Dear Sirs

I would like to make the following comments and responses in relation to the above paper.

<u>Chapter 2</u>

Comment: The opening sentence of the chapter refers specifically to "the mortality assumptions to be used when illustrating *personal pensions*" (my italics), followed immediately by reference to the ECJ Test Achats ruling. I enclose a copy of an extract of a document issued by the European Commission on 22/12/11 entitled "Guidelines on the application of Council Directive 2004/113/EC to insurance, in the light of the judgment of the Court of Justice of the European Union in Case C-236/09 (Test-Achats)". This appears to argue that there is a distinction between how the ruling will affect annuities under 'personal pensions' and 'occupational pensions'. By explicitly referring to 'personal pensions' in CP12/10, are you also implying some distinction between these and occupational money purchase pensions such as EPPs, S32s, SSASs and CIMPs? In your consultations with annuity providers (and perhaps with other pension providers), are you certain that they do not anticipate any such distinction?

Q1. I agree the proposed new mortality basis should be used simply because it is imperative that there is consistency between projections. My experience is that projections from all sorts of different sources are used willy-nilly to compare options, however much those of us who know better try and tell people (even IFAs) not to make spurious comparisons. Any unnecessary difference in underlying assumptions is therefore to be avoided at all costs.

As you may be aware, in the original consultation document issued by BAS on the proposed revision of TM1, it was stated that the intention was to change the mortality assumption to be that of females (PCFA00) with the existing mid-cohort improvement assumption. The change to using a 50/50 blend of PCMA00 and PCFA00 with CMI model mortality improvements was 'parachuted' onto unsuspecting users (as far as I was concerned) without any consultation. Whilst I thoroughly support the move towards a more up to date set of assumptions, it was the 50/50 blend that surprised me most because that was not the prevailing expectation (as far as I was concerned) prior to that. The previously unseen final version was also badly worded as regards the way the mortality improvement was mean to apply and I welcome a less ambiguous codification.

Your comments in CP12/10 that there is still disagreement amongst annuity providers about the effects on rates post-21/12/12 makes me question whether the highly simplistic '50/50 blend' model is suitable and on what research and intellectual analysis it is based. This 50/50 proportion should therefore be kept under review.

Q2. The sooner the better.

Q3. No comment.

<u>Chapter 3</u>

Q4. I agree that a separate CPI-linked revaluation assumption is appropriate and, based on the PWC study, I agree that 2% seems a reasonable figure to adopt.

However, and I think you are deliberately obfuscating by not asking *this* question: is 2.5% still appropriate for the RPI-linked revaluation? You simply state at paragraph 3.5 "that [relabelled] rate will remain the same", without asking the important question of whether we agree with the figure of 2.5%! Reading the PWC report it is clear they do not expect the RPI-CPI wedge to be just 0.5% - based on the OBR report they suggest an "average of around 1.4% over the medium term". They go on to look at other evidence such as RPI implied by bond yields and even there they struggle to justify an RPI inflation figure of 2.7%. Whilst we are generally looking for an assumption for 'RPI capped at 5%', it is hard to see how you can justify sticking to the old 2.5% figure for this.

Q5. I agree with the approach, subject to the same provisos as above about why a difference of 0.5% is appropriate, but I recommend it is kept under careful review as I fear we could find conditions change in ways that we had not expected and what looks sensible now may not do so with the benefit of hindsight.

The explanation of options in COBS 19.1.4R (1) is now horribly complicated and I found I needed to create a logic diagram to help me understand what happened under different conditions. I enclose a copy (I hope I have got it right!) and would ask if the FSA might consider producing something similar to simplify the options.

While on this area, I have realised that COBS 19.1.4BR is rather ambiguous. When it says "apply the provisions of COBS 13 Annex 2 3.1R(6) on a monthly basis" where the rolling 12 month average is more than +/- 0.2% different to the previous 15th Feb rate, does it mean "use *that* month's actual ILG yield" or "use *the last 12 months rolling average* ILG yield" for that month? I am unclear on this.

Q6. No comment.

Chapter 4

Q7. I have a number of objections to this proposal. First, the use of the word "accurately" before "reflect the investment potential" is asking for the impossible. No one can predict future investment returns, which use of the word 'accurately' implies. Neither does the word 'potential' have any firm definition in the context of investment. How, therefore, could you possibly police compliance with this rule based on this proposed wording? A better word to use might be "realistically", which is at least subjective, whereas 'accurately' implies objectivity and measurement.

More fundamentally, I have been concerned for a long time that the FSA expects product providers to estimate what adjustment should be made to 'standard' future expected returns to reflect the asset allocation and other characteristics of the underlying investment portfolio when my own understanding, going back to LAUTRO days, was that the lower and higher 'flanking rates' were what people should use to judge the potential of their own particular investment. I do not believe it is possible to predict future returns from different asset classes but only to say, as PWC do, that there are differences in the likely expected *ranges* of returns from different asset classes. If the product I proposed to buy was in a largely bond-orientated fund I would err towards the lower growth rate projection as compared to one with a more equity-orientated fund, but I would not expect the product provider to try and *quantify* the difference in growth rate because I know that is not something it is possible for it to do. It would imply a totally spurious accuracy. If however I wanted to compare the effective prices of products, I would (and did for years) compare projected funds knowing that all providers used the same growth rates for their illustrations. Now I can no longer do that, and neither can I rely on Reductions in Yields if I am comparing existing and proposed products for possible pension switching advice since existing products do not have to provide this information. As a result, pension switching advice has become *less* open to accurate financial analysis than it was before the change in FSA emphasis on projection rates, and therefore *more* open to consumer detriment, which is to be deplored.

Q8. I do not agree with the proposal to dock 2% off the intermediate growth rate assumption when PWC clearly suggests it should be "around 6%" now. After an enormous amount of research and academic review and analysis, PWC arrived at this conclusion, only for some unnamed and for all I know unqualified bureaucrat at the FSA to put a finger in the air and say "lets make it 5%". There is no attempt at analysis and it does not stand up to any sort of academic scrutiny. Nor is it justified when you paid PWC to produce a report and recommendation.

I do not object to the widening of the span of the flanking rates but I would comment that this again seems to be an arbitrary and random choice, plucked out of the air with no basis in academic analysis or research, which provides little confidence in the FSA's processes.

Chapter 5

Q1. Yes, the assumptions used for TM1 and COBS 13 Annex 2 should be consistent as far as is possible. Any differences should be explicitly justified. It is fact that the two are used to make comparisons, e.g. for possible pension switching, and however much professionals try to explain that there may be differences that make such a comparison unreliable or biased, I fear people will continue to do so and we have a responsibility to minimise or eliminate such problems.

Q2. The rules for accumulation rates used for SMPI purposes should be consistent with those specified in equivalent FSA illustration rules for the same reasons as above. It is hard to see why they should differ and if they were to do so, the lack of agreement on it would undermine confidence in our financial regulators and hence in our financial products themselves.

Q3. Certainly the existing TM1 v2 wording is ambiguous. I had a number of discussions with other actuaries on the proper interpretation of it, and that was time-wasting and should not have been necessary. I hope this will be corrected. I also recommend some further official guidance on how to go about the calculations: trying to pick apart the CMI Model spreadsheet does not seem the right way to have to approach this but was all I could find to do.

Q4. I have no problem with a short consultation period.

Q5. I am disappointed that it is not envisaged the changes could be introduced sooner but I accept this may be unavoidable.

Q6. No comment.

Yours sincerely
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COMMUNICATION FROM THE COMMISSION (22.12.2011)

Guidelines on the application of Council Directive 2004/113/EC to insurance, in the light of the judgment of the Court of Justice of the European Union in Case C-236/09 (Test-Achats)

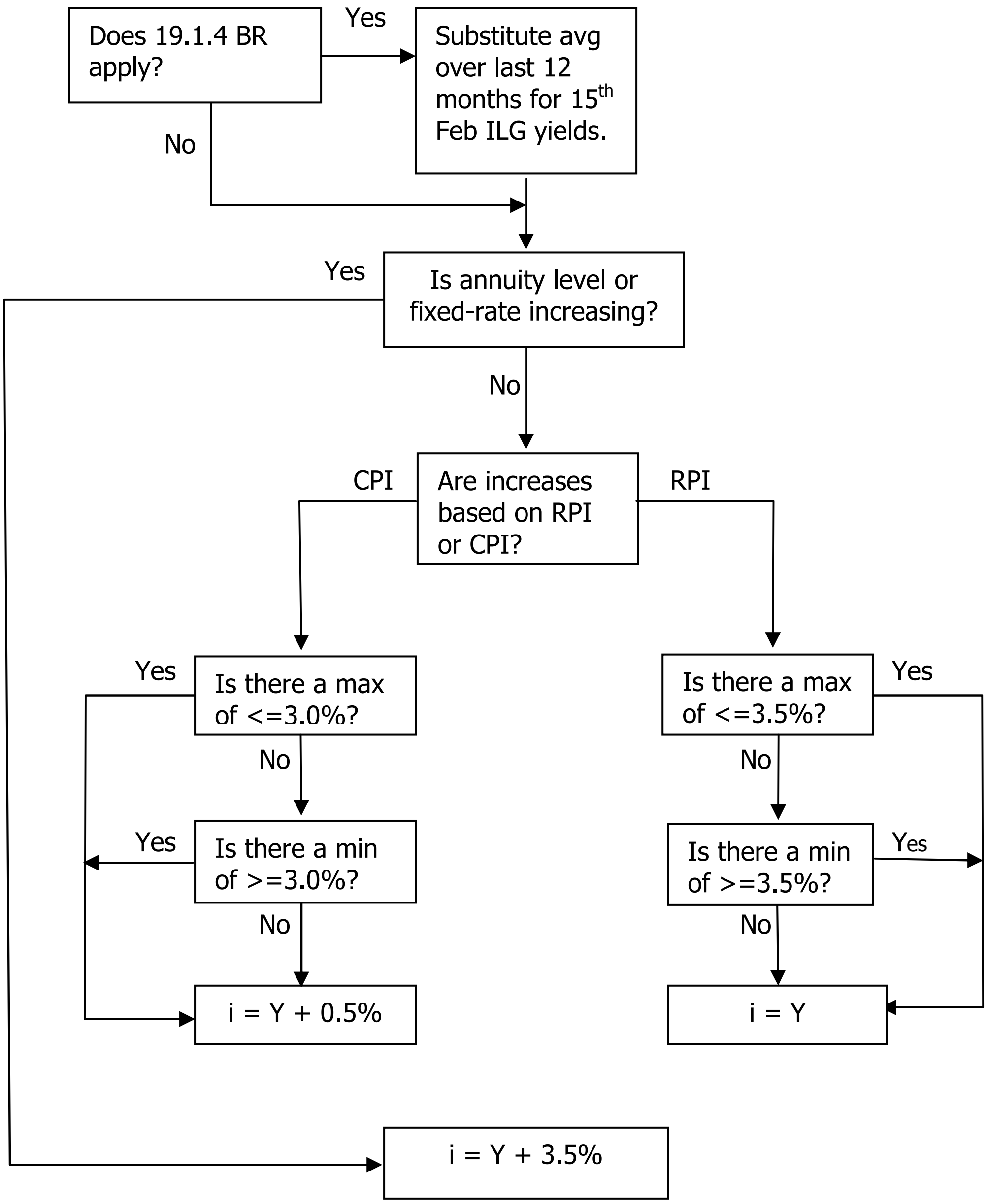
- Extract -

2.4 Insurance and occupational pensions

21. Some insurance products, such as annuities, contribute to retirement income. The Directive however only covers insurance and pensions which are private, voluntary and separate from the employment relationship, employment and occupation being explicitly excluded from its scope. Equal treatment of women and men in relation to occupational pensions is covered by Directive 2006/54/EC of the European Parliament and of the Council of 5 July 2006 on the implementation of the principle of equal opportunities and equal treatment of men and women in matters of employment and occupation.

22. Some occupational pension schemes provide for the payment of a benefit under a specific form, such as annuities. Where that is the case, the scheme in question will fall under Directive 2006/54/EC even if it relies on an insurer to pay out the benefit. On the contrary, if the individual employee has to conclude an insurance contract directly with the insurer without involvement of the employer, for example to convert a lump sum into an annuity, the situation will fall within the scope of the Directive. Article 8(1) (c) of Directive 2006/54/EC specifically excludes from its scope insurance contracts concluded by workers and to which the employer is not a party.

23. Article 9(1) (h) of Directive 2006/54/EC allows for the setting of different levels of benefits between men and women when justified by actuarial calculation factors. The Commission considers that the Test-Achats ruling has no legal implications for this provision, which applies in the different and clearly separable context of occupational pensions and which is also drafted in a very different way from Article 5(2) of the Directive. Indeed, under Article 9(1) (h) of Directive 2006/54/EC, the setting of different benefits for men and women is not considered discriminatory when justified by actuarial data.


Does 19.1.4 BR apply?
Yes
Substitute avg over last 12 months for 15th Feb ILG yields.
No
Yes
Is annuity level or fixed-rate increasing?
No
CPI
Are increases based on RPI or CPI?
RPI
Yes
Is there a max of <=3.0%?
No
Yes
Is there a min of >=3.0%?
No
i = Y + 0.5%
Is there a max of <=3.5%?
Yes
No
Is there a min of >=3.5%?
Yes
No
i = Y
i = Y + 3.5%