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Our Ref: JM/JB/4.22

June 4th 2010

Dear Sir or Madam,

CONSULTATION PAPER: TM1 STATUTORY ILLUSTRATIONS OF MONEY PURCHASE BENEFITS

We welcome the opportunity to comment on the above consultation paper.

INTRODUCTION TO SPC

SPC is the representative body for a wide range of providers of advice and services to work-based pension schemes and to their sponsors. SPC's Members' profile is a key strength and includes accounting firms, solicitors, insurance companies, investment houses, investment performance measurers, consultants and actuaries, independent trustees and external pension administrators. SPC is the only body to focus on the whole range of pension related services across the private pensions sector, and through such a wide spread of providers of advice and services. We do not represent any particular type of provision or any one interest - body or group.

Many thousands of individuals and pension funds use the services of one or more of SPC's Members, including the overwhelming majority of the 500 largest UK pension funds. SPC's growing membership collectively employs some 15,000 people providing pension-related advice and services.

This consultation document has been considered by SPC's, Actuarial, Administration and Money Purchase Committees, which comprise representatives of actuaries and consultants, pension administrators, insurance companies, pension lawyers and product providers.

COMMENTS ON THE CONSULTATION PAPER

Question 1: How effective have SMPs and TM1 been in meeting 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, subject to some of our comments later, that TM1 has met the overall aim of producing illustrations of pension benefits on a broadly consistent basis across various types of money purchase pension provision. This is an aim which we support. It is helpful to people who have benefits under more than one scheme, as will often be the case, to essentially be able to add together the relevant numbers in the SMPs of these schemes, to form a picture of their total provision. However, because SMPs contain a significant amount of detail, only a small engaged and informed minority take advantage of the opportunity.

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Particularly for lower paid people, it is important that they are encouraged to take their state benefits into account in making an overall assessment of the adequacy of their arrangements.

We are not sure to what extent SMPs have assisted individuals in assessing the extent to which they need to make further provision. As suggested later in the consultation paper, we consider that it would be helpful from this point of view to differentiate between funds accumulated from contributions already made and the possible outcome from future contributions, perhaps including an indication of what an additional 1% contribution might produce in terms of extra pension.

We consider that it is difficult to convey a sense of uncertainty when providing illustrations on a single basis, but the difficulty in incorporating, say, more than one investment return into the illustrations might be that they would cause confusion, rather than illustrate uncertainty.

In all cases, as far as possible, and particularly bearing in mind the costs involved in achieving this, we suggest that graphical means should be considered as a means of conveying messages, rather than simply numbers.

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

In principle more probably should be done to highlight uncertainties, but against this one must set realistic expectations of how likely members are to properly understand what they are told and the costs involved in providing the probably more detailed information needed.

One possibility, although the systems costs in doing so would still need to be taken into account, might be to include with current year figures, where relevant, figures for the two previous years. This would probably give an impression of how changeable the possible outcome is. However, there would be a significant risk of confusing the reader and if, as would be quite possible, the possible outcome declined sharply from one year to the next, discouraging further retirement saving.

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

No.

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?

The consensus among our commentators was that the explanation and assistance provided in TM1 is helpful.

We consider that one of the purposes of TM1 should be to assist providers who produce SMPs.

Question 5: Could any changes be made to the structure of TM1, to improve its clarity?

We have no changes to the structure to suggest.

TM1 could be viewed as excessively long, but it is broken down into quite readily manageable sections.

However, it would be an improvement if information could be grouped in the same place. For example, all information about calculating the projected fund and the information about converting the fund to an annuity.

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

The main aim should be to maintain consistency across SMPIs. If the level of detail in TM1 can be reduced, without prejudicing this aim, we would be in favour. However, it is important that less detail in TM1 does not lead to less consistency in SMPIs.

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?

An important argument for quoting a higher, non increasing pension, is that this produces a more encouraging picture, which could make it more likely that the member will continue to contribute.

Many members do, in fact, choose a level pension and for some of them the availability of higher buying power early in their retirement proves to provide a better fit with the pattern of their life in retirement than one increasing with inflation. 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 the other hand, if only a single assumption is permitted, a significant number of our commentators were not opposed to requiring that it is assumed that the pension increases in line with inflation.

We do not consider that there is an overwhelming case for change in this area. As paragraph 5.4 notes, if the assumption of increases in line with inflation is maintained, members are free to obtain additional assumptions based on a non increasing pension.

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

We have no comprehensive data relevant to this question

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

We do not consider that there is an overwhelming case for change in this area. One reason for not making a change would be that uniformity across SMPIs would be reduced, given the different cash bases, which in practice apply across the range of trust and contract – based defined contribution arrangements.

As the consultation paper notes, there is no prohibition on including a cash sum and a reduced pension in addition to other information and it is clear that many members choose to take part of their pension as a cash sum.

Question 10: Do respondents agree that the mortality basis should be updated? If so, what tables and allowances for improvements do they consider should be adopted in TM1?

We agree that the mortality basis should be updated. The great majority of our commentators agreed that use of the PCMA00 and PCFA00 tables would be appropriate, although a concern was expressed that these rates would still be too heavy.

Concerning approaches to future changes in mortality, we see no reason for TM1 to track the approach taken by PPF (we view consistency between TM1 and FSA's requirements as much more important) and we suggest that the second approach described is adopted – the use of CMI's recently issued mortality projection model. However, the practical application of the model will need consideration. The model contains parameters, which can be varied, so there will need to be clarity on the parameters to be used in this context.

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

No, because this would undermine the important aim of consistency across SMPs. The only exception could be in the year before expected retirement, where the use of specific mortality tables would better reflect the likely pension benefits.

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

The great majority of our commentators agreed, although there was a suggestion that the proposed rate would be too high.

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?

No, because the existing volatility is one means of demonstrating the uncertainties surrounding illustrations and because the use of non market rates would complicate the preparation of illustrations.

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 on whether an alternative approach would be preferable? If a fixed reference date is preferred, should it be February 15th?

Again, the volatility, which can arise from using a fixed date helps to demonstrate uncertainty.

If there is to be a fixed preference date, there is no strong argument against using February 15th.

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?

Consistency with FSA requirements is, as we have already stated, important, although technically, for smaller funds, a more realistic assumption might be a fixed amount plus a percentage.

Question 16: Do respondents have any comments on the appropriateness of the long term maximum rate of accumulation of 7% per annum?

We see no strong arguments for changing the current provisions of TM1.

Our only observation is that, for members in default or passive investments, it is questionable whether a rate of accumulation of 7% per annum is realistic, even in the long term.

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% per annum?

This is a question on which the responses of individual providers will be more relevant than that of a body such as SPC.

Question 18: Do respondents have any comments on the long term inflation assumption of 2.5% per annum?

We support the approach in the consultation paper.

Question 19: Do respondents have any comments on the long term earnings inflation assumption of 2.5% per annum?

We support the approach in the consultation paper.

On a broader point, it is a source of potential confusion that there is inconsistency with FSA assumptions in this area. Consistency would be highly desirable.

Question 20: Should TM1 require SMPI projections to allow for guarantees?

We can see no reason in principle why TM1 should not require SMPI projections to allow for guarantees, since this could be helpful to members in deciding on the adequacy of their provision,

However, guarantees will generally be identified and illustrated in benefit illustrations just before benefits are due to come into payment. It might therefore be sufficient not to allow for guarantees in SMPs, on the basis that they are explained and illustrated during the more detailed and specific maturity process.

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

We have no evidence that the approach is inappropriate.

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

Emphatically yes.

Neither basis is in any sense guaranteed to correctly predict actual outcomes and we suggest that it would be helpful from every point of view if the two bases were harmonised. That FSA illustrations at the point of buying a personal pension give rise to better projected outcomes, than seem to be subsequently justified by illustrations on the TM1 basis, is particularly confusing and unhelpful.

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

The difficulty with the approach suggested would be that presenting the information, in a way which would be comprehensible to all but a small minority of recipients, would be a formidable challenge.

Question 24: Do respondents have any comments on our proposal in paragraph 8.4 to allow signposting?

We support the proposal.

Question 25: Would the timetable outlined in section 9 allow providers sufficient time to make changes from statements with effective dates on or after April 6th 2011? What benefits, if any, would there be if changes were to be effective a year later?

The view of our commentators is that on balance it would be better to make the changes a year later.

As well as the factors referred to in the consultation paper, this would then allow changes to systems and procedures on account of the abolition of defined contribution contracting out in 2012 to be taken into account.

We suggest that, from a member's point of view, making staggered changes would be very likely to cause confusion.

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?

While we recognise that this would add to the information which had to be provided, as we have stated earlier, we consider that this would be helpful, possibly as an optional addition.

It would help recipients to better assess how close they are to meeting their objectives and how much of the expected outcome is not dependent on continuing existing working and contribution patterns. Our only reservation would be that, especially if an inflation linked pension must be projected, without explanation, the return from contributions already made might be low enough to contribute a disincentive to increasing, or even continuing, contributions.

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?

We suggest that providing a range of pension amounts could be misleading, without some further explanation of the probabilities of actual outcomes falling within the range. Whilst this would be necessary, to avoid recipients making the mistake of assuming that the outcome could be no worse than indicated by the range, it would be likely to add an unacceptable degree of complexity.

We therefore suggest that it would be more straightforward to give three years' figures, if relevant, and rely on any variation between the figures to convey the message that uncertainty is considerable.

Question 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?

We do not have a strong perception that consistency between statements is a major difficulty and we are therefore not sure that it need be a high priority to develop a mechanism, presumably through some form of pension industry grouping, for developing and maintaining a suite of "best practice" SMPs.

Yours sincerely

John Mortimer
Secretary