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Ref: R&LC/DI

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Dear Sir or Madam

### **Amending TM1 For Revised Contracting Out Provision: Consultation Paper**

HBOS Insurance and Investment welcomes the opportunity to comment on the consultation proposals.

Before providing our comments we think it is useful to provide some background information on HBOS: HBOS's Insurance and Investment (I&I) Division includes the Clerical Medical and Halifax Financial Services brands which between them invest almost £50 billion for nearly two million customers. As such HBOS is a major provider of life assurance, pension, investment and long-term savings products. This response reflects the views of HBOS I&I.

We note that BAS intend to carry out a detailed review of TM1 "taking account of changing market conditions, improving life expectancy and feedback resulting from experience of SMPIs to date" and that any amendments resulting from this review will likely be required to take effect from 6 April 2010 or 6 April 2011.

HBOS I&I welcome this review and whilst we would prefer to make any changes to SMPIs in one exercise, we recognise the need to maintain the alignment of the SMPI calculations with current pension legislation and that the following issues necessitate action in 2009:

- dealing with technical aspects of the contracted-out rebate calculation as a consequence of the legislative change to the calculation of relevant earnings used for S2P accrual purposes, that takes effect in 2009.
- seeking to ensure that recipients are not misled as a result of the abolition of DC contracting-out that is intended around 2012.

Responses to specific questions:

**Question 1: Do respondents agree that the proposals set out in paragraphs 2.4, 3.2, 3.3 and 4.1 serve the interests of the recipients of SMPIs by ensuring that the illustrations reflect the best available information about the likely payment of rebates?**

*Paragraph 3.2*

The proposal set-out in paragraph 3.2 deals with the introduction of the Upper Accrual Point (UAP) with effect from 6 April 2009. This is a confirmed legislative change that takes effect from 6 April 2009 and will impact the calculation of future APP and COMP rebates.

Yes. We agree that the BAS proposals on this issue are in the interest of recipients of the SMPIs since they ensure ongoing correlation between the rebate calculation and the S2P accrual basis that will apply from 6 April 2009.

*Paragraph 3.3*

The proposal set-out in paragraph 3.3 removes the worked examples of APP and COMP rebate calculations currently detailed in Appendix B of TM1.2.

Yes. We agree that providers should be able to determine the relevant calculation methodology without the need to refer to worked examples and see no detriment to recipients in their removal.

*Paragraph 2.4*

The proposal set-out in paragraph 2.4 deals with the removal of contracted-out rebates for the 2012 tax year and beyond (with flexibility to allow for the possibility of the abolition date being put back).

Section 1.1 of TM1 states that the SMPI is intended to assist individuals to assess in broad terms the adequacy of their pension arrangements and the extent to which they need to make further provision. As such, we feel that it is important that the contributions included in the SMPI roll-up calculation should as far as possible reflect those that the recipient will expect to see applied to their policy during its lifetime.

Consequently, although the actual date of abolition of future DC contracting-out is not a legislative certainty, we feel that the detriment to recipients of continuing to include future rebates that are due beyond the intended abolition date in SMPIs outweighs this risk. We therefore agree that the BAS proposals on this point are in the best interest of recipients of the SMPIs. However, please note the additional comments in reply to Question 2 below.

*Paragraph 4.1*

The proposal set-out in paragraph 4.1 deals with the communication *in the 2009/10 SMPI only* of the impact of the changes proposed by paragraph 2.4.

Whilst only impacting a sub-set of SMPI recipients and even allowing for the fact that the pension benefit displayed on the SMPI is presented in real terms, it is true that many recipients will nevertheless see a decrease in their 2009 SMPI in comparison to their 2008 SMPI if future rebates are removed and we agree that the proposal is in the best interests of recipients of SMPIs (although again, please note the additional comments in reply to Question 2 below).

**Question 2: Do respondents have any comments on the proposed changes to TM1 set out in the Appendix?**

We agree with the rationale behind the BAS proposals and welcome the fact that you have chosen to consult with the industry on these proposals. However we feel that the intended timescale for implementation is unachievable due to the following reasons:

- the inclusion of the UAP in the SMPI calculations is not straightforward as it requires the creation of a new parameter to replace the UEL and changes will be required to the calculation routines for the earnings upon which the rebates are based. Furthermore, the proposal to remove future contracted-out rebates due after the abolition date from the roll-up is much more complex to implement as it affects calculations *and outputs* - existing calculation routines will need to be amended to accommodate the abolition date, output logic will need to be amended to ensure that relevant contracted-out messages are altered and/or suppressed and output templates will need to be revised to ensure presentational issues do not arise.
- SMPIs have to be issued with the annual renewal statements and there are legislative requirements that dictate when annual renewal statements have to be issued. Our internal processes for issuing the renewal statements and SMPIs for our several hundred thousand customers have been designed to ensure that the legislative deadlines are met, with statements being issued 4 - 6 weeks before the prescribed due date and the SMPI calculations performed up to 2 weeks earlier still to ensure that there is sufficient time to handle any exceptions. Hence we will need to be performing the calculations for our April SMPIs in mid February and, as we will not have certainty over the changes that BAS require until January, this gives us approximately one month to implement them. The fact that the changes will have to be implemented so quickly poses a risk to our business and we will not have adequate time to complete system testing.
- HBOS is a multi-brand pension provider and these changes need to be made across a variety of system platforms. In common with many other large companies we operate a Release Management Process with each release subject to a defined and tightly controlled delivery footprint. The safest release to target would be in Q3 2009 - this would enable coding to start based on a confirmed set of requirements following the publication of the amended version of TM1. It would also allow sufficient time for a controlled phase of requirements gathering and assessment of the system solution prior to coding changes being made

All that it would be possible to implement for 6 April is to include an insert with SMPIs explaining that DC contracting-out will cease from a date yet to be agreed and that this will impact the projected benefits shown. However HBOS I&I do not support this approach as we feel it does not help the recipients and potentially undermines the credibility of the industry to be able to provide accurate and meaningful information.

Consequently we feel that it is unreasonable to expect providers to make these changes within the timescale proposed in the consultation. **We suggest a 6 month transitional period from 6 April 2009 would be appropriate, during which providers may implement the required changes within the framework of their scheduled IT system releases in a controlled manner.**

We would also make two further comments regarding the BAS proposals:

- the removal of future contracted-out rebates has implications for only a subset of SMPI recipients (since contracted-in and paid-up individuals will not be impacted by these changes) and even amongst active contracted-out policyholders the level of impact will vary according to individual circumstances. We suggest that it is unreasonable to expect providers to identify relevant policyholders and make specific SMPI output changes (to communicate the reason why the benefit has decreased) for one year's statement only and suspect that many will seek to meet this requirement through a generic message by means of an insert or flyer. As such we feel that BAS should specifically allow this option in TM1 – e.g. the text in paragraph 4.1 of the consultation could read: "The 2009/10 statement should therefore include *or be accompanied by* an explanation of the change and the reason for it."
- from 6 April 2010, the accrual rate for band 3 earnings in the calculation of S2P benefit will reduce to 10%, which means that the S2P benefit effectively becomes a two-tier calculation. However, there is no mention of this issue within the current consultation and we ask BAS to specifically clarify whether providers are required to reflect the impact of this change within SMPs (i.e. on the contracted-out rebates due in the 2010/11 tax year and beyond).

We hope you find our comments useful. However, if you have any queries regarding our response please give Derek Irwin a call on 0117 376 4073.

Yours sincerely,

Mike Brown  
Head of Pensions Development