

The Actuarial Profession  
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# The 2004 Pensions Convention

7-8 June 2004, Sheraton Skyline Hotel, Heathrow

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## Setting Valuation Bases

### The Role of Professional Guidance

- Why professional guidance?
- Problems with traditional methods
- GN 34 (dc illustrations)
- The Regulation 30 Statement
- Development of GN 9 version 7.0
- Challenges for the future



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## Caveats

Comments may not reflect the views of:

- The Institute
- The Pensions Board
- The Guidance Committee
- My employer
- Me



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## Royal Charter

*The responsibility attaching to the profession of an Actuary is consequently great, requiring the services of well-educated and trustworthy men, specially trained in Actuarial business and calculations, more especially as the subject of their professional study is one with which the general public are most entirely unacquainted, and in which, therefore, they must be wholly dependent upon the skill and integrity of the Actuary employed.*



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## Public interest responsibility (Institute website)

**The Actuarial Profession's public interest responsibility falls into three key areas:**

- Education, which creates and maintains qualified actuaries to serve the public
- Setting standards to influence the quality of actuarial work performed
- Taking action - directly or by seeking change by others - on public interest issues

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## Purpose of a Profession

- Maintain quality of advice (value of FIA/FFA)
  - Education / examination / CPD
  - Standards / peer review / disciplinary procedures
- Help members
  - Limit commercial pressure (level playing field)?
  - Scope of advice / responsibility for decisions?
  - Seek statutory roles?
  - Interaction with other professions?

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## Professional standards

Maintain quality of advice

- Necessary in actuarial areas
  - Reflect best practice
- Dangerous in other areas
  - Tertiary legislation
  - Legal / audit
- Is the actuarial profession in a position to judge what is in the public interest and, if so, are we doing this?

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## Professional conduct standards

“Advice should normally include sufficient information and discussion about each relevant factor and about the results of the members investigations to enable the intended recipient of the advice to judge both the appropriateness of the recommendations and the implications of accepting them, including .....the implications for .....the beneficiaries of the retirement arrangement....”

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## General problems

“Mr Micawber was waiting for me within the gate (*of the debtors prison*) and we went up to his room and cried very much. He solemnly conjured me to observe that, if a man had £20 a year for his income, and spent £19 19s 6d, he would be happy, but that if he spent £20 1s, he would be miserable”



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## General problem Asymmetric outcomes

- Favourable experience good
- Unfavourable experience catastrophic
- Use of utility functions?
  - Difficult to measure / communicate

Guidance to ensure consequences of unfavourable outcomes are understood?

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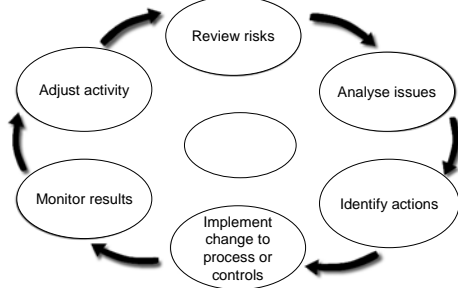
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## Actuarial control cycle



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## Oil-tankers

In some situations, it is very difficult to change course.



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## General problem

### Actuarial control cycle/oil-tankers

- At some point opportunity to correct is lost
  - Individual – too close to retirement
  - Company – deficit contributions unbearable
  - Avoid further investment risk?
  - Reduce benefits/expectations?

Guidance to ensure limitations of control cycle are understood?

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## Pension Board

### Role (from website)

- The Board gives strategic direction to the profession's activities in the pensions arena

### Purpose (presentation to ACA)

- High Standards
  - Guidance
  - Education and CPD
- Public Interest
- Plan of Action

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## GN34: Illustration of dc benefits

### Central issue: the value of a defined benefit

(...sufficient information is given to enable the recipient to appreciate the risks involved in a dc arrangement)

- Initiated following concern about advice to members on transfers from db to dc
- Difficulties:
  - actuarial advice not required
  - conflict with FSA projections
  - conflict with TM1 projections
  - db benefits are not guaranteed (hindsight!)

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## GN34: Approach

- Assumptions: consistent & reasonable
- Link to benefits on immediate retirement
- Illustrate volatility
- Complete & balanced picture (to ultimate recipient)
  - Are we right to try and control this?
  - Yes, if presented/considered as actuarial advice
- Relate illustration to current income
- Draw attention to favourable options in db scheme

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## Regulation 30 Statement

3.3 The contributions shown in the Statement must include the longer term contributions referred to in section 2.4.11.

2.4.11 The report must set out the future contributions that on the stated assumptions will be required to meet the stated funding objective over the longer term.

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## Regulation 30 Statement

- Encouraged to provide qualified statement if this gives greater clarity on the financial condition of the scheme
- Revise unqualified statement if aware of developments such that a new valuation is likely to lead to materially higher contributions
- If qualified statement identifies conditions where it becomes invalid, need not revise if such conditions arise

*(See article in June 2003 Actuary)*

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## GN 9 v7.0

- Initial driver was SSAS
  - Postponed following IR simplification proposals
- Misleading picture from closed scheme figures
  - (Personal view!)
- Concern about under-funded wind-ups
  - Trustees unaware of situation
  - Adverse publicity re fractional benefits
- PB took stronger view (than before) on the solvency issue

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## Purpose / approach of GN

- "To enable trustees to understand the expected future course of a scheme's contribution rates and the current solvency level"
  - Use of "solvency" is deliberate
- Separation of funding and solvency issues
  - Strong feedback from consultation
  - Concern about emphasis on buy-out solvency
  - Disclosure of funding levels relative to funding target required if objectives include a target funding level

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## Funding objectives

(Used for recommended contributions)

- What are they?
- Who set them?
- Note implications for stability of contribution rates
- Comment on differences between multiple objectives

*(See also separate paper on funding)*

**NB:** Protection for members if advice based on objectives set by the Trustees?

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### Non-traditional objective?

- 90% probability that debt on employer is < 20% of market value of assets
- 95% probability that contributions reduce or increase by not more than 20% at next valuation

PB believes PU used in great majority of cases and hence a statement of ongoing funding level will be required

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### Assumptions and method

- Do not intend to restrict actuary's freedom of choice
- Describe or illustrate how results will differ if key assumptions are not borne out
- Confirm compatibility of asset and liability valuation basis
- Reconcile surplus – normally include some quantification of material items of gain or loss

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### Solvency

- Market value vs buy-out cost or proxy:
  - Actual quote
  - Detailed analysis/Insurance Company parameters
  - Gilts – 0.5%
- Quantify impact of priority order (approx.)
- Recommended contributions likely to maintain current level of coverage (state assumptions used for assessment – solvency reconciliation next revision!)?

*(See also separate paper on solvency)*

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## Gilts – 0.5% - safe harbour?

- Where actuary considers detailed analysis not appropriate
- Required caveats
  - Only a guide
  - No one estimate can be relied on
  - Can find true position only on buy-out
- Practical/Safe?



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## Scheme specific funding requirement

### Expected role of scheme actuary

- Certification of “technical provisions”
  - Prescribed methods/assumptions/principles?
  - Prescribed guidance and requirements?
- Advise on statement of funding principles
- Advise on recovery plan
- Prepare / revise schedule of contributions

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## Transfer values PB Chairman's letter

### Professional Responsibilities in Volatile Markets

- Regulation 30
- Recertification of schedule of contributions
- Transfer values
  - increasingly difficult to certify MFR cash equivalents satisfy “the mandatory requirements of GN11”
  - position close to untenable
- Discretionary benefits

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## Transfer values

- Working party exploring several options
- Value of benefit may derive from:
  - Pension fund
  - Employer's covenant
  - Pension protection fund
- Public interest
  - Consistency
  - Understanding - does "value" have an absolute meaning to pension plan members?

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## Accounting Standards (IAS 19)

What should any guidance cover?

- Assumptions – duration/risk/ERP?
  - Use of "outlier" AA bonds
  - Appropriate levels of ERP
  - Actuarial sign-off required?
- Projection of results
- Materiality
- Liaising with auditors

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## Conclusion

- Actuarial bases may be increasingly restricted by public interest issues
- The profession is not in a good position to judge "public interest"
- There is little appetite for using Guidance Notes as "tertiary legislation"
- The profession may be able to provide practical assistance to members by identifying "safe harbours".

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