ASSOCIATION OF CONSULTING ACTUARIES

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3 August 2023

The Director of Actuarial Policy
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Dear Sirs

## FRC consultation on Technical Actuarial Standards for Pensions

I am writing on behalf of the Association of Consulting Actuaries in response to the above consultation. We were grateful for the opportunity to discuss the consultation with your team on calls last month and we would be happy to have further discussions in due course.

### TAS 300

Our key observations in relation to TAS 300 are:

- As drafted, we consider the scope of changes to TAS 300 is wider than intended (Q1).
- Retaining flexibility in the timing of factor reviews may help improve quality of advice (Q3).
- Practitioners provide actuarial advice on factors, but their remit is not generally to specify the value for money that members must receive, which rests with decision-makers. We consider it is important for standards to recognise explicitly the respective roles, and that decisions on the level of scheme benefits also include non-actuarial considerations (Q4,Q5).
- We consider evidence indicates the impact assessment is likely to be higher costs than suggested in paragraph 4.5 of the consultation document (Q20).

### TAS 310

We have several concerns in relation to TAS310. Our most significant concerns are:

- The requirements, for modelling and assumptions, to consider and report on 'credible alternatives', and the accompanying additional costs along with possible unintended consequences – such as pressure on the actuary to change their preferred approach and

potentially facilitate the deferral of difficult decisions (see our comments on P3.5 for Q12, and both P6.1b and P6.2a for Q17).

- A lack of clarity on whether the 'credible alternative' requirements would introduce an obligation to consider a full range of credible alternatives or simply two or three possible alternatives.
- The introduction of a definition of 'central estimate' which differs from the definition set out in legislation (Q11).
- The proposed requirements for post valuation experience (see P6.1c and P6.2b comments on Q17).
- A focus on downside over upside scenarios which could introduce bias into the decision-making process (see P3.2 on Q12 and P5.4f on Q14).
- The introduction of a particularly onerous new requirement, to model the probability that the live running tests might be failed at some future date using stochastic modelling (see P3.2 comments on Q12).

These issues are likely to push up costs (and perhaps even discourage the introduction of CDC arrangements) unless they are addressed. Therefore, as TAS310 is currently drafted, we do not agree with your suggestion that any costs arise solely from the legislation and regulation of CDC. TAS310 would add material costs if it is implemented in its current form.

Given these issues are likely to require significant redrafting to address, we would be happy to work with FRC to develop a new version of TAS310 as soon as possible, given the first CDC scheme has already been approved.

## Detailed consultation responses

Our responses to your specific questions are set out in the appendix to this letter.

We hope that you find the contents of this letter of assistance. We would be happy to discuss them further if that is helpful. In that event, please contact in the first instance or David Roberston at the ACA Secretariat.

Yours faithfully

**Steve Taylor FIA,**
**Chair of the Association of Consulting Actuaries Limited**

On behalf of the Association of Consulting Actuaries Limited

## APPENDIX

**1. What are your views on the proposed changes to the scope of TAS 300? Are there any other areas of pensions work that you consider to be inadequately covered by TAS 300 and should be included?**

We agree the proposed changes to scope in light of the output of the thematic review and current and potential future industry developments in transfer of pensions liabilities to different arrangements.

We do not consider it essential that the revised TAS 300 should reflect all future legislative developments, given the comments in Q2 below and given the expected continued evolution of superfund type options that may require further consideration in the short term.

We have a concern that your proposed simplification of the definition of "scheme funding and financing" will (presumably unintentionally) significantly expand the technical actuarial work that is subject to section 2 of TAS 300. We suggest that you keep the old scope definition. This also ties in with your proposal to defer any changes to section 2 (other than the new P2.9).

*(If you were to keep the definition as drafted, then the text of the more detailed principles (particular those within P2.1-P2.8) would need to be amended to make clear which elements of work the principle applies to, and some of the comments would need to be made more general.)*

We support separating out considerations around CDC work into a new document, TAS310.

**2. Do you agree our intention to defer any changes to requirements under scheme funding and financing until there is greater legislative certainty? Do you have any other specific concerns in relation to provisions on scheme funding and financing that you believe require addressing over a shorter period?**

We agree that deferment is sensible in light of the delay in the introduction of a new funding code and associated regulations. This may also be advisable in light of a different financial background that has developed recently for many schemes in comparison to the financial conditions linked to low interest rates that had persisted for many years before last year, which may shift some of the proposed funding code principles set out in earlier drafts.

It would be necessary to link the 'in-force' date for any future TAS amendments here to valuations with effective date after the legislation takes effect, and in orderly fashion with the in-force dates for the new funding code and regulations.

**3. What are your views on the proposed changes to TAS 300 in relation to the frequency of review of the actuarial factors? What are your views on the proposed changes to TAS 300 in relation to the timing of review of actuarial factors?**

We agree the general provisions of P3.1 requiring advice on the frequency of reviews of actuarial factors, it being envisaged that these would normally be carried out in full after no more than 3 years unless there are specific reasons for other approaches (which may for example include proportionality for a scheme with few members, or even for larger schemes with for example very few deferred members).

The provisions of P3.2 do not seem necessary. A practitioner can always undertake a review anyway coincident with the Scheme funding assessment if this is thought to be beneficial.

The justification for coincident timing in the consultation paper appears to be that this would then not *"unintentionally constrain future decisions on factors through decisions made on the funding valuation"*. One might equally say that being tied to the valuation timetable constrains future decisions, given all the events that can happen between valuations (an opportunity due to events to partly de-risk investment strategy further and unexpectedly between valuations perhaps being just one example).

We suggest the timing is left flexible so that the Trustees/Employer /Practitioner can discuss and agree the best times for review, to support the aim of quality of advice. Indeed the 2016 IFoA Risk Alert called for actuaries to consider the frequency of providing advice and be aware of market trends. P2.9 seems to enable the more flexible approach.

**4. Do you consider the proposed changes to Section 3 would enable decision-makers to reach a fully informed view in setting actuarial factors?**

No, because reaching a fully-informed view depends not only on absorbing the important pure actuarial aspects (such as the financial and demographic background) but also many other considerations.

Practitioners will often need to consider, synthesise and explain matters to their clients and decision-makers such as the purpose of the Employer in establishing the Scheme, the provisions of the Scheme's trust deed and rules (including "hard-coding" or "certification") and relevant legislation, the inter-generational considerations in making changes, the merits of a reasonably straightforward approach in helping members understand benefit options, the ability of Scheme administrators to reliably communicate benefit options and put these into payment, and other aspects.

Best practice, adherence to the Actuaries' Code and reflection of any conclusions from IFoA thematic reviews should be enough to encourage practitioners to give sufficient advice for decision-making - without the need to incorporate into TAS 300.

**5. Do you consider that the remit of TAS 300 includes specifying how actuarial factors are set, either in relation to the value for money members should get from cash commutation or in making allowance for future changes to investment strategy in CETV factors? Please explain your rationale.**

We do not think the remit of TAS 300 includes specifying how actuarial factors are set in relation to value for money for members. The legal basis for setting actuarial factors for benefit options from the Scheme is very different from CETVs where the principles of CETV best estimate assumptions and CETV equivalent value for a deferred pension are deeply embedded.

The practitioner can (and will be expected to) advise on how the value of any set of factors compares with CETVs, but it is not for the actuary to unilaterally grant members this level of value for Scheme options where it is not either the decision-makers intention or a legislative or Scheme requirement. Practitioners advise but decision-makers decide. A prime example of this is the largest public sector pension schemes where commutation factors are permanently fixed at 12:1.

Factors are generally set homogeneously for large groups of members, without individual member underwriting. A close theoretical value for money approach cannot be achieved when it is known that for example health conditions will vary widely within large group of members implying greater or lesser value for individuals from a common set of factors.

Existing approaches to setting factors have dealt with such issues for many years.

The thematic review includes a number of references to perceived poor value for members, but aside from "overdue" reviews, this is perhaps ascribing a notion for a member's right to an ongoing market-related value for money for benefit options. This is possibly comparing a parallel notion with some wider financial services practices such as insurers' obligations for "treating customers fairly" where there is a separate contractual arrangement.

In terms of allowance for future changes to investment strategy in CETV factors, we agree this should be a consideration when CETV factors come to be reviewed, and a view formed on the likelihood or otherwise and possible timing, and communicated as envisaged by P3.8. However in many cases plans (for example around de-risking) will be uncertain.

**6. Are there other provisions relating to actuarial factors which you believe should be introduced?**

No. other than to recognise in the provisions of P3.3 d. and e. that the rationales are not necessarily only actuarial, as highlighted in Q4 above. This is a critical issue for actuaries who are required to certify factors are reasonable, when the Scheme's trust deed will not include any further provisions on the reasonability criteria.

It is also perhaps worth recognising and mentioning that an insurer's factors will often be adopted following or approaching a buy-in, and how this may be dealt with in the context of the provisions of P3.4.

**7. What are your views on the proposed provisions in section 5 in relation to bulk transfers? Do you think that the proposed provisions would ensure the actuarial advice given to decision-makers would allow them to be fully informed when considering potential bulk transfers?**

An additional comment to highlight different advisory obligations for buy-in style transactions and bulk transfers may be helpful.

It may in fact be helpful to separate the provisions of section 5 for each type of bulk transfer, as many provisions for one type will not apply for another type. At the same time, when a series of buy-ins is being carried out, much of the advice for the final buy-out may already have been provided.

For decision-makers to be fully informed they will also need to consider the input of third parties, and its reasonableness, separately from the practitioner's advice.

It is important that the standard of considering credible alternatives in P5.1a is realistic given some schemes will have limited options in terms of the number of available market quotes, and in terms of constraints on time and resources.

**8. Do you consider that the proposed changes to TAS 300 on modelling work relevant to superfunds would help mitigate the risks associated with pensions practitioners' lack of familiarity with features of the modelling required?**

Practitioners already need to consider competence under the Actuaries' Code, so arguably detail in P5.4 would not be needed in order to mitigate the risks. It is of course early days for superfunds work and practitioners will need to consider competence and risk issues closely as in other developing fields.

There may also be circumstances where some conclusions may be largely self-evident (for example where there is an underfunded scheme and cash constrained sponsor compared with a strong superfund) so that relatively less detailed modelling would be required.

**9. Are there other provisions relating to bulk transfers which you believe should be introduced into TAS 300?**

Specific references are given in response to Q7 above, but generally this may become more evident over time with the continuing evolution of superfund type options.

**10. Do you have any comments on our intention to have an effective date for TAS 310 of within one year of the first CMP scheme being in operation? Is there an alternative timing that would be more appropriate? Please provide any supporting evidence for alternative timings. We agree that the existing requirements should apply to new whole-life multi-employer schemes**.

Ideally, this TAS would have been in place before advice was given on the first CDC designs to be put forward for authorisation. Given the nature of CDC schemes, the design of the scheme is key and many aspects are 'set in stone' once the design is formalised in the scheme rules. Subsequent valuations must follow the design set out in the scheme rules.

This would suggest that the TAS should be brought into effect as soon as possible. However, it is also important for the TAS to be well drafted and, as noted in the executive summary above, we have several significant concerns relating to the draft put forward for consultation which will need careful consideration before TAS310 can be finalised.

**11. Do the proposed provisions provide sufficient clarity of requirements for practitioners to set central estimate assumptions? Please set out any areas of setting CE assumptions you believe require further provisions, including reasons for these.**

The provisions seem reasonable and consistent with the approach we would expect to be adopted, except in the definition of "central estimate". This term is already defined in legislation – Regulation 2 of the OPS (Collective Money Purchase Schemes) Regulations 2022 defines it as "an estimate that is not deliberately either optimistic or pessimistic, does not include any margin for prudence and does not incorporate adjustments to reflect the desired outcome", the glossary should reference this definition and not introduce a second definition for the same term (or amend the terminology and use a competing definition for a very similar concept).

**12. What are your views on the proposed provisions in relation to CMP modelling? Do you expect the proposed requirements on communication to support intended users in making relevant decisions based on modelling? Do you believe there are further items where additional requirements would be appropriate?**

P3.1 requires models to "reflect the complexity of scheme benefits". We are not sure what the words "the complexity of" are intended to add. In practice, the benefit structure of a CDC scheme is likely to be significantly simpler than (for example) a legacy DB arrangement. We suggest this wording should be replaced with "reflect the scheme benefits".

We have several concerns over P3.2:

- P3.2 proposes a stochastic assessment of the probability of the live running tests being failed at some point in the future. Given the complexity of these tests, projecting them forward on a stochastic basis seems extremely disproportionate and is likely to be very expensive. In addition, it is not clear what actions the trustees might take as a result of knowing that there is an x% rather than a y% probability of failure. It seems that this information would be unlikely to influence trustee decisions and so imposing significant additional costs would be disproportionate.

- P3.2 suggests models should be able to "identify scenarios (including probabilities)" relating to certain events happening. This appears to confuse scenario planning with stochastic modelling. We would suggest this wording be replaced by "estimate the probability that:"
- P3.2 focuses on downside scenarios in isolation – in practice upside scenarios might be equally likely and also present challenges for the management of CDC schemes. A focus on downside outcomes might bias decision making towards making central estimates which err towards prudence.
- We note that P3.2 does not suggest a period over which the probabilities should be assessed. We do not think a specific period should be set by the TAS but it would be helpful to state that the actuary should select an appropriate period.

Paragraph 3.18 of the consultation document indicates that stochastic modelling might not be required to form a view on soundness, despite the expectation set out in P3.3, that stochastic modelling should be used. In principle we are supportive of the use of stochastic modelling for CDC schemes.

However the comments in paragraph 3.18 (that an alternative approach can be used provided this satisfied P3.1 and P3.2 and the reliability objective) would need to be included within the TAS, if that is indeed FRC's intention.

We are not sure what P3.4 is intended to achieve. Clearly changing the underlying model could result in significantly different modelling results but simply confirming that this is the case (which would appear to satisfy this requirement) would not be of particular benefit. We are concerned that any change to the wording of this requirement could easily introduce a very onerous requirement, without adding any benefit.

On P3.5, it is not clear whether this is a requirement to comment on one or two credible alternatives, or the possible range of credible alternatives. The latter seems virtually impossible to satisfy as there would be a huge range of "credible alternative modelling". Even considering one or two alternative models seems disproportionate, given the complex nature of the exercise.

This is therefore potentially an extremely onerous requirement, particularly if a quantitative evaluation is required. Our preference is to remove the requirement completely – or to simply require communication of the fact that different models could produce very different outcomes.

More fundamentally, we are concerned that requiring consideration of alternative modelling could lead to pressure on the actuary to adopt more optimistic approaches, and in turn this could lead to contentious benefit reductions being deferred and unsustainable expectations being set.

P3.6 might usefully be extended to include which variables have not been modelled in a stochastic manner and why this approach was taken.

P3.10 partially mirrors the wording in P3.2 and our concerns over that paragraph, as set out above, are similarly mirrored. We note that the "identify scenarios (including probabilities) where" wording has morphed into "explain scenarios where".

We suggest, given the analysis is likely to be built on stochastic modelling rather than scenario testing, that this wording is replaced by "estimate the probability that" (provided the requirement to comment on the live running tests being failed in future is removed, as we suggest above).

**13. What are your views on the proposed provisions in relation to Scheme design? Do you envisage any difficulties in meeting the requirements of these provisions. Please provide details to accompany your response.**

P4.1 requirement to use data which is "as comprehensive as possible" seems an unnecessarily high benchmark, suggesting all data conceivably possible to collect would need to be collected. The requirement is particularly onerous given it could be applied to very early preliminary and therefore approximate assessments of a possible CDC arrangements. We would suggest use of data that is "appropriate to the advice being given, to the extent that this is available".

In addition, we are not sure why these requirements should not also apply to schemes which are in the process of applying for authorisation.

**14. What are your views on the proposed provisions on completing assessments of scheme viability and certifying soundness? Do you consider it is appropriate to require practitioners to consider areas beyond those outlined in legislation when certifying soundness? Please give reasons for your response.**

We agree that it would not be appropriate to define soundness within the TASs, given there is no definition provided in legislation. We would be concerned if the TASs added specific additional requirements to the legislative provisions relating to soundness.

P5.1 should refer to "all relevant *actuarial* matters" rather than "all relevant matters (see Q15). Otherwise, we are satisfied with P5.1 as drafted which simply emphasises that the actuary could go beyond the legislative provisions where they consider there to be additional 'relevant (actuarial) matters', and then lists some matters which might (or might not) be considered relevant by the actuary.

We do not think the items listed in a to c of P5.1 would necessarily suggest a scheme is no longer sound, and our preference would be to remove this list, in particular the reference to "intergenerational fairness" which is not defined and may have various interpretations. We do not have strong objections to the other items being included, given the actuary can simply ignore the factors listed where they are not considered to be relevant.

On consideration of member communication by the scheme actuary, Regulation 11 (2)(b)) of the OPS (Collective Money Purchase Schemes) Regulations 2022 limits the scope of the documentation that an actuary would be required to review to specific named items of communication – so that the actuary is not obliged to read through many different items of communication (most of which will not be relevant and will not be cost effective for the actuary to consider). Whilst we agree that it <u>may</u> in some circumstances be appropriate for the actuary to take into account a wider range of member communications in forming a view on soundness, the TAS should not introduce a requirement to review a wider range of documentation than is set out in the legislation. Whilst P5.2a does not necessarily cause a direct problem – as it can be read as simply requiring the actuary to review the communication they consider relevant – we think it would be more helpful if the reference to "all member communications" was amended to "the member communications".

We note that P5.4d refers to "any running or gateway tests". This should presumably say "any <u>live</u> running or gateway tests".

P5.4e requires some qualification as to the probability of such events occurring. The actuary should not be required to consider all possible events that could materially impact soundness (however unlikely).

P5.4f requires amendment to cover both downside and upside scenarios which could lead to a scheme become unsound (e.g. scenarios in which very high future pension increases might be required, making the design inappropriate and hence potentially unsound / unviable).

**15. Do you agree that the considerations for a practitioner certifying scheme soundness via a viability certificate are the same as those a practitioner should communicate to trustees in their own consideration as to whether the design of the scheme is sound for their viability report?**

Not necessarily. As soundness is not defined and is based on judgement, the actuary might wish to flag wider issues to the trustees – issues which are not considered to prevent certification from an actuarial perspective but which the trustees should consider in forming their own view on soundness, for the purposes of their annual viability report. Paragraph 3.2 of the IFoA's APS P1 requires the actuary to draw the trustees' attention to any matters which the trustees should bear in mind before taking any action associated with the certification.

**16. Are there any other areas in relation to soundness (including practitioners' communications of their work on soundness) which require further standards? Please provide as much detail as possible.**

No.

**17. What are your views on the proposed provisions on actuarial valuations for CMP schemes? Are there other key areas of judgement beyond the central estimate assumptions? Are there further areas you would expect to be included? Please give reasons for your response.**

We can see no reason for the requirement in P6.1a, to compare assumptions with those used in the first gateway test. These are likely to become less and less relevant as time progresses – and this could happen quite quickly if there are significant financial change shortly after the scheme commences. In any case, it is not clear why consistency with a historic test should be required or even what benefit this would provide, to justify the additional costs of this analysis.

The commentary at paragraph 3.39 of the consultation discusses a comparison with the original aspiration for (say) inflationary pension increases. We can see that it might be helpful to comment on this particular point but this seems much narrower than the P6.1a requirement to compare (all?) assumptions with those adopted for the original gateway test. A comparison with the assumptions adopted for the most recent previous valuation might be more reasonable.

On P6.1b, (and as for P3.5 above), it is not clear whether this is a requirement to consider one or two credible alternative sets of assumptions, or the possible range of credible alternatives for each assumption. The latter seems virtually impossible to satisfy as there would be a range of "credible alternative central estimates" for each assumption. The former would not appear to add a great deal of information, to justify the increased costs associated with multiple calculations.

More fundamentally, we are concerned that requiring reporting of alternative bases could encourage trustees to push the actuary towards the more optimistic scenarios, and in turn this could lead to contentious benefit reductions being deferred and unsustainable expectations being set. Conversely it could worry trustees into pushing the actuary towards the more pessimistic scenarios. Either way, this requirement could lead to bias in decision making and therefore intergenerational unfairness.

The requirements for consideration of post valuation experience (PVE) are disproportionate. CDC valuations are carried out every 12 months and can take up to 10 months to complete. If the actuary has to consider allowing for PVE (which is inevitably a constantly moving target) in setting the benefit adjustment there would be a risk that the valuation cannot be completed (as CDC valuations must be based on central estimates, which would change from day to day). We accept that there might be circumstance (for example following a significant market crash shortly after the effective date) where ignoring allowance for PVE would be inappropriate.

Our understanding is that the legislation - in particular Regulation 19(2) - was drafted with this specific point in mind. Allowance for PVE is a trustee decision – which we might expect to be applied in extreme circumstances - and in normal circumstances PVE should be ignored. This is a further example where TAS310 introduces requirements beyond those set out in the legislation and regulation of CDC, and where compliance with TAS310 would add material cost if it is implemented in its current form

Against this background, the wording of P6.1c is highly problematic. Firstly, we do not think that the correct test should be whether there has been “material” PVE. “Material” in this sense would be taken to mean impacting on the level of the benefit adjustment – but this could easily vary from day to day so this test would very frequently be met. The threshold for having to calculate revised benefit adjustments based on PVE should be much higher.

We would suggest that the requirement should be replaced with something that reflects the fact that the decision to allow for PVE or not is a trustee decision and that in normal circumstances the valuation can be completed based on conditions at the valuation date without requiring additional calculations. Perhaps this could be a requirement for the actuary to state “whether post valuation experience has been so significant that it would be inappropriate to calculate the benefit adjustment based on financial conditions at the valuation date.”

P6.2a again raises the problems associated with “credible alternatives” – see our comments on P3.5 and P6.1b above. Paragraph 3.38 of the consultation document explains that FRC “considers it necessary” without confirming exactly what it has in mind (in terms of the potential range or one or two alternative suggestions) or why this might be necessary – or even beneficial, given the additional costs involved and the potential for the actuary to be encouraged to move towards one end of a given range of alternatives, introducing bias, as a result of requiring these additional disclosures.

The P6.2b requirement to consider a ‘credible alternative’ to the approach adopted for PVE should be removed. We set out above in our comments on P6.1c, why PVE should only be allowed for in extreme circumstances and should generally be ignored. Given the choice is to allow for PVE or not allow for it, if the actuary has concluded that there is not a compelling reason to allow for PVE, the TAS should not introduce a requirement to consider the alternative approach of making allowance for PVE and assessing what the benefit adjustment would have been had allowance for PVE been made (and incur the costs associated with the additional calculations etc).

**18. Do you agree the required content of the valuation report set out in Appendix A is reasonable for CMP schemes? Is there further content which should be included?**

Paragraph h should be restricted to material risks.

**19. What are your views on the proposed provisions in relation to factors for CMP schemes? Do you envisage any issues complying with provision P7.4 regarding selection risk? Are there certain groups of members you believe this may disadvantage? Please provide reasons for your response.**

On P7.3, we think that "Where cash equivalent transfer values are to be calculated on a share-of-fund basis" should simply say "For cash equivalent transfer values", given legislation requires a share-of-fund basis.

In addition, the TAS should make it clear that the requirement for factors to be "cost neutral on a central estimate basis" and the communication requirements in P7.5 and P7.6 do not require consideration of sex-specific factors versus unisex factors, where trustees wish to (or are required to) adopt unisex factors.

**20. Do you agree with our impact assessment? Please give reasons for your response.**

TAS 300 **:** Although paragraph 4.5 of the consultation states it is not expected the proposed changes will result in significant additional work within a factor review, this seems at odds with some of the new provisions. For example P3.4 requires a comparison of commutation factors with the cost of purchasing an annuity, with the CETV, and with any long-term funding objectives, Given the reported statistics on page 15 of the thematic review at least, this points to additional work in many examples.

For bulk transfers, we agree with paragraph 4.7 of the consultation that new costs would arise from a new type of transaction.

TAS 310 : As noted above, we have significant concerns over the current draft of TAS310, which would add a large amount of additional cost to the requirements of legislation. Examples include the proposed additional requirements to consider and report on 'credible alternatives' in several areas and considerations and reporting in relation to post valuation experience. It is therefore not correct to suggest, as set out in paragraph 4.8 of the consultation document, that any costs arise solely from the legislation and regulation of CDC. We hope that these issues will be addressed as a result of this consultation, so that the final version of TAS310 does not introduce significant additional costs

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