

Meeting of the Actuarial User Committee of the FRC held on 25 March 2010: TM1 – points made by individual members

Points made by individual members:

On the form of benefits that should be displayed, there should be no move to only showing a level annuity. Whilst the providers are right that more than 80% of people opt for a level annuity, this is not always an informed choice in the full knowledge of the consequence of doing so. Instead the illustrations should show both the annuity that would be received as a level annuity and on an RPI indexed basis with a short explanation of what the difference is between the two options. The illustration would need to show the initial pension and also perhaps in 10 or 15 years time to demonstrate the point that the RPI indexed annuity will have increased in value relative to the level annuity.

Many providers use the maximum permitted assumed investment return of 7% pa rather than using more realistic assumptions of say 3.5% real return and 5.5% nominal return. The use of a range of assumptions might be preferred.

It is important to show the impact of inflation on a level annuity e.g. over 20 years, inflation at 3% would reduce the buying power of the level annuity by half. It is essential that the impact be explained of choosing a level annuity, particularly given the marked differences by way of demographics and gender. The FSA has made useful points both on the assumptions to be made and the benefit from giving a range of possible outcomes.

A long-run nominal investment return of 7% seems high. In PPI modelling a long-term rate of 3.5% real, or 5.5% nominal is used. A range of assumptions should be used and the different outcomes shown. TM1 should move away from showing point estimates only.

Some consumer testing is needed for SMPs; they should be helpful and informative to read. What is needed is a comprehensive picture of the individual's anticipated income into retirement based on a range of assumptions and including the individual's entitlement to stakeholder pension, other occupational pension and NEST income.

Many individuals compensate for a drop in anticipated income at retirement by increasing pre-retirement savings. The existing letters need to be developed further and made fit-for-purpose by recognising the choices open to those approaching retirement age. There are advantages in this approach and in outlining the likely implications of loss of income that would result from certain courses of action.

Information should be given in context with recipients told why this information matters to them. Awareness is very low and individuals will therefore benefit from seeing the likely outcomes based on a range of growth assumptions with either a level or an index-linked annuity. It is as much about how the information is presented as about the information itself. Single estimates are acceptable so long as they are at the lower end of expectations and come with a health warning.

More research would be needed on how to get the message over. The most effective arrangement would be to have the opportunity via the internet of entering all details and running a number of different scenarios to gain an understanding of the range of outcomes. The best arrangement would be to go for a straightforward presentation but with the option to go to the internet to run a range of different scenarios.

Chair's summary:

There is an important distinction between level and index-linked annuities, and for survivor cover, depending on gender and demographics. A single figure for assumptions only works if a suitable health warning is given. More research and consumer testing is needed to convey a more comprehensive set of outcomes.