Policy Statement

PS12/14

Financial Services Authority

Mortality assumption for pension Key Features Illustrations

Feedback to Chapter 2 of CP12/10 and final rules

July 2012

Financial Services Authority

Contents

This Policy Statement reports on the main issues arising from Consultation Paper 12/10 (*Product Projections and Transfer Value Analysis*) and publishes final rules.

Please address any comments or enquiries to:
Sandra Graham
Investments Policy
Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Telephone: 020 7066 1208
Fax: 020 7066 1209
Email: cp12_10@fsa.gov.uk

Copies of this Policy Statement are available to download from our website – www.fsa.gov.uk. Alternatively, paper copies can be obtained by calling the FSA order line: 0845 608 2372.

Abbreviations used in this paper

CMI	Continuous Mortality Investigation
COBS	Conduct of Business sourcebook
CP	Consultation Paper
DWP	Department for Work and Pensions
ECJ	European Court of Justice
FRC	Financial Reporting Council
FSMA	Financial Services and Markets Act 2000
GAD	Government Actuary’s Department
HMRC	HM Revenue & Customs
KFI	Key Features Illustration
MiFID	Markets in Financial Instruments Directive
PS	Policy Statement
RDR	Retail Distribution Review
SMPI	Statutory Money Purchase Illustration
TVA	Transfer Value Analysis

1
Overview

1.1 In May 2012, in Consultation Paper (CP) 12/10, we proposed changing the rules in the Conduct of Business sourcebook (COBS) that set out the mortality assumption for firms to use when illustrating a future annuity within a Key Features Illustration (KFI).

1.2 In this Policy Statement (PS), we give feedback on the responses we received to those proposals and present the final rules we have adopted, which are in Appendix 1.

Background

1.3 Firms give a KFI to potential buyers of packaged products which do not come within the scope of the Markets in Financial Instruments Directive (called non-MiFID packaged products in this paper) at the point of sale. This enables consumers to consider the range of possible outcomes of the contract and compare the charges of different products. Pension KFIs illustrate the range of possible outcomes by projecting the future annuity income at the date at which the consumer intends to start taking benefits from the pension.

1.4 Firms use specific assumptions laid out in COBS to determine the annuity basis used to convert the lump sum into a regular income, including an assumption on future mortality. In CP12/10, we proposed changing the mortality assumption to:

- update it for improved longevity and align it with the basis used by the Financial Reporting Council (FRC), so that the mortality basis for KFIs is consistent with that for annual pension statements; and
- calculate annuities on a gender equal mortality rate, in line with the European Court of Justice's decision in March 2011.

Implementation and timetable

1.5 In the CP, we said we were aware that consumers receiving KFIs currently, but intending to retire after 21 December 2012, were already receiving information which might overstate their potential retirement income. We specifically asked whether an implementation date of 21 December 2012 was appropriate.

1.6 We have concluded that the new rules in Appendix 1 should come into force on 21 December 2012, as originally proposed.

Equality and diversity

1.7 In CP12/10, we noted the equality and diversity impact of our proposals in relation to the proposal to introduce gender equal mortality assumptions when considering the value of future annuity income. Respondents to CP12/10 did not comment on equality and diversity specifically in their responses.

Who should read this PS?

1.8 This PS will be of interest to life insurers and other providers of personal pensions and also to firms that advise on personal pensions.

CONSUMERS

Consumers will benefit from these new requirements, which reduce the risk of detriment associated with under-provision for retirement by ensuring that projections using mortality assumptions are prepared on a suitable basis.

2

Changes to mortality assumptions

Introduction

2.1 This chapter outlines the views of respondents to the proposals made in Chapter 2 of CP12/10. We received 19 responses to our consultation. Responses came from a range of sources, including professional services providers, product providers and wealth management firms, as well as software providers, trade bodies and professional bodies. A full list of non-confidential respondents is provided in Annex 1.

2.2 We also set out our views on these responses and how we have decided to proceed.

Our mortality proposals and summary of feedback

2.3 Our rules on pension illustrations require firms to illustrate the potential retirement income that could be achieved from a personal pension by using an annuity basis designed to reflect current market annuity rates. Our rules (in COBS) set out the interest rate, mortality basis and expenses to be assumed in projecting the future annuity income.

2.4 Historically, the annuity basis has been consistent with the one used in annual pension statements, known as Statutory Money Purchase Illustrations (SMPIs). The technical detail of SMPIs is governed by Actuarial Standard Technical Memorandum 1 (AS TM1) published by the FRC, under delegation from the Department for Work and Pensions (DWP). In general, we think it is sensible that an individual who purchases a personal pension and receives a projection of the potential benefits when they buy it should continue to receive annual statements indicating future benefits determined consistently.

2.5 During 2011, following discussions with us, the FRC consulted on and published an updated mortality basis for use in TM1. This was to reflect improved longevity as well as to take account of the European Court of Justice's (ECJ) ruling in March 2011 that the provision allowing the use of actuarial and statistical data to differentiate proportionately premiums and benefits on grounds of sex was invalid and that their ruling[1] should be complied with from 21 December 2012. This will change the annuity rates available in the market. So we and the FRC agreed that the mortality basis would need to allow for equal male and female rates, to reflect the terms that may be available in practice.

2.6 In April 2012, we implemented the agreed basis, but clarified the blending of male and female rates, for Transfer Value Analysis (TVA). Respondents to the TVA consultation urged us to introduce the same basis for KFIs as soon as possible.

2.7 So in CP12/10, we proposed updating the mortality basis consistently, as follows:

50% of PCMA00 including improvements based on CMI_(20yy-1)_M[1.25%]

+

50% of PCFA00 including improvements based on CMI_(20yy-1)_F[1.25%]

where 20yy is the 12-month period starting 6 April 20yy.

2.8 We asked:

Q1: *Do you agree with the new revised mortality basis? If not, please explain what alternative basis you think is more appropriate.*

2.9 Virtually all respondents agreed with our proposals for the mortality assumptions, with many welcoming us making the blending method for males and females clearer, as well as making the basis for annual pension statements more consistent. One respondent believed it should not be based on a 50-50 mix of male and female mortality but should take into account the population weighting of males and females. Another respondent thought that the future improvement factors should only be updated every three years rather than every year. They thought this would provide greater stability and consistency in annual statements to consumers, as well as reducing the resources needed to implement the change.

2.10 A number of respondents commented on the need to keep the blending ratio of 50% males and 50% females under review. These respondents pointed out that there has still been no indication how annuity providers themselves will adopt gender neutral annuity rates and the extent to which they will take into account the actual mix of annuitants, most of whom are male.

1 See Directive 2004/113, Article 5, and Association Belge des Consommateurs Test-Achats, Case C-236/09

2.11 A small number of respondents sought more clarity on the range of product projections included in our rules, particularly with reference to the distinction between personal pensions and occupational pensions.

2.12 One respondent pointed out a potential error in the draft rules where the improvement factor for males was stated as .25%.

Our response

We were pleased that virtually all respondents agreed with our proposals and welcomed the clarification on the blending method. As the methodology proposed was consistent with the basis adopted by the FRC, we do not consider that using an alternative weighting for blending would be appropriate.

We note that the Continuous Mortality Investigation (CMI) has published mortality rates including blended improvement factors on its website. Firms who choose to use these remain responsible for ensuring that they use correct factors in projections.

The rules apply to all future annuity projections which fall under our illustration rules for individual pension packaged products such as personal pensions, including Group Personal Pensions, and stakeholder pension schemes which are not occupational pension schemes. Firms should refer to the guidance published by the European Commission.[2]

The improvement factor for males should have been 1.25% and this is reflected in the final rules we have published.

We agree that the blending ratio may need to be reviewed from time to time and encourage firms to make their systems changes in such a way that would enable them to implement any future change efficiently.

Timing

2.13 In CP12/10, we recognised that consumers initiating pension contracts now but intending to retire after 21 December 2012 may already be receiving KFIs which overstate the projected annuity benefit. However, we also acknowledged that firms need time to change their systems, alongside the changes already being made for the Retail Distribution Review (RDR), and we reduced our normal consultation period in order to speed up the consultation process and increase the time available to firms to make these changes. Consequently, we concluded that requiring firms to implement the changes by 21 December was appropriate. We asked:

2 Guidelines on the application of Council Directive 2004/113/EC to insurance, in the light of the judgment of the Court of Justice of the European Union in Case C-236/09 (Test-Achats) Text with EEA relevance (http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52012XC0113(01):en:NOT)

Q2: Do you agree with the timing for the introduction of the new mortality basis? If not, please describe the approach you believe should be taken.

2.14 Most respondents agreed with our proposal, with many stating that an effective date of 21 December 2012 was consistent with both the ECJ ruling as well as the implementation of the new TM1 basis. A number of provider firms commented that any delay in implementing the new basis beyond the date for TM1 changes would result in them incurring higher costs.

2.15 Two respondents thought that firms should have the option to implement the new basis sooner but by no later than 21 December. Another firm suggested that the implementation date should be delayed by ten days to 31 December 2012, to coincide with the date when the RDR becomes effective.

2.16 Two respondents commented that the lack of definition of the blending method in TM1 may cause issues for firms who have already implemented TM1 with a different approach to blending than that proposed in CP12/10. One of these respondents suggested that, while the FRC consulted on mirroring the FSA-proposed approach to blending, either basis could be used over a transition period until 6 April 2013.

2.17 One respondent wrote of the need for a coordinated approach with HM Revenue & Customs (HMRC), due to the need to review the Government Actuary's Department (GAD) rates for drawdown pensions and for valuation of lifetime transfers under Discounted Gift Schemes.

Our response

We have considered the responses carefully but have decided to maintain an implementation date of 21 December 2012, which is consistent with the effective date of the ECJ ruling.

As consumers are already being provided with future annuity projections which are not representative of annuity rates that will be available in the market, we cannot see any justification for delaying the policy.

The implementation date is consistent with the date by which firms must also make changes for TM1. Some firms, who use the same systems for KFIs and annual pension statements, may incur additional costs if there is a difference in the implementation dates.

Given the lead-in time that firms require for making systems changes, we consider that the rules we are making now cannot be delayed in order to coordinate with the authorities responsible for other types of products that may be affected by the ECJ ruling.

Cost benefit analysis

2.18 In our consultation, we identified one-off costs to pension providers of £7.9m. We acknowledged that for the cost estimates to be met, the timetable should not change and should remain consistent with the timetable laid down by the FRC.

2.19 In our assessment of the indirect impact, we highlighted a risk that individuals may be deterred from purchasing a pension contract if they perceive it to be poor value for money. On the other hand, a more realistic projection might encourage increased saving as well as increase consumers' focus on charges and put pressure on providers to reduce these.

2.20 Overall, we considered it to be beneficial to consumers to receive illustrations which did not overstate the potential benefits and give rise to misleading expectations. KFIs should be useful to consumers and enable them to make plans for their future on a realistic basis.

2.21 We asked:

> *Q3: Do you have any comments on the cost benefit analysis for our proposals in Chapter 2?*

2.22 Only three respondents commented on the cost benefit analysis. In regard to compliance costs, there was support for our view that changing the basis from 21 December 2012 would allow firms to combine the changes to their illustration systems with those to implement RDR and TM1 changes and so help to use resources more efficiently and contain costs.

2.23 One firm commented on the indirect impacts on consumers and the effectiveness of changes depending on the way they are presented to consumers. This respondent welcomed any measures which give consumers a realistic idea of the level of their possible retirement income and, in particular, the level of contribution required to achieve it.

2.24 One firm commented on the extra cost to firms who may have already implemented TM1 but using a different blending method for male and female rates.

Our response

We were pleased that the costs we identified were considered appropriate and that firms agreed that making changes alongside those needed to implement other regulatory initiatives was efficient.

We agree that consumers must be given a realistic indication of the potential level of retirement income as a result of investing in a pension to help their financial planning. We are pleased that the importance of the way in which changes are presented is recognised.

We are unable to comment on the precise detail of the TM1 basis in relation to blending of male and female rates, but note the FRC asked a specific question in relation to this in Chapter 5 of CP12/10.

Compatibility statement

2.25 We consider that the compatibility statement in Annex 2 of CP12/10 is still valid and does not need to be amended.

Annex 1

List of non-confidential respondents to Chapter 2 of CP12/10

Aegon
Association of British Insurers
Aviva
Axa Wealth
Bridges UK Actuarial Services
Capita
Friends Life
Hargreaves Lansdowne
Hymans Robertson
MGM Advantage
Prudential
Scottish Life
Skandia
Society of Pension Consultants
St James's Place Group
The Actuarial Profession
The Phoenix Group
Zurich

Appendix 1

Made rules (legal instrument)

CONDUCT OF BUSINESS SOURCEBOOK (MORTALITY ASSUMPTIONS FOR FUTURE ANNUITY PROJECTIONS) INSTRUMENT 2012

Powers exercised

A. The Financial Services Authority makes this instrument in the exercise of:

(1) the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(a) section 138 (General rule-making power);
(b) section 149 (Evidential provisions); and
(c) section 156 (General supplementary powers); and

(2) the other powers and related provisions listed in Schedule 4 (Powers exercised) to the General Provisions of the Handbook.

B. The rule-making powers referred to above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force on 21 December 2012.

Amendments to the Handbook

D. The Conduct of Business sourcebook (COBS) is amended in accordance with the Annex to this instrument.

Citation

E. This instrument may be cited as the Conduct of Business Sourcebook (Mortality Assumptions for Future Annuity Projections) Instrument 2012.

By order of the Board
26 July 2012

Annex

Amendments to the Conduct of Business sourcebook (COBS)

In this Annex, underlining indicates new text and striking through indicates deleted text.

13 Annex 2 Projections

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3	How to calculate a projection for a future annuity		
3.1	A *projection* for a future annuity must:		
	(1)	be calculated by rounding all factors to three decimal places before applying them to the relevant retirement fund;	
	(2)	~~be based on the mortality tables PMA92 and PFA92, using the medium cohort projection based on year of birth mortality rates~~ use a mortality rate based on the year of birth rate derived from each of the Institute and Faculty of Actuaries' Continuous Mortality Investigation tables PCMA00 and PCFA00 and including mortality improvements derived from each of the male and female annual mortality projection models, in equal parts;	
	(3)	[deleted]	
	(4)	(for an annuity where two lives are concerned):	
		(a)	reflect the age difference between the two lives; or
		(b)	be based on the assumption that the male life is three years older than the female (if the genders differ) or the two lives have the same age (if the genders are the same);
	(5)	include an expenses allowance of 4%;	
	(6)	be based on the following rates of return as appropriate:	

…

E	
3.1A	For any year commencing 6 April, the use of the male and female annual CMI Mortality Projections Models in the series CMI(20YY-1)_M_[1.25%] and CMI(20YY-1)_F_[1.25%], where YY-1 is the year of the Model used, will tend to show compliance with *COBS* 13 Annex 2 3.1R(2).

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3.2	…

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The Financial Services Authority
25 The North Colonnade Canary Wharf London E14 5HS
Telephone: +44 (0)20 7066 1000 Fax: +44 (0)20 7066 1099
Website: www.fsa.gov.uk