

## TM1 Consultation Response

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# Response to Consultation on TM1

## Introduction

Hewitt Associates is pleased to submit a response to the consultation on the TM1: Statutory Illustrations of Money Purchase Benefits.

## Question 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.**

For those schemes providing the bare minimum of information to members, the SMPI projections go some way towards meeting the aim set out in paragraph 2.4. However, for schemes which provide additional information appropriate to their particular membership, in line with best practice, SMPI illustrations can represent an unnecessary additional administrative burden with limited benefit.

We do have a concern that the length of the disclosures required may discourage many members from reading the statements. One solution might be for the DWP to provide a web address containing all the standard disclosure information and for the statements themselves to simply include this web address, rather than all the disclosures currently required.

## Question 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.**

We do not think that this should be incorporated into TM1 as a requirement. Some employers request alternative scenarios to be shown. This can be done without amending TM1 for those who want it, but it would be a regulatory burden on those who do not if it were made a requirement.

## Question 3

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

We are happy for it to remain unchanged.

## Question 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?**

The explanations and assistance are helpful. TM1 should assist providers in producing SMPIs.

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**Question 5**

**Could any changes be made to the structure of TM1 to improve its clarity?**

No comments.

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**Question 6**

**What views do respondents have on our proposal to reduce the level of detail in which TM1 sets out the calculation methodology?**

We are of the view that it is currently over-prescriptive in places. For instance, the assumed age of spouse or civil partner for protected rights is rather over the top – although this will fall away from 2012. In general any two providers should show similar projected values at point of sale under FSA rules, in order to prevent unfair competition, and TM1 should follow the level of detail prescribed for FSA illustrations.

There was a tri-party agreement between the Actuarial Profession, the FSA and the DWP when TM1 was the responsibility of the Actuarial Profession. We would hope that a similar tri-party agreement is in place between the BAS, the FSA and the DWP to ensure that BAS and FSA assumptions were kept as closely aligned as possible in the light of Government policy.

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**Question 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?**

We think that this is a natural corollary of the requirement in legislation that pensions should be shown in today's prices. If this is to be changed, this should be part of a DWP consultation. Answers to question 8 may be relevant in considering whether the legislative requirement reflects actual experience.

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**Question 8**

**In respondents' experience what proportion of members on retirement opt to take annuities with index-linking, fixed pension increases and no increases?**

Based on a sample of readily available data (c3000 cases) over 90% of members opt for non-increasing pension.

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**Question 9**

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

This additional information, or alternative method of presenting the projection, would not be consistent with the disclosure requirements for DB schemes and our preference would be to keep these two in line.

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**Question 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?**

We agree that the 92 series of tables is now outdated. As most DC arrangements will end up being used to purchase an annuity, we are happy for the consensus view of life offices to be the driving force for the mortality assumptions, both base tables and projected improvements. Any

change should be agreed with the FSA.

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**Question 11**

**Should TM1 allow providers to choose specific mortality tables which are appropriate for the members of the arrangement in question?**

We would have no objection in principle to this proposal, although divergence from the FSA position should be viewed with caution. We note that this could lead to individual members receiving inconsistent illustrations from two or more providers.

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**Question 12**

**Do respondents agree with the proposal to change the yield used for annuity calculations?**

This assumption should be driven by the market.

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**Question 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?**

We can see no advantage in this proposal. As it is not broken, do not try to fix it. Complexity will increase costs and should be avoided.

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**Question 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?**

We see no advantage in using an average of yields over an historic period in place of a yield at a fixed date. Both are going to be wrong as a proxy for future yields and there is merit in using the most up-to-date yield. As the yield used is to be held fixed for a year from 6 April, we think that using 15 February is as late as some providers could leave it if literature is to be provided with effect from 6 April.

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**Question 15**

**Are the expense assumptions currently specified in TM1 reasonable, in particular the assumption of 4% of the value of the annuity at retirement?**

We are happy for life offices to provide the answer to this question.

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**Question 16**

**Do respondents have any comments on the appropriateness of the long term maximum rate of accumulation of 7% pa?**

It has worked well enough since 2003.

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**Question 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?**

Our current guidance is:

The gross rates to be used are:

For a fund invested at least 50% in equities: 7% pa

For a 100% gilt/bond fund: 4% pa

For a cash fund: 2.5% pa

For a lifestyle fund with at least a 50% equity content: 7% pa

For a lifestyle fund with less than 50% equity content: 5% pa

For a property fund: 7% pa

Where funds are a combination of any of the above a rate determined by interpolation may be used, but the strong preference is for simplicity even if this results in discontinuities.

The above rates are reviewed from time to time in line with our internal model of investment returns.

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**Question 18**

**Do respondents have any comments on the long term inflation assumption of 2.5% pa?**

It has worked well enough since 2003.

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**Question 19**

**Do respondents have any comments on the long term earnings inflation assumption of 2.5% pa?**

Again, it has worked well enough since 2003 and we see no merit in changing it.

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**Question 20**

**Should TM1 require SMPI projections to allow for guarantees?**

This would be a tricky provision to introduce as it would interact with the main investment return assumption in complex ways and there would be no certainty that two different providers would arrive at the same solution. We nevertheless think that it is a laudable aim but are concerned both on the complexity and the cost to providers of making this change.

One alternative might be to require the existence of a guarantee to be highlighted in the notes with an explanation of the approach adopted.

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**Question 21**

**Is the approach for with-profits funds set out in section 6.7 of TM1 appropriate?**

With profits fund returns can be complex to ascertain and we would defer to life office responses on this question.

However, we note that there can be practical problems. For example, we have recently entered into correspondence with the Regulators in respect of with-profits providers who are primarily invested in gilts (and whose Report and Accounts make it clear that they expect this to continue) but who use the higher end of the growth assumptions for SMPI. Given that it is the Trustees' responsibility to ensure reasonableness but that they have no control over providers' assumptions, this can cause significant

concerns.

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**Question 22**

**Would pension scheme members benefit from the FSA and TM1 bases being harmonised?**

If this would result in non-current price money projections, we would object to such a change (it would also be breach of legislative requirements and we think that this point should be consulted on by Government, not by BAS). If FSA bases were to be brought into line with TM1, we would not object.

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**Question 23**

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

We would be in favour of FSA guidance requiring point of sale projections to be given in current money terms as well as future money terms if they were so minded to do this. Our preference would be for FSA point of sale guidance to move from future money to current money projections.

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**Question 24**

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

We support this proposed change.

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**Question 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?**

We would be happy with a 6 April 2011 change date, subject to a minimum of six months' notice. The notice period could be reduced if the suggestion of issuing standard templates were to be adopted.

We are happy to defer to life office considerations regarding Solvency II and the Retail Distribution Review.

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**Question 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?**

This would help recipients in schemes where the information provided is currently limited but making this change would add to the administrative burden of schemes that already provide alternative information with limited or no benefit to members.

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**Question 27**

**Do respondents believe that recipients of SMPs would benefit from additional information illustrating the uncertainty in the amount of the illustrated pension? If so, how would this best be achieved?**

This information would be welcomed, but it would come at a cost and we are not sure that this cost would be worth the additional information supplied.

Over-sophistication should be avoided. The vast majority of recipients

would not understand stochastic projections with, for instance, 25% and 75% percentiles being given. We would favour prescribed changes from the central gross investment return (say plus/minus 1% pa) with the inflation assumption held constant.

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**Question 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?**

We would welcome this. It would promote best practice across the industry.

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