~~BOARD FOR ACTUARIAL STANDARDS~~

FINANCIAL REPORTING COUNCIL

PENSIONS TECHNICAL ACTUARIAL STANDARD

SIGNIFICANT CONSIDERATIONS

~~OCTOBER 2010~~

NOVEMBER 2012

CONTENTS

1 INTRODUCTION

PURPOSE

1.1 The ~~Board for Actuarial Standards (BAS)~~ Financial Reporting Council (FRC)[1] is responsible for setting technical actuarial standards in the UK~~: it is~~. Before 2 July 2012 this responsibility lay with the Board for Actuarial Standards (BAS) which was an operating body of the ~~Financial Reporting Council (the FRC)~~[2]FRC. The FRC is assisted in the setting of technical actuarial standards by its Actuarial Council.

1.2 In October 2010, after a process of consultation, the BAS published its Specific Technical Actuarial Standard (Specific TAS) on Pensions (the Pensions TAS).

1.3 This document reviews the considerations and arguments that were thought significant by the BAS in developing the Pensions TAS and by the FRC, advised by its Actuarial Council, in making amendments to the Pensions TAS after July 2012.

BACKGROUND

1.4 In ~~our~~the BAS's consultation paper *Towards a Conceptual Framework*, which was published in November 2007[3], we proposed that our standards would be of two types: generic, applying to a wide range of actuarial work, and specific, limited to a defined context. Generic standards would help to provide coherence and consistency across the range of actuarial work.

1.5 That document also set out our proposals that standards be principles-based rather than rules-based, and that they address outputs and responsibilities, with output-based standards focusing on the users of actuarial services and their needs as decision makers.

1.6 In April 2008 we published a consultation paper on the *Structure of the new BAS Standards*, in which we set out our proposals to develop a suite of TASs of which three would be Generic TASs on *Data*, *Modelling* and *Reporting Actuarial Information*. There would also be a number of Specific TASs, applying to work in particular areas such as insurance and pensions. The Pensions TAS is the first Specific TAS that we have developed.

1.7 Following consultations, we published our Generic TAS on *Reporting Actuarial Information* (TAS R) in September 2009, our Generic TAS on *Data* (TAS D) in December 2009, and our Generic TAS on *Modelling* (TAS M) in April 2010.

1.8 In June 2009 we published a consultation paper on *Pensions*, followed by an exposure draft of the Pensions TAS in February 2010.

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[1] The Financial Reporting Council is the UK's independent regulator responsible for promoting high quality corporate governance and reporting to foster investment.

[3] All ~~BAS~~FRC publications are available from ~~http://www.frc.org.uk/bas/publications/~~ http://www.frc.org.uk.

1.9 We consulted on proposed Specific TASs on *Insurance* and *Transformations* in 2009, and issued exposure drafts in April 2010 and June 2010 respectively. We also consulted on a possible Specific TAS on *Actuarial information used for accounts and other financial documents*. Following that consultation we decided to cover the work in the Pensions and Insurance TASs rather than in a separate TAS.

1.10 Following a consultation in June 2012, the scope of the Pensions TAS was amended to include actuarial work concerning incentive exercises.

~~1.10~~1.11 We aim to ensure that our standards are consistent with the wider strategic aims established by the FRC including its *Actuarial Quality Framework*, which was issued in January 2009 and updated in June 2010.

PENSIONS TAS

~~1.11~~1.12 In developing the Pensions TAS, we considered the responses to the consultations mentioned above. We also held discussions with a number of bodies including the FRC's Actuarial User Committee.

~~1.12~~1.13 The Pensions TAS is the first Specific TAS to be developed by the ~~BAS~~FRC. The structure and style used for the Pensions TAS are reviewed in section 2. Sections 3 to 8 review the development of the content. Section 9 reviews amendments made in November 2012 to bring actuarial work concerning incentive exercises into the scope of the Pensions TAS.

2 STRUCTURE AND STYLE

INTRODUCTION

2.1 The structure and style of the Pensions TAS (and our other TASs) reflect the objectives and characteristics of our standards that are set out in our *Conceptual Framework*[4]. In particular, our TASs are written in a way which favours principles over prescriptive rules, and each TAS has its own specific objectives.

STRUCTURE

2.2 Information including the status of the TAS and its relationship with other TASs and with Guidance Notes is included in a rubric that precedes the content of the TAS.

2.3 Part A of the TAS covers its purpose and Part B covers how it should be interpreted. Part C sets out its scope. The remaining parts of the TAS set out principles. Part D contains general principles applicable to all work within its scope. Part E applies only to work for pension schemes which are subject to the *Pensions Act 2004* Scheme Funding regime. Part F applies only to work for other funded pension schemes.

STYLE

2.4 In drafting the Pensions TAS, we have tried to tread the fine line between being clear about the requirements of the TAS and being unnecessarily prescriptive. We consider that, for writing standards, clarity of expression and the substance of the text are more important than the tone in which the text is written. We therefore use the word “shall” to express requirements, and “will need to” to describe the implications of those requirements, in order to provide clarity about what the Pensions TAS requires. The use of these words is consistent with the Pensions TAS’s mandatory nature.

2.5 Some of the requirements in the Pensions TAS are for indications or explanations. These terms were chosen because they can be interpreted quite broadly, and therefore the level of detail that they require is a matter for judgement.

2.6 The whole of the Pensions TAS is subject to the provision in the *Scope & Authority* that it is only material departures that need be disclosed. There is an explicit statement to this effect in Part B, and the word “material” is therefore used sparingly in the TAS. Similarly, Part B states that the requirements should be interpreted proportionately, and the word “proportionate” is not used in the remainder of the text.

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[4] The *Conceptual Framework for Technical Actuarial Standards*, published in July 2008.

3 PURPOSE OF THE PENSIONS TAS

PURPOSE

3.1 All our standards serve the overall purpose set out in our Reliability Objective, that the users for whom a piece of actuarial information was created should be able to place a high degree of reliance on the information's relevance, transparency of assumptions, completeness and comprehensibility, including the communication of any uncertainty inherent in the information.[5]

3.2 Our standards are intended to ensure the quality of actuarial information that the users receive, whoever performs the work. Actuaries performing work that is not designated as being within the scope of our standards may choose to comply with them, and people doing actuarial work who are not actuaries may well be required by others to meet the same standards. The purpose of TASs is to set out requirements that must be met in order to comply with them, not to explain best practice or recommend good practice.

3.3 We identified three broad categories of actuarial work in pensions which we considered should be covered by the Pensions TAS. These areas of work are critical for the proper governance of pension arrangements and therefore the underlying actuarial work should be of the highest quality. The three categories are:

- actuarial work carried out to assist decisions on financing and benefits;
- actuarial work carried out to support trustees and others in fulfilling their regulatory duties (such as Scheme Funding and financial reporting); and
- the calculation of benefits payable to members (such as transfer values and early retirement pensions).

3.4 The purpose of the Pensions TAS has been drafted around these three categories of work (paragraph A.1.2).

3.5 As stated in paragraph B.1.7, the interpretation of the Pensions TAS is governed by its purpose. If it appears that any provision in the Pensions TAS conflicts with its purpose, then that provision is being misinterpreted. However, the purpose does not in itself impose any requirements.

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[5] *Scope & Authority*, paragraph 8.

4 INTERPRETATION OF THE PENSIONS TAS

INTRODUCTION

4.1 Part B of the Pensions TAS consists of two sections. The first describes how the TAS should be interpreted and the second defines a number of terms that are used in the remainder of the TAS.

INTERPRETATION

4.2 The text in section B.1 of the Pensions TAS is intended to assist practitioners to make judgements about how to comply with the standard. All our TASs are principles-based: they are not intended to foster a tick-box mentality. Awareness of the objectives and spirit of the standard should help practitioners make judgements about compliance.

Materiality and proportionality

4.3 Many of the responses to our consultations and the discussions we have had with practitioners indicate that there can be a tendency to interpret our standards as requiring more work and more detailed work than is our intention. In section B.1 we have therefore emphasised:

- the provision in the *Scope & Authority* for immaterial departures;
- that the standard should not be interpreted disproportionately; and
- the scope for interpretation in the details of the principles.

4.4 We do not consider that it would improve the clarity of the Pensions TAS to repeat the word "material" in every principle. We have therefore explicitly reminded its readers that the standard should be read in the context of paragraph 23 of the *Scope & Authority*, which permits immaterial departures (paragraph B.1.2).

4.5 We consider that actuaries (and others complying with our standards) should not act disproportionately, and in particular they should not use ~~BAS~~FRC standards as an excuse for doing so. We have taken care to ensure that it is not necessary to perform work that is disproportionate to the needs of the users in order to comply with the Pensions TAS, and have explicitly reminded readers of the standard that it should not be interpreted disproportionately (paragraph B.1.3). Proportionality applies to documentation, including work carried out to document compliance with our standards, as well as to information in reports and the work on which the information is based.

4.6 There is an important distinction to be made between materiality and proportionality. If a piece of actuarial information is not material, there is no requirement to follow the principles set out in the standard. In this context a piece of actuarial information might be either the result of substantive work performed or information required to be in an aggregate report by our standards. If actuarial information is material, the principles must be complied with proportionately. For example, in some cases a required explanation might be comparatively brief, or an indication might consist of a short description, while in other cases a detailed explanation or full quantitative analysis might be appropriate.

Actuarial work

4.7 The term “actuarial work” is used throughout Part C. There is no universally accepted definition of “actuarial work” and we consider that it is not possible to provide a precise definition, especially as the actuarial profession evolves and the range of work that it performs changes. We also consider that actuaries and users generally know what work is actuarial work when it is performed. Nevertheless we recognise that it would be helpful to have a description of what we regard as actuarial work for the purpose of the Pensions TAS. This description is written for the specific purpose of the Pensions TAS and cannot necessarily be applied more widely. It is a broad description and so judgement will have to be used in determining what work is actuarial work for the purposes of the Pensions TAS (paragraph B.1.4).

4.8 Often actuarial work forms part of a wider exercise such as the wind-up of a pension scheme. In such cases it is only the actuarial work that is within the scope of the Pensions TAS. For example, work such as estimating the cost of buying out benefits or comparing the value of benefits before and after buy out is actuarial work and is within the scope of the TAS, whereas dealing with data problems is not.

4.9 Not all work that includes actuarial matters is necessarily actuarial work. For example, we consider that most work directed towards trustee training is not actuarial work, and is not within the scope of the Pensions TAS. However, in some cases a trustee training session for a board of trustees might include material which contributes towards compliance with the TAS for another exercise, such as information on assumptions including sensitivities which would assist trustees to formulate the Statement of Funding Principles.

4.10 Similarly, we do not consider that the project management of an exercise including actuarial work, such as a bulk transfer or a wind-up, is actuarial work.

Explanations, descriptions and indications

4.11 Throughout the Pensions TAS we have used words such as “indicate” and “explain” in order to avoid being prescriptive about the type of analysis or level of detail that is required. In paragraph B.1.5 we have emphasised that the level of detail is a matter for judgement. Where possible, we have illustrated the principles in the Pensions TAS with examples, in order to better convey the intention behind the principle.

DEFINITIONS

4.12 Section B.2 defines a number of terms used within the text of the standard. Many of the definitions appear in the Generic TASs and will also appear in other Specific TASs.

Data

4.13 The definition of data is the same as in the other TASs and includes examples. Other items of data in pensions work might include legal opinions and information from earlier reports which have been prepared for the user.

Fund

4.14 The Pensions TAS contains several references to funded pension schemes. For clarity we have included a definition of "to fund".

4.15 It has been argued that schemes with a Crown guarantee, such as the Local Government Pension Scheme (LGPS), are not funded and that the holding of assets is simply a mechanism to meet benefits. Although there may be fundamental differences between these schemes and funded trust based private sector schemes, we consider that the mechanism through which benefits are met shares most of the salient characteristics of the usual funding mechanism. We therefore consider that LGPS is a funded defined benefit pension scheme for the purpose of the Pensions TAS.

Governing body

4.16 The term "governing body" is used to define some of the work within the scope of the TAS and to specify the work to which some of the principles apply. It is defined as "the trustees of an occupational pension scheme or the administering authority of a section of the Local Government Pension Scheme". We have used this very explicit definition in order to exclude other bodies, including scheme sponsors, which may have governance roles in relation to some pension arrangements.

Informed reader

4.17 Paragraph 7.25 explains why we have included a definition of the term "informed reader". The term is used only in the context of Scheme Funding and analogous reports.

Materiality

4.18 Our definition makes it clear that the judgement of materiality must take place within the context in which the work is performed and reported. The context includes the time at which the activities take place, so that there is no element of hindsight, but does not limit it to either the time at which the work is performed or the time at which it is reported (which are not always the same). The definition also introduces an element of reasonableness into the judgement.

4.19 We have adopted the same core definition of materiality in all our TASs and in our *Scope & Authority*.

4.20 Information in a Scheme Funding Report might be considered not to influence decisions as the material Scheme Funding decisions are usually taken prior to the production of the report. However, we consider it is important that material listed in section E.3 of the TAS is included in the report and so we have supplemented the definition to make it clear that this information is material.

Measures and methods

4.21 The terms "measures" and "methods" are used throughout our standards. The distinction between a measure and a method was discussed in Appendix A of our *Conceptual Framework*. In actuarial literature relating to the assessment of liabilities,[6] the term "valuation method" is often used to refer to a measure of the liabilities rather than to the method of quantifying them. When the language is used in this way, given the same data and the same assumptions, two different valuation "methods" will (deliberately) arrive at different outcomes. For example, in the context of pension schemes, the method of valuation known as "projected unit" takes into account prospective future salary increases which the method known as "current unit" ignores (by design).

4.22 This use of the word "method" is quite different from normal business parlance, in which two different "methods" of valuation would normally be intended to produce similar results. For example, a deferred annuity could be valued either by discounting all future cash flows or by multiplying the pension amount by an annuity factor and then discounting the result. Both approaches would produce the same result but are different methods.

4.23 Some practitioners have commented that the projected unit and attained age methods produce the same measure of past service liabilities. For this purpose, the two are not different methods of assessing this one measure, but are identical. However, they provide different measures of the cost of future accruals.

Pension scheme

4.24 A pension scheme is defined in the Pensions TAS as an occupational or personal pension scheme established under UK legislation. It was suggested that there should be a more precise definition which included references to the relevant legislation. We have deliberately used a less explicit definition in order to include the full range of formally constituted pension schemes in the UK, which includes unregistered and unfunded pension schemes as well as those to which the *Pensions Act 2004* applies.

Scheme Funding assessment

4.25 The term "actuarial valuation" is used in the *Pensions Act 2004* to describe the full actuarial investigation which must be carried out at intervals of no more than three years for schemes subject to the Scheme Funding regime. The term "actuarial report" is used to define the annual actuarial updates. This terminology can be ambiguous – actuarial valuation in common language can cover a much wider range of tasks than its definition in the Pensions Act – and misleading – the actuarial investigation is more of a planning exercise than a valuation exercise, as those terms are commonly used. For clarity we have therefore defined the term "Scheme Funding assessment" to cover the Pensions Act term "actuarial valuation".

Users

4.26 In many cases the use of and reliance on actuarial information are not confined to those paying for its preparation. We consider that all the intended

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[6] This literature includes the actuarial standard GN 26, *Pension Fund Terminology*, which the Actuarial Profession first issued in 1996 and retained until handing over responsibilities for technical standards to the BAS.

users, regardless of their commercial relationship with those responsible for preparing the report, should be able to rely on the information.

4.27 In many cases, it is trustees or insurance companies who are responsible for communicating the results of simple calculations such as transfer values or surrender values to scheme members or policy holders. In these cases it is the reporting of the results by actuaries to trustees or insurance companies that falls within the scope of TASs, not the communication to the end user.

4.28 The definition of “users” deliberately refers to those who are intended to be assisted by the actuarial information. Those who may have access to the information are not necessarily users. For example some reports are addressed to and intended for a limited group of people, such as pension scheme trustees, but are available to (but not addressed to) a wider group of stakeholders, such as scheme members. It is only those for whom the report is specifically intended who are users of the information it contains.

5 SCOPE OF THE PENSIONS TAS

INTRODUCTION

5.1 Part C sets out the scope of the Pensions TAS. The scope includes actuarial work that supports the purpose set out in paragraph A.1.2.

GENERAL COMMENTS

5.2 We have defined much of the work in broad terms. For example, any work carried out for a governing body of a funded pension scheme to support decisions on contribution requirements or benefit levels is within the scope (paragraph C.1.5). This work includes not only major Scheme Funding exercises but also work such as assessing the cost of an augmentation of a member's benefits.

5.3 Some work might be within the scope of the Pensions TAS by virtue of more than one paragraph. For example, work relating to a bulk transfer might be covered by both paragraph C.1.11 (bulk transfers) and paragraph C.1.5 (decisions to support contribution and benefit level decisions) if it involves advice to the trustees on the level of contributions to be made after the transfer has been effected.

5.4 The scope of the Generic TASs is set out in the Schedule to our *Scope & Authority*. The Generic TASs apply to all work that is within the scope of any Specific TAS, and so they apply to the work that is within the scope of the Pensions TAS (paragraph C.1.1).

5.5 Some of the areas of actuarial work described in Part C, such as bulk transfers and wind-ups, are very broad. In many cases the TAS includes some examples of work that is within its scope, and in some cases examples of work that is not. The examples are not exhaustive.

5.6 A large proportion of actuarial work carried out for pension schemes is for governing bodies of funded pension schemes. This is reflected in Part C which refers to work carried out for governing bodies of funded pension schemes in several instances. Some areas of work for unfunded pension schemes, such as Reserved Work and work concerning individual calculations to members, are also within the scope of the TAS.

WORK NOT WITHIN THE SCOPE OF THE PENSIONS TAS

5.7 A number of areas of work concerned with pensions are often or almost always carried out by actuaries but are not within the scope of the Pensions TAS. In some cases we considered that the work was not actuarial work, and in other cases that it would not be proportionate to include the work within scope.

5.8 Work that we considered for inclusion within the scope of the TAS, but decided against doing so, includes:

- investment work including asset/liability modelling;
- advice to parties other than governing bodies on defined benefit pension scheme design;

- financial assessments of unfunded pension schemes;
- merger and acquisition work for employers; and
- advice on liability management exercises such as ~~enhanced transfer values and~~ longevity hedging.

5.9 The decision not to include these areas of work was finely balanced and was influenced by a number of factors including whether the work supports regulatory requirements, whether the work involved is generally regarded as actuarial work and considerations of proportionality. Reserved Work in these areas is within the scope of the TAS (paragraph C.1.2).

WORK WITHIN THE SCOPE OF THE PENSIONS TAS

Reserved Work

5.10 Our *Scope & Authority* defines Required Work as work carried out in order that the entity commissioning the work complies with regulations, or with some other legal obligation, that require the entity to have the work carried out (or make certain outcomes conditional on the work having been carried out). Reserved Work is defined as Required Work for which the regulations or other legal obligation require the entity in question to commission the work from an individual who holds a prescribed actuarial qualification (usually Fellowship) from the Institute and Faculty of Actuaries.

5.11 The Pensions TAS applies to Reserved Work that concerns pension schemes (paragraph C.1.2). In this context a pension scheme is an occupational or personal pension scheme established under UK legislation. Our definition includes funded and unfunded pension schemes, defined benefit and defined contribution schemes. Reserved Work is already within the scope of the Generic TASs[7].

5.12 Many areas of Reserved Work in pensions must be carried out by a Scheme Actuary appointed under section 47 of the *Pensions Act 1995*. These areas of work include advice on Scheme Funding and the calculation of technical provisions under the *Pensions Act 2004*. Certain pension schemes are exempt from the Scheme Funding provisions of the Act but are subject to other funding requirements. For example, a Fund Actuary is required to carry out certain duties in connection with the Local Government Pension Scheme, which is subject to other legislation including the *Local Government Pension Scheme Regulations* as amended. Appendix A of our consultation paper on *Pensions* described some of the Reserved Work in pensions created by legislation.

5.13 Reserved Work may be created for individual pension schemes through provisions in their governing documents. For example, a scheme's trust deed and rules may require that actuarial input is used in:

- setting terms for converting pension to cash at retirement;
- setting factors for calculating reduced pensions on early retirement;
- calculating transfer values; or

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[7] See the Schedule to the *Scope & Authority*.

- calculating additional payments required to meet the cost of benefit improvements.

5.14 Reserved Work may also arise as a result of terms in contractual arrangements. For example, a sale agreement may require an assessment of any shortfall in the funding of a scheme to be calculated by a qualified actuary.

Work for contribution and benefit level decisions

5.15 Actuarial work carried out for a governing body of a funded pension scheme to support decisions on contribution requirements or benefit levels is fundamental to the governance of a pension scheme, and so is within the scope of the TAS (paragraph C.1.5). This work includes major funding assessments (which are often Reserved Work and so are also covered by paragraph C.1.2) and some work that is performed between major assessments, such as assessing the contributions required to meet any enhancements made to members' benefits. Often such exercises are based on a previous major funding assessment and documents for that assessment might sometimes be component reports for the subsequent exercises.

5.16 Exercises are carried out from time to time for some pension schemes which might result in changes to the level of benefits. Because the level of benefits provided to individual members might depend on these exercises we have decided to include this work within the scope of the TAS (paragraph C.1.5). Such exercises include determining the amount of discretionary increases to be provided to pensioners, and adjustments to the level of benefits to reflect changes in life expectancy.

5.17 Section 75 of the *Pensions Act 1995* may require employers to make a payment into a pension scheme when there is an insolvency or when a participating employer leaves a scheme. The certification of a section 75 payment is Reserved Work and is therefore within the scope of the Pensions TAS (paragraph C.1.2) and the Generic TASs. Additional actuarial work may be involved in advising the various parties on matters concerning the payment. As the payment is not a contribution this work is not covered by paragraph C.1.5 unless it also involves information to support decisions on contribution requirements or benefit levels.

Benefit changes

5.18 Governing bodies usually rely on actuarial information when making or agreeing to any changes to scheme rules which might affect members' benefits As changes to scheme rules can affect the level of benefits which members receive, or the underlying security of the benefits, the work is within the scope of the TAS (paragraph C.1.7).

5.19 The work covered by paragraph C.1.5 includes actuarial work concerning the contributions required to meet any obligations arising through the effects of overriding legislation, and so we did not consider it necessary to include a separate paragraph explicitly mentioning that work.

5.20 Changes to the rules of a pension scheme cannot usually be made without the agreement of the governing body, which is likely to use actuarial information when coming to its decision. As the preparation of this information is within the scope of the Pensions TAS, we do not consider it necessary to include actuarial work performed for a sponsor proposing the changes.

Scheme Funding advice for sponsors

5.21 The Scheme Funding regime imposes obligations on trustees and sponsors to reach agreement or consult on certain matters. Actuarial information assists them in meeting their regulatory obligations, so that the provision of this information to sponsors is within the scope of the TAS (paragraph C.1.9). The provision of information to governing bodies in such circumstances is covered by paragraph C.1.5.

5.22 The work covered by paragraph C.1.9 includes the provision of information to support sponsors in fulfilling their duties under section 229(1) of the *Pensions Act 2004*.

5.23 It has been suggested that there could be duplication of work because the provision of information to both trustees and sponsors on the same matter is within the scope of the TAS. However, the TAS does not require that separate work is performed for trustees or sponsors, or that one party cannot make use of information originally prepared for another party. We do not intend our standards to result in unnecessary duplication of work and expect that in some circumstances some of the information provided to the trustees will be shared with the sponsor. There may be professional or ethical considerations involved in sharing such work, and practitioners will need to follow the appropriate professional standards, such as the Actuaries' Code.

Bulk transfers

5.24 Bulk transfers can affect members' benefits, and the security of their benefits, and so actuarial work for governing bodies in this area is within the scope of the TAS (paragraph C.1.11).

5.25 The work covered by paragraph C.1.11 includes work for trustees of both the receiving and transferring schemes. It includes all bulk transfers, whether they are made with or without the consent of members (paragraph C.1.12). The scope of the Pensions TAS in this area thus differs from that of the adopted guidance note GN16 (*Retirement Benefit Schemes - Transfers Without Consent*) which applied only to transferring schemes and only to transfers made without members' consents. We consider that bulk transfers can result in material changes to the nature of members' pension scheme arrangements even when the members have to consent to the transfer and it is therefore important that trustees receive information of the highest quality to support their decisions. Bulk transfers can have significant financial effects on receiving schemes as well as transferring schemes, and in particular can affect the security of members' benefits, and so actuarial work for trustees of receiving schemes is within the scope of the TAS.

5.26 Work concerning bulk transfers that is performed for sponsors is not within the scope of the TAS, because it is governing bodies which are responsible for making decisions to proceed with transfers.

5.27 The work covered by paragraph C.1.11 includes all actuarial work concerning the bulk transfer, and is not limited to certifying to the trustees of the transferring scheme that benefits after the transfer would be “broadly no less favourable” than those before (paragraph C.1.13). For example, the work that is within the scope of the TAS includes assessing the impact of the transfer on matters such as the security of members’ benefits, the funding level and the recovery plan to eliminate any deficit. It does not, however, include arranging the transfer of liabilities (paragraph C.1.14).

5.28 We intend that actuarial work concerning bulk transfers will also be within the scope of the Transformations TAS.

Wind-ups

5.29 When a pension scheme is wound up and its liabilities are transferred to an insurer, members’ benefits can be affected – they might be reduced or member options such as terms for taking a cash sum on retirement might be changed. Actuarial work relating to a transfer of liabilities to an insurer is therefore within the scope of the Pensions TAS when the work is provided to a governing body of a scheme in wind-up or contemplating wind-up (paragraph C.1.15).

5.30 The work covered by paragraph C.1.15 does not include work performed in connection with a partial wind-up of a scheme triggered by one or more participating employers leaving the scheme. However the calculation of the employer debt on partial wind-up is within the scope of the TAS as it is Reserved Work (paragraph C.1.2). Work concerning the subsequent funding requirements is also within the scope of the TAS (paragraph C.1.5).

5.31 A wide variety of work is performed in connection with the transfer of liabilities to an insurer, not all of which is actuarial work and hence within the scope of the Pensions TAS. Whether the work is within the scope of the TAS is a matter of judgement. For example, we consider that using actuarial models to estimate the cost of buying out the benefits on wind-up is actuarial work but that simply obtaining quotations and passing them to a client is not. Likewise, we consider that reconciling contracting out earnings data with HMRC is not actuarial work. Comparing members’ benefits before and after the proposed transfer is actuarial work, but arranging the transfer is not (paragraphs C.1.16 and C.1.17).

5.32 In recent years many governing bodies have purchased annuities in order to control the risks faced by pension schemes. In these cases the annuity policies are held by the trustees who remain responsible for the provision of benefits to the pension scheme members, rather than being assigned directly to the members in question. Transactions of this type are commonly known as “buy-ins”. Actuarial work in connection with buy-ins is not covered by paragraph C.1.15. We consider that buy-ins are essentially investment decisions taken by the trustees and are therefore not within the scope of the TAS (see paragraph 5.7).

5.33 We intend that some actuarial work concerning wind-ups will also be within the scope of the Transformations TAS.

Individual calculations and factors

5.34 Actuarial calculations in respect of individual members of a pension scheme may directly affect the benefits they receive or the financial position of the pension scheme, and so actuarial work concerning them is within the scope of the Pensions TAS (paragraph C.1.18). Actuarial calculations are calculations which involve actuarial factors, such as factors used to convert a pension at a member's normal retirement date into a lower pension payable from an earlier date or to convert some of a member's pension into a cash sum on retirement (paragraph C.1.19).

5.35 We consider that the provision of instructions to administrators and others on how to perform actuarial calculations is actuarial work (paragraph C.1.20). However, the principles that apply to such work are limited (paragraphs D.4.1 and D.4.2).

5.36 We do not consider that using previously calculated actuarial factors is actuarial work (paragraph C.1.21). However, if such calculations are Reserved Work by virtue of the scheme rules, they are within the scope of the Pensions TAS (paragraph C.1.2).

Defined contribution projections

5.37 Projections of benefits from defined contribution schemes are provided to members from time to time to help them understand their financial position. Projections are also given to employers for various purposes such as determining the level of contributions to be provided in respect of employees. As the information can affect decisions which might affect benefit levels the supporting actuarial work is within the scope of the Pensions TAS (paragraphs C.1.22 and C.1.23).

~~5.38 If the assumptions to be used are specified in legislation or other rules we consider that performing the calculations is not actuarial work, as there is no scope for judgement to be applied. Assumptions are, for example, specified by FSA rules under the *Financial Services and Markets Act 2000* and by *TM1: Statutory Money Purchase Illustrations*.~~

Financial statements

~~5.39~~5.38 In October 2009 we issued a consultation paper on *Actuarial information used for accounts and other financial documents*. As a result of the responses we received, we decided not to issue a separate Specific TAS covering this area of work, but to include relevant aspects of the work in the Specific TASs on Pensions and Insurance. We consider that actuarial work concerning pensions that is used in the preparation of accounts and similar documents assists sponsors and others to carry out their regulatory responsibilities, and have therefore included it within the scope of the Pensions TAS (paragraph C.1.24).

~~5.40~~5.39 Paragraph 13 of the *Scope & Authority* restricts the geographic scope of ~~BAS~~FRC standards to work done in relation to the UK operations of entities and any overseas operations which report into the UK within the context of UK legislation or regulation. Therefore, actuarial work for reporting under the Financial Accounting Standards Board (FASB) standards, for example, is not within the scope of the Pensions TAS.

~~5.41~~5.40 Actuarial work performed for the auditors of financial statements assists auditors to carry out their regulatory responsibilities, and so is within the scope of the TAS, as is work performed for preparers of financial statements (paragraph C.1.26).

Disclosure of directors' remuneration

~~5.42~~5.41 Actuarial work performed to support disclosures of directors' pension arrangements in annual reports and account assists those responsible for those documents to carry out their regulatory responsibilities, and is therefore within the scope of the Pensions TAS (paragraphs C.1.27 and C.1.28).

Incentive exercises

5.42 Following a consultation in June 2012 we amended the Pensions TAS to bring actuarial work relating to incentive exercises into the scope of the Pensions TAS (paragraphs C.1.29 to C.1.31). This change was effective for aggregate reports completed after 1 January 2013. Section 9~ covers this change in more detail including the rationale.

6 GENERAL PRINCIPLES

INTRODUCTION

6.1 Part D of the Pensions TAS contains general principles that apply to all work within the scope of the TAS.

Judgement

6.2 Because the Pensions TAS is principles-based and has been written to cover a wide range of work, judgement will be required in order to apply it. We consider that such judgement should be reasoned and justifiable (paragraph D.1.2).

6.3 Judgement might be needed on many matters when complying with the Pensions TAS, including whether the work in question is within the scope of the TAS, whether matters are material, and what constitutes proportionate work (paragraph D.1.3). When making such judgements it is important to be guided by the spirit and reasoning behind the principles in the TAS, as well as how they are drafted (see paragraph 20 of the *Scope & Authority*).

6.4 We consider that requiring a justification of all judgements would be unduly onerous, and so require only that it is possible to justify them, rather than requiring justifications to be documented (paragraph D.1.4). We consider that proportionality should apply to the work done in order to demonstrate compliance with the TAS as well as to work done in order to comply. We therefore consider that documentation of compliance should be proportionate to the scope of the work (see paragraph B.1.3).

ASSUMPTIONS

6.5 Section D.2 sets out principles concerning the selection of assumptions.

6.6 Actuarial work in pensions involves assumptions about many matters, including:

- discount rates;
- mortality rates;
- future levels of inflation;
- the proportion of members withdrawing;
- the number of members exercising options such as early retirement and exchanging pension for cash on retirement; and
- running costs.

6.7 We consider that there are some general principles that should be applied when selecting any assumptions in pensions, and these are covered in paragraphs D.2.1 to D.2.12. For two types of assumption, those concerning discount rates and mortality, we consider more specific principles will ensure more reliable information, and principles concerning them are in paragraphs D.2.13 to D.2.19.

6.8 The principles in paragraphs D.2.1 to D.2.12 are likely to be similar to those in other Specific TASs, and it is possible that some of them might at some time be consolidated into a Generic TAS.

6.9 However, it is not necessarily the case that a principle that is capable of being applied to other areas of actuarial work should be so applied. It is possible that a principle that is proportionate in one field of work would be disproportionate in another. The Generic TASs apply to a broad range of actuarial work, and even principles that are both applicable and proportionate to work in insurance and pensions might be inapplicable or disproportionate for work in other areas. The appearance of a principle in more than one Specific TAS does not therefore necessarily imply that it should be in a Generic TAS.

General considerations

Overall approach

6.10 The Pensions TAS is principles-based, and does not prescribe particular assumptions to be used in specific circumstances, or ranges within which assumptions should lie. Although it has been suggested that more prescription would provide greater consistency and help trustees of pension schemes, we consider that the most important outcome is that assumptions should be appropriate for the context in which they are used.

6.11 In many cases, actuaries are responsible only for providing information on the basis of which others choose assumptions, rather than choosing the assumptions themselves. Actuarial standards therefore cannot limit the assumptions that are chosen, but can only influence the choice. We consider the best way of ensuring that appropriate assumptions are used is to ensure that those making the decisions are well informed, understand the rationale underlying any recommendations, and understand the implications of their decisions.

6.12 We consider that any prescriptive rules or ranges could apply only in limited circumstances, and should be based on appropriate research. As our TASs come into operation we will monitor their effect, and keep under review our approach to assumptions.

Selection of assumptions

6.13 For some exercises the assumptions are set by the practitioner who performs the work. In other cases assumptions are set by the user, or are prescribed by regulations. In the latter cases the practitioner performing the work may not be in a position to ensure that the assumptions meet some of the requirements of the Pensions TAS (paragraph D.2.1).

6.14 Different assumptions are appropriate in different circumstances and for different purposes. The reliability and relevance of actuarial information depends on whether the assumptions on which it is based are appropriate (paragraph D.2.2).

6.15 TAS R requires an aggregate report to include sufficient information to enable its users to judge its relevance to the decisions for which they use it. We consider that the assumptions on which information is based affect the relevance of that information: if the assumptions are inappropriate, then the information is less relevant. If the assumptions used are considered to be materially inappropriate by a person responsible for a report, the report will need to include a statement to that effect, or other explanations.

6.16 An important factor in whether assumptions are appropriate is the evidence on which they are based. We consider that basing assumptions on sufficient relevant information will help to ensure that they are appropriate, but recognise that sufficient information is not always available (paragraphs D.2.3 to D.2.6).

6.17 If a report includes an opinion on assumptions, we consider that the opinion should cover whether the assumptions are appropriate (paragraph D.2.7). An opinion that did not cover their appropriateness would, we consider, be incomplete and could be misleading, as it could convey the impression that the report's author considered them to be appropriate even if this was not the case.

6.18 In many cases, assumptions should reflect the state of the world at the effective date of the calculations. For some exercises, such as Scheme Funding assessments, the calculations may be performed and decisions may be taken some time after the effective date of the calculations. Material events after the effective date might affect the decisions to be made. Examples of such events include falls or rises in asset values, changes to the scheme sponsor and changes to the membership. In some of these cases it may be appropriate to base some assumptions on the more recent information if it is material (paragraph D.2.8).

6.19 There have been instances where one assumption is adjusted in order to compensate for a shortcoming in another. For example, the discount rate used to value liabilities has sometimes been decreased as a proxy for making a reduction in future mortality rates, instead of incorporating an explicit assumption about mortality improvements. We consider that adjusting one assumption in order to compensate for a shortcoming in another makes information less transparent to users, and is inconsistent with the achievement of our Reliability Objective (paragraph D.2.9).

6.20 There may be cases where a model has been simplified so that assumptions such as the level of members withdrawing from the scheme are not modelled. In these cases an adjustment is sometimes made to another assumption such as salary growth. This approach is not transparent and risks confusing the user. If it would be disproportionate to model an assumption and its impact is material we consider it would be much clearer to make an explicit adjustment to the output from the model and explain the limitations of the approach to the user.

6.21 We do not intend that paragraph D.2.9 should prevent margins for prudence in a set of actuarial assumptions being contained in only one assumption such as the discount rate.

Changes to assumptions

6.22 Paragraph C.5.17 of TAS R requires results to be compared with those previously provided for a similar purpose. We consider that it is important that users understand the reasons for any change in the rationale underlying the assumptions as this could influence their decisions (paragraph D.2.11).

6.23 If the previous exercise was carried out by another practitioner it may not always be possible to determine the rationale for the selection of the assumptions. If so, an explanation of the position will need to be given.

Discount rates

6.24 Discount rates are often among the assumptions that have the most significant effect on the results of the work that is being performed. We therefore consider it especially important that users understand how they are derived, the implications of adopting them and the cash flows to which they are applied (paragraphs D.2.13 to D.2.15).

6.25 In particular, we consider it important that, for a funded pension scheme, users understand how the discount rate adopted for a particular exercise compares with the possible return on assets. Although it is clearly impossible to know what the future return on assets will actually be, it will be heavily influenced by the current and future investment strategy (paragraph D.2.16). This is especially important for Scheme Funding exercises, in which the use of a discount rate higher than that which could be supported by the likely future investment strategy will need to be justified.

Mortality

6.26 Future rates of mortality depend on both current rates of mortality and the way in which those rates are expected to change in the future. As we explained in our discussion paper on *Mortality*, we consider that these two factors are very different in nature: in principle it is often possible to obtain reliable information about current rates of mortality, whereas it is impossible to know what the future holds in terms of changes to mortality rates. We therefore consider that separate assumptions should be used for base mortality rates and subsequent changes, as the uncertainties in the two are so different (paragraph D.2.17).

6.27 In addition, we consider that, although both current mortality rates and future changes to mortality are likely to depend on the makeup of the membership of the pension scheme under consideration, it is not possible to determine the way in which the make up of the membership might affect future changes. It is, however, possible to assess the effect on current rates of mortality, and so we consider that the membership of the scheme should be taken into account when deriving assumptions (paragraphs D.2.18 and D.2.19).

6.28 If the scheme is large enough, and has been operating with a similar membership profile for a long enough period, it may be possible to use its mortality experience in the derivation of the assumptions. Otherwise, adjustments will have to be made to publicly available mortality tables, or mortality rates will have to be derived from a wider base such as data derived from a firm's client base. Information that can be used to adjust standard tables includes salary levels, occupation, location and the nature of the work. For example we consider that it would be difficult to justify the use of the same mortality rates for a scheme mainly consisting of low paid manual workers working in heavy industry as for a scheme for highly paid professionals.

Discretionary practices

6.29 Sometimes members are awarded discretionary benefits, such as pension increases above the rates guaranteed by the scheme or enhanced early retirement terms. Such discretionary benefits might have become usual practice, or there might be an explicit policy for the exercise of future discretion. For example, there may be a policy that discretionary increases to pensions in payment are awarded if the funding level exceeds a specified level. As future benefits can be affected, information about the past exercise of discretion and what is likely to happen in the future can affect the modelling of liabilities, and, if it is material to the exercise being performed, we consider that practitioners should endeavour to obtain it (paragraph D.2.20). We also consider that explaining to users the extent to which assumptions take account of past experience of discretionary practices and information about the anticipated exercise of discretion in the future will assist them in understanding the implications of their decisions (paragraph D.2.22).

INFORMATION

6.30 Section D.3 contains principles concerning information that may affect the assumptions that are selected or proposed for use.

Parties with influence or control

6.31 Much actuarial work in pensions involves modelling the future benefits payable to members. Information about the likely future levels is therefore significant, and we consider that information from parties that influence future benefits is especially important (paragraphs D.3.1 to D.3.5).

6.32 There are many parties who might in theory exercise influence or control over benefits, including both members of the pension scheme (who may, for example, choose when to retire), and the Government (whose policies might affect members' benefits). We do not intend paragraph D.3.1 to include either of these, or other external bodies that are only remotely connected to the scheme (paragraph D.3.3).

6.33 We recognise that it may not always be possible to obtain such information, and that in some cases it would not be proportionate to seek it, especially if there are many potential sources (paragraph D.3.5). In particular, it might not be proportionate to seek information from participating employers with only small numbers of members of the scheme.

Legislative uncertainty

6.34 In some cases there is uncertainty over the effect of changes in legislation on scheme rules (and hence the benefits that are paid). The requirement to equalise benefits for men and women following the Barber and Coloroll judgements is a well known example. Relevant legal opinions are important information that should be used in judging how to allow for such uncertainty, and so we consider that information about them should if possible be obtained (paragraph D.3.6).

6.35 TAS R requires that any material uncertainty in the information in a report should be disclosed to users (paragraph C.5.2 of TAS R). This includes the result of legislative uncertainty. Because legislative uncertainty can have such significant effects on benefits, we consider that appropriate reporting in this area is especially important (paragraph D.3.7).

CALCULATIONS OF PAYMENTS TO MEMBERS

Instructions for other parties

6.36 It is usually a pension scheme's administrators who are responsible for calculations concerning individual members. They are often provided with instructions for performing the calculations, and factors to use in them, by the scheme's actuary. As misunderstandings can lead to incorrect calculations and payments we consider that it is important that instructions are sufficiently clear and complete that following them will result in the correct calculations being performed (paragraph D.4.1).

6.37 Mistakes can arise in many ways, but a common cause is that the instructions are applied in the wrong circumstances – for example to the wrong calculations or to special cases for which different procedures should apply. The instructions might be insufficiently detailed, relying on unjustified assumptions about how or under what circumstances the calculations will be performed. Factors used in the calculations may become out of date through the passage of time or because of changed market conditions.

6.38 We consider that the information that is material to those performing the calculations is limited, and that the Reliability Objective can be fully satisfied through the provision of clear and complete instructions. No other principles in the Pensions TAS therefore apply to the work described in paragraph D.4.1, nor do the principles in the Generic TASs (paragraph D.4.3).

6.39 Other principles in the Pensions TAS apply to the actuarial work involved in actually performing calculations for individual members. Paragraphs D.4.1 to D.4.3 are intended to apply to the actuarial work involved in preparing instructions that enable others to perform the calculations, thus ensuring that all the actuarial work connected with such calculations is covered.

Information for setting actuarial factors

6.40 Actuarial factors are used in the calculation of payments to or on behalf of individual scheme members under various circumstances. For example, they can be used to convert part of a member's pension into a cash lump sum at retirement, or to calculate the reduction in the amount of pension that is paid on early retirement. Factors depend on assumptions such as mortality rates, interest rates and inflation, and can therefore become outdated through the passage of time or because of changed market conditions. Using inappropriate factors can result in detriment to scheme members or the financial position of the scheme as a whole, as was pointed out in a review carried out by the Actuarial Profession in 2006[8].

6.41 In many cases it is the governing body of the pension scheme that is responsible for determining the actuarial factors that are used in various calculations. Because of the possible problems if inappropriate factors are used, we consider that governing bodies should be given sufficient information to enable them to understand the financial implications of choosing the factors (paragraph D.4.4).

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[8] Member options working party report: December 2006.

Transfer values

6.42 Since 1 October 2008 trustees of many schemes have been responsible for setting assumptions for cash equivalent transfer values. Legislation requires the trustees to use a best estimate basis for calculating minimum cash equivalent transfer values and to take actuarial advice before setting the assumptions. In addition, the Pensions Regulator has issued guidance to trustees on transfer values.

6.43 The requirement to use best estimate assumptions differs from the requirement for prudence in the selection of assumptions for Scheme Funding exercises. We consider that an explanation of the relationship between the two sets of assumptions would assist trustees in understanding the implications of the factors that are chosen (paragraph D.4.7). In many cases a comparison of the transfer values calculated on the two bases would be an important component of the explanations (paragraph D.4.8).

FINANCIAL STATEMENTS

6.44 Section D.5 of the Pensions TAS sets out principles concerning actuarial work supporting information provided to preparers and auditors of financial statements.

6.45 Time and budgetary constraints often mean that actuarial calculations carried out for disclosures in financial statements prepared in accordance with accounting standards such as FRS17 and IAS 19 use approximate methods. In order to be able to select appropriate methods it is necessary to understand what is material for accounting purposes (paragraph D.5.3).

6.46 Approximate methods inevitably depend on simplifying assumptions, which, if not borne out in practice, can lead to significantly inaccurate results. For example, the amounts appearing for pension schemes in sponsors' accounts are often calculated by rolling forward the results of the last Scheme Funding exercise and making adjustments for the different assumptions. Their accuracy depends on various factors such as the period of the roll forward and the magnitude of the difference between the assumptions used for Scheme Funding and those used for the information for the financial statements. We consider that the preparers of the accounts, who are the users of the actuarial information, should understand the circumstances in which the approximation might be materially inaccurate for accounting purposes (paragraph D.5.3).

6.47 Paragraphs D.5.2 and D.5.3 refer to materiality in the accounting context. This is not the same as the materiality as defined and used in the TASs and is therefore not in bold in the text.

6.48 Sometimes a materiality limit might not be available or is not provided when requested. In such cases paragraph C.5.2 of TAS R, which requires that the aggregate report indicates the nature and extent of any material uncertainty in the information it contains, would apply.

WORK NOT EXPLICITLY COVERED IN THE TAS

Roll forward calculations

6.49 The results of past calculations may be rolled forward for various purposes, including the provision of information for financial statements (for example in compliance with FRS17 or IAS19), the calculation of the PPF levy and annual Scheme Funding updates.

6.50 Roll forward calculations typically take assets and liabilities at one date and project them to a later date, taking account of changing financial conditions and some but not all changes to the data. Roll forward calculations enable updated numbers to be produced more quickly and at a lower cost than carrying out full calculations using data at a later date.

6.51 Roll forward calculations have limitations. The longer the period from the date of the original calculation the less reliable the projection becomes. The reliability of roll forward calculations may also decrease when there are changes in financial conditions which affect the assumptions used in the roll forwards. It is important that users of actuarial information understand the limitations of roll forwards.

6.52 The Generic TAS on *Modelling* contains principles on reporting the limitations of models to users. We did not consider that any further principles were needed for roll forward calculations.

7 PENSION SCHEMES SUBJECT TO PART 3 OF THE PENSIONS ACT 2004

INTRODUCTION

7.1 Part E of the Pensions TAS contains principles that apply to pension schemes which are subject to the Scheme Funding provisions in Part 3 of the *Pensions Act 2004*.

7.2 The principles in Part E apply only to work concerning the Scheme Funding exercise called the “actuarial valuation” in the Act. They do not apply to the annual Scheme Funding updates called “actuarial reports” in the Act (paragraphs E.2.1 and E.3.1). We consider that in view of the limited scope of “actuarial reports” the principles in Part D and those in the Generic TASs are sufficient.

SCHEME FUNDING ASSESSMENTS

7.3 Section E.2 covers the actuarial information provided to governing bodies to support them in making decisions on matters including the selection of assumptions and funding measures, the content of the Statement of Funding Principles, the schedule of contributions and the recovery plan.

Risk and uncertainty

7.4 TAS R requires that aggregate reports should state the nature and significance of each major risk and uncertainty and the approach taken to the risk. We have listed some of the major risks a pension scheme can face in relation to its funding (paragraph E.2.3). Much of this list was contained in the adopted guidance note GN9 *(Funding Defined Benefits – Presentation of Actuarial Advice)*.

Measures

7.5 In setting a funding strategy different approaches can be adopted to matters such as the treatment of new members and whether there should be any allowance for future salary increases. The different approaches are reflected in the use of different funding measures. We consider that an understanding of the measures that have been used, and the implications of choosing them over other measures, will assist governing bodies (paragraph E.2.5).

Statutory duties

7.6 The *Pensions Act 2004* requires trustees to set assumptions for Scheme Funding and to set a funding strategy. It also requires them to take advice from the Scheme Actuary. We consider that in order for the information supplied by a Scheme Actuary to be complete it must include sufficient actuarial information to enable the trustees to fulfil their statutory duties (paragraph E.2.7). However, we recognise that actuarial information alone may not be sufficient to enable the trustees to fulfil all their duties (paragraph E.2.8). For example, trustees may well seek information concerning the employer covenant from a specialist adviser.

Technical provisions

7.7 In the consultation paper on *Pensions* published in June 2009 we proposed that the level of prudence in Scheme Funding exercises should be quantified by a best estimate accompanying any prudent estimate. We also proposed that any change in the level of prudence from that in the previous Scheme Funding exercise should be explained to users. We made the proposal because we consider that trustees and other governing bodies should understand how prudent they are being when choosing assumptions and setting contribution rates. We also considered that presenting best estimates in the course of Scheme Funding exercises would assist trustees to assess how, if at all, the level of prudence had changed from the previous exercise.

7.8 In the exposure draft of the Pensions TAS we included a proposal that a neutral estimate of the liabilities should be presented alongside any prudent estimate. We used the term "neutral" in both that exposure draft and TAS M because a number of respondents to our consultations had concerns about requirements for best estimates. We have used the term "neutral" to describe estimates that are not influenced by the desired outcome. A best estimate is always a neutral estimate, but there may be a range of neutral estimates, not all of which are best estimates.

7.9 Many practitioners expressed concern about the proposal. However users, including firms of independent trustees, were generally supportive of the proposed principle. We continue to consider that a neutral estimate of the liabilities represented by the technical provisions (which are calculated on a prudent basis) will assist trustees in their understanding of the implications of their decisions on assumptions and other matters, as long as matters such as the relationship between the neutral estimate and the technical provisions are communicated effectively (paragraph E.2.10). The provision of a neutral estimate will also enable trustees to identify how margins in the technical provisions change over time.

7.10 The concerns expressed by practitioners included:

- providing a neutral estimate would confuse users, who already receive a considerable range of information, including the solvency position, and would not add any value;
- the existence of a neutral estimate would weaken the trustees' negotiating position with the sponsor and could result in reduced funding for pension scheme members; and
- a lack of clarity about what a neutral estimate is – in particular what allowance if any may be made for possible outperformance of equities and other assets over bonds.

7.11 We do not consider that the provision of a neutral estimate would confuse users provided that it is communicated clearly. One of the principal requirements of TAS R is for clear and comprehensible communication. We agree that other information such as the solvency position might also help trustees, but do not consider that the solvency position is an adequate substitute for a neutral estimate. We do not consider that the solvency position indicates the level of prudence in the technical provisions, as it is a different measure of the liabilities.

7.12 We do not consider that the provision of a neutral estimate is the only way to assist trustees in understanding the level of prudence in the technical provisions and have made it clear that other methods may also be used (paragraph E.2.12).

7.13 A number of practitioners suggested that the provision of a neutral estimate could undermine the negotiating position of trustees and that this might lead to a reduction in security for members. We do not consider that it is the ~~BAS's~~FRC's role to support the negotiating position of any one of the parties involved. We also note that sponsors have always been able to ask trustees how much prudence they consider exists in the technical provisions.

7.14 We consider that it is important that practitioners understand the principles in our TASs. As so many argued that they did not find the principle in the exposure draft clear, we have amended it to give more detail about how the neutral estimate should be calculated in these circumstances (paragraph E.2.10(a)). This inevitably reduces the scope for judgement, but on balance we considered the increase in clarity to be more important.

7.15 A particular issue that concerned practitioners was that it was possible to calculate a neutral estimate by using a discount rate with no allowance for equity outperformance over bonds even though there was such an allowance in the discount rate used to calculate technical provisions. Paragraph E.2.10 now makes it clear that if the discount rate used to calculate technical provisions has an allowance for equity outperformance there should also be an allowance (possibly greater) in the discount rate for the neutral estimate.

7.16 We consider that it is not necessary to calculate the neutral estimate to the same degree of precision as the technical provisions in order to help trustees and others understand the level of prudence (paragraph E.2.11).

SCHEME FUNDING REPORT

7.17 Section E.3 covers the Scheme Funding report that is produced at the end of the Scheme Funding exercise.

7.18 The Scheme Funding report is essentially a report of record. The decisions on the Scheme Funding exercise have usually been made before the report is completed. A Scheme Funding report cannot therefore contribute to the aggregate reports for those decisions (paragraph E.3.2). It can, however, contribute to the aggregate report for the Scheme Funding exercise as a whole, for other pieces of work, and for other decisions made by the governing body or by others.

7.19 Legislation allows members of the scheme being reported on to request copies of the report. It also sets out the minimum information that the report should contain.

Contents

7.20 It has been suggested by practitioners that the TAS should not impose any additional requirements for the contents of the report over those in legislation. It has been argued that few members ever ask for the report and therefore its production might in many cases result in unnecessary expense. However, some members, member organisations and unions have told us that they do indeed find the report valuable. We consider good governance is supported by setting out comprehensive information on the financial position of the schemes it covers. The report is also often used as a reference document by trustees and advisors when carrying out subsequent exercises. Overall, we consider that restricting the report's contents to the legislative requirements would not support our Reliability Objective, as it would then be of limited use to scheme members. Although it is not addressed to the members, it is available to them, and we considered that their interests should influence the contents of the report.

7.21 However, we do not consider that all the information provided to trustees during the Scheme Funding process would be useful to scheme members. We also consider that it would be disproportionate to require the report to contain significant amounts of information that had not been produced during the Scheme Funding exercise. Most of the information that the Pensions TAS requires should be in the report is information that is likely to have been produced for the trustees earlier in the exercise.

7.22 It has been suggested that the ~~BAS~~FRC should, in conjunction with the DWP and tPR, review what the Scheme Funding report should aim to achieve. We have discussed the matter with the DWP and it indicated that it wished the ~~BAS~~FRC to continue to set requirements for the information to be contained in the report.

7.23 It has been suggested that the list of requirements for the content of Scheme Funding report is out of place in a principles-based standard, and that it would make more sense if it appeared in a different type of document: possibly a Technical Memorandum, along the same lines as TM1 (which sets out requirements for Statutory Money Purchase Illustrations). The focus in these requirements on scheme members, rather than the intended users of Scheme Funding reports (who are principally the trustees), adds force to these arguments.

7.24 We agree that the requirements in Section E.3 are more prescriptive and rules-based than other requirements in our TASs, but we have never dismissed the possibility of using rules when we consider them to be appropriate. We also consider it important that the needs of scheme members are taken into account. We have not ruled out the possibility of developing other types of document, such as Technical Memoranda, in the future, but are not currently in a position to do so. We consider that on practical grounds we should retain the list of requirements in the Pensions TAS.

Informed reader

7.25 We recognise that it would be disproportionate to consider scheme members as users (in the sense that the term is defined in the Pensions TAS) of Scheme Funding reports – the reports are not addressed to them, and it would not be practicable to write a report so that it can be understood by every single member. However we consider that for the report to be useful to members it should written so that it can be understood by members who are capable of understanding financial issues (possibly with help from someone such as a financial adviser or a union pensions expert). We have therefore defined the term "informed reader" to refer to such a person (see the definitions in Part B).

7.26 Although we do not consider that scheme members should be considered as users as defined in the Pensions TAS, we consider it important for the achievement of the Reliability Objective that Scheme Funding reports contain sufficient information to be of use to them. We have therefore supplemented the definition of “material” in the Pensions TAS to make this clear (Part B and paragraph E.3.6). Information specified in section E.3 of the Pensions TAS should not be omitted on the grounds of materiality.

7.27 In addition, although comprehensibility is important, we consider that, because of the possible broad range of readership, information should not be omitted from the reports on the grounds that some readers might not understand it (paragraph E.3.4). When drafting the report, it is sufficient to make sure that it is comprehensible by informed readers, rather than by all possible readers.

Information

7.28 We consider that the information that is likely to be useful to scheme members is that which helps them understand the financial position of the scheme being reported on. In order to be complete, the information should cover how the financial position has developed since the previous Scheme Funding exercise and how it might change in the future (paragraph E.3.3). Such information might help members assess their own financial position and the options that are open to them. We consider that reports containing this information would not be unduly onerous to produce, as most of it is likely to have been produced for the trustees earlier in the exercise.

7.29 Reports should contain the information required by legislation, which includes an estimate of the liabilities on the solvency basis as well as a statement of the technical provisions. We have not repeated the requirements in the Pensions TAS (paragraph E.3.3(a)).

7.30 We consider that an understanding of trustees’ funding objectives is fundamental to an understanding of how they will manage the financial position of a pension scheme (paragraph E.3.3(b)).

7.31 Many members of pension schemes are concerned about what would happen to their benefits if their scheme is wound up. They might want to understand matters such as how much their benefits might be reduced by and whether their benefits will be met by the Pension Protection Fund. Paragraph E.3.3(c) therefore requires a description of the effect of winding up on members’ benefits. The calculations that would be required in order to quantify how much members benefits would be reduced are, we consider, disproportionately complex, especially as effects such as the potential reduction in pension amounts on wind-up can change significantly over a short period of time.

7.32 As the reports must contain estimates of the liabilities on two different bases (technical provisions, and on the solvency basis) we consider that an explanation of the difference between the two will assist understanding and help to dispel possible confusion (paragraph E.3.3(d)).

7.33 An understanding of how the funding position of the scheme might change is an important aspect of the future financial development of a pension scheme. We consider that requiring separate estimates of future assets and liabilities could give a spurious impression of accuracy, as there is inevitably significant uncertainty in such projections. Projections of the funding level (ie the ratio of assets to liabilities) are more robust, and we consider they are less likely to be misunderstood by members. Paragraph E.3.3(e) therefore requires projections of the future funding level on the two bases on which estimates of the liabilities have to be calculated (technical provisions and the solvency basis). It also requires disclosure of the current funding level to enable comparisons with the current financial position. Because of the uncertainties involved in projections, it might be disproportionate to calculate them to the same level of accuracy as the current liability values (paragraph E.3.5).

7.34 The information described in paragraph E.3.3 is necessary for an understanding of the financial position of a pension scheme, but we consider that it is by no means sufficient. A full understanding requires, in addition, background information about the data on which the results are based and the methodology and assumptions that have been used (paragraphs E.3.7 and E.3.8). Other important aspects include the development of the scheme and its financial position since the last Scheme Funding exercise (paragraph E.3.9) and what might happen in the future, including the cash flows and agreed contribution plan (paragraphs E.3.10 and E.3.11). Finally, a full understanding requires information about risk and uncertainty (paragraph E.3.12).

7.35 It was suggested that the Pensions TAS could allow signposting to other documents. We consider that it is reasonable to allow signposting to other documents which have been prepared explicitly for members, and which are therefore readily available to them and are written in terms that are understandable to them. We therefore decided to allow signposting to the scheme booklet or other similar communication material instead of summarising benefit provisions (paragraph E.3.7). However we did not consider it was appropriate to allow signposting to documents such as the Statement of Funding Principles and the Statement of Investment Principles which are not necessarily readily available to members or understandable by them.

7.36 Overall, the requirements in section E.3 of the Pensions TAS are similar to, though rather less detailed than, the requirements in GN9. We therefore do not expect major changes to the structure of Scheme Funding reports as a result of the introduction of the TAS.

8 FUNDED PENSION SCHEMES NOT SUBJECT TO PART 3 OF THE PENSIONS ACT 2004

INTRODUCTION

8.1 Part F applies to pension schemes which are not subject to the Scheme Funding provisions in Part 3 of the *Pensions Act 2004* but for which there is a requirement to have a regular funding assessment.

REQUIRED FUNDING ASSESSMENTS

8.2 There are some funded schemes to which the Scheme Funding rules do not apply but for which there may be requirements to carry out regular funding assessments. An example is the Local Government Pension Scheme. We consider that the principles in Part E should apply to these scheme but in the context of their specific legal framework (paragraph F.2.1).

8.3 For schemes subject to Scheme Funding there is a requirement to quantify the level of prudence in Scheme Funding exercises (paragraphs E.2.10 to E.2.12). The Pensions TAS includes no such requirement in Part F. We included the requirement for schemes subject to Scheme Funding because of the specific requirement in the *Pensions Act 2004* that assumptions for these schemes are chosen prudently. For schemes subject to Part F paragraph C.5.4 of TAS M requires that an aggregate report that includes estimates that are not neutral shall indicate their relationship to neutral estimates. If results are presented as being calculated prudently, users will therefore need to be given an indication of their relationship to a neutral estimate.

8.4 It will be a matter for judgement how the principles should be applied in any given situation (paragraphs F.2.2 and F.2.3).

9 INCENTIVE EXERCISES

INTRODUCTION

9.1 Following a consultation the scope of the Pensions TAS was amended in November 2012 to include actuarial work concerning pension scheme incentives. Paragraphs 9.2~ to 9.15~ set out the advice from the Actuarial Council to the FRC. The FRC followed the advice in all areas.

ADVICE OF ACTUARIAL COUNCIL TO THE FRC

Background

9.2 Concerns have been expressed about the potential for poor decision-making by pension scheme members arising from pensions incentive exercises, in which an employer seeks to remove some or all of its defined benefit pension scheme liabilities and risks by persuading members to transfer or modify benefits, usually by providing a financial incentive.

9.3 Actuaries are usually involved in incentive exercises at some stage - particularly when the level of incentive is being determined – so that it is appropriate to consider the scope and content of technical actuarial standards. However, there is no requirement for advice to be taken from an actuary, and actuarial advice is not normally communicated directly to scheme members. Consequently, changes to actuarial standards need to be co-ordinated with action by other agencies, the actuarial profession and industry and consumer bodies. Relevant external developments in this area include various initiatives by the Institute and Faculty of Actuaries to its members, and an industry Code of Practice (June 2012) and a statement from the Pensions Regulator (July 2012).

9.4 There are two forms of incentive exercise which have attracted significant publicity.

Enhanced transfer values (ETVs)

9.5 The most common form of incentive exercise is an enhancement to a member's transfer value, a cash payment in addition to the transfer value, or a mixture of the two, on the condition that the benefits are transferred to another pension scheme which is usually defined contribution. Anecdotal evidence suggests ETV acceptance has been in the region of 25% to 40% although the number depends on factors such as the level of the incentive and the financial position of the employer.

Pension increase exercises (PIEs)

9.6 A PIE involves asking members to give up non-statutory post-retirement pension increases (usually for benefits from service before 1997) in return for a higher flat rate pension in the scheme. Employers offer incentive exercises to reduce risk or costs. Incentive exercises have grown in popularity recently as deficits have increased and employers have looked at ways of reducing or eliminating pension risks.

Consultation

9.7 In June the FRC, through the Board for Actuarial Standards, consulted on bringing actuarial work in relation to incentive exercises into the scope of the Pensions TAS. The consultation:

- proposed that actuarial work concerning incentive exercises be brought into the scope of the Pensions TAS;
- proposed the inclusion of two new principles in the Pensions TAS requiring the reporting of changes to benefits and risk of members to employers and sponsors – the aim of these principles, which had similar objectives to two of the principles in the Transformations TAS, was to ensure that those entities implementing incentive exercises understood how members might be affected – whereas most requirements in the Pensions TAS focus on the needs of employers and pension scheme trustees in making decisions based on actuarial information, and do not explicitly require consideration of the impact of their decisions on scheme members;
- asked whether any further principles concerning incentive exercises should be included in the Pensions TAS; and
- proposed that the changes would be effective for aggregate reports completed on or after 1 December 2012.

9.8 The FRC's consultation was one of a series of initiatives to address concerns that pension scheme members might be accepting offers which are not in their interests and could result in a fall in the value in benefits or a change in the risks to the member. Other initiatives included:

- the publication in June 2012 of an industry developed Code of Practice for Incentive Exercises[9] – to comply with this Code incentive exercises must not include cash offers and must satisfy specified thresholds for advice and information provided to members;
- revised FSA rules for IFAs providing advice to members transferring out of DB pension schemes – these include revised assumptions to be used in transfer value analysis systems; and
- the Institute and Faculty of Actuaries raising awareness of issues concerning incentive exercises which its members should consider.

Scope

9.9 Members who are offered incentives face difficult and complex choices. It is therefore important that members are provided with clear and sufficient information so they can take informed decisions. Actuarial work is carried out at various stages of these exercises and can influence the terms of incentives offered and the communications to members. In order to provide an assurance of the quality of actuarial information provided to employers and trustees, actuarial work concerning incentive exercises should be in the scope of the Pensions TAS.

9.10 In response to detailed representations from practitioners, the supplemental description of activities which fall within the scope of the

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[9] http://www.incentiveexercises.org.uk/

Pensions TAS as proposed in the consultation paper can and should be consolidated, without excluding any significant area of actuarial work in connection with incentive exercises.

Principles

9.11 As discussed above, the risks to scheme members need to be considered and understood by employers and trustees in determining the terms of incentives offered and the content of communications to members Actuarial work can play a significant part in promoting such understanding.

9.12 Nevertheless, practitioners have argued that additional principles are not needed as:

- the principles in the Generic TASs and the Pensions TAS, in conjunction with the recently published industry Code of Practice for Incentive Exercises, are sufficient to ensure that employers and trustees involved in incentive exercises have the information they require to make informed decisions;

- the industry Code of Practice for Incentive Exercises sets out, in considerable detail, the information which should be provided to members who are offered incentives and sets out good practice for the operation of these exercises; and

- additional principles would be unlikely to affect member outcomes as there are various safeguards (including the Code of Practice, the existing TAS provisions and the FSA rules for advice on transfers).

9.13 Having considered these representations and the views of users, a majority of members of the Actuarial Council agreed that the existing TAS principles, in conjunction with the industry Code of Practice and the FSA's Pension Transfer Analysis Assumptions, provide a suitable and proportionate framework for the consideration of the needs of members, without the need for additional principles. However, the position should be kept under review and the inclusion of further principles should be reconsidered at the first full review of the TASs taking account of the impact of the new industry Code of Practice.

9.14 One member of the Actuarial Council considered that the additional principles on changes to benefits and risk of scheme members proposed in the consultation should be included in view of the high number of scheme members whose benefits could change as a result of accepting options to change the nature of their benefits and the Pensions Minister's well known concern about pension incentive exercises. The industry 'Code of Practice' on Pension Incentive Exercises was developed under the auspices of the DWP. A decision by the FRC Board to include the additional principles would signal the strongest possible support for the DWP's initiative.

Effective date of changes

9.15 The changes should take effect for aggregate reports completed on or after 1 January 2013 so the changes can take effect as early as possible in view of the public interest. Early implementation was supported by respondents to the consultation. The effective date is one month later than proposed in the earlier consultation and reflects the likelihood that the revised TAS will be published one month later than originally envisaged.

Version	*Approved on*
1	11 October 2010
2	1 November 2012