

**Private and Confidential**

The Director of Actuarial Policy  
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Dear Sirs

**Exposure Draft – AS TM1: Statutory Money Purchase Illustrations**

Capita Employee Benefits is one of the largest employee benefits consultancies in the UK. Formed in October 2012, the company brought together the award-winning consultancy and technology solutions of Bluefin Corporate Consulting, and the award-winning pension administration services of Capita Hartshead.

As a combined business we now offer the most comprehensive range of employee benefits and pensions services, with expertise in administration, consultancy and technology: DB and DC trust, Master Trust, GPP, healthcare, risk, and flex – supported by specialists in HR consultancy, benefits administration and technology, communications consultancy, graphic design and employee education.

We employ over 2,400 members of staff and service over 1,600 corporate clients and 4 million individual pension scheme members/company employees across the UK and in Ireland.

We welcome the opportunity to respond to your consultation on changes to AS TM1: Statutory Money Purchase Illustrations. Our comments on the questions set out within the consultation have been included below.

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

We believe that the definition of lump sum should be linked to the Pension Commencement Lump Sum that is available at retirement, as set out under Finance Act 2004. Although we appreciate that the new Disclosure of Information Regulations ('the Regulations') do not specify the type of lump sum, the reasons why we would not want other authorised lump sums to be included in the illustration are set out in our response to question 2.

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**2. Do respondents agree with the proposed approach to the allowance for cash in the calculation of the statutory money purchase illustration (paragraph 3.6 to 3.8)?**

It is highly unlikely that providers will produce a Statutory Money Purchase Illustration on the basis that a member enters a flexible drawdown arrangement, because it would not be known in advance whether the eligibility criteria set by HM Revenue & Customs (HMRC) for flexible drawdown would be met. The vast majority of the eligibility criteria are completely outside of the control of the provider. The same would apply for trivial commutation lump sums or commutation on serious ill health; until benefits are taken, the provider would not be aware of whether HMRC's eligibility criteria for these authorised lump sums had been met, so a provider should not in our view be quoting on an assumption that it could be in the future.

In addition, members would be entitled to the Open Market Option to secure an annuity, so it is our understanding that schemes would therefore still need to produce illustrations on the basis of purchasing an annuity.

There are other scenarios where the lump sum taken can be more than 25% and this is where the member has scheme specific lump sum protection or lump sum protection under enhanced or primary protection. These protections are unlikely to apply to all members of a scheme. Therefore, it is our understanding from the consultation response to the Regulations that the assumptions can be set at scheme level, rather than individual member level. This means that providers would have the choice of quoting protected lump sums for relevant members or assume everyone is entitled to a lump sum of 25% of the fund.

Also, we note in the Exposure Draft that when determining the lump sum the nominal accumulated fund is used, which is inconsistent with how the pension is calculated where the real accumulated fund is used?

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

It is now quite unusual for the Scheme Rules of defined contribution schemes to stipulate requirements about the amount of spouse's pension to be purchased, because the member is able to secure whatever level of spouse's pension he or she may require on the open market. However, the exception to this rule may be schemes that are/have been contracted out, where there may be minimum, rather than maximum, dependant's pensions stated within Scheme Rules. On the basis that there may be a few schemes, which may have a maximum amount, we do not object to the wording proposed in C.3.13.

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

We think option 2 is likely to give a better answer than option 1. Although not a perfect match, the proposal has the merit of simplicity. Although we believe this is good enough for illustrations for members some way from retirement, given all the uncertainties involved in the illustration, we have slight concerns about those members closer to retirement. Within, say 5 years of retirement, we might expect members to take greater account of the illustration in preparing for retirement, and the proxy might be misleading.

Against this, there is a need to make systems simple and cost-effective for providers. One thought might be to go with the proposal but to allow providers the option to use alternative evidence-based assumptions for members close to retirement.

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

The proposed approaches to inflation-linked annuities and to level annuities are not necessarily themselves consistent, so to determine an interest rate that is consistent with the inflation-linked annuity and the level annuity could be a challenge. Therefore, we therefore suggest that C.3.7 is amended so that an approach consistent with **either** basis can be used because at the moment it implies that it needs to be consistent with both bases: *'When it is assumed that the statutory illustration increases in payment at a*

*rate other than those described in C.3.3 and C.3.4, the annuity rate must be determined using an approach consistent with C.3.3 or C.3.4.'*

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

The legislation does not require schemes to disclose the accumulation rate used net of inflation, and nor does the Exposure Draft of AS TM1 so presumably this would be optional and providers could not be forced to adopt this? Further, what rate of inflation would be used? The inflation rate used elsewhere within AS TM1 is assumed to be 2.5% pa. Would providers be obliged to discount the accumulation rate by 2.5% or could they use their own assumptions about inflation?

On a more general point, we have some concern about the reference to 'inflation'. Given the potential difference between RPI and CPI and the effect of this difference over time for members who are some way from retirement, there seems to be a lack of focus on which inflation measure is being used and why that measure is being used. The implication appears to be that the inflation measure is RPI from the fact that the FTSE Actuaries Government Securities Index-Linked Real Yields is being used. We believe that this should be clarified.

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

Based on current levels of RPI and CPI price inflation and, in particular, economic policy to try to keep inflation at the target 2% level, we agree that the price inflation assumption should not be amended at the current time.

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

Based on current levels of earnings increases which appear to be constantly fluctuating, we agree that the earnings inflation assumption should not be amended at the current time.

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

As flagged in Paragraph 3.27, the potential inconsistency between the interest rate used for pensions with inflation-linked increases and that used for pensions with no increases needs to be addressed at the next update to AS TM1.

Also, we note that this Exposure Draft does not address the draft Pensions Act 2011 (Transitional and Consequential Provisions) Regulations 2014, which amend the Disclosure of Information Regulations, and introduce a proposed requirement for members of cash balance schemes to request a statement of benefits which includes an illustration 'where appropriate, in a manner consistent with relevant guidance'.

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

We strongly disagree that the changes to AS TM1 should be effective for statutory illustration issued on or after 6 April 2014. It should only apply to those illustrations with an **effective date** on or after 6 April 2014. Otherwise, it would be theoretically possible to issue a statement, for example, one with an effective date of 1 January 2014, on a different basis from that which was allowed within the legislation at that effective date. The Regulations were not retrospective so in our view AS TM1 should not be. In addition, the new Regulations require schemes to notify members before making any changes to their SMPI basis. In our view, it would only be possible to do this going forwards and not retrospectively.

Additionally, although the changes are permissive, there will be some providers who will want to change their SMPI basis and take advantage of the flexibility in the illustration. This will require an extensive re-write to systems and the assumptions that lie behind the calculation routines. Providers need adequate

time to re-configure the additional flexibility provided within the Regulations and a way of providing sufficient time is to ensure that it only applies for those statements with an effective date after 6 April 2014.

If you wish to discuss these comments further, please do not hesitate to contact me.

Yours sincerely

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