Financial Reporting Council

October 2012

Exposure Draft
AS TM1: Statutory Money Purchase Illustrations

Version 3.0

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Contents

PAGE

Analysis of Responses and Invitation to Comment

1 Introduction

Introduction

1.1 On 31 May 2012, the Financial Services Authority (FSA) and the Financial Reporting Council (FRC) published a joint consultation paper which considered various aspects concerning assumptions which are used in projections of money purchase pensions.

Background

1.2 Since 6 April 2003, members of certain money purchase pension arrangements must be given annual Statutory Money Purchase Illustrations (SMPIs). The FRC sets the actuarial methods and assumptions to be used in SMPIs through its Actuarial Standard Technical Memorandum 1: Statutory Money Purchase Illustrations (AS TM1).

1.3 The FSA specifies assumptions for point of sale illustrations for personal pensions in its Conduct of Business Sourcebook (COBS). Historically, there has been some consistency between the assumptions in AS TM1 and COBS but differences have included the following:

- COBS requires three projections using an intermediate accumulation rate with a maximum of 7% pa and two flanking rates normally 2% above and below this rate (i.e. three maxima of 5%, 7% and 9% pa), whereas AS TM1 requires one projection using an assumption which reflects expected investment returns with a maximum of 7% pa;
- COBS does not require projections to be inflation-adjusted; this results in significantly higher projected pensions than SMPIs which are in current money terms; and
- COBS allows projections to be personalised by allowing flexibility in the assumed pension for dependents, the rate at which pensions increase in payment, and the amount of cash taken at retirement, whereas the SMPI legislation does not permit this flexibility.

Consultation and responses

FSA consultation

1.4 In chapters 2 to 4 of the consultation paper the FSA consulted on proposals to:

- reduce the intermediate accumulation rate for point of sale pension projections from 7% to 5% (4.5% real to 2.5% real);
- change the lower and higher flanking rates from 2% to 3% below and above the intermediate assumption; and
- emphasise that a lower rate than the intermediate rate should be used if the investments cannot be expected to achieve that return.

1.5 On 1 November the FSA published Policy Statement 12/17 which gave feedback on the responses it had received to its proposals and presented the final rules. The statement confirmed that the changes would be introduced with effect from April 2014 with a transitional rule allowing providers to comply with the amended rules from April 2013 so they can make changes to systems and documentation at the same time as other changes. At the same time the FSA published a consultation on changing projections under its rules to show inflation-adjusted pensions in line with AS TM1.

FRC consultation

1.6 In chapter 5 of the consultation paper the FRC consulted on changes to the assumptions used in SMPIs including whether the maximum accumulation rate used in projections should be changed or removed.

1.7 The consultation period for matters in chapter 5 ended on 31 August 2012. A total of 19 public responses[1] were received by the FRC (see Appendix). We received one confidential response. The consultation was also discussed at a meeting of the FRC's Actuarial User Group. We thank all those who have contributed a response to the consultation.

Summary of responses to the consultation paper

1.8 Almost all respondents wanted consistency between the assumptions in AS TM1 and those specified in section 13 of the COBS. However, there were mixed views on whether a maximum accumulation rate should be specified in AS TM1. There were also mixed views on whether, if a maximum accumulation rate was specified, it should be the same as the intermediate projection rate specified in COBS, particularly if the latter rate was changed to 5% as proposed by the FSA in its consultation.

FRC proposals and exposure draft of version 3.0 of AS TM1

1.9 Having considered the responses, we propose to remove the maximum accumulation rate. We expect providers to use an accumulation rate which can be justified in light of a particular member's investment strategy and market conditions.

1.10 AS TM1 states that the rationale for the accumulation rate used should be documented. We are proposing to amend AS TM1 to state that this rationale should be provided to members on request. This will create an incentive to providers to produce a robust rationale. When provided, the rationale should be clear and understandable to the recipient. Providers might wish to include a simple description of their general approach to selecting an appropriate accumulation rate in generic supporting material provided in hard copy with SMPIs or on the internet.

1.11 In order for us to understand how the removal of the maximum accumulation rate affects the accumulation rates used by providers and how these rates are determined, we intend to seek feedback from providers and other stakeholders. If we find that providers are using accumulation rates which are not justifiable we will consider further action. If necessary, this might include the reintroduction of a maximum rate – if necessary, following a short consultation.

1.12 We also propose to clarify:

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[1] The responses are available at http://www.frc.org.uk/bas/publications/pub2053.html.

- how male and female mortality tables are blended to form a unisex table; AS TM1 will be consistent with the text proposed by the FSA for COBS; and

- how the reference date for setting the interest rate used in the annuity calculation is determined.

1.13 Section 2 covers the feedback we received and our responses to that feedback. Section 3 sets out our proposals. Section 4 contains our invitation to comment on the exposure draft of AS TM1 v3.0. The second part of this document contains the proposed text of AS TM1 v3.0 including the changes set out in paragraphs 1.9 and 1.12.

Responses to this Consultation Paper

1.14 Details of how to respond to this paper are set out in Section 4. Comments should reach the FRC by **12 December 2012**.

2 Responses to consultation questions

Introduction

2.1 In this section we summarise the comments we received in answer to the specific questions posed in Chapter 5 of the consultation together with our reaction to them. We have included those questions in boxes with the same numbering as in the consultation paper.

Consistency between AS TM1 and FSA rules

2.2 We consider that there is merit in using consistent assumptions and methods for SMPIs and FSA regulated projections. Consistency helps consumers to compare different projections and also makes the provision of projections simpler for providers.

2.3 We therefore asked for views on the benefits of consistency between AS TM1 and the assumptions specified in section 13 of the FSA's Conduct of Business Sourcebook (COBS):

Q1	Do you agree that the assumptions in AS TM1 should be consistent as far as possible with those specified in COBS 13 Annex 2 of the FSA Handbook?

2.4 All respondents agreed that there should, as far as possible, be consistency between the assumptions set out in AS TM1 and the assumptions specified by the FSA. Many respondents considered that consistency benefited customers. However, some respondents commented that consistency should not be achieved at all costs.

2.5 We will continue to consider consistency between AS TM1 and COBS 13 when making future revisions to AS TM1 and intend to liaise regularly with the FSA with the aim of achieving consistency between the regimes wherever it is appropriate.

Maximum accumulation rate

2.6 Version 2.0 of AS TM1 states that the accumulation rate used for SMPIs must take account of the expected returns from the current and anticipated future investment strategy of the member's funds over the period to the retirement. It is important that providers, and the actuaries advising them, use an accumulation rate which is justifiable.

2.7 AS TM1 currently specifies that the maximum accumulation rate of funds before retirement which may be assumed is 7% pa. The FSA's current intermediate rate for pension scheme projections required by COBS 13 Annex 2 is also 7% pa.

2.8 In Chapter 2 of the consultation paper, the FSA asked whether the intermediate rate used for point of sale projections should be reduced from 7% pa to 5% pa. This followed a review of financial assumptions for projections undertaken by PwC for the FSA.

2.9 We asked for views on whether AS TM1 should continue to specify a maximum rate and if so whether the specified rate should be the same as the FSA's intermediate projection rate. We asked the following three questions:

Q2	a) Should AS TM1 continue to specify a maximum accumulation rate?

2.10 The majority of respondents considered that AS TM1 should continue to specify a maximum accumulation rate. The justification for this was consistency with the FSA's intermediate rate. However, one respondent noted that many recipients of SMPIs are members of trust-based schemes for whom consistency with the FSA's intermediate rate is not relevant as they do not receive FSA-regulated projections.

2.11 Five respondents suggested that the single maximum rate be removed. Some of these respondents suggested that a maximum was no longer necessary given the changes in version 2.0 of AS TM1 which requires providers to use a justifiable rate. One respondent suggested that the requirement in AS TM1 to use a justifiable accumulation rate and document the rationale should be extended to require the rationale to be made available to members on request.

2.12 One respondent said that a maximum rate may not be required in the long term but there was no immediate need to remove the maximum as currently the maximum of 7% is not unduly restrictive. It was suggested that any decision to remove the maximum be deferred until other significant changes are introduced.

2.13 Some respondents suggested that instead of setting a maximum accumulation rate at an aggregate level, AS TM1 should specify maximum accumulation rates for each major asset class. We had considered this approach but concluded that it would be unnecessarily complex to implement.

Q2	b) If AS TM1 continues to specify a maximum accumulation rate, should it be the same as the FSA's intermediate projection rate?

2.14 Fifteen respondents answered the question with a mixture of views. Seven respondents considered that the maximum specified in AS TM1 should be the same as the FSA's intermediate rate although one respondent considered that this should only occur if the FSA's intermediate rate is based on an appropriate asset mix.

2.15 Three of the eight respondents that did not agree considered that the maximum rate in AS TM1 should remain at 7% and two considered that the maximum rate in AS TM1 should be based on a 100% equity fund. The remaining respondents who did not agree noted that SMPIs and point of sale projections have different purposes.

2.16 It was suggested that a reduction in the maximum accumulation rate to 5% could lead to member disenchantment with pension products as a result of lower pension projections giving the perception of poor value.

Q2	c) If your answer to b) is "No", what rate do you consider should be specified in AS TM1?

2.17 There were only seven responses to this question. Suggestions included keeping the maximum rate at 7%, using a rate based on 100% equity investment or using the FSA's highest flanking rate.

2.18 Having considered various options we propose that AS TM1 should cease to specify a maximum accumulation rate for statutory illustrations. We therefore propose to delete paragraph C.2.7 which specifies the maximum rate.

2.19 Statutory illustrations are intended to give members an estimate of the pension which they would be likely to accrue from money purchase pension arrangements. The removal of the cap will mean that there will no longer be a maximum rate which can be used as a default rate by providers of SMPIs. This, with the requirement that the accumulation rate must be justifiable, will further reinforce our intention that providers must carefully consider the rates they use. A maximum accumulation rate could in some circumstances result in projections showing a projected pension which is lower than the pension likely to be accrued calculated using the provider's best estimate of the accumulation rate assumption. This could result in members receiving unreliable information.

2.20 In deciding to remove the maximum accumulation rate, we decided not to reduce the maximum accumulation rate to 5% pa simply to be consistent with the FSA. The purposes of SMPIs and point of sale illustrations, and therefore the justifications for imposing maximum rates, are different. In particular, a primary objective of the FSA is consumer protection, guarding against the significant risk that misleadingly high illustrations at the point of sale could lead to inappropriate sales. In contrast, the FRC's objectives are to foster investment through reliable actuarial information and to promote high quality corporate governance and reporting.

2.21 We would not expect the removal of the cap of 7% to result in providers using significantly higher rates than at present. However, to understand what effect, if any, the removal of the cap has in practice, we intend to obtain feedback regularly on the accumulation rate providers use in statutory illustrations and how these rates are derived. If our feedback indicates that providers are using accumulation rates which are not justifiable we will consider what action we might take including, if necessary, the reintroduction of a cap, if necessary following a short consultation.

2.22 Paragraph 2.6 of AS TM1 states that the rationale for the accumulation rate should be documented. One respondent suggested that this wording should be extended to providing the rationale to members on request. We agree, as we consider the transparent provision of this information to those interested would be good practice. This change, which will create an incentive to providers to produce a robust rationale, is included in the exposure draft. When provided, the rationale should be clear and understandable to recipients. Providers might wish to include a simple description of their general approach to selecting an appropriate accumulation rate in generic supporting material provided in hard copy with SMPIs, or on the internet.

Mortality assumptions

2.23 The mortality assumptions to be used in SMPIs were last changed in version 2.0 of AS TM1, which was published in December 2011. The current mortality assumptions are gender-neutral and are based on a blend of male and female mortality tables.

2.24 In May 2012, we published an answer to an FAQ on how the mortality assumptions should be blended for producing SMPIs under version 2.0 of AS TM1. In that answer, we noted that several approaches to blending the mortality assumptions were possible. We highlighted that the Continuous Mortality Investigation (CMI) had produced a table of factors using one of the possible approaches. The table is based on 50% of the rate derived from table PCFA00 including mortality improvements based on CMI_(20YY-1)_F[1.25%] added to 50% of the rate derived from tables PCMA00 including mortality improvements based on CMI_(20YY-1)_M[1.25%].

2.25 In Chapter 2 of the consultation paper, the FSA proposed to adopt the same approach to mortality assumptions as in version 2.0 of AS TM1 for their projections, but to be more specific about how the tables are blended. The approach they intended to specify was the one outlined in paragraph 2.24 above.

2.26 We asked whether AS TM1 should include similar wording on the approach to blending the mortality assumptions to that proposed by the FSA for their rules:

Q3	Should the wording for the mortality assumption in AS TM1 be changed along the lines of the wording proposed in chapter 2?

2.27 The majority of respondents who answered the question agreed that the wording should be aligned with the wording proposed by the FSA. However, some respondents considered that other approaches to determining gender-neutral mortality factors should be permitted as the impact on statutory illustrations of different approaches to blending is minimal.

2.28 We intend to amend AS TM1 to specify the approach to the blending of the mortality assumptions used for the production of SMPIs. The approach will be consistent with the FSA's approach and consistent with the factors produced to date by the CMI. However, we also propose to amend paragraph A.1.2 to permit the use of different approaches provided they do not materially affect the result of the calculations.

Consultation period

2.29 Given the specific and limited nature of the changes, we proposed a four-week consultation period for the exposure draft of the revised version of AS TM1. Having a short consultation period wouldhelp us to publish the final version of AS TM1 more quickly. We asked for views with the following question:

Q4:	Given the proposed nature of the changes to AS TM1, do you envisage any difficulties with a four-week consultation period for an exposure draft of a revised version of AS TM1?

2.30 No respondents envisaged any difficulties with a four-week consultation period. We are therefore consulting on the changes detailed in the exposure draft over a four week period ending on 12 December 2012.

Timing of the changes

2.31 We proposed that the changes would be effective for SMPIs with illustration dates on or after 6 April 2013 and asked the following question:

Q5: Do you agree with our proposals for the timing of any changes?

2.32 Most respondents who answered the question agreed with our proposals on implementing these changes for statements with illustration dates on or after 6 April 2013.

Impact assessment

2.33 In Chapter 5 of the consultation paper we included an assessment of the impact of the changes being considered in the consultation. We asked for views on our assessment:

Q6: Do you have any comments on the impact assessment for our proposals?

2.34 Several respondents to this question highlighted that there would be costs for providers arising from the proposals. It was suggested that the costs would not be insignificant for providers with legacy systems. Other respondents questioned whether the benefits of the changes would outweigh the costs of making the changes.

2.35 In order to reduce costs, many respondents urged us to align the timing of any changes to AS TM1 with the FSA's timetable for changes to the COBS assumptions.

2.36 We consider that the benefits of the changes we are proposing outweigh the relatively low costs which providers will incur if their systems have been written to permit assumptions to be changed easily. AS TM1 makes it clear that we review AS TM1 regularly and states that the methods and assumptions used may be amended as a result of our reviews. AS TM1 states that providers are strongly advised to take account of the possibility of such changes when devising systems to produce statutory illustrations.

Other comments

2.37 Paragraph C.3.2 of version 2.0 of AS TM1 makes provision for cases in which 15 February is not a working day. One respondent noted that there is ambiguity on how the yield date is determined when 15 February is not a working day. We propose to amend paragraph C.3.2 to remove the ambiguity.

2.38 Another respondent noted, with the advent of automatic enrolment, the increased importance of SMPIs to members' financial planning, urging us, in conjunction with the DWP and other regulators, to undertake a wider review of SMPIs. We are working with the DWP on a wider review of SMPIs as part of the DWP's review of disclosure regulations. We understand that DWP expect to consult on this in the new year.

3 Proposals

Introduction

3.1 The section summarises the action we propose to take having considered the feedback to Chapter 5 of the consultation paper set out in Section 2.

Proposals

3.2 In summary, we propose to:

- insert new text in paragraph C.2.6 stating that the rationale for the selection of the accumulation rate should be provided to members on request;
- delete paragraph C.2.7 which specifies a maximum accumulation rate;
- clarify in paragraph C.3.2 how the reference date for setting the interest rate used in the annuity calculation is determined; and
- clarify in paragraphs C.3.7 to C.3.9 how male and female mortality tables are blended to form a unisex table; the revised wording is consistent with the text proposed by the FSA for COBS but permits the use of other methods of blending provided they do not result in material differences in the pension figures produced.

3.3 The text effecting these changes is set out in the exposure draft.

3.4 We propose that these changes will be effective for statements with illustration dates on or after 6 April 2013.

3.5 We also intend to seek feedback regularly on what accumulation rates are used in statutory money purchase illustrations and how these rates are determined.

4 Invitation to comment

Questions

4.1 The FRC invites the views of those stakeholders and other parties interested in actuarial information who wish to comment on the content of this document. In particular, the FRC would welcome views on the following issues:

1 the text of the exposure draft of AS TM1 v3.0;

2 views on any other aspects of the proposed changes to AS TM1.

Responses

4.2 For ease of handling, we prefer comments to be sent electronically to **TM1@frc.org.uk**. Comments may also be sent in hard copy form to:

The Director of Actuarial Policy
Financial Reporting Council
5th Floor, Aldwych House
71-91 Aldwych
London
WC2B 4HN

4.3 Comments should reach the FRC by **12 December 2012**.

4.4 All responses will be regarded as being on the public record unless confidentiality is expressly requested by the respondent. A standard confidentiality statement in an e-mail message will not be regarded as a request for non-disclosure. We do not edit personal information (such as telephone numbers or email addresses) from submissions; therefore only information that you wish to publish should be submitted. If you are sending a confidential response by e-mail, please include the word “confidential” in the subject line of your e-mail.

4.5 We aim to publish non-confidential responses on our website within ten working days of receipt. We will publish a summary of the consultation responses, either as a separate document or as part of, or alongside, any decision.

EXPOSURE DRAFT OF

TECHNICAL MEMORANDUM TM1: STATUTORY MONEY PURCHASE ILLUSTRATIONS

VERSION ~~2.0~~3.0

~~**DECEMBER 2011**~~

TM1: STATUTORY ILLUSTRATIONS OF MONEY PURCHASE BENEFITS

Status

Legislation provides that **statutory illustrations** must be produced in accordance with relevant guidance prepared by a prescribed body. The ~~Board for Actuarial Standards~~Financial Reporting Council (FRC) has been appointed as the prescribed body for that purpose. Technical Memorandum *TM1: Statutory Money Purchase Illustrations* is that relevant guidance.

TM1 does not replace or amend the **legislation**. If it appears that any matter in TM1 conflicts with any provision of the **legislation** then the latter will prevail.

~~Neither the Board for Actuarial Standards nor the~~The FRC does not accept~~s~~ any liability to any party for any loss, damage or costs howsoever arising, whether directly or indirectly, whether in contract, tort or otherwise from any action or decision taken (or not taken) as a result of any person relying on or otherwise using this document or arising from any omission from it.

Purpose

The purpose of TM1 is to specify the assumptions and methods to be used in the calculation of **statutory illustrations** of money purchase pensions.

Application

TM1 applies to the production of any **statutory illustration**.

Effective date

TM1 version ~~2~~3.0~~.0~~ is effective for **statutory illustrations** with an **illustration date** on or after 6 April 201~~2~~3. ~~However, providers may comply instead with TM1 version 1.4 for **statutory illustrations** issued before 21 December 2012.~~

Future changes to TM1

The ~~Board for Actuarial Standards~~FRC reviews TM1 regularly. It is possible that the methods and assumptions used will be amended as a result. It is likely that some of the assumptions in Part C will be changed from time to time, and **providers** are strongly advised to take account of the possibility of such changes when devising systems to produce **statutory illustrations**.

CONTENTS

A INTERPRETATION

A.1 INTERPRETATION OF THE TEXT

A.1.1 This technical memorandum (TM1) should be interpreted in the light of the purpose set out in the rubric on page 1.

A.1.2 **Providers** may adopt a different approach from that specified in TM1 if it does not affect the result of the calculation of the **statutory illustration**. For example, this may apply to the order in which the calculations are carried out.

A.1.3 Any assumptions that are used which are not specified in TM1 should be appropriate to the purpose of TM1 set out in the rubric on page 1. Such assumptions might include the valuation of property assets or the treatment of contributions if payment records are incomplete.

A.1.4 If a **member**'s **current fund** is invested in a with-profits fund (including with-profits deferred annuity contracts) the **statutory illustration** should be provided in a manner consistent with TM1 and with the insurer's bonus policy.

A.2 GLOSSARY

A.2.1 Terms appearing in **bold** in the text are used with these meanings:

accumulation rate The annual rate of return assumed to be earned up to **retirement date** from the **current fund** and **future contributions**.

annuity rate The value of an annual pension of £1 at **retirement date** calculated using the assumptions specified in TM1.

current fund The relevant assets of the **scheme** in relation to the **member**'s money purchase benefits at the **illustration date.**

future contributions All money purchase contributions due after the **illustration date** which the **provider** determines to be part of a regular pre-determined series of contributions expected to continue until the **member**'s **retirement date**.

illustration date The date specified by the **provider** as the date by reference to which amounts are calculated for the purpose of the **statutory illustration**.

The **illustration date** will normally be the **specified date.**

inflation factor The accumulated assumed inflation from the **illustration date** to the **retirement date**.

inflation rate The assumed annual rate of inflation.

legislation	Legislation governing the provision of **statutory illustrations** including but not limited to: a) *the Pension Schemes Act 1993 (c.48) Section 113*; b) *the Personal Pension Schemes (Disclosure of Information) Regulations 1987 (SI 1987/1110)*; c) *the Occupational Pension Schemes (Disclosure of Information) Regulations 1996 (SI 1996/1655)*; d) *the Stakeholder Pension Schemes Regulations 2000 (SI 2000/1403)*; e) *the Occupational and Personal Pension Schemes (Disclosure of Information) Amendment Regulations 2002 (SI 2002/1383)*; and f) *the Occupational, Personal and Stakeholder Pension Schemes (Disclosure of Information) Amendment Regulations 2010 (SI 2010/2659*). Northern Ireland has its own body of law relating to pensions with corresponding legislation.
member	Any person eligible to receive a **statutory illustration** from a **scheme**.
nominal accumulated fund	The **current fund** and **future contributions** accumulated to the **retirement date** adjusted where relevant for tax relief, charges and expenses.
provider	The trustees or managers of a **scheme**, or any other party preparing a **statutory illustration** on their behalf. Other parties might include advisers, insurance companies or software houses.
real accumulated fund	The **nominal accumulated fund** expressed in today's (inflation adjusted) terms.
retirement date	A date which the **member** has specified to the **provider** and which is acceptable to the **provider**; or where no acceptable date has been specified by the **member**, a date specified by the **provider**. A **member** may have more than one **retirement date** for different funds or contracts within a **scheme**.
risk benefits	Benefits payable on death, sickness or critical illness.
scheme	A pension arrangement that is required to provide a **statutory illustration** under the **legislation**.
scheme year	The period specified for the provision of a **statutory illustration**.

specified date	The date the fund is valued for the purpose of the **legislation**. For an occupational pension **scheme**, this is normally the last day of the **scheme**'s administrative year.
statutory illustration	The amount of pension calculated in accordance with TM1.
statutory illustration statement	The **statutory illustration** and accompanying information.

B DETERMINING THE AMOUNT OF PENSION TO BE ILLUSTRATED

B.1 INTRODUCTION

B.1.1 This Part sets out the method which must be followed for calculating **statutory illustration**s.

B.2 THE AMOUNT OF PENSION TO BE ILLUSTRATED

B.2.1 The **statutory illustration** is the annual amount of pension calculated by dividing the **real accumulated fund** (see section B.3) by the **annuity rate** (see section B.7).

B.2.2 The **statutory illustration** must be shown in whole pounds, rounded down to 3 significant figures. If the result is under £1,000 and is not an exact multiple of £10, it may be rounded down to the next lower multiple of £10.

B.2.3 Any resulting monthly pension of less than £10 may be shown as “less than £10 each month” or “less than £120 each year”.

B.3 ACCUMULATED FUND

B.3.1 The **real accumulated fund** must be calculated by dividing the **nominal accumulated fund** by the **inflation factor** (see paragraph B.3.5).

B.3.2 The **nominal accumulated fund** must be calculated as the sum of:

- the accumulated **current fund**, if any;
- the accumulated **future contributions**, if any; and
- the accumulated amount of any tax relief expected to be reclaimed and credited to the **scheme** for the benefit of the **member** in respect of **future contributions**;

reduced by:

- the accumulated amount of the costs of any **risk benefits**; and
- the accumulated amount of charges or expenses, if the terms of the **scheme** require such charges or expenses to be deducted from **future contributions** or the **current fund**.

B.3.3 Each element of the **nominal accumulated fund** must be accumulated from the relevant date to the **retirement date** at the rate of accumulation determined in accordance with paragraphs C.2.3 to C.2.7. The relevant date is:

- for the **current fund**, the **illustration date**;
- for each individual payment of **future contributions** or tax relief, the date on which the payment is due to be received by the **scheme**; and
- for each individual payment of charges or expenses or cost of **risk benefits**, the date on which the payment is due to be paid.

B.3.4 If the **nominal accumulated fund** is less than zero, zero must be used instead.

Inflation factor

B.3.5 The **inflation factor** must be calculated by compounding the **inflation rate** specified in paragraph C.2.8 from the **illustration date** to the **retirement date**.

B.4 CURRENT FUND

B.4.1 The **current fund** is the value of the relevant assets of the **scheme** in relation to the **member**'s money purchase benefits at the **illustration date**. The **current fund** must be based on a realistic asset value such as:

a) the market value of the assets;

b) the bid value of relevant units;

c) for an insured **scheme**, the policy value on an ongoing basis;

d) for a **scheme** where a **member**'s rights are determined as a share of the **scheme**'s assets, the value of the **member**'s share; or

e) for a with-profits fund or if assets are not readily marketable, a value consistent with the principles of TM1 **.**

B.4.2 The **current fund** includes allowances for any contributions due at the **illustration date** and for the recovery of any tax due to the **illustration date**. It is not necessary to discount these allowances from their expected payment dates. Allowances which are unlikely to change the **statutory illustration** may be omitted.

B.4.3 A **provider** may omit the allowances referred to in paragraph B.4.2 from the **current fund**, provided that if there are **future contributions**, any items due but unpaid which have been omitted from the **current fund** are treated as **future contributions**.

B.4.4 If the **member** is in receipt of income drawdown in respect of part of the assets of the **scheme**, those assets must be omitted from the **current fund**.

B.4.5 Outgoing transfer values which have been agreed but not paid on or before the **illustration date** must not be deducted from the **current fund**.

B.5 FUTURE CONTRIBUTIONS

B.5.1 **Future contributions** are all money purchase contributions due after the **illustration date** which the **provider** determines to be part of a regular pre-determined series of contributions, irrespective of the formal basis on which contributions are determined. They do not include contributions made after the **illustration date** which are not part of a series of pre-determined payments which are expected to continue.

B.5.2 When determining whether a **member** should be treated as paying **future contributions**, **providers** should take into account factors including the **member**'s expectations and the certainty of payment. In the following examples the **member** should normally be treated as paying **future contributions**:

- a **member** of an occupational **scheme** paying a percentage of earnings from time to time (irrespective of whether or not the **member** has an option to change the percentage rate); an exception might be if the **member** is employed on a short-term contract and there is no continuity of employment or of contributions;
- a **member** paying regular contributions into a personal pension or stakeholder pension **scheme** under a direct debit or standing order;
- it is clear from the **provider**'s records that regular payments (such as a particular cash amount or a percentage of earnings) are intended; and
- a **scheme**'s terms describe future money purchase contributions as being single payments, and they form a series of pre-determined payments which are expected to continue until the **member** reaches **retirement date** or State Pension Age.

Initial level of future contributions

B.5.3 The initial level of **future contributions** must be the actual amount of **future contributions** payable for the **scheme year** following the **illustration date** if it is known.

B.5.4 If paragraph B.5.3 does not apply and if the amount of **future contributions** is determined as an amount which increases in line with inflation or as a proportion of the **member**'s earnings, the initial level of **future contributions** must be the latest known amount of contributions increased for the appropriate period at the rate specified in paragraph C.2.8 or C.2.9 respectively.

B.5.5 If neither paragraph B.5.3 nor paragraph B.5.4 applies the initial level of **future contributions** must be the last known annual amount.

B.5.6 If the amount of **future contributions** is related to the **member**'s earnings and if the **provider** does not have detailed information about the **member's** earnings or if earnings are expected to fluctuate significantly from year to year, the initial level of **future contributions** must be estimated.

B.5.7 For many occupational **schemes** the definition of earnings for pension contributions is updated annually, on the first day of the **scheme year**. In such cases the initial level of **future contributions** may be based on the **member**'s earnings on the day after the **illustration date**. **Providers** may ignore any information they have about changes in the **member**'s earnings which occur after the day after the **illustration date.**

Subsequent levels of future contributions

B.5.8 **Future contributions** must be assumed to increase in accordance with **scheme** provisions or with recognised practice. If there are no **scheme** provisions regarding the increase of contributions, or if there is no recognised practice of increasing contributions, **future contributions** must be assumed to remain unchanged until **retirement date**.

B.5.9 **Future contributions** which are determined as a proportion of the **member**'s earnings must be assumed to increase at the rate specified in paragraph C.2.9.

B.5.10 **Future contributions** which increase in line with inflation must be assumed to increase at the rate specified in paragraph C.2.8.

B.5.11 It may be assumed that **future contributions** which relate to the payment of the maximum non-earnings-related amount into a personal or stakeholder pension **scheme** remain fixed or increase at the rate specified in paragraph C.2.8.

B.5.12 If the amounts of contributions payable are subject to a maximum of a fixed monetary amount or a deduction of a fixed monetary amount the **provider** must deal with the situation in an appropriate manner.

B.5.13 A deduction which is specified in such a way that it will, or is expected to, increase broadly in line with State benefits or contribution limits or with earnings must be assumed to increase at the rate specified in paragraph C.2.8 or C.2.9 as appropriate.

B.5.14 Contributions which are age-related or term-related must be dealt with in an appropriate manner.

B.5.15 If the last known amount of contributions does not relate to a period of 12 months the **provider** must deal with the situation in an appropriate manner.

Transferred benefits

B.5.16 Incoming transfer values which have been agreed but are outstanding at the **illustration date** must not be included in **future contributions**.

B.6 RISK BENEFITS

Initial level of the cost of risk benefits

B.6.1 If the cost of **risk benefits** payable for the **scheme year** following the **illustration date** is known, it should normally be used for the initial level of the cost of **risk benefits**.

B.6.2 If paragraph B.6.1 does not apply and if the cost of **risk benefits** is determined as an amount which increases in line with inflation or as a proportion of the **member**'s earnings, the initial cost of **risk benefits** should be the latest known cost increased for the appropriate period at the rate specified in C.2.8 or C.2.9 respectively.

B.6.3 If neither paragraph B.6.1 nor paragraph B.6.2 applies, the initial cost of **risk benefits** should be the last known annual amount.

B.6.4 If the last known cost of **risk benefits** does not relate to a period of 12 months the **provider** must deal with the situation in an appropriate manner.

Subsequent levels of the cost of risk benefits

B.6.5 If **risk benefits** are determined as a proportion of the **member**'s earnings their cost must be assumed to increase at the rate specified in paragraph C.2.9.

B.6.6 If the cost of **risk benefits** increases in line with inflation it must be assumed to increase at the rate specified in paragraph C.2.8.

B.6.7 If the cost of **risk benefits** increases as the **member** ages then **providers** must deal with the situation in an appropriate manner.

B.6.8 If none of paragraphs B.6.5 to B.6.7 applies, the cost of **risk benefits** must be assumed to increase at the rate specified in paragraph C.2.8.

B.7 ANNUITY RATE

B.7.1 The **annuity rate** is the value of an annual pension of £1 at **retirement date** calculated using the assumptions in Part C.

B.8 GENERAL CONSIDERATIONS

B.8.1 Appropriate adjustments to the calculations must be made if a **scheme year** is not a period of 12 months. Where annual rates are specified in Part C, the equivalent rates for part of a year should be calculated as the appropriate root of the annual rate, not as an arithmetic proportion. For example, the monthly rate equivalent to 2.5% per annum is approximately 0.00206 (1.025^(1/12)-1) and not 0.00208 (0.025/12).

B.8.2 If it is necessary to calculate the period between two dates, the period must be calculated to an exact number of months or more accurately (for example, to the exact number of days). Similarly, if contributions will continue for part of a year, **statutory illustrations** must include an allowance for such contributions for an exact number of months or more accurately.

B.8.3 The **pension** illustrated may be shown as a weekly, monthly or annual amount.

C ASSUMPTIONS

C.1 INTRODUCTION

C.1.1 This Part sets out the actuarial assumptions which must be used in providing **statutory illustrations**.

C.2 ACCUMULATION

C.2.1 This section specifies the assumptions to be used in determining the **real accumulated fund.**

Mortality

C.2.2 No allowance is to be made for mortality before retirement (other than in the calculation of the cost of any **risk benefits**).

Accumulation rate

C.2.3 In determining the **accumulation rate** the **provider** must take account of the expected returns from the current and anticipated future investment strategy of the **member**'s funds over the period to the **retirement date**.

C.2.4 The **accumulation rate** must be based on expected returns before the deduction of expenses or charges.

C.2.5 The **accumulation rate** must be justifiable and consistent with the **inflation rate** assumption specified in paragraph C.2.7~~C.2.8~~.

C.2.6 The method used to determine the **accumulation rate** in accordance with paragraphs C.2.3 to C.2.5 should be consistent from year to year, and the rationale used should be documented~~.~~ and made available to members on request.

~~C.2.7 The maximum annual **accumulation rate** is 7.0% per annum compound.~~

Rates of increase in inflation and earnings

~~C.2.8~~C.2.7 The **inflation rate** must be 2.5% per annum compound.

~~C.2.9~~C.2.8 Earnings and any earnings-related indices must be assumed to increase at 2.5% per annum compound.

Expenses

~~C.2.10~~C.2.9 If the terms of a **scheme** require future charges or expenses to be deducted from **future contributions** or the **current fund**, then:

- for **schemes** subject to the FSA Rules on projections, charges or expenses must be assumed to be an amount not less than those required by the FSA Rules;
- for other **schemes**, amounts no less than the actual charges or expenses of the **member**'s arrangement must be assumed. The assumed charges or expenses should include the costs of investment management, but exclude any dealing costs for the underlying portfolio and any routine management and servicing costs of existing property investments.

~~C.2.11~~C.2.10 Future charges or expenses which are related to **future contributions** (such as those which are calculated as a percentage of contributions) must be calculated by reference to the **future contributions**.

~~C.2.12~~C.2.11 Future charges or expenses up to **retirement date** which are related to the **scheme**'s assets must be calculated using a projected fund as at each annual anniversary of the **illustration date** or, more frequently, from the **illustration date** to the **retirement date**. The projected funds must be based on the **current fund** and allow for any **future contributions**, tax relief, the cost of **risk benefits** and relevant charges or expenses.

~~C.2.13~~C.2.12 If future charges or expenses are not known and cannot reasonably be obtained or estimated, the approach set out in paragraph C.2.12 must be used with charges or expenses of 1% per annum of the projected fund at the start of each year.

~~C.2.14~~C.2.13 Future charges or expenses which relate to the **member**'s arrangement and which are not deducted from **future contributions** or from the underlying assets must be ignored for the production of the **statutory illustration**.

Tax relief on contributions

~~C.2.15~~C.2.14 Tax relief must be assumed to be at the rate at which it is expected to be reclaimed. The expected rate should allow for any known future changes.

C.3 ANNUITY

Lump sum at retirement

C.3.1 No allowance may be made for the payment of a lump sum at retirement.

Interest rates to be used in calculating annuity rates

C.3.2 The rate of interest must be determined as at each 15 February. This rate must be used for all **statutory illustrations** with **illustration dates** occurring in the following financial year (6 April to 5 April). If the information on which the rate of interest is to be based is not published for~~on~~ 15 February, **providers** must use the relevant information for the previous ~~working~~ business day for~~on~~ which such information is published.

C.3.3 The **annuity rate** must be calculated using annual interest equal to 50% of the sum of the FTSE Actuaries Government Securities Index-Linked Real Yields over 5 years assuming:

- 5% inflation; and
- 0% inflation

minus 0.5%.

C.3.4 The interest rate must be rounded to the nearest multiple of 0.2%. Intermediate exact multiples of 0.1% should be rounded down.

C.3.5 Published interest rates must be used without any adjustments (such as to convert the published rate from a convertible half-yearly rate to an annual rate).

Expenses

C.3.6 An allowance of 4% of the value of the annuity at retirement must be made for expenses.

Mortality

C.3.7 The mortality of the **member** and the **member**'s spouse or civil partner must be based on the year of birth rate derived from ~~50% of each of~~ the Institute and Faculty of Actuaries' Continuous Mortality Investigation tables PCFA00 and PCMA00 and including mortality improvements derived from ~~-~~each of the male and female annual mortality projection models, in equal parts.~~(as published by the Actuarial Profession)~~.

C.3.8 For **statutory illustrations** produced with **illustration dates** in the range
6 April 20YY to 5 April (20YY+1), mortality improvements must be derived from the ~~a blend of 50% of each of the~~ CMI mortality projection models[1] CMI_(20YY-1)_F[1.25%] and ~~-~~CMI_(20YY-1)_M[1.25%].

C.3.9 For example, **statutory illustrations** produced with an **illustration date** of
6 April 2014 the mortality assumptions must be based on~~must be derived from 50% of each of CMI_2013_F [1.25%] and CMI_2013_M [1.25%].~~

50% of PCMA00 including improvements based on CMI_(2013)_M[1.25%] +

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[1] The model can be found at: http://www.actuaries.org.uk/knowledge/cmi

CMI_20NN_x [a%] refers to the model published by the CMI where:

- 20NN is the version number of the model reflecting the year of its publication;
- x is the gender and is either M (male) or F (female); and
- a% is the long-term rate of mortality improvement.

50% of PCFA00 including improvements based on CMI_(2013)_F[1.25%].

~~C.3.9~~

C.3.10 These rates of mortality improvement apply to both the **member** and the **member**'s spouse or civil partner.

~~C.3.11 For each person, the set of mortality rates used must be those applicable to that person's year of birth.~~

Spouse's or civil partner's pension

~~C.3.12~~C.3.11 **Legislation** specifies the assumption to be used for the amount of pension to be provided to the spouse or civil partner on the death of the **member**.

Age difference between member and spouse or civil partner

~~C.3.13~~C.3.12 It must be assumed that a husband is three years older than his wife and that those in a civil partnership are the same age as each other, except that:

- at the **provider**'s discretion the **member** may specify the spouse's or civil partner's age to be used;
- the spouse's or civil partner's age shown in the **provider**'s records may be used.

Guaranteed annuity terms

~~C.3.14~~C.3.13 No account should be taken of a guarantee of annuity terms which produces a higher amount of initial pension as at the **retirement date**, or a higher amount of pension in a subsequent year, than would be produced using the assumptions in TM1.

Payment frequency and format

~~C.3.15~~C.3.14 When calculating the **annuity rate, providers** may allow for benefits, other than a spouse's or civil partner's pension, payable on the death of the **member** after the pension commences (such as the payment of the balance of five years' payments on death within five years after retirement).

~~C.3.16~~C.3.15 The pension illustrated must be assumed to be payable monthly in advance and increase annually in payment in line with inflation. Pension increases in payment in line with inflation are implicitly allowed for in the rate of interest specified in paragraph C.3.3.

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1.3	06.04.09
1.4	08.02.11
2.0	06.04.12
3.0	06.04.13

Appendix: Respondents to the consultation paper

Professional and trade bodies

Association of British Insurers
Institute and Faculty of Actuaries
Society of Pension Consultants

Insurers, consultants and actuaries

Aegon
Actuarial Solutions
Aon Hewitt
Aviva
Bridges UK Actuarial Services
Capita Hartshead
Deloitte LLP
Ernst & Young LLP
Friends Life
HBOS Scottish Widows
Hymans Robertson LLP
Hargreaves Lansdown
KPMG LLP
Mercer
PricewaterhouseCoopers LLP
Standard Life
Towers Watson
Zurich

Others

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