act 1990 which took place during the passage through Parliament have resulted in a requirement on schemes to use actuarial surpluses that arise after A-Day to provide Limited Price Indexing (LPI) on pensions currently in payment and the accrued pension rights as at A-Day of pensions for those not yet up to retirement age.

The Social Security Act of course already provides that the scheme should provide LPI for future service accrual after A-Day. Here again the DSS approached the Faculty and the Institute and asked whether they would be prepared to consider giving professional guidance as this is the DSS's preferred alternative to laying down the basis for the calculation of the surplus. As actuaries will be aware, the two Councils agreed in principal to go down this route and advised the DSS accordingly earlier this year.

It has been suggested that the Committee is being too rigid in laying down just one basis – the projected accrued benefit method – for the calculation of surpluses. The Working Party producing this document did consider this point very carefully but concluded that only one method should be allowed. Consideration was given by the Working Party of exceptions, the obvious one being the case of the closed scheme. The difficulty here is where to draw the line. A number of schemes are experiencing a drop in new entrants since the change in the legislation of no longer making entry to schemes compulsory and also the attraction to young employees of personal pensions. The Working Party therefore felt that exceptions and the use of more than one method left room for possible abuse.

EXD8 retains the same flexibility as is currently enjoyed by the profession for the future funding of the scheme and ensures that there is consistency between the funding assumptions and method, the actuarial certificate for disclosure purposes and the Guidance Note for future contribution requirements. This is covered in paragraph 3.2.

Paragraph 4.1 takes account of the concerns of those involved with small schemes, particularly insured schemes, whose experience by their very nature is likely to be volatile. It was felt inappropriate to allow an explicit margin, for example 5%, to cover those schemes, but conscious of the fact that whilst small insured schemes are excluded from the 1986 surplus regulations whereas they will be included in the current ones we felt that the Actuary could make an appropriate implicit allowance for the volatility of experience in the terms of the wording in paragraph 4.1.

Mr A. U. Lyburn said:—Without giving away too much of the discussion on Monday evening, paragraphs 3.2, 4.1 and 4.2 and their interplay came in for considerable comment. So much so in fact that they will certainly require to be amended. Further comments will clearly be welcome and on these grounds let me lead off.

If, as appears likely, we are confined to the use of one method, namely the projected accrued benefit method, there is concern regarding schemes which e.g. are closed to new entrants and which fund in such a way as to keep the contribution rate constant, thus enhancing the likelihood of increased surpluses in the early years following closure.

It has been suggested that paragraph 4.1 which states that the actuarial assumptions used "... should reflect the particular circumstances of the scheme" is designed to be sufficient to allow the actuary to make appropriate implicit margins. That would allow us to make implicit margins for small schemes but it would be no help for schemes closed to new entrants because the same assumptions, including implicit margins, have to be used whatever the method used for arriving at the contribution rate.

Mr T. M. Ross said:—I think it is very difficult to gauge the appropriate tone of both of these EXD7 and EXD8 without having a feel for what the Government is intending and what lies behind them. My own view from discussions that I had been involved in is that the Government's intention is in essence that pension funds which have surpluses should look after their pensioners before they take reductions in contributions. It is not that pensioners must get increases no matter what, I think it is the combination of the desirability of pension increases and where that should rank in relation to reductions in employer contributions and no more than that. That brings me to the use of the term 'realistic' in 4.1 and I now think that 'realistic' is rather too restrictive. If I may make a broader comment, I think that as a profession we do need to face up to the fact as the results of our work reach a wider audience. This is true of SSAP24. It is true of the bulk transfer guidance, it is true of GN11 and now the Guidance Note on surpluses. Because of the virtually total freedom which we have enjoyed for our own good, we have got to consider as a profession management and curtailment at the edges. This is a hard thing to say because total freedom to exercise professional judgement is obviously something that we must guard very jealously, but we must not put our heads in the sand. I think that if we guard it too jealously it may be removed from us totally. However, I think that 'realistic' is too strong a word and I do believe that here what we are seeking is something rather more like 'reasonable'. If I can draw parallel with the message in relation to the research done on the answers which are being found in practice in relation to individual transfer values in GN11, we have all been given quite a strong hint that if we are not somewhere reasonably near the middle we ought to be considering why not. I think that one needs to find a form of words in 4.1 that conveys that sort of intention rather than the much stronger word 'realistic' which I think is much too strong in the context of this Guidance Note and it might indeed fly in the face of some of the words in GN9.

I also have come to the conclusion that in 4.3 the provision that discretionary benefits should be left out of account in determining the surplus available does need to be revisited. It is perhaps confusing to many in the sense that the words used in 4.3 include 'promised' and a 'commitment' and 'discretionary'. I do not think it's helpful to have three different words of that kind.

Many pension schemes in my experience do make provision for early retirement (even although early retirement is not a promise being subject to consent) and I do believe that if there has been a long history of this and it is reasonable in relation to 4.1, to include it as part of the valuation basis, then that is fair enough. I also think that it is not inconsistent with what I perceive to be the Government's objectives funding sensibly for future benefits and not necessarily forcing the surplus to come out to give LPI quickly.

I therefore think that we should re-examine which discretionary benefits should be excluded, it seems obvious to me that pension increases should be.

Mr P. Randall F.I.A., said:—I am again speaking on behalf of my colleagues. I make no apologies for repeating points already made; it is important that the breadth of members' views is known.

On EXD8, our main criticism is of the unsatisfactory compromise I referred to earlier, between retaining maximum flexibility and meeting the Government's desire for pension increases to be guaranteed and paid wherever schemes can afford them from current funds. As between the two objectives, whilst we see some flexibility as being valuable we feel that too much will lead to conflicts of interest that would be difficult to resolve.

We hope, however, that the Regulations will make clear that the LPI provisions are not to apply to cases such as past Section 32 buy-outs. It would be a matter of great concern if this is not done.

We agree with the draft's prescription of the Projected Accrued Benefit method. On a detail, it would be helpful to refer, as in other guidance, to the Pension Fund Terminology Document.

The draft then specifies, by an unhappy combination of paragraphs 3.2 and 4.2, that the normal, disclosed funding assumptions should be used. 3.2 in particular is unhelpful. Its only apparent purpose is to enable paragraph 4.2 to refer to these assumptions, yet it appears in section 3 rather than section 4. 3.2 also refers to the funding method, which has no application in the whole of the draft, and it introduces a gratuitous and misleading reference to the standard contribution rate. It is important to realise that the legislation does not in any way directly control the level of employer contributions. We only have the very indirect requirement for the identified surpluses to be spent on pension increases as they arise.

Why not call a spade a spade, move the reference to funding assumptions, in simpler form, from 3.2 to 4.2, and delete the rest of 3.2 altogether?

The draft then implicitly recognises that a combination of weak funding method and strong funding assumptions could open the door to limited abuse, diluting the intended effect. To counter this, we have paragraph 4.1 which would require these actuarial assumptions to be 'realistic'.

This creates a fresh set of problems. To start with, it conflicts with the existing guidance in GN9, which requires that the Actuary should take a "prudent view of the future, without taking into account every conceivable unfavourable development." Moreover, the draft fails to give any guidance about what is meant by 'realistic', matters on which trustees and employers, for example, may hold different views.

There are similar, but lesser, problems with paragraph 5.1.

It is no help if the guidance is not capable of being interpreted sensibly and implemented by the ordinary practitioner. We think it would be better to retain the use of the funding assumptions, but drop 4.1 and the relevant part of 5.1, replacing them with a well-defined floor, by requiring that the surplus should be no less than the amount determined under the Inland Revenue regime. We stress that most funding bases will give answers well above this floor, and that it is only there as a more effective protection against abuse.

We do not think that the last sentence of paragraph 4.2 is helpful. If such short-term considerations do not form part of the funding assumptions, they should not be allowed to affect the estimate of long-term surplus to be applied to pensioners' increases.

Finally, having tried to avoid an over-prescriptive note, the authors have fallen into just that trap with paragraph 4.3. The requirement that no allowance may be made for discretionary enhanced early retirement pensions is more stringent than even the Inland Revenue surplus regime. If it is retained, it will mean that money which has already been set aside for the legitimate purpose of non-guaranteed early retirement benefits will be diverted to the very different purpose of guaranteed pension increases. In this uncertain, post-Barber phase it would be wrong for the Faculty and Institute to compound the political felony by forcing employers to guarantee every aspect of their discretionary early retirement terms just to be able to fund them properly.

I have a personal comment on which to close. I concur with much of Mr Brimblecombe's remarks in his introduction. I am sure it is right for the profession to give all the assistance we can to DSS in achieving better legislation. But we should stand back at the end, and be clear about whether the results of our efforts really are professional guidance, or whether they are quasi-regulations. In the second case, I believe it is often better for us to face up to the facts, to offer our work to DSS, but to say that it should appear in secondary legislation.

The test must be the character of the putative 'guidance', and the power we in fact have to determine its contents and to change it if we think this desirable or necessary. For my part, EXD8 in its essential form, unlike EXD7, fails this test, and would be better enacted in regulations. I think that fears about statutory valuation bases are overstated: it is the Inland Revenue who have more to gain from such a basis than DSS, and they have one on the statute book already.

Mr C. M. Stewart said:—Those who were at the Institute on Monday evening will know that I have already had the opportunity to speak on EXD8. I have been turning over in my mind what I said then and there was one aspect of EXD8 which I glossed over in half a dozen words which I think is very important. I should like to expand on that point this evening. It ties in with the latter part of Mr Randall's remarks.

It seems to me that there are really two questions to be answered on EXD8. Where should the line be drawn and who should draw it? The second question is at least as important than the first. A few years ago in the Pension Schemes Surpluses Regulations the Government itself drew the line above which surplus would be deemed excessive for tax purposes. The fact that the Government has not now simply made the award of pension increases on earlier service component a first charge on an excessive surplus is a clear indication to me that they wish the line to be drawn somewhat lower for this purpose, but where? I agree with the Joint Committee that this lower level should be based on the actuarial assumptions used for funding and disclosure. I also agree with them that this is as far as we should go on flexibility. There really has to be a single method, but which? The choice as I see it has to be between the defined accrued benefit method and the projected accrued benefit method which the Joint Committee have put forward. It is no secret that I would prefer the defined accrued method to be at the heart of our strategy for pension schemes for funding, disclosure and therefore for this purpose too.

Although as I explained in my earlier remarks this evening the defined accrued benefit method sometimes gives a higher accrued liability than the projected accrued benefit method, in the majority of cases at present it does not and it is therefore bound to be regarded as the method which squeezes out the most surplus.

We actuaries should not be deciding how hard to squeeze pension schemes. That is for the Government to decide. Before deciding which method should be specified in paragraph 3.1, we should really seek guidance from our clients – in this case the Government – as to their wishes. We could perhaps then add a few words at the beginning of this paragraph so that our guidance to members would then say "after consultation with the Government it has been concluded that the actuarial method to be used to value the accrued liability is the Defined Accrued Benefit Method" – or whatever. Only in this way can we avoid leaving ourselves open to criticism by pensioners with earlier service component that <u>we</u> hadn't squeezed hard enough or by clients that <u>we</u> had squeezed too hard or by the Government that <u>we</u> hadn't drawn the line where they had intended.

Perhaps all three would criticise us at one and the same time.

Mr G. G. Bannerman said:—What worries me about this situation is basically the suggestion that projected unit basis should be the only one to use.

We are asked by accountants to certify a contribution rate which is both stable from year to year and is based on realistic assumptions (the word 'realistic' comes through in EXD8 as well). Those assumptions are going to be stated in the company's accounts. In the disclosure statement the Actuary is required to state the contributions which he regards as adequate to maintain discontinuance solvency and to state the methods and assumptions he has used.

If you have two sets of assumptions that are in public documents I find it difficult at times to explain why they should be different and I would therefore expect to use the same assumptions in the disclosure ones as come up in the company accounts. If you have different ones the Unions are going to ask questions since they have access to both documents.

If there is a closed fund or a scheme with a low average age a contribution rate designed to achieve stability will be higher than the current cost. This means that if you start from a nil surplus position today you would maybe have a projection for about ten years, in three years time when you have your next valuation you will have put in more money that the pure current cost year by year. Therefore by definition in three years time if we use the method that is in the draft we are going to have a surplus. That surplus has to be distributed that puts the benefits up, that means that we now have to increase the contribution rate which was not the intention. Then you do it again in another three years and it has got to go up and up – its the opposite of the ever decreasing circles.

The accountants accept a level contribution basis, in fact they want it and companies tend to want to pay what the accountants say they ought to pay and the actuary says is the appropriate one. There is also a desire for flexibility, but under EXD8 we are bound hand and foot. Once the assumptions are set the surplus is fixed automatically regardless of the funding basis of the scheme. Don't think you can get away with this – it has been suggested that in a small scheme you might fiddle you assumptions or do something like that. If you do that then you have got to get an appropriate contribution rate again based on notes. What are the alternatives? We could propose a multi method approach but Council feel that this would be complicated. We could have different bases for the disclosure regulation statement from those used for SSAP24, but the public would raise questions.

The approach which I prefer is consistent with the Revenue's valuation of surplus regulations, namely the setting of a standard whether by the profession or by Government at a level at the top end of what is currently regarded as the range of acceptable valuation assumptions. Any surplus over this level would be required to be used to provide increases. But anything below it could be regarded as part of the normal working of the scheme. If the employer wished to use a surplus below this level for other purposes but not for a refund he would be free to do so. It is a strange logic but I feel that a fixed basis may actually give us greater flexibility.

The previous speaker raised an interesting point. Our client might be the Government. But it is a professional requirement that we should charge a fee to our client. Can we do this now?

Mr M. Little said:—I was pleased that we are able to use our own basis rather than a prescribed basis. I doubt if there is much scope for hiding surpluses because of the tie-in with the disclosure regulations although I suppose it could be done. There might be some pressure on the Actuary to dispose of a surplus temporarily but I just can't see it happening.

I might have liked some margin in the basis, say 5% below which surplus could be ignored. My main experience is with smallish insured schemes and from experience surpluses do fluctuate fairly wildly. I hadn't realised, as somebody said earlier, that Section 4.1 enables some discretion and perhaps that should have been amplified. However a 5% margin probably wouldn't be that valuable anyway because surpluses can easily be 6% so you are still left with this problem of very small excesses that you have got to get rid of.

I must admit I concur with an earlier speaker about paragraph 3.2. When I read it I didn't know why it was there and then deduced it was only there because it was referred to in 4.2 and 5.1 so maybe some re-drafting is required. I note that there was a lot of discussion on the use of the projected accrued benefits method and I wondered naively what other method could have been used, since that is the basis that I tend to use almost exclusively.

I would concur with Mr Ross that we need some amplification of what is promised or what is committed. The question of discretionary increases or provision for early retirement is a problem that we really need to sort out, otherwise the surplus will obviously be used for purposes for which it is not intended. I imagine some people would not like to go all the way of promising pension increases, although I suppose that the purpose of the Social Security Act is to give some firm commitment.

The President said:—Like some of the speakers I think it is a bit unfortunate that one has to read more into 4.1 than was obvious to me at least. I am rather keen on some kind of explicit contingency margins and a larger specific contingency margin might be appropriate for small schemes. I think one can visualize a relatively small scheme where perhaps the death or withdrawal of one or two members might well occasion a considerable surplus and instead of that they are going to have to use it to increase the benefits for the other members rather fortuitously. It rather reminds me of a tontine which concept interestingly came into Mr Brown's earlier remarks in a different context.

I would now ask Mr Brown to sum up the discussion on EXD8.

Mr H. W. Brown, closing the discussion, said:—It was heartening that a number of speakers agreed that one method should be defined in the draft Guidance Note and indeed with Mr Stewart's exception the method should be the projected accrued benefit method.

There were a number of points made that were common to a number of speakers and also common from the discussions that took place at the Institute on Monday. The question of closed schemes that Mr Lyburn mentioned in his remarks is one that has been given a lot of attention by the Working Party. We shall revisit it but I still have reservations about whether we can really do anything in this area without opening the flood gates to possible abuse.

Mr Bannerman was possibly also speaking about closed schemes. He confused me slightly when he started speaking about assumptions, assumptions in the company accounts for SSAP24 purposes and assumptions in the actuarial certificate for disclosure. Of course there is no reason why these assumptions cannot be the same and indeed the same assumptions that are used in this Guidance Note. But I think what he was really talking about was more the method as opposed to the assumptions and as far as increasing cost is concerned I did not really understand why that should be the case with whatever method is being used for future funding of accruing benefits, unless of course, the scheme is closed. Then you have an ageing population and if the reserve that has been built up in the past to maintain a level contribution throughout the lifetime of these people is treated as surplus and, I would agree that you are going to have an increasing contribution rate. In a scheme that is open to new members and assuming that the average age is going to remain constant, I cannot see why we should expect an increasing contributions rate but maybe I am missing a relevant point and I am sure some of my colleagues who were in the Working Party and who are here tonight will put me right.

A number of speakers spoke about a margin for small schemes. I still have concern about providing or putting a margin into a Guidance Note. The problem is that when you start speaking about margins in the funding level of 105% or 110% as being appropriate for a small scheme, where do you draw the line? How do you define what a small scheme is? Why should a large scheme not have that same margin built into it? When does a small scheme become a large scheme? It's the grey areas in between that create the problems but again it's a point that has been well noted and will certainly be revisited.

Mr Randall in his remarks covered a number of these points but also mentioned about the Inland Revenue regime and I think what he meant by that is the Finance Act 1986 surplus requirements. That was a blunt instrument that was introduced by the Revenue to catch schemes that were considerably overfunded and certainly would not be acceptable to the Government for this purpose. I am sure if we went down that route with our Guidance Note it would not be very long before the Guidance Note was overtaken by secondary legislation and maybe that is really what Mr Randall wants.

The Working Party has certainly been very happy to have the comments made by members tonight and we shall certainly endeavour to look at those and take account of the comments that have been made.

Mr R. E. Brimblecombe F.I.A., said:—Like Mr Brown I very much welcome the comments tonight which will obviously give the committee food for thought.

I just want to make one or two comments of my own on the various Exposure Drafts.

On EXD6, at the Institute Meeting on Monday, Graham Ward representing the Auditing Practice Committee did say that he was by and large happy with EXD6. We have formally sent it to the APC for comment and therefore Mr Stewart will perhaps be happy that if our interpretation of paragraph 88(h)(iii) is wrong no doubt they will tell us. The other point I do take on board very much is Mr Low's point about the inter-relationship between EXD6, 7 and 8.

On EXD7 our reference to expectations is because we colloquially refer to the OPB report as being one of the 'Rights and Expectations of pension scheme members' whereas of course the actual title referred to 'protecting members' rights'. Certainly our reference to it is fundamentally related to such items as discretionary pension increases and certainly the inter-relationship between what will become the Guidance Note and the Regulations is something we will have to sort out with the DSS. I agree entirely that the certificate should be smartened up and we will be working on that to make it more positive.

Several people made the point that in the commercial world it would be unfortunate for employers if they cannot continue to have bulk transfer values without consent but I made the point earlier on, that if there is a reduction in the number of them then I believe that that will not necessarily be a bad thing. Also even if we go for consents those people who feel that they are worse off if they transfer can alternatively take their money to a personal pension, particularly if as we expect over the next two or three years the right to a transfer value while still in service will extend to pre-1988 rights.

To answer Mr Lyburn's point on the relationship between the bulk transfer value proposals and the 1984 Regulations, as I understand it the draft Regulations that the OPB are looking at which introduce the requirements for actuarial certificates do in fact revoke the previous Regulations simultaneously.

On the question of money purchase schemes, I am of the personal view that bulk transfer values really ought to be allowed only if there is a transfer from one insured scheme to another insured scheme and the Insurance Companies are the same in both cases because only in that way can you fully protect the member's rights. I do firmly believe that, irrespective of the commercial decisions as to whether schemes want to tidy up things, it is up to our profession to realise that the purpose of the OPB report was to protect member's rights. It always slightly surprises me that members of our profession who go about their daily life relying on the professional expertise of other professions find it difficult when asked to stand in a similar position and protect the members of the public. I think members of the public in the situation where they are being transferred from one scheme to another particularly in circumstances of take-overs would look to us as a profession to protect their rights.

On EXD8, fundamentally we have to realise that the legislation is in place, that all surpluses should be used to provide LPI before anything else and I think our guidance when it comes out will really relate to the pace at which that happens rather than whether it will. One or two people did comment on the stand we were taking on discretionary benefits; again we will have a look at the wording there, but it is supposed to be an anti-avoidance provision to avoid actuaries being asked by employers to put margins in for various benefits which we were not actually promised, but I do take the point about early retirement.

Mr Brown has already commented about why we cannot go down the Inland Revenue route. I still believe that flexibility is better. We have to remind ourselves that since we persuaded the Government that transfer values should be the subject of professional guidance we have actually changed GN11 three times and I challenge anybody to try and persuade the Government to change Regulations three times in four or five years. Mr Bannerman's point about the push-me pull-you nature of the inter-relationship between surpluses and funding rates is of course a fundamental truth, hence my comment on the fact that the provision of LPI is basically a question of timing.

Generally I very much welcome the comments that have been made tonight – I do believe that professional guidance is the way forward. I take Mr Ross's point that it is a way in which the profession is in the driving seat to preserve our professional freedom and I think we should grasp that opportunity with both hands.

I would like to give personal thanks to Mr Brown, and Mr Wise in his absence, as Chairmen of the Working Parties for all the hard work they have done over a very short period of time to produce the guidance we have been discussing tonight and to members of the Committee for their help in getting the guidance so far.

The President said:—I know what it is like to be one of the authors of Draft Guidance because I was the Faculty representative on the Working Party that drafted GN11 and I can tell you that it is a pretty thankless task. We must therefore thank the members of the Pensions Joint Committee, especially the Working Parties and particularly Messrs Lyburn, Brown and Brimblecombe for attending here today and responding so well.

The following written contributions have been received.

Mr J. M. Brown wrote:—The proposals contained in the draft will be workable in most situations and place even more importance on sound actuarial judgement. This is obviously good for the profession and therefore my congratulations are extended to the authors in resolving what must have been a difficult problem.

My concerns are directed to two issues, which with luck, will not materialise. However, if they do, serious irreversible long-term decisions affecting potentially millions of people (not sufficiently fortunate to be in pension schemes paid for by public money) may be made on the basis of short-term temporary positions. This would be wrong and I suggest we have a responsibility to the public to minimise this risk.

1. Valuation of the Assets

It is widely accepted that market values at a valuation date can be irrelevant to the long-term funding of a scheme.

In particular circumstances it would be possible to value assets (for the purposes of long-term financing) at 125% of their market value – or even more if the markets were truly 'depressed'.

In such a situation, a scheme deemed to be in surplus (long-term financing) would have the surplus removed by awarding past service pension increases. However, the discontinuance position (measuring assets by market value) may not be so healthy and the very action of increasing past service benefits could jeopardise the discontinuance position. I have not done any detailed calculations, however I envisage in these circumstances a Company would be told "Congratulations, you have a surplus. The Social Security Act 1990 requires the surplus to be spent retrospectively on benefits which you voluntarily established for your employees. Unfortunately when you implement these statutory benefit improvements the Scheme will be technically insolvent on a wind-up and therefore you should make a special payment of £X million in order to alleviate the discontinuance position."

If presented with this message my conclusions would be:

(a) this is actuarial mumbo-jumbo in the extreme.

(b) the Company's pension scheme is financially unviable.

2. Removal of 'Surplus'

I am confident that this will be a common theme at the meeting. It is, perhaps, disappointing that the DSS is moving the goal-posts and considers 'surplus' to be something tangible which is a left-over in a bank account at the end of the month and not as a prudent cushion against adverse experience.

A scheme which utilises all of its 'surplus' at one valuation could suffer in the period to the next valuation – poor investment returns and high inflation are not a thing of the past. In the event of unfavourable experience during the inter-valuation period companies could be faced with a significant increase in their pension costs because of statutory improvements to past service benefits. Whilst it may be impractical to consider adopting yet another set of assumptions to measure surplus for the purposes of the Act an explicit margin of (say) 10% of liabilities may be sufficient to reduce this risk.

Without this safety-net Finance Directors of companies who voluntarily sponsor employee pension schemes will seriously reconsider the issue.

In conclusion, I suggest these proposals on the treatment of 'surplus', rather than meeting with the original intention of protecting pensions, will finally convince employers to abandon sponsorship of pension schemes and millions of pensioners will have to suffice with the provisions of the State.

Mr A. N. Walton wrote:—After the meeting, I realised that a point in respect of EXD7 had not been raised.

EXD7 is to cover those transfers without members' consents which are governed by the Regulations. Over the next year it is possible that a large number of transfers without consent will be where Trustees transfer members' benefits to non-profit deferred annuities with life assurance companies. To what extent is the exposure draft to be applied in these circumstances, or does it apply only to scheme to scheme transfers?

Mr J. Forrest wrote:—I write from the point of view of an Actuary who works with insured schemes many of which have a membership measured in 'tens' rather than 'hundreds'. These schemes have certain characteristics which lead me to conclude that EXD8 is unsatisfactory.

Small final salary schemes are particularly vulnerable to variation in experience; the funding of such schemes can be dominated by earnings growth for one or two individuals. If surplus is used up at one valuation then obviously scheme experience need only be adverse for a short period and the scheme will be in deficit, thus reducing the security of members' benefits and perhaps requiring a special contribution. It could be argued that since the surplus has been used to improve earlier service components then the members are in reality no worse off. This, however, depends on just how the surplus was applied to earlier service components and does not adequately cover the case where the employer decides that 'enough is enough' and terminates the scheme.

Secondly, I consider the discretion to be allowed to Trustees as described in Section 6.4 of EXD8 to be yet another administrative burden of small final salary schemes. Under EXD8 if I prepare a report which discloses a surplus I will then have to present options to the Trustees. I can envisage great difficulties in explaining to Trustees just what is going on. I do not relish the prospect of writing to Trustees along the lines of 'the contribution rate for your scheme has increased by 50%, there is a surplus of £X, how would you like the surplus used bearing in mind that it cannot be used to reduce future contribution?' No doubt best practice is for the Actuary to the scheme to meet the Trustees prior to preparing a final report and to discuss matters such as valuation assumptions and how the Trustees might want to exercise a discretion with regard to any emerging surplus. Such a meeting is a luxury not often allowed to the Actuary of an insured scheme.

Thirdly, I believe that difficulties will arise when pensions have been 'bought out' with an insurance company. Not infrequently Trustees exercise the Open Market Option and buy-out the pension with an insurance company other than the main insurer. I can foresee problems in deciding just how the cost of LPI on such a 'bought out' pension is to be calculated. Do the main insurers set up a small amount of additional pension? It is expensive to administer small pensions and they may also be subject to an extra charge because of their size. I can imagine that the pensioner would prefer that all his pension be paid from the same source. Of course, it may be that the insurer of the 'bought out' pension would be willing to augment the pension without an extra administration charge, but presumably the Actuary to the main scheme will have to determine whether this is the case at each valuation and perhaps check annuity rates as well. This amount of work is not going to look well against the charging structures with which I am familiar.

I suggest that one way to avoid excessive administrative work and keep funding on a sound basis is to adopt the same procedure for determining surplus under SSA90 as is used for FA86, i.e. use the basis prescribed in JOM82 including the 5% margin. While on the subject of JOM82, I would draw attention to paragraph 5 (ii) of this document. This is the paragraph which effectively exempts insured schemes from the surplus regulations of FA86. I have heard various comments about this particular paragraph none of which I wish to repeat here, I only wish to comment that I find it a very useful provision and consider that a similar provision should appear on any JOM relating to surplus under SSA90.

ACCOUNTING FOR PENSION COSTS UNDER SSAP24 (EXD6)

Classification (see APC)
This Guidance Note is classified in relation to the code of professional conduct as *best practice.*

Scope
United Kingdom and abroad as required by SSAP24.

Application
Any Actuary responsible for calculating pension costs and related disclosures which are to be stated in the company's accounts.

Regulatory Framework
This Guidance Note must be read in conjunction with SSAP24, of which relevant paragraph numbers are noted in the margin.

(1) Statement of Standard Accounting Practice No. 24 applies to the accounting for pension costs in accounting periods starting on or after 1 July, 1988. In relation to defined benefit pension schemes the Statement requires that actuarial calculations of pension cost and of other figures to be disclosed should be made in accordance with the stated accounting principles.

Relationship with Client
(2) The information presented in a company's accounts is the responsibility of the directors of the company subject to the audit procedure. The role of the Actuary in relation to SSAP24 is to consult with the company, taking account of its circumstances and its workforce, to settle the principles and assumptions to be followed and to calculate the required figures. The client in this respect is the company, not the scheme trustees. An Actuary who is advising both the scheme trustees and the company has two distinct clients.

(3) Normal professional principles apply: in particular the Actuary should ensure that his client is given sufficient information to enable the expected future course of the pension cost to be appreciated, having regard to the method chosen for spreading variations in cost.

(4) The attention of the client should be directed to those assumptions to which the pension cost is sensitive. The Actuary should ensure that he is aware of changes in benefits, membership and any other relevant factors after the date of the last valuation and should take due account of any expected changes in the future. Benefits to be assessed include lump sums and any other scheme benefits not specifically referred to in SSAP24. The cost of administration expenses which are borne by the schemes should also be included. Members should bear in mind their responsibilities to the various users

of company accounts who may place reliance on their professional judgement and calculations (see *D/73 to D/79 of the Institute Members' Handbook and C/79 of the Faculty Handbook).

(5) In some cases an Actuary advises a subsidiary and its pension scheme within a group of companies but not the parent company, or vice versa. This situation can apply in particular with multi-national groups with various Actuaries advising foreign schemes which are to be accounted for in accordance with the standard. Whatever the situation it is fundamental that all concerned are clear as to who is the client.

Relationship with the Auditor

(6) The Auditor is concerned with the overall application of the standard and will need to satisfy himself that the Actuary has worked within the framework laid down in the standard. He may require a full description of the approach taken including, for example, the methods and assumptions adopted, the treatment of variations from regular cost and, if this is not clear, whether the method and assumptions taken as a whole lead to the Actuary's best estimate of cost. The Actuary has no direct relationship with the Auditor but in practice communication between them will be helpful and the Actuary can, with the consent of his client, provide such information as is reasonably requested by the Auditor. Accounting Practice Note 2 deals with the liaison between the Actuary and the Auditor in relation to SSAP24.

Materiality

(7) The Actuary may judge the significance of detail in his calculations relative to the results, but is not in a position to judge the materiality of pension costs and of the relevant disclosures under SSAP24 relative to the company's accounts as a whole. The client should be asked for instructions if the need for particular calculations is unclear. An actuarial method and assumptions which might otherwise be unsatisfactory for SSAP24 may in fact be acceptable where the magnitude of the assessed pension cost, or the magnitude of the difference relative to a valid method, is not regarded by the company and Auditor as material in the company's accounts.

Pension Cost

8) SSAP24 requires disclosure of the pension cost charge for the period. The basic requirements are:

79 (a) For defined benefit schemes the pension cost should be calculated using actuarial valuation methods which are consistent with the requirements of SSAP24.

(b) The actuarial assumptions and method, taken as a whole, should be compatible and should lead to the Actuary's best estimate of the cost of providing the pension benefits promised.

(c) The method of providing for expected pension costs over the service lives of employees in the scheme should be such that the regular pension cost is a

* Renumbered D/121 to D/127 in Supplement 13 to Handbook.

substantially level percentage of the current and expected future pensionable payroll in the light of the current actuarial assumptions.

72 (9) The regular cost is defined in the Statement as the consistent ongoing cost recognised under the actuarial method used. This should normally be equated to the standard contribution rate as defined in Pension Fund Terminology (See *D/81 to D/84 of the Institute Members' Handbook and C/59 to C/63 of the Faculty Members' Handbook). The definition of the standard contribution rate for any actuarial method implies that the rate is subject to re-calculation at every actuarial valuation.

(10) Companies may operate more than one pension scheme, or different pension arrangements (including different accrual scales) within the same scheme. Pension cost may be assessed separately for each pension arrangement and, if appropriate, different actuarial methods and assumptions may be used for the different arrangements.

20 (11) The pension cost for a year is the regular cost adjusted by any variation in cost. Subject to exceptions stated in SSAP24, variations in cost are spread over expected remaining service lives or an equivalent average period. There are different methods of spreading variations, the essential requirements being that the cost of pensions is recognised on a systematic and rational basis. Several methods of spreading meet this requirement, notably percentage of pensionable payroll, fixed annual charge, equal instalments of capital plus reducing interest, and instalments of capital reducing in proportion to expected future residual membership plus reducing interest. The Actuary should make clear to his client which method is being used for the calculations.

(12) In calculating an average period of remaining service lives, the weightings used should be consistent with the assumptions used in the calculation of regular cost. If the fixed annual charge method were used for spreading variations, it would be appropriate to exclude current and projected future pay levels from the weightings used in calculating the average period of remaining service lives.

Validity of the Actuarial Methods

(13) A range of actuarial methods has been developed, primarily for funding purposes, in response to the varying circumstances of individual pension funds. The selection of the appropriate method for a set of particular circumstances is an important area for the exercise of professional judgement. It is not the case that all possible methods are equally suitable for all situations and the following paragraphs set out certain combinations of method and situation which do not satisfy the criteria for best practice in relation to SSAP24.

(14) The Entry Age Method is unsatisfactory if the standard contribution rate is based on a weighted average of rates applicable to existing members of the scheme and the weights are likely to change in respect of future entrants. A change might for example be foreseeable because:

* Renumbered D/129 to D/132 in Supplement 13 to Handbook.

(a) new entrants join at ages which are on average either higher or lower than the ages at which existing members joined; or

(b) new entrants are admitted on a pension scale which is materially different in cost from that of current members who joined on another scale.

(15) The Attained Age Method is unsatisfactory in the following circumstances:

(a) A scheme with a regular and significant flow of new entrants where the payment of the standard contribution rate in respect of the new entrants is expected to create material surpluses.

(b) A scheme which is or will be closed to new entrants when the standard contribution rate is expected to increase materially at each succeeding valuation. (However the method can be satisfactory for a closed scheme when this regular cost is based upon the standard contribution rate calculated in respect of the membership present at the time when the scheme was closed).

(16) The Projected Unit Method is unsatisfactory if it is evident from the circumstances that the standard contribution rate is likely to change materially in future years. A change might, for example, be foreseeable because:

(a) the scheme is or will be closed to new entrants; or

(b) new entrants are admitted on a pension scale which is materially different in cost from that of current members who joined on another scale.

(17) The Current Unit Method is unsatisfactory if used without a control period of adequate length as set out in paragraph (19), or if it is evident from the circumstances that the standard contribution rate is likely to change materially in future years. A change might for example be foreseeable:

(a) if the scheme is or will be closed to new entrants or if new entrants are admitted on a pension scale which is materially different in cost from that of current members who joined on another scale; or

(b) as an effect of future pay increases upon accrued pension rights.

(18) The Aggregate Method has no standard contribution rate but is often perceived as a variant of the Attained Age Method for the purposes of assessing pension cost and, as such, its validity is as described in paragraph (15). It is also a variant of the Entry Age Method, the validity of which is described in paragraph (14). Where the regular cost is required explicitly in terms of the standard contribution rate, it is appropriate to substitute either the Attained Age Method, if it is considered suitable for the purpose, or the Entry Age Method in place of the Aggregate Method. (The regular cost may not always be required, and where this is so in relation to a scheme which is closed to new entrants the Aggregate Method may be entirely suitable).

(19) Methods with control periods. The above methods may be modified by the use of a control period. A method which is used with a control period of adequate length may

be satisfactory for the purposes of SSAP24 when, in the circumstances, the method would be unsatisfactory otherwise. A control period can be regarded as of adequate length if:

(a) the resulting standard contribution rate to which the regular cost is to be equated is not altered materially by extending the control period, and

(b) the calculation of that rate makes specific provision for future increases in earnings not materially different from a full provision for expected future increases in earnings including merit increases.

(20) Actuarial methods in general. The Pension Fund Terminology does not list all possible actuarial methods and further guidance should be sought from the Faculty or Institute about the general validity for the purpose of SSAP24 of any method which is not specifically dealt with above.

Actuarial Assumptions

(21) The selection of actuarial assumptions to be used in assessing pension cost for SSAP24 purposes is a matter of judgement for the Actuary in consultation with the company. The actuarial assumptions and the actuarial method taken as a whole should be compatible and lead to the Actuary's best estimate of the cost of providing the benefits promised.

(22) The method and assumptions used for SSAP24 may well differ from those used for funding purposes because of factors which may be relevant to funding but which are not relevant to SSAP24. The Actuary should be prepared to explain to his client any difference between the approaches for funding and SSAP24.

(23) There can be no uniquely correct assumptions in most cases and SSAP24 does not require the Actuary to make his best estimates of all the individual financial and demographic factors. Nevertheless a notional yardstick against which a basis of assumptions could be judged is one in which each assumption is taken from a narrow range within which it satisfies the description of being a best estimate. It is not inappropriate to adopt assumptions which, taken together, are somewhat more likely to lead to surplus rather than deficiency at future valuations, this being in accordance with the accounting convention of prudence. However it is not satisfactory to use significant margins which are likely to lead to future surpluses or deficits which are material in the sense of paragraph (7).

(24) As implied by paragraph (29) it is necessary to disclose levels of funding independently of the actuarial method which is used to derive the pension cost. Because of this, the basis of financial and demographic assumptions should meet the requirement of providing a best estimate when considered in isolation from the actuarial method of costing. This is a more stringent condition that the one stated in SSAP24 paragraph 79.

Prepayments and Provisions

(25) When calculating a variation in pension cost or a cumulative adjustment in respect of prior years (see SSAP24 paragraph 53) any pension prepayment already

shown in the company's balance sheet should be deducted from the value of the scheme assets to avoid double counting. Likewise any pension provision should be treated as an addition to the scheme assets. These adjustments to the value of scheme assets are not applicable to credit or debit positions between the company and the pension scheme to the extent that these positions are already recognised in the scheme's balance sheet. Nor are they applicable to the disclosures referred to below.

Disclosures

88(g) (26) SSAP24 requires disclosure of any deficiency of assets to meet accrued benefits based, for members in pensionable service, on pensionable service to and pensionable earnings at the date of valuation including revaluation on the statutory basis or such higher basis as has been promised. Market related investment assumptions may be used for the calculation if this is more appropriate than the assumptions used for calculating pension cost. If the result differs according to the rule under which the benefits are assumed to be payable (noting in particular the choice between early leaver and scheme termination rules) then the Actuary should draw attention to the difference and if necessary provide the information for the alternative approaches.

88(h) (i) (27) The Statement requires disclosure of the actuarial method and main actuarial assumptions used at the most recent formal actuarial valuation or later formal review of the scheme on an ongoing basis. When the method and assumptions used for SSAP24 differ from those used for funding purposes (see paragraph 22) then the method and assumptions to be disclosed are those pertaining to SSAP24, being those used for the latest formal review for the company.

(28) The degree of disclosure should be consistent with the requirements, in relation to funding, of the Disclosure Regulations and GN9. If a control period is used and is a significant factor in the calculations then, in accordance with the approach of GN9, this should be disclosed as a part of the method and assumptions along with any other such aspects such as allowance made for new entrants.

88(h) (iii) (29) The Statement requires disclosure of the level of funding in percentage terms, based on the most recent formal actuarial valuation or later formal review of the scheme on an ongoing basis. The appropriate value of the accrued liabilities for this purpose is that given by the Projected Accrued Benefit Method, using the same assumptions as those used to derive the pension cost.

(30) Unless either the Projected Unit or the Attained Age Method is being used for funding, part or all of any surplus of deficiency to be disclosed under 88(h)(iii) will be attributable to the use of the Projected Accrued Benefit Method for the disclosure. It would be appropriate to include a comment to this effect along with any other comments called for by 88(h)(iv) on material surplus or deficiency disclosed.

(31) The responsibility for the disclosures required under SSAP24 rests with the employer. If an Actuary is asked to produce draft wording he should ensure that his draft complies with the provisions of SSAP24. The draft wording should aim to give the user

of the financial statements a proper understanding of the impact of the pension arrangements on the employer's financial statements. If the actuarial method for determining the pension cost is not precisely defined by reference to Pension Fund Terminology, a clear and accurate description of the method should be given. Actuarial values of liabilities, surplus or deficiency should not be quoted in the disclosures unless either:

(a) those values are properly to be compared with the market value of assets at the date of valuation; or

(b) the difference, if any, between market and actuarial value of assets is explained in the disclosures.

RETIREMENT BENEFITS SCHEMES – BULK TRANSFERS (EXD7)

Classification (see APC)
This Guidance Note is classified in relation to the code of professional conduct as *mandatory*.

Scope
United Kingdom.

Application
Any Actuary responsible for giving advice to the Trustees of a UK Pension Scheme.

Legislation or Authority
This Guidance Note must be read in conjunction Regulations . . .

1. INTRODUCTION

1.1 On occasion the Trustees of a retirement benefits scheme may wish to pay a bulk transfer value. The transfer can take place with or without the members' consents. Where the Trustees require the transfer to take place without the members' consents the transfer is governed by Regulations . . . and this Guidance Note must be read in conjunction with those Regulations.

1.2 The Regulations are designed to protect the rights and expectations of the members who are being transferred without their consent. This Guidance Note relates to the certificate that is required to be given under the Regulations.

1.3 The certificate which will be addressed to the Trustees should be given by the Actuary of the transferring scheme on the request of the Trustees. In the absence of such a certificate, the Trustees of the transferring scheme will not be able to pay a bulk transfer value without members' consents.

1.4 The Actuary has an obligation to explain to the Trustees of the transferring scheme the scope and the limitations of the certificate. In particular, the Trustees must be made aware that it is <u>their</u> decision to pay a bulk transfer value without members' consents and that the certificate should not be taken as the power or their authority to so do. The Trustees may have to carry out other investigations for this purpose.

1.5 The certificate should not only cover active members but also members with deferred pensions and current pensioners if the bulk transfer value is to include their rights and expectations.

2. GENERAL CONDITIONS

2.1 The Actuary must satisfy himself before giving the certificate that the members who are to be transferred in the above circumstances acquire past service rights and expectations in the receiving scheme at least broadly equivalent to those given up in the transferring scheme, taking account of any pension increases whether promised or part of a regular practice. Subject to paragraph 3.4, the equivalence should be assessed on the basis of the benefits as a whole and the membership as a whole, and not on an individual basis.

2.2 In giving the certificate, the Actuary does not need to ensure that every individual member's expectations are preserved in full. An Actuary signing the certificate should be careful not to give this impression whilst acting in this capacity.

2.3 The Actuary need not consider, in giving the certificate, the pension terms and conditions or future service benefits under the receiving scheme compared with those that would have existed under the transferring scheme.

3. CERTIFICATION

3.1 Although the Actuary giving the certificate is likely to know what the benefits, terms and practices are within the transferring scheme, he will need to determine what these are in the receiving scheme.

3.2 It is the responsibility of the Actuary of the transferring scheme to obtain information, including actuarial information and benefit practices, about the receiving scheme. In signing the certificate, the Actuary, having taken whatever steps he feels are reasonable to obtain this information, will only be able to accept responsibility for the certificate based on the information that has been provided to him and has been summarised by him on his certificate. If, in the opinion of the Actuary, he has not been provided with sufficient information to enable him to carry out a proper assessment, he will not be able to give the certificate.

3.3 To enable the Actuary of the transferring scheme to give the certificate, he will need to be satisfied that the value of the past service benefits in the receiving scheme is not less than the value of the past service benefits in the transferring scheme.

3.4 The benefits in the receiving scheme do not need to mirror those of the transferring scheme for the Actuary to give the certificate. However, the Actuary will need to satisfy himself that different categories of members, beneficiaries and contingent beneficiaries (e.g. having regard to members with different levels and types of benefits, members with materially different salary levels and members in different age groups) do not have materially inferior benefits in the receiving scheme.

3.5 The Actuary will also need to be satisfied that on wind up the appropriate rules of the schemes, including the rule regarding the disposal of any surplus, provide benefits for different categories of members in the receiving scheme at least broadly equivalent to those under the transferring scheme. In particular, if the transferring scheme has surplus on wind up and the rules require this surplus to be used for the benefit of the members whilst the receiving scheme provides the same level of promised benefits, but does not require surplus to be used for members' benefits, it is unlikely that the Actuary would be able to complete the certificate.

3.6 The Actuary is not, in giving the certificate, required to take into account the financial strengths of the principal or participating employers or of the transferring or receiving schemes, except in as far as the financial strengths of the schemes affect the benefit expectations of the transferring members.

3.7 Generally, different considerations apply in Defined Contribution Schemes. A certificate is therefore unlikely to be given, unless in exceptional circumstances, in transfers where at least one of the schemes is a Defined Contribution Scheme.

4. DISCLOSURE

4.1 The certificate should give a list of the documents and/or give a summary of the information, for both the transferring and receiving schemes, that have been taken account of by the Actuary in giving the certificate.

4.2 The items taken into account that need to be disclosed are listed below.

Broad Groups

4.3 A brief explanation of the different categories of members and beneficiaries that have been taken into account should be given. (See paragraph 3.4).

Benefits

4.4 The promised benefits under the schemes should either be briefly described or reference made to the appropriate scheme documents.

4.5 Any discretionary benefits that have been awarded as a regular practice which members would reasonably count as an expectation and which it is assumed will continue as a practice in the future, and have been taken account of for the purposes of the certificate, should be recorded.

4.6 Any other benefits which have been taken account of for the purposes of the certificate need to be recorded.

Actuarial Method

4.7 The actuarial method that has been used to determine the equivalence in giving the certificate needs to be stated.

Actuarial Assumptions

4.8 The key actuarial assumptions that have been used to value the benefits in giving the certificate need to be recorded. Particular mention should be made of the assumptions that were used for valuing any benefits not promised under the schemes. Reference to a document (e.g. valuation report) listing these assumptions would be sufficient.

Other Assumptions

4.9 A brief summary of any other assumptions that have been made in giving the certificate should be stated.

DRAFT CERTIFICATE

To: The Trustees of the Transferring Scheme.

Having been requested by the Trustees of the transferring scheme this certificate is given in accordance with Regulations .... dealing with bulk transfers without members' consents.

In giving this certificate, no account has been taken of the financial strengths of the principal or participating employers of the transferring or receiving schemes or of the schemes themselves, except in as far as the financial strengths of the schemes affect the benefit expectations of the transferring members.

Name of Transferring Scheme ....
Inland Revenue Reference Number ....
OPB Reference Number ....

Name of Receiving Scheme ....
Inland Revenue Reference Number ....
OPB Reference Number ....

I hereby certify that in my opinion, having taken account of the information listed overleaf, there are no actuarial reasons why the Trustees may not, if they have the power under the rules of the scheme and they so decide, pay a bulk transfer value without the members' consents.

In giving this certificate I have taken account of the following:

(i) Description of broad groups of Transferring Members.

(ii) Description of Benefits of Transferring Scheme.

(iii) Description of Benefits of Receiving Scheme.

(iv) Actuarial Method.

(v) Actuarial Assumptions.

(vi) Other Assumptions.

This certificate is valid only in respect of the above Regulations and if there are no changes in the benefits and basis of transfer described above and if the bulk transfer specified above takes place within three months of the date of signing below, otherwise a fresh certificate will need to be obtained if the bulk transfer without members' consents is to proceed.

Signature	Date ....
Name	Qualification ....
Address	Name of Employer (if applicable) ....

RETIREMENT BENEFITS SCHEMES – GUARANTEED PENSION INCREASES FROM SURPLUSES (EXD8)

Classification (see APC)
This Guidance Note is classified in relation to the code of professional conduct as *mandatory*.

Scope
United Kingdom.

Application
Any Actuary responsible for giving advice to the Trustees of a UK Pension Scheme.

Legislation or Authority
This Guidance Note must be read in conjunction Regulations . . .

1. INTRODUCTION

1.1 This Guidance Note applies to the methods and assumptions that are to be used for the determination of surplus and the application of such surplus for the provision of guaranteed pension increases, as required under Regulations . . . . This Guidance Note must be read in conjunction with these Regulations.

1.2 The Guidance Note applies to all retirement benefit schemes in the United Kingdom to which the Regulations apply, unless the schemes already promise pension increases at or better than 5% per annum compound or the Retail Price Index if less.

1.3 Although the Guidance Note principally relates to defined benefit schemes it should also be complied with in the case of other types of retirement benefits schemes where the circumstances are appropriate.

2. PURPOSE OF THE GUIDELINES

2.1 The purpose of the guidelines is to ensure, when a surplus is disclosed by an actuarial valuation to which GN9 applies on the basis outlined in these guidelines, that the Actuary determines and reports to the Trustees the future rate of guaranteed pension increases per annum compound that needs to be promised under the rules of the scheme for 'earlier service component' as defined in the Regulations mentioned above.

3. ACTUARIAL METHODS

3.1 The actuarial method to be used to value the accrued liability is the Projected Accrued Benefit Method.

3.2 The actuarial method to be used to determine the standard contribution rate will be the method used for the purposes of Section 2 and Section 3 of the Actuarial Statement required under Regulation 8(7) and Schedule 4 to the Occupational Pension Schemes (Disclosure of Information) Regulations 1986 (SI 1986/1046), as amended by the Occupational Pension Schemes (Disclosure of Information) (Amendment) Regulations 1986 (SI 1986/1717).

4. ACTUARIAL ASSUMPTIONS

4.1 The actuarial assumptions used must be realistic and bear a reasonable relationship to each other and should reflect the particular circumstances of the scheme.

4.2 The actuarial assumptions used to determine the amount of surplus and to value the guaranteed pension increases must be the same as those used for the Actuarial Statement referred to in Section 3.2 above. If the guaranteed pension increases are to be insured it is acceptable to treat the value of the guaranteed pension increase as the appropriate insurance cost.

4.3 In the calculation of the accrued liability, only those benefits that are promised under the retirement benefits scheme will be taken account of. No allowance can be taken for this purpose, in the actuarial assumptions or otherwise, of benefits that are not promised under the scheme, but for which advance funding provision has been or is being made (e.g. funding for discretionary post retirement pension increases or enhanced early retirement pensions), unless a commitment has been made to the members to provide those benefits.

5. VALUATION OF THE ASSETS

5.1 The basis used for the valuation of the assets of the scheme should be consistent with the basis used for the valuation of the accrued liability and the same as that employed by the Actuary for the purposes of the Actuarial Statement referred to in Section 3.2 above.

6. GUARANTEED PENSION INCREASES

6.1 If the value of the assets calculated as in paragraph 5.1 is greater than the value of the accrued liability on the aforementioned basis, the difference is termed the surplus for the purposes of this Guidance Note.

6.2 If the value of the additional accrued liability arising from the provision of Limited Price Indexation (LPI) for all categories of membership (as defined in the aforementioned Regulations) for earlier service component is less than the amount of the surplus, as calculated in paragraph 6.1, the Actuary will confirm to the Trustees that LPI can be provided from the surplus.

6.3 When the amount of surplus determined by the Actuary, using the above basis, is not sufficient to provide LPI for all categories of membership in respect of earlier service component, a lower rate will be calculated by the Actuary for all categories of membership, such that when this rate is applied to earlier service component the value of the additional liability created will be equal to the surplus determined in the basis. The Actuary will confirm the lower rate to the Trustees. The Regulations allow certain rounding of the rate for practical purposes in these circumstances.

6.4 Under the Regulations, when the surplus determined by the Actuary on the above basis is not sufficient to provide full LPI for all categories of membership, the Trustees of the retirement benefits scheme may exercise discretion and treat the category of members receiving pensions or members over a certain age, together with any contingent spouses' pensions, as a priority class for LPI. Any balance of surplus after providing full LPI for this priority class would be applied across the board for all other categories of members.

6.5 If the Trustees exercise the discretion under paragraph 6.4 and direct the Actuary accordingly, the Actuary should ignore paragraph 6.3 above and calculate the lower rate that is to apply to all other categories of members if there is surplus remaining after those members in the priority class have been provided with LPI. If the surplus is not sufficient in these circumstances to provide full LPI for those members in the priority class, the Actuary will calculate the lower rate that will apply to this category. The Actuary will confirm the appropriate rates to the Trustees.

6.6 In determining the rate of increase in paragraph 6.2 to 6.5, the Actuary will take due allowance for any increases already promised under the scheme, including any LPI or such lower rate increases awarded at previous valuations.