



**The Actuarial Profession**

making financial sense of the future

# Consultation Response Financial Reporting Council

Pension Scheme Incentive Exercises

---

4 September 2012

## **About the Institute and Faculty of Actuaries**

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous 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' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

Paul Kennedy  
The Director of Actuarial Policy  
The Financial Reporting Council  
5<sup>th</sup> Floor, Aldwych House  
71-91 Aldwych  
London  
WC2B 4HN

5 September 2012

Dear Paul,

### **Pension Scheme Incentive Exercises: The Institute and Faculty of Actuaries' response**

In anticipation of a wider review that the FRC has indicated will be carried out, the Institute and Faculty of Actuaries has set up a working party to lead on pensions aspects of the TASs. This working party is comprised of experienced pensions actuaries including members of both the Pensions Practice Executive Committee and the Council of the Institute and Faculty of Actuaries. This working party, supported by the executive staff of the Institute and Faculty of Actuaries, has taken the lead in drafting this response to the Consultation Paper dated June 2012.

We support bringing incentive exercises within the scope of the Pensions TAS but believe the proposed changes to the Pensions TAS are not consistent with the FRC's own conceptual framework.

An issue that is of concern for practicing actuaries is how different aspects of the TAS regime interact with each other. We believe that existing principles within the TASs can be extended to cover work relating to incentive exercises and that this would be consistent with paragraph 2.12 of the conceptual framework: '*BAS will bear in mind cost, proportionality and benefits from the perspectives of beneficiaries*'. The growing body of guidance is, bit by bit, moving us away from a principles based regime. As things stand, there is a significant volume of technical guidance relevant to pensions actuaries once the Pensions TAS, the Generic TASs, the associated significant considerations, and questions and answers are all considered.

We therefore respond on the basis that there may be some short-term adjustment to the Pensions TAS pending a more widespread review of the TAS regime at a later date.

In places, the proposed approach will look to both actuaries and users of their advice like prescriptive rules rather than principles. Overall, we do not consider that the approach being taken is consistent with section 2.5 of the conceptual framework that reads: '*The BAS wishes to avoid a "tick box" approach to standard setting... professional judgement and the needs of the users is paramount. With this in mind, TASs will be written in a manner which favours principles over prescriptive rules.*' We will return to these points in our answer to question six.

As you have noted in section 2.3 of the conceptual framework, there is no requirement for the advice of an actuary to be taken. Furthermore in section 4.2 of the conceptual framework it is noted that, '*The BAS is mindful of the practical risk that if a TAS restricts the output of the work done by actuaries, but not the equivalent work done by*

*others, entities may, on occasion, be deterred from choosing an actuary for the work', and continues '...but there may be risks to the beneficiaries, and perhaps to the entities themselves, if those who commission work were deterred from using actuaries at just a point in time when the training of the actuary and the ethical code of the profession were most needed.'* We are of the opinion that there are aspects of the work connected to incentive exercises where these considerations are particularly relevant. For example, it would be to the detriment of scheme members if including the review of communication material resulted in users being less inclined to commission work from actuaries because of a perception that this work's inclusion within the scope of the Pensions TAS would make the advice more expensive.

Below are our responses to the questions posed within the consultation paper.

**1. Do respondents agree that actuarial work concerning incentive exercises should be brought into the scope of the Pensions TAS?**

We support including incentive exercises within the scope of the Pensions TAS provided this can be done in a measured and proportionate way.

We believe that a less prescriptive approach would give actuaries the freedom to use their professional judgement to consider what will be the critical issues in the specific circumstances, whilst bearing in mind the paramount needs of the users of their advice.

**2. Do respondents agree that bringing actuarial work on incentive exercises into the scope of the Pensions TAS is consistent with the existing purpose of the Pensions TAS?**

We agree that extending the scope of the Pensions TAS to include work on incentive exercises is consistent with the purpose of the existing Pensions TAS provided this is done in a proportionate way.

**3. Do respondents agree that the definition of an incentive exercise should be consistent with the definition in the industry Code of Practice?**

We agree that it is helpful for the definition of an incentive exercise to be consistent with the one used in the industry code.

**4. Do respondents agree that the changes to the Pensions TAS should be effective for work performed for aggregate reports completed on or after 1 December 2012?**

We support the FRC's intention to bring this work within the scope of the Pensions TAS as quickly as practically possible.

It is anticipated however, that our members will already be engaged in work on some exercises. Given the nature of these exercises, it will be some time before the exercise is completed and the final reports prepared. We agree with your comment in section 5.5 of the consultation, '...in many cases comprehensive actuarial information is already provided'; it is, however, a non-trivial exercise for actuaries to check that the advice they have already given is compliant with a TAS that did not apply at the time and so even if such checks simply demonstrate that the information already provided was indeed comprehensive, the cost would not be modest. To avoid the need for such additional costs, we would ask the FRC to be very clear that changes to the Pensions TAS are not retrospective in their effect.

**5. Do respondents agree the proposed text in paragraphs C.1.29 to C.1.31 which bring actuarial work concerning incentive exercises into the scope of the Pensions TAS?**

It is important that these paragraphs accurately describe the work that is within the scope of the Pensions TAS. In paragraph 3.8 we agree that the first four, and final bullets cover actuarial work that should be within scope of the Pensions TAS.

We do not believe '...drafting and reviewing communication material to be provided to the members' is actuarial work. Clearly, any actuaries who find themselves engaged in this work will need to be mindful of the requirement of the Actuaries Code as they prepare their recommendations. We believe including this work within the scope of the Pensions TAS is likely to lead to actuaries being excluded from, or excluding themselves from, this work and we strongly believe that such an outcome is contrary to the interests of the pension scheme members.

We do not believe that it is the FRC's intention to bring work done by actuaries operating as Independent Financial Advisors within the scope of the Pensions TAS. We therefore would suggest that C.1.31 be extended to make it clear that the work already regulated by the FSA is not within the scope of the Pensions TAS.

**6. Do respondents agree that the proposed principles should be included in the Pensions TAS? (Paragraphs 4.3 to 4.10)**

Our preference would have been not to add new principles specifically intended to apply to a particular exercise. The Pensions TAS already segments the work that actuaries do so that principles that otherwise could be viewed to apply more generally appear to be restricted to a narrow class of activities. This is likely to have unfortunate consequences, for example:

- The "principles" appear like rules, which could encourage a "tick box" approach (contrary to the intention set out in the conceptual framework published by BAS)
- Actuaries could reasonably infer that each principle has only a narrow application and does not apply to actuarial work that does not entirely match the definition in the Pensions TAS
- Small differences in the way apparently identical principles are expressed leave actuaries confused about their purpose since it is unclear whether the apparent differences are intended to result in different outcomes.

Our view is that this segmentation makes it likely that principles in the Pensions TAS and other TASs that already (in our view) meet the FRC's objective as set out in the consultation document, could be viewed as not applying even after incentive exercises have been explicitly brought within the scope of the Pensions TAS. Consequently, although we accept that one way of meeting the FRC's objective is to add the proposed principles to the Pensions TAS and that it is expedient to proceed on this basis, we consider that a better approach would be to extend the application of existing principles.

We understand that the FRC wants to revise the Pensions TAS as soon as possible so we have made some suggestions on the assumption that the proposed approach will be implemented as a temporary measure. We also understand that the FRC is intending to embark on a comprehensive review of the TASs which we would encourage. We are keen to be closely involved in this review and hope that when it happens, the structure of the Pensions TAS will be changed to include a smaller number of principles which have a wider application across the work that is within the scope of the TAS so that the risk that gaps in coverage appear is reduced (for example, due to developments in the work carried out).

For information, the principles we consider to be sufficient if their application were made clearer are:

- Pensions TAS D.4.5 which requires information on the financial implications on decisions in relation to factors to be provided
- Pensions TAS D.4.4 which requires that advice provided to clients ensures they understand the financial consequences of decisions taken as a result of that advice
- C.5.5 in TAS R, which ensures that clients understand the material risks associated with the information they are provided
- C.5.10 of TAS R requires information on cash flows to be provided.

Naturally, the principles already exist, more or less, in the Transformations TAS. That said, however, they have not been transposed directly, which could result in uncertainty over their application.

In reviewing this section of the Pensions TAS, we have set these concerns to one side and considered how effective the proposed amendments to the Pensions TAS are likely to be.

Whilst we broadly agree with the principles being proposed (D.6.2 and D.6.6), we are concerned that the descriptions are not in keeping with the rest of the Pensions TAS and may inadvertently contribute to the principles being applied only in the case listed rather than more generally. For example, for D.6.2, it may be more effective for the FRC to specify a more general requirement for the actuary to consider all material risks. As such, we would question whether D.6.3 and D.6.4 are necessary, particularly as the lists of risks are unsurprising.

The list in the final paragraphs of D.6.5 and D.6.9 is not intended to be exhaustive and we wonder whether this should be made explicit, as has been done for D.6.3 and D.6.4.

We agree that, as explicitly required by D.6.6 and D.6.7, it is important to draw attention to the need for the actuary to consider how different groups are affected by the changes. However, balanced advice would indicate (where likely) that there could be positive as well as negative outcomes, e.g. D.6.6.c)

Finally, we question the need for the definition of “representative members” in D.6.5 and D.6.9, as the term “representative” seems clear enough. If the FRC considers that the definition is needed then it would be better to locate it alongside other definitions in section B2 rather than repeating it in the body of the TAS.

#### **7. Are there any further principles which would support trustees, sponsors, and members in their decisions that we should consider including in future revisions of the Pensions TAS (Paragraphs 4.11 to 4.16)?**

We believe that the issues considered in these sections would be best addressed as part of a wider review of the effectiveness of the voluntary code and that such a review will be something the Industry Working Group will want to consider once the code has had a chance to take effect.

#### **8. Do respondents agree with the assessment of the impact of the proposals in section 5?**

We agree with the FRC that it is important that trustees, scheme sponsors, and others are provided with information so that they can understand how members might be affected if they accept the offers and that this will be beneficial to members. It is also important that trustees and sponsors understand any potential change in the material risks.

Our answer to question six highlights how the approach that the FRC is proposing may actually make it more difficult for actuaries to bring these material issues to light if all items in the various lists need to be addressed to demonstrate compliance with the Pensions TAS.

Our answer to question five highlights how a potential consequence of including the '...drafting and reviewing of communication material' within the scope of the Pensions TAS may be that there will be less involvement by actuaries in these tasks which could potentially reduce the quality of information available to members.

**9. What costs and benefits do respondents consider would arise from the proposed amendments to the Pensions TAS?**

We believe the firms that provide these services will be better placed than us to assess the costs of incorporating the FRC's recommendations into their work.

Our answer to question six highlights how the way in which the FRC is proposing to incorporate these exercises into the scope of the Pensions TAS may give rise to further unanticipated costs. Actuaries who do work in this area will need to consider how the existing principles in the Pensions TAS need to be reflected in their advice.

Yours sincerely,



Jane Curtis  
Immediate Past-President  
The Institute and Faculty of Actuaries