To: The Director of Actuarial Policy
The Financial Reporting Council
5th Floor, Aldwych House
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Dear Director

I have pleasure in submitting the response of Friends Life to your recent consultation on Statutory Money Purchase Illustrations.

FRC consultation

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?

A1: We agree that FSA and SMPI projections should be on a common basis. We do not agree with FSA's proposed basis. We reproduce below our response to FSA's Question 8 in your joint consultation:

Q8: Do you agree that the proposed changes to these assumptions are appropriate? If not, what changes would you propose? Please explain why you would make other proposals.

A8: On balance, no, we do not agree with FSA's proposals.

> We do not see the logic in setting maximum rates for projections using mixed funds. We believe that the maximum rate ought to be appropriate for the fund class likeliest to produce the highest yield. That is equity funds. On this basis, we would prefer a maximum central rate of within the range recommended for PwC of 6.5% to 8%. We do not believe that FSA has validly made the case for fixing the maximum rate below the range proposed by PwC. This should be coupled with guidance on the rates appropriate for lower risk funds, otherwise firms would use different bases for similar funds, which would not be helpful for customers.

We do not necessarily object to the proposed changes to the maximum upper and lower projection rates as a short term measure to increase risk awareness amongst customers. This has the benefit of simplicity, although should gilt rates return to 5%, a 3%/5%/7% projection which might seem appropriate would not be permitted. A solution which might be longer lasting would be for the lower rate to be set at 3% but coupled with guidance as the appropriate 'spread' to be assumed between the low and intermediate rate for equity funds (e.g. 4% or 5%) and lower risk funds (e.g. 2% or 3%).

On balance, we support the reduction in the adjustment for tax-disadvantaged products from 1% to 0.5%, although we would not object, for example, to deductions of 0.25/0.5/0.75 to reflect the gearing due to indexation relief on equity gains.

We are pleased to see that FSA has not proposed more extensive changes at this point in time, given the large volume of changes brought about by such changes as RDR and NEST. However, we are not confident that the current disclosure regime, including projections, provides customers with appropriate information to enable them to make appropriate and informed decisions. We believe that the disclosure system should be reviewed root and branch.

Of particular concern to us is the illustration basis for existing products in the run-up to maturity/retirement, where FSA rules appear to permit far too narrow a spread, with a short term to run, and some centralised pressure is necessary to ensure that all firms move together to allowing projections to bring out the proper downside risk.

In this context, we would like to highlight the ambiguity in draft COBS 13 Annex 2 2.3R where the requirement that "*rates accurately reflect the investment potential of the product*" is to be applied to each of the low, intermediate and high projection rates. Whilst it might be assumed that the intermediate rate should reflect the median investment potential, it is far from clear what is meant by 'low' and 'high' investment potentials, including whether the resulting growth rates should reflect any form of duration dependency or be selected for a term such as 15 years and then applied to projections of all durations. We suggest that FSA either provide guidance or reconsider the wording.

We would not wish to see any diminution in firms' ability to use generic projections as a result of this change of illustration basis.

Q2: a) Should AS TM1 continue to specify a maximum accumulation rate?
A2a: Yes

b) If AS TM1 continues to specify a maximum accumulation rate, should it be the same as the FSA's intermediate projection rate?
A2b: No, if FSA's maximum intermediate rate continues to be based on a mixed fund, and particularly not if the rate is as low as 5% (rather, we would recommend that FRC adopts an independent approach based on a reasonable 100% equity fund return assumption) . Yes, if FSA bases its maximum on 100% equity return, particularly if within the PwC recommended range

c) If your answer to b) is 'No', what rate should be specified in AS TM1?
A2c: See previous answer.

Q3: Should the wording for the mortality assumption in AS TM1 be changed along the lines of the wording proposed in Chapter 2?
A3: Yes

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?ex 2
A4: No

Q5: Do you agree with our proposals for the timing of any changes?
A5: Yes, provided that FSA changes are not made at the same time or earlier, in view of the volume of the volume of FSA changes.

Q6: Do you have any comments on the impact assessment for our proposals?
A6: We strongly support the moves to ensure consistency between FSA and SMPI illustrations. This is important not just for insurers in simplifying system design and maintenance; it helps ensure that customers get a clearer and consistent message.

Yours faithfully

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