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The Director of Actuarial Policy
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Dear Sir/Madam

Consultation on v4.0 of TM1

Thank you for the opportunity to respond to this consultation. This response has been prepared on behalf of Towers Watson, a global firm with a substantial presence in the UK pensions consultancy market; the firm provides advice to around one-half of the top 100 pension funds in the UK.

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.

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

Our main points about the new TM1 are as follows:

- TM1 should make it clear that, where providers allow for a cash lump sum, the cash lump sum should be included with the pension in the SMPI. The draft v4.0 of 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 about this and how providers should deal with the limitations in the legislation.
- Can it also be made clear that if providers wish to provide more than one projection, for example showing level and increasing annuities or ‘with cash’ and ‘without cash’, then this is permissible?

Our responses to the consultation questions are set out in the Appendix to this letter.

As ever, we would be very happy to discuss any of the points raised in greater detail if you wish.

Yours faithfully

Graham Everness and Spencer Bowman
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Appendix: Responses to consultation questions and other comments

1 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 what lump sum should be quoted with the pension in the SMPI statement. If TM1 excludes this because the Disclosure Regulations simply refer to “the amount of the pension”, TM1 should nevertheless include a requirement to quote the assumed cash sum alongside the residual projected pension, and to be consistent with the pension shown we suggest that this should be expressed in real terms.

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

The proposal is to 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 or in connection with the Minimum Income Requirement, which would be subject to additional tax, so we are doubtful that the reference to legislation actually achieves the FRC’s objective. Is this reference therefore meant to be to tax-free lump sums (‘pension commencement lump sums’ in FA04 terminology)? We would suggest that, rather than having a ‘rule’ in C.3.1 that seeks explicitly to limit the lump sum by reference to the legislation, the FRC instead builds in a more principles-based requirement for providers to “have regard to” or “bear in mind” scheme rules and legislation on ‘tax-free’ lump sums.

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

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

Similar comments to those in the response to Q2 above apply here too. We also think that the draft wording of C.3.13 might be seen (through the placing of the word “any”) to be communicating a default or even expectation that there would normally be no dependant’s pension allowance. We suggest replacing the draft C.3.13 with a statement to the effect that providers may choose to include a contingent dependant’s pension at anything from nil to 100% of the member’s pension, subject to the scheme rules.

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)?

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, nevertheless, be desirable wherever possible to those providers who are required to provide both FCA illustrations and TM1 SMPIs, and who will need to use different annuities for level pensions, creating additional costs for them and potentially some confusion for users.

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)?

In our view the proposed approach is reasonable. The fact that the current approach for index-linked annuities and the proposed new approach for level annuities may not be consistent with each other (as acknowledged in 3.27) could make it difficult to achieve a consistent approach under C.3.7 for all possible forms of annuity, although we suspect that this is likely to be more of a theoretical than a practical problem as, in our experience, annuities with a ‘mix’ of index-linked and fixed elements are less common in the DC space than in DB.

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)?

It is interesting that research suggests that end-users find it easier to understand accumulation rate assumptions when written net of inflation. For certain asset classes, such as gilts or cash, this may mean showing negative real returns (particularly after allowing for charges), which we would expect individuals to find more confusing or worrying. We are mindful that other investment savings do not generally show investment return assumptions net of inflation and this may lead to end-users incorrectly concluding that pension savings provide poor returns in comparison with other savings vehicles.

SMPI projected pensions have always been shown in real terms, whereas the FCA was specifically looking into a change from projected nominal amounts to real amounts. Is it possible that the conclusions drawn from the research primarily reflect participants wishing to see inflation-adjusted projected **amounts** in shorter statements, rather than a clear preference for seeing the accumulation rate assumptions disclosed in a particular way?

Also, should accumulation rates be shown net of charges, noting that the research suggested there were wide reactions to charges and expenses amongst the sampled participants?

If disclosing accumulation rate assumptions net of inflation is to be suggested in TM1, how does FRC intend to incorporate this within TM1? Will this form part of the 2014 review and consultation? We would be open to such approaches being ‘suggestions’ in order to ensure that providers have flexibility to continue to challenge and improve the content of SMPIs for the end-user’s benefit, rather than it being a requirement or a ‘preferred’ method. With more employees entering pensions for the first time, it is important to ensure that communications continue to adapt to the changing needs of the public.

7 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 in its transfer analysis standard that this rate refers to the RPI (with CPI being assumed to be 2.0%). We believe this should be reconsidered in the 2014 review.

8 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, although we think that whether contributions should always be assumed to go up in line with earnings is a more general question worthy of consideration in the next full review.

9 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 in detail, but will be happy to consider this further in due course. One immediate thought, however, is that the provisions in C.3.14, C.3.15 and C.3.17 are now inappropriately restrictive, given the significantly increased freedom from April 2014 as to how the SMPI is determined.

10 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 new flexibilities introduced by the Disclosure Regulations changes and therefore reflected in this revised TM1 are permissive, it makes sense for the new TM1 to tie in with the Regulations and be effective from 6 April 2014.

Other comments

1. In our view the Supplementary Information document issued with TM1 v2.0 is useful and should be maintained. We wonder why the decision to dispense with it was not the subject of a consultation question?
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. the fixed annuity basis) between TM1 and FCA requirements.
3. We have not considered in detail what the more in-depth review of TM1 might cover in 2014, but we would be happy to assist the FRC with its considerations closer to the time.
4. Why has the FRC added further initials ‘AS’ to TM1? The name is usually quoted in SMPIs, and it seems unnecessary and potentially confusing to change or expand the name with a further acronym.