

To: All Home Fellows

October 2004

Dear Member,

Technical Memorandum 1 (TM1): Statutory Illustrations of Money Purchase Benefits Consultation on Version 1.1 - changes to the assumptions in Appendix D

Please note that responses to this consultation are required by 15 December 2004.

Background

Under the disclosure requirements for money purchase benefits introduced by the Department for Work and Pensions (DWP) from April 2003, pension scheme trustees or managers are required to produce a projection once a year showing the amount of annuity that an individual's pension fund might buy at retirement. The projection is based on a single set of assumptions that are set out in a document known as Technical Memorandum 1, or TM1 for short. TM1 is produced and maintained by the Actuarial Profession and subject to approval by the Secretary of State for Work and Pensions.

In accordance with paragraph 2.6, the Actuarial Profession has been regularly reviewing TM1. In our latest report we recommended a change to the basis in Appendix D and the DWP has accordingly agreed to this consultation. Our advice shows that the annuity basis in Appendix D of version 1.0 now understates the cost of insuring a pension with an insurance company by about 15% for male annuitants at age 65, and by about 10% for females. See www.actuaries.org.uk/files/pdf/pensions/tm1_oct04.pdf for full details of the recommendations from the Actuarial Profession.

Proposed Changes to Appendix D of the Technical Memorandum

The following changes are being proposed to Appendix D of TM1 version 1.0:

- Paragraph D1.1 to be changed so that the allowance made for mortality improvements will incorporate the improvements that have been referred to as the medium cohort projection – see Working Paper 1 of the Continuous Mortality Investigation Bureau <http://www.actuaries.org.uk/files/pdf/cmi/CMIWP1.pdf>. The rates of mortality improvement can be obtained from http://www.actuaries.org.uk/Display_Page.cgi?url=/cmi/cmi_workingpapers.html
- Paragraph D4.1 to be changed so that the rate of interest to be used in the calculation of the annuity rate is reduced by 0.5%. It may also be necessary to change paragraph 15.2 to ensure that this adjustment is made with effect from the implementation date.

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Consideration was given to using the unadjusted long cohort basis instead. However, the Actuarial Profession, DWP and Financial Services Authority (FSA) agree that the TM1 basis and the FSA basis used for point of sale projections should remain identical as far as possible. Since other considerations prevent the FSA from adopting a long cohort basis for all types of annuities, the adjusted medium cohort basis has, therefore, been selected as the preferred basis for the revised TM1 and is the sole subject of this consultation.

Implementation

The FSA has agreed that it will, in due course, be consulting on changes to its rules with the aim of achieving consistency between the basis proposed in this revision to TM1 and its own basis for illustrations.

The current intention is for the revised version of TM1 to be in effect for all annual benefit statements from 5 April 2005 onwards. We hope to be able to issue the completed TM1 version 1.1 early in 2005.

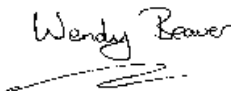
If you wish to comment on the proposed changes to TM1, please respond, preferably by email, no later than 15 December 2004 to:

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Unless you specifically request otherwise, responses to this consultation may be shared with the DWP.

It should also be noted that new mortality tables are being worked on at present and research is being carried out by the Actuarial Profession into mortality improvements so further changes to the assumptions may be necessary in future.

Yours sincerely,



Wendy M Beaver
Chairman, Pensions Board

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