The Actuarial Profession
making financial sense of the future

Consultation Response
Financial Reporting Council
Exposure Draft AS TM1: Statutory Money Purchase Illustrations

12 December 2012

About the Institute and Faculty of Actuaries

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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12 December 2012

Dear Paul

Exposure Draft AS TM1: Statutory Money Purchase Illustrations (SMPI)

The Institute and Faculty of Actuaries welcomes the opportunity to respond to this Exposure Draft. This response was prepared by experienced actuaries from Life and Pensions backgrounds who had previously prepared the Institute and Faculty of Actuaries' response to the joint FSA/FRC consultation (CP12/10, Chapter 5) on SMPI. Our comments detailed below refer to the questions in Section 4 (Invitation to Comment) of the consultation document.

Whilst we are disappointed that the FSA and the FRC could not reach a mutually agreed approach to the basis of the growth assumptions underlying SMPI and the FSA intermediate illustrations, we are comfortable with the FRC decision to remove the cap for SMPIs.

For pensions arrangements where actuarial advice is sought, we are confident that our members will be recommending considered and realistic assumptions, informed by the strong professional framework including the Actuaries' Code, the Pensions TAS, and ongoing relevant CPD requirements.

However, below we illustrate some potential consequences of the proposal we would like to draw your attention to:

1. There is likely to be inconsistency between the FSA pension illustrations, particularly the real point-of-sale illustrations for personal pensions proposed in CP12/29, and SMPI, for scheme members intending to invest in higher return potential assets[1]. This may create confusion for the customers concerned, as the projections are broadly intended to illustrate the same eventuality. This may need to be addressed by means of an explanation accompanying the SMPI and point-of-sale illustration.
2. We are unclear as to how the FRC will obtain information on the rates being applied by the industry but would welcome an early indication as to how this information will be gathered. We would be particularly interested to note if FRC notice any difference between the practices of schemes advised by our members and others.
3. Whilst we do not object to an implementation date of 6 April 2013, we are aware that the FSA has given the firms it regulates until 6 April 2014 to move to the lower cap. The removal of the TM1 cap ought not to affect the advice given to schemes by actuaries. However, it is likely that FSA-regulated pensions providers will seek actuarial advice at different times throughout 2013 and some may opt to implement both TM1 and the FSA changes simultaneously for April 2014. The FRC may therefore need to consider allowing for an appropriate bedding-in period in their monitoring of compliance.

[1] FSA point-of-sale intermediate real projections are proposed to be at 5%-2.5% = 2.5%. It is not inconceivable that an SMPI for an investor intending 100% equity exposure throughout would be at 7%-2.5% = 4.5%. The step up in the projected pension between the POS projection and the SMPI at the end of the first year will be material for longer terms to retirement. Indeed, the SMPI will be closer to the FSA upper projection, potentially confusing the customer about the positioning of the SMPI on the likelihood spectrum.

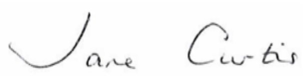
We have no objection to the proposed requirement to provide justification for the rate assumed on request, which may assist member understanding of the projections, nor of the changes proposed to TM1 in respect of annuity rates.

We also note that paragraph 2.28 of the Analysis of Responses states that the FRC proposes to amend paragraph A.1.2 to permit the use of different mortality blending approaches, provided they do not materially affect the result of the calculation. However, this proposal is then missing from the Proposals in Section 3 and the Exposure Draft itself. We support this proportionate approach and believe this proposal should be included by inserting the word ‘materially’ between ‘not’ and ‘affect’ in A.1.2.

Finally, we are aware that the FRC are working with DWP on a wider review of SMPIs. The Institute and Faculty of Actuaries would be keen to provide input prior to the consultation being issued, as we are anxious to ensure that the scope adequately addresses the most material concerns we have about the current regime (which we raised in our response to the CP12/10 consultations).

Please contact Daniel de Búrca, Policy Coordinator at the Institute and Faculty of Actuaries, with questions or comments regarding this response at Daniel.DeBurca@actuaries.org.uk.

Yours sincerely,



Jane Curtis
Immediate Past President
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