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**STANDARDS FOR GAD WORK CONCERNING PENSION SCHEMES
(‘THE GAD STATEMENT OF UNDERSTANDING’)**

INTRODUCTION

The Financial Reporting Council (FRC) has issued five Technical Actuarial Standards (TASs) which potentially cover the work GAD does in relation to pension schemes. They are on:

- Reporting
- Data
- Modelling (calculations)
- Pensions
- Transformations

These standards apply in different circumstances. GAD wishes to ensure that it delivers appropriate high quality actuarial work to a standard in excess of any minimum delivered by standards in relation to its work. Accordingly, GAD has produced this Statement of Understanding or simply ‘Understanding’. It represents a simple, clear statement of requirements which if followed is designed, through extensive analysis and checks, to ensure that the TASs will be met in relation to pension scheme work within GAD. It also introduces some extra requirements which can provide further assurance.

GAD will follow the requirements in this Statement of Understanding in relation to all pension scheme work unless it is inappropriate to do so, or unless instructed otherwise by any client. In such cases, we will advise at the relevant time (and explain any areas of the TASs which are not being complied with).

GAD’s approach has been shared with the FRC, HM Treasury and Treasury Ministers who have not raised any objections nor pointed out any flaws.

This Understanding will be applied by GAD actuaries when carrying out any work in connection with pension schemes with effect from 1 October 2012.

This Understanding will be updated from time to time; the latest version will be maintained on the GAD website at <http://www.gad.gov.uk>.

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A: GENERAL PRINCIPLES

The following general principles should be considered for all work covered by this standard.

A.1. GENERAL

Fundamental principle - Actuaries should ensure that they have sufficient up-to-date knowledge and experience relevant to the work in question, consider all factors and parties and where applicable undertake sufficient consultation.

- A.1.1 The actuary should ensure that they have kept abreast of all developments that may be relevant to the work in question.
- A.1.2 The actuary should ensure that:
 - a) They have undertaken sufficient consultation relevant to the work in question (including where required to meet any legal requirement to do so).
 - b) The outcome of any such consultations is properly taken into account in the resulting work.
- A.1.3 The actuary should take account of professional requirements relevant to the work being carried out.
- A.1.4 The actuary should ensure that they consider the party or parties that the work is designed to assist and endeavour to ensure that the needs and objectives of those parties are met.
- A.1.5 Where the work may have a direct impact on either the benefits for individuals or payments made to or by individuals, the actuary should factor this in when considering the principles in this document. In particular the actuary should bear this impact in mind when considering sufficiency of consultation, sufficiency of data, all aspects of the modelling and the detailed communication.
- A.1.6 Where it is not possible or practical to gather sufficient data or undertake sufficient consultation and if, in the actuary's opinion, it would not be proportionate to adopt any other course of action, the actuary may work on the basis of the collected information. In such a case the actuary must



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disclose this to the recipients of the work as soon as this conclusion is reached.

- A.1.7 The actuary should consider what documentation is appropriate and ensure that such documentation is completed. This should be done in relation to both the work delivered and underlying work carried out to deliver that work.
- A.1.8 The actuary should be alert to risks that may affect the work or advice. The actuary should highlight any such risks and seek to ensure that any resulting limitations of advice are understood.
- A.1.9 The actuary should understand and take into account the terms and conditions applicable to the work set out in the service level agreement, letter of appointment or other terms of engagement.

A.2. COMMUNICATION

Fundamental principle - There should be sufficient and clear information for recipients to take appropriate decisions¹.

- A.2.1 The actuary should ensure that any communication which is produced with the expectation that the recipient or a known third party may act on it contains sufficient written information such that the recipient or third party could not reasonably be expected to take a different decision if more, relevant, information were added. If the actuary is of the view that insufficient information has been requested or will be provided to enable a sensible decision to be taken, the communication should make a statement to that effect.
- A.2.2 Where possible, the actuary should ensure that the communication does not provide information which, in the actuary's opinion, may be regarded as irrelevant to the decision.
- A.2.3 The actuary should not exclude information about complex matters within the communication on the grounds that it might be too difficult for some readers to understand, although the communication should be written to be comprehensible.

¹ *For the avoidance of doubt, a decision not to act or defer acting (and, for example, seek more data) is a decision in this context.*



A.3. DATA²

Fundamental principle - Enough data should be collected, verified and properly documented for appropriate advice to be given and appropriate decisions taken.

- A.3.1 The actuary should request, test for veracity and use sufficient data such that decisions to be made by the recipient of any communication would not reasonably be expected to change if further data were to be available and used.
- A.3.2 The actuary should ensure that any information supplied provides relevant caveats where there is a gap in data such that there is a risk that the communication could be expected to be materially different, and so affect decisions, if the gap were to be filled. The caveats should cover reliance on the information and warn on the likelihood and potential impact of the risks being taken by not securing more information.
- A.3.3 The actuary should ensure that all data held by them is adequately labelled and documented so that another actuary picking up the working papers could reasonably be expected to be able to understand what had been collected, any limitations, how calculations had been performed and what judgements had been made.

A.4. MODELLING, CALCULATIONS & ASSUMPTIONS

Fundamental principle - Modelling should be carried out using appropriate, and properly documented, methods and assumptions. Actuarial calculations should deliver the correct answers based on the assumptions selected.

- A.4.1 The actuary should ensure that the methodology and assumptions used are such that they could sensibly assume that another reasonable actuary would conclude that the calculation approach is fit for purpose.
- A.4.2 The actuary should satisfy themselves that they would not expect a more sophisticated methodology to change the results to an extent where the decisions of recipients would be expected to change as a consequence.

² *Data includes numbers, documents, consultations and data checks.*

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- A.4.3 The actuary should ensure that the documentation is clear and unambiguous and is sufficient so that another actuary could reasonably be expected to reproduce the results of the calculations (within an acceptable range).
- A.4.4 The actuary should ensure that sufficient checks are performed and documented such that the actuary could reasonably assume that there would be no change to the results (within what the actuary considers to be reasonable bounds) if further checks were carried out.
- A.4.5 Where assumptions are made for an exercise that may affect more than one group, the actuary should ensure that the selection of assumptions places proper emphasis on how interests of all relevant parties are affected. The extent to which this has been done should be documented.
- A.4.6 The actuary need not comment on assumptions or methodology set by a third party (or in legislation or equivalent) other than to state who has set the assumption or methodology unless, in the actuary's view, comment could affect any decisions made or where there is a statutory duty to do so. Further, the actuary need not apply any other principle in this document to such assumptions or methodology.

A.5. FUNDED SCHEMES: FUNDING ASSESSMENTS

For work relating to funding assessments for funded schemes, the actuary should also follow the principles set out below.

- A.5.1 Any communication in respect of a funded scheme to a party who may take actions relating to funding strategy, assumption setting or contribution arrangements as a result shall contain sufficient actuarial information to support that party in taking those actions.
- A.5.2 Any communication relating to the funding of the scheme shall be written so that a party who may act on the communication and/or which, at the time of the communication, can be expected to be made available to third parties who may so act shall be written so that those parties can understand the financial position of the scheme, including its development since the previous similar communication and how it might change in the future.



B: CONSIDERATIONS

In applying the General Principles, this section lists considerations which the actuary should, using his or her judgement, consider either including in the communication or acting upon (or both) if relevant to the work in question. In doing this the actuary should take into account the level of knowledge and understanding of the recipient(s) and/or decision takers.

The actuary only needs to include a particular consideration in the communication, or do what a particular consideration states, if it is relevant and if the actuary feels that to otherwise ignore it could be expected to result in a change to a decision made by recipients.

B.1. GENERAL

- B.1.1 Any recent developments that could affect the advice given or the service provided.
- B.1.2 The impact of any statutory requirements (or scope of the job requested by the client) in relation to the work performed and the need for cross checks to ensure that these have been met.

B.2. COMMUNICATION

In deciding which of the matters listed in this section to include in the communication the actuary should adopt a style that is suitable for the user and remember that a concise communication is often clearer to the recipient than a heavily caveated longer document.

General

- B.2.1 Who has commissioned the communication (and in what capacity) and who may otherwise be expected to make use of it (and in what capacity).
- B.2.2 A statement of the purpose for which the communication can and cannot be used, and the decisions that can and cannot reasonably be taken from it.
- B.2.3 A cross-reference to any other previous communication which could fill in any gaps which may otherwise cause different decisions to be made.



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- B.2.4 A statement on professional compliance including, where material, a statement of any TASs complied with.
- B.2.5 Confirmation in writing of any information conveyed in a verbal or other non-permanent form.
- B.2.6 A suitable statement regarding how the needs of recipients and other relevant persons are met by any models together with any limitations of those models and the implications of those limitations. An indication of the nature and extent of uncertainty in the information the communication contains.
- B.2.7 A comparison with any communication which has previously been provided for a similar purpose (if one exists), with explanations of any differences. The comparison could cover any one or more of data, assumptions, results of calculations, recommendations and other material matters. The comparison of the results of calculations could include a full reconciliation of the two sets of results.
- B.2.8 Clarification of the intended meaning of any terminology (including the meaning of data items).
- B.2.9 Further information to clarify any known, or easily anticipated, misunderstandings.
- B.2.10 The extent to which non-actuarial matters can or should affect decisions to be taken and any information required by legislation, including schemes' governing documents.
- B.2.11 Any external constraints on the content of the communication, including any advice being given, for example limitations imposed by legislation or government policy.
- B.2.12 Any other considerations relevant to the circumstances in hand in delivering to the principles.
- B.2.13 For each material risk or uncertainty faced by the entity in relation to the communication, the nature and significance of the risk and an explanation of the approach taken to the risk.
- B.2.14 Any warnings for third parties as to whether or not the communication can be used as a basis for their decisions.
- B.2.15 In relation to the preparation of actuarial factors, the financial implications to the pension scheme of choosing a particular set of factors.



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- B.2.16 In relation to instructions to a third party to carry out calculations of benefits, the clarity of those instructions.

Data

- B.2.17 Any material changes or events that are known to have occurred since the effective date of the data and other information on which it is based.
- B.2.18 The source of any data or any other information used and a description of that data or information.
- B.2.19 If there is any material uncertainty over the accuracy of the data, a description of the uncertainty along with details of any approach taken to the uncertainty in the calculations or in the results.
- B.2.20 If the effect of any grouping of data is material, details should be included in the communication.

Assumptions

- B.2.21 The material assumptions on which any calculations or judgements are based, the nature and objective of those calculations, what the calculations are designed to show and their derivation.
- B.2.22 Where any estimates are derived using assumptions which include a margin for prudence or optimism, an indication of the relationship to the corresponding best estimate or neutral estimate (using neutral assumptions) should be provided. The term 'best estimate' or 'neutral estimate' should not be used if an estimate includes a margin for prudence or optimism.
- B.2.23 Any differences between the assumptions used or recommended in different parts of the work (and/or differences with previous advice) together with an explanation for any such changes. A description of the rationales for:
- a) Any material assumptions used or recommended;
 - b) Any differences between the assumptions used or recommended in different parts of the work; and
 - c) The measures and methods used in calculations.
- B.2.24 A suitable statement of any uncertainties in the assumptions, measures, methods or other information.
- B.2.25 The extent to which assumptions take account of discretionary practices (whether past practice or future expectations).



Calculations & models

- B.2.26 If the communication includes the results of calculations of monetary amounts, an explanation, for each result, of whether it is the outcome of an exercise carried out for budgeting or target setting purposes, whether it was carried out to quantify an amount for use in a transaction or to record in a formal document or whether it was for some other purpose.
- B.2.27 An indication of the nature of any future cash flows being quantified, including their timing.
- B.2.28 If the communication includes probabilities:
- a) The intended meaning of the probability; and/or
 - b) The nature of any statistics on which the probability is based.
- B.2.29 A communication that includes the results of calculations that are performed at regular intervals could indicate the projected results from future corresponding calculations.
- B.2.30 Information on relevant alternative scenarios with likelihoods to enable the recipients to assess the potential impacts and risks of any main scenario.
- B.2.31 The impact of adopting alternative plausible assumptions.

Determinations

- B.2.32 For an exercise where the actuary is making a determination (as opposed to giving advice), a statement of the data gathered and consultation information received and the thinking that led to the determination in order to give validation to the building blocks of the determination.

Changes to accrued benefits

In relation to a communication concerning the effects of a change in the terms underlying the accrued benefits of some or all of the scheme members without their consent:

- B.2.33 Whether any groups of beneficiaries have not been considered in the analysis, and whether in the analysis only adverse impacts have been considered.
- B.2.34 Whether and how any material risks borne by the classes of beneficiary may change.

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- B.2.35 Any material changes (positive or negative) to the cashflows or likelihood of cashflows expected by beneficiaries, and any changes to the factors that might affect those cashflows. The extent of any potential reduction in the amount of the benefits, when they are likely to be adversely affected and any likely quantifiable gains.
- B.2.36 The rationale of those parties proposing the change.
- B.2.37 If giving an opinion as to whether the change should take place, the information on which the opinion is based and the rationale for the opinion should be set out.

B.3. DATA³

In applying the principles relating to data, consideration should be given to:

- B.3.1 The full range of possible data requirements which may be appropriate to deliver the required information.
- B.3.2 The data checks that need to be made to ensure the accuracy of the data at a material level in order to comply with A.3.1, and the extent to which these checks need to be documented.
- B.3.3 The extent to which reliance can be placed upon data validated by others and the extent to which different standards can be applied to different sources of validated data (e.g. data validated by a professional auditor, a solicitor in practice or an individual with a vested interest in the outcome etc).
- B.3.4 At what stage, and to what extent, information can be provided to recipients where there are data gaps or inadequacies and in what circumstances is it right to insist on further data before providing the work; noting that this depends on how the recipients and interested third parties may act as well as potential legal and regulatory obligations.
- B.3.5 Adjustments that may be made to improve incomplete or inadequate data.
- B.3.6 For accounting work, seeking information regarding materiality levels.
- B.3.7 Gathering and understanding all the governing documents and applicable legal requirements.

³ *Data includes numbers, documents, consultations and data checks.*

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- B.3.8 Obtaining any known legal opinions concerning the impact of legislation on the calculation of benefits.
- B.3.9 Whether there is sufficient data collected such that a technically competent layperson with no previous knowledge of the exercise for which the data is being used could understand the matters involved and assess the judgements made.
- B.3.10 The provision of material relevant data used in determining any communication from an actuary (covered by the previous section) in a suitable summarised form such that (a) another actuary could not, using that data, reasonably be expected to conclude that any actuarial figures supplied were unreasonable, (b) the recipient can use it as a testing mechanism to check that there are no material errors in the data used and (c) it is easy to see where the gaps occur if working within the principle A.3.2 above.
- B.3.11 Whether data may have been provided by a party with a vested interest.
- B.3.12 For grouped data, the reasons and rationale and any likely impacts.

B.4. MODELLING, CALCULATIONS & ASSUMPTIONS

In applying the principles relating to modelling, consideration should be given to:

- B.4.1 Whether measures, assumptions and judgements used to derive an estimate include a margin for optimism or pessimism appropriate to the estimate described.
- B.4.2 Whether the data used is appropriate to the purpose of the model for the work in question.
- B.4.3 Whether it is appropriate to group data.
- B.4.4 The extent to which assumptions used within associated models or calculations need to be consistent with each other.
- B.4.5 Whether the documentation describes the assumptions used and their derivation.
- B.4.6 Whether it is appropriate to document, rationalise and explain the impact of any items of data which have been removed from the dataset.



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- B.4.7 The extent to which the issues modelled, the results of the model together with any judgements made can, or should, be understood by a technically competent layperson.
- B.4.8 Whether the model is fit for purpose (i.e. sufficiently takes account of the problem being modelled).

Assumptions & calculations

Where assumptions to be used in determinations, or in part of the process of deriving advice, are set by the actuary:

- B.4.9 The need to consult with relevant stakeholders (but consider also whether this might lead to potential conflicts).
- B.4.10 The extent to which further information is required, and in particular to determine the practice in relation to discretionary benefits.
- B.4.11 The purpose of the calculations.
- B.4.12 The availability of sufficient or relevant experience to derive the assumptions.
- B.4.13 The appropriateness of the assumptions to the exercise being conducted, and the needs of users.
- B.4.14 The need to adopt assumptions for the scheme specific base rate of mortality (using the scheme's own mortality if statistically significant) and, separately, for changes to mortality rates.
- B.4.15 The consistency of assumptions adopted between two similar and related exercises and between the current exercise and previous such exercises.
- B.4.16 Whether all assumptions used are independently appropriate and without any margin to compensate for a shortcoming in, or adjustment made to, a different assumption.
- B.4.17 Whether insolvency of 'sponsor/employer' is an issue to be allowed for.
- B.4.18 Whether inter-generational equity is an issue to be allowed for.
- B.4.19 Whether a holistic approach to Government finances is to be allowed for.
- B.4.20 The degree of prudence (or not) in the assumptions used.



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- B.4.21 The links between the following factors: the assumptions made, the data gathered, the results of consultation and the purpose of the exercise.
- B.4.22 The extent to which discretionary benefits should be allowed for.
- B.4.23 Where approximations are used in calculations, the impact that this might have on the accuracy or sensitivity of the results.

B.5. FUNDED SCHEMES

Extra considerations

In considering the application of the principles in this document to funded schemes the actuary should also consider, and consider including within the communication, the following matters.

Discount rates

- B.5.1 An explanation of the derivation of, and implications of adopting, any discount rates used in, or proposed for use in, an exercise, and details of the cashflows that are being discounted.
- B.5.2 An explanation of how the discount rates used, or proposed for use, in an exercise compare with the return on assets that can be expected from assets invested according to any stated investment strategy, including any anticipated changes in that strategy.

Transfer values

For schemes subject to the funding provisions set out in Part 3 of Pensions Act 2004 when giving information to allow schemes to set assumptions for cash equivalent transfer values.

- B.5.3 A comparison of the proposed assumptions with those used for the Scheme Funding assessment including an explanation of the differences between the two sets of assumptions.

Funding assessments

For work relating to funding assessments for funded schemes, the actuary should also consider, and consider including within the communication, the following matters.



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- B.5.4 A description of different funding measures and an explanation of the implications of adopting them.
- B.5.5 Any information required by legislation, including the scheme's governing documents.
- B.5.6 Any funding objective specified by the scheme managers or other body.
- B.5.7 If the scheme contains provision for wind-up, a description of the effect on members' benefits had the scheme been wound up at the effective date of the funding assessment.
- B.5.8 The current funding level and projections of the funding level at the expected effective date of the next funding assessment on the current funding basis.

Schemes subject to Part 3

For schemes subject to the funding provisions set out in Part 3 of Pensions Act 2004, the actuary should also consider including within the communication the following matters.

- B.5.9 An explanation of any difference between the technical provisions and the value of the liabilities calculated on the solvency basis.
- B.5.10 An approximate estimate of the value of the liabilities represented by the technical provisions with any margins for prudence removed, explaining the relationship between the technical provisions and this estimate.
- B.5.11 An explanation of any change to the relationship between the technical provisions and the approximate estimate described in B.5.10, when compared to the previous exercise of the same type, if any.

B.6. NEED FOR FURTHER ADVICE

If the actuary becomes aware of any matter that may be significant to either the actuary's statutory or professional responsibilities, the actuary should consider:

- B.6.1 Whether further advice is required by scheme managers or other associated parties, whether from the actuary or another adviser. If so, the actuary should consider informing the scheme managers and/or other relevant decision making bodies accordingly.



C: MATTERS ALWAYS COVERED IN COMMUNICATIONS

All work

All work covered by this standard should contain a statement of compliance, to confirm the standards that have been applied. The manner in which this will be achieved will be set out in other internal guidance.

All funded schemes

The provisions of the remainder of this part apply to the following reports:

- a) for schemes subject to Part 3 of the Pensions Act 2004 - the report referred to as the “actuarial valuation” under section 224(1) of that Act
- b) for all other funded schemes - the equivalent report so produced

The actuary will include the following matters within the report and will consider including these matters in other communications relating to funding assessments.

C.1.1 The following information on data and information:

- summary membership data including average ages
- a summary of the benefit provisions or a reference to a document already provided to members summarising benefit provisions
- a statement of the assets (if the scheme holds real rather than notional assets)
- a summary of any stated investment strategy
- a summary of experience since the previous funding assessment including membership changes, contributions paid and investment returns; and
- a summary of significant events, including changes to benefits, that have taken place since the previous funding assessment.

C.1.2 The funding measure and key assumptions used for the funding assessment along with a summary of and comparison with the key assumptions used in the previous funding assessment.

C.1.3 An explanation of the reasons for changes in the funding level from the previous funding assessment and quantification of any significant change in the funding level by cause (including scheme experience and changes in assumptions).



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- C.1.4 A description of the nature of future cashflows, split by category of membership if relevant.
- C.1.5 A description of the risks to the financial position of the scheme and any actions taken to mitigate them.
- C.1.6 A summary of the results of the calculations together with an analysis of the sensitivity of the results of the calculations to changes in key assumptions. If relevant to the purpose of the report, agreed contributions payable should also be detailed.

Schemes subject to Part 3

For schemes subject to the funding provisions set out in Part 3 of Pensions Act 2004 the actuary will also include:

- C.1.7 A description of the effect on members' benefits had the pension scheme been wound up at the effective date of the Scheme Funding assessment.
- C.1.8 The current funding level and projections of the funding level at the expected effective date of the next Scheme Funding assessment on the solvency basis and on the technical provisions basis.