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Board for Actuarial Standards
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Dear Sir / Madam

Consultation Paper: TM1: Statutory Illustrations of Money Purchase Benefits

This letter sets out Punter Southall's response to the above consultation. Punter Southall provides a full range of actuarial advice, pensions consultancy and pensions administration services. Our clients are primarily large and medium sized occupational pension schemes and their employers.

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.

In our view, the high level aim of TM1, of providing illustrations on a consistent basis across various types of money purchase pension provision, has been met. However, considering the three ways set out in paragraph 2.4 of the consultation in which SMPs are intended to assist individuals, we would argue that SMPs do not necessarily show the adequacy of a pension arrangement or extent to which further provision might be needed. This could be improved by a more explicit illustration of the shortfall against some sort of "target" pension, or by showing the amount of additional monthly contributions required to provide an additional £100 per annum, say, of pension.

In addition, providing a single pension figure based on one set of assumptions does not provide any indication of the uncertainties faced by a typical member. Whilst it would be possible to require additional information to be shown to highlight the inherent uncertainties, this needs to be balanced against:

- the additional costs of providing the figures, which would most likely be passed to the sponsoring employer at a time when the majority of companies are seeking to cut costs as far as possible; and
- the disadvantages of more complex and longer statements, which members may be less likely to read or act upon. This would obviously be a concern to us, as well as to scheme trustees and the employers who sponsor the schemes. A simple approach to SMPs is key.

2) Should more be done to highlight the significant uncertainties involved in using illustrations of benefits?

We would welcome the recommendation that some sort of sensitivity to investment returns is shown (for some of our clients we already show the impact on projected pensions of investment returns plus I minus 1% per annum, and this is done without a significant increase in costs or the length of statements). Showing the sensitivity to annuity rates might also be useful. However, as stated above, a balance needs to be found in this area. Compulsory figures would most likely increase costs and increase the complexity of the illustrations, which could mean these “improvements” to SMPIs are counterproductive.

3) Should the stated aim in paragraph 2.4 be modified?

Overall, we believe that the stated aim of SMPIs and TM1 remains appropriate. We see no reason for changing it.

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 in TM1 were helpful initially to ensure that statements produced by different providers were consistent, but we would expect providers to now be comfortable with the overall approach and so need to rely less on the guidance.

Assisting providers is a valid secondary objective of TM1, as it should help to provide consistency in the production of SMPIs across different schemes and different providers.

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

We see no reason for a major overhaul of TM1.

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

See our response to question 5.

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?

Our view is that the requirement to illustrate pensions assuming inflation-linked increases should continue, as there are no compelling arguments to move away from this approach. Whilst flat rate pensions may be more suitable for a large proportion of scheme members, and therefore consideration could be given for allowing this type of pension, amending this requirement would result in a step-change in projected pensions for the next round of SMPIs, which could prove difficult for communication purposes.

It would be better to ensure the disclosure requirements in TM1 include information on the variety of annuity options that are available.

We also note that the current version of TM1 does not prevent providers including additional illustrations if they so wish.

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

From our experience, approximately two thirds of members purchase annuities with no increases.

9) Do respondents have any comments concerning the option to take a cash sum at retirement?

We have no strong views on this. We do not see an issue with allowing providers to show this information, but it should be in addition to, and not instead of, the projections currently required. However, as noted in our response to question 7, the current version of TM1 does not prevent providers including additional illustrations if they so 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?

We strongly agree that the mortality basis should be updated. The PCAOO tables would seem reasonable on the ground that these are commonly used by insurers when setting annuity rates.

The CMI mortality projection model should be used for future improvements, as it is the most up to date mortality projections model currently available. This should also ensure that the assumption for future improvements in mortality remains appropriate for some time. We have no view on the allowance for the long-term improvement rate that should be made within the CMI model, although the aim should be to reflect what is used in the insurance market as far as possible. We see no reason that the PPF basis (that is, the mortality underpin used in conjunction with the cohort projections) should be considered applicable when determining a long-term rate for use in the CMI model.

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

We disagree with this approach as it would mean that consistency was not possible across all pension schemes. It would also make it more difficult for a member to understand his or her benefits.

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

We feel that this is a sensible suggestion based on current market practices.

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 disagree with this approach. Volatility is not necessarily something to be avoided as annuity rates on retirement can be highly volatile and SMPIs should not shy away from illustrating this. Making such a change will also increase the cost and complexity of the calculations, and it will be difficult to transition to market related rates for individuals approaching retirement.

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?

Our view is that using a single date remains a valid approach and therefore we see no reason to change this. Using average annuity rates across a range of dates only adds to the complexity and is not guaranteed to provide any “better” results.

If it is decided that a single date approach is used, there seems little reason to move away from the 15 February date, as providers are now accustomed to this approach.

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 have no comment to make on this point.

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

We have no strong view on this assumption. It is a long term assumption and recent market movements should not overly influence this 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?

Our typical approach is to assume 5% per annum returns for bond and cash funds. However, more recently we have had schemes that have assumed lower expected rates on cash as a result of the currently low bank base rate. Where members’ funds are lifestyled, we also make an allowance for this in our calculations.

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

We have no strong view on this assumption. Again, it is a long term assumption and setting it at a different level (either up or down) would be subjective, as well as resulting in a step-change in members’ projected pensions following any amendment. As long as the notes in the SMPIs clearly state the assumptions made, we see no reason to change this.

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

See our response to question 18 above.

20) Should TM1 require SMPI projections to allow for guarantees?

We have no strong view on this assumption. Making allowance for the guarantees would most likely increase the complexity of the calculations. We feel that providing a description of these guarantees should still be sufficient, and therefore believe TM1 could be left unchanged.

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

We have no strong view on this assumption as it is not an area where we have much experience.

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

We are strongly in favour of the two bases being harmonised as it would provide better consistency and aid member understanding of the figures provided in both cases.

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

We feel that these are sensible suggestions. However, making it compulsory to produce additional figures will add to the cost and complexity of the statements. This cost is then likely to be passed on to sponsoring employers, as mentioned in our response to question 1.

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

We would welcome the introduction of signposting which would allow a reduction of compulsory material that was included in a SMPI. It is also consistent with the proposed changes to the disclosure regulations.

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 see no reason that the changes should not be put into place for statements with effective dates on or after 6 April 2011. However, if it was decided that fundamental changes were required, then it might be necessary to stagger these changes, or delay the effective date, to give providers more time to amend their systems.

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?

We are strongly in favour of this additional requirement and in fact already include this figure on the majority of SMPs we produce. We would not expect it to result in a significant increase in the length (or cost) of SMPI statements for the majority of providers.

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?

Our view is that the requirements should not be too complicated as it would just add to the cost of producing the statements. In addition, if the statements are too long, then members are less likely to read them. It is also difficult to decide what is a suitable range — there is a danger that a member might read the figures as “minimum”, “expected” and “maximum”, which would not be appropriate.

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 see no value in adding “best practice” documents at this stage. All providers have now had significant experience in this area and will have the necessary standards in place.

We hope these comments are of some assistance to you.

Yours faithfully

Alison Bostock FIA
Principal