Statement

Financial Reporting Council

December 2014

Version 4.1 of AS TM1: Statutory Money Purchase Illustrations

Rationale for change

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.

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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: Statutory Money Purchase Illustrations* (AS TM1) which it reviews regularly.

Aims and audience of this paper

1.4 The aim of this document is to set out the rationale for the amendments we have made to AS TM1 following our review of AS TM1 carried out in 2014. This document has been written for anyone with an interest in SMPIs, including those responsible for providing SMPIs (trustees, insurers, and administrators), the pension scheme members and policyholders who receive SMPIs, and those organisations which represent and advise these groups.

Nature of changes made in version 4.1 of AS TM1

1.5 AS TM1 has been amended to allow for the legislation permitting same-sex marriage. AS TM1 must be updated to reflect relevant legislative changes. The other two changes introduce flexibility for providers on a permissive basis and concern future contributions in schemes used to meet automatic enrolment requirements and those schemes which provide minimum guaranteed annuity rates. We obtained input from various stakeholders, including members of the Association of British Insurers, in developing the amendments. In view of the nature of the changes, we have concluded that it would be disproportionate to undertake a formal consultation on the changes effected in version 4.1 of AS TM1. We believe there is greater value in early certainty of the changes.

Contents and structure of this paper

1.6 Section 2 describes the background to, and the scope of, this review of AS TM1. Section 3 describes the changes effected in version 4.1 of AS TM1 and their rationale; it also describes the timing of those changes. Section 4 contains our impact assessment. Part II contains version 4.1 of AS TM1 with changes tracked from version 4.0.

2. BACKGROUND AND SCOPE OF THE REVIEW

Introduction

2.1 The FRC is committed to reviewing AS TM1 regularly. In November last year, we signalled our intention to undertake a comprehensive review of AS TM1 in 2014.

Feedback from consultation on version 4.0 of AS TM1

2.2 The consultation on version 4.0 of AS TM1 (November 2013)[1] focused on amendments to the standard resulting from changes to the Disclosure Regulations. In that consultation we asked for views on aspects of AS TM1 that we should consider in the 2014 review.

2.3 The most common theme across the responses to that consultation[2] was the desire for greater consistency with the FCA's rules. Several respondents suggested particular areas of AS TM1 for consideration: rates of inflation, mortality, expenses, the approach to guaranteed annuity terms, and risk and uncertainty.

2.4 One respondent noted that 2014 would be a significant year with automatic enrolment, and that any changes should have a flexible and realistic timescale; another suggested that members' interests (in terms of consistency) and providers' interests (in terms of costs) might be best served by a period of minimal changes.

Budget announcement and other developments

2.5 The comment noted in paragraph 2.4 about the significance of 2014 for the pensions industry proved apposite. Changes announced in the Budget on 19 March 2014 have been described as the most significant changes to affect the pensions industry in almost a century, introducing substantial changes to the way in which individuals can access their retirement savings.

2.6 From 6 April 2015, members of defined contribution arrangements who are over 55 will have flexibility both in terms of the timing and the form in which they draw down their pension funds. Members will be able to buy an annuity or draw down amounts of any size from the fund at any time after age 55 (rising to 57 in 2028). Under the new regime, 25% of funds can be taken tax-free. The remainder will be taxed at the individual's marginal rate.

2.7 Additionally, on 27 March 2014, the European Commission published a proposal to revise the IORP[3] Directive which introduces new governance and communications requirements for pension schemes.

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[1] https://www.frc.org.uk/Our-Work/Publications/Actuarial-Policy-Team/Exposure-Draft-AS-TM1-Statutory-Money-Purchase-Ill-File.pdf

[2] https://www.frc.org.uk/Our-Work/Publications/Actuarial-Policy-Team/Feedback-Statement-AS-TM1-money-purchase-illustrat.pdf

[3] Institution for Occupational Retirement Provision

2.8 The draft revisions to the Directive included a requirement for a mandatory, EU-harmonised pension benefit statement, to be sent at least annually to every scheme member.

Scope of our 2014 review

2.9 Flexibilities introduced by the 2014 Budget will mean that the annuity market and the wider retirement income market are likely to change in coming years. Given this backdrop of an evolving domestic and European landscape, we approached our 2014 review of AS TM1 from the standpoint that it would be premature to make any significant changes to the method or assumptions in AS TM1 unless the existing method or assumptions were found to be not fit for purpose. It could also lead to disproportionate costs and IT resource pressure for providers.

Future reviews of AS TM1

2.10 The requirement for SMPIs in their current form comes from the DWP's Disclosure Regulations[4]. We consider that a projected pension illustration may remain useful for individuals, but, following the changes announced in the Budget, additional information may be warranted.

2.11 We have discussed this with the DWP and understand it may propose changes to the Disclosure Regulations in due course. We may therefore need to make further amendments to AS TM1 to reflect any legislative changes made by DWP.

[4] The Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 (SI 2013/2734)

3. CHANGES TO AS TM1 AND TIMING OF CHANGES

Introduction

3.1 In this section, we summarise the outcome of the 2014 review of AS TM1, and we explain the changes which we have made to AS TM1. We also outline the timing of those changes.

Outcome of the review

3.2 We have reviewed all elements of the methodology and the assumptions set out in AS TM1.

3.3 In light of the evidence gathered, we do not propose to make any significant changes to the existing method or assumptions set out in AS TM1 as we consider they remain fit for purpose.

3.4 However, in the course of our review three issues were raised:

- the approach to future contributions under automatic enrolment;
- the approach to guaranteed annuity terms; and
- the age difference assumption for individuals in a same-sex marriage.

3.5 As a result, we have made three amendments to AS TM1 which:

- allow providers to use their judgement to determine reasonable assumptions where AS TM1 is not explicit on the assumptions that should be used;
- give providers discretion to take account of guaranteed annuity terms in statutory illustrations; and
- amend the text on the age difference assumption for same-sex marriage.

3.6 The issues and the amendments are discussed in more detail below.

Future contributions under automatic enrolment

Issue

3.7 AS TM1 requires providers to take account of future contributions in calculating the statutory illustration.

3.8 Under automatic enrolment legislation, from 1st October 2012 all eligible employees must be auto-enrolled into a qualifying workplace pension scheme. For schemes used for the purposes of satisfying automatic enrolment legislation, minimum contribution levels are being phased in over a period up to 2018.

3.9 Some providers have asked for clarification on the extent to which phased increases to minimum contributions under automatic enrolment legislation should be taken into account in the calculation of the statutory illustration.

3.10 Providers can find it difficult to accurately establish the future levels of contributions that will be payable in arrangements used to meet the requirements of automatic enrolment, either because of lack of data (particularly around earnings) or because individuals' intentions on future contributions are unknown.

3.11 AS TM1 does not state the approach that should be adopted, and we understand that providers are taking one of two approaches:

- ignoring the phased increases to minimum contributions required under automatic enrolment legislation and projecting contributions at the level received during the statement year. This approach means that any increase in the level of pension contributions will only be reflected in statutory illustrations after the increase happens; or
- taking account of the phased increases to minimum contributions under automatic enrolment legislation. This approach increases the calculation complexity and is reliant on the availability of appropriate data.

Response and proposed amendment

3.12 Specifying either of the approaches in paragraph 3.11 may lead to costs for providers in amending their data collection processes and/or their calculation systems. We have therefore amended paragraph A.1.3 of AS TM1 to allow providers to use their judgement to choose reasonable assumptions when they are not specified in AS TM1. This will allow providers to adopt either of the two approaches.

3.13 The Disclosure Regulations specify information which must be provided either alongside the statutory illustration or on a suitable website. These include a statement of any assumptions made relating to future contributions to the scheme.[5] We would expect providers to ensure that this statement is sufficiently clear to enable individuals to determine if phased increases to minimum contributions under automatic enrolment have or have not been assumed.

Guaranteed annuity terms

Issue

3.14 Some pension arrangements have guarantees, such as guaranteed annuity rates (GARs) at retirement. For some schemes these guarantees can significantly increase the prospective pension.

3.15 Paragraph C.3.15 of AS TM1 states that providers should not take account of any guaranteed annuity terms which produce a higher amount of initial pension at the retirement date - or a higher amount of pension in a subsequent year than would be produced using the assumptions in AS TM1. The *Supplementary Information Document*[6] states that providers should consider giving a description of any guarantees which may apply.

3.16 It has been suggested that providers should be allowed to allow for GARs in the calculation of the statutory illustration, as the guarantees can sometimes significantly increase the pension.

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[5] Part 3 of Schedule 6 of The Occupational and Personal Pension Scheme (Disclosure of Information) Regulations 2013

[6] https://www.frc.org.uk/Our-Work/Publications/BAS/Technical-Memorandum-TM1-Statutory-Money-Purchase/Technical-Memorandum-TM1-Statutory-Money-Purchase.pdf

Response and proposed amendment

3.17 We consider that the presentation of a statutory illustration which allows for guaranteed annuity terms may improve the reliability and the usefulness of the statutory illustration for individuals. We have therefore amended paragraph C.3.15 of AS TM1 to give providers discretion to take account of guaranteed annuity terms. Providers will be able to continue to use their current approach to guaranteed annuity terms, or to amend their illustrations to reflect them. This approach is consistent with the FCA's Rules where providers are not prohibited from reflecting guarantees in projections for existing business.

3.18 Guaranteed annuity terms are sometimes only available in specific circumstances - for example there may be restrictions on the form of benefit that attracts the guaranteed rate or restrictions on when the guaranteed rate applies. Providers should consider the likelihood of the guarantee taking effect when making allowance for it in the statutory illustration.

3.19 Under the amended provision C.3.15, where providers take account of guaranteed annuity terms, the fact that the illustration reflects those guaranteed annuity terms should be disclosed alongside the statutory illustration. We would expect providers to ensure that the SMPI is sufficiently clear to enable individuals to determine when guaranteed annuity terms have been assumed in the statutory illustration.

Same-sex marriage

3.20 Same-sex marriage legislation[7] has been in force in England and Wales since 13 March 2014. Legislation to allow same-sex marriage in Scotland is effective on 16 December 2014.

3.21 Paragraph C.3.14 of AS TM1 specifies the age difference between husbands and wives and between partners in civil partnerships; it does not however specify the age difference to assumed in same-sex marriages.

Response and proposed amendment

3.22 Currently, paragraph A.1.3 allows providers to use their judgement in determining the age difference to be assumed in same-sex marriages.

3.23 We have amended the text at paragraph C.3.14 to specify the age difference to be used for same-sex marriages.

Timing of changes to AS TM1

3.24 Version 4.1 of AS TM1 will be effective for statutory illustrations issued on or after 6 April 2015.

3.25 We do not envisage that the relatively short time for implementation should cause any difficulties as the changes are permissive. We do not consider there is a need for transitional provisions and early adoption will be permitted.

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[7] Marriage (Same Sex Couples) Act 2013

4. IMPACT ASSESSMENT

Introduction

4.1 In this section, we summarise our assessment of the benefits and costs of the amendments.

Benefits

4.2 The amendment at paragraph A.1.3 gives providers flexibility to use their judgement to determine an assumption where AS TM1 is not explicit on the assumptions which should be used.

4.3 This amendment reduces the uncertainty when AS TM1 does not state the assumptions to be used, and makes AS TM1 more durable as there will be less need for future amendments for transitory issues. Additionally, the amendment addresses the frequently asked question on the assumptions to be used for future contributions under automatic enrolment.

4.4 The change to the provision at paragraph C.3.15 in AS TM1 allows providers to provide more reliable illustrations where the guarantees might significantly affect the pension.

4.5 Finally, amending the text on the age difference assumption for same-sex marriage means that the standard reflects current legislation.

Costs

4.6 The change to A.1.3 allows providers to continue their existing approach for the assumptions concerning contributions to automatic enrolment schemes and should not lead to additional costs.

4.7 The change permitting providers to allow for guaranteed annuity terms is permissive and will only result in additional costs if providers decide to amend their systems to allow for guarantees.

4.8 We would not expect providers to incur any material costs amending systems for the change to allow for same-sex marriages as the approach to be taken is the same as for civil partnerships.

TRACKED CHANGES OF

AS TM1:
STATUTORY MONEY PURCHASE ILLUSTRATIONS

VERSION 4.1

FROM VERSION 4.0

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 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 4.1~~0~~ is effective for **statutory illustrations** issued on or after 6 April 2015~~4~~. Earlier adoption of version 4.1 is permitted.

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~~reasonable. Such assumptions might include the valuation of property assets or the treatment of contributions if payment records are incomplete or the level of contributions which will be paid to schemes used to satisfy automatic enrolment legislation.~~.~~

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 Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 (SI 2013/2734);* c) *the Stakeholder Pension Schemes Regulations 2000 (SI 2000/1403)*; and d) *the Occupational, Personal and Stakeholder Pension Schemes (Disclosure of Information) Amendment Regulations 2010 (SI 2010/2659*). 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**.
net nominal accumulated fund	The **nominal accumulated fund** reduced by the **lump sum**, if any.
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.
net real accumulated fund	The **net 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 **net 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 **net real accumulated fund** must be calculated by dividing the **net nominal accumulated fund** by the **inflation factor** (see paragraph B.3.6).

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 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 The **net nominal accumulated fund** is the **nominal accumulated fund** reduced by the **lump sum**.

B.3.5 If the **net nominal accumulated fund** is less than zero, zero must be used instead.

Inflation factor

B.3.6 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 Where a **provider** assumes a **lump sum** will be paid at **retirement date,** that **lump sum** should be disclosed in today's (inflation adjusted) terms in the **statutory illustration statement.**

B.8.2 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.8.3 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.8.4 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 **net 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 FCA Rules on projections, charges or expenses must be assumed to be an amount not less than those required by the FCA 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 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 the tax-free lump sum permitted by the **scheme** rules or legislation, the **provider** should document the rationale for doing so.

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, the **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 FTSE Actuaries' Government 15 year Fixed Interest Yield Index except that at the **provider**'s discretion the annuity rate may be calculated using the yield set out in paragraph C.3.3 plus 3.5%.

C.3.5 The interest rate (before the addition of 3.5% made in accordance with the exception permitted in paragraph C.3.4) 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 or C.3.4.

Expenses

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

Mortality

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.3.10 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[8] CMI_(20YY-1)_F[1.25%] and CMI_(20YY-1)_M[1.25%].

C.3.11 For example, **statutory illustrations** produced with an **illustration date** of 6 April 2015~~4~~ the mortality assumptions must be based on

50% of PCMA00 including improvements based on~~-~~ CMI_(2014~~3~~)_M[1.25%] ~~-~~+

50% of PCFA00 including improvements based on CMI_(2014~~3~~)_F[1.25%]~~.~~

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.3.13 Where illustrated, the amount of any spouse's or civil partner's pension should not exceed the amount permitted under the **scheme** rules or legislation.

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[8] 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.

Age difference between member and spouse or civil partner

C.3.14 It must be assumed that ~~a husband is~~males are three years older than ~~his wife~~ female spouses and that spouses or civil partners of the same gender ~~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.3.15 ~~No account should~~ Account may be taken of ~~a~~ guaranteed ~~of~~ annuity terms which produce~~s~~ 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. Where account is taken of guaranteed annuity terms, this should be disclosed alongside the **statutory illustration**.

Payment frequency and format

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

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