



THE LAW SOCIETY
of SCOTLAND
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Board for Actuarial Standards
TM1: Statutory Illustrations of Money Purchase Benefits

The Law Society of Scotland's Response

June 2010

INTRODUCTION

The Pensions Law Sub-Committee ('the Committee') of the Law Society of Scotland welcomes the opportunity to comment on TM1: Statutory Illustrations of Money Purchase Benefits. The Committee has the following comments to make.

Question 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.

The results of the DWP survey would indicate that SMPs and TM1 have not been effective in meeting their aims. The Committee submits that the lack of knowledge identified by the DWP survey cannot be fully addressed through a re-write of TM1; a wider programme of pensions education is probably required.

On a long term basis, it may be that the aims of SMPs will be met over time, when members receive them throughout their working lives, building up a picture of what they can expect in retirement (and how that may vary).

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. (paragraph 2.7)

Yes. The information to accompany the illustration (Appendix A of TM1) does not address the uncertainty and more should be done to illustrate the issue. A major uncertainty, which should at least be mentioned, is the effect of means-tested state benefits which affects overall retirement income. There should also be some illustration of the variation over time, reflecting real life uncertainties.

However, there is a balance to be struck. If too little information is given, the aims will not be met. Too much information could give such a wide range of possible outcomes that the illustration would be meaningless, off-putting and would make people less likely to read the information provided.

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

The three bullet points in paragraph 2.4 are not mentioned in the Disclosure Regulations and so could be regarded as making or interpreting government policy. If BAS is happy to take this role, then 2.4 is acceptable as it stands.

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 SMPs? (paragraphs 4.2 and 4.3)

The Committee notes that the legislation says that the illustrations must be produced in accordance with TM1 and so by definition its entire purpose is to help providers produce SMPs.

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

The Committee has no comments on this question.

Question 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)

One of the features of SMPIs is that they can be produced without any judgement by the provider, and this is particularly helpful avoiding the need to comply with various professional standards. Detailed explanations of the approach helps limit the need for judgement. As the detail provided already exists, there doesn't seem to be much reason to remove it – people already comply in the way set out in TM1, and it will be easiest to continue to do so. Removing the detail opens up the possibility of people manipulating the figures. .

Furthermore, providers have programmed their systems to cope with TM1; simplification may require these systems to be changed. Such change may not be welcome.

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? (paragraphs 5.2 and 5.4)

Yes, but see also comments also the response to Question 9.

Question 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)

The Committee has no comments on this question.

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

The proposed approach regarding member options at retirement (including pension increases and commutation) seems sensible – the illustrations should show consistent figures regardless of provider.

However, the proposal that other illustrations can be shown alongside the official SMPI can be problematic, if such projections are seen as outside of the SMPI special case. For example, would a projection of a different pension benefit become subject to the Pensions TAS?

It should be made clear that consistently produced figures showing the impact of different options at retirement form part of the SMPI, and therefore qualify for the same exemptions.

It is also noted that the legislation mentions 'an illustration', which may mean only one set of benefits will be illustrated. If 'illustration' can include several types of benefits, then there may

be a case for illustrating a variety of possible cash options and non-escalating pensions as well. A graphic may helpful in illustrating these comparisons.

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? (paragraphs 6.7 and 6.16)

The Committee agrees with the proposed approach of using the PCMA00 and PCFA00 tables as the PPF is currently using.

Movement towards the CMI formula would be more technically accurate and should be considered at a future time. However, this change would require some re-writing of systems and so sufficient notice should be given to providers if this is to happen.

Question 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. Such an approach is overly complex. Furthermore, any approach along these lines would have to be specific to the individual concerned, rather than working as an average for the membership of a particular scheme, which would prevent SMPs from being easily comparable.

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

Yes. However, the annuity market is quite volatile and Solvency II could impact on pricing bases.

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)

No. Volatility in the outcome for the member is a design characteristic of money purchase arrangements, and there is no reason to try to hide this. One of the benefits of using volatile market annuity rates is that it helps, over time, to illustrate the volatility of defined contribution pensions.

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)

A fixed date is preferable. In practice members will be purchasing annuities based on pricing on a fixed date. This also prevents providers from picking dates which suit them.

The Committee has no preference as to date and is satisfied with 15 February as the reference date.

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

In the overall scale of volatility of outcome, 4% seems acceptable. However, for some money purchase arrangements which do not insure annuities, 4% is probably too high.

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)

A 7% maximum rate of accumulation seems too high.

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)

It would be useful if TM1 gave more detail of the maximum rate that can be assumed on some commonly held investments that are not likely to yield 7% in the long-term. For example, a maximum return on cash or gilt funds could be based on long term gilt yields at the statement date, and a similar approach could be taken for corporate bonds. This would lead to greater consistency.

However, to reflect the actual individual asset mix in every illustration would be in practice very difficult, and may not be a worthwhile exercise.

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

The Committee has no comments on this question.

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

This seems like a sensible, cautious approach. Members with significantly higher earnings growth will be able to see the impact of that on successive statements.

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

No.

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

The Committee has no comments on this question.

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

Yes. It would certainly be easier for members to understand their statements if these were

harmonised. Care should be taken to ensure the benefits of showing pensions in real terms, and easy comparability should not be lost in doing so.

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

The Committee has no comments on this question.

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

Signposting should perhaps be allowable, but the Board should be aware that 'signposted' information is less likely to be read than hard copy.

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 in changes were to be effective a year later?

The Committee believes Autumn 2010 is too vague to be used as a meaningful deadline. The Committee notes that the Scheme Funding Regulations were planned for Autumn 2005 but did not come out until December 2005.

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

Yes, this would be helpful, and should generally be shown. It may be necessary to have a *de minimus* level below which this split is not required, because for new joiners, the pension in relation to contributions so far may be very small.

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? (paragraph 10.3)

No.

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

The Committee has no comments on this question.



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