The Actuarial Profession
making financial sense of the future

Consultation response
Board for Actuarial Standards

TM1: Statutory illustrations of money purchase benefits

June 2010

The Actuarial Profession
making financial sense of the future

About The Actuarial Profession

The Actuarial Profession is governed jointly by the Faculty of Actuaries in Edinburgh and the Institute of Actuaries in London, the two professional bodies for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuing professional development and a professional code of conduct supports high standards reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business's assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals, and advise on social and public interest issues. Members of the Profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

The Profession also has an obligation to serve the public interest and one method by which it seeks to do so is by making informed contributions to debates on matters of public interest.

The Actuarial Profession
making financial sense of the future

basTM1@frc.org.uk

4 June 2010

The Director
Board for Actuarial Standards
5th Floor, Aldwych House
71-91 Aldwych
London
WC2B 4HN

Dear Sir/Madam

Consultation Paper: TM1: Statutory Illustrations of Money Purchase Benefits

I am writing on behalf of the Actuarial Profession in response to the Consultation Paper issued by the Board for Actuarial Standards in March 2010.

We welcome this in depth review of the Technical Memorandum. Since its issue in April 2003 it has been "patched and mended" with no material changes since November 2006. A thorough review is overdue and welcome.

We have chosen not to respond to your detailed questions as we believe that they may be best answered by practitioners and providers of illustrations. However we do have some general observations to make which we set out below.

1. Your role and that of the Department for Work and Pensions

We think it is right that at this stage you should be asking some policy questions, such as those in Questions 1, 2, 7, 26 and 27. However, it is our understanding that the Department for Work and Pensions (DWP) sets the policy and the role of the Board for Actuarial Standards is to supply the technical guidance that operates within that policy. As you will appreciate, this is an entirely different role to your main one of producing Technical Actuarial Standards.

We note that you have consulted extensively with the DWP, amongst others and perhaps they have delegated responsibility for consulting on policy issues to you, but if this is so it is not clear from the Consultation Paper that this is the case. Our comments in this and the next section should be seen in this light.

A point that does not appear to have come across sufficiently clearly is the currently intended nature of these illustrations. The length of the Memorandum is in part due to the current policy requirement for projections to be consistent across providers, and the level of prescription can obscure the fact that the projections themselves are only intended to give a broad indication of the likely pension outcome for the individual. They are not intended to be that specific to the individual.

We believe that the policy requirement needs to be clear in the first instance, since if illustrations are intended to remain consistent across providers some of the suggestions in the Consultation Paper may not be appropriate. Examples are the flexibility in choice of mortality assumption, increases in payment and format of pension; and using an accumulation rate below 7% even where the member's fund is invested in a mix of investments, predominantly equity-type.

2. The nature of the guidance within the Technical Memorandum

It is not clear to us whether you intend to restrict yourself to technical drafting changes or if you have a wider plan to restructure the guidance. There are hints from section 4 that you may be thinking of a wider role. Whilst we accept that the Technical Memorandum is lengthy, those who currently need to make reference to it are familiar with its contents. A major rewrite could make it more difficult for existing practitioners and providers to establish what changes are needed to their systems. We suggest that you keep the drafting approach largely unaltered and make clear in the published version, what has changed by supplying a track-changed version (against version 1.3 of the Technical Memorandum), so that existing users can quickly see what changes they need to make.

Related to this, you suggest that it may not be necessary for the Technical Memorandum to contain *"numerous references to, and paraphrases of legislative requirements."* There may be some scope for reduction in this area, but this may run against the original policy intention that the document is a complete and self-contained reference to the legislative and technical requirements.

You also suggest that it may not be necessary to have such detailed explanation of exactly how the calculations should be performed. To the outsider, the Technical Memorandum can seem overly detailed, but once again, if you cut down in this area you risk running against the current policy intention of consistency between providers.

As you are aware, the Technical Memorandum is a very different type of document to Actuarial Guidance Notes (and to some extent it is aimed at a different audience). The replacement of the latter by Technical Actuarial Standards should have no bearing on the way in which you approach any restructuring of the Technical Memorandum.

3. Known technical issues

When responsibility for the Technical Memorandum was passed to you in April 2007 we handed over a number of known technical issues which would otherwise have been dealt with by the Actuarial Profession at the Memorandum's next fundamental review. We cannot see any acknowledgement of this in the Consultation Paper, but it appears from the drafting of it that a number of the issues have been raised for discussion. A further copy of the issues list is enclosed for completeness (this includes a list of issues from 2005 from the Department of Social Development in Northern Ireland which was enclosed with the April 2007 list).

If you have any questions or would like to discuss any of these matters further, please do not hesitate to contact us. Should you wish to do so, please contact Martin Hewitt, Pensions Practice Manager on 0207 632 2185 or via martin.hewitt@actuaries.org.uk.

Yours sincerely

Robert Hails
Chairman, Consultations Group of the Pensions Practice Executive Committee

TM1 - Items deferred and other issues for consideration when developing the next full consultation version, (i.e. v2.0 - which was originally planned for late 2007)

1.) Points raised in responses to the consultation on v1.1 which were not deemed suitable for inclusion as technical/non-consultation amendments and so deferred:

- Consider applying 15 Feb interest rates to illustrations in the following 1 April to 31 March period rather than for the financial year (so that the large number of 1 April valuations are caught by the more recent figures). Another responder noted that many large schemes have illustration dates of 31 March and that TM1 should be amended so that these are caught by that year's 15 February figure.
- If there is concern that short-term SMPI statement will overstate the pension, then the basis for these could be altered to be consistent with the FSA basis so that immediate annuity rates are used for projections with a term of less than 1 year though there are issues with how this could work in practice.
- Significant divergence in mortality for those on large versus small pensions –consider factoring this into TM1 to give the best chance of providing meaningful projections for members.
- Consider rewording 15.2 to clearly indicate whether it refers to the interest rate at close of business on 14 or 15 February. Ideally this should be made the same as the date used by FSA for point of sale projections.
- Coordination with CMI to be considered (see point 10 below), though restricting mortality changes in TM1 to whenever tables adopted by the actuarial profession are changed would not appear to be sensible unless life offices adopted that approach to their pricing. Practical approach of using a standard approach and some parameter that could be changed regularly - e.g. a market 'fudge' factor - may be worth considering but that should be done as part of a more fundamental future review of TM1 since that is not how TM1 was originally set up and this point was not included for consultation in the latest review.

2.) Memo received from Stuart Orr, Department for Social Development in Northern Ireland, 31 January 2005 detailing comments & copy editing on version 1.0 carried through to 1.1 - copy attached at Annex 1 Please note the changes thought to be minor and not requiring consultation have been incorporated into v1.2.

3.) If changes are being made to Appendix D, should there be a permissive, optional transitional period before they become mandatory (i.e. similar to FSA 2005 proposals to amend their baseline (mandatory from 1 Aug 05 but providers were given the option of using them from 6 April (5 April?) if they wished to do so)).

4.) 16.1.4 relates to the expenses that Providers should charge if, for whatever reason, they don't know the charges that relate to their particular scheme. TM1 currently sets this at 1% but it's been announced maximum charge cap for Stakeholders will increase to 1.5% for the first 10 years of a contract and 1% thereafter. Should TM1 be altered to reflect this/is the intention that Providers charge expenses equal to the "current maximum rate" allowed for Stakeholder Pensions in such circumstances?

5.) Reword para 2.4.1 to avoid any confusion over the distinction between the version TM1 relevant to an illustration (date) versus the version in force at time an illustration is prepared

6.) Differences between TM1 and FSA point of sale illustrations that might need looking at, e.g., the guaranteed fund at retirement and growth rates for with profit funds

7.) Consider inserting a statement in A2, perhaps at 2.3.1, regarding the possibility of exceeding the lifetime allowance

8.) Reconsider the assumption in para 19.1 about remaining contracted-out until retirement, due to the effects of the cap on COMPS and PPs

9.) Consideration of whether the gilts minus 0.5% basis for annuity rates as specified at D4.1 is still satisfactory. Our review at February 2007 indicated there was no urgent need to change TM1 to reflect changes in annuity rates. However, if the present trends continue, this aspect of TM1 may require alteration in the not-too-distant future.

10.) Should the 00 Series Mortality Tables be used in the revised version of TM1?

11.) Question received 29 Mar 07: "The profession's March eNews Bulletin provides a link to the helpful note the Pensions Board's Technical Support and Research Committee have issued clarifying how the annuity interest rate for TM1 should be determined this year.

The very next item in the Bulletin says:

Change in FTSE- Actuaries Gilt Indices (all members)

FTSE is changing the method it uses to calculate the yield of the price indices published in the FT with effect from 1 April, 2007. The yield on the new method is a weighted average of the constituent stock yields and is only an approximation compared to the old and accurate method in which the yield is calculated from the aggregate cash flows of all constituent stocks. The yield on the new basis will be the same or lower than if calculated on the old method. Yields on the old method will continue to be calculated and made available to members on the Profession's website (http://www.actuaries.org.uk/gilts.cgi)). There will be more detail in the next edition of the Actuary.

Can you clarify whether in the future the annuity interest rate for TM1 will be the approximation published in the FT or the accurately calculated one published on the Profession's website? Or if this is a matter for the BAS, will you be referring it to them?"

Our reply simply stated that we would include this in the list of issues to bring to your attention.

From: Stuart Orr
SSPLD
DSD NI

To: David Hone
DWP

Date: 31 January 2005

Comments on TM1 v1.1

David,

Please see following comments on the draft TM1 v1.1.

Covering letter	In the first para, should "approved by both The Actuarial Profession and the Secretary of State for Work and Pensions" read "approved by both The Actuarial Profession, the Secretary of State for Work and Pensions and the Department for Social Development in Northern Ireland."?
	In para 3, should the web address read: www.actuaries.org.uk/pensions/smpi.html? See para 2.5 (pg 11) for reference to website. I checked the address – the one mentioned in 2.5 worked, the one in the letter leads to "Page Not Found".
	In para 6, should DSD be included?
General	Would it not be best to have all the defined terms (currently in italics) in normal type? This would make the document easier to read.
	The use of italics is inconsistent: e.g in 3.1, "illustrations" and "Technical Memorandum" are in normal type. There are numerous other examples throughout the document to this inconsistency.
	Punctuation in bullet points etc. – would it not be best to have commas or semi-colons at the end of all bullet points?
1.3.2, page 9	Should "*Technical memorandum* " read "*Technical Memorandum*" for consistency with other references?
2.1, page 10	Should there be a fullstop at the end of (d)?
2.3.2, page 10	This version has not been approved yet, and the dates

	given refer to the date when the first version of TM1 was approved.
2.4.2, page 11	Should "**then the latter will prevail.**" read "**then the legislation or any other relevant legislation will prevail.**" for clarity?
6.5, page 22	This para wasn't very clear to me – I thought the formulae could have been explained clearer.
6.6, page 22	In line 8, the words "or more accurately" didn't seem to make sense to me – do what "more accurately"?
11.1, page 32	Should "there is therefore normally" read "therefore, there is normally"?
12.1.2, page 33	Should "in substitution for" read "In substitution for" i.e. use a capital letter at start of the sentence?
15.1.1, page 35	"Regard has been had to past experience, although such experience is not necessarily a good guide to the future." – I'm not sure what this means. Should this sentence be re-worded for clarity?
16.1.2, page 37	Should "the *Future contributions* projected as set out in paragraph 10.2." read "the projected *Future contributions* (as set out in paragraph 10.2.)"?
16.1.5, page 37	Should "the M*ember's* employer" read "the *Member's* employer" i.e. have all the word in italics?
A2.1.2, page 41	In the first bulletpoint, does "the relevant regulations" mean "the relevant *Legislation*"? Or does it refer to regulations not listed in para 2.1? If so, should these other "relevant regulations" be listed someplace?
A2.3.5, page 43	In the first bulletpoint, should "however. a more detailed" read "however, a more detailed"?
A2.3.6, page 44	Should "contracted out until" read "contracted out of State earnings-related pension arrangements until"? See para A2.9.2 for similar wording.
A2.3.8, page 44	In the second bulletpoint, should "*approved contracts*" read "*Approved contracts*"?
A2.8, page 45	In the first bulletpoint, should "than value of the *Current fund*" read "than the value of the *Current fund*"?

A2.9.3, page 46	Should "the Guaranteed Minimum Pension provisions of the State pension arrangements (GMP)" read "the Guaranteed Minimum Pension (GMP) provisions of the State pension arrangements"?
A2.14, page 47	In the second bulletpoint, should the indent at the start of the text be removed?
B2.1, page 50	Should "State Second Pension" read "S2P"? S2P had been defined in para B1.1.
	Should "SERPS" be defined?
B2.4, page 50	Could the formula be presented in a clearer manner?
B2.5, page 51	"LEL" is used but hasn't been defined in the document. I presume is refers to "Lower Earnings Limit".
B3.2, page 52	Should "Qualifying Earnings Factor" read "QEF"?
	Should "Upper Earnings Limit" read "UEL"?
B3.3, page 52	"LEL" is being used here, without being previously defined. (see above comment).
Annex C	Should "The Occupational and Personal Pension Schemes (Disclosure of Information) Amendment Regulations 2002" read "The Occupational and Personal Pension Schemes (Disclosure of Information) Amendment Regulations 2002. SI 2002/1383"?
	Should "The Occupational and Personal Pension Schemes (Disclosure of Information) (Amendment) Regulations (Northern Ireland) 2002" read "The Occupational and Personal Pension Schemes (Disclosure of Information) (Amendment) Regulations (Northern Ireland) 2002. SR 2002 No. 410"?

Regards,

Stuart Orr
SSPLD
GTN 440 22312