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13 December 2013

Subject: Consultation on Assumptions for Statutory Money Purchase Illustrations

Dear Sir / Madam

We welcome the opportunity to respond to the consultation on assumptions for statutory money purchase illustrations (SMPIs) TM1 version 4.0 as published in November 2013.

Mercer is a global consulting leader in talent, health, retirement and investments.

In the UK, our client base includes employers and trustees providing occupational and work-based pension schemes to employees in all sectors of industry. We provide pensions advice and services to companies in the FTSE100, but we also have a large proportion of clients that are employers classed as “Small to Medium sized Enterprises”, or trustees of pension schemes with sponsoring employers in this class. We also provide outsourcing pensions administration services to clients. In our response we will comment from both of these perspectives.

In principle, we support the increased flexibility to allow schemes to provide members with more meaningful illustrations. In particular, where pension schemes utilise online tools, this flexibility will appeal to many members as it will enable them to obtain SMPIs that more accurately reflect their own circumstances and allow schemes to better reflect their own benefit provisions.

However, for schemes that prepare annual statements, if a scheme changes the approach in setting the assumptions from one year to another, this does make the year on year comparison of a member’s projection harder. Schemes and providers should therefore be encouraged, if not required, to ensure adequate explanation is provided, with the rationale for making the changes being stated in the statement or clearly signposted.

Alternatively, schemes can be encouraged to continue to adopt the existing common set of assumptions for providing the base illustration, and use the flexibilities to provide alternative illustrations (this approach is already voluntarily adopted by some schemes, but principally for the purpose of illustrating investment return volatility).

We also suggest that theTM1 should make it clear that the changes introduced are optional rather than compulsory.

Our response to the detailed questions are set out in the appendix.

Yours faithfully

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The Financial Reporting Council

Appendix

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

Yes, we agree with the approach. Our understanding is that making allowance for the cash lump sum is an option that providers could choose to take. Illustrations can be provided assuming no lump sum is taken. Section B.3.2 of the exposure draft needs to clarify this. This can be achieved by adding the words “if any” after “the lump sum”.

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

We agree with the approach. It gives pension schemes flexibility over the approach they take, which would be useful where members have access to online tools. However, we would suggest where the lump sum shown is greater than allowed by the scheme rules, or 25% of the fund at retirement, rationale should be provided with the SMPI, or via appropriate signposting to the information, to aid member understanding.

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

Yes, we agree with the approach. Where pension schemes utilise online tools this will appeal to many members as it will enable them to obtain SMPIs that more accurately reflect their own circumstances, as well as allow schemes to better reflect their own provisions.

4. 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)?

Yes.

5. 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)?

Yes.

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

Yes.

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

Yes.

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

Yes.

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

We have no further suggestions. Although we agree that there are areas of AS TM1 that need to be kept under review and updated from time to time, we believe that it is in the best interests of members from a consistency point of view and providers/schemes from a cost point of view to keep the changes minimal and only make them if there is a very strong argument for doing so. We would propose that unless there is an immediate or urgent need for change e.g. to meet legislative requirements, the FRC considers making future changes on a three year cycle.

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

The proposed effective date seems reasonable given the changes proposed are optional. However, it needs to be recognised that providers may need to make significant changes to their systems to offer these flexibilities. Therefore, it would be unrealistic to expect schemes /providers to be able to consider and implement the changes from 6 April 2014, or prioritise the work required, particularly in the light of the numerous other initiatives impacting defined contribution schemes over the next 12-18 months.