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Your reference:
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The Director
Board for Actuarial Standards
5th Floor, Aldwych House
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Dear Sir

Consultation Paper on Amending TM1 for revised contracting out provisions

Thank you for the opportunity to comment on this consultation paper. This response has been prepared by the Benefits Practice of Watson Wyatt and therefore primarily reflects pensions-related issues. It does not expressly reflect views that our Insurance and Financial Services Practice may hold as advisers to specific insurance companies. Watson Wyatt is a global consulting firm with particular strength in the area of UK pensions. We advise over half of the 100 largest corporate pension schemes, and the firm as a whole employs over 300 qualified actuaries in the UK.

Our detailed comments, including responses to the specific questions posed, are attached. We generally support the proposed changes since it will be misleading to continue to project contracting out rebates beyond the abolition of money purchase contracting out. However, we do have some concerns from a practical angle, particularly regarding the short implementation timescale that is proposed.

We would be very happy to discuss with you any of the points raised in this response.

Yours faithfully

Simon Fox

Proposed amendments to TM1 for revised contracting out provisions

1. General

In principle, we support the proposed changes to TM1 consequent on the expected abolition of money purchase contracting out. However, we do have some concerns regarding the implementation of these changes and the administrative burden they will impose on providers and administrators.

Providers will ideally want several months' notice of the final changes, to allow sufficient lead-in time for systems re-programming and testing. Also, some providers offer members web-based projection models using the SMPI assumptions – it is likely to be particularly onerous to have these re-programmed by April 2009 to ensure consistency with their annual SMPI projections. For these reasons it will therefore be very helpful if the amendments to TM1 can be agreed and finalised without undue delay.

We note also the proposal for a more detailed review of TM1 during the next year or two. Providers will again be anxious to minimise the number of separate systems changes that have to be implemented.

2. Implementation date

We note that the proposed changes are to apply to SMPIs *issued* on or after 6 April 2009. Most past changes to TM1 have applied to *Illustration Dates* falling on or after the relevant 6 April – this gives the administrator or provider greater clarity as to which version of TM1 to apply and more time to plan and implement system changes.

Some arrangements with *Illustration Dates* of say 31 December 2008, or even earlier, may struggle to issue their SMPIs before 6 April 2009 and so have to repeat work in order to satisfy TM1 if their statements are delayed beyond that date. Occupational DC schemes with 'integrated' contribution scales (see 5. below) in particular will need time to consider the best way forward.

We wonder if the changes could instead be made:

- *mandatory* for SMPIs with *Illustration Dates* on or after 6 April 2009, or with *Illustration Dates* before 6 April 2009 but issued on or after, say, 1 July 2009, *but*
- *voluntary* for SMPIs with *Illustration Dates* prior to 6 April 2009 that are issued before, say, 1 July 2009 (but with an appropriate disclosure note to the statement).

3. Abolition date

We agree that the proposal to assume initially an *Abolition date* of 6 April 2012 would best serve the interests of recipients, even though this will result in rather more administrative changes to providers' systems than the alternative in 2.3 and 2.4 of the Consultation Paper of assuming immediate cessation of contracting out rebates.

However, if the *Abolition date* is eventually confirmed as a date after 6 April 2012, this will necessitate yet another change to providers' systems. Should this occur, it is important that a suitable transitional period is available before this later *Abolition date* must be reflected in SMPIs – otherwise providers may face the prospect of having to re-work statements that they are on the point of releasing.

4. Contracted out earnings

We note the proposal that, as well as reflecting the expected abolition of contracting out rebates, SMPI projections should reflect a flat rate Upper Accrual Point of £770 per week.

We agree that the UAP amount, rather than the higher Upper Earnings Limit, should be reflected in SMPIs.

However, we expect that some providers will find the systems re-programming required to reflect a flat rate UAP relatively onerous, if they have been accustomed to projecting all contributions in line with assumed inflation (of 2.5% a year). Given the outlook for low, perhaps even negative, inflation in the short term, the practical impact of projecting future rebates up to April 2012 on an inflation linked, as opposed to flat rate, UAP assumption will be small. We wonder therefore if the option of assuming the UAP grows in line with inflation could be permitted, perhaps with a note to the statement to indicate that an approximation has been made.

5. Integrated contribution designs

Some occupational DC schemes are contracted out on a money purchase basis with a contribution scale expressed as, say, 3% employee plus 12% employer (for ages 50+) *inclusive* of contracting out rebates. Such schemes will clearly have to redesign their contribution scales from *Abolition date* to reflect the S2P that will then start to accrue to members. This will not be a straightforward process, particularly if consultation is required. The Consultation Paper does not expressly refer to such arrangements and it is not totally clear how they should proceed. For example, they might simply assume no further rebates from 2012, but with unchanged overall contribution rates (if fully integrated), but this could significantly overstate the overall contributions to be paid post-redesign.

The alternative of assuming that the scheme's contribution scale is in future cut back by the 'lost' rebates would require additional programming and communication work (essentially each member would be deemed to have an 'individual' contribution rate) and is again likely to mis-state the position once the scheme's redesign has been concluded.

Although such integrated arrangements are not particularly common, some do operate with a substantial membership. We would prefer to see such schemes given transitional flexibility on how they cope with the proposed TM1 changes – for example, to project on the current contribution regime but include a prominent note to the effect that contribution scales will be restructured to take account of the abolition of money purchase contracting out.