FRC Consultation - Exposure Draft of AS TM1: Statutory Money Purchase Illustrations v4.0

Aviva's response to FRC consultation
6 December 2013

Introduction
Aviva provides 34 million customers with insurance, savings and investment products. We are one of the UK's largest insurers and one of Europe's leading providers of life and general insurance. In the UK we manage pensions for over 2 million people as well as over 5,000 company pension schemes and send over 1.3 million SMPI projections to customers every year.

We welcome the opportunity to respond to this consultation paper.

Summary

- The increased flexibility given to providers through The Occupational and Personal Pension Schemes (Disclosure of information) Regulations 2013 and AS TM1 is welcomed allowing us to illustrate on a basis we feel to be most appropriate for our members.

- The assumptions relating to the provision of a lump sum require further clarification to ensure consistency across providers.

- 6 April 2014 is an appropriate date for this guidance to come into effect. The permissive nature of the changes means we can adopt a measured approach to any changes we make from 6 April 2014 or later.

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

We agree that allowing SMPI projections to include provision of a lump sum is a sensible move. The majority of members opt for a lump sum payment at retirement and having the flexibility to be able to include this in line with The Occupational and Personal Pension Schemes (Disclosure of information) Regulations 2013 (the 'disclosure regulations') is welcome.

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

There are some inconsistencies and points in need of clarification regarding the approach to lump sums which we feel need to be addressed in the published version of AS TM1.

Firstly, the definition of a 'statutory illustration' in A.2.1 is, "*the amount of pension (after allowance for any lump sum) calculated in accordance with AS TM1*." Even though the disclosure regulations state that we must disclose, "*An illustration of the amount of pension*," and that, "*the calculation of the amount of pension may take account of a lump sum*" (Schedule 6, Part 2 paragraphs 6-7), we feel that the intention must be to disclose the amount of that lump sum too. Otherwise it gives an unbalanced view of the member's total benefits from the pension scheme and causes confusion.

With this in mind, the Exposure Draft describes how the lump sum is to be deducted from the 'nominal accumulated fund' (B.3.2) however it does not go on to clearly explain how the lump sum is to be presented to the member within the illustration. Presumably the intention is to present the lump sum in inflation-adjusted "real" terms to be consistent with the rest of the illustration and this should be reflected in the guidance. If it is not clearly described there is a risk that providers will adopt an inconsistent approach which might include showing the lump sum in nominal terms, real terms or not showing the lump sum amount at all.

A better description for 'statutory illustration' in A.2.1 would be, "*the amount of pension and any lump sum calculated in accordance with AS TM1*".

There is also inconsistency in the terminology used. B.3.2 defines the 'nominal accumulated fund' as being after the deduction of any lump sum. However, C.3.1 states "where the lump sum assumed is greater than 25% of the nominal accumulated fund". If the lump sum has already been deducted in accordance with B.3.2 then it is incorrect to assume a percentage of 25% in C.3.1. This would more appropriately be 33.33% of the nominal accumulated fund.

We also note that the draft describes the method for calculating the lump sum based on a "fund" based approach. FRC may consider it appropriate to provide guidance on how to present illustrations for schemes that calculate their lump sum benefits on a different basis (e.g. salary/service based formula).

There may be instances where a member has exceeded their lifetime allowance by taking benefits from other pension schemes and therefore has no entitlement to any further lump sum. As providers will potentially be unaware of the members wider pension provision it is possible that we inadvertently illustrate a lump sum to which they are not allowed by legislation. Could C.3.1 include a statement that providers are to assume the member has sufficient lifetime allowance to illustrate the lump sum?

Finally, whilst we understand the point being made in paragraph 3.7 of the consultation (about lump sums in excess of 25%), the flexible drawdown example used is not particularly helpful. If the entire value is deducted from the nominal accumulated value as a lump sum this would leave no fund available on which to illustrate a pension. In this case, would there be a requirement to still produce an SMPI illustrating only the lump sum?

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

We agree with the approach to give providers the flexibility to provide either a 'single life' illustration or one which includes a spouse's or civil partner's pension. It will allow us to provide projections on a basis which more accurately reflects our experience of our members' preferred annuity options at retirement. The flexibility could be more clearly stated in C.3.13 if the paragraph commenced, "*Where illustrated, the amount of any spouse's or civil partner's pension…*"

Q4. 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 3.19 to 3.23)?

We do not agree with the proposed approach for the interest rate used when calculating an annuity which does not increase. Whilst it is true that an interest rate based on fixed interest gilts might be more accurate than index-linked gilts, we don't feel the difference between the two methods is great. The use of either method would not be inappropriate. For this reason our preference would be to use the interest rate based on index-linked gilts plus 3.5% which is consistent with the FCA COBS approach.

If fixed interest gilts are indeed the better measure in this respect it would be interesting to understand the FCA rationale for using index-linked gilts. We would like to see the FRC work with the FCA to ensure the most appropriate rate is used consistently throughout all illustrations and is reflected in AS TM1 and COBS.

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)?

We believe the guidance in the draft is sufficient for this point. We already have an existing model which we can apply should we decide to illustrate on an escalating basis other than in line with inflation.

However, C.3.7 requires the method used in this instance to, "*be determined using an approach consistent with C.3.3 and C.3.4.*" We feel that it will not be possible to always be consistent with both methods and the guidance should allow the use of, "*an approach consistent with C.3.3 or C.3.4.*"

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

Although we have a desire for consistency across all illustrations, and in particular with FCA COBS rules, we feel that showing the accumulation rate net of inflation is not the best option for members.

It would become difficult for providers/financial advisers to explain the reduced rate to members and, to an untrained eye, a reduced accumulation rate might be considered to be the effect of charges or some other means of reducing what they might get back. When purchasing any other financial product (for example, an ISA) the advertised interest rate would be shown gross and not adjusted to allow for inflation.

We suggest a compromise, whereby providers illustrate the gross accumulation rate and the nominal accumulated fund, followed by a statement of the assumed rate of inflation and the real accumulated fund. Would you consider it appropriate for providers to illustrate on this basis?

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

Yes, we agree with the proposal to leave the rate of price inflation at 2.5%.

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

Yes, we agree with the proposal to leave the rate of earnings inflation at 2.5%.

The text of the consultation paper acknowledges that earnings inflation is generally higher than price inflation but states a number of reasons for keeping the rate at 2.5% including to reduce the risk of overstating the amount of pension. We agree with the rationale for this in the current climate and perhaps this can be fully explored as part of the wider review of AS TM1 next year.

In particular we are concerned that the FCA COBS rules assume earnings inflation at 4%. Again there is an opportunity for FRC and FCA to work together to provide a consistent and realistic approach.

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

There are no specific elements of AS TM1 which we feel need special attention as part of a fuller review next year.

We would encourage the FRC to work very closely with FCA to provide a consistent view where appropriate. As mentioned in the responses above, we would like greater consistency but we do not consider this to be for FRC to always conform to FCA rules. For example, both questions 4 and 8 suggest approaches which may actually be more appropriate than the current COBS rules.

We would also suggest that a fuller review of AS TM1 should involve a degree of member testing to gauge what members really want to see in their annual SMPI projection. They may have a different view to us as providers which would make these illustrations even more relevant in their retirement planning.

It appears that AS TM1 is reviewed to some extent every year. We feel that the needs of the members do not fundamentally change year on year and so the assumptions we make when illustrating for them are also fairly static. Of course rates will change from time to time but the underlying assumptions should not need regular amendments. These amendments come at a cost to providers who have to make system changes, but also to members through lack of understanding and consistency in the information provided to them.

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

Yes, the timescale proposed is appropriate as it falls in line with the changes to the disclosure regulations. Also, as the vast majority of the changes are permissive, we will be able to deliver the non-mandatory changes at a time later than 6 April 2014 if needs be.

The impact of making changes to systems should not be underestimated for future consultations. If any changes from AS TM1 v4.0, likely to be published in January 2014, were to require mandatory change by 6 April 2014 this would be impossible to achieve. This is particularly important if a fuller review of AS TM1 next year requires a significant amount of change.

Other observations
Payment frequency and format

Paragraph C.3.17 states the assumptions specifically for pension increases in line with inflation but does not mention pensions which are assumed to increase at a rate other than inflation (C.3.7). Presumably the format and frequency would be consistent, though the interest rate assumed will be different.

We suggest C.3.17 is amended to read as follows: *"The pension illustrated must be assumed to be payable monthly in advance. When it is assumed the statutory illustration increases in payment in line with inflation or at a fixed rate those increases are assumed to apply annually and are implicitly allowed for in the rate of interest specified in paragraph C.3.3 or C.3.7."*

Supplementary information

We understand the intention is to not update the supplementary information regularly. However these latest proposed changes make that document considerably out of date. For example, it refers to:

- SMPIs providing an annuity which increases in line with inflation (1.1.3)
- Incorrect outdated legislation (A.1)
- FCA illustrations in nominal terms (2.4.2)

This document will become increasingly outdated unless it is maintained and we would propose that it is either updated or removed completely to prevent it becoming misleading.

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