



Standard Life Assurance Limited

Response to the

Consultation Paper:

**TM1: Statutory Illustrations of Money
Purchase Benefits**

(March 2010)

General Points

SMPI are of course just one aspect of communication to customers about their long term retirement savings. An overall improvement of communication can only come with a degree of consistency and harmonisation that does not exist at present, for example the discord between SMPI and the FSA's point of sale illustrations.

Rather than communications helping people understand their long-term savings better, it often causes confusion. The many customers who have benefits built up in more than one scheme can often receive different information from each scheme and have had conflicting information about projected benefits within the same scheme.

Consistency is required in the information that customers are provided through all stages of their savings, at inception, annually, at retirement or leaving before retirement.

We would like all government departments to take the opportunity to create a single simpler set of requirements for all types of defined contribution schemes. This would have major benefits for all concerned, allowing pension administrators and pension schemes to communicate with customers in much simpler terms making it easier to engage people's interest in their savings. The more complicated the rules and explanations, the less likely the customer will read them. This simpler and more consistent requirement would also bring cost savings to providers that market competition would ensure are passed on to customers.

We welcome the review of TM1 as an opportunity to improve the communication to customers about their long term retirement savings and move towards the desired simplicity and consistency.

We believe that this should result in:

- simpler illustrations
- the use of signposting, and
- the greater use of e-communication.

Consultation Questions

Q1 – In terms of the effectiveness of SMPIs, the illustrations are contained within an annual statement which itself fails to properly engage our customers. It is unsurprising therefore that SMPIs are also failing to achieve the objectives outlined in TM1. Extensive customer research (initiated by both ourselves and the ABI) clearly expresses the desire from customers for annual statements which are clearer, briefer and which present key information in a simple, straightforward manner. Whilst noble in the intention of providing real terms illustrations, SMPIs have unfortunately contributed to both policyholder confusion and information overload.

Specifically, the key concerns regarding SMPIs are as follows:

The SMPI format is rarely that of the pension taken by most policyholders. Almost all take the tax-free cash sum and the vast majority take a level pension. SMPI assumes no tax-free cash sum and increases in line with RPI. In addition, SMPI assumes a 50% spouse's pension on death after retirement regardless of whether the policyholder is married or not. This is the cause of numerous calls to our Customer Service departments from policyholders.

The SMPI basis is high cost and so the pension shown is far lower than the pension typically chosen at retirement. This can have the effect of putting off customers from making future provision or even worse, from continuing their premium payments.

TM1 requires a series of explanatory notes and warnings. Although it says that these should be kept to a minimum, it goes on to mandate a long list of messages. SMPIs have therefore, added at least another complex page to statements.

Q2 – More should be done to highlight the significant uncertainties. One way this could be achieved might be by giving a range of illustrations at different growth rates rather than just one, but this could confuse some customers. Another approach could be to give a probability statement – customer research would be needed to establish whether customers would understand this. Alternatively, the issue of significant uncertainties in illustrations would be removed if projections were no longer provided.

Q3 – No (unless we abolish illustrations altogether).

Q4 – The explanations and assistance in TM1 provide a useful reference and guidance on the method that should be used to produce the illustration. We feel that one of the purposes should be to assist providers. This helps to ensure consistency across providers.

Q5 – It would be helpful if all information for each point was in the same place. For example the basis to use for the projection before retirement appears in a number of sections and similarly the basis for converting the fund to annuity appears in a number of sections. It would be helpful if all information about calculating the projected fund was in one section and the information about converting the fund to annuity was in one section.

Q6 – Some detail is necessary, for example stating the approach to be taken regarding the assumptions of future contributions. In some instances, if the information is not in the rules/guidance, then it can be seen as 'don't need to do this' or 'it's not a must do'. It

could also be open to different interpretation by different companies. This could lead to inconsistencies in illustrations being provided where a member has a policy with more than one company.

- Q7 – There should be flexibility over the type of pension escalation, if any, that should be allowed for. The member should be able to state the pension escalation basis for their illustration and if not stated then a default basis could apply. Given that most customers opt for a level annuity, then it would appear to be more appropriate to use this as the default basis. The basis should also take account of any legislative escalation requirement, for example for protected rights (RPI linked basis is not permitted) or Guaranteed Minimum Pensions (the minimum 3% escalation required on Post 88 GMP could be higher than the change that would occur on an RPI linked annuity if for example the RPI increase was only 2%).

It would also appear to be more appropriate to provide the annuity on a single life basis instead of allowing for a widow/civil partner's pension since most members do not take up this option on retirement. We have received complaints from customers about the inclusion of a widow/civil partner's pension in their illustrations when they've not asked for this.

- Q8 – The vast majority of our customers opt for a non-increasing pension.
- Q9 – Since cash at retirement is currently a popular option (and likely to remain so whilst it continues to be tax free) it would seem sensible to require a reduced pension and cash sum to be shown instead of the full pension (both are permitted but not required by TM1 and the FSA COBS rules). Almost all of our customers currently take a tax-free cash sum. Showing the full pension could be permissive.
- Q10 – It is sensible to update the mortality basis, but only at the same time and in the same way as for FSA projections (this includes moving from a prescribed basis to one no more favourable than the life office's current annuity rate, or the relevant market annuity rate as appropriate, for projections within a year of retirement).
- Q11 – Providers should be able to choose specific mortality tables within one year to retirement to the extent necessary to reflect the annuity basis that they would offer to such members. This would give a better reflection of likely benefits for a member who is close to retirement and is consistent with the FSA approach.
- Q12 – This proposed change would take the basis for RPI linked annuities out of line with FSA projections which also have the 0.5% deduction, and so whilst in isolation the change seems sensible, unless and until the FSA make the corresponding change to COBS, we would not agree with this proposed change.
- Q13 – This would introduce inconsistencies with FSA projections, and so is undesirable from this aspect. It also seems spurious to attempt to remove a small source of volatility when much larger sources remain, and to go against highlighting the significant uncertainties that exist.
- Q14 – The fixed reference date of 15th February is consistent with FSA projections, and so desirable. The potential to have large changes from year to year are consistent with the changes in the costs of buying an annuity from year to year, and so seems sensible to include as part of highlighting uncertainty.
- Q15 – The 4% expense assumption is consistent with COBS but appears to be unreasonably low.

- Q16 – A maximum intermediate growth rate of 7% still seems reasonable, and is consistent with COBS, but the requirement to use lower projection rates where appropriate should be enforced, and lower and higher projections could also be included to highlight uncertainty.
- Q17 – We use lower projection rates where we believe that the asset mix of the fund(s) invested in does not support the maximum permitted rate for both SMPIs and FSA projections. Where investment is in more than one fund, we calculate the projection on a fund by fund basis allowing for the appropriate growth rates and charges for each fund. We believe the requirement to use lower projection rates where appropriate should be enforced and this is the approach that the FSA is now taking for projections produced under COBS rules.
- Q18 – Price inflation of 2.5% is consistent with COBS and seems not unreasonable.
- Q19 – Earnings inflation of 2.5% is inconsistent with COBS and, as acknowledged in 6.35 of this consultation paper, does not reflect reality. This should be changed to 4% pa in line with the COBS requirements.
- Q20 – SMPI projections should be required to allow for any guarantees on annuity options, to reflect what would happen in practice. It may not be appropriate to allow for guarantees in all scenarios though, for example if the guarantee on a projected fund is dependent on the fund then being used to purchase an annuity, the member would lose this guarantee if income drawdown was chosen instead and the projected fund could then be overstated. In this circumstance, it may be appropriate to show two values, one with a guarantee and one without with accompanying wording.
- Q21 – Yes
- Q22 – Members would benefit from the FSA and TM1 basis being harmonised. This would reduce the potential for confusion that currently exists.
- Q23 – Showing additional projections to explain differences in bases is far less desirable than having harmonised bases, as experience has shown this can confuse customers. We already include a projection in today's prices in new business quotes, with the basis for this being consistent with the basis for the future money terms (allowing for price inflation of 2.5%), thereby explaining the impact of inflation.
- Q24 – If signposting is used, the information would have to be provided in a way that all members can access. For example, whilst many members would welcome signposting to a website, not all members will use the internet and therefore only providing signposting to a website may mean that some members fail to access/review the relevant information. Paper copies of any signposted information would have to be made available on request. Requirements will also need to be clear about what information can be signposted and what must appear with the SMPI.
- Q25 – We generally issue statements very shortly after the effective date and therefore, assuming that the final rules are published in the autumn of 2010, if this were say October then this would only give around 6 months to make all changes. Depending on the scale of the changes needed, it is likely that there would be insufficient time to make these changes, especially considering the other work that will be required arising from the Retail Distribution Review and the possible disclosure changes required following the European Commission's review of Packaged Retail Investment Products.

Q26 – This could help some members but could confuse others. It's not clear whether the proportion of those who would find the additional information helpful would outweigh the proportion of those who would be confused by the additional information.

The addition of this information could lead to members stopping contributions if they think that the projected return for contributions already paid looks very low, especially given the requirement to provide the illustration on the basis of an RPI linked annuity. During the early years of a policy, illustrations are more likely to appear low in relation to contributions already paid if a member is paying a regular contribution and an initial commission charge period or initial adviser fee applies. If someone is leaving service or considering stopping contributions then they could ask for an existing business illustration showing the effect of ceasing to contribute.

We do not believe though that the SMPI is the place for providing this additional information.

Q27 – The provision of a range of illustrations at different growth rates may be better for highlighting the significant uncertainties.

Q28 – The FSA has moved away from the use of a lot of prescribed wording in COBS. This allows different product features to be better explained and assists innovation in product design. Customer research has shown in the past that prescribed wording often doesn't meet their needs and isn't easily understood. Firms should be able to take customer feedback into account. Wording should be able to be tailored to suit the typical market that the product is for. The TM1 requirements should just list the key points which need to be covered without prescribing the wording that should be used.