The Actuarial Profession
making financial sense of the future

Consultation response
Board for Actuarial Standards

Exposure Draft

TM1 Statutory Money Purchase Illustrations

June 2011

About the Actuarial Profession

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous 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' 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 offer comment 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.

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10 June 2011

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Dear Sir/Madam

Exposure Draft: TM1: Statutory Money Purchase Illustrations

I am writing on behalf of the Actuarial Profession in response to the Exposure Draft issued by the Board for Actuarial Standards in March 2011.

We are not responding to all of your detailed questions as we believe that many will be best answered by practitioners and providers of illustrations. However, we do have comments on some of them, as shown below.

Question 2: Do respondents agree that the proposed purpose of TM1 in paragraph 2.5 reflects its statutory role?

Our understanding is that the existing purpose of TM1 was established in accordance with DWP's original policy intention in 2002. It is not clear to us whether you have consulted the DWP before issuing the Exposure Draft and therefore we question whether this purpose should now be changed without specific DWP input.

In particular, the existing TM1 is clear that it aims for consistency of illustrations across various types of money purchase pension provision and we understand that this was a very specific policy intention of DWP. In changing the purpose and in some of the other proposed changes (which we address later), the Exposure Draft appears to us to be moving away from the aim of consistency (notwithstanding that the aim is repeated in the proposed supplementary information) and we ask whether this is appropriate.

On a lesser point, the legislation only states that illustrations "must be determined by reference to the relevant guidance", where that guidance is TM1. It does not state the statutory role of TM1 and therefore one might even argue that there *is* no statutory role (other than to exist). The new purpose suggested in the Exposure Draft is certainly possible but it is questionable whether it is a *statutory* purpose.

Question 6: what are respondents' views on the change of emphasis described in paragraphs 3.12 to 3.14 and the requirements for determining the accumulation rate to be used?

As described above, we understand that one of the aims of TM1 was consistent illustrations between different providers and funds. Using a maximum rate in most cases, but with adjustment where this is clearly unrealistic (for example where the member invests in cash and has no option to change his or her investments), seems to fit with this consistency aim.

Whilst we share the concern that the maximum rate may be used in inappropriate circumstances, we are concerned that the proposed new wording of TM1 will encourage inconsistency and also raise many new issues for trustees and providers to contend with. For example:

- trustees and providers will almost certainly require additional actuarial and/or investment advice to determine an appropriate expected return on specific funds.
- it isn't clear how the member's "anticipated future investment strategy" can be factored in in most cases. If your intention is that only *known* future changes should be allowed for (for example, planned "life-styling" moves into bonds close to retirement), then we would prefer this to be stated. Alternatively it may be that you would be comfortable with the maximum rate being used if members have complete discretion to move their existing investments? Again, some clarity will be helpful, particularly as this guidance is aimed at providers, not necessarily actuaries, meaning that the users may be less comfortable with making judgements than your traditional actuarial audience.
- Similar comments to those above apply to the suggestion that "the accumulation rate *must* take account of the expected returns from the different asset classes that *might* form the investments of the member's fund". The use of the word "might" requires a considerable amount of judgement to be exercised and we are concerned that this could lead to still more inconsistency.
- The proposals could be interpreted to mean that the accumulation rate needs to be determined individually for each member and each fund, based on the member's current investment strategy and known and potential future changes. This could significantly increase the scope of the task for trustees and providers (and require additional communication to recipients).

There is also the concern that a member with a gilt fund with provider X will compare his illustration with his equity fund illustration from provider Y and take possibly inappropriate investment decisions based on the implicit message.

If your main concern is that some providers may be using an unjustifiably high "default" rate, then we suggest that simply reformatting the guidance on when (and how) to consider a lower rate might be a simpler alternative to the current proposals.

Question 10: Do the respondents agree that mortality improvements should be based on the medium cohort with a minimum annual improvement of 1%?

As noted in Working Paper 41 (introducing a new mortality projection model) issued by the Continuous Mortality Investigation of the Actuarial Profession, "In recent years the Continuous Mortality Investigation (CMI) has become concerned about the continuing widespread use of the Interim Cohort Projections of mortality. These projections do not take account of experience data published for calendar years after 1999 and, as a result, have become increasingly out-of-date." As BAS is proposing a change to the mortality assumptions, we think that this would be a good opportunity to update the mortality projection assumption methodology, rather than just introducing a long-term underpin.

Question 12: Do respondents have any views on the other assumptions which are set out in part C?

We suggest that proposed paragraph C.3.2 could be clarified in terms of whether the rates published in the FT on the 15 February should be used or whether rates at close of play on 15 February (and published in the FT on 16 February) are required. We are aware that the Actuarial Profession clarified this point a few years ago and determined that yields on 15 February, published in the FT on 16 February, should be used. For most years, the difference is academic, but it would still be helpful to clarify the point whilst an opportunity is available.

Question 13: Do respondents have views on the proposed purpose and content of the accompanying document?

We have some concerns about the guidance becoming optional, because this suggests requiring more judgement from providers than is currently required (currently, the abundance of prescription enables providers to prepare most or all of the calculation routine without actuarial assistance or judgement). It will also lead to less consistency between providers, although of course there will be some established practice on which to rely in the short term. Overall, we are not entirely convinced that additional flexibility will be helpful to users of the guidance *or* recipients of the illustrations, not least because it is likely to require additional consideration and cost in the first year as trustees or providers and their advisers familiarise themselves with the new material.

Question 15: Do respondents have any views on the proposal that the BAS does not maintain the accompanying document?

We have very considerable reservations, from the point of view of ensuring consistency and aptness of practice, about publishing a guidance document that is then not maintained and we would prefer BAS to retain responsibility, at least until an alternative “guardian” is agreed. The advantage of BAS retaining responsibility is that it should be easier to ensure consistency with TM1, particularly as frequent changes are unlikely to be necessary.

Finally, we note that BAS intends to make the new TM1 effective from 6 April 2012 for all illustrations *issued* on or after that date. This contrasts with past practice which has generally required changes for illustrations with *effective dates* on or after the amendment, albeit that there has been encouragement to adopt early. We suggest that past practice may present fewer practical problems for providers (because it is clear in advance which version will or can apply), but we also note that if the stated intention remains in place it will important for BAS to finalise TM1 quickly and to clarify whether the changes can be adopted early.

We hope the above will be helpful, but if you have any questions or would like to discuss any of these matters further, please do not hesitate to contact us. Please contact Kirstin Lambert (kirstin.lambert@actuaries.org.uk or on 020 7632 2168) in the first instance.

Yours faithfully

Martin Lowes
Chairman, Consultations Group, Pensions Practice Executive Committee