

Board for Actuarial Standards Consultation Paper: TM1: Statutory Illustrations of Money Purchase Benefits



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1. Introduction

AEGON welcomes the opportunity to respond to this consultation on TM1: Statutory Money Purchase Illustrations (SMPI). We support improving the quality and clarity of financial material for the benefit of customers. Such enhancement will not only benefit the consumer, but all stakeholders who are involved in the process.

The Board for Actuarial Standards (BAS) will be aware of a number of major initiatives taking place in the UK and European marketplace which have implications for disclosure. These, while not exhaustive, include

- the FSA's Retail Distribution Review (RDR);
- Pension Reforms including NEST and automatic enrolment;
- the European Commission's approach regarding the regulation of mandatory disclosures for Packaged Retail Investment Products (PRIPs);
- CEIOPS's work on risk disclosure;
- any interim solution the FSA requires when the RDR goes live, pending clarity on PRIPs; and
- the FSA's focus on ensuring projections use realistic rates of return

In addition, we note that the government's paper "The Coalition: our programme for government" states

- We will explore the potential to give people greater flexibility in accessing part of their personal pension fund early.
- We will simplify the rules and regulations relating to pensions to help reinvigorate occupational pensions, encouraging companies to offer high-quality pensions to all employees, and we will work with business and the industry to support auto enrolment.

We would ask that BAS take full account of these developments and the significant impact they are either having, or could potentially have, on provider resources, and to link the outcome for SMPI with what may emerge from each of these. We would want to avoid a scenario where we are asked to make changes to meet one set of requirements for TM1, only to find further changes further down the line due to one or several of the above initiatives.

We are aware of the 2006 ABI Review of Yearly Statements – "Making information work for customers" and believe it would be appropriate to consider this, together with any updated research on potential future disclosure, before making any changes. We suggest that any alterations should not only reflect the outcome of any consumer research, but also have regard to a full cost-benefit analysis.

Ultimately the best outcome, particularly for consumers, would be a single approach to projections, as opposed to having (currently, two) different projection bases to satisfy (two) different sets of rules. Whilst this is our stated aim, all parties must be realistic in

what is actually deliverable in the timescales taking into account regulatory changes elsewhere.

We would strongly argue for

- change only where this is absolutely necessary for the present;
- no change where there is the potential for future regulation to override what may be currently 'desirable';
- realism in terms of time to implement change, that includes postponing any substantial changes until 2013;
- an interim solution providing least confusion to existing customers; and
- a longer term view, lasting well beyond 2012, taking into account the views of a wide range of stakeholders, and in particular what customers would like to see, where a desirable outcome for all parties is to ensure a minimum number of ongoing changes to disclosure requirements.

2. Responses to Consultation Questions

1. How effective have SMPIs and TM1 been in meeting the stated aim set out in paragraph 2.4? If the aim has not been met, please provide information concerning the effectiveness of SMPIs, with examples if possible, or provide suggestions for enabling SMPIs to better meet the stated aim.

Our own customer research, used for our statements redesign, showed that with up to 20 accompanying notes it can be difficult for the customer to engage with such a technical document.

Anecdotally, we know the combination of monetary (FSA) projections and SMPI projections in an annual statement does cause confusion, as the customer looks at two different methods of illustration on the same page. This could be resolved by only having SMPI on annual statements (which is the approach AEGON is taking in redesigning of our statements).

In addition, the SMPI regulations do not cover "what if" scenarios so it may be difficult for customers to see the effect of contribution increases (the FSA projections cover increases, but this is on a different basis).

We return to this in our answer to question 27.

2. Should more be done to highlight the significant uncertainties involved in using illustrations of benefits? Respondents are asked to supplement their responses with examples of how this could be done. (paragraph 2.7)

There is extensive wording in both the SMPI and accompanying notes so there should be enough warning that this is only an estimate, but there is an opportunity to simplify this.

With fewer words, an appropriate warning message that the illustrative benefits are not guaranteed could be added. This should also highlight that the SMPI is based on assumptions being borne out in practice and that the variables include return on investments, annuity terms on retirement and the type of annuity purchased, and also that it assumes contributions continue to be paid.

Again, we return to how uncertainties may be highlighted in our answer to question 27.

3. Should the stated aim in paragraph 2.4 be modified and if so how?

No. We think that these aims are appropriate and do not suggest any changes are made.

4. How helpful do respondents find the explanations and assistance in TM1? Should one of the purposes of TM1 be to assist providers who produce SMPIs? (paragraphs 4.2 and 4.3)

The explanations and assistance in TM1 are helpful. Providers may be familiar with SMPIs to the extent they no longer need as much assistance, but TM1 is useful in providing explanations to other parties who may query the rules from time to time. In addition, as staff change, it's a useful reference document for them.

5. Could any changes be made to the structure of TM1 to improve its clarity? (paragraphs 4.2 and 4.3)

TM1 is relatively easy to understand as it is and we don't propose any changes.

6. What views do respondents have on our proposal to reduce the level of detail in which TM1 sets out the calculation methodology? (paragraph 4.4)

The detail is required to be certain of the rules. We find the level of detail useful and propose no changes other than perhaps moving some of the finer detail to an appendix. We see no advantage in giving less detail in TM1 as this will only increase the chance of misunderstanding.

7. Do respondents agree with our proposal that TM1 should continue to require that the pension a member takes at retirement is assumed to increase in line with inflation? (paragraphs 5.2 and 5.4)

AEGON believes that it's in the customer's best interest to target retirement benefits that keep pace with inflation. While there are circumstances where that may not be appropriate, for the majority of scheme members this should be the aim.

Moving to quoting a level pension will be confusing for existing savers and quoting the larger commencing pension will not encourage greater saving. Indeed, it may do the opposite.

8. In respondents' experience what proportion of members on retirement opt to take annuities with index-linking, fixed pension increases or no increases? (paragraph 5.4)

In our experience since August 2009 (the date we started offering RPI-linked annuities) the distribution is as follows:

Index-linking:	3%
Fixed increases:	2%
No increases:	95%

9. Do respondents have any comments on paragraphs 5.5 to 5.6 concerning the option to take a cash sum at retirement?

The full pension at retirement should be continued to be shown at this stage. Adding tax free cash to disclosure will only make the output longer.

Longer-term, it would be helpful for customers to see the effect of taking a tax free lump sum on their pension, among other variables (see our answer to question 27), but this development should be held over until requirements for disclosure coming from FSA and the EC are clearer.

10. Do respondents agree that the mortality basis should be updated? If so, what tables and allowance for improvements do they consider should be adopted in TM1? (paragraphs 6.7 to 6.16)

Ideally, SMPs should reflect the most recently available information and a process should ultimately be adopted that provides a certain element of future-proofing so that changes in this areas are more of an 'update' to the underlying assumptions, as opposed to representing a fundamental modification to the underlying method of derivation. This would seem to suggest the approach BAS considers in paragraph 6.13 of the consultation paper, on the basis that the CMI will continue to provide updates in the same format.

However, this represents a significant change and, again, we would urge BAS to defer any such changes of significance until we have clarity of direction from the other initiatives highlighted in our introduction.

11. Should TM1 allow providers to choose specific mortality tables which are appropriate for the members of the arrangement in question? (paragraph 6.16)

No. We think this will be too complex to operate and has the potential to create confusion for customers that could arise in disclosure of any concurrent holdings and on any subsequent change in employer; both where different mortality may be justified due to different industry types. In addition, such differences in mortality may not be reflected in annuity terms on retirement.

12. Do respondents agree with the proposal to change the yield used for annuity calculations? (paragraphs 6.18 to 6.22)

For simplicity, we don't propose any change here.

13. Should a non-market related annuity rate be used for younger members? If so, what rate should be used and how should it transition into a market related rate for individuals close to retirement age? (paragraph 6.24)

While we see benefits in using a non-market related annuity for younger members to avoid spurious fluctuations far from retirement, again we would argue for no change here for the present.

14. Do respondents have any views on the use of a fixed reference date for setting the interest rate for calculating annuity rates and whether an alternative approach would be preferable? If a fixed reference date is preferred should it be 15 February? (paragraph 6.26)

We agree that basing the interest rate on a single point-in-time figure can produce large changes, and the suggested approach represents an improvement here.

We have no objections if publication of the relevant interest rate fell to BAS.

15. Are the expense assumptions currently specified in TM1 reasonable, in particular the assumption of 4% of the value of the annuity at retirement? (paragraphs 6.27 to 6.29)

We would argue for no change here for the present. The impact of Adviser Charging remains uncertain and we would prefer to wait until the position on the FSA's Retail Distribution Review (RDR) becomes clearer.

16. Do respondents have any comments on the appropriateness of the long term maximum rate of accumulation of 7% pa? (paragraphs 6.30 to 6.33)

The FSA has retained 7% as the maximum mid-point growth rate in illustrations, but is scrutinising the approach providers are taking to using lower rates where 7% is unlikely to be achieved. In view of this, there is no need for BAS to review its rules in this area.

17. What approach do providers take when members' investments are in funds which are expected to accumulate at less than the maximum rate of 7% pa? (paragraph 6.33)

We are currently implementing a new methodology which bases the mid projection rate on our assumed returns on underlying asset categories.

18. Do respondents have any comments on the long term inflation assumption of 2.5% pa? (paragraphs 6.34 to 6.36)

For simplicity, we don't propose any change here.

19. Do respondents have any comments on the long term earnings inflation assumption of 2.5% pa? (paragraphs 6.34 to 6.36)

For simplicity, we don't propose any change here.

20. Should TM1 require SMPI projections to allow for guarantees? (paragraphs 6.37 to 6.38)

We would not argue for any change here as this would be shown elsewhere in the annual statement.

Some guarantees can only be taken in a restricted form which would be clear from policy documentation, but may lead to confusion if this format does not match what should be shown in the SMPI.

This is undoubtedly a complex area and its introduction would require careful planning and implementation, together with appropriate communication to customers. Any change here would need a significantly longer lead-in time than some of the simpler changes proposed in the consultation paper.

21. Is the approach for with-profits funds set out in section 6.7 of TM1 appropriate? (paragraph 6.39 to 6.40)

We would not argue for any change here for the present as the current approach remains appropriate.

22. Would pension scheme members benefit from the FSA and TM1 bases being harmonised? (paragraphs 7.4 to 7.7)

If pre and post-sale disclosure was on an equivalent basis it would make it easier for customers to understand and compare point of sale illustrations and statements over time. (It would also reduce the regulatory burden on providers.)

While there are advantages to both approaches, in harmonising the two, one method must change. We note that BAS is to work with the FSA on an investigative basis. AEGON would like the scope of this to become more comprehensive, taking into account consumer research into what disclosure material they would find most helpful. We suggest this also needs to take into account what emerges from the RDR and PRIPs work.

23. Do respondents have any views on the approach set out in paragraph 7.8?

Having SMPI and monetary on the same document, however much information is provided, could lead to confusion. We do not favour making any additional information compulsory.

24. Do respondents have any comments on our proposal in paragraph 8.4 to allow signposting?

We welcome anything that allows more flexibility which could simplify SMPs. We agree signposting would help the industry move away from having two pages with a number of accompanying notes. It should take less than a page to show an estimate of pension with key caveats that the customer might read.

25. Would the timetable outlined in section 9 allow providers sufficient time to make changes from statements with effective dates on or after 6 April 2011? What benefits, if any, would there be if changes were to be effective a year later?

Any changes of significance would need a minimum of 12 months notice. At present our IT schedules are fully booked up until the end of 2012. Any change, particularly of significance, is highly problematic and can only be coped with if integrated with other changes to the same systems.

26. Would an illustration of the pension attributable to contributions already made help recipients of SMPs and if so, should there be a requirement for this to be shown on SMPs? (paragraph 10.2)

Longer-term, this would be one way of meeting the aims in paragraph 2.4 of the consultation paper. While it adds a layer of complication, for the present disclosure should make clear that the estimate assumes contributions continue, and if they stop, the figure could be substantially less.

27. Do respondents believe that recipients of SMPIs would benefit from additional information illustrating the uncertainty in the amount of the illustrated pension? If so, how would this best be achieved? (paragraph 10.3)

The uncertainty over what future benefits may ultimately be payable can best be shown through illustrative figures. While straightforward to explain in words, this may not be the best way of presenting the information to the customer. However, as we argue above, we would not advocate significant change in the short-term.

Straightforward core SMPI illustrations could be shown in annual statements and, to allow customers and their advisers to model different scenarios, they could be pointed in the direction of a SMPI calculator hosted by DWP, BAS or providers. This would allow customers to combine all of their defined contribution benefits in one place and give them the facility to see the effect of different scenarios and actions on their overall retirement planning, for example, on changing investment returns, changes to annuity rates and on changing their existing contribution rate.

28. Would the production of a suite of "best practice" SMPIs be of benefit to members and providers? If a suite of "best practice" SMPIs is developed who should maintain it? (paragraph 10.7)

It would be useful to have some reference material where we could look at actual examples, see any emerging issues and share ideas. We have no view on who should facilitate this.

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