ASSOCIATION OF ACA CONSULTING ACTUARIES

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12 December 2013

The Director of Actuarial Policy
Financial Reporting Council
5th Floor, Aldwych House
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Dear Sir

AS TM1: Statutory Money Purchase Illustrations – version 4.0

I am writing on behalf of the Association of Consulting Actuaries (ACA) in response to the proposals for version 4.0 of this Standard.

We have set out our response to each of the questions in the appendix to this letter.

We agree that the proposed, limited, changes to TM1 allow for the options introduced by the changes to the Disclosure Regulations effective from 6 April 2014 and bring more convergence with FCA rules for illustrations governed by the FCA.

At this stage our comments are limited to the changes being proposed currently. We note that the FRC is planning a more in-depth review of TM1 in 2014.

Our main points about the new TM1 are as follows:

- TM1 should make it clear that where providers allow for a lump sum, it should be included with the pension in the SMPI. TM1 is silent on this. If this is because the FRC believes the legislation is defective on this aspect, it is appropriate for the FRC to provide guidance to avoid any doubt among providers on this and how it should be done.

- Can it be made clear that if providers wish to provide TM1- compliant illustrations with annuities on different bases in the same statement, e.g. level and increasing pensions, then this is permissible?

We hope that you find our comments of assistance and would be happy to discuss them further if that is helpful.

Please contact either me on 020 7432 6635 (david.everett@lcp.uk.com) or my colleague, Spencer Bowman, (who prepared this response) on 020 72272170 (spencer.bowman@towerswatson.com).

Yours sincerely

David Everett
Chairman
ACA Pension Schemes Committee

Sent by e-mail to TM1@frc.org.uk

ACA'S comments on the proposals and invitation to comment on AS TM1: Statutory Money Purchase Illustrations 4.0

Q1. Do respondents agree with the proposed approach to the allowance for cash in the calculation of the statutory illustration (paragraph 3.3)?

The proposed approach is satisfactory as far as it goes. However, there does not appear to be any guidance as to how the lump sum should be illustrated with the pension in the SMPI statement. To be consistent with the pension shown, we suggest that the lump sum should be expressed in real terms.

We note that the wording of paragraphs 6-7 of Schedule 6 to the 2013 Disclosure Regulations could have been expressed more clearly so that there is no doubt that the lump sum also needs to be illustrated where account is to be taken of that lump sum when illustrating the pension. We ask that TM1 makes clear that any such lump sum must be illustrated.

Q2. What are respondents' views on the proposed approach to the cash assumption (paragraphs 3.6 to 3.8)?

The proposal is to normally limit the lump sum to scheme rules or legislation. Strictly, legislation does not prevent the payment of lump sums as unauthorised benefits under the Finance Act 2004, which would be subject to additional tax, so we do not believe it is likely that the reference to legislation is the correct wording to use. Is this reference therefore meant to be to tax-free lump sums? We suggest that the FRC states that rather than limiting the lump sum, providers are required to 'have regard to' or 'bear in mind' scheme rules and legislation on 'tax-free' lump sums.

In our experience, tax issues are rarely taken into account in SMPIs currently, given the difficulty of trying to do so. Typically, individuals are advised that their benefits may be affected by the Lifetime Allowance.

Q3. Do respondents agree with the proposed approach to the spouse's or civil partner's pension (paragraphs 3.10 to 3.12)?

The comments regarding legislation in the response to Q2 above arguably apply here too. So might this provision refer to a contingent partner's pension of between nil and 100% of the member's pension subject to scheme rules?

Q4. Do respondents agree with the proposed approach for the interest rate used for annuity rates when providers illustrate a non-increasing pension (paragraph 3.19 to 3.23)?

We have no objection to the FRC's proposal on this aspect, given the input the FRC has received from providers.

Consistency with the FCA rules would, however, be desirable to those providers who are required to provide both FCA illustrations and TM1 SMPIs, who will need to use different annuities for level pensions, creating additional costs for them and potentially some confusion for users.

Q5. Do respondents agree with the proposed approach for the interest rate used for annuity rates when providers illustrate a pension that increases at other rates (paragraph 3.25)?

In our view the proposed approach is reasonable.

Q6. Should AS TM1 suggest that providers should disclose the accumulation rate used net of inflation (paragraphs 3.28 to 3.29 and 3.36)?

We suspect there is little call for this from users. Should this also be net of investment charges?

For certain asset classes, such as gilts or cash, this may mean showing negative real returns particularly after allowing for charges, which individuals are likely to find confusing.

Q7. Do respondents agree with our proposal not to amend the price inflation assumption (paragraph 3.32)?

We agree that there is no material new evidence that would warrant a change to the inflation assumption currently.

We remain dissatisfied that TM1 is not clear what measure of inflation the assumption of 2.5% refers to. The FCA makes clear this refers to RPI for its guidance. We believe this should be reconsidered in the 2014 review.

Q8. Do respondents agree with our proposal not to amend the earnings inflation assumption (paragraphs 3.33 to 3.34)?

While consistency with the FCA rules is desirable, we have no objection to the FRC's proposal at this stage.

Q9. What other aspects of AS TM1 do respondents suggest should be considered in our review of AS TM1 next year?

Given the timescale, we have not had the opportunity to consider this aspect, but will be happy to consider this further in due course.

Q10. Do respondents agree that the changes to AS TM1 should be effective for statutory illustrations issued on or after 6 April 2014?

We agree that since the Disclosure Regulations changes are permissive and effective from 6 April 2014 it makes sense for the new TM1 to tie in with the Regulations.

Other comments

1 In our view the Supplementary Information document issued with TM1 v2.0 is useful and should be maintained.

2 The cost assessment in the consultation is limited, given that the changes arise from the Disclosure Regulations rather than TM1. Having said this, providers of FCA illustrations and TM1 SMPIs would face additional costs from the decisions made by the FRC to maintain and introduce further differences (e.g. upon fixed annuity basis) between TM1 and FCA requirements.

3 We have not considered what the more in-depth review of TM1 might cover in 2014. We would be happy to assist the FRC with its considerations closer to the time.

4 Why has the FRC introduced further initials 'AS' to TM1? The name is usually quoted in SMPIs, and it seems unnecessary to change the name.

About the Association of Consulting Actuaries (ACA)

Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes. Members of the Association are all qualified actuaries and all actuarial advice given is subject to the Actuaries' Code. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the majority of members of private sector defined benefit pension schemes.

The ACA is the representative body for UK consulting actuaries, whilst the Institute and Faculty of Actuaries is the professional body.

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