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Subject: Consultation on Assumptions for Statutory Money Purchase Illustrations

Dear Sir / Madam

We welcome the opportunity to respond to the consultation on assumptions for statutory money purchase illustrations (SMPIs), as set out in Chapter 5 of the FSA and FRC's joint consultation paper CP12/10 published in May 2012.

Mercer Limited is a global leader for HR and related financial advice and services. In the UK, our client base includes employers and trustees providing occupational pension schemes to employees in all sectors of industry. We provide pensions advice and services to companies in the FTSE100, but we also have a large proportion of clients that are employers classed as "Small to Medium sized Enterprises", or trustees of pension schemes with sponsoring employers in this class. We also provide Outsourcing pensions administrative services to clients. In our response we will comment from both of these perspectives.

Whilst we agree that there are areas of AS TM1 that need to be kept under review and updated from time to time, we believe that any changes should be minimal and only made if there is a very strong argument for doing so. This is important from both a member (understanding) perspective and a provider/scheme (cost) perspective.

TM1 has already been substantially revised with effect from 6 April 2012. Whilst we understand the rationale for making further changes now for consistency between SMPIs and point of sale projections for contract-based schemes, this rationale does not easily extend to trust-based schemes (except to the extent that members compare their trust-based SMPI with point of sale projections for other products) and therefore we consider that certain easements should be provided so that trust-based schemes are not unnecessarily affected. These easements are discussed in our responses to the specific questions raised in the consultation, as set out in the attached Appendix.

In summary our views are:

- Refrain from imposing a 5% maximum accumulation rate, or removing the maximum altogether;

- If the existing maximum accumulation rate is to be removed, delay this change until closer to such time as the effect on selected assumptions is expected to be material.

- Allow schemes that have already reprogrammed their systems to allow for the mortality changes in version 2 of AS TM1 to continue to use their existing methods, either indefinitely or until a further set of material changes to the calculation routine is required;

Yours faithfully

Dina McDonald
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Appendix

Q1: Do you agree that the assumptions in AS TM1 should be consistent as far as possible with those specified in COBS 13 Annex 2 of the FSA Handbook?

We agree that from the point of view of pension providers and of individuals receiving both sets of projections, it is desirable that the two sets of assumptions are consistent as far as possible. However, as noted in our covering letter, we are concerned that for a trust-based scheme, for which point of sale projections are not required, any consistency, or lack of it, will be much less relevant.

Q2: a) Should AS TM1 continue to specify a maximum accumulation rate? b) If AS TM1 continues to specify a maximum accumulation rate, should it be the same as the FSA's intermediate projection rate? c) If your answer to b) is 'No', what rate should be specified in AS TM1?

Although we agree in principle that keeping point of sale assumptions and SMPI projections consistent is desirable from the point of view of an individual with a personal or a group personal pension, it should not be forgotten that any changes to AS TM1 will affect members of trust-based money purchase schemes as well. These members are not "sold" pensions and are never issued with point of sale projections, so the only projections they ever get to see for their DC 'pot' are their annual SMPIs. For them, the consistency principle is therefore much less relevant and what is more important is that the SMPI assumptions are reflective of their investment strategy. This latter requirement has already been made via version 2 of AS TM1 with effect from 6 April 2012. This version was much clearer than previous ones that the assumed return must reflect the actual and anticipated investment strategy and, as such, we believe that any scope for providers to use the maximum rate as their default return is now much restricted. On the basis that providers are already setting assumptions appropriately (and we question whether in fact it is too soon to determine whether this is the case following the introduction of version 2), we therefore do not think that a change to a 5% maximum rate is appropriate, as certain members may have strategies where the expected return can be justified to be greater than this. We accept that the current economic climate is challenging and higher returns are improbable, but there is nothing to suggest that they would not be available in the future. Having a maximum rate restricts assumption setting and would mean that more realistic assumptions couldn't be set until the SMPI assumptions have been formally changed again, involving further consultation and a potential delay in application. Having said this, we do not currently believe that the current 7% maximum is unduly restricting assumption setting and therefore it may be more sensible to delay any change or removal until such time as the FRC has more justification for it and can perhaps make a number of necessary changes at the same time. We have in mind here that mortality will inevitably require further changes in the future. Arguably, there would also be presentation problems with removing the maximum now, at a time when expected returns appear more likely to be overstated than understated.

We would therefore support a general principle of no maximum in the longer term, although we feel this is currently an unnecessary, and possibly inappropriate, change. If the maximum is removed, a possible solution to address the comparison problem would be to require providers to use an accumulation rate that is consistent with any recently issued point of sale projection.

Q3: Should the wording for the mortality assumption in AS TM1 be changed along the lines of the wording proposed in Chapter 2?

We have no objections in principle to AS TM1 specifying the approach, although we question the need for such precision (and any cost associated with achieving it), as we do not expect that there would be a material impact on the figures that are produced using any other reasonable approach. Following the publication of version 2 of AS TM1, some SMPI providers will already have made changes to the mortality calculations that may not be precisely in line with the proposed wording and we do not agree that they should need to spend further resources on making changes that have little impact on the SMPIs produced.

We therefore think that if the method is specified, there should also be scope for providers to use any other reasonable blending methodology. If unlimited flexibility cannot be tolerated, then an acceptable solution might be an easement to allow existing methods to be used until, say, the next set of material changes is required.

Q4: Given the proposed nature of the changes to AS TM1, do respondents envisage any difficulties with a four-week consultation period for an exposure draft of a revised version of AS TM1?

A four-week consultation period should be sufficient, provided that, in addition to the exposure draft of the new version of AS TM1, the FRC also publishes version 2 with the proposed changes clearly marked up. Whilst four weeks is undoubtedly short, we certainly favour this over the alternative of a shorter period to implement any changes prior to 6 April 2013 and, with this in mind, would encourage the FRC to view the end of 2012 as a long-stop deadline for publishing a new AS TM1.

Q5: Do you agree with our proposals for the timing of any changes?

We agree that any changes should be made for SMPIs with illustration dates on or after 6 April 2013. However, for some trust-based schemes (e.g. those with a scheme year end and illustration date of 1 July, say, where statements are issued in October each year) this would potentially mean providing SMPIs on 3 different versions of TM1 on 3 consecutive occasions, each time requiring changes to calculation routines and statement wording, but without any benefit to members. The easements suggested above would greatly help such schemes to minimise their unnecessary costs.

Q6: Do you have any comments on the impact assessment for our proposals?

None, other than those already noted in our responses to the individual questions above in relation to trust-based pension schemes.