welcome to brighter

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Subject: AS TM1: Statutory Money Purchase Illustrations Consultation

Dear FRC,

Thank you for the opportunity to comment on these draft regulations.

We are responding based on our experience in advising trustee clients and corporate sponsors of pension arrangements in the UK. Our response to the consultation is in the appendix to this letter.

I confirm that we are happy for our comments in this response to be published.

We would welcome the opportunity to discuss our response further with you if that would be helpful.

Yours sincerely

Paul Barber

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Appendix

Question 1: Do you agree with the proposed change to accumulation rate for volatility group 1 (from 1% p.a. to 2% p.a.)? If not, what alternative accumulation rate do you think would be appropriate for this group? Please provide supporting evidence for any alternative view.

We agree that the evidence supports an increase in the accumulation rate for volatility group 1.

There are arguments that a greater increase would be appropriate, given the evidence in the FRC's technical analysis, base rate projections from the Bank of England and the fact that most of the evidence underlying lower accumulation rates is from a "significantly different" period. That said, these arguments are mitigated by recent market volatility that means that some assets (such as longer dated gilts and bonds) which the FRC expected to be in volatility group one may end up in a higher volatility group.

On balance we don't disagree with the proposal for a 2% rate, given the desire for long term consistency and caution about suggesting rates of returns which may not be achievable in the long term.

Question 2: Do you agree with not amending the accumulation rate for volatility group 4? If not, what alternative accumulation rate do you think would be appropriate for this group? Please provide supporting evidence for any alternative view.

We agree with the proposal to retain the accumulation rate of 7% for volatility group 4.

Question 3: Do you have any other comments on the proposed accumulation rates as set out above?

With schemes starting to issue statements under AS TM1 version 5.0, we have seen many schemes with their funds allocated to volatility groups with unrealistic investment return assumptions. We recognise the limitation of the volatility model, and note the rationale provided by the FRC in the technical paper for the type of funds that fall into each volatility group. However, our main concern has been how the volatility groups and resulting investment return assumptions for different types of funds provided by the same scheme compare to each other, and the potential misleading messages that these assumptions might deliver to the members.

For example, a scheme that provides a standard mixed growth fund with equity and bonds in volatility group 2 (3% return assumption) could be compared to annuity matching pre-retirement funds in the same scheme that are allocated to volatility group 3 (5% return assumption), and an Indexed Linked Gilt fund in group 4 (7% return assumption). We believe there is a risk that members who are many years before retirement will switch from growth funds to annuity matching funds, purely based on the growth assumptions communicated to them.

We have seen many examples of schemes where the volatility derived assumptions appear illogical and can provide suitably anonymised details if this would be helpful.

We feel that without fundamentally changing the volatility method for determining the investment return assumptions, narrowing the differences between the volatility group investment assumptions will at least minimise the significant variation in projection outcomes. This might reduce the number of members at risk of making potentially inappropriate investment decisions based purely on a table of volatility-derived expected investment returns e.g. younger people investing in index-linked Gilts rather than equities based on a higher SMPI growth assumption.

The FRC might also consider expanding the circumstances in which volatility group 3 is used to also cover scenarios where the resulting volatility group is deemed to be unreasonable.

Question 4: Do you agree with the proposed effective date of 6 April 2024?

Many schemes that we advise and/or administer have illustration dates which fall on 30 March & 5 April and will be preparing statements under AS TM1 Version 5.0 for the first time in 2024. An effective date of 6 April 2024 for the proposed changes would mean that these schemes will have to make significant changes to illustrations in two consecutive years, increasing implementation costs and potentially confusing members.

In the interests of schemes using the most up-to-date assumptions, we suggest the revised investment assumptions and the interest rate as determined as at 15 February 2024 are used for all illustrations with an effective date from 15 February 2024, both to make the transition smoother for scheme providers and so that members receive statements with assumptions that are determined closer to the illustration date rather than one or two years out of date. In addition, the FRC may wish to consider allowing schemes to adopt the revised investment return assumptions earlier on a discretionary basis, for example, for all illustrations with effective dates on or after 30 September 2023.

Question 5: Do you agree with our impact assessment? Please give reasons for your response, and estimates of costs where possible?

We agree that the updating parameters within the SMPI calculation system only incurs minimal cost to providers. However, we believe there is potentially significant cost involved in educating members on the projection method, the changes to the assumptions and what the changes mean to them in practice.

Pension projections are hopefully used by individuals to plan for their retirement and make important financial decisions. Pension projections that are deemed by members to be unreliable because they change significantly from year to year as a result of changes to underlying assumptions, as opposed to market experience of actions taken by the members, could lead to mistrust and inadequate financial planning, resulting in a shortfall of funds during retirement. The FRC noted in the consultation that Statutory Money Purchase Illustrations are a general pension illustration, rather than an accurate individualised pension projection. Where the statutory illustrations do not provide reasonable projections because of the limitations of AS TM1, they will need to be carefully explained to members and/or supplemented with alternative illustrations, increasing the complexity of the communications and making it less likely that members will read, understand and engage with their pension savings, defeating the purpose of providing the projections.

Pension projections that are seen to be unreliable, particularly those that change too quickly from year to year or are otherwise considered by the recipient to be “inaccurate” will also erode members' trust and confidence in their pension plan(s).

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