



TM1: Statutory Illustrations of Money Purchase Benefits

The ABI's Response to the Board for Actuarial Standards Consultation Paper, March 2010

The ABI is the voice of the insurance and investment industry. Its members constitute over 90 per cent of the insurance market in the UK and 20 per cent across the EU. They control assets equivalent to a quarter of the UK's capital. They are the risk managers of the UK's economy and society. Through the ABI their voice is heard in Government and in public debate on insurance, savings and investment matters.

Introduction

The ABI welcomes the opportunity to respond to this consultation. We believe the SMPI is a key part of the annual statement and as such this consultation provides an opportunity to improve the quality and clarity of this important information provided to pensions policyholders.

However, we would like to stress that we believe that consistency between the SMPI basis and the basis in the FSA Handbook, specifically COBS 13 Annex 2, should be maintained, and where possible, any inconsistencies removed. We believe this consistency is important so as to avoid differences that can cause customer confusion.

We would also like to stress the need for any changes to TM1 to take into account the range of initiatives affecting disclosure that are currently taking place in the UK and European marketplace. We want to ensure any changes lead to greater harmonisation of SMPs, and where possible to avoid the need for providers to make piecemeal changes.

- 1. How effective have SMPs 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 SMPs, with examples if possible, or provide suggestions for enabling SMPs to better meet the stated aim.**

SMPs in their current form provide policyholders with a figure that can be used to assess the extent to which they need to make additional contributions, or review their pension arrangements, and their consistent basis across all providers allows comparability between statements from all money purchase policies they hold.

However, research amongst policyholders shows that the annual statement within which the SMPI is contained does not engage them or serve as a 'call to action' to assess the adequacy of their pension arrangements, or the extent to which they need to make further provisions.

We believe SMPIs are ***not helped*** in their stated aim by:

Inconsistencies between point of sale illustrations and annual statements

FSA point of sale illustrations and annual statement illustrations are inconsistent, with the point of sale illustrations being expressed in monetary terms whereas SMPIs are expressed in today's terms allowing for future inflation. This inconsistency of approach results in point of sale illustrations tending to illustrate a more generous retirement income. This leads to customer confusion and makes it difficult for firms to manage customer expectations.

Presentation of too much information. For example:

- the communication of the complex basis of assumptions on which they are calculated. The long list of assumptions, such as investment growth and annuity rates, marital status and age of spouse, pension formats and escalation, obscures the key information and confuses the policyholder.
- a long list of mandatory caveats and risk warnings required by TM1. These add to the complexity and length of the annual statement and detract from the key information needed to engage and call a policyholder to action.

Spurious accuracy/relevance to the individual policyholder

The SMPI **format** is rarely that of the pension taken by most policyholders. For example:

- most take the tax-free lump sum. The main illustration excludes a tax-free lump sum but an additional illustration showing the tax-free lump sum is permitted.
- the SMPI shows pensions increasing each year in line with RPI whereas few policyholders take this option and in any case not all providers actually provide it.
- the SMPI shows a spouse's pension of 50% of the member's pension on death after retirement, whereas most policyholders opt to take a single life annuity, except on Protected Rights funds.

The SMPI **basis** is high cost and so the pension is far lower than the format of pension typically chosen at retirement. These high cost "poor value for money" illustrations risk putting off policyholders from increasing their contributions or, even worse, may lead to some customers stopping paying into their pensions altogether.

Suggestions for better meeting the stated aim:

Policyholders express a clear desire for annual statements that are clear, brief and present key information in a simple, straightforward way.

In line with the DWP's plans to amend disclosure requirements so that some information can be provided via signposting and electronic communications, we are

seeking greater flexibility as to where providers can present the caveats and warnings to customers relating to the SMPI basis.

We believe statements could refer to the SMPI figure as being an important pension planning tool.

We also believe the optional inclusion of information in signposted areas such as “what if” scenarios, e.g. what if I contribute £100 per month more to my pension? what if I retire at an age later than nominated retirement date?, what if I take a tax-free lump sum at retirement? could help to engage policyholders and aid understanding of the steps individuals can take to improve the expected retirement income from their pension plan.

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)

Providers want customers to understand that their illustrated potential retirement income is subject to a number of uncertainties. However, providers do not want the message about uncertainties to undermine their confidence in the value of the information provided, and thus become an obstacle to member engagement or taking steps to action.

Reference could simply be made to the principal factors affecting future values, which are premium payments and fund performance. Most customers are not interested in the assumptions underlying the calculations and if the assumptions are not in line with their individual circumstances, e.g. a woman’s husband is not 3 years older, this can create the perception that the statement is not personal to them and further disengage individuals from managing their pension. Many customers will not understand the assumptions and it is unrealistic to expect them to.

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

No. The aims are entirely laudable. The annual statement should provide the customer with an indication of the adequacy of their current arrangements and act as a “call to action” if required.

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)

We believe one of the main purposes of TM1 should be to assist providers who produce SMPIs. Providers find the explanations and assistance in TM1 help them to understand the rationale behind the assumptions and are important to maintain consistency across the industry (which is one of the main aims of the SMPI). The alternative of a principles-based approach would we believe result in a loss of consistency across industry.

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

Providers believe it might be helpful to remove some areas of duplication. It might also be helpful to include a summary of the main points at the end of each section.

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)**

Providers do not want to lose clarity regarding prescribed calculations. They believe reducing the level of detail could lead to ambiguity and would leave providers having to make reasonable judgements on interpretation. This would lead to differences in SMPIs produced across the industry and would seem to defeat the aim of achieving consistent SMPIs across various types of money purchase pension provisions.

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)**

On balance, we suggest leaving TM1 unchanged on the basis that it already allows providers to offer additional illustrations on an alternative basis if they wish to do so.

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)**

A large majority of members opt to take a level annuity on retirement. While figures vary between providers, numbers choosing to take a level annuity range from 80-95%, with those choosing to take an index-linked retirement income ranging from less than 5% to 15%, and those taking an RPI-linked annuity ranging from less than 1% to 5%.

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

We favour providers being given the option to illustrate a tax-free cash sum at retirement given the majority of policyholders elect to do this on retirement. This is more likely to engage policyholders as it will make the SMPI more meaningful to them.

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)**

Whilst we believe SMPIs should reflect the most up to date information available, we would seek to ensure any changes maintain the consistency with the mortality basis used by the FSA.

An update to the mortality basis would represent a significant change and we would also therefore seek to defer any changes to the mortality basis until there is further clarity from other initiatives affecting disclosure (as mentioned in the introduction above).

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

On balance, we believe TM1 should not allow providers to choose specific mortality tables appropriate for the members of the arrangement in question. We believe this would contradict the aim of producing consistent SMPs across the industry. We also believe that as policyholders have the option to buy an annuity on the open market at retirement, market-based assumptions, as opposed to scheme-based assumptions, are more suitable.

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

On balance, we suggest this is left at the current rate.

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)**

On balance we seek to continue to use the same annuity rate basis at all ages. A non-market related rate would introduce inconsistencies with FSA projections, which is undesirable. It also seems spurious to remove a small source of volatility when much larger sources remain.

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)**

The fixed interest rate of 15 February is simple and consistent with FSA projections, and so desirable. The potential large changes from year to year are also consistent with the changes in the costs of buying an annuity from year to year.

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 seek no change at present. This is also consistent with FSA COBS Rules.

16. **Do respondents have any comments on the appropriateness of the long term maximum rate of accumulation of 7% pa (paragraph 6.33)**

This should be consistent with the FSA's approach. The FSA has retained 7% as the maximum mid-point growth rate in illustrations and is scrutinising the approach providers take to use lower rates where 7% is unlikely to be achieved.

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)**

Please see response to question 16.

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

This rate is consistent with FSA assumptions and seems reasonable.

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

This is inconsistent with the FSA assumption which uses 4%. We believe this should be changed to be consistent with the FSA.

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

We believe providers should have the flexibility to decide whether or not to allow for any guarantees.

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

We believe the current approach is appropriate.

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

Yes. If pre and post sale disclosure were on an equivalent basis, it would make it easier for customers to understand and compare point of sale illustrations and statements over time. It is also easier for firms to manage customers' expectations.

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

We believe showing additional projections to explain the differences between FSA and BAS bases would confuse customers. Rather than making short-term changes, we believe the dialogue concerning harmonisation of bases between the BAS and the FSA should be accelerated.

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

We warmly welcome the proposal to allow signposting. Allowing signposting would help firms de-clutter the annual statement and help customers see and understand the key information. It would also be in line with the DWP's new disclosure guidance. We believe it should be possible to show an estimate of a pension with key caveats on one page. We would also like to point out that signposting needs to consider access for those without internet access, and as such it would be advisable to include non-internet based options.

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?**

The ability to meet an effective date of April 2011 depends very much on the extent and nature of the changes. Any changes of significance need a minimum of 12 months notice. Any change, particularly of significance, can only be managed if it is integrated with other changes to the same systems.

We believe that bearing in mind the other important pension business system changes resulting from legislation changes, e.g. abolition of contracting-out in 2012 and changes resulting from the introduction of workplace pension reforms from 2012, which will lead to different FSA disclosure rules, it would be sensible to delay implementation of SMPi changes to coincide with the FSA changes.

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

We believe this could be a useful way for customers to understand the link between their contributions and an estimated income in retirement.

However it would add a layer of further information and at this point we would favour focusing on making statements clear and simple. For disclosure in the near future we would therefore favour TMI allows firms to make clear that the estimate assumes contributions continue, and if they stop, the figure could be substantially less. Longer-term, we believe this should be on the basis of being an optional rather than mandatory requirement.

27. **Do respondents believe that recipients of SMPi 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)**

We believe key areas affecting variability can be explained simply with further detail signposted elsewhere. It is also important that the uncertainty is not overlaid in case it makes customers believe they have limited ability to take control of their own pension fund and are in a compromised position to make a difference to their retirement income.

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)**

We believe it may be useful to provide examples of best practice approaches, however it may prove to be complex to cover sufficient possible scenarios (e.g. with cash, without cash etc). It may be that the TM1 guidance, combined with the ABI Good Practice Guides, is sufficient.

Were best practice guides developed, we have no strong view as to who should maintain them.

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