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Dear Sirs

Response BAS Consultation on TM1: Statutory Illustrations of Money Purchase Benefits

Jardine Lloyd Thompson provides consulting, actuarial and administration services to trustees and employers in relation to 1,500 or so work-based pension arrangements with assets ranging from a few thousand pounds to over £1,400m, and to individuals with regard to individual pensions. Following the combination of the JLT and HSBC Actuaries and Consultants businesses we now employ close to 100 qualified actuaries. This letter sets out JLT's response to the consultation.

Before dealing with the detailed points and specific questions posed by the BAS, we would like to make a general point. We will comment specifically on the issue later, but it is clear that at present recipients pay limited attention to and have limited understanding of the illustrations they are sent. For this reason, we believe there are two themes running through all our detailed responses:

- Keep the illustrations as simple as possible
- Practitioners now have systems in place to produce the illustrations efficiently. It will be costly and counterproductive if substantial changes have to be made to these systems.

We turn now to your specific questions.

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.*

We consider that SMPs and TM1 have been very effective in meeting the primary aim set out in paragraph 2.4 of providing "illustrations of pension benefits on a broadly consistent basis across various types of money purchase pension". However that paragraph goes on to say that this is intended to assist individuals to assess the adequacy, need for further provision, and uncertainties in relation to their pension arrangements. We do not consider they are currently achieving this.

Your paper makes reference to the DWP research, *Understanding Responses to Pensions Forecasts*, and summarises the findings of this. Our experience would not lead us to disagree with the DWP findings.

The DWP research highlights the general lack of understanding of pensions as a barrier to SMPs' effectiveness in assisting individuals as envisaged. We consider addressing this issue beyond the scope of this consultation, other than to observe that the public's understanding of pensions may have to be improved as part of the "2012 changes". The

research also highlights some ways in which the layout of SMPIs could be changed to increase their effectiveness, and the ideas would seem promising if they can be incorporated without significant system changes. However, again, we are unsure if the layout of SMPI is a matter for the BAS.

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)*

Again referring to the DWP research, this seems to suggest that there is reasonable appreciation of the uncertainties. We do not consider that there is any need to mandate more than the present statement on the actual amount of any pension payable.

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

We see no reason to modify the stated aim. It may simply have to be recognised that the second part is more a statement of overall aspirations than something which can realistically be achieved by SMPIs alone.

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).*

When it was published, providers might have taken the view that the detailed explanations were not always helpful. But after a number of years of operation we would expect that providers have systems in place which produce SMPIs consistent with those detailed explanations. Therefore, we do not consider existing providers either wish or would be assisted by reducing the level of detail in TM1. Indeed there would be a concern that if the level of detail was reduced, there might be some inadvertent requirement to change existing systems.

If there are new entrants to the market, the existing level of detail in TM1 is required if the objective of producing consistent illustrations is to be met.

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)*

As stated above, we would now be against any such reduction in the level of detail in TM1.

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 agree. If it is felt necessary to recognise that most members do not take index-linked pensions, and the implications of this, then this should be done by extending the requirements for the statement on the index-linked nature of the illustrative pension. Keep it simple.

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)*

We do not maintain MI on this but we can safely say that upwards of 80% of members retiring take a pension with no increases, and in fact the number could be 90%.

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

We advocate the retention of a pension only illustration as the requirement. Keep it simple. Again the situation can best be covered by providing members with an enhanced explanation of the possible variations from the illustrated pension (and governing bodies/providers can provide a pension/cash illustration if they wish).

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)*

Yes. PCMA00 and PCFA00 base tables. As regards allowing for future mortality improvements, the cohort adjustments are based on increasingly outdated experience, and presumably it is intended that the new TM1 basis should be sustained for some time in the future. Therefore, whilst it is early days yet for the CMI projection model, this would seem the most appropriate approach, and the 1.25% and 1% minimum improvement levels would seem reasonable at this stage.

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. How would they do this in any consistent way? Keep it simple.

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

Yes

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)*

We sympathise with the idea behind non-market related annuity rates for younger members and some sort of transition into market related rates for older members. However, it would involve a degree of complication and system change which would be disproportionately large compared to any benefit for the younger members whose SMPIs would be affected.

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) Paragraph 6.26 articulates well the potential drawback of a fixed reference date. However these drawbacks exist anyway to the extent that fund values are volatile from year to year. The use of an average yield would not remove the drawbacks, although it might mitigate the most extreme variations. We would be comfortable with either an average yield or the continuation of the status quo.*

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 have no evidence to suggest that any other simple allowance would be more 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)*

In the context of an inflation assumption of 2.5% pa and an assumption of "predominantly" equity based investment strategy (i.e. maybe assuming a bit of "lifestyling" approaching retirement?), we would not argue for any change from 7% pa.

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 have experience of 5% pa for gilts/bonds funds and 3% pa for projected cash return.

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

At the time of writing, the "break even RPI inflation rate" implied by the difference between fixed interest and index-linked gilt yields is approximately 3.4%. On the other hand the Bank of England is charged with taking action to target an annual 2% pa CPI increase. All sorts of arguments can be put forward for assuming long term inflation rates at various points between these figures, but to cut to the chase, 2.5% pa currently looks low for RPI increases. In isolation, an increase to 3% pa would seem reasonable. However, could this open up arguments that the 7% pa equity return assumption should be increased?

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

We are comfortable with the rationale that sets the assumed earnings inflation rate equal to the assumed price inflation rate.

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

No. Keep it simple

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

Whilst sympathising with the theory expressed in paragraph 6.40, we would not advocate any change from the current wording of TM1 for With-Profits Funds.

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

No comment

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

No comment

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

Consistent with the findings of the DWP research referred to earlier, we consider that "signposting" could help in achieving the aspirations set for SMPI. However, in order to avoid enforcing short term system changes, we would want the change to allow rather than require "signposting" at this stage.

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?*

This depends on what the changes are, and whether they require substantive system changes. If system changes are required, then 6 April 2011 may be too soon. The

argument that illustrations are normally issued "some time after their effective date" is not compelling where trustees and members are used to receiving 6 April illustrations shortly after this date. If you consider that 6 April illustrations should be issued by 31 December, a more constructive deadline might be for the new requirements to apply to all statements issued on or after 1 January 2012.

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

As commented earlier, more illustrative information is likely to further confuse and overwhelm many recipients, and this would certainly require material systems changes.

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)*

See earlier

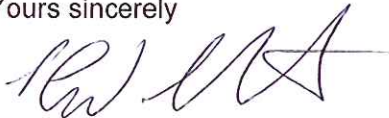
28. *Would the production of a suite of "best practice" SMPIs be of benefit to members and providers? If a suite of "best practice" SMPIs is developed who should maintain it? (paragraph 10.7)*

It would only be helpful if any changes it encouraged could be easily adopted and were clearly seen to be assisting with the more aspirational aspects of SMPI.

We have no other comments.

We thank you for giving an opportunity to comment as well as, in advance, for the consideration of our comments. We hope that you regard our comments as helpful. My colleague Stewart Lee, who led the drafting of our response, or I would be more than happy to discuss any of the points in more detail.

Yours sincerely



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