



22 December 2008

The Director  
Board for Actuarial Standards  
5th Floor, Aldwych House  
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London  
WC2B 4HN

Subject: Amending TM1 for revised contracting out provisions: Consultation paper

Dear Sir

I welcome the opportunity to respond, on behalf of Mercer, to your consultation paper on changes to TM1. Our comments are listed below.

### ***Allowing for cessation of contracting out***

We agree that statutory money purchase illustrations (SMPs) should reflect future changes to contracting-out and in principle it seems reasonable to assume that rebates will cease in 2012. However, the uncertainty around the 2012 date, coupled with the additional calculation requirements and the possibility of further changes if the Government subsequently amends the date, suggest to us that the simpler alternative of ignoring future rebates altogether might be the preferable way forward. In saying this, we are mindful that some providers will charge members for calculation changes and also that for many members the contracted out portion of their benefits will be relatively small.

Our views also reflect the fact that SMPs are an illustration only, based on a number of assumptions, and that the potential divergence of the financial assumptions from reality will likely far outweigh any divergence resulting from not including rebates for 3 years. SMPs issued in the past for people retiring now are a good example of this and illustrate that single estimates of DC outcomes are highly likely to be unreliable.

If rebates were to be assumed to cease from 2012, this would require significant changes to calculation routines, not only to split the projection period to retirement into two parts (pre and post 2012), but also to allow for the fixed Upper Accrual Point (UAP) instead of a UEL





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which is currently assumed to increase in line with earnings. In addition the explanations accompanying the revised projections would need to be quite complex. Having to make a further change to accommodate any replacement date for cessation of contracting out would compound these calculation changes (and the consequential explanations and potential charges to members) and this is before allowing for any further changes which may come out of BAS' longer term review of TM1!

On balance therefore, we feel that the interests of scheme members would be better served by a one-off simple approach to address the cessation of contracting out, which is to assume no future rebates for all SMPs issued after 5 April 2009.

### ***Effective date of changes***

The consultation paper proposes that changes should be effective for SMPs issued from 6 April 2009. Whilst we agree that this approach is preferable, we also note that it is much more onerous than the previous approach to changes, which has been that they should apply to SMPs in respect of scheme years ending after the effective date of the change. It means that there will be a step change on 6 April 2009 and has timing implications for the issue of SMPs that are already in production in the months leading up to that date.

In the context of the very short timescale proposed for implementation, a simple approach for addressing the cessation of contracting-out is even more crucial.

An alternative approach to the introduction of the changes would be to make them effective for scheme year-ends on or after, say, 1 January 2009. This would still ensure the change was brought in as early as possible, whilst allowing providers sufficient time to amend their systems and issue SMPs within the statutory deadlines.

Finally, we note that paragraph 2.2 of the consultation document states that if the Government changes the abolition date, any SMPs prepared after the announcement must take the change into account. In our view, this requirement would be too onerous for most providers because it allows no time for system changes and seems to suggest that SMP production would have to be suspended while the changes are made. This is yet another argument in favour of assuming an immediate cessation of rebates.



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## **Communications**

We agree that the statements should include an explanation of the changes made to the contracting-out projections. It would also be reasonable for TM1 to include guidance on this, given that much of the wording of the current statement is prescribed. In addition, we suggest that where rebates are currently included within the employer rate for occupational pension schemes, some consideration should also be given to mentioning or warning of any future changes to the scheme to take account of the cessation of contracting out.

## **Consistency with State benefit projections**

We note that SMPs are often viewed by members in conjunction with their State benefit projection (and that this is ultimately Government's intention through its Combined Pension Forecast initiative). Therefore it will be important for the BAS to ensure that the requirements of TM1 are consistent with whatever DWP will be assuming about a member's future contracted-out status when it produces future State benefit projections.

Yours faithfully

Jane Biggerstaff FIA APMI  
On behalf of Mercer Limited