



The Actuarial Profession

making financial sense of the future

consultation response

Board for Actuarial Standards

Transformations

March 2010

About The Actuarial Profession

The Actuarial Profession is governed jointly by the Faculty of Actuaries in Edinburgh and the Institute of Actuaries in London, the two professional bodies for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuing professional development and a professional code of conduct supports high standards reflecting the significant role of the Profession in society.

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

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

The Profession also has an obligation to serve the public interest and one method by which it seeks to do so is by making informed contributions to debates on matters of public interest.

bastransformations@frc.org.uk

9 March 2010

Dr L M Pryor
Director, Actuarial Standards
The Board for Actuarial Standards
5th Floor, Aldwych House
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Dear Louise,

BAS Consultation Paper on Technical Actuarial Standard – Transformations

Thank you for providing the Actuarial Profession with the opportunity to comment on this Consultation Paper. We set out below our observations on your proposals. We are happy for the letter and the Appendix to be placed in the public domain.

The subject of this consultation paper covers several different actuarial practice areas, namely pensions, general and life insurance. The BAS' approach seems to apply the same principles across all areas, but we are firmly of the opinion that transformations in pensions and insurance involve different processes and are not susceptible to the same set of principles. For example, the role of the pensions actuary as set out in GN16 certification is very narrowly defined and does not embrace the wider issue of fairness which is not required by the Regulations which gave rise to GN16. The Profession believes that a standard that allows greater flexibility rather than across-the-board standardisation is needed.

We do consider, however, that there is a need for standards covering work undertaken in this area and that the issues being addressed are very important. We also consider that it is right that the work of an Independent Expert in a Part VII transfer or a reattribution and the actuarial work done in support of a Policyholder Advocate should be subject to BAS Standards.

However we query the need for a separate generic TAS on Transformations. It would seem more appropriate to have specific sections on transformations contained within the Insurance and Pensions TASs. This would also help to avoid duplication of standards affecting transformations across different TASs, which we believe may lead to confusion in interpreting standards. We give an example of this in the response to question 8 below.

Finally, the consultation's discussion of fairness raises ethical issues that cut across the technical/ethical divide and may have implications for the Actuarial Profession's

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responsibilities for ethical actuarial standards. The Professional Regulation Executive Committee will need to watch these implications closely.

Additional comments have been collated from views expressed by actuaries in the general insurance, life insurance and pensions areas. These responses are included in the attached appendix.

If you have any questions or would like to discuss any of these matters further, please do not hesitate to contact us. Should you wish to do so, please contact Martin Hewitt, Pensions Practice Manager on 0207 632 2185 or via Martin.Hewitt@actuaries.org.uk.

Yours sincerely,

Caroline Instance
Chief Executive

APPENDIX

Additional comments to the questions asked by the BAS.

Question 1 – *Do respondents agree that the benefits of a separate transformations TAS outlined in 1.24 outweigh the benefit of one fewer Specific TASs?*

No. This issue has been discussed in the attached letter.

Question 2 *Will the proposed purpose of the transformations TAS that is set out in paragraph 2.5 help to ensure that users of actuarial information can place a high degree of reliance on its relevance, transparency of assumptions, completeness and comprehensibility?*

In pensions work, the principle of 'fairness' is understood in a legal rather than an actuarial sense. The pensions actuary works within a different context to the insurance actuary. For example, scheme certification does not require attention to fairness and the other principles listed in paragraph 2.5. Moreover the pensions actuary is not legally required to address fairness in the sense stated here. The purpose of the TAS moves the playing field beyond what pensions actuaries can do and are expected to do under legislation and by users. GN16, for example, does not place this range of requirements on the actuary. Nonetheless GN16 works reasonably well as a basis for the transformations governed by the legislation the guidance refers to. Likewise s67 and insurance buyouts are also narrower than the principles listed in paragraph 2.5. There might be a danger in a TAS T of trustees and pension actuaries entering uncharted territory where there are no clear solutions.

It might be possible to test the feasibility of TAS T by examining the different guidance notes that could be affected by paragraph 2.5.

In relation to paragraph 2.5 b), within existing regulations, we do not identify any pension work areas that would count as material.

Question 3 *Do respondents agree that the areas of work listed in paragraph 4.56 should be within the scope of the transformations TAS?*

Pensions – The scope falling under the transformations TAS itemised in paragraph 4.56 a), b), c) & d) looks reasonable from a pensions perspective. The paragraph could provide a check list for the feasibility test described under Question 2.

Could the BAS please clarify what is meant by, and who is referred to in, the reference to pensions in item k?

Life – We would advocate including the roles of Independent Expert and Policyholder Advocate within the Insurance TAS to bring them within scope of the Generic TASs and do so within a specific section on Insurance Transformations which stated the additional principles required to be applied to such work. We do not accept that changes to PPFM constitute a transformation and consider that such changes are already adequately covered in the proposed TAS I.

Question 4 *Should the areas of work listed in paragraph 4.57 be within the scope of the transformations TAS?*

Pensions – no comment

Life – We would recommend that the work of the AFH and the WPA in compiling work in connection with a Transformation is included specifically within the Insurance TAS, and do not consider it sufficient to say that the AFH work is implicitly in scope because of the need to advise on capital requirements. All the work of the AFH in support of a Part VII transfer should be within scope. Equally where there is with-profits business involved we would recommend that all work of the WPA in support of the Part VII transfer is specifically brought within scope. The same applies to reattribution exercises and to schemes of arrangement.

Question 5 *Do respondents agree that the areas of work listed in paragraph 4.58 should not be within the scope of the transformations TAS?*

Pensions – no comment

Life – see comment above for question 4.

Question 6 *Do respondents agree that information provided for one party to a scheme of arrangement should be within the scope of the insurance TAS? (paragraph 4.27)*

Pensions – no comment

Life – It is right that actuarial work done in connection with Schemes of Arrangement should be within scope. However, we are less sure about Skilled Person reports. These are almost invariably commissioned by the FSA who are not unsophisticated users of information. If the FSA have decided that the Skilled Person role requires an actuary, then they should ensure that the work done is up to the standard they require. They could of course do this by asking for the work to conform with the Standards in the Generic (or for that matter the Insurance) TASs.

Question 7 *Is there any other work which is not mentioned that should be within the scope of the transformations TAS? (section 4)*

Pensions – no comment.

Life – no comment

Question 8 *Do respondents have any comments on the proposal concerning data that is presented in paragraph 5.4?*

We question why the treatment of data in TAS T differs from its treatment in other TASs? For example, if the generic data TAS stresses the importance of accuracy and completeness of data-based information, then this should apply to all actuarial work and not just to transformations. It is not clear what additional tests are envisaged by referring to “neutrality” but in any event we are of the view these should be included in TAS D. Is paragraph 5.4 intended to pick up on subtleties in insurance that are not applicable to pensions, or vice versa? If so these subtleties should be included in TAS D.

Question 9 *Are there any other data issues which respondents consider should be covered by principles in the transformations TAS? (section 5)*

Pensions – Nothing to add, other than that all data issues should be covered by TAS D and not TAS T and to note that if there are any concerns that the data is biased in some way this may be a matter for referral to tPR.

The BAS is arguing that transformations must be neutral, but if there is insufficient information what other tests might be required to achieve neutrality and fairness? Does this require a new principle or should an existing principle be given an especial force in transformations?

Question 10 *Do respondents have any comments on the proposals concerning assumptions that are presented in section 6, and in particular on the principles proposed in paragraphs 6.5, 6.7, 6.10, 6.13 and 6.19?*

Regarding paragraph 6.19, we are of the view that 6.19 cannot be applied to a GN16 calculation which is more to do with the benefits being provided in the receiving scheme than the basis on which the transfer is calculated.

The principle in 6.19 is too broad. We request it be amended to say something like “The selection of assumptions should place proper emphasis on how the interests of all parties identified as within the scope of the actuarial information are affected by the transformation”

Question 11 *Are there any other principles on the selection of assumptions which respondents believe should be in the transformations TAS? (section 6)*

No.

Question 12 *Are there any specific issues relating to modelling and calculation work for actuarial information provided for transformations which respondents believe should be covered by principles in the transformations TAS? (section 7)*

No.

Question 13 *Do respondents have any comments on the proposed principles on reporting in paragraphs 8.5, 8.6 and 8.7?*

Pensions – We would request clarification of the principle in paragraph 8.5. When referring to ‘changes to the nature of cash flows tomembers.....affected directly by the transformation’ does this mean only those members whose benefits have been transformed, or does it (as paragraph 8.6 could be read to imply) also extend to the impact (if material) of those changes on other members (whose benefits have not been transformed) of the pension scheme, the pension scheme itself or of the sponsoring employer?

In relation to bulk transfers, does the scope extend to impacts on both the exporting and importing schemes?

Paragraph 8.6 as worded refers to the nature and extent of risk *per se*. Should it not reference changes in the nature of risk resulting from the transformation?

We are not clear how the principle in paragraph 8.7 is intended to address neutrality.

Question 14 Do respondents believe that reports should include an opinion on the fairness of a transformation together with a rationale for that opinion? (paragraphs 8.8 to 8.9)

Pensions – We consider that there may be a danger here in crossing over into legal territory. If the BAS wants to extend the pension actuary’s brief, on the one hand actuaries may not be required by law to action any such extended brief and on the other it may open actuaries up to new competition. However, this again marks a difference from insurance where there is a strong ‘treating customers fairly’ legal ethos which doesn’t (so far) apply to UK pensions.

Life – Re paragraph 8.9 would not favour a blanket inclusion of this requirement, but it could be required where the actuary is being asked a question regarding the balance of advantage in a transformation.

Question 15 Are there any other principles on reporting which respondents believe should be in the transformations TAS? (section 8)

Pensions – No.

Life – in a commutation proposal the actuary could also perhaps be required to quantify the allowance made for the possibility that the insurer would otherwise be unable to meet the obligations to the policyholders.

Question 16 Do respondents have any comments on the proposed transitional arrangements from the adopted GNs to TASs described in section 9?

Pensions – Depending on the detail of what is envisaged, pension actuaries would not be required by law to act if a ‘fairness’ concept were introduced into pensions work (see comments on Q.2. above) where none exists today.

We note that the BAS does not intend to take account of the Counsel’s opinion on GN16.

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