Exposure Draft

Financial Reporting Council

November 2013

AS TM1: Statutory Money Purchase Illustrations

The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries; and oversee the regulatory activities of the accountancy and actuarial professional bodies.

CONTENTS

PROPOSALS

AND

INVITATION TO COMMENT

1 INTRODUCTION

Background

1.1 The Financial Reporting Council (FRC) is responsible for setting technical actuarial standards in the UK.

1.2 Since 6 April 2003, certain money purchase pension arrangements have been required to provide members with Statutory Money Purchase Illustrations (SMPIs). Legislation requires that statutory illustrations are produced in accordance with guidance prepared by a prescribed body approved by the Secretary of State for Work and Pensions and by the Department for Social Development in Northern Ireland.

1.3 The FRC is the prescribed body and has been since 6 April 2007. The FRC fulfils its obligations through the publication of Actuarial Standard *Technical Memorandum TM1: Statutory Money Purchase Illustrations* (AS TM1). It reviews AS TM1 regularly.

Aims and audience of this paper

1.4 The aim of this document is to set out and consult on proposed amendments to AS TM1 in light of revisions to the disclosure legislation effected by *the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 (SI 2013/2734)* which will come into force on 6 April 2014.

1.5 We are seeking stakeholders' views on the proposed changes to AS TM1 set out in this paper which include an exposure draft of a revised version of AS TM1.

1.6 Various stakeholders have provided valuable input during the preparation of this document including the FRC's Actuarial User Group and the Association of British Insurers. We have also worked with the Department of Work and Pensions (DWP) and the Financial Conduct Authority (FCA).

1.7 This document has been written for anyone with an interest in SMPIs including those responsible for providing SMPIs (trustees, insurers, and administrators) and the pension scheme members and policyholders who receive SMPIs, as well as organisations which represent and advise these groups.

1.8 We would welcome views on the matters addressed in this document, and in particular on the questions listed at the end of sections 3 and 5 and collated in section 7.

Contents and structure of this paper

1.9 Section 2 of this paper describes the amendments brought into effect by *The Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013*, as they relate to SMPIs. Section 2 also describes changes to the FCA rules to require inflation-adjusted projections. Section 3 describes the changes we propose to make to AS

TM1 to reflect the changes in both the Disclosure Regulations and the FCA rules. Section 4 relates to the supplementary information document and section 5 discusses the timing of changes to AS TM1. Section 6 contains our impact assessment in relation to the proposed changes to AS TM1

1.10 Part II contains the proposed text of version 4.0 of AS TM1.

Responses to this exposure draft

1.11 Details of how to respond to this paper are set out in section 7. Comments should reach the FRC by **13 December 2013**.

2 PROPOSED CHANGES TO DISCLOSURE REGULATIONS AND FCA RULES

Introduction

2.1 In this section, we outline the changes introduced by *the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013*[1] ("the revised regulations") that are relevant to SMPIs and AS TM1. We also discuss changes that the FCA has made to its rules for projections.

Changes to the Disclosure Regulations

2.2 The provision of SMPIs to members of certain money purchase arrangements has been a requirement of the Disclosure Regulations since 2003.

2.3 The existing Disclosure Regulations (SI 1996/1655, SI 1987/1110 and SI 2000/1403) require that:

- SMPIs must show the amount of pension likely to accrue to a member on the assumption that:
  - contributions continue to the member's retirement date;
  - the pension in payment will increase at the "relevant percentage" set out in AS TM1;
  - there is a dependant's pension of 50% of the members pension; and
  - members are assumed to be married unless records indicate they are not married, or it is agreed otherwise with the member.
- SMPIs must include a statement that the amount of pension is expressed in today's prices; and
- SMPIs must include certain statements on matters including investment risk, annuity purchase risk and the real terms nature of the illustration.

2.4 The revised regulations will come into effect on 6 April 2014. They consolidate and simplify the requirements (under the existing disclosure regulations) for pension schemes to disclose prescribed information to members (and others).

2.5 The revised regulations do not alter the requirement to provide an SMPI but they alter some aspects of the illustration. In particular, the revised regulations permit the personalisation of SMPIs to reflect the form of pension the member will choose at retirement. The revised regulations

[1] SI 2013/2734

remove the previous requirement for the statutory illustrations to show an annually increasing pension with a 50% dependant's pension payable on the member's death.

2.6 In the consultation paper on the revised Disclosure Regulations[2] the DWP clarified that a cash lump sum may also be included in the SMPI.

2.7 The revised regulations continue to require that statutory illustrations are produced in accordance with the assumptions and methodology set out in AS TM1. However, the following amendments to AS TM1 are required to reflect the changes made in the revised regulations:

- a change to the calculation methodology to allow for a cash lump sum;
- an additional annuity rate assumption for a pension that does not increase annually; and
- a change in the wording on dependant's pension to allow varying percentages of dependant's pension.

Changes to the FCA rules for projections

2.8 The FCA Handbook specifies how illustrations that are provided for personal pension and stakeholder pension schemes at the point of sale, and when a plan is in force, should be prepared.

2.9 The FCA Handbook currently requires an illustration at the point of sale to be expressed in projected money ("nominal") terms. This illustration is not directly comparable with the statutory illustration produced under AS TM1, which is expressed in today's money ("real") terms.

2.10 Following a recent consultation (CP12/29[3]), the FCA has amended its rules for personal pension and stakeholder pension schemes to require projections (which are produced on three growth rates[4]) to be shown in "real" terms. The revised rules are effective from 6 April 2014, with a transitional rule allowing firms to provide real illustrations from 6 April 2013 if they wish. The new rules align FCA projections with the statutory illustration produced in accordance with AS TM1.

2.11 A further amendment to the FCA rules relates to the presentation of the growth rates used in FCA projections. The revised FCA rules require that the projections show the net growth rate being used, after inflation has been taken into account.

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[2] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/221411/occupational-personal-pension-schemes-disclosure-information-regulations-2013.pdf

[3] http://www.fsa.gov.uk/static/pubs/cp/cp12-29.pdf

[4] Following a joint consultation with the FRC in May 2012, the FCA rules will require the pension at retirement to be projected using three different maximum rates of assumed investment return – 2%, 5% and 8%pa from 6 April 2014.

3 PROPOSED CHANGES TO AS TM1

Introduction

3.1 In this section we explain and seek comments on the amendments which we are proposing to make to AS TM1 to reflect the changes in the revised regulations.

Lump sum at retirement

3.2 AS TM1 currently states that, in calculating the pension shown on an SMPI, no allowance should be made for any option available for members to take part of their entitlement as a cash lump sum. Consequently, the calculation methodology currently set out in AS TM1 assumes no cash lump sum is taken.

3.3 The revised regulations allow a cash lump sum to be shown within the illustration. In light of this we propose to amend AS TM1 to:

- define **lump sum** as “the amount of the benefit assumed by the **provider** to be taken as cash by the member at **retirement date**”; and
- amend the calculation methodology for the illustrated pension; where providers assume a lump sum is taken, the lump sum is deducted from the nominal accumulated fund.

3.4 We would welcome stakeholders’ views on this approach to allowing for a cash lump sum in the calculation of the statutory illustration.

3.5 In practice, most members opt to take the maximum amount of their pension fund as a cash lump sum allowed by the scheme rules. Usually this is 25% of the fund at retirement.

3.6 The proposed text states that the lump sum assumed to be paid at retirement should not normally exceed the amount permitted by the scheme rules or legislation.

3.7 In some situations, members may be entitled to a cash sum which is greater than 25% of the fund. For example, members who are eligible for flexible drawdown may be able to take the whole of the fund as cash although not all of the cash would be tax-free.

3.8 We have therefore included text in the exposure draft to state that where the provider has assumed a lump sum greater than 25% of the nominal accumulated fund or greater than permitted by the scheme rules or legislation, the provider should document the rationale for doing so.

3.9 We would welcome respondents' views on the proposed approach to the lump sum assumption.

Spouse’s or civil partner’s pension

3.10 Under most arrangements, members can choose to use part of their fund at retirement to provide a pension to a spouse, civil partner or other dependants on death. Depending on the nature of the arrangement and the circumstances of the member, the pension provided to the spouse or civil partner on the death of the member can range from nil to a pension equal to the member’s pension.

3.11 The Disclosure Regulations previously stated that the statutory illustration must normally include a dependant’s pension of 50% of the member’s pension. The revised regulations do not specify the assumption for a dependant’s pension.

3.12 AS TM1 currently states that legislation specifies the assumption to be used for the amount of pension to be provided to the spouse or civil partner. We are proposing to amend the text in AS TM1 to state that the assumed amount of any spouse’s or civil partner’s pension should not usually exceed the amount permitted under the scheme rules or legislation.

3.13 We would welcome respondents’ views on the proposal in relation to dependants’ pensions.

Interest rates to be used in calculating annuity rates

3.14 The assumptions set out in AS TM1 for the annuity rate aim to broadly replicate the current cost of purchasing an annuity so members have a broad indication of the level of benefits they might receive from their pension arrangement.

Annuity rates for pensions increasing with inflation

3.15 AS TM1 sets out a formula for determining the rate of interest to be used in calculating the annuity rate for a pension with increases which are based on inflation.

3.16 The interest rate to be used is currently 50% of the sum of the FTSE Actuaries’ Government Securities Index-Linked annualised Real Yields over five years assuming:

a) 5% inflation; and

b) 0% inflation;

minus 0.5%.

3.17 We propose that AS TM1 should continue to use this formula in determining the interest rate for inflation-linked annuities.

Annuity rates for non-increasing pensions

3.18 As the revised regulations remove the requirement to show an increasing annuity, AS TM1 needs to include a formula for determining the interest rate to be used in calculating an annuity rate that does not increase in payment.

3.19 We have considered two approaches for setting the interest rate for determining the annuity rate for a non-increasing pension:

- the yield specified for increasing pensions (paragraph 3.16 above) plus 3.5%; or
- the yield on the FTSE Actuaries' Government 15 year Fixed Interest Index.

3.20 The former is based on index-linked gilt yields and is the interest rate specified by the FCA in its rules for projections where a non-increasing pension in payment is assumed. The latter is based on fixed interest gilt yields. It is similar to the rate used by the Pension Protection Fund (PPF) when setting assumptions for determining the non-increasing pension liabilities of pension schemes for the PPF levy, and in calculations for pension schemes entering the PPF (although the PPF include a 0.4% addition to the fixed interest yield). The PPF assumption is chosen to reflect the cost of purchasing non-increasing annuities from life offices on a bulk buy-out basis.

3.21 As noted in paragraph 3.14, the annuity assumptions in AS TM1 aim to give an indication of the current cost of purchasing an annuity in the current market. The assumptions in AS TM1 are intended to be a proxy for the pricing bases used by insurers selling non-increasing annuities. In determining which approach to propose in the exposure draft, we sought the views of various stakeholders including insurers currently offering fixed interest annuities. The pricing of annuities is complex and depends on a number of factors; any approach set out in AS TM1 will not be able to capture all these complexities and will therefore be an approximation.

3.22 Feedback from providers and others indicates that an interest rate based on fixed interest gilts is a better proxy than index-linked gilts for the pricing bases used by insurers for non-increasing annuities.

3.23 We have considered whether to adjust the fixed interest gilt yield to reflect additional returns which providers might expect to achieve from other assets such as corporate bonds. Having considered feedback from providers who use a variety of approaches when setting pricing bases, we have not included any addition to the fixed interest yield for determining the annuity rate for a non-increasing pension.

3.24 We would welcome respondents' views on our proposed approach.

Annuity rates for pensions increasing at other rates

3.25 We have also included text applicable where providers choose to illustrate a pension that increases at a rate other than inflation. In these circumstances we are not proposing to set a basis for determining the interest rate as there are many different levels of pension increase which might be illustrated. Instead we are proposing that the interest rate used for determining the annuity rate should be consistent with the interest rates for non-increasing and increasing pensions set out in AS TM1.

3.26 We would welcome respondents' views on our proposed approach.

3.27 This consultation is confined to changes required as a result of the revised regulations. We have not reviewed the interest rate used in the annuity rate calculation used for pensions increasing with inflation. Therefore there may be some inconsistency between the interest rate used for pensions with inflation-linked increases and the interest rate used for pensions with no increases. We intend to review the actuarial assumptions in AS TM1, including the interest rate used for pensions increasing with inflation, in 2014.

Inflation-adjusted projections and rates

3.28 The changes to the FCA Handbook outlined in paragraphs 2.8 to 2.11 will help to improve the consistency and comparability of the projections received by members with FCA-regulated products over the period up to retirement.

3.29 As the statutory illustration is currently shown in real terms, we do not consider that changes are required to either the methodology or the assumptions specified in AS TM1 to ensure consistency with projections brought about by amendments to the FCA rules.

Rates of inflation

3.30 The methodology in AS TM1 for converting the expected value of the fund at retirement into its value at today's prices, and the methodology needed to project the level of future contributions into the pension arrangements, require assumptions for future rates of price inflation and earnings inflation.

3.31 Currently AS TM1 specifies the assumption for both price and earnings inflation as 2.5% pa. The approach under AS TM1 differs from the FCA rules where different rates are assumed for price and earnings inflation (2.5% pa and 4% pa respectively).

Price inflation

3.32 We do not intend to change the price inflation assumption at this time as there is no evidence of a significant change in expectations of future inflation and there has been no change to the Bank of England's long-term inflation target.

Earnings inflation

3.33 We acknowledge that it is generally expected that in the medium to long-term earnings inflation will be greater than price inflation. However, we are not proposing to change the earnings inflation assumption in AS TM1 as:

- the assumption for earnings inflation applies for the entire period up to retirement and earnings patterns over this period can vary considerably for individuals;
- earnings patterns vary by individual and depend on factors including age, occupation and seniority;

- the earnings inflation assumption by necessity is a broad representation of average levels of salary growth over the working life of individuals;
- specifying a rate of earnings inflation equal to price inflation simplifies the calculations; and
- continuing to specify a rate of earnings inflation equal to price inflation means that the illustrations are less likely to be overstated.

3.34 We would welcome respondents' views on our proposals not to amend the price and earnings inflation assumptions.

Presentation of inflation-adjusted accumulation rates

3.35 The revised regulations continue to require a statement that any amounts provided in the statutory illustration are expressed in today's terms and a statement that general assumptions have been made.

3.36 AS TM1 does not impose requirements for the additional information to be provided with statutory illustrations. However, so that all the information presented to members with statutory illustrations is consistent, we consider that when the accumulation rate assumption is described it should be shown net of inflation. This would be consistent with the information required for projections prepared in line with the FCA rules and would, according to the FCA's research, be easier for members to understand.

3.37 We would welcome respondents' views on whether AS TM1 should suggest that providers consider disclosing the accumulation rate used, net of inflation.

Mortality

3.38 We review the mortality assumptions set out in AS TM1 regularly. The current mortality assumptions are gender-neutral and based on a blend of male and female mortality tables and mortality improvements. Since the introduction of version 2.0 of AS TM1, providers have been required to update the improvement assumption element of the mortality assumption annually.

3.39 We do not have any evidence to indicate a change to the mortality assumptions is required at present. However, we may change the mortality assumptions in future if we consider that the current assumptions are no longer appropriate. When designing and updating systems, providers should note that mortality assumptions might to be changed from time to time.

Other assumptions

3.40 We are not proposing to change any of the other assumptions specified in AS TM1. However, other assumptions might change as a result of future reviews. Providers should ensure that their systems and procedures can be easily updated when assumptions in AS TM1 are changed.

2014 review of AS TM1

3.41 We intend to undertake a comprehensive review of the basis set out in AS TM1 next year. In preparation for that review, we would be interested in respondents' views on aspects of AS TM1 not covered in this consultation paper including the appropriateness of the mortality assumptions and the interest rate used for pensions which are assumed to increase with inflation.

We would welcome responses to the following questions:

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

2. What are respondents' views on the proposed approach to the cash assumption (paragraphs 3.6 to 3.8)?

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

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

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

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

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

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

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

4 SUPPLEMENTARY INFORMATION DOCUMENT

Introduction

4.1 When we published version 2.0 of AS TM1, we also published an accompanying document *Technical Memorandum TM1: Statutory Money Purchase Illustrations, Supplementary Information.* This document contains material which was in the previous version of AS TM1 which was guidance rather than material required to fulfil the statutory function of AS TM1 (ie to specify methods and assumptions for statutory illustrations).

4.2 The content of the supplementary information document is as follows:

- The first section sets out the background to the provision of statutory illustrations, states the purpose of the document and describes the limitations of statutory illustrations. It also discusses the differences between statutory illustrations and certain projections produced in accordance with FCA rules.
- The second section lists some considerations of what information might be provided to members with statutory illustrations and lists additional information and estimates which providers might wish to consider providing alongside statutory illustrations.
- The third section describes the approach taken to setting the assumptions to be used to calculate the pension shown on statutory illustrations.
- Appendix A contains the glossary of terms used in the document and in AS TM1.

Maintenance of accompanying document

4.3 Although we are required to issue and maintain AS TM1, we are not required to provide guidance and it is our policy to do so only under limited circumstances.

4.4 We have stated in the past that we do not intend to maintain the accompanying document and that it is possible that some other body may choose to provide guidance on the practical aspects of preparing statutory illustrations in the future.

4.5 We do not intend to update the supplementary information document at present.

5 TIMING OF CHANGES TO AS TM1

5.1 The consultation period for this paper and the exposure draft closes on 13 December 2013. Subject to the nature of the responses to the consultation, we intend to issue the final version 4.0 of AS TM1 so that it is effective for statutory illustrations issued on or after 6 April 2014 and coincides with the new revised regulations and changes to FCA rules. We do not envisage that the relatively short time for implementation should cause any difficulties as the changes for statutory illustrations introduced by the revised regulations are optional. Consequently, we do not consider there is a need for transitional provisions.

5.2 We would welcome views on the timing of changes to AS TM1.

The FRC would welcome responses to the following question:

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

6 IMPACT ASSESSMENT

Benefits

6.1 The proposed changes are intended to ensure that AS TM1 is aligned with the revised Disclosure Regulations. DWP's aims, set out in its consultation paper on the revised regulations, are to:

- ensure that SMPIs are appropriate not only for existing scheme members but also for the new cohort of savers introduced by automatic enrolment – providing them with information that they need to make appropriate retirement provision;
- attain closer harmonisation with projections provided to members of personal pension schemes at point of sale, as required by the FCA; and
- give schemes greater flexibility to tailor the statements to the needs of their members by allowing for a more personalised approach.

6.2 The amendments to AS TM1 specifically address the second and third of these aims.

6.3 In our previous consultations on AS TM1, respondents have frequently called for the harmonisation of the rules relating to projections and have urged the FRC, the DWP and the FCA to work together to achieve consistency.

6.4 We consider that the changes to AS TM1 and to the Disclosure Regulations on personalisation of statements, and the changes to the FCA rules to require inflation-adjusted projections, increase the degree of harmonisation across projections produced using different rules.

6.5 There will be less impact on occupational pension schemes which are not regulated by the FCA, although greater consistency may be helpful for members of such schemes who also buy or hold additional personal or stakeholder pensions regulated by the FCA.

Costs

6.6 Any changes to the systems used for producing SMPIs as a result of the changes to the Disclosure Regulations and the consequent changes to AS TM1 will generate costs for providers.

6.7 However, providers have been strongly advised to take account of the possibility of changes when devising systems to produce statutory illustrations for SMPIs. If systems and processes have been designed with a capacity for change, we consider that the cost of making changes as a result of the proposed revisions to AS TM1 should not be significant.

6.8 Additionally, as noted in paragraph 5.1, the changes effected in the revised regulations and implemented through revisions to AS TM1 are optional. Therefore providers have the flexibility to introduce the changes to SMPIs at a convenient time, for example when they are updating systems for the FCA's or other changes.

7 INVITATION TO COMMENT

Questions

7.1 The FRC invites the views of anyone with an interest in SMPIs (including those responsible for providing SMPIs) and the pension scheme members and policyholders who receive SMPIs who wish to comment on the content of this document. In particular we would welcome views on the following issues:

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

2 What are respondents' views on the proposed approach to the cash assumption (paragraphs 3.6 to 3.8)?

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

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

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

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

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

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

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

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

Responses

7.2 For ease of handling, we prefer comments to be sent electronically to **TM1@frc.org.uk**. Comments may also be sent in hard copy form to:

The Director of Actuarial Policy
Financial Reporting Council
5th Floor, Aldwych House
71-91 Aldwych
London
WC2B 4HN

7.3 Comments should reach the FRC by **13 December 2013**.

7.4 All responses will be regarded as being on the public record unless confidentiality is expressly requested by the respondent. A standard confidentiality statement in an e-mail message will not be regarded as a request for non-disclosure. We do not edit personal information (such as telephone numbers or email addresses) from submissions; therefore only information that you wish to publish should be submitted. If you are sending a confidential response by e-mail, please include the word "confidential" in the subject line of your e-mail.

7.5 We aim to publish non-confidential responses on our website within ten working days of receipt. We will publish a summary of the consultation responses, either as a separate document or as part of, or alongside, any decision.

EXPOSURE DRAFT OF

~~TECHNICAL MEMORANDUM~~ AS TM1: STATUTORY MONEY PURCHASE ILLUSTRATIONS

VERSION 4.0 ~~3.0~~

AS TM1: STATUTORY ILLUSTRATIONS OF MONEY PURCHASE BENEFITS

Status

Legislation provides that **statutory illustrations** must be produced in accordance with relevant guidance prepared by a prescribed body. The Financial Reporting Council (FRC) has been appointed as the prescribed body for that purpose. AS~~Technical Memorandum~~ *TM1: Statutory Money Purchase Illustrations* is that relevant guidance.

AS TM1 does not replace or amend the **legislation**. If it appears that any matter in AS TM1 conflicts with any provision of the **legislation** then the latter will prevail.

The FRC does not accept any liability to any party for any loss, damage or costs howsoever arising, whether directly or indirectly, whether in contract, tort or otherwise from any action or decision taken (or not taken) as a result of any person relying on or otherwise using this document or arising from any omission from it.

Purpose

The purpose of AS TM1 is to specify the assumptions and methods to be used in the calculation of **statutory illustrations** of money purchase pensions.

Application

AS TM1 applies to the production of any **statutory illustration**.

Effective date

AS TM1 version 4~~3~~.0 is effective for **statutory illustrations** ~~with an **illustration date**~~issued on or after ~~6 April 2013. Providers may comply instead with TM1 version 2.0 for **statutory illustrations** issued before~~ 6 April 2014.

Future changes to AS TM1

The FRC reviews AS TM1 regularly. It is possible that the methods and assumptions used will be amended as a result. It is likely that some of the assumptions in Part C will be changed from time to time, and **providers** are strongly advised to take account of the possibility of such changes when devising systems to produce **statutory illustrations**.

CONTENTS

A INTERPRETATION

A.1 INTERPRETATION OF THE TEXT

A.1.1 This technical memorandum (AS TM1) should be interpreted in the light of the purpose set out in the rubric on page 1.

A.1.2 **Providers** may adopt a different approach from that specified in AS TM1 if it does not materially affect the result of the calculation of the **statutory illustration**. For example, this may apply to the order in which the calculations are carried out.

A.1.3 Any assumptions that are used which are not specified in AS TM1 should be appropriate to the purpose of AS TM1 set out in the rubric on page 1. Such assumptions might include the valuation of property assets or the treatment of contributions if payment records are incomplete.

A.1.4 If a **member**'s **current fund** is invested in a with-profits fund (including with-profits deferred annuity contracts) the **statutory illustration** should be provided in a manner consistent with AS TM1 and with the insurer's bonus policy.

A.2 GLOSSARY

A.2.1 Terms appearing in **bold** in the text are used with these meanings:

accumulation rate — The annual rate of return assumed to be earned up to **retirement date** from the **current fund** and **future contributions**.

annuity rate — The value of an annual pension of £1 at **retirement date** calculated using the assumptions specified in AS TM1.

current fund — The relevant assets of the **scheme** in relation to the **member**'s money purchase benefits at the **illustration date.**

future contributions — All money purchase contributions due after the **illustration date** which the **provider** determines to be part of a regular pre-determined series of contributions expected to continue until the **member**'s **retirement date**.

illustration date — The date specified by the **provider** as the date by reference to which amounts are calculated for the purpose of the **statutory illustration**.

The **illustration date** will normally be the **specified date.**

inflation factor — The accumulated assumed inflation from the **illustration date** to the **retirement date**.

inflation rate — The assumed annual rate of inflation.

legislation	Legislation governing the provision of **statutory illustrations** including but not limited to: a) *the Pension Schemes Act 1993 (c.48) Section 113*; ~~b) *the Personal Pension Schemes (Disclosure of Information) Regulations 1987 (SI 1987/1110)*;~~ ~~c) *the Occupational Pension Schemes (Disclosure of Information) Regulations 1996 (SI 1996/1655)*;~~ b) *the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 (SI 2013/2734);* ~~d)~~c) *the Stakeholder Pension Schemes Regulations 2000 (SI 2000/1403)*; and ~~e)~~d) ~~*the Occupational and Personal Pension Schemes (Disclosure of Information) Amendment Regulations 2002 (SI 2002/1383)*; and~~ e) *the Occupational, Personal and Stakeholder Pension Schemes (Disclosure of Information) Amendment Regulations 2010 (SI 2010/2659)*. ~~*f)* .~~ Northern Ireland has its own body of law relating to pensions with corresponding legislation.
lump sum	The amount of the benefit assumed by the provider to be taken as cash by the **member** at **retirement date**.
member	Any person eligible to receive a **statutory illustration** from a **scheme**.
nominal accumulated fund	The **current fund** and **future contributions** accumulated to the **retirement date** adjusted where relevant for tax relief, charges and expenses.
provider	The trustees or managers of a **scheme**, or any other party preparing a **statutory illustration** on their behalf. Other parties might include advisers, insurance companies or software houses.
real accumulated fund	The **nominal accumulated fund** expressed in today's (inflation adjusted) terms.

retirement date	A date which the **member** has specified to the **provider** and which is acceptable to the **provider**; or where no acceptable date has been specified by the **member**, a date specified by the **provider**. A **member** may have more than one **retirement date** for different funds or contracts within a **scheme**.
risk benefits	Benefits payable on death, sickness or critical illness.
scheme	A pension arrangement that is required to provide a **statutory illustration** under the **legislation**.
scheme year	The period specified for the provision of a **statutory illustration**.
specified date	The date the fund is valued for the purpose of the **legislation**. For an occupational pension **scheme**, this is normally the last day of the **scheme**'s administrative year.
statutory illustration	The amount of pension (after allowance for any **lump sum)** calculated in accordance with AS TM1.
statutory illustration statement	The **statutory illustration** and accompanying information.

B DETERMINING THE AMOUNT OF PENSION TO BE ILLUSTRATED

B.1 INTRODUCTION

B.1.1 This Part sets out the method which must be followed for calculating **statutory illustration**s.

B.2 THE AMOUNT OF PENSION TO BE ILLUSTRATED

B.2.1 The **statutory illustration** is the annual amount of pension calculated by dividing the **real accumulated fund** (see section B.3) by the **annuity rate** (see section B.7).

B.2.2 The **statutory illustration** must be shown in whole pounds, rounded down to 3 significant figures. If the result is under £1,000 and is not an exact multiple of £10, it may be rounded down to the next lower multiple of £10.

B.2.3 Any resulting monthly pension of less than £10 may be shown as “less than £10 each month” or “less than £120 each year”.

B.3 ACCUMULATED FUND

B.3.1 The **real accumulated fund** must be calculated by dividing the **nominal accumulated fund** by the **inflation factor** (see paragraph B.3.5).

B.3.2 The **nominal accumulated fund** must be calculated as the sum of:

- the accumulated **current fund**, if any;
- the accumulated **future contributions**, if any; and
- the accumulated amount of any tax relief expected to be reclaimed and credited to the **scheme** for the benefit of the **member** in respect of **future contributions**;

reduced by:

- the **lump sum;**
- the accumulated amount of the costs of any **risk benefits**; and
- the accumulated amount of charges or expenses, if the terms of the **scheme** require such charges or expenses to be deducted from **future contributions** or the **current fund**.

B.3.3 Each element of the **nominal accumulated fund** must be accumulated from the relevant date to the **retirement date** at the rate of accumulation determined in accordance with paragraphs C.2.3 to C.2.6. The relevant date is:

- for the **current fund**, the **illustration date**;
- for each individual payment of **future contributions** or tax relief, the date on which the payment is due to be received by the **scheme**; and
- for each individual payment of charges or expenses or cost of **risk benefits**, the date on which the payment is due to be paid.

B.3.4 If the **nominal accumulated fund** is less than zero, zero must be used instead.

Inflation factor

B.3.5 The **inflation factor** must be calculated by compounding the **inflation rate** specified in paragraph C.2.7 from the **illustration date** to the **retirement date**.

B.4 CURRENT FUND

B.4.1 The **current fund** is the value of the relevant assets of the **scheme** in relation to the **member**'s money purchase benefits at the **illustration date**. The **current fund** must be based on a realistic asset value such as:

a) the market value of the assets;

b) the bid value of relevant units;

c) for an insured **scheme**, the policy value on an ongoing basis;

d) for a **scheme** where a **member**'s rights are determined as a share of the **scheme**'s assets, the value of the **member**'s share; or

e) for a with-profits fund or if assets are not readily marketable, a value consistent with the principles of AS TM1 .

B.4.2 The **current fund** includes allowances for any contributions due at the **illustration date** and for the recovery of any tax due to the **illustration date**. It is not necessary to discount these allowances from their expected payment dates. Allowances which are unlikely to change the **statutory illustration** may be omitted.

B.4.3 A **provider** may omit the allowances referred to in paragraph B.4.2 from the **current fund**, provided that if there are **future contributions**, any items due but unpaid which have been omitted from the **current fund** are treated as **future contributions**.

B.4.4 If the **member** is in receipt of income drawdown in respect of part of the assets of the **scheme**, those assets must be omitted from the **current fund**.

B.4.5 Outgoing transfer values which have been agreed but not paid on or before the **illustration date** must not be deducted from the **current fund**.

B.5 FUTURE CONTRIBUTIONS

B.5.1 **Future contributions** are all money purchase contributions due after the **illustration date** which the **provider** determines to be part of a regular pre-determined series of contributions, irrespective of the formal basis on which contributions are determined. They do not include contributions made after the **illustration date** which are not part of a series of pre-determined payments which are expected to continue.

B.5.2 When determining whether a **member** should be treated as paying **future contributions**, **providers** should take into account factors including the **member**'s expectations and the certainty of payment. In the following examples the **member** should normally be treated as paying **future contributions**:

- a **member** of an occupational **scheme** paying a percentage of earnings from time to time (irrespective of whether or not the **member** has an option to change the percentage rate); an exception might be if the **member** is employed on a short-term contract and there is no continuity of employment or of contributions;
- a **member** paying regular contributions into a personal pension or stakeholder pension **scheme** under a direct debit or standing order;
- it is clear from the **provider**'s records that regular payments (such as a particular cash amount or a percentage of earnings) are intended; and
- a **scheme**'s terms describe future money purchase contributions as being single payments, and they form a series of pre-determined payments which are expected to continue until the **member** reaches **retirement date** or State Pension Age.

Initial level of future contributions

B.5.3 The initial level of **future contributions** must be the actual amount of **future contributions** payable for the **scheme year** following the **illustration date** if it is known.

B.5.4 If paragraph B.5.3 does not apply and if the amount of **future contributions** is determined as an amount which increases in line with inflation or as a proportion of the **member**'s earnings, the initial level of **future contributions** must be the latest known amount of contributions increased for the appropriate period at the rate specified in paragraph C.2.7 or C.2.8 respectively.

B.5.5 If neither paragraph B.5.3 nor paragraph B.5.4 applies the initial level of **future contributions** must be the last known annual amount.

B.5.6 If the amount of **future contributions** is related to the **member**'s earnings and if the **provider** does not have detailed information about the **member's** earnings or if earnings are expected to fluctuate significantly from year to year, the initial level of **future contributions** must be estimated.

B.5.7 For many occupational **schemes** the definition of earnings for pension contributions is updated annually, on the first day of the **scheme year**. In such cases the initial level of **future contributions** may be based on the **member**'s earnings on the day after the **illustration date**. **Providers** may ignore any information they have about changes in the **member**'s earnings which occur after the day after the **illustration date.**

Subsequent levels of future contributions

B.5.8 **Future contributions** must be assumed to increase in accordance with **scheme** provisions or with recognised practice. If there are no **scheme** provisions regarding the increase of contributions, or if there is no recognised practice of increasing contributions, **future contributions** must be assumed to remain unchanged until **retirement date**.

B.5.9 **Future contributions** which are determined as a proportion of the **member**'s earnings must be assumed to increase at the rate specified in paragraph C.2.8.

B.5.10 **Future contributions** which increase in line with inflation must be assumed to increase at the rate specified in paragraph C.2.7.

B.5.11 It may be assumed that **future contributions** which relate to the payment of the maximum non-earnings-related amount into a personal or stakeholder pension **scheme** remain fixed or increase at the rate specified in paragraph C.2.7.

B.5.12 If the amounts of contributions payable are subject to a maximum of a fixed monetary amount or a deduction of a fixed monetary amount the **provider** must deal with the situation in an appropriate manner.

B.5.13 A deduction which is specified in such a way that it will, or is expected to, increase broadly in line with State benefits or contribution limits or with earnings must be assumed to increase at the rate specified in paragraph C.2.7 or C.2.8 as appropriate.

B.5.14 Contributions which are age-related or term-related must be dealt with in an appropriate manner.

B.5.15 If the last known amount of contributions does not relate to a period of 12 months the **provider** must deal with the situation in an appropriate manner.

Transferred benefits

B.5.16 Incoming transfer values which have been agreed but are outstanding at the **illustration date** must not be included in **future contributions**.

B.6 RISK BENEFITS

Initial level of the cost of risk benefits

B.6.1 If the cost of **risk benefits** payable for the **scheme year** following the **illustration date** is known, it should normally be used for the initial level of the cost of **risk benefits**.

B.6.2 If paragraph B.6.1 does not apply and if the cost of **risk benefits** is determined as an amount which increases in line with inflation or as a proportion of the **member**'s earnings, the initial cost of **risk benefits** should be the latest known cost increased for the appropriate period at the rate specified in C.2.7 or C.2.8 respectively.

B.6.3 If neither paragraph B.6.1 nor paragraph B.6.2 applies, the initial cost of **risk benefits** should be the last known annual amount.

B.6.4 If the last known cost of **risk benefits** does not relate to a period of 12 months the **provider** must deal with the situation in an appropriate manner.

Subsequent levels of the cost of risk benefits

B.6.5 If **risk benefits** are determined as a proportion of the **member**'s earnings their cost must be assumed to increase at the rate specified in paragraph C.2.8.

B.6.6 If the cost of **risk benefits** increases in line with inflation it must be assumed to increase at the rate specified in paragraph C.2.7.

B.6.7 If the cost of **risk benefits** increases as the **member** ages then **providers** must deal with the situation in an appropriate manner.

B.6.8 If none of paragraphs B.6.5 to B.6.7 applies, the cost of **risk benefits** must be assumed to increase at the rate specified in paragraph C.2.7.

B.7 ANNUITY RATE

B.7.1 The **annuity rate** is the value of an annual pension of £1 at **retirement date** calculated using the assumptions in Part C.

B.8 GENERAL CONSIDERATIONS

B.8.1 Appropriate adjustments to the calculations must be made if a **scheme year** is not a period of 12 months. Where annual rates are specified in Part C, the equivalent rates for part of a year should be calculated as the appropriate root of the annual rate, not as an arithmetic proportion. For example, the monthly rate equivalent to 2.5% per annum is approximately 0.00206 (1.025^(1/12)-1) and not 0.00208 (0.025/12).

B.8.2 If it is necessary to calculate the period between two dates, the period must be calculated to an exact number of months or more accurately (for example, to the exact number of days). Similarly, if contributions will continue for part of a year, **statutory illustrations** must include an allowance for such contributions for an exact number of months or more accurately.

B.8.3 The **pension** illustrated may be shown as a weekly, monthly or annual amount.

C ASSUMPTIONS

C.1 INTRODUCTION

C.1.1 This Part sets out the actuarial assumptions which must be used in providing **statutory illustrations**.

C.2 ACCUMULATION

C.2.1 This section specifies the assumptions to be used in determining the **real accumulated fund.**

Mortality

C.2.2 No allowance is to be made for mortality before retirement (other than in the calculation of the cost of any **risk benefits**).

Accumulation rate

C.2.3 In determining the **accumulation rate** the **provider** must take account of the expected returns from the current and anticipated future investment strategy of the **member**'s funds over the period to the **retirement date**.

C.2.4 The **accumulation rate** must be based on expected returns before the deduction of expenses or charges.

C.2.5 The **accumulation rate** must be justifiable and consistent with the **inflation rate** assumption specified in paragraph C.2.7.

C.2.6 The method used to determine the **accumulation rate** in accordance with paragraphs C.2.3 to C.2.5 should be consistent from year to year, and the rationale used should be documented and made available to members on request.

Rates of increase in inflation and earnings

C.2.7 The **inflation rate** must be 2.5% per annum compound.

C.2.8 Earnings and any earnings-related indices must be assumed to increase at 2.5% per annum compound.

Expenses

C.2.9 If the terms of a **scheme** require future charges or expenses to be deducted from **future contributions** or the **current fund**, then:

- for **schemes** subject to the FC~~S~~A Rules on projections, charges or expenses must be assumed to be an amount not less than those required by the FC~~S~~A Rules;
- for other **schemes**, amounts no less than the actual charges or expenses of the **member**'s arrangement must be assumed. The assumed charges or expenses should include the costs of investment management, but exclude any dealing costs for the underlying portfolio and any routine management and servicing costs of existing property investments.

C.2.10 Future charges or expenses which are related to **future contributions** (such as those which are calculated as a percentage of contributions) must be calculated by reference to the **future contributions**.

C.2.11 Future charges or expenses up to **retirement date** which are related to the **scheme**'s assets must be calculated using a projected fund as at each annual anniversary of the **illustration date** or, more frequently, from the **illustration date** to the **retirement date**. The projected funds must be based on the **current fund** and allow for any **future contributions**, tax relief, the cost of **risk benefits** and relevant charges or expenses.

C.2.12 If future charges or expenses are not known and cannot reasonably be obtained or estimated, the approach set out in paragraph C.2.11 must be used with charges or expenses of 1% per annum of the projected fund at the start of each year.

C.2.13 Future charges or expenses which relate to the **member**'s arrangement and which are not deducted from **future contributions** or from the underlying assets must be ignored for the production of the **statutory illustration**.

Tax relief on contributions

C.2.14 Tax relief must be assumed to be at the rate at which it is expected to be reclaimed. The expected rate should allow for any known future changes.

C.3 ANNUITY

Lump sum at retirement

C.3.1 ~~No allowance may be made for the payment of a **lump sum** at retirement.~~The **lump sum** assumed to be paid at retirement date should not normally exceed the amount permitted by the **scheme** rules or legislation. Where the **lump sum** assumed is greater than 25% of the nominal accumulated fund or is greater than permitted by the **scheme** rules or legislation, the **provider** should document the rationale for doing so.

~~C.3.1~~

Interest rates to be used in calculating annuity rates

C.3.2 The rate of interest must be determined as at each 15 February. This rate must be used for all **statutory illustrations** with **illustration dates** occurring in the following financial year (6 April to 5 April). If the information on which the rate of interest is to be based is not published for 15 February, **providers** must use the relevant information for the previous business day for which such information is published.

C.3.3 When it is assumed that the **statutory illustration** increases in payment at a rate linked to inflation, t~~T~~he **annuity rate** must be calculated using annual interest equal to 50% of the sum of the FTSE Actuaries' Government Securities Index-Linked Real Yields over 5 years assuming:

- 5% inflation; and
- 0% inflation

minus 0.5%.

C.3.4 When it is assumed that the **statutory illustration** does not increase in payment, the **annuity rate** must be calculated using the yield on the FTSE Actuaries' Government 15 year Fixed Interest Index.

~~C.3.4~~C.3.5 The interest rate must be rounded to the nearest multiple of 0.2%. Intermediate exact multiples of 0.1% should be rounded down.

C.3.6 Published interest rates must be used without any adjustments (such as to convert the published rate from a convertible half-yearly rate to an annual rate).

C.3.7 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 and C.3.4.

Expenses

~~C.3.5~~C.3.8 An allowance of 4% of the value of the annuity at retirement must be made for expenses.

Mortality

~~C.3.6~~C.3.9 The mortality of the **member** and the **member**'s spouse or civil partner must be based on the year of birth rate derived from the Institute and Faculty of Actuaries' Continuous Mortality Investigation tables PCFA00 and PCMA00 and including mortality improvements derived from each of the male and female annual mortality projection models, in equal parts.

~~C.3.7~~C.3.10 For **statutory illustrations** produced with **illustration dates** in the range
6 April 20YY to 5 April (20YY+1), mortality improvements must be

derived from the CMI mortality projection models[1] CMI_(20YY-1)_F[1.25%] and CMI_(20YY-1)_M[1.25%].

~~C.3.8~~C.3.11 For example, **statutory illustrations** produced with an **illustration date** of 6 April 2014 the mortality assumptions must be based on

50% of PCMA00 including improvements based on CMI_(2013)_M[1.25%] +

50% of PCFA00 including improvements based on CMI_(2013)_F[1.25%].

~~C.3.9~~C.3.12 These rates of mortality improvement apply to both the **member** and the **member**'s spouse or civil partner.

Spouse's or civil partner's pension

~~C.3.10~~C.3.13~~**Legislation** specifies the assumption to be used for the amount of pension to be provided to the spouse or civil partner on the death of the member~~ The amount of any spouse's or civil partner's pension should not exceed the amount permitted under the **scheme** rules or legislation.~~.~~

Age difference between member and spouse or civil partner

~~C.3.11~~C.3.14It must be assumed that a husband is three years older than his wife and that those in a civil partnership are the same age as each other, except that:

- at the **provider**'s discretion the **member** may specify the spouse's or civil partner's age to be used;
- the spouse's or civil partner's age shown in the **provider**'s records may be used.

Guaranteed annuity terms

~~C.3.12~~C.3.15No account should be taken of a guarantee of annuity terms which produces a higher amount of initial pension as at the **retirement date**, or a higher amount of pension in a subsequent year, than would be produced using the assumptions in AS TM1.

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[1] The model can be found at: http://www.actuaries.org.uk/knowledge/cmi
CMI_20NN_x [a%] refers to the model published by the CMI where:

- 20NN is the version number of the model reflecting the year of its publication;
- x is the gender and is either M (male) or F (female); and
- a% is the long-term rate of mortality improvement.

Payment frequency and format

~~C.3.13~~C.3.16 When calculating the **annuity rate, providers** may allow for benefits, other than a spouse's or civil partner's pension, payable on the death of the **member** after the pension commences (such as the payment of the balance of five years' payments on death within five years after retirement).

~~C.3.14~~C.3.17 The pension illustrated must be assumed to be payable monthly in advance. ~~and increase annually in payment in line with inflation~~. When it is assumed that the statutory illustration ~~Pension~~ increases in payment in line with inflation, those increases are assumed to apply annually and are implicitly allowed for in the rate of interest specified in paragraph C.3.3.

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