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THREE PENSIONS EXPOSURE DRAFTS

[A Discussion Meeting held by the Institute of Actuaries, 22 October 1990]

ABSTRACT

EXD6: The purpose of this draft Guidance is to enable the actuary, in the interests of his client, to determine the appropriate method and assumptions for calculating pension costs, while recognising and interpreting, in the actuarial context, the requirements of SSAP 24.

EXD7: The purpose of the proposed Guidance results from a report from the Occupational Pensions Board: 'Protecting Pensions: Safeguarding Benefits in a Changing Environment'. This recommended that bulk transfers of members without consent from one pension scheme to another should be permitted only if the actuary believes that certain conditions have been fulfilled to protect the interests of members and that in this context Professional Guidance should be given.

EXD8: This draft Guidance results from a request from the DSS to provide Professional Guidance in connection with the implementation of those provisions of the Social Security Act 1990 regarding the determination and application of the 'valuation surplus' to provide Limited Price Indexation for pensions in payment.

KEYWORDS

Guidance Note; Pension Schemes; Occupational Pensions Board; Surplus

EXPOSURE DRAFT EXD6

DRAFT GUIDANCE NOTE GN**

ACCOUNTING FOR PENSION COSTS UNDER SSAP 24

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 SSAP 24.

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 SSAP 24, of which relevant paragraph numbers are noted in the margin.

Date of Issue
. . . . . .

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 SSAP 24 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 SSAP 24. The cost of administration expenses which are born by the scheme 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/121 to D/127 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 SSAP 24.

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 SSAP 24 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 SSAP 24 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. SSAP 24 requires disclosure of the pension cost charge for the period. 79
The basic requirements are:

(a) For defined benefit schemes the pension cost should be calculated using actuarial valuation methods which are consistent with the requirements of SSAP 24.
(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 unexpected pension costs over the service lives of employees in the scheme should be such that the regular pension cost is a substantially level percentage of the current and expected future pensionable payroll in the light of the current actuarial assumptions.

9. The regular cost is defined in the Statement as the consistent ongoing 72
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/129 to D/132 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.

11. The pension cost for a year is the regular cost adjusted by any 20
variation in cost. Subject to exceptions stated in SSAP 24, variations in cost are spread over expected remaining service lives or an equivalent average period. There are different methods of spreading variations, the essential requirement 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 SSAP 24.

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:

(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

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 § 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 § 15. It is also a variant of the Entry Age Method, the validity of which is described in § 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 SSAP 24 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 Institute or Faculty about the general validity for the purpose of SSAP 24 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 SSAP 24 purposes is a matter of judgement for that 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. 79

22. The method and assumptions used for SSAP 24 may well differ from those used for funding purposes because of factors which may be relevant to funding but which are not relevant to SSAP 24. The actuary should be prepared to explain to his client any difference between the approaches for funding and SSAP 24.

23. There can be no uniquely correct assumptions in most cases and SSAP 24 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 acounting 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 § 7.

24. As implied by § 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 acturial method of costing. This is a more stringent condition than the one stated in SSAP 24 § 79.

PREPAYMENTS AND PROVISIONS

25. When calculating a variation in pension cost or a cumulative adjustment in respect of prior years (see SSAP 24 § 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

26. SSAP 24 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(g)

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 SSAP 24 differ from those used for funding purposes (see § 22), then the method and assumptions to be disclosed are those pertaining to SSAP 24, being those used for the latest formal review for the company. 88(h)(i)

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.

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. 88(h)(iii)

30. Unless either the Projected Unit or the Attained Age Method is being used for funding, part or all of any surplus or deficiency to be disclosed under 88(h)(iii) will be attributable to the use of the Projected Accrued Benefit Method for that 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 SSAP 24 rests with the employer. If an actuary is asked to produce draft wording he should ensure that his draft complies with the provisions of SSAP 24. 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.

EXPOSURE DRAFT EXD7

DRAFT GUIDANCE NOTE GN**

RETIREMENT BENEFITS SCHEMES—BULK TRANSFERS

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 U.K. Pension Scheme.

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

Date of Issue
. . . . . .

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 *their* 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 § 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 for 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 § 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 3 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*)

....

EXPOSURE DRAFT EXD8

DRAFT GUIDANCE NOTE GN**

RETIREMENT BENEFITS SCHEMES—
GUARANTEED PENSION INCREASES FROM SURPLUSES

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 U.K. Pension Scheme.

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

Date of Issue
. . . . . .

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 § 3.2. If the guaranteed pension increases are to be insured it is acceptable to treat the value of the guaranteed pension increases 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 these 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 § 3.2.

6. GUARANTEED PENSION INCREASES

6.1 If the value of the assets calculated as in § 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 §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 on the above 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 §6.4 and direct the actuary accordingly, the actuary should ignore §6.3 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 §§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.

ABSTRACT OF THE DISCUSSION

INTRODUCTION

The President (Mr H. H. Scurfield): In our discussion we are seeking the views of the profession on the Exposure Drafts of three new Guidance Notes.

There are those who say that, since we already have 14 Guidance Notes and two Practice Notes, that is enough, and we should rely upon the training, experience and judgement of the actuary to do the right thing without further formal guidance. However, this ignores the increasing pressures of the commercial world of the 1990s, the Government's desire to have more regulation, with a view to increased protection of the consumer, and world trends. Accountants, both in this country and elsewhere, have an increasing number of Guidance Notes. Actuaries in the United States of America have more formal guidance than we do. We value our system of freedom with disclosure and are seeking to avoid the straitjacket of too much regulation. The Department of Trade and Industry and the Department of Social Security recognise similar advantages in avoiding over-regulation, but need the assurance that will come from additional actuarial guidance. With that background, we must accept that increased guidance is a way of life for the future, that it is the best way forward, and that there will be more Guidance Notes.

The notice of the meeting stated that we will be adopting a five-minute rule for contributions to the discussion. This will also apply to the other discussions during this session, for a number of reasons: a maximum of five minutes provides a good discipline, and concentrates the mind; while it is entirely appropriate at a formal discussion that there are some formal contributions, it became very apparent last year that much value came from a rather less formal debate with shorter contributions reacting to each other, with some people even speaking more than once if there was time; and there are increasing numbers of people who wish to speak at these meetings, and I want to give as many as possible that opportunity.

Mr R. E. Brimblecombe (introducing the Exposure Drafts): 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 by way of such Guidance Notes, especially where they are used as a surrogate for legislation. I also believe very strongly that this gives us the opportunity to be far more flexible and to apply our undoubted professional judgement in areas which otherwise might be subject to rigid, inflexible legislation.

I now consider the question of timing. For EXD8 the DSS have asked that the Guidance Note on surplus should be available, if possible, a year before the Appointed Day. No announcement has been made about this, but, so far as we know, it could well be 1 January 1992. For EXD7, draft regulations have already been published for comment. Both of these points predicate the need for issue of the final versions around the turn of the year. For EXD6, while there is less time constraint, there has been pressure on the profession to issue guidance to actuaries on SSAP 24, and I would hope, therefore, that we can be in a position to issue the final document without undue delay.

However, I emphasise that the three Exposure Drafts being discussed are, as their name implies, just that, and the Pensions Joint Committee looks forward to hearing the discussion on the proposals. Together with those submitted in writing, all the views expressed here, and at the Faculty meeting on 24 October 1990, will be taken into account by the Committee before it makes recommendations for the final versions of the Guidance Notes to the two Councils, which, if approved, will then be published.

ABSTRACT OF THE DISCUSSION ON EXPOSURE DRAFT EXD6

Mr R. E. Brimblecombe (introducing EXD6): This is the long-awaited guidance to actuaries in relation to SSAP 24. The Auditing Practices Committee issued a Practice Note (No. 2) in August 1990, 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 this draft Guidance Note is the actuarial counterpart of the accountants' Practice Note.

I think the draft Guidance Note is fairly self-explanatory. There is, however, one point that I make at the outset. Concern has been expressed that the requirements of SSAP 24 involve yet another series of actuarial valuations, which can only add to the cost of running schemes, particularly for smaller schemes. However, it is clear from the accountants' Practice Note that I have referred to, that the starting point in relation to SSAP 24 is for the auditor and the actuary to discuss to what extent the last valuation meets, in the actuary's professional judgement, the requirements of SSAP 24, and, if not, to what extent it needs to be modified. The draft guidance for discussion is designed to help actuaries assess whether their normal valuation method does, indeed, meet those requirements.

Mr M. J. Jones: I speak principally in my role as Chairman of the Accounting and Funding Standards Sub-Committee of the Association of Consulting Actuaries. The Guidance Note on SSAP 24 was the subject for debate at a specially convened ACA meeting on 27 September 1990, and I have attempted to put together some of the main themes that came from there, although the views expressed were almost as variable as the actuarial methods and assumptions used for SSAP 24.

The need for a Guidance Note and its status as best practice guidance is likely to be generally accepted by the ACA. Also those accountants who were at the ACA meeting generally gave a warm welcome to the Guidance Note, or at least to the principle of having one. One of them made the comment that he and his colleagues would feel less of a need to consult with their internal actuaries for second opinions on SSAP 24 figures where the actuary calculating the figures stated that those were in accordance with the Guidance Note.

There are three main areas of concern to the ACA. The first is the section on actuarial methods. In § 13 it is stated that "The selection of the appropriate method for a set of particular circumstances is an important area for exercise of professional judgement". The rest of that section then attempts to state circumstances in which certain methods are inappropriate for SSAP 24. It is unfortunate that the note concentrates so much on the detail of actuarial methods and so little on the detail of assumptions, which can have at least as much effect on the SSAP 24 figures. From the comments that I have received so far, I believe that this section of the Guidance Note will only cause confusion in the profession.

Turning next to the actuarial assumptions, there are three main issues that we have identified.

(1) Is it right, as indicated in § 24, that the assumptions, taken as a whole, should be a best estimate when isolated from the costing method? I am still trying to obtain a consensus ACA view on this particular question, but it is obviously a major point of principle.
(2) Is it right that the assumptions should be more likely to lead to surplus than to deficiency—a proposal designed to fit in with the accounting concept of prudence? Perhaps the accountants ought to answer that question, although I have so far interpreted the best estimate to mean just that, rather than slightly conservative estimate.
(3) I believe that the concept of a notional yardstick for individual assumptions would be a good idea for general financial assumptions, provided that the yardstick is in real terms—that is, linked to underlying price inflation. However, I suspect that the idea will be a difficult one to adopt, and may well be rejected by many actuaries.

My third area of comment relates to disclosure of actuarial assumptions in company accounts, where he ACA believes that more positive help should be provided by the profession. We would, therefore, propose that the Guidance Note includes a recommendation as to which actuarial assumptions should be disclosed and how, as well as recommending disclosures of other appropriate factors, including the asset valuation method, the method of spreading the variation in cost, and the length of the average service lifetime. Any difference in the assumptions used for costing and funding should also be covered. It is often pointed out that companies have a strong resistance to adding to their disclosures and are likely to reject the idea of taking up a page or more of their accounts on pensions disclosure. One solution could be for the actuary to prepare a detailed statement on the acturial method and assumptions, etc., which would be made available to shareholders and others on request, and would avoid the need for detailed disclosure in the accounts. The Institute and Faculty might like to consider this possibility in conjunction with the accounting profession.

Mr E. A. Drake: I had the privilege of participating in the drafting of the Standard, and I find it instructive to look back at the process in some wonderment that the document, which seemed so admirably clear when we published it, should now seem rather less than clear in some areas, and rather torn apart in others. However, I emphasise that it is important to get the Guidance Notes as appropriate as possible to begin with, and if that means that we have to leave the period for discussion open a little longer, I hope that that will be done.

My main complaint about EXD6 concerns § 20. Here we are instructed to refer to the Institute if we wish to use a non-standard method. My view is that this is wrong in principle, because it undermines individual responsibility and it might discourage innovation. I think it is also wrong in practice, because it will slow things up at times when it may be most inconvenient in the excitement of trying to get a company's annual report and accounts finalised. I suspect that it may strain Institute resources, particularly if things have to be done very quickly. There is also the general need to assess any method being used against the circumstances in which it is being used, and that will be difficult for a third party not in possession of all the facts. As it is quite common to change or alter a method to cope with particular circumstances, this could be a very real problem, and I would have thought it better to caution the actuary to be doubly careful in using a non-standard method, and to give him the opportunity of discussing the matter with the Professional Guidance Committee or a special committee for the purpose, if he feels the need. That would help the person in a small practice who may not have anybody else to consult. That would be much more flexible and leave the professional responsibility where it belongs—with the actuary dealing with the case.

When we drafted the Standard, we meant the disclosures to be on the funding basis adopted, not the basis which appears in the company records. That is why we called it the last formal valuation of the scheme, and it will relate to the funding of the scheme. It does not necessarily relate to the way the scheme is reflected in the company's accounts, which might be on a different basis, one much less conservative, quite legitimately, on occasion. If that is a formal valuation, there is a great danger that it triggers into action the Social Security Act 1990 with Limited Price Indexation, and also the Finance Act 1986, for over-funding in different circumstances, and it is not intended to do that. We meant it to be the funding basis, but I accept that the Standard could have been more clearly worded at that point. If we were re-writing it today I am sure the words we used would be much more explicit.

Mr G. N. C. Ward (a visitor): I speak as a chartered accountant, as chairman of the Auditing Practices Committee Working Party which drafted Practice Note No. 2, 'Accounting for Pension Costs Under SSAP 24, liaison between the actuary and the auditor', to which Mr Brimblecombe referred, and also as chairman of a joint working party of actuaries and chartered accountants formed under the auspices of the Pensions Research Accountants Group to consider SSAP 24.

The area of pensions costs is one where it is vital that there is close co-operation between our professions, if the investing public is to be provided with the high quality of information on pensions which it requires. I welcome, therefore, EXD6, and hope that the formal guidance emanating from it will be made available to accountants as well as to actuaries.

EXD6 shows a remarkable insight into the application of the accounting concept of prudence. I only wish that most of my members understood it so well. Considering Mr Jones' query, I believe that it is acceptable for the best estimate to be included in a set of accounts drawn up in compliance with the Companies Act, which includes, as a fundamental concept, that the accounting concept of prudence has been followed. Also, one of our professional standards, SSAP 2, requires prudence to be adopted, so I believe that it is acceptable for 'best estimate', as referred to in SSAP 24, to include a small margin for prudence. The line taken in EXD6 is very much acceptable from the point of view of the accountancy profession.

Mr P. N. Downing: I do not think that the Guidance Note has been drafted with sufficient prominence to what I regard as the primary area of the actuary's required advice, and here I speak, not so much as an actuary or as an accountant, but as a user; namely, a finance director.

Let us consider the finance director of a medium-sized group of companies, many of which are located overseas, but the holding company of which is based in the U.K. For the purpose of the holding company's accounts, the finance director will need advice concerning the interpretation and application of SSAP 24 to these consolidated accounts. The company has two U.K. subsidiaries, each with separate pension funds and, for historical reasons, separate consulting actuaries from unrelated firms. One of the group's overseas subsidiaries, for example, may show a substantial surplus, but the detecting eye will notice that that has largely arisen from the fact that what is funded is a lump sum at retirement, despite the fact that the proceeds are then used to purchase an immediate annuity at current interest rates, giving rise, not only to a substantial surplus in the fund on retirement, but, interestingly, subsequent pensions increases purchased by incremental annuities, the capital costs of which are, of course, charged to the profit and loss account. The finance director needs to have that drawn to his attention and needs advice as to how to deal with it.

It seems that the key test of SSAP 24 is materiality. It is interesting to read in GN13 on FAS 87, that "Materiality is the responsibility of the employer and the auditor", and "Any questions of materiality which the actuary may have should therefore be discussed with his client". Why it is so important for that advice to be given to those of my profession involved with FAS 87, whereas it is not relevant, apparently, to make such definitive statements in respect of SSAP 24, I do not understand.

The Guidance Note, quite rightly, identifies that a clear identification of the relationship between an actuary giving advice and his client is paramount. However, in the example I have given, I submit that it is extremely unlikely for the finance director of a holding company to have a direct client relationship with an actuary. Most pensions actuaries' relationships are with the particular subsidiary company in respect of whose pension fund they are giving advice, not with the holding company in respect of consolidated accounts.

Those responsible for drafting this Guidance Note might well point to § 5 in which it is stated that "In some cases an actuary advises a subsidiary . . . within a group of companies, but not the parent company, or vice versa". My contention is that it is the vice versa that is paramount, and the Guidance Note needs to be redrafted accordingly. I believe that it is totally acceptable for the note to that holding company's accounts to say that any differences between contributions actually payable and the accruing pensions costs are not regarded as material, and, accordingly, no accounting adjustments need to be made to comply with SSAP 24. The Guidance Note should focus on this requirement before dealing with the detailed calculations that may be required subsequently.

So my question to the profession is: which actuary is responsible for helping the finance director with that advice? All I have heard so far is: the actuary will do this or that; the actuary should apply this or that method, but, unfortunately, the actuary of a subsidiary company's pension plan is not the person from whom the finance director needs his advice.

Mr T. S. Shucksmith: In interpreting the requirement to express regular pension cost as "a substantially level percentage of current and expected future pensionable payroll" (§ 8(c)), too much weight is placed on the level percentage of future payroll, and insufficient weight is given to the word 'substantially'. The accounting principles are clearly spelt out in SSAP 24. The objective is to reflect the true underlying cost of each current employee incurred in the accounting period. The pension cost is to be recognised in a systematic and rational way. To me the ideal way would be to calculate a notional individual contribution rate for each employee, expressed as a constant percentage of pensionable pay throughout service, and to calculate the regular pension cost as the aggregate of the appropriate percentage of pensionable pay for every employee. This is more or less the entry age method.

I do not accept the criticisms of this method. Even if prospective employees have a somewhat different notional contribution rate to the average for existing members, the expected path of the average contribution rate is still, I would suggest, substantially level. After all, in the preparation of accounts, adjustment is not made for other differences in expected employment costs. For instance, salaries paid are not adjusted for expected salary levels of new employees, nor would allowance be made for expected differences in other benefits, such as motor cars.

Mr R. Davis: I hope that we will reciprocate with the accountancy profession and obtain their agreement with what we are saying, as, in some cases, we are expressing opinions on an accountancy standard.

I feel that the fundamental issue that we need guidance on is that of best estimates, and that the Standard is a step backwards. I do not agree that a prudent best estimate can be something that exists. There are many different interpretations of this, and different professionals will hold different opinions. SSAP 24 asks for a best estimate. EXD6 fails to deliver that guidance.

I see a danger in that the accountancy profession will look to the U.S.A., where the actuary has become purely a calculator. The accountants and the company set the assumptions on FAS 87 and the actuary performs the calculations. I would not want to see that being the position in the U.K. At present there is a good relationship between the two professional bodies, with the accountancy profession relying on the actuarial profession to express an opinion. I would like to see that position strongly maintained.

Mr J. D. Punter: I do not understand how you can have the concept of a prudent best estimate. If the accountants want us to be prudent, then they should say so; if they do not, then they should confirm that best estimate is what we should be aiming for.

The explanatory note at the beginning of the Standard is rather different from the words used in the body of the Standard, where it states "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" (SSAP 24, § 79). That makes §§ 13–20 of EXD6 almost totally redundant.

I do not understand how the current unit method can be seen to be at all appropriate in the way it has been expressed, even with the current proviso of control periods, and so forth. The only way it can ever be justified is by using a projected unit method valuation, putting in heavy withdrawal assumptions, and then using a current unit method, adjusting the control period until the same answer is obtained. So why not use reasonable individual assumptions and a reasonable actuarial method in the first place?

If I ever showed this Standard to most of the auditors I deal with or to any of the finance directors of holding companies that I have advised they would consider it to be meaningless. I would choose the projected unit method as the preferred method of preparing these figures, although I would accept that the attained age method, in some circumstances, is probably appropriate.

Mr G. N. C. Ward (a visitor): The accountancy profession would be delighted to respond to any invitation that you make to us to consult on EXD6.

The concern of Mr Davis on the role of actuaries in the U.S.A. is something that I share. I confirm that we are not in any way wishing to diminish the independent professional judgement of the actuary through accounting standards.

The concept of prudent best estimate is slightly better known among accountants than some of your members have indicated. It is a concept with which many of us are familiar—admittedly with SSAP 24 we do not say simultaneously that you should be prudent and that you should make the best estimate. That is because the Accounting Standards Committee rather sliced up the job of setting accounting standards. There is a standard, SSAP 2, which deals with prudence. The Companies Act 1985, Schedule 4, also deals with prudence. Therefore it was felt unnecessary by the Accounting Standards Committee to repeat these matters within SSAP 24.

If you look at any of the judgements that are made in preparing a set of accounts for publication to shareholders under the Companies Act 1985, you will find that prudence has been built into estimates of provisions. The building in of prudence to estimates of provisions, provided that it is not excessive, and that it is to take account of reasonable uncertainties, a combination of the exercise of the professional judgement of the finance director and of the auditor and, in the case of pension cost, also of the actuary, is required to make sure that shareholders are not optimistically misled by the publication of accounts. There is more work to be done by our professions, and by individual members of our professions, getting together to make sure that this concept is fully understood.

Mr A. J. Wise (closing the discussion on EXD6): A fundamental principle in the preparation of this draft has been the need to strike a balance between maintaining the freedom of the individual actuary to choose both method and assumptions in advising his client and the need for some form of general consistency in the overall approach of the actuarial profession to what it is that the accountants are asking us to do. There is need for a balance here, and it is inevitable that not everyone will be pleased with where the balance has been struck in the draft. On the whole, from the comments I have heard, I am quite encouraged.

I am very encouraged to hear Mr Ward's positive remarks, and also welcome Mr Jones' comments on behalf of the ACA. Mr Downing's comment from the point of view of the finance director, is very valid, but this draft is giving guidance to an actuary rather than to a finance director, and I think it might be difficult to say more about the subject within the guidance to the actuarial profession.

ABSTRACT OF THE DISCUSSION ON EXPOSURE DRAFT EXD7

Mr R. E. Brimblecombe (introducing EXD7): I should like to remind members that this draft guidance has been produced at the request of the DSS, following the Government's acceptance of an Occupational Pensions Board recommendation in their report, published in 1989, on the rights and expectations of pension scheme members. The recommendation was that bulk transfer values from one scheme to another 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. The OPB went on to recommend that there should be professional guidance given on the preparation of the certificate by the professional actuarial bodies.

Again, the document is fairly self-explanatory, but I make one point. It has been suggested that the requirements on the actuary before he can be satisfied that he should sign the certificate are relatively onerous, and this can only lead to there being relatively few bulk transfers in the future without consent. I make no apology for this, because I believe it is right for individuals to be protected in the way proposed, and if, as a result, there is a reduction in the number of such bulk transfers without consent, then, in my view, so be it. The alternative of obtaining consent is always open to schemes.

Mr R. Key: I consider there to be many areas in which EXD7 is unsatisfactory. Reference is made in several places to members' expectations. No actuary can hope to value members' expectations unless he asks each member what they are. We should therefore avoid the word 'expectations', referring, perhaps, to discretionary benefits granted as a regular practice, or, perhaps, to those to which a commitment has been made. It would also be helpful if some guidance could be given on the subject of valuing such discretionary benefits. Should they be given the same weight as entitlements or, perhaps, be given a lesser weight?

I believe the point of principle at the heart of this guidance note is wrong. This certificate is intended to give protection to those whose benefits are transferred without their consent. In my view, it does not. At present the draft states "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" (§3.3). Furthermore, "different categories of members . . . do not have materially inferior benefits in the receiving scheme" (§3.4). However, despite Mr Brimblecombe's comments, there is no protection for the individual member. It will be no consolation to the member who loses out to be told that his colleagues have gained by just as much as he has lost. I believe that this Guidance Note must give explicit protection to each individual involved.

Concerning the wording of the certificate, it says "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". I am not sure that I understand the phrase, 'actuarial reasons', but, if it has a meaning, I am sure that this Guidance Note does not cover enough to allow that statement to be made. It is concerned only with those whose benefits are transferred, not those who remain. There may, therefore, be very good reasons—perhaps even actuarial ones—why a bulk transfer should not take place. You could, according to this Guidance Note, transfer 100% of the assets and 90% of the liabilities, and give a certificate stating that there are no actuarial reasons why the bulk transfer should not take place! I believe the certificate must reflect the Guidance Note and the regulations to which it refers, and it should not include such vague, generalised statements.

Mr C. J. Young: This Guidance Note ought to be welcomed by the profession. Actuaries are qualified to comment on transfers of pensions between pension schemes, and we should be pleased that we are being given a statutory role in being called on to comment on transfers under certain circumstances.

My problem, like that of Mr Key, is that we may be seen to be rubber-stamping transfers where benefits will be inferior for some individual pension scheme members. I do not think that the certificate should give individual protection to all the members. It is desirable for there to be purchases and sales of businesses, and I accept that, but it would be administratively impossible to maintain all the pensions benefits for individual members. We should not be taking on the responsibility for choosing the cut-off point below which legislators should not permit a transfer without members' consent. That is a matter of politics. Similarly the actuary's certificate should not be worded in a way that appears to give *carte blanche* to the transfer. As things stand the actuary does his limited investigation, the scope of which is laid down in the Guidance Note, but, as Mr Key said, he sums it up in that gloriously precise phrase, "there are no actuarial reasons why the Trustees may not . . . pay".

I should like to see in the certificate full disclosure of the scope of the work that has been done, as set out in § 2 of the Guidance Note. I do not insist that the work must involve a consideration of members' individual rights. Perhaps the Guidance Note should also say, in a document separate from the certificate, that the actuary should be drawing the trustees' attention to the areas in which individual members may lose out.

There is a rather surprising absence from the Guidance Note; in that it states that we have to disclose what actuarial assumptions and method we have used in our calculations, but does not give us any guidance as to what those assumptions and method should be. So there would be nothing, for example, to stop us using the current unit method and saying that giving everybody ordinary withdrawal benefits is acceptable. We should also be being warned about simplifying bases. Is an actuarial basis that does not include an ill-health decrement fair in a case where two pension schemes are being compared and the only difference between them is that one scheme does not provide as generous ill-health benefits as the other?

I query what constitutes materiality. I understand materiality when I am presenting a valuation result; but this is a different situation, looking at individual members' benefits, so there should be some guidance as to what is material in this context.

The section on the protection that should be afforded to members where the winding-up clause is changed appears inconsistent. For example, it does not protect members' dilution of interests in a surplus where the transfer is from a scheme which has a surplus to one which has a smaller surplus. However, it gives more protection than in the case where members are asked for their individual consents, where, I think, it would be unusual for a company to refer in disclosure material to a change in the winding-up clause.

Mr C. M. Stewart: EXD7 does not address how to calculate the amount of the bulk transfer value. It deals only with the responsibilities of the actuary of the transferring scheme in determining the relative values of the past-service benefits on offer and those being given up, stopping short of considering what the bulk transfer value at the very centre of the transaction is supposed to represent. It is this which we need to answer.

My view on how to fit in with the general predelection for using the projected accrued benefit method as the basis for bulk transfer values is to prescribe an earnings revaluation with a 7% limit in the definition of the wind-up benefit. The Social Security Act does not do that. The requirement there is for prices revaluation with a 5% limit. This is rather less than earnings revaluation, but it still gives a good degree of protection for accrued pension rights on wind-up. What is now required is recognition that bulk transfers between schemes can properly be based on the value of wind-up benefits as set out in the scheme rules, whether these are at the statutory level or at some higher level.

The most important part of EXD7 is § 3.6, which states that the financial strengths of the two schemes should not be taken into account. I agree with that. A member's expectations should not be affected by the pace of funding. If a scheme is in surplus the employer's contribution will be temporarily reduced until the surplus is eliminated. If there is a deficit the employer's contribution will be temporarily increased, and if the scheme is wound up any shortfall compared with the statutory minimum wind-up benefits becomes a direct charge on the employer's assets. One way or another, the employee's expectation is that the benefits will be paid in full as and when they fall due, no more and no less.

Let us suppose that two pension schemes, identical in every respect, are involved in a takeover. The scheme being transferred is funded by the defined accrued benefit method and is exactly solvent; that is to say, it has no more than the usual implicit solvency margin resulting from the actuary's prudent assumptions. The employer's contribution is a regular 12% of payroll. The receiving scheme, by choice, is funded by the projected unit method. It too is exactly on target, but with a regular pension cost of only 11·5% of payroll; that is 0·5% lower, reflecting the higher funding level. What should the transfer arrangements be in such a case?

Should the transferring members be given full past-service rights in the receiving scheme, and the two employers left to discuss the financial arrangements? These might involve the receiving employer accepting the existing funding target, in which case the regular pension cost would remain at the same 12% rate as before transfer. On the other hand, if the receiving employer chose to apply his own higher funding target to the transferring members, the fact that the regular pension cost would thereafter be only 11·5% would be a factor to be taken into account in the financial arrangements. Alternatively, should the members of the transferring scheme be expected to suffer a cut in past-service benefits to reflect the lower, although adequate, funding level in their present scheme? In that case, immediately after transfer, the receiving employer would benefit from having the smaller pension charge of only 11·5% deducted from profits.

My worry is that many actuaries appear to prefer the second alternative, which looks only at the assets in the fund and ignores the effect upon contributions and future profitability. If they were advising the scheme from which the members were being transferred, they might even interpret the exception mentioned in the last two lines of §3.6 as suggesting that they should aquiesce in their members' expectations being reduced. If this is the reality behind EXD7, then I think it places an unnecessary obstacle in the way of securing members' pension rights, and we ought to look again at this aspect of bulk transfers.

Mr A. Chaplin: Five years ago in a discussion here (*J.I.A.* **113**, 23) I called for some Institute guidance on bulk transfers. Since that time there have been several court cases: Imperial Foods, Mettoy and, most recently, Fisons.

The Fisons case, which took place in summer 1990, could become the most significant of all the cases so far as the calculation of bulk transfers is concerned. The case concerned a terrible muddle over a transfer value of around £30 million. The court was asked first to decide under which rule the transfer value should have been paid. Unfortunately for the actuarial profession, the judge found that the transfer value should be determined under a rule which contains the wording, "such part of the assets as the trustees, after consulting the actuary, decide to be just and equitable". The judge also found that the trustees, in arriving at the transfer value, had not complied with the provisions of that rule. Having made those preliminary findings, the judge adjourned the case and sent the actuaries away to work out the past-service reserve as at the date of transfer. The two actuaries concerned happened to disagree on how this amount should be determined. That, however, is incidental to the principles involved. It is quite clear, reading the judgment and the transcript of the case, that, when the case returns to court, as it almost certainly will have to, because of the nature of the litigation, the judge, with the agreement of counsel on either side, will agree that a just and equitable transfer value means the past-service reserve in respect of the contractual benefits only; this, despite the fund being in surplus, despite the trustees declaring a policy of wanting to increase pensions above the contractual promise, and despite the company paying more than the strictly necessary actuarial rate. The actuary who asked for a share of the surplus was described by counsel as an 'old-fashioned' actuary; and even his own counsel deserted him at the end of the trial.

If the contractual past-service reserve is just and equitable, clearly anything less is unjust and inequitable to those transferring, but anything more is unjust and inequitable to those remaining in the fund. I believe that the Fisons case may well bring to an end the practice of transferring any amount in excess of the past-service reserve in respect of the contractual benefits. Any actuary so certifying is taking his life in his hands.

You may say that this case is binding on trustees and it is not binding on actuaries. However, the courts have already decided, in the George Newnes case 20 years ago, and reiterated in the Imperial Foods case in 1986, that, when an actuary has to act in a matter not governed precisely by the terms of the trust deed and rules, he has to act with the greatest degree of fairness to all parties. To my mind, to act with the greatest degree of fairness is synonymous with being just and equitable, and I believe the Fisons case is, therefore, binding upon actuaries. Under most trust deeds the discretion to determine a transfer value is usually vested in either the trustees, the actuary or the employer. The Mettoy case appears to tell the employers that, where they are acting under the trust deed and rules, they have to act in a fiduciary capacity. If that is so, Fisons will be binding on trustees, actuaries and employers.

It appears that, if the transfer value contains nothing for expectations, this will prevent the transferring actuary from giving his blessing to the transfer. In practice, I suspect the only way transfers of expectations will be made is by converting them to rights immediately prior to transfer, and having these rights expressed as rights in the receiving scheme. The alternative would be for the purchaser to negotiate a reduction in price to compensate him for the lack of an expectations element in the transfer value. In this case the cash value of the expectations will, in effect, reside in the purchasing employer's assets rather than the fund, and I am not sure I would be happy to give a certificate in those circumstances. I believe it would be better if only rights and not expectations were dealt with in the actuary's certificate. Having seen the relevant draft regulation, I believe this view may now be held by the DSS. It is very difficult in law to give people rights to non-obligations.

Miss C. H. Dawes (a visitor): The Guidance Note appears to go further than the draft regulations, which are confined to certification of rights. There is no mention of expectations in the regulations.

There are aspects of expectations which are not part of a member's benefits under the plan, yet, from the way that the draft Guidance Note is written, it seems to me as though someone could argue that, for example, a custom of electing a member trustee could be counted as an expectation and, therefore, ought to be transferred into a receiving scheme.

Mr P. A. Randall: Neither EXD7 nor EXD8 have been well received by my firm. 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 meet such higher standards. Both 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 to tie down and quantify members' expectations. It is also essential to draw clear distinctions between the matters that are necessarily the actuary's responsibility and those that are only the responsibility of the trustees.

We agree with many of the points made by earlier speakers about EXD7, in particular those of Mr Key. 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 § 2.1 become the rather looser 'benefits' for the rest of the draft. One possible aid to the problem of 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 of unhelpful drafting is the use of 'actuarial reasons' in the wording of the certificate.

It is clear 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 in § 1.4 that require 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 Institute and Faculty 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 think this should be done as a matter of urgency. Many of us would be unhappy about giving any such certificate 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. It would also undermine public confidence in our profession as a whole. However, it is very far from clear that EXD7 would prevent this possibility. If it does, it is likely to have been because actuaries feel too exposed to give any certificates.

We are not satisfied that EXD7 achieves the right balance, or, indeed, a clear and consistent one, over whether the actuary is to take into account 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 have several problems with § 3.5. First, it has given rise to different interpretations among 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 appears to some that, even where members' benefit rights are 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 § 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.

I am sure it is right for the profession to give all the assistance it can to the DSS in achieving better legislation, but we should stand back at the end and be clear about whether the results of our efforts are really professional guidance or whether they are quasi-regulations. In the second case, I believe it is better for us to face up to the facts, to offer our work to the 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 have to determine its contents and to change it if we think this 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 over-stated; it is the Inland Revenue who have more to gain from such a basis than the DSS, and they have one on the statute book already.

Mr S. F. Yeo: I do not welcome EXD7. My two main complaints are the wording and the presence of § 3.5. Many of the words can be taken and be made to mean what one wants them to mean in the circumstances in which they are being used. For example, in § 2.1, we have the words, 'taking account of'. Does this mean taking full account of, some account of, or reasonable account of? I know not. In the last sentence of § 3.5 there is the very unhelpful word 'unlikely'. It does not help to find it in the Guidance Note, unless it tells in what circumstances something is likely, and in what circumstances it is not. It just leaves it to the reader to assume. The words, 'which it is assumed' appear in § 4.5. It does not say assumed by whom. Does it mean assumed by the member or by the actuary? It refers to the question of discretionary benefits which, in most of the schemes I advise, are something in the gift of the company, which has the right to decide whether discretionary benefit improvements carry on. Surely it is what the company is assuming will happen, rather than what the members or the actuary are assuming. I also have problems with many other words occurring throughout the document.

I question whether § 3.5 is necessary, given the presence of § 3.6. Surely § 3.6 can stand on its own, and leave it for the actuary to determine whether the winding-up clause and the priorities accorded in it are likely to be relevant, given the state of funding of the scheme. However, that is not the way that EXD7 is worded. Even in cases where it is clear that the winding-up clause will not be relevant, it has to be taken into account. One reaction to this requirement may be that archaic winding-up clauses would have to be imported into modern trust deeds if bulk transfers are to proceed. Despite the words of Mr Key, it is likely that the consequence of this is that there will be fewer bulk transfers without members' consents. It is all very well saying, "Fine! Go ahead, get members' consents", but have you ever tried tracing 5,000 pensioners? That may not be too bad, but getting all their consents may be a bit harder. Moreover, have you ever tried tracing 5,000 deferred pensioners? It takes a great deal of time and it does the profession no credit at all for the actuary to have to go to his multi-million pound client and say, "I am sorry, we have to track down these people because of what this Guidance Note says". I do not welcome it.

Mr D. H. Loades: I speak as member of the working party. I have listened to the discussion somewhat in confusion. First, there has been much discussion implying that the document should have given guidance on how to calculate bulk transfer values. That was not the purpose. These certificates, in my view, are made after all these issues have been settled; after all the negotiations on the size of the bulk transfer value, what benefits are being given up and what benefits are going to be given. Then the actuary is asked to certify whether or not members' benefits and expectations are likely to be met in the receiving scheme.

Second, there was comment on the actual form of the certificate. Given that certificate does not compel the bulk transfer, there are still other issues which need to be investigated by the trustees. They are the people who release the money and authorise the transfer. Therefore, the certificate simply removes the bar that, in the absence of a certificate the trustees are not permitted to make the bulk transfer. Given the certificate, they may make it, if they so wish. Therefore, there is still a duty on the trustees to consider many of the issues which we have been discussing.

Third, having been put into the situation of trying to give some comfort to people who are being transferred from one scheme to another, you realise that it is impossible, when the benefit packages are different, to certify that each individual will not, in any circumstance, suffer a loss of benefits. If you go down that route you finish up with the problems of the judges in the Barber judgment, who decided, for the purposes of transparency, that you cannot say two benefit packages are equal unless each individual part of those packages is equal. If that criterion is met, then there is no need for actuarial certification. Actuarial certification is required when it is not obvious that the benefit packages are equal.

There was some discussion about expectations. In fact, the working party worked from the OPB recommendation in their report 'Protecting Pensions: Safeguarding Benefits in a Changing Environment'. This stated that there should be actuarial certification that the benefits in the new scheme in respect of the past service of transferring members should be equivalent, on an overall basis, to the rights and expectations in respect of past pensionable service in the original scheme. It refers to past service and about an overall basis, not individual members and individual benefit packages, and it brings in the concept of expectations. That was the starting point for the working party, which decided that it was not really fair to give a certificate based on the overall value of the total benefits of the two schemes. In other words, equating the overall value or cost of two schemes could benefit some people more than others, and, in fact, some individuals could suffer a great deal. Therefore, the working party felt that it had to put in some constraints, which are contained in § 3.4. We did not feel able to say how far you could deviate from absolute equivalence in terms of individual benefits when there was overall equivalence for each group before the actuary felt unable to give a certificate.

If it is not possible to get individual consents, there is great pressure, then, to improve the benefit packages so that the actuary can give the certificate. Surely, that is what we should be aiming for.

Mr H. W. Brown (closing the discussion on EXD 7): 'Expectation' is a problem. The working party started from the point that an expectation was more than just a right under the rules of the scheme. It was taken as a commitment that had been made by the employer in the past, which a member had every right to expect would continue in the future. Some regular practice of the employer in the past might also be taken as an expectation. It is these benefits, that would not be quantified in the rules of a scheme, that the working party felt needed to be taken into account if a member was not to lose out in the transfer.

The next main area that the working party considered was just how far the actuary needed to base his assessment on the individual compared to the group. A number of speakers have mentioned the fact that it would be impracticable in a large scheme to look at the value of the benefits of each individual in the bulk transfer. As a realistic compromise, the working party felt that, so long as the transferring membership could be split into homogeneous groups by their age, levels of benefit, types of benefit, and so on, and that the actuary could satisfy himself that these groups were not losing out on the transfer, then he would be able to give his certificate. In this situation the individual member should have a satisfactory degree of protection. If there are individuals who are so different from the rest of the group, then I can see no reason why those individuals could not be treated simply as one-member groups in the calculations and assessment by the actuary.

Mr Loades mentioned the calculation of the transfer value, and I think that he is right. EXD7 is not concerned with what method or assumptions the actuary uses in the calculation of the amount of the transfer value, it is concerned with the benefits being transferred and requires the actuary to use the same method and assumptions in valuing the benefits in the transferring scheme compared with the benefits in the receiving scheme.

A number of speakers have made reference to the certificate. I agree that the working party needs to carry out some further work in this area. The certificate should reflect better the appropriate paragraphs of the Guidance Note.

I should like to stress the fallback of 'individual consents'. If the actuary cannot give the certificate for whatever reason, this will not necessarily block the transfer. The transfer can still go ahead, but with members' consent. I do not think we should lose sight of that basic principle.

ABSTRACT OF THE DISCUSSION ON EXPOSURE DRAFT EXD8

Mr R. E. Brimblecombe (introducing EXD8): Members will be aware of the changes in what is now the Social Security Act 1990, which took place during its passage through Parliament, with the result that there is now a requirement on schemes to use actuarial surpluses that arise after the Appointed Day to provide LPI on pensions currently in payment, and the accrued pension rights, as at the Appointed Day, of pensions for those not yet up to retirement. The Social Security Act already provides that schemes will have to provide LPI for future service accrual after the Appointed Day.

Here again, the DSS approached the Institute and Faculty and asked whether they would be prepared to consider giving professional guidance as their (i.e. the DSS's) preferred alternative to laying down a basis for calculation of the surplus. As members will be aware, the two Councils agreed in principle to go down this route earlier this year, and advised the DSS accordingly.

Concerning EXD8, it has been suggested that the committee is being too rigid in laying down just one basis—the projected accrued benefit method—and that other methods, particularly those normally used for the calculation of funding rates for the scheme concerned, could be used. The working party did consider this very carefully, but concluded that only one method should be allowed; hence the comments in EXD8. They felt that the use of other methods was open to possible abuse. Commentators have suggested that the laying down of just one method could lead to anomalies, possibly quite extreme, between the surplus position on the one hand and the on-going funding position on the other. However, I emphasise that the requirements of §§3.2, 4.1 and 4.2 are primarily designed to ensure that there is consistency between the valuation for surplus purposes and the normal method used for the calculation of funding rates.

Because we are laying down just one method, for the reasons I have already stated, concern has been expressed, in particular regarding schemes which have been closed to new entrants and which fund in such a way as to keep the contribution rate stable, thus enhancing the likelihood of increased surpluses in the early years following closure. However §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 take appropriate implicit margins.

Paragraph 4.1 is also designed to meet the concerns of those involved in small schemes, particularly insured schemes, whose experiences, by their very nature, are 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, while small insured schemes are excluded from the provisions of the 1986 surplus regulations, whereas they will be included in the current ones, it was felt that the actuary could make an appropriate implicit allowance for the volatility of experience, again in the terms of the wording suggested in §4.1.

On transitional arrangements, the Institute and Faculty have been in discussion with the DSS about the problem of the period immediately following the Appointed Day. Under the legislation, the first increase, if any, will be no later than 12 months later than the Appointed Day. This means, at least in theory, that an actuarial valuation will be needed as at the Appointed Day, which may not be practicable. We propose, therefore, to add a wording to the guidance to state that "while an actuarial valuation is required to be conducted on the Appointed Date or in the 12-month period following the Appointed Date, discretion is given to the actuary if, in his opinion, an earlier valuation can be suitably modified for the purpose of quantifying the amount of surplus, if any, as at the Appointed Date under the regulations, and determining the rates of increase that must be provided by the scheme, provided that the previous valuation can be modified in such a way that it adheres to the final version of this Guidance Note".

Mr E. S. Thomas: It appears that the objective in EXD8 has been to maintain flexibility in the choice of actuarial methods and assumptions. My own view is that, while this might serve to boost the ego of the actuarial profession, it is a doubtful compromise under what is essentially prescriptive legislation. Too much flexibility could lead to conflicts of interest, which might be difficult to resolve. An alternative approach would be to specify assumptions, as has already been done for the surplus legislation, though not necessarily the same assumptions. This might be done, for instance, in relation to the surplus assumptions by a suitable modification.

Flexibility is desirable. EXD8 implies, but does not state clearly, that the appropriate method and assumptions will often be those for normal valuation purposes, and Mr Brimblecombe has confirmed that. This is consistent with the objective of flexibility, since GN9 states that "It is not intended to restrict the actuary's freedom of judgement in choosing the method of valuation and the underlying assumptions". It is essential, if this is a fundamental principle of EXD8, that it is stated clearly.

Is more required? Perhaps yes, in order to restrain those few clients (and their advisers?) who, contrary to current trends, wish to use excessively cautious methods and assumptions. The risk does not seem great, but the DSS or members of the schemes might be comforted by the knowledge that prudence is limited.

Therefore, it seems sensible that the projected accrued benefit method should have been specified, and I think that we are comfortable that there is a single method. I suggest that the source of this definition should be given in the Guidance Note. This practice is followed in GN9. It is less obvious that any reference is required to a standard contribution rate. That in §3.2 is not required in conjunction with the projected accrued benefit method, in the definition of which there is no reference to standard contribution rate. I do not see what useful purpose §3.2 has. It could well be deleted or re-worded to give a clearer explanation of the objective that Mr Brimblecombe has just enunciated.

With regard to actuarial assumptions, §4.1.2 of GN9 says, in relation to the actuarial statement, that "the actuary should take a prudent view of the future without taking into account every conceivable unfavourable development". In contrast, §4.1 of EXD8 says that "The actuarial assumptions used must be realistic". Not only is there a conflict of objectives here, there is also uncertainty about the objective that is being required under EXD8. Is there any actuary who uses unrealistic assumptions? Assumptions which are regarded as realistic by trustees might be far from a company finance director's idea of realism. Admittedly, it is difficult to define the objectives for assumptions in a Guidance Note such as this, but, if it is to be done, it must be capable of being interpreted sensibly, and implemented by an ordinary practitioner. SSAP 24 and FAS 87, in spite of the reservations about them, are examples of better attempts in this area.

The objective for actuarial assumptions is further confused by the reference, in §4.2, to insuring pensions. This sentence is totally inappropriate, confusing and wrong, and should be deleted. It carries the suggestion, not of a prudent long-term approach, but rather of a short-term buy-out approach. We are not concerned with the mechanics of guaranteeing pension increases, we are only concerned with deciding to what extent a guarantee must be given.

We must be allowed to take account of early retirement benefits. The reference to them is even more restrictive than the Government Actuary's surplus requirements, and will result in schemes being forced to guarantee early retirement terms if they want to fund sensibly for them. The impact of this Guidance Note will be to divert resources away from early retirement benefits into guaranteed pension increases.

Mr R. B. Colbran: Under the approach being proposed, employers who are rash enough to continue to run final salary schemes should accept that, sooner or later, they are going to be granting LPI on all benefits. Mr Thomas referred to people using excessively cautious assumptions, but I suggest that all that would do would be to increase the contribution rate and lead to further surplus emerging at the next valuation, with a greater likelihood of then having to guarantee LPI.

Concerning the investment aspects, it is obvious that there are no securities on the market which can match a liability for LPI. This has probably not been generally taken into account, because in recent years in this country we have become conditioned to the idea that inflation is unlikely to fall below 5% p.a., and so LPI means really a fixed 5%. On the other hand, we have also accepted very high equity contents in pension funds, even against pension liabilities. These are justified on the grounds that there is a very substantial discretionary element, particularly if aiming to inflation-proof pensions, and so the guarantees in respect of just the level pensions are not particularly onerous or risky. Once 5% increases have to be guaranteed, the discretionary element becomes very much smaller or may even disappear, and so, if pension liabilities are material, the question of matching becomes far more important. I suspect that, at the moment, many people would go for fixed-interest securities against an LPI requirement, which makes sense with current levels of interest and inflation. Life offices would certainly take that view for annuities. That assumes there will be an adequate supply of such securities, but I think that to proceed down that route is going to eliminate a source of profit which might have been used in the past when inflation was high, and so may well reduce the chance of matching inflation where it exceeds 5%.

To find a period when inflation was well below 5% you have to go back to the early 1960s. In that period gilts were yielding between 5% and 7%, and inflation was averaging about 3%. If we thought, in those conditions, that LPI meant a fixed 5%, then that would be unacceptably expensive. That seems to mean that, in low inflation, you need to buy index-linked stock, which may not be available, or if it is, may not be on acceptable terms. So, in either case, there is a risk of over-providing, of adding to cost if you want to reduce risk. I would like to know whether, in all the negotiations, the investment issues were taken into account.

Following Mr Brimblecombe's comment about volatility, can §4.1 be interpreted to allow us a mismatching reserve, which concept, I believe, is fairly familiar to life office actuaries?

Mr T. E. Crowter: I have approached EXD8 on the basis that the profession has not, at this point, been subjected to any Government restrictions. I accept that the Government has the final right of veto over the Guidance Note, because it is for the Government to issue regulations under the Society Security Act 1990. However, if EXD8 already reflects Government limitations, I feel very strongly that our membership should be given details.

I agree with many of the points made by Mr Thomas. I should like to look at the impact of the EXD8 on a scheme in a very common position, that of a final salary pension scheme which has so far given pension increases well below LPIs, and to consider whether it achieves a desirable result. The scheme has a surplus, the employer is taking a contribution holiday and there is a certain amount of pressure on the employer's cash position. To my mind, it is this situation that is the key one in the light of EXD8, and I believe that employers could find the present draft extremely damaging. Under EXD8, and provided suitable actuarial assumptions can be chosen, the actuary to the scheme in the position we are looking at would have the choice of:

(1) Using the present or a more optimistic valuation basis. This would result in a surplus that would need to be used to provide LPIs. However, it might permit a relatively low contribution rate to be recommended; or
(2) Choosing more conservative actuarial assumptions, so that the scheme no longer appears to have a surplus. This would mean recommending a relatively high contribution rate, which would be likely to result in a surplus within a relatively short-time frame. This surplus would then need to be applied to provide LPIs in respect of service before the Appointed Day.

Either way, LPIs are conceded on pension accrued before the Appointed Day. It is simply a question of whether they are conceded now or within a few years. EXD8 effectively appears to give the Social Security Act 1990 retrospective effect, and it seems to go way beyond what was intended. I think this is a most unsatisfactory state of affairs. Far from allowing flexibility, as suggested in the covering note distributed with EXD8, it seems to deny flexibility. It will impose additional pension costs on companies that can ill-afford them and that are, in all probability, already facing heavy additional costs due to the post-Appointed Day provisions of the Act, not to mention the Barber judgment.

I should like to see EXD8 redrafted to reflect what I call an upper-funding-limit approach. I believe that the point that triggers the use of surplus to provide pension increases in respect of service before the Appointed Day should be the same as the point that triggers the availability of surplus refunds. I should like to see a conservative funding limit over which LPIs would need to be conceded in respect of service before the Appointed Day, but which would allow funding flexibility up to that limit. I accept, however, that there has to be some control over the degree of flexibility, otherwise the intent of the legislation would be lost. This implies that an employer would need to pay normal contributions on the funding basis if pre-Appointed Day LPIs have not been conceded, even if the scheme is in surplus. The surplus would effectively become a buffer against periods of adverse experience. The actuary would still have some flexibility in calculating the normal contribution level, and there would be a reasonable chance that pre-Appointed Day LPIs would not have to be conceded against an employer's will.

I suggest that the method and assumptions currently used for the Finance Act 1986 surplus test would represent a reasonable starting point for the upper-funding limit. There would need to be some extension to cater for the position of insured schemes that come within the scope of the Social Security Act 1990, but did not come within the scope of the Finance Act 1986, but it should be reasonably straightforward for the profession to devise an appropriate approach.

I believe that to adopt EXD8 in its present form would be of disservice to our profession and to the clients of many of us. I should be much happier with a redraft along the lines I have indicated. The effect would still be unpalatable for many companies compared with the current position, but it would be less unpalatable than under the present version of EXD8.

Mrs A. Stoye: Some sensible Institute guidance is better for us than Government regulations. It should give us flexibility and it must be sensible and practical, something that we respect.

EXD8 has made an attempt to achieve the Government's intentions of bringing members' rights and expectations closer together, in particular by using the disclosed funding basis for the purpose of assessing the surplus. I have much sympathy with the Government's intentions behind the legislation and with this way of trying to implement them, but have one large proviso, and that concerns safety margins. This legislation is intended as consumer protection, but I do not see that that is best achieved by the removal of all safety margins. I am particularly concerned about schemes which are funded to a level which is between nought and LPI, so that, under this legislation, they are forced to use the whole of their past service reserves to guarantee increases, and they will no longer have any free reserves.

In the right hands, discretion has been very valuable, and members have benefitted. It has enabled schemes to continue giving increases of rather higher than LPI in a number of cases, but knowing that they could draw back if absolutely necessary and if times became hard. Most trustees want to give the best benefits they can to their members, and it is not a case of trying to abuse these flexibilities. Trustees are becoming increasingly accountable to members and to unions under the disclosure regulations, so I am happy to increase rights, but not to an extent that removes all discretion from many funds.

Mr M. W. Lomax: My first concern is with the scope of the provisions set out in EXD8, which is more limited than the relevant provisions in the Social Security Act 1990. The application of the Guidance Note is stated to be to "Any actuary responsible for giving guidance to the Trustees". Paragraph 2.1, on the other hand, links the scope to "an actuarial valuation to which GN9 applies".

The scope of application of GN9 is not clear to me—certainly it includes written reports to trustees required under the disclosure regulations. The Social Security Act 1990 is quite clear, however: Schedule 2, § 3(3)(b) states that pension increases from surplus crystallise whenever "the assets and liabilities of the scheme in question are actuarially valued *for any purpose*". However, I cannot see how, in practice, this provision in the Social Security Act can be applied without further clarification. In this context, it is also interesting that the enabling powers in the Act, which might otherwise provide for a more well-defined scope to be prescribed in regulations, are restricted to the method and assumptions for valuing assets and liabilities and do appear to extend the scope of application of the relevant provisions of the Act. In summary, I would welcome guidance on when an actuarial valuation is an actuarial valuation for the purpose of crystallising pension increases from surplus.

I was confused by §§ 3.1, 3.2, 4.1 and 4.2 when read together. I could not understand the reference to the standard contribution rate in § 3.2, nor the reference to the disclosure regulations in §§ 3.2 and 4.2. What I could glean was that the method to be used to value liabilities should be the projected accrued benefit method, and that actuarial assumptions should be 'realistic', I agree with previous speakers that this will cause problems of interpretation and application. Is it right that the actuarial profession should bear the burden of the conflicts of interest between employers and trustees which are bound to arise?

I agree with the comments of Mr Thomas concerning § 4.3, and the need to allow for unpromised early retirement pensions in the valuation of liabilities. Many employers will not want to promise early retirement pensions. It takes away flexibility from a personnel point of view, and also has costly preservation implications.

Mr T. S. Shucksmith: Fortunately, the Social Security Act 1990 does not require the actuary to confirm that LPI increases can be provided from surplus. It requires valuations to be made of assets and liabilities in accordance with regulations, and envisages a calculation and verification process in which the calculator determines the rate of pension increases on the earlier-service component, which makes the value of the assets and liabilities equal in accordance with the regulations. The regulations may take the form of delegation to guidance from a prescribed body. What members of pension schemes expect is that guaranteed increases will be granted according to an objective standard, based on the funds held, however they may have come about.

In most defined benefit schemes the employer convenants to meet the balance of the cost of the benefits. Consequently, any benefits granted in excess of those promised under the rules represent an addition to the employer's cost. Scheme trustees are not in a position to award additional benefits without the employer's consent, nor are they in a position to dictate to the employer how the balance of cost is to be met. As a result, the actuary is, in reality, advising the employer, whatever the formal contractual or professional relationship. In this context, the flexible professional approach, referred to in the Institute's notice accompanying EXD8, is entirely reasonable and proper.

In the context of the calculation of guaranteed pension increases out of surplus, the actuary is in a situation of serious conflict. The employer will probably want to minimise the guarantees or delay them, while members will want maximum guarantees. The considerations relating to funding, which may find expression in the actuarial statement for disclosure of information purposes, are irrelevant.

For these reasons, I favour a set valuation basis. We can certainly live with this; we do with the actuarial surplus regulations. Although it may go against the grain, I think it would be wiser to ask the DSS to set out the basis fully in regulations, rather than for the profession to decide it. While the profession should co-operate with Government over the implementation of the Act, there is no reason to share any responsibility for the enormous risk which will be imposed upon many employers. The DSS should take full responsibility.

Mr C. M. Stewart: I share the doubts of some other speakers. My view on what is proposed would be different if it was being imposed by Government, but it is not, it is our own design, and we, therefore, have to be very careful. For that reason I have doubts about the choice of the projected accrued benefit method. There are three good reasons why, in my opinion, the defined accrued benefit method would have been preferable.

First, as a profession we ought to be recommending the method which is tailored to each scheme's true accrued liability, that is to say, to the value of its wind-up benefits. Even with the new statutory minimum for those benefits, for the great majority of schemes this liability will still be somewhat lower than the actuarial liability under the projected accrued benefit method, but there will also be schemes where the reverse is true, and we also have to take the opposite into account. The present proposal would therefore mean, in very many cases, not identifying surpluses which could safely be used for pension increases, and in some cases forcing the award of increases when, in reality, no surplus existed.

Second, I wonder how the Government will view this proposal. It is possible that they will not mind greatly, and will accept that, for the majority of schemes, the surplus will have to be fairly large before their new requirement bites. On the other hand, there will be enthusiasts in Government who might object to the actuarial profession taking it upon itself to moderate the impact of their strategy for helping those whose pensions have fallen in value.

I know what scheme pensioners will think. They will not be pleased if the actuarial profession sets a standard which is unnecessarily high. They will not have to wait until their schemes are actually wound up and large surpluses are then disclosed, to realise that their pensions could have been increased earlier. Word will get around that use of the defined accrued benefits method would have released those surpluses. Not that a surplus on winding-up would necessarily go to members with 'earlier service component'. Unless I have misunderstood what is being proposed, the first tranche of surplus would have to be applied in accordance with the rules of the scheme, whatever those might be.

Only surplus in excess of the actuarial liability calculated by the projected accrued benefit method, if any, would have to be applied to increase pensions as the regulations require. Should we really be advocating a system in which members with 'earlier service component' might have to take second place in winding-up?

Mr R. Key: The main problem with EXD8 is that we do not seem to know what we are trying to achieve. The Government's stated objective is that the first call on surplus should be LPI increases. Companies may not take a refund or contribution holiday until they have guaranteed LPI.

Politicians might think that there is a well-defined thing called surplus, and, therefore, if the first call upon it is LPI increases, companies will not be able to have refunds or contribution holidays until they have guaranteed those LPI increases. So what would be the Government's objective if it really understood all the implications? Is it control over contribution holidays, or does it want an objective measure of surplus, so that identical schemes are treated identically? If identical schemes are to be treated identically, then this Guidance Note fails, because schemes which are identical would be treated differently, because different actuaries would use different assumptions. Therefore, if this is the objective which is to be satisfied, we must have prescribed not just a method, but a set of assumptions. Should we do this, or should we leave it to the DSS? If, on the other hand, the real objective is that LPI increases should be guaranteed before a contribution holiday is taken, again this proposed Guidance Note fails.

Under the proposed guidance, an actuary can declare that there is no surplus for Social Security Act purposes, but, by using the current unit funding method, or any other method which has a lower target fund than that disclosed under the projected accrued benefit method, he can declare a surplus for funding purposes and recommend a contribution holiday.

It is also somewhat unfortunate that actuaries will be put in the position whereby the choice of assumptions for funding purposes also dictates whether or not benefit improvements must be granted. For that matter, is it reasonable that realistic assumptions should be used to decide whether surplus funds are available for benefit improvements? After all, is that money really available if there is only a 50% chance that it will not be required for the benefits already promised? May I suggest, therefore, that we ascertain and publicise what the Government's real objectives are before redrafting this proposed Guidance Note.

Mr C. J. Young: The opener queried § 3.2 and the intention behind it, and wondered why there was any need to calculate a standard contribution rate. I had rather assumed that the standard contribution rate was going to be something that was referred to somewhere in the regulations. Perhaps it was going to be a minimum contribution rate that employers were going to have to pay. I do not know. The point here is that it is rather difficult for us to put together our final comments on EXD8 when it is seen in isolation from the regulations. I hope that we shall have a chance to see the draft regulations before the Guidance Note is finalised.

Concerning the Social Security Act 1990, there are a number of questions which a number of finance and personnel directors are asking when they have a scheme which is not currently providing LPI, and does not have enough surplus to provide for LPI either. These questions are: can the finance director grant individual augmentations of benefits to, say, the new director, or can he give other general benefit improvements, other than granting additional pension increases, before giving full LPI? The cynical answer is that it is fine if you do not put the actuary into a position where he has to report under GN9 and so comply with the surplus requirements under the Act, or, in other words, it is all right if you do not ask the actuary how much the change will cost.

Mr J. M. Young (a visitor): As an accountant, I think that you, as actuaries, are in some danger. You have been teaching us all for many years, and we have learnt slowly, that there are appropriate valuation methods for appropriate circumstances; and we have just begun to learn, perhaps, when they are required. Here we are suddenly told that, to give the Government the impression of standardisation, you are going for one particular method, and, whenever there is a difficulty, the assumption figures will be fudged, if I may put it that way. That is a very dangerous thing for a profession to do.

We should not introduce sentiment relating to the trustee's wishes in the matter. This is a matter of hard economics and personnel policy. It is the company, in most situations, that determines pension increases, and that takes a view about levels of security, albeit in quasi-negotiations with unions, or at least in consultation. The idea of the benign trustee is a false image.

Tying something to GN9 and the certificates we already have may be rather unrealistic for many years, because, so long as the only difference in the certificate is whether it is going to be a six-year or eight-year contribution holiday, that does not concentrate anybody's mind very much. Therefore, you may not be testing what is the real ground or real margin of what the situation will stand. It may be very good in theory, but I suspect, at the moment, that the GN9 certificate is a very flexible wall against which you are leaning.

Mr H. W. Brown (closing the discussion on EXD8): The working party and the joint committee will be studying all your comments and the various written submissions that we have received.

Paragraph 3.2 has given a number of people considerable trouble. If we were to look solely at the surplus position and LPI, I agree that § 3.2 becomes redundant. However, when the future funding of a scheme is considered, § 3.2 is required to establish the actuarial method that is to be used. This becomes particularly relevant when 'contribution holidays', as mentioned by Mr Key, are considered. I think it is the Government's intention that contribution holidays should not be taken until all the surplus from the pension scheme has been used for LPI increases. There is, however, no requirement at present by the Government for a company to fund its pension scheme, and, even though a company may very well have funded its pension scheme in the past, it does not necessarily have to continue funding its future accruing benefits.

Paragraph 3.2 is there to pull three items together: the basis for the surplus/LPI; the basis for funding; and the basis in the disclosure of information requirement. One area of concern of the working party was that the members to whom the disclosure information is available could be misled. A scheme that purports to be funded, or partially funded, might not be funding its future accruing benefits at all. Paragraph 3.2 tries to ensure that proper disclosure of what is being funded is made available to the membership. That may be no contributions if the company decides not to fund its future accruing benefits on the basis adopted. Since § 3.2 has given so many speakers so much trouble, the working party will consider it again.

When is a valuation, a valuation for the purposes of surplus? I am sure, as actuaries, we all look, from time to time, at specific costs under pension schemes and value certain benefits, or look at the value of the assets at certain times, but when do these specific investigations become an actuarial valuation? The working party's conclusion was that when an actuarial report was produced, after the valuation of all of the benefits and all of the assets under the scheme, this would constitute an actuarial valuation for surplus/LPI purposes. I note the comments made by several speakers and agree that further discussions need to take place between the profession and the DSS to ensure that this is the Government's intention, and that an actuarial valuation does not occur every time an actuary puts pen to paper.

The opener asked why EXD8 had taken account of insured pensions. Although we are concerned about the long term for assumptions to quantify the amount of surplus, this surplus has to be converted into LPI or a lower rate. If this rate is to be insured, the working party felt that the cost was best quantified by the actual insurance rate.

One speaker thought that there was no allowance for a lower rate. I think that is covered in § 6.3. We should remember that it is the trustees or the scheme sponsor who have the power to award LPI. As actuaries, we can only provide the various figures to the trustees to enable them to exercise their powers/discretions as to whether or not they will exercise that discretion for a particular priority class, or whether they prefer to spread the increase across the whole group of membership. Paragraph 6.3, taken in conjunction with § 6.5, covers those particular areas.

The President (Mr H. H. Scurfield): I should like to thank you for your views, which I know will be very helpful to the committee. They will also take into account what will be said at the Faculty meeting on 24 October, and then consider the draft Guidance Notes again where they think fit.

I thank you for adhering to the five-minute rule. It enabled us to have all 32 speakers. I think that was helpful, although I do not know that I would like to have had the committee's task had we gone on longer and had another 32, because we were getting a variety of views. That is inevitable when we gather actuaries together.

The committee have put in much effort. Some indication of this is that so many people have spoken. Those who have spoken from the platform deserve a special thanks: Mr Wise, Mr Brown and Mr Brimblecombe, who has been leading the Pensions Joint Committee. Thanks are also due to Mr Lyburn.

I am sure that you would like to join me in showing our gratitude for all the work that the members of the committee have done in getting us this far.

Mr R. E. Brimblecombe (replying): Somebody asked a question about timing. For EXD7, the new rules will come into place when the DSS and the Government lay the regulations and put a commencement date to them. We do not know when that is yet, but it is likely to be in the relatively near future. As far as EXD8 is concerned, the guidance is likely to come into force on 1 January 1992, if that is the Appointed Day, but we must have the guidance ready and working before that.

Because we have had such a rush during the summer, I take the point made by several speakers to the effect that the wording needs tidying up, particularly the certificate under EXD7.

On EXD8, we are dealing with the law as it is. One or two speakers are, therefore, perhaps under a slight misconception. The requirement to provide LPI is the desired aim of Government and is now part of legislation. The question really is the pace at which it happens. I believe flexibility is the best approach, and hence the way forward through professional guidance.