Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

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Dear Stephen

Pension Projections – CP134

I am responding on behalf of the Consumer Panel to CP134. I should say at the outset that the Panel is concerned about the imminent introduction of Statutory Money Purchase Illustrations (SMPIs) showing a pension projection in **real** terms. This is because we have serious doubts about the ability of a large number of consumers to understand the information they will receive. We believe it will be confusing for consumers to receive an illustration in terms of "today's prices" unless a very clear explanation of what the figure means is also provided. Without such an explanation, we think there is a risk that receipt of the new SMPIs with figures in real terms will discourage some consumers from making further pension contributions. We have said this to the Department for Work and Pensions and have suggested that consumer testing of SMPIs needs to be undertaken before they are introduced. We understand that work to this end is now in hand.

Turning to the questions raised in CP134:-

Q1 Do you agree that a single real pension projection should be given in the KFD?

Yes. We agree that, providing it is accompanied by an adequate explanation of what it constitutes, a real projection of pension income is likely to be more helpful to consumers than monetary projections. We note that the proposals set out in CP134 are confined to those driven by the SMPI initiative. However, we hope that more substantial changes to the projection rules will occur as a result of the disclosure review. Our preferred outcome would be for **all** projections given in the KFD to be quoted in real terms (except in cases where the pension is for the specific purpose of paying off a finite sum of money – eg a mortgage).

Q2 Do you agree that it is appropriate for us to introduce a market-related annuity interest rate?

Yes. We agree that a market-related annuity interest rate consistent with that used in SMPIs should be introduced.

Q3 Is the formula for calculating the RPI linked and monetary annuity interest rates appropriate? If not, what alternative would you suggest?
We have no alternative suggestions.

Q4 Do you agree that the annuity interest rate formula for annuities increasing in line with LPI should be the same as that for annuities increasing in line with RPI?
Yes.

Q5 Is it appropriate to update the rates yearly and are the suggested yield calculation and effective dates appropriate?
Yes.

Q6 Is the 0.5% addition included in the fixed rate annuity interest formula appropriate?
We have no comments on this.

Q7 Do you agree that our mortality assumptions should be updated to reflect the improved life expectancy of pensioners?
Yes.

Q8 & Q9 [For firms]

Q10 Do you agree that 2.5% is an appropriate inflation assumption?
Yes – in line with both the SMPI assumption and the Bank of England's target figure.

Q11 Do you agree that it would be appropriate to allow real projections in terms of earnings?
Q12 Do you agree with the proposed approach for contribution increases?
Yes. We agree that an additional real projection in terms of earnings should be allowed (but not compulsory); we also agree with the proposed approach for contribution increases. However, we suggest that exactly where it is best to provide this additional information should be considered as part of the disclosure review. We also think that the inclusion of additional real projections strengthens the argument for monetary projections to be excluded altogether from KFDs (except in specific cases) if consumer confusion is to be avoided - as we said in our answer to Q1 above.

Q13 Do you agree that we should not prescribe increases for monetary projections to be in line with the RPI?
Yes. However, the potential for inconsistency between the pension increase rates in the real and monetary projections in the KFD could cause confusion among consumers and certainly will not help them to understand the concept of the real projection shown on their SMPI. Our preference, as expressed in our answer to Q1,

would be to restrict projections shown in the KFD to those given in real terms (except in cases where the pension is for the specific purpose of paying off a finite sum of money – eg a mortgage).
Q14 Do you agree that it is no longer necessary to show the final year's contribution for real projections?
Yes.

Q15 Do you agree with our proposed approach for existing business projections?
No. We do not think that firms should be allowed to continue giving 'existing business projections' on a monetary basis as this would be confusing to consumers when they come to compare them with the real projection shown on their SMPI. Again, there may be a case for an exception where the pension is for the purposes of paying off a finite sum of money (eg a mortgage).

Q16 Do you agree that real rates of 1% and 3% can be removed except in connection with contracting out of S2P?
Yes.

Q17 Do you agree with our proposal for the annuity expense assumption?
Yes – on the assumption that an annuity expense allowance of 4% is realistic and that a regular check is made to ensure that a 4% allowance remains appropriate.

Q18 Do you agree with the use of the projection annuity interest rate for transfer analysis purposes?
Yes.

Q19 Should the interest rate for transfer value analysis be calculated yearly or quarterly?
A yearly calculation would be sufficient in our view.

Q20 Do you agree with our interpretation of the particular situations where SMPI and FSA rules should apply?
Yes. Our expectations of the disclosure review are that it will bring the SMPI and FSA rules into line and make interpretations of this nature unnecessary.

Q21 Are you aware of any other situations where clarification is needed in determining which set of rules apply and if so what are they?
No.

Q22 Do you have any concerns about the revision of TM1 and changes to the FSA rules?
Yes – as expressed at the beginning of this letter.

Q23 Are the proposed statements appropriate?
No. We feel that the proposed explanation of the real projection is inadequate.

Q24 Do you have any suggestions that could improve the statements or their layout?
We have doubts about consumer understanding of the concept of ‘today’s prices’ and suggest that the prescribed statement should be subjected to rigorous consumer testing with a view to improving it. We also think it should be made clear that the pension will be subject to tax and this is not reflected in the illustration.

Q25 What are your views on the merits and drawbacks of developing a standard format to help individuals understand the information given to them in SMPIs?
We support the development of a standard format, which should be consumer–tested to ensure that it is understandable by as wide a range of consumers as possible.

Q26 What are the merits and drawbacks of uniform explanatory material, for example a factsheet, produced by the FSA or by other means?
We agree that a short consumer-tested factsheet would be helpful.

Q27 Do you agree that keeping the existing APP projection basis will produce a reasonable comparison with S2P allowing for: (a) mortality on our revised basis; and (b) post-retirement interest as at present rather than the revised FSA basis?
Yes. However, we believe that the FSA should monitor the position to ensure that the APP projection basis continues to produce the desired consistency for pension projections so that consumers can decide whether or not to contract out of S2P.

Q28 Should stochastic projections be allowed under our rules and should they be provided: a) only in addition to deterministic projections, or b) as an alternative to deterministic projections? In which situations (if any) would the provision of stochastic projections be preferable to the provision of deterministic projections?

Q29 What is the best approach for regulating stochastic projections?

Q30 What constraints should be imposed on the models used for stochastic projections?

Q31 How should stochastic projections be presented?

We believe that there is a good case for encouraging the development of stochastic projections, but not for issuing them at present, unexplained, to the general public nor for permitting them to replace the existing deterministic projections. At this stage, therefore, we support option (vii) of paragraph 6.26 - that is, allowing stochastic projections to be given only when the consumer is advised by someone with the appropriate qualifications and experience to interpret and apply the information.

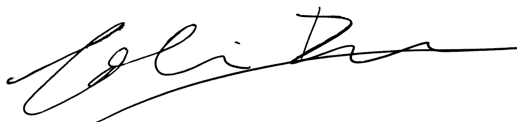
We are surprised that, in suggesting various ways forward, CP134 does not seem to have considered controlled experiments with stochastic and deterministic projections.

The Panel would be glad to play a part in setting up such research. For example paragraph 6.14 states, correctly, that deterministic projects are sometimes interpreted as an expectation or even a promise of the amount an individual will get back. But it is not clear that probabilistic projections are any more intelligible to the general public: paragraphs 6.7 to 6.10 may be far clearer to professionals in the industry than to consumers.

In principle, stochastic projections can give better information to consumers. But much of their superiority over deterministic projections may be lost if they are subject to too many central rules. Of the safeguards outlined in paragraph 6.26, we do not support (i) and (iv) which would be likely to reduce their usefulness and inhibit their development: we do support (iii) and (v). We support (vii), as mentioned above. The answers to (ii) and (vi) might well emerge from the consumer research we recommend.

Finally we would emphasise that no matter how sophisticated and subtle the statistical techniques deployed, there is no way of foretelling the future, particularly the long distance future. As Keynes remarked over 60 years ago, the present is already subject to changes we have not identified, so does not form a firm platform for projections; the future is less like the past than we believe; and all markets are highly subject to conventional views which can then suddenly change. Consider as an example someone taking out a 25-year savings contract in 1978. Faced with the combination of inflation and unemployment which followed the 1973/4 oil price rise, no fund manager would have predicted the low inflation/high employment situation of UK today; nor would he or she after the second oil price rise of 1979, the international debt problem of the early 1980s or the "Reaganomics" of later that decade. On the other hand in the mid-1990s fund managers interpreted the long US bull market as a "new economic paradigm", and would have forecast large terminal bonuses for contracts ending in 2003. Even more startlingly, funds that remained invested in old "value" stocks and eschewed ‘dot.com’ and telecommunications equities three years ago would then have been castigated, but would now be hailed for their prescience. The future is not just risky, which is susceptible to statistical analysis, but also uncertain, which is not.

Yours sincerely,



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