

Consultation Paper – TM1: Statutory Illustrations Of Money Purchase Benefits

We appreciate the opportunity to comment on the questions raised in the consultation document. Our comments are as follows:

1. How effective have SMPI's 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 SMPI's, with examples if possible, or provide suggestions for enabling SMPI's to better meet the stated aim.

There has been no obvious behavioural change in customers as a result of issuing SMPI's. It is possible that the uncertainties inherent in SMPI's are not emphasised enough and it's the responsibility of providers to bring these out and highlight them to customers. In addition, the inconsistencies between SMPI's and FSA illustrations doesn't help customers understanding.

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)

Yes, providers need to ensure that messages around potential uncertainties are included in a way which customers will be able to understand and appreciate.

This could be achieved with a prominent headline/strapline type warning displayed immediately where the projection is shown rather than being embedded amongst the rest of the general warnings/important notes in the statement or being 'signposted' out elsewhere. However, it's important to make sure this isn't overplayed to ensure that customers confidence in the statement is maintained.

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

The stated aim itself is fine but it is important to make sure the uncertainties are highlighted and are strong enough in order to satisfy the final bullet on uncertainties inherent in SMPI's.

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 SMPI's? (paragraphs 4.2 and 4.3)

The main purpose of TM1 is to assist providers who produce SMPI statements. It is very helpful as a detailed statement of requirements for SMPI's and is important if consistency across the industry is to be achieved. The alternative of a principles based approach would result in a loss of the consistency which forms one of the main aims of SMPI's.

It would be helpful to reduce the length of TM1, in particular removing some of the duplication. A summary of the main points at the end of each section could be helpful.

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

See above.

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)

Reducing the level of detail could lead to ambiguity and it would leave providers having to make reasonable judgements on interpretation. This would lead to differences in SMPI's produced across

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the industry and would seem to defeat the aim of achieving consistent SMPI's across various types of money purchase pension provision and particularly between providers.

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)

We have no strong opinion on this but our experience of the type of pension increases chosen by annuitants with money purchase arrangements is:

RPI – chosen by less than 1%

Increases other than RPI – chosen by less than 5% (for external OMO business), increasing to between 10% – 15% (for internal annuity business)

No increases – chosen by 80% - 85% of annuitants.

This particular evidence suggests that assuming RPI increases in illustrations is out of step with what generally happens in practice.

It is worth noting that the default basis expected to apply to NEST benefits is to allow for a level annuity on the basis that NEST is aimed at the low paid, their life expectancy is lower and therefore a level pension is better for them as it maximises the annuity payable.

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 and no increases? (paragraph 5.4)

See above.

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

Our experience of money purchase arrangements suggests that 99% of annuitants opt for a cash sum at retirement. However, some policyholders may not have the option of a cash sum and others may have a guaranteed annuity rate option which would also present difficulties in illustrating on this basis. We suggest that TM1 remains as it is with the ability to illustrate on this basis as an option.

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)

We agree that the mortality basis should be updated. Our only concern is that the suggested rates (PCMA00 (males) and PCMA00 (females)) would still be too heavy. An alternative suggestion would be to move to long cohort improvement factors or adjust the suggested rates to say 80%.

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

This would lead to differences in the basis for SMPI's and contradict the aim of producing consistent SMPI's across the industry. Also, scheme based assumptions wouldn't necessarily be appropriate as all members would have the option to buy an annuity on the open market at retirement and in that case market based assumptions would be more suitable.

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

We think this change would mean the rate would be too high and so we suggest it 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)

As eventually there would have to be a switch to market rates there doesn't seem to be any great benefit in doing this. Retirement can occur at any time in the range 55 – 75 so determining the appropriate point to switch to market rates could be problematic. In addition masking volatility in this way almost suggests a guarantee of what may be available, which could then ultimately change for the worse when it's almost too late for members to do anything about it.

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 have no strong views on this point. GAD rates use a similar date so it's consistent. If the rate happened to be exceptionally high or low on any 15 February then it could cause problems if the rate corrected itself within a few weeks of that date. An option therefore would be to allow averaging over say the last 3 months. Perhaps averaging along these lines could be permitted as an alternative option in exceptional circumstances.

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 believe the current assumption is reasonable.

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)

SMPI's are long term projections. The rate achieved in the short term may be low but there is every chance that the economy could be entering an inflationary spiral and so there may be no need to reduce the long term assumption too significantly. 7% is consistent with the FSA basis and could still be said to be valid as, dependent on asset mix, it is still achievable on equities.

Adopting a 5%/7%/9% range as for FSA rules would complicate the SMPI illustration at a time when generally the content of SMPI's is being cut back. Looking ahead, the default fund aims for NEST are based on the rate of inflation + 1% or 2%. Adopting something similar would require changes also to FSA rates to achieve consistency, so an alternative suggestion is to use a flat 5% across the

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board, which may be more appropriate and which would maintain consistency with the existing FSA lower rate.

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)

At present we reduce the rate for certain with-profit funds that have a lower equity backing ratio or charges that mean a long term rate of 7% p.a. may not be achieved.

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

This is higher than we would currently anticipate in the medium/long term but that of course can change. This rate is consistent with FSA assumptions and so there seems no reason to change.

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

This is not consistent with the FSA assumption which is to use 4% in conjunction with the 7% rate of return. This difference can lead to confusion and it would be far better for the assumptions to be consistent.

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

Guarantees may only exist at certain points in the life of a contract so trying to allow for them and explain them would be problematic. They may even give an expectation of certainty which may be misleading. Guarantees will generally be identified and illustrated in benefit illustrations just before maturity and therefore we would have thought it best to not allow for guarantees in SMPI's on the basis that they are explained and illustrated during the more detailed and specific maturity process.

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

Our view is that this remains appropriate. Our approach is to allow for both the difference between the current transfer value and the 'asset share' that would be used to set bonus policy and any potential guarantees such as there being no Market Value Reduction at retirement.

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

Yes, from a customers view point in particular, harmonisation of the assumptions used would be ideal.

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

We believe this would result in customers being provided with too many projections and too much information, which the majority of people simply will not understand. If it is permitted then we think it should only be as an optional basis and not something customers have to right to be given or request.

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

The changes proposed by DWP in their draft regulations does introduce a significant reduction in the amount of information included in the illustration. In addition the cessation of contracting-out and the impact of all rights being subject to the same rules and conditions will further simplify statements.

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?

Section 9 indicates that the final version of the revised TM1 will be issued in the autumn this year at the earliest. The ability to meet an effective date of 6 April 2011 depends very much on the extent and nature of the changes. If the changes are simply the use of different assumptions within the existing statement framework with no change required in format or structure then 6 April 2011 may possibly be achievable.

If changes are more significant then these could not be done in 2011 and 2012 is the earliest that this could be achieved. Bearing in mind the limitations on cost and resource and all the other changes occurring in 2012, in particular the fact that auto-enrolment only starts in October 2012 and that this will lead to different FSA disclosure rules, it makes sense 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's and if so, should there be a requirement for this to be shown on SMPI's? (paragraph 10.2)

In theory it is a good idea and would be useful for some customers and their advisers, although it does add further complexity to an already busy statement. If this proposal is to proceed then we suggest it should be on the basis of being an optional rather than a mandatory requirement.

27. Do respondents believe that recipients of SMPI's 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)

As mentioned under question 2 above, although it is necessary to keep things as simple as possible, it is important that customers understand the inherent uncertainties involved.

Adopting a 5%/7%/9% range approach as under FSA rules to demonstrate the potential variances would complicate the SMPI illustration at a time when generally the content of SMPI's is being cut back. It is important that providers ensure that messages around potential uncertainties are included in a way which customers will be able to understand and appreciate.

This could be achieved with a prominent headline/strapline type warning displayed immediately where the projection is shown rather than being embedded amongst the rest of the general warnings/important notes in the statement or being 'signposted' out elsewhere. However, its important to make sure this isn't overplayed to ensure that customers confidence in the statement is maintained.

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

It depends really on what 'best practice' means. If a suite of SMPI's are produced purely as examples of what would be an acceptable approach then that would be reasonable and could be very useful, enhancing TM1's helpfulness at the same time.

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We wouldn't however want to see these introduced in any form of mandatory way with providers having to adopt a prescribed format for SMPI's. It also raises the question of who decides what is best practice, would they be consumer tested before publication? If developed, it may make sense for them to be maintained along with TM1 so they don't get out of step with each other.