Dunstan Thomas

Response to the proposed revision to AS TM1: Statutory Money Purchase Illustrations consultation paper

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1 About Dunstan Thomas

Dunstan Thomas provides consumer and adviser tools, calculators, illustration, and disclosure systems, as well as portal and administration solutions for the financial services market with Imago Administration, Imago Illustrations, Imago Tools, Imago Automation, and Imago Portal.

Imago Illustrations is a configurable, powerful, and scalable solution for delivering illustrations, disclosure, and reporting solutions to meet the unique and personalised needs of product providers, platforms, and advisers, including the production of SMPIs. In total, we estimate that our Imago Illustrations software generates more than one million SMPI illustrations every year. This is spread across both our own in-house administration and several leading pension providers who have taken a licence for our software.

2 Executive summary

Dunstan Thomas is pleased to respond to the FRC consultation - Proposed revision to AS TM1: Statutory Money Purchase Illustrations and would be happy to answer any queries you may have regarding our response or to help you further in any way; please use the contact details on the front page to get in touch with us.

SMPIs can be incredibly useful to consumers in their retirement planning but for this to be the case, it is important that the underlying calculation methodology for these is up to date and allows for as accurate a projection as possible. An SMPI is a forward-looking statement and as such, there is always a degree of uncertainty as to how accurate they will be, but it is important that the methodology used is proportionate and easily explained to a consumer if required. It is also important to make it clear to consumers that the ERI or any other projected figure is merely an indication based on a set of assumptions, should only be used for broad retirement planning purposes, and may turn out not to be accurate based on events outside of anyone's control.

Whilst the concept of the Estimated Retirement Income is a sound one, and it makes perfect sense to use the same methodology in an SMPI as on the Pensions Dashboards, we believe that some of the other changes proposed in this consultation aren't necessary and don't relate to the Pensions Dashboards work or improve the SMPI for consumers; for example, is there any real-world evidence that the volatility-based approach is any more accurate than the current method where schemes can use their own, reasonable, growth rates? In addition, attempting to explain the volatility-based approach to a consumer would be impossible and do nothing to reinforce the message that the industry wants to promote, of consumer engagement and pensions being accessible for all. It is our view that this consultation has not focussed on the consumer experience as much as it should have done; we cannot see any real link between the proposed changes and a better consumer outcome in SMPIs.

Whilst we appreciate that AS TM1 is reviewed annually, it has not been changed in five years, so that would lead us to assume that the assumptions have been accurate and up to date since the last review in 2017; it seems odd that the Pensions Dashboard initiative has triggered these changes, some of which are quite significant.

An SMPI statement is, for some consumers, their only touchpoint with a provider throughout the year and as such represents a singular opportunity to engage with the consumer about their pension. To that end, we feel that there are several changes that would enhance the SMPI for a consumer. These include changing the deterministic projection for a stochastic one to show the consumer how likely it is that they might achieve a particular outcome, and adding nudges or peer comparisons into the document to show consumers what other people in their demographic are doing and the potentially positive impact of adding more money into their pension.

Lastly, amongst other things, the pandemic has had an impact on life expectancy in England according to research; this would seem like an ideal opportunity to make the mortality tables used in AS TM1 as up to date as possible and include the latest data, rather than use the "16" series tables which, as they relate to the period 2015-2018, are out of date.

3 Question responses

Q1. How supportive are you of the approach to prescribe the accumulation rate and form of annuitisation more precisely, in order to improve consistency across projections from different providers? In particular, do you have any concerns arising from the loss of independence and judgement allowed to providers to set these terms?

We are supportive of the drive for consistency across all illustrations but question what it is about the current approach that requires change and why it has taken the introduction of Pensions Dashboards to trigger this; surely if the approach is inappropriate or incorrect now, it has been so for some time and could have been changed as part of one of the annual reviews of AS TM1 since 2017. An SMPI is a forward-looking projection based on a set of assumptions and should be treated merely as an indication of the benefits that you might receive in future, and in that respect, we don't believe that the proposed changes make an SMPI more accurate, and indeed that the extra effort and complexity required to implement and maintain the accumulation rate assumptions is highly disproportionate to any perceived benefit. In answer to the specific question posed, we believe that providers are best placed to make reasonable decisions about the most appropriate growth rates for assets and so they should be the ones to set them, albeit with guidance/rules to ensure that providers cannot 'game' the system and make their proposition look more attractive than a competitor's.

Q2. What are your views on the proposed effective date of 1 October 2023?

Given that SMPI changes are normally aligned with the tax year, this seems an unusual effective date, even considering the proposed Pensions Dashboards timelines. We would suggest an effective date of 6 April 2024.

Q3. What are your views on the proposed volatility-based approach for determining the accumulation rate?

We do not believe that volatility is an appropriate measure, and in addition, the prescribed method for calculating and then maintaining the groups is unnecessarily complex, placing a huge burden on those responsible for their calculation for what we perceive to be little benefit to the consumer.

Low volatility does not always equate to low returns; using the prescribed methodology, illiquid assets would be in volatility group 1 due to being treated as unquoted assets with a zero-growth rate and this would lead consumers to believe that their returns might be extremely low when in reality, they would probably be significantly better.

In addition, if an asset is highly volatile and is in group 4, it is reasonable to assume that the growth rate for that asset is likely to be less accurate than the growth rate in the groups that have lower volatility; this would need to be made clear to consumers to manage their expectations of actually achieving that growth rate.

Given that you state in 3.4 of the consultation that the approach to determining the accumulation rate assumptions should be "easy to describe to savers" and "not place an undue burden on providers", we do not think the volatility approach is appropriate. An easier approach would be to use asset classes, applying current industry categorisations to ensure that there is consistency across providers. Whilst we understand that you have considered this approach as part of the consultation but not taken it forward, we are of the opinion that this approach is much easier to describe to a consumer and places much less burden on providers. It is, of course, important to ensure that this approach does not allow providers to 'game' the system by making their proposition look more attractive than one using the same funds but offered by a competitor, but we believe with the right framework, this is a much more appropriate option for both consumers and providers.

Q4. Based on an assumed CPI of 2.5% do you find the accumulation rates proposed for the various volatility indicators to be reasonable and suitably prudent?

These seem reasonable, taking into account the points raised in our response to Q3 above regarding the volatility-based approach in general.

Q5. What are your views on the proposed approach to reflect derisking when calculating the accumulation rate assumptions?

More detail is needed on the calculation method to be used in the proposed approach, but this seems sensible.

Q6. What are you views on the proposals that the recalculation of volatility indicator should be annually as at 31 December with a 0.5% corridor?

The fact that the corridor concept is required just highlights how complex the volatility-based approach is, adding more unnecessary work on top of what has already been proposed.

Q7. What are your views on the proposed approach for with-profits fund projections?

We agree with the proposed approach.

Q8. Do you have experience of unquoted assets held in pension portfolios and what are you views of the proposed approach for unquoted assets? In particular do you regard a zero real rate of growth to be acceptable and if not please provide suggested alternatives with evidence to support your views?

Our view is that using the prescribed methodology, unquoted assets such as illiquid assets would be in volatility group 1, and this would lead consumers to believe that their returns might be lower than in reality. The knock-on effect of this is to perpetuate a negative view of pensions as a long-term savings vehicle and promote disengagement – exactly the opposite of what we are trying to achieve as an industry.

Q9. What are your views on the proposed approach to determine the accumulation rate assumption across multiple pooled funds?

This brings yet more complexity to the growth rate calculation. A methodology based on asset classes would be much easier to implement and maintain, as well as being easier to explain to consumers.

Q10. What are your views on the proposed prescribed form of annuitisation and treatment of lump sum at retirement? In particular, does the recommendation to illustrate a level pension without attaching spouse annuity cause you any concerns in relation to gender equality or anticipated behavioural impacts?

Consistency with the Pensions Dashboard approach of not disclosing the lump sum is a good idea, regardless of our view that it should be disclosed as it is the most common approach taken at retirement. Saying that the limits to a tax free lump sum are complex and using this as a reason not to disclose it does not, in our opinion, constitute a good enough argument; a simple change of the term “tax-free lump sum” to “cash lump sum” and an explanation that it is an indication and can be affected by a consumer’s personal circumstances would, in our opinion, allow the lump sum to be disclosed in a manner that is clear and unambiguous to the consumer.

Regarding the level annuity, we do not agree that ignoring inflation is a good idea for a consumer who might be looking at taking an annuity for 30 years or more and will not know that they need to discount it for inflation to make sure it will sustain them for as long as it needs to. In addition, a level annuity will cost the consumer less to buy than an inflation linked one and will lead to an overly optimistic view of how much of their retirement savings they will need to use to buy an annuity that will sustain their required level of income for the rest of their life.

Q11. What are your views on the proposed approach to determine the discount rate assumption when used to determine the annuity rates for illustration dates which are a) more than two years from retirement date and b) less than two years from retirement date?

We agree with the proposed approach.

Q12. What are your views on the proposed new mortality basis for determining the annuity rates where the illustration date is more than 2 years from the retirement date?

The pandemic has had an impact on life expectancy in England according to research; this would seem like an ideal opportunity to make the mortality tables used in AS TM1 as up to date as possible and include the latest data, rather than use the “16” series tables which, as they relate to the period 2015-2018, are out of date. Whilst we recognise your comment in 4.21 of the consultation around Covid, given that the “16” series tables relate to the period 2015-2018 and data shows that life expectancy in England fell in 2020 to the same level as ten years ago, we believe this decision should be revisited.

Q13. Do you have any other comments on our proposals?

There is an opportunity in this consultation to address another inconsistency where the inflation rates used in SMPIs compared to FCA projections are different; 2.5% for an SMPI and 2% for an FCA illustration (which is in line with the government’s long term inflation target). Given that consistency across all illustrations is something that we are looking to achieve, it would be sensible to align these assumptions so that consumers are getting a consistent approach. We appreciate that the FRC has always maintained a rate of 2.5% and that it is the FCA that changed their assumption in 2019 but the consistency point is still valid here as it represents another area where we have to explain to a consumer why there are different assumptions for different illustrations, when to a consumer, they should just be the same.

Q14. Do you agree with our impact assessment? Please give reasons for your response.

No response.