The Director of Actuarial Policy
Financial Reporting Council
8th Floor, 125 London Wall
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By email to: APT@frc.org.uk

6 May 2022

Dear Director of Actuarial Policy,

Proposed revision to AS TM1: Statutory Money Purchase Illustrations

The Universities Superannuation Scheme (USS) welcomes the opportunity to respond to the Financial Reporting Council's consultation on the proposed revision to AS TM1: Statutory Money Purchase Illustrations.

By way of background, Universities Superannuation Scheme (USS) is one of the largest pension schemes in the UK, with total fund assets of over £90 billion. The Scheme's trustee is Universities Superannuation Scheme Ltd, a corporate Trustee which provides scheme management and trusteeship. USS Investment Management Ltd (a wholly owned subsidiary of Universities Superannuation Scheme Ltd) is the principal investment manager and advisor to the Scheme.

Until September 2016, USS was entirely a defined benefit (DB) scheme. It is now a hybrid scheme, into which contributions made in respect of earnings above a salary threshold (currently £40k per annum) are paid into the DC section: USS Investment Builder. USS Investment Builder also acts as the Scheme's facility for members who wish to pay additional contributions. As at 31 March 2022, the DC section had around 97,000 members with £1.7bn assets.

Since 2017, USS members have received a joint Annual Member Statement, which shows their accrued DB pension and the associated tax-free cash lump sum, plus any accrued savings within the DC scheme. The statement includes an illustration of DC savings at the point of retirement, along with the annual income this may provide. This illustration is created in line with the current AS TM1 Version 4.2 guidelines and is shown in the same document as the accrued DB benefits.

In providing a response to this consultation, we have consolidated our thoughts to the various questions below.

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?

We understand the desire to ensure consistency across providers when SMPIs and ERI illustrations are

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shown in one place on a pensions dashboard. However, we note that USS currently adopts an approach to align the form of annuitisation more closely with the DB benefit provision to allow for comparison between the DB and DC elements of the scheme. We also aim to ensure that the assumed accumulation rate is not too far away from the longer-term member-facing return objectives, which are what the Trustee will be aiming to deliver. We are concerned that the current proposal could penalise diversified DC investment strategies, including those (like ours) that invest in less liquid assets. Further detail is provided on this in following questions.

Question 2: What are your views on the proposed effective date of 1 October 2023?

We envisage this being enough lead time to update processes and work with external providers (where necessary) to implement the proposed changes from our subsequent scheme year end as at 31 March 2024.

Question 3: What are your views on the proposed volatility-based approach for determining the accumulation rate?

We are sympathetic to the desire to have a consistent methodology when calculating accumulation rates and the use of groups seems like a sensible approach. That said, we are concerned that the current proposal could penalise diversified DC investment strategies, including those (like ours) that invest in less liquid assets.

For example, our USS Growth Fund is a diversified growth oriented strategy with c. 20% allocated to less liquid investments. The benefits of diversification are expected to lead to improved risk-adjusted returns over the longer term for our members. Over the five-year period to 31 December 2021 the fund had an annualised volatility of 9.4% p.a. Therefore, if the proposed volatility groups remain unchanged from the table in the consultation (based on market conditions as at 31 August 2021), this would imply a 3% p.a. nominal accumulation rate for the USS Growth Fund, or 0.5% p.a. in real terms based on the 2.5% p.a. inflation assumption. This is significantly lower than the longer-term member facing objective of the fund. We are concerned that this could be misleading to our members and potentially lead to members not valuing their benefits within the DC scheme and taking action as a result.

Similar to the proposal to disclose and explain their approach to investing in less liquid assets, Trustees could be required to document their historic volatilities and why they are adopting either a 1%, 3%, 5% or 7% p.a. nominal return for their respective funds. We would also note that there may be significant variations in projected member outcomes depending on which group is used and would be supportive of there being more granularity (e.g. groups at every whole number from 1% to 7% p.a.). Ultimately, most members will not know or need to know the group to which their fund is assigned, so there does not appear to be much advantage in simplifying it to four groups.

In summary, we would encourage the approach to be less prescriptive and support the ability for the Trustee to overlay other relevant factors, either qualitative or quantitative, when determining which volatility group is appropriate for each member option.

Question 4: Based on the assumed CPI of 2.5% p.a. do you find the accumulation rates proposed for the various volatility groups to be reasonable and suitability prudent?

As referenced in our response to Question 3, we have concerns that the proposed volatility groups may be too prescriptive and not allow enough room for trustee to ensure that the accumulation rates are set in conjunction with stated objectives and targets of their respective funds. We believe that adopting such an approach does not fully capture the benefits of diversification and may lead to misleading information being presented to members. This could result from the accumulation rates being either overly or underly prudent.

Question 5: What are your views on the proposed approach to reflect derisking when calculating the accumulation rate assumptions?

We understand the proposal to be consistent with our current process for calculating SMPI projections.

Question 6: What are your views on the proposals that the recalculation of volatility groups should be annually as at 31 December with a 0.5% corridor.

As referenced in Question 3 and 4, we have concerns with this approach in general. However, if a more prescriptive approach is to be followed, we would support additional provider input to ensure the prescribed output is not overly prudent and reflects differences in approaches to asset allocation (e.g. less liquid assets).

Question 7: What are your views on the proposed approach for with-profits fund projections?

We have no comment on this question.

Question 8: Do you have experience of unquoted assets held in pensions 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 alternatives with evidence to support your views?

While we do not have any specific comment on the proposal for unquoted assets that are held directly by pension scheme members, our members do hold unquoted or less liquid assets within our default investment strategy. As referenced in previous questions, we are concerned that the impact of holding less liquid assets is not appropriately captured within the accumulation rate assumptions proposal. Being diversified and allocating to less liquid assets improves expected risk-adjusted returns and reduces the daily price volatility experienced by members. We note the Government's desire to facilitate more DC pension schemes investing in less liquid assets and that this may become an issue for a greater number of providers in the future.

Question 9: What are your views on the proposed approach to determine the accumulation rate assumption across multiple pooled funds?

We have no comment on this question.

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?

We understand the desire to align methodologies across providers and believe that clear and concise communication will be imperative in making this work, regardless of the assumptions used. At present, USS takes the decision to show SMPI illustrations for income in retirement in a manner that is consistent with our members' DB provision, which has spousal benefits attached and a level of inflation protection. While the consultation suggests that single life annuitisation is aligned with current market practice, we do note that converting DC benefits into an annuity is not common market practice which weakens the argument in our view. Ultimately, if the desire is to show DC pensions as income, then we suggest that showing benefits with a level of inflation protection might be more instructive to members (and align with other retirement provision, such as the State Pension). We also note that given that we calculate pot sizes in real terms, it would seem consistent to acknowledge the significant impact inflation may have on individuals' purchasing power and living standards in retirement.

Question 11: What are your views on the proposed approach to determine the discount rate assumptions 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?

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 retirement date?

The proposals outlined in these questions seem appropriate given the stated aim of the consultation.

Question 13: Do you have any other comments on our proposals?

We have no further comment on this question.

Question 14: Do you agree with our impact assessment? Please give reasons for your response.

We have no further comment on this question.

Summary

The current proposal is prescriptive for both the accumulation rates and annuitisation assumptions which may lead to some undesirable member outcomes if action is taken as a result of this information. In setting accumulation rates we would prefer a 'disclose and explain' approach, as the current proposal does not capture the benefits of diversification and holding less liquid assets within DC investment strategies. In setting the annuitisation rate, we would prefer that the impact of inflation is acknowledged due to its impacts on individuals' purchasing power and living standards post-retirement.

USS acknowledges the desire for a consistent approach and methodology when calculating an Estimated Retirement Income in the context of the Pensions Dashboard.

We hope that our response to your consultation will assist your deliberations. Please let me know if we can provide any further information or assistance as you consider next steps in this area.

Yours sincerely

[redacted]

Dr Daniel Summerfield
Head of Corporate Affairs
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