



Financial Reporting Council

Proposed revision to AS TM1: Statutory Money Purchase Illustrations

Consultation paper

February 2022

Contents

	Page
Introduction	2
Pensions dashboards	4
Accumulation rates assumptions	6
Annuitisation assumptions	14
Other considerations	17
Impact assessment	19
Summary of Consultation Questions	21

Annex 1 Exposure Draft of version 5.0 of TM1

1 Introduction

Background

- 1.1 The Financial Reporting Council (“FRC”) is the UK’s independent regulator responsible for promoting high quality corporate governance and reporting to foster investment. The FRC is responsible for setting technical actuarial standards in the UK.
- 1.2 Since 6 April 2003 money purchase pension arrangements have been required to provide members with Statutory Money Purchase Illustrations (“SMPIs”). These illustrations are governed by the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013¹ as amended. 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 has been the prescribed body since 6 April 2007 and fulfils its obligations through the publication of Actuarial Standard Technical Memorandum 1: Statutory Money Purchase Illustrations (“AS TM1”). AS TM1 specifies the assumptions and methods to be used in the calculation of statutory illustrations of money purchase pensions, also known as defined contribution (“DC”) pensions. The FRC reviews AS TM1 regularly.
- 1.4 Providers’ point of sale and ad hoc projections are subject to the assumptions set within Section 13 Annex 2 of the Conduct Of Business Sourcebook (“CoBS13”)² issued by the Financial Conduct Authority (“FCA”).

Aims and audience of this paper

- 1.5 The aim of this paper is to consult on proposed amendments to AS TM1. The majority of the proposed amendments are the result of the intention for the provision of Estimated Retirement Income (“ERI”) provided on the pensions dashboards to follow the methods and assumptions specified in AS TM1. Such intention is detailed in the consultation in January 2022 by the Department of Work and Pensions (“DWP”)³. We have also proposed other changes which aim to ensure the assumptions are up to date.
- 1.6 This paper has been written for anyone with an interest in SMPIs including those responsible for providing SMPIs (trustees, insurers, wealth managers and administrators) and the pension scheme members and policyholders who receive SMPIs or access the pensions dashboards, as well as organisations which represent and advise these groups.
- 1.7 This consultation is concerned solely with assumptions in those projections subject to AS TM1, i.e. SMPIs and dashboard projections. Any wider questions of whether AS TM1 should apply beyond annual SMPIs and dashboard ERI projections are beyond the scope of this consultation. We therefore request that responses do not include comments related to either point of sale or to subsequent ad hoc projections (i.e. not the annual required SMPI) where these are not carried out in pensions dashboards.

Contents and structure of this paper

- 1.8 Section 2 of this paper describes how the emergence of the pensions dashboards creates a new context and the background to the DWP’s consultation on pensions dashboards as they relate to SMPIs and ERI. Sections 3 to 5 describe the changes we propose to make to AS TM1. Section 6 contains our impact assessment in relation to the proposed changes to AS TM1 and section 7 lists the questions. Annex 1 contains the proposed text of version 5.0 of AS TM1.

¹ Consolidated Regulations may be accessed [here](#)

² [CoBS 13 Annex 2](#)

³ [Consultation on the draft Pensions Dashboards Regulations 2022](#)

How to Respond

- 1.9 Comments on the questions set out in this consultation document are requested by 6 May 2022. Responses should be sent by email to APT@frc.org.uk.

Or in writing to:

The Director of Actuarial Policy
Financial Reporting Council
8th Floor,
125 London Wall
London
EC2Y 5AS

- 1.10 It is advisable to send your response electronically.
- 1.11 All responses will be regarded as being on the public record unless confidentiality is expressly requested by the respondent. A standard confidentiality statement in an email message will not be regarded as a request for non-disclosure. We do not edit personal information (such as telephone numbers or email addresses) from submissions; therefore only information that you wish to publish should be submitted. If you are sending a confidential response by email, please include the word "confidential" in the subject line of your email.

2 Pensions dashboards

Pensions dashboards ERI requirements

- 2.1 As pensions dashboards are intended ultimately to display a user's pensions in one place, we anticipate a significant increase in people with multiple pension arrangements accessing and comparing projections from different policies and plans, and an expectation of consistency between such projections.
- 2.2 The Money and Pensions Service ("MaPS") Pensions Dashboards Programme has published a draft data standards guide which contains the detailed information on the data elements that are likely to be required for initial dashboards.⁴ This data standards guide contains a section on the ERI data elements.
- 2.3 DWP is proposing that pension schemes sending data to dashboards will be required to supply an ERI alongside other data elements including the ERI type, basis, calculation date, payable date and an indication of whether the ERI includes safeguarded benefits. Under DWP's proposals, money purchase schemes will also be required to include the projected pot size (known as "ERI pot") used to calculate the ERI, if this is held. This means that a user logging on to a dashboard would be able to see their projected ERI for all schemes and also a final projected pot value for their money purchase schemes, where schemes hold it. The current proposal is for the methodology and assumptions for AS TM1 to be used to project both the ERI and the ERI pot data elements.

Implications of pensions dashboards on AS TM1

- 2.4 While leaving AS TM1 unchanged would minimise the work required of providers, the resultant ERI projections would not provide the individual saver with consistency in projections from different providers. This would raise concerns about the validity of aggregating resulting ERIs and continue to present significant communication challenges in explaining why the projections are not consistent. It might also not be possible for the individual to see the differences in the assumptions that produce the various illustrations as these are not part of the proposed data standards.
- 2.5 Allowing inconsistency in the ERIs also carries reputational risk for pension and dashboard providers, as well as government and regulators. It is likely that inconsistencies would be publicised and undermine public confidence in pensions dashboards and in pension saving more widely.
- 2.6 Although these risks do exist under the current regime, they are brought to light by the introduction of pensions dashboards. For these reasons, we consider it essential that dashboard ERI projections are prescribed in such a way that any two providers projecting identical funds for identical members should calculate identical ERIs.
- 2.7 In particular, the assumptions used in the ERI projection include the accumulation rate and the terms on which the fund at retirement is converted to an income. These are both key assumptions. AS TM1 currently allows providers some flexibility in determining both the accumulation rate used for projecting fund values, and in the form of annuitisation chosen. We propose that both of these should be prescribed for dashboard ERIs.
- 2.8 Similarly, inconsistencies between dashboard ERIs and projections on SMPI statements may undermine confidence in both figures. We are therefore proposing to align the set of assumptions for ERIs used in dashboards and SMPI statements to avoid confusion.
- 2.9 The proposed changes are informed by discussions at the Joint Forum for Actuarial Regulation ("JFAR") ERI Task Force, which included representatives of all members of the JFAR, MaPS, DWP, industry bodies representing insurers, pension funds and administrators, as well as specialists in consumer advocacy and academia.

⁴ <https://www.pensionsdashboardsprogramme.org.uk/2020/12/15/data-standards-guide/>

QUESTION 1:

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?

Pensions dashboards and timing for revising AS TM1

- 2.10 Version 5.0 of AS TM1 updates the assumptions to be made for SMPs and also provides the assumptions to be made when ERI is illustrated on the pensions dashboards. It is anticipated to be effective for all SMPs and ERI illustrations on dashboards from the same date which is expected to be 1 October 2023. Industry will then roll out the new AS TM1 in statements and dashboards, as SMPs are produced between October 2023 and October 2024. This is an extended lead in time for industry.
- 2.11 Subject to the nature of the responses to the consultation, we therefore intend to issue the final version 5.0 of AS TM1 so that it is effective for statutory illustrations issued on or after 1 October 2023. We do not consider there to be a need for transitional provisions.

QUESTION 2:

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

3 Accumulation rates assumptions

Considerations in determining the accumulation rates assumptions

- 3.1 The current AS TM1 sets out the methodology on the determination of the accumulation rate in paragraphs C.2.3 to C.2.6.
- 3.2 We consider that the proposed prescribed accumulation rates should aim to reflect a reasonable estimate of the returns that the individual may expect over the long term for the purpose of the statutory illustration.
- 3.3 In setting these rates we acknowledge that the future is uncertain and our models for projection are imperfect. As such it is also appropriate to introduce a degree of prudence given that one can reduce contributions closer to retirement, but a shortfall discovered too late may be unbridgeable.
- 3.4 In developing the methodology to determine the accumulation rate assumptions, we observed the following principles:
- The resulting accumulation rate assumption can be considered reasonable given observed data in the market
 - The resulting accumulation rate assumption should take account of additional returns that can be expected from higher-risk funds, in respect of a fundamental assumption of capital market theory that increased risk should be correlated with increased long term average return.
 - The resulting accumulation rate assumption can be determined consistently for different funds
 - The resulting accumulation rate assumption and the resulting statutory illustration should be easy to describe to savers and to be understood by them.
 - The determination of the resulting accumulation rate assumption should not place an undue burden on providers.
 - The methodology should not, as far as is practicable, cause or encourage unintended behaviours which are not in consumers' interests.

Determining the accumulation rates assumptions using a volatility-based approach

- 3.5 A vast amount of resource has been dedicated to set expected return assumptions on various asset classes across the financial sector, given the range of uses of such assumptions. A wide range of methods and calibrations are deployed in such exercises. There is no consensus view on the precise methodology and calibration of expected returns in the market.
- 3.6 A fundamental assumption of capital market theory is that increased risk should be correlated with increased long term average return. We have taken fund price volatility as a measure of risk and investigated how we may apply the above assumption to develop a methodology to determine the prescribed accumulation rates which respects the principles set out above.

- 3.7 We considered a methodology which sets accumulation rates to funds which are categorised into different levels of risk based on their historic volatilities, using a method similar to the Synthetic Risk and Reward Indicator ("SRRI") categorisation of UCITS funds.
- 3.8 The SRRI methodology was developed in 2009 by a technical subgroup of the EU Committee of European Securities Regulators (CESR⁵) for use by Undertakings for Collective Investment in Transferable Securities (UCITS) in the Key Investor Information Document (KIID) and was consulted on and adopted by the EC⁶ in 2010. Fund volatility based on the latest 5 years' weekly price movements is used to assign UCITS portfolios into one of seven volatility (or risk) classifications. The calculated level is then required to be published at point of sale in the KIID to give the saver an indication of the relative level of risk in the fund they have chosen.
- 3.9 External academic research has shown that for multi-asset defined contribution funds, there is an upward sloping relationship between volatility (measured as the annualised standard deviation of returns over the preceding 5 years) and subsequent forward-looking investment return. The further forward we project, the stronger that relationship becomes.
- 3.10 However, the research shows the SRRI risk categorisation, without adjustment, is limited in its usefulness as a proxy to expected fund returns. As such, we conducted further analysis to adjust the calibration of the risk categorisation structure to address the issues highlighted. This includes adjusting the number of risk categories used and the boundaries of the risk categories.
- 3.11 We have proposed four volatility groups, which we have found to be broadly aligned to a segmentation of funds by asset types based on 5-year volatilities at 31 August 2021. Money-market funds fall into volatility group 1. Lower volatility fixed interest funds fall into group 2, with the remainder in group 3. Equities funds are mainly captured in group 4, with some lower volatility funds in group 3.
- 3.12 In determining the expected rate of return for each risk category or volatility group, we relied on past experience based on the performance of UK wholesale pooled pension funds since the 1990s. This was then adjusted to account for drivers of performance over the period of analysis which we do not expect to be maintained, and for prudence to reflect uncertainty and the limitations of such methodology.
- 3.13 Based on fund data and market conditions up to 31 August 2021, and a long term inflation rate of 2.5% as set out in AS TM1, our preliminary proposal for determining a fund's accumulation rate is as follows:

Volatility Group	Volatility Intervals	Accumulation rate
1	0% - 5%	1%pa
2	5% - 10%	3%pa
3	10% - 15%	5%pa
4	>15%	7%pa

Funds would be placed in a volatility group according to the volatility of their monthly returns over the past 5 year period, measured by annualised standard deviation.

⁵ [CESR 09-1026](#)

⁶ [CESR 10-673](#)

3.14 We plan to review the suitability of these volatility groupings and accumulation rates against the prevailing market conditions closer to when the changes to AS TM1 are effected, and review these regularly thereafter to ensure the calibration remains appropriate.

Alternative structure to determine the prescribed accumulation rates

3.15 We considered two other alternatives to determine the prescribed accumulation rates:

- A single accumulation rate for all funds regardless of the asset type and mix or volatility of funds.
- An aggregate accumulation rate for each fund based on prescribed accumulation rates by asset types and portfolio make up.

Single accumulation rate

3.16 It could be argued that all projections are speculations and that attempts to introduce further structure into them are spurious. This would suggest using the same undifferentiated future accumulation rates for all funds.

3.17 However, projecting cash funds at the same accumulation rates as equity funds over the long term may be perceived as being too simplistic, or even misleading. Further, it is likely to be perceived as a backward step from the current AS TM1 approach where providers anticipate returns in line with the constitution of their portfolios. Therefore, we do not view this option as being viable.

Accumulation rates by asset type

3.18 We considered whether accumulation rates could be prescribed by asset class. This approach has some merit in that we have observed in the annual surveys⁷ conducted into accumulation rates assumed by providers that there are clear differentials by broad asset type. However, variation by asset type between providers is also evident and sustained, which is also expected given the broad definition of asset type.

3.19 Classification of assets into classes at a level which is sufficiently comprehensive and clear for the purpose of prescribing accumulation rate is a complex exercise.

- The framework would need to define the prescribed rate for all available asset classes in the market. To do so consistently across the multitude of asset types available, with the desired distinction between different characteristics is problematic.
- Further, even within a particular class of asset there will be many different approaches to investment philosophy and practice which will invalidate the reasonableness of the grouping. For example, different property funds may contain different levels of cash and varying types of long term assets. (This is however not an issue with the proposed volatility-based approach as differences in risk profile will register as differential volatility).
- Such a method of prescribing accumulation rates is also expected to need frequent review and updating to cater for emerging new financial instruments.

⁷ Past surveys may be found on the [FRC website](#).

-
- 3.20 For these reasons it would not be appropriate to specify one unique accumulation rate for funds within any specific asset category. Therefore we consider this alternative suboptimal.

QUESTION 3:

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

QUESTION 4:

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

Treatment of lifestyling and target date funds

- 3.21 Lifestyling and target date funds both attempt to reduce the volatility of the portfolio in the period approaching retirement. They differ in that lifestyling requires switching the saver from higher risk funds to lower risk funds, whereas a target date fund does this switching of the fund's investments internally for all savers invested in that fund at the same time. In this latter case the individual does not switch funds. Regardless of the difference in implementation, the members' underlying asset exposures would be the same. For the purpose of this section, we will refer to both types of funds as "lifestyling".
- 3.22 In annual surveys between 2017 and 2019 we asked providers whether they allow for lifestyling in SMPI projections of their funds where it applies (as it would with the default fund). Overwhelmingly providers replied that they allowed for the impact of lifestyling. However, there was no consensus on how this was done. Approximately half of the providers reduced the prospective rate of accumulation for those years when the individual was scheduled to reduce risk, and other half of the providers made an approximate adjustment to the overall projection rate to reflect anticipated risk reduction in later years.
- 3.23 We propose to specify the former approach - that the accumulation rates are reduced in future years as the plan approaches retirement, in line with the anticipated derisking. We intend to specify also that target date funds should follow an approach consistent with a lifestyling arrangement.
- 3.24 We propose that such reductions in rates should be included only in cases where these changes are programmatic or where there is an established practice of such switching having been made.

QUESTION 5:

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

Treatment of funds with insufficient performance history

- 3.25 If a fund does not have a sufficient performance history to calculate its volatility group, the performance history should be supplemented by an existing fund with a full returns history for the period which is deemed to have similar characteristics, by way of the fund's target asset mix or benchmark. This should be concatenated with the actual performance history, where available.
- 3.26 Given that funds will be apportioned into 1 of 4 volatility levels we do not believe that this should give rise to significant differences in approach by different providers.

3.27 Where an existing fund with a full returns history for the period which is deemed to have similar characteristics cannot be identified, we propose that the calculation be based on the published prices of the shortened history. We do not expect this to be used frequently and in any case the effect should be transient.

Stability of the volatility group over time

3.28 To maintain stability and to limit the burden on providers, we consider it appropriate not to require a continuous recalculation of the fund risk level. However, given the possibility of genuine secular changes to the volatility of a fund over time, the funds would need to update their volatility calculations at regular intervals and change their volatility group and accumulation rate if necessary. Updates would ideally capture genuine changes in risk profile which would impact expected returns, without short term market fluctuations.

3.29 We examined various approaches to the recalculation of the volatility group (i.e. the 5-year historical volatility category) the fund falls into:

- Different frequencies of recalculation of the volatility group and accumulation rate (for example, annually or triennially)
- Allowing a corridor so that as long as a fund does not breach its assigned level by more than a specified proportion of the volatility range or does not exceed the volatility range for a continuous specified time period it does not need to reclassify
- Reducing the impact of extreme market movements in the calculation to limit the impact of crises while not ignoring them
- Using different time-periods for calculating volatilities.

Different frequencies of recalculation

3.30 Based on monthly recalculation and with no interventions the average period between funds switching volatility groups is 2.6 years. However, we consider it too onerous to require a monthly recalculation even if new data is available on a monthly interval.

3.31 We propose to take a proportionate approach and to recalculate once a year. We considered the historical impact of recalculations either at 31 March or 31 December. The historical data shows that the average time periods between switches would be 4.7 and 4.6 years respectively. There is little statistical reason to prefer one to the other. We consider 31 March an appropriate date, as this is more consistent with the fiscal year and with the scheme year adopted by many pension funds. However, we are proposing recalculation as at 31 December to leaves providers 3 months to perform the recalculation and prepare the SMPI for the following 6 April on that basis.

Corridor

3.32 Even with an annual recalculation there would be some funds (close to the top or bottom of a volatility group) that would switch regularly based on random fluctuations.

3.33 We considered introducing a corridor around the boundary of the groups which will help to remove the idiosyncratic fund movements. Applying a corridor would mean that the indicator will not be updated until the volatility moves beyond the corridor around the boundary. For example, in applying a corridor of 0.5%, a fund with an indicator of 3 will not be reclassified to level 4 unless the volatility exceeds 15.5%. Similarly, a fund at indicator level 4 with decreasing volatility would not be reclassified until the volatility fell below 14.5%.

3.34 When applying a 0.5% corridor, this increases the average time between switches by 0.7 years. A corridor of 0.25% has very limited increase of 0.3 years. On the other hand, a corridor of 1.0% increases the average time between switches by 2.3 years but threatens to undermine the structure of assigning volatility groups to the funds. Therefore we propose that the default position should be that the assignment of a fund to a risk level should be done annually with a 0.5% corridor.

Other measures

- 3.35 We considered the use of time lags, adjusting the data to reduce the impact of the large market movements and using alternative time periods for the volatility measurement. We considered none of these alternatives provide a better result than the use of corridors based on annual recalculation.

QUESTION 6:

What are your views on the proposals that the recalculation of volatility group should be annually as at 31 December with a 0.5% corridor?

Treatment of With-Profits funds

- 3.36 With-profits funds are a type of 'pooled investment' fund which typically allow for smoothing of returns. In turn, the volatility of the smoothed returns in a with-profits fund would be anticipated to be lower than in a non-smoothed fund with similar assets.
- 3.37 With-profits funds have a variety of different structures but overall the returns received by the individual policyholder will depend on:
- the unsmoothed value - the value of the investments underlying a plan, based upon the fund's actual performance and
 - the smoothed value - the amount paid out, after smoothing the peaks and troughs of our fund's performance.
- 3.38 If the value of the assets underlying an individual's policy falls then firms can apply a Market Value Adjustment ("MVA") in with-profits funds. The MVA acts to reduce any payout before retirement⁸ when the underlying assets have fallen in value so that a full unadjusted transfer out cannot be afforded by the fund without adversely impacting the value of other people's fund holdings. Therefore it could be argued that with-profits funds are similar to other regular pooled funds with similar investment policies and will have similar the long-term returns, but with the proviso that the returns received by individual policyholders could depart from these returns in the short-run due to the smoothing process.
- 3.39 We could measure volatility in a with-profits fund based on the unsmoothed returns or we could leave the quoted or smoothed prices unadjusted and accept a potentially lower risk category and lower long-term return accumulation rate for with-profits funds.
- 3.40 The former approach could more accurately reflect the long-term returns available from the assets in the with-profits fund and it is based on actual asset performance as for other types of funds. We therefore propose to adopt this approach, but we would like to hear from providers whether such an approach would introduce too great a burden either because the data is unavailable or because it will involve extensive calculation.
- 3.41 With-profits funds can also have underlying guarantees including for investment returns or Guaranteed Annuity Rates ("GARs"). AS TM1 already allows for SMPs to allow for the terms of a GAR where these would deliver a higher pension than that of the standard assumptions. It could be argued that a similar approach should be taken to projections of the accumulation rate where the guarantee would lead to a higher rate of return. The extent of the application of investment guarantees is unknown but they would exist mainly within with-profits funds. The audit of legacy pension schemes conducted in 2014 also identified a small amount of pension assets which had growth guarantees but were not with-profits products.⁹

⁸ In the case of pension funds this would relate principally to transfers from the fund to another provider or fund.

⁹ <https://www.fca.org.uk/publication/research/defined-contribution-workplace-pensions-ipb.pdf>

-
- 3.42 In these circumstances we propose for accumulation rate assumption to be calculated based on the unsmoothed asset returns or an adjustment could be made if the accumulation rate is lower than the level of the guaranteed return.

QUESTION 7:

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

Treatment of unquoted assets

- 3.43 The calculation of volatility requires the existence of a published value or price for the asset. As such, it is uncertain how to estimate volatilities where the asset price is unquoted.
- 3.44 We considered excluding unquoted assets from the illustration of ERIs. However, pension funds may be holding increasing amounts of unquoted assets and they are included in the SMPI projection currently.
- 3.45 Where such unquoted assets are within a pooled portfolio which overall has a quoted price the issue falls away. As volatility is calculated at a portfolio level, the presence of unquoted assets is allowed for in the portfolio calculations.
- 3.46 Where unquoted assets are held separately (for example within a SIPP) a current value becomes subjective and it becomes speculative to assess the volatility of such an asset. In these circumstances we propose to assume that the value of the asset as displayed on the pensions dashboards should be the same as the latest available valuation and that the asset value should remain unchanged in real terms in future (i.e. in effect that the asset increases with CPI indefinitely).
- 3.47 We consider this approach is to be a pragmatic solution given the complexity of typical unquoted assets and we would welcome any suggestions that respondents may have on how we can better reflect the value of unquoted assets fairly but robustly.

QUESTION 8:

Do you have experience of unquoted assets held in pension portfolios and what are your 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?

Policies or plans that contain multiple funds

- 3.48 A pooled fund may include investment in sub-funds which have their own unit prices. To reduce burden on providers, we propose that in this case the volatility should be calculated using the unit price of the composite fund of funds, rather than by aggregating the volatilities of the sub-funds.
- 3.49 However, an individual policy or plan may be invested directly in more than one pooled fund. In this case, there is no single fund with a unit price which could be used to calculate the volatility of the policy/plan. The historic allocation of such funds in the policy/plan would vary over time, either due to different rebalancing strategies, active choice of individuals to switch investments, or passive choice such as lifestyling. By choice of the individual, the allocation of future contributions could also be different to the assets allocations of the policy at the time.

-
- 3.50 One way to reflect the specific risk characteristics of each policy/plan would be to require the policy/plan to be considered as a single fund for the purposes of the calculation of historic volatility when determining the accumulation rate assumption. In other words, the volatility level of the plan would be based on the performance of the combined funds that make up the plan and that overall performance would lead to a single volatility group.
- 3.51 However, such an approach would implicitly take into account the variable historic allocation of the pooled funds which may not be a good representation of future allocations (and aggregate expected returns). It would also place an undue burden on providers as they would be obliged to recalculate the volatility group for each policy/plan at each illustration as weighting between the various pooled funds would vary due to differential investment returns or different contribution apportionments.
- 3.52 We therefore prefer the aggregation to take into account fund allocation based on current or known future strategies. This requires knowing only the current fund allocation and can be addressed by projecting each fund separately before recombining to produce the illustrated fund and ERI at retirement.
- 3.53 We propose the following methodology to aggregate across pooled funds:
- Future contributions should be assumed to be allocated to the pooled funds in line with the current allocation split of contributions.
 - Each pooled fund with its allocated contributions should be projected as described above for the single pooled fund situation based on the volatility indicator of that single pooled fund.
 - The overall illustrated amount should be the sum of the individual pooled fund illustrations.
 - Any unquoted assets should be treated separately as detailed above.

QUESTION 9:

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

4 ANNUITISATION ASSUMPTIONS

Lump sum at retirement and form of annuities

- 4.1 AS TM1 currently allow providers and/or individuals to choose whether the annuity at retirement will be illustrated as level in monetary values or increasing to keep pace with inflation. Further, there is flexibility in the amount of benefit assumed to be taken as a lump sum at retirement.
- 4.2 Although the tax free lump sum at retirement is commonly taken, the limits to this benefit are complex. The amount of cash taken within tax limits depends on various personal circumstances. As such during the early period of the implementation of pensions dashboards it is preferable to ignore tax free cash at retirement and to show the full annuity as the ERI. Given that the pensions dashboards data specification is proposing to not illustrate tax free lump at retirement, we propose to do the same for consistency.
- 4.3 Pensions dashboards projections are designed to illustrate the ERI of all pensions held by the individual in a manner that encourages comparison. As such it is important that illustrations presented on the pension dashboard are shown on a common basis to facilitate this comparison being made fairly in a way that does not mislead the individual. The implication of this is that we do not feel that it remains reasonable to continue to allow such flexibility in the choice of annuitisation in the AS TM1 method and assumptions.
- 4.4 We believe that the annual SMPI will continue to be delivered automatically each year to the member for each policy or plan. To avoid confusion between the amounts shown in the SMPI and those that may be accessed on the dashboard, the form of annuity and the assumptions related to annuitisation must coincide with those used for both purposes. Individuals who wish to consider alternative types and forms of retirement income are likely to request additional ad hoc illustrations which come under the regulation of the FCA CoBS13 Annex 2.
- 4.5 There is an argument to state that the annuities should be shown to include attaching spouse or partner benefits and should increase with inflation. Adopting such a form will provide a truer representation of the sustainable income that keeps pace with inflation as well as being more consistent with the form of most Defined Benefit pensions.
- 4.6 On the other hand, it is known that the vast majority of annuities actually purchased are level in monetary amounts (i.e. not including any increases in payment) and do not include attaching spouse or partner benefits.
- 4.7 Given the importance of communication we propose, on balance, that AS TM1 should prescribe the form of annuitisation to be a level annuity without attaching spouse or partner benefits so to align with current market practice.

QUESTION 10:

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?

Provision of ERIs less than 2 years from retirement date

- 4.8 Currently the pensions disclosures regulations¹⁰ do not require a SMPI projection where the individual is within 2 years of retirement date for the policy/plan concerned. We note that we do not propose to change the current definition of retirement age¹¹, which can be applied separately to each specific policy or plan. Therefore, any individual may be expected to have more than one retirement age.
- 4.9 It is anticipated that ERIs on pensions dashboards will be available within the two years preceding retirement. As such, although AS TM1 does not need to specify the methodology and assumptions for ERIs where the individual is within 2 years of retirement date for the purpose of SMPs, such specification is expected to be required in respect of the pensions dashboards ERI.

Annuity rates where the illustration date is more than 2 years from the retirement date

- 4.10 The current approach to assessing the cost of annuitisation uses gilt yields on the previous 15th February.
- 4.11 Whilst the annuity market allows personalisation of annuitisation factors, such as recognising lifestyle and health factors, allowing flexibility will risk distortions to comparison on dashboards and impose additional extra work on providers. Another consideration is that for longer term projections the real fund accumulation rate is a more material assumption for the ERIs and not the cost of annuitisation.
- 4.12 The current approach retains the merit of varying with the movement in gilt yields while producing some consistency for ERIs calculated within the same year. However, for the calculation of level annuities, AS TM1 currently allows providers to use a discount rate based either on a fixed interest yield index, or by calculating the discount rate used for an increasing annuity and adding a margin of 3.5%. In order to achieve greater consistency, and recognising that 3.5% may not be an appropriate margin given that RPI is being phased in to CPI-H, we propose removing the latter allowance.

Annuity rates where the illustration date is less than 2 years from the retirement date

- 4.13 For illustrations where the illustration date is less than 2 years from retirement date, we consider whether the same methodology can be adopted as per illustrations which are more than 2 years from retirement date.
- 4.14 As the projection period shortens the cost of annuitisation becomes a more material assumption for the ERI.
- 4.15 Where the illustration date is far from the retirement date, there is much less information and certainty concerning the economic conditions around the retirement date. However, as the illustration date approaches the retirement date (i.e. the overall projection period is much shorter), it is reasonable to assume that further insight can be gained to anticipate the conditions at retirement by observing the annuity rates available in the market.
- 4.16 We propose to assume an annuity rate which is consistent with that which is available in the market, provided that the annuity conversion is no more generous than the provider's own annuity rates (where applicable). This should include any applicable guarantees and be consistent with rates available in the market for non-increasing single life annuities with no lifestyle or health adjustments and based only on age.

¹⁰ [The Occupational and Personal Pension Schemes \(Disclosure of Information\) Regulations 2013 No. 2734](#) Para 17(6)

¹¹ 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

-
- 4.17 This proposed approach is consistent with the approach adopted in CoBS13 for projections within one year of retirement

QUESTION 11:

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?

Annuity mortality

- 4.18 Paragraph C.3.9 of AS TM1 refers to tables PFA08 and PMA08 as the base mortality tables to be used to calculate the annuity rates. Since AS TM1 was last updated the Continuous Mortality Investigation Bureau have published updated tables based on experience of pensioners in the period 2015 to 2018.
- 4.19 As the "16" series is the most up to date experience available we propose changing AS TM1 to refer to these tables than to the "08" tables as at present. This will ensure that the calculation of the annuity is based on the latest available mortality information.
- 4.20 Paragraph C.3.10 of AS TM1 deals with projections of the base mortality table to reflect the future year in which retirement is projected to occur. It states "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 CMI_(20YY-2)_F[1.25%] and CMI_(20YY-2)_M[1.25%]. Currently mortality in retirement is specified as CMI have published updated tables."
- 4.21 Covid has had a significant impact on pensioner mortality since 2020. Given that the long-term impact of Covid on mortality rates is speculative we do not propose making any changes to the "16" tables or subsequent improvements to adjust pensioner mortality.
- 4.22 We propose updating to the new "16" tables, to keep 50/50 M/F blend and to leave the improvements as they are currently.
- 4.23 In recent years the CMI has been moving more towards allowing more flexibility and customisation by the actuary using the model to specify the values of certain parameters. By specifying the mortality assumption in AS TM1 in the current form we are effectively assuming that these parameters will be taken at the core values.

QUESTION 12:

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?

5 OTHER CONSIDERATIONS

Presentation of results

- 5.1 Currently AS TM1 allows providers to show illustrated pensions as a weekly, monthly, or annual amount. To improve comparability, we propose that annual amounts should be used.

Inflation assumptions

- 5.2 The inflation assumption is used to discount the accumulated fund from retirement age to today's purchasing power, and therefore needs to be suitable for long-term periods. This is currently specified to be 2.5% per annum.
- 5.3 We observe from research by HM Treasury and Office of Budget Responsibility on CPI and RPI forecasts that, after a short period of higher, unstable inflation, the expected CPI will substantially return to the Government's target of 2% within 5 years of projection from 2022. This would indicate that a medium and long-term CPI inflation assumption of 2% (i.e. Government target rate) is reasonable but speculative. Whilst it is recognised that expected RPI is higher than expected CPI by 1%, RPI will be aligned with CPI-H by 2030.
- 5.4 We also note that the inflation assumption is of second order to the accumulation rate assumption (net of inflation) which is one of the key drivers of the size of the accumulated fund. Given uncertainty and in the interest of simplicity, we consider the current long term inflation assumption of 2.5% to continue to be reasonable and should remain unchanged.

Number of projections

- 5.5 Currently the SMPs require only a single projection. The proposed pensions dashboards are intended to show only one illustration for each element of a policy/plan. The data standards guide says that "multiple blocks of data should be used where multiple benefits are accrued under the arrangement, or where multiple tranches of benefit are payable from different retirement dates."¹² If this remains true we do not propose to make any changes to AS TM1 in this respect.

The Illustration of uncertainty

- 5.6 In specifying the accumulation rates for fund growth, this does not imply that we are able to predict such growth with significant certainty. It is recognised that it is also important for individuals to be aware that the future is not yet written and that illustrations are no more than that.
- 5.7 We considered the various ways in which this uncertainty can be communicated whether quantitatively or qualitatively within the scope of AS TM1. As such inclusion is not permitted by the current legislative requirements and by the proposed content of the new Simpler Annual Benefit Statements, we have therefore not sought to widen the scope of AS TM1 for this purpose at this time.

¹² Page 12, <https://www.pensionsdashboardsprogramme.org.uk/wp-content/uploads/2020/12/PDP-data-standards-guide.pdf>

Treatment of Hybrid pension schemes

- 5.8 The current legislation does not require SMPIs to be produced for hybrid pension schemes where there are elements of both defined benefit (“DB”) and DC benefits, although we are aware that some providers do provide projections for the Money Purchase/DC elements of the benefits on the same basis as SMPI.
- 5.9 These hybrid pensions are expected to be shown on the pensions dashboards. We expect the DC element of these pension schemes to be calculated by following the requirements as set out in AS TM1. For example,
- for hybrid pension schemes where the DC element acts as a top-up to the DB element, the ERI for both elements is expected to be shown separately on dashboards and the DC element must follow the requirements set out in AS TM1.
 - for hybrid pension schemes where the benefit paid by the scheme is the higher of a DB or DC benefit, the DC element of the scheme, where shown, must follow the requirements set out in AS TM1

Other assumptions

- 5.10 We are not proposing to change any of the other assumptions specified in AS TM1 in this review.

QUESTION 13:

Do you have any other comments on our proposals?

6 IMPACT ASSESSMENT

Benefits

- 6.1 The majority of proposed changes in this consultation have been developed in response to the proposed requirement for AS TM1 to be used for the purpose of calculating ERI in pensions dashboards. The overlay of this new purpose over the traditional SMPI usage requires us to make certain changes to AS TM1 as follows:
- Specifying fund accumulation rates rather than allowing providers to decide on the rates themselves
 - Specifying volatility measures against which fund accumulation rates will be determined
 - Specifying assumptions for ERI illustration when there is less than 2 years to retirement date
 - Removal of the flexibility to show at retirement either increasing annuities, spouse or partner benefits or lump sum.
- 6.2 In particular, the dashboard will present pension plans side by side and therefore facilitate and encourage direct comparison between the various plans/pensions. The changes to AS TM1 will ensure that these comparisons are made on a consistent basis.
- 6.3 Further, we propose to update the mortality base table in retirement to reflect the latest table published by the CMI Bureau. This proposed change is necessary to ensure the assumptions remain appropriate.

Costs

- 6.4 Any changes to the systems used for producing SMPIs as a result of the changes to the Disclosure Regulations and the consequent changes to AS TM1 will generate costs for providers.
- 6.5 The changes which we believe will generate costs are:
- Calculation of the volatility group for each fund
 - Illustrations using multiple accumulation rates where the policy or plan is invested in more than one fund
 - Annual recalculation of each fund's volatility group
 - Changes to the mortality table for calculating annuities.
- 6.6 The first and third changes are in relation to the change to prescriptive accumulation rate assumptions rather than allowing providers to decide on the rates themselves.
- 6.7 While the first two changes represent an additional burden on providers, we do not think that the burden is heavy as long as the provider has access to monthly unit prices for the past five years (or since fund inception if shorter). The calculation process is simple and a similar approach is well-established for UCITS. Once the fund has been assigned to a volatility group, the rate of accumulation is specified. Thus there is an offsetting saving in that providers will not have to perform further ongoing analysis to decide on the rates themselves or justify the accumulation rate used to the regulator.
- 6.8 With regard to SIPP, to limit the extra cost that might apply to providers seeking to calculate the volatility of the funds and assets, we have introduced a proposal to assume that unquoted assets increase in value in line with inflation. We welcome comment on the proposal that we have made, but feel that this serves to eliminate extra costs for these plans.

-
- 6.9 In relation to the annual recalculation of each fund's volatility group, we considered the burden of ongoing cost if the fund changes volatility group. To mitigate disproportionate cost we have limited the recalculation to once a year. Further, the FRC will consider, as part of our annual review of the standards, whether to amend the volatility group ranges or the calibration of the prescribed accumulation rate in order to alleviate the burden of volatility group switching to providers caused by market shocks or temporary market wide movements.
- 6.10 Changes to the mortality table are routine and we do not foresee significant burden to providers.
- 6.11 Further, providers have been strongly advised to take account of the possibility of changes when devising systems to produce statutory illustrations for SMPs. If systems and processes have been designed with a capacity for change, we consider that the cost of making changes as a result of the proposed revisions to AS TM1 should not be significant.

QUESTION 14:

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

7 SUMMARY OF CONSULTATION QUESTIONS

1. 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?
2. What are your views on the proposed effective date of 1 October 2023?
3. What are your views on the proposed volatility-based approach for determining the accumulation rate?
4. 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?
5. What are your views on the proposed approach to reflect derisking when calculating the accumulation rate assumptions?
6. What are your views on the proposals that the recalculation of volatility indicator should be annually as at 31 December with a 0.5% corridor?
7. What are your views on the proposed approach for with-profits fund projections?
8. Do you have experience of unquoted assets held in pension portfolios and what are your 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?
9. What are your views on the proposed approach to determine the accumulation rate assumption across multiple pooled funds?
10. 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?
11. 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?
12. 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?
13. Do you have any other comments on our proposals?
14. Do you agree with our impact assessment? Please give reasons for your response.



Financial Reporting Council

**Financial
Reporting Council**

8th Floor
125 London Wall
London EC2Y 5AS

+44 (0)20 7492 2300

www.frc.org.uk