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Consultation Response
Pension Protection Fund

Consultation on Funding Determinations and amendments to section 151 in the Pension Protection Fund (Miscellaneous Amendments) Regulations 2012

27 July 2012

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Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

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Dear Stephen

Response: Consultation on Funding Determinations and amendments to section 151 in the Pension Protection Fund (Miscellaneous Amendments) Regulations 2012

As discussed when we met, we welcome what the PPF is trying to achieve with the introduction of Funding Determinations, and with the pragmatic approach being taken. Our only concern is that the wording of the certificate expected to be provided by the actuary should not imply greater certainty than actually achievable, bearing in mind the approximate nature of the calculations that will be undertaken.

It will be helpful if the PPF issues guidance setting out what factors the actuary is expected to allow for (and what factors the actuary can ignore) in carrying out the approximate conversion from the previous s179 valuation to estimated s143 liabilities at that earlier date and in rolling forward the result to the required date.

We acknowledge that in relation to some issues it will be possible for the actuary to make safe side approximations for the likely impact. This might, for example, include the impact of members passing normal retirement age for example. As discussed in the consultation paper, whether it is "safe side" to understate or overstate the likely impact will depend on whether the actuary is being asked to assess whether the estimated funding level is below 90% or is being asked to assess whether the estimated funding level is above 100%.

However, as well as these "known unknowns" (as the jargon has it) there are also "unknown unknowns" for which it may not be practical for the actuary to make safe side estimates. Depending on the data available at the date the actuary is performing these calculations, such factors could include the impact of deaths since the previous valuation date (in a small scheme, the death of the former managing director could have a large impact), the effect of individual pay increases since the previous valuation date, or the amount included within the previous valuation results in respect of previous benefit improvements or benefit augmentations which fall away for the s143 calculations.

As discussed, we therefore believe that it would be appropriate for the certification by the actuary to be along the lines of, "In my opinion, based on approximate calculations, it is likely that ..." together with scope for the actuary to explain what has and has not been allowed for in the approximate calculations. This might be by reference to an exchange of correspondence with the PPF agreeing the approximations to be made (as discussed in the consultation paper).

As we noted when we met, we think it is important that there is a single statement by the actuary relating to the funding level, rather than separate statements referring to the amount of each of the assets and liabilities, due to it being both inappropriate for the actuary to certify an unaudited asset value and undesirable for them to certify a potentially very approximate liability amount.

As discussed, our concerns become much greater the tighter the margins become and clearly it is preferable to use approximations to certify that the underlying position is outside a wide range from the 90%/100% position – for example, outside the range 50% to 150%. If at the extreme, the PPF intends to apply the approach to schemes where the true s143 funding level may be only just under 90% or only just over 100%, we would be much less comfortable and in these circumstances we believe it would become even more important for actuaries to be able to rely on explicit guidance on the nature of the permissible approximations. Although of course, very explicit guidance might outweigh the benefits of the approximate approach.

Yours sincerely

Martin Lowes
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Institute and Faculty of Actuaries