

Emily Brown

From: Ben Carroll [ben.carroll@uk.zurich.com]
Sent: 02 June 2010 14:43
To: BAS TM1
Subject: TM1 response to consultation

I respond to your consultation paper "TM1: Statutory Illustrations of Money Purchase Benefits" on behalf of Zurich. The questions raised in the consultation are wide-ranging and I welcome the opportunity to reply.

In general:

We think that you are right to begin the consultation paper (and TM1 itself) with a restatement of the purpose and key objectives of statutory money purchase illustrations. It is absolutely essential that we focus on our customers' needs. In particular, we would emphasise that SMPs should help customers to assess their income needs throughout their lifetime, "How much income do I need?", and so to answer the question "Am I saving enough?".

In addressing this principle, we consider it important that SMPs do not create any expectation for customers that the amount shown in the illustration is the amount which they will receive. If apparent accuracy leads customers to expect a particular amount of income from their pension, it will prevent them from considering the key questions above and does not serve their needs.

In response to specific consultation questions:

Q.1, 2 and 3.

While we do not have any evidence concerning the effectiveness of SMPs, we believe that they are likely to be valuable to customers because they are the only regular communication which provides a real terms indication of possible income. SMPs are unique in this and in their stated aim of equipping customers to address the key questions.

SMPs might better meet the stated aim if they minimised the risk of members expecting any particular level of income from their pension and instead helped to focus on the key questions. We think that apparent accuracy does not serve customers' needs and, in fact, consideration should be given to making an obvious reduction in accuracy.

For example, if a statement that possible retirement income could be £4,386.00 creates more expectation than a statement that possible retirement income could be "about £4,500", then focus on the key questions might be better achieved by rounding SMP income to the nearest £500pa.

Q.7

We agree that TM1 should continue to require an escalating pension. While, in a low-inflation environment, many members might be better off taking a flat-rate pension and we believe most members do so, it is less important that SMPs should reflect the anticipated form of benefits than it is that SMPs should help customers to assess their lifetime income needs. In our opinion, an escalating pension best meets this aim.

Q.9

The same considerations apply to the question of taking a cash sum at retirement. The aim of SMPs should remain to equip customers to assess their lifetime income needs and to judge whether they are saving enough. The actual form of benefits taken at retirement is not relevant and SMPs should therefore continue to assume that no cash sum is taken.

Q.10

Yes, we agree that the mortality basis should be updated. Failure to do so risks overstating the value of customers' benefits. We believe that the SMPI should be based on the PCMA00 and PCFA00 tables. Without a specified calibration in TM1, the CMI model risks a step toward reflecting an actuary's view of the market and away from standardisation.

Q.11

We do not believe that specific mortality tables meet the aims of SMPs or are helpful to customers in answering the key questions.

Generally, we believe that SMPs should be standardised as far as possible and should not attempt to model a particular scheme's annuity rates for two reasons: firstly, we are concerned that any spurious accuracy will encourage an expectation in customers and, secondly, many members ought to take advantage of a right to an open market option. We believe that a like-for-like basis for all pension schemes best helps members to answer the key questions.

Q.13

We cannot provide an answer to the specific question, but more generally, we question whether SMPs continue to address the needs of customers who are approaching retirement in a low-inflation environment.

For younger members, we "push out" SMPI information in order to help customers to assess whether they are saving enough. For members close to retirement, there is limited time to address any short-fall in retirement provision. It is suggested that we should instead "pull in" customers to take financial advice as to whether their investment strategy properly protects the savings they have made and to consider their wider retirement options. If this can better be achieved by not giving these members SMPs, or by changing the aims of SMPs for these customers, then we should consider more significant changes.

Q. 16, 18 and 19

We have no strong feeling on the individual assumptions. Using the same assumption for inflation and earnings increases is unusual but the figures might not be unreasonable in relation to the assumed rate of equity return. We would also contrast the generality of the 7% assumed rate of equity return with the precision implied in the mortality assumptions. It may well be that generality better meets customers' needs than precision.

Q.20

While we have argued that the aims of TM1 are best met by not attempting to mirror the benefits likely to be taken under any particular scheme, we recognise that a customer cannot make an assessment of whether he or she is saving enough if any significant annuity guarantee under an existing arrangement is not reflected in an SMPI. Where income in retirement is significantly higher than it would otherwise be due to an annuity guarantee, we feel that customers must be made aware of this.

Q.22

We do not feel that customers understand the differences between FSA illustrations and SMPs. Superficially, harmonising bases so as to remove inconsistencies might reduce confusion and so appears to benefit customers. However, unless or until the aims of FSA illustrations and SMPs are harmonised, these illustrations perform different roles and must each adopt assumptions appropriate for the roles they perform.

Q.25

We think that the timetable for implementing changes to TM1 will prove challenging for many providers of SMPs. The changes to SMPs would compete for resources involved in other work, such as the implementation of Solvency II.

There would be benefits in efficiency in implementing changes to SMPs at the same time as changes associated with the abolition of defined benefit contracting out and so would much prefer the changes to TM1

to take effect from 2012.

With kind regards,

Ben Carroll
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