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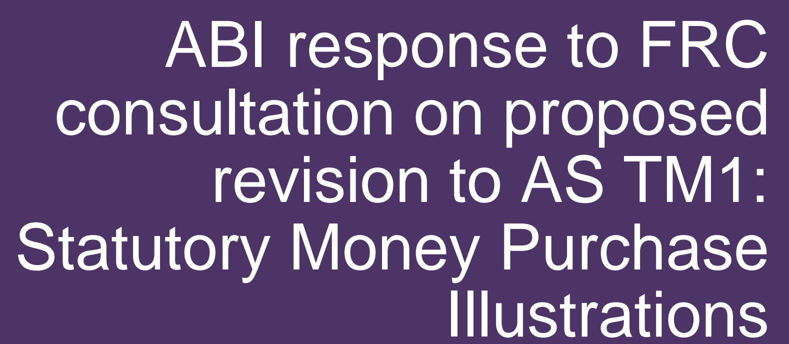

ABI response to FRC consultation on proposed revision to AS TM1: Statutory Money Purchase Illustrations

20 May 2022

The UK insurance and long-term savings market and the ABI

The Association of British Insurers is the voice of the UK's world-leading insurance and long-term savings industry. A productive and inclusive sector, our industry supports towns and cities across Britain in building back a balanced and innovative economy, employing over 321,300 individuals in high-skilled, lifelong careers, two-thirds of which are outside of London.

The UK insurance and long-term savings industry manages investments of over £1.9 trillion, contributes over £16bn in taxes to the Government and supports communities across the UK by enabling trade, risk-taking, investment and innovation. We are also a global success story, the largest in Europe and the fourth largest in the world.

The ABI represents over 200 member companies, including most household names and specialist providers, giving peace of mind to customers across the UK.

For the purposes of this response, 'insurers' refers to insurance, reinsurance and long-term savings companies.

ABI response to FRC consultation on proposed revision to AS TM1: Statutory Money Purchase Illustrations

6 May 2022

Executive summary

1. We welcome the opportunity to respond to the FRC's consultation on proposed revisions to AS TM1. It is an important step to improve consistency across pension projections provided to consumers. But to achieve that, we propose consideration should also be given to aligning the assumptions with the FCA's COBS 13.
2. The proposal contains complex changes to AS TM1 and will have widespread impact across the industry. The industry will need substantial time and at least 12 months to fully understand the new requirements. A transition period might be needed if there is any delay to finalising the revised guidance. At the same time, more consumer research is required to understand the additional warnings customers need to fully comprehend the new assumptions. Mandatory warnings should be explained either in AS TM1 or relevant DWP regulations.
3. We are not convinced that volatility-based assumptions are appropriate. The assumptions are flawed as the projection will be purely based on past performance, and they will likely give overly optimistic or pessimistic projections. Compared to asset-class based assumptions, the concept is also difficult to explain to consumers and might lead to poor outcomes, such as consolidation to pots with unsuitably high volatility in the expectation of higher returns.
4. The proposal will also need to strike a better balance between consistency and accurately reflecting benefit features in individual schemes. Excluding tax-free cash lump sums from the annuitisation assumptions will return customers with higher projected income, even when most customers would take all of the available cash lump sum, and potentially mislead them to lower their contribution. More consideration is also required in specific areas to reflect variations in scheme structure and investment approach, for example Guaranteed Annuity Rates (GARs), the assumptions for unit-linked funds and unquoted assets.
5. While the revision was proposed in response to the coming launch of pensions dashboards, we do not believe AS TM1 is the right set of assumptions for dashboards projections because of its complex nature and change process. FRC should ensure the DWP is aware that this revision can only be an interim solution. Digital propositions like dashboards will need a more light touch and flexible projection regime to fulfil customer expectations in the long run.

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?

6. We are supportive of prescribing the accumulation rate and form of annuitisation more precisely to improve consistency across different projections in principle. This should not be limited to assumptions used within AS TM1, but also among the projection regimes across the industry. A better approach would be for the FRC's assumptions in AS TM1 and FCA's COBS 13 assumptions to be aligned, so all projections that consumers receive in formal communications are comparable. This is a great opportunity for both regulators to consider the benefits of a unified projection regime and how differences between regimes can be aligned. As any changes to projection assumptions would result in substantial and costly process changes throughout the industry, ideally any adjustment and unification of regimes should be done in one go to avoid redundant efforts.
7. Although we support having more consistency in the assumptions in principle, we do not believe the

suggestion of using volatility as a projection basis is appropriate. Given the wide range of pension policy and structures available in the market, there should still be some flexibility on detailed areas that will fundamentally impact the customers' retirement income (e.g. GAR), so the projection can best reflect the structure of specific products. More details to the technical concerns can be found in the rest of the response.

8. We understand that the changes are being proposed because of the Pensions Dashboards, and we agree with the importance of consumers receiving comparable projections once they are shown side by side. However, we do not believe AS TM1 and COBS13 are appropriate projection assumptions for the service. Returning static and dated projections does not fit dashboards' objective to support retirement planning and customers' expectations[1]. Projection methodologies used by similar fintech services are much simpler and can accommodate variables and personalisation. Dashboards should aim to provide a similar service to this by undertaking light-touch calculations and returning immediate and tailored projections.
9. Furthermore, the complex nature and governance of AS TM1 means any further changes will be costly and time consuming. As pensions dashboards are a brand-new digital service, it is almost certain that further iterations will be required to get the projections right. AS TM1 will not be able to support rapid changes demanded by a digital proposition. Although this is outside of the FRC's remit, we believe the DWP should review their data requirements and consider how simpler and more interactive projections can be returned to users in the future.

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

10. The proposed effective date of 1 October 2023 is challenging but should be deliverable, depending on how quickly the new requirements can be finalised. The proposed changes will impact not only projections to be presented on dashboards, but also annual statements. Changes will be required in legacy mainframe systems which are not involved in the dashboards project to ensure the new AS TM1 is consistently implemented in all channels and would take quite some effort. The industry need at least a year to prepare for the change, so the revised AS TM1 assumptions should be finalised and announced by 1 October 2022. A transitional period might be necessary if there are any delays.
11. We understand that the proposed effective date was set to align with the DWP's timeline for pensions dashboards. Operationally, it will be more sensible to launch the new AS TM1 on 6 April 2024 so the accumulation rates will not need to be reviewed twice within the first year. Annuity assumptions might also need to be reviewed twice as the proposal now requires illustrations to take account of guaranteed annuity terms which produce a higher amount of initial pension, instead of being optional as in the current AS TM1.
12. We have concerns about whether sufficient consumer testing can be done on the new projections before the effective date and the potential impact on consumer outcomes. Unlike the existing assumptions that have been tested with customers on statements for years, the new projections will be launched on paper statements and dashboards at the same time. It will be difficult to decide whether existing warnings or explanations are sufficient and what information consumers might need to understand the changes. Since the new projections will be used on both statements and dashboards, different approaches and wordings might also be required depending on the communication medium. We propose that once the assumptions are finalised, the FRC should work with the Pensions Dashboards Programme (PDP) to test and develop warning messages for consumers to ensure there will not be any unintended negative consequences.
13. If new warnings or explanations are needed, especially to warn about the risk/return trade-off, any requirement to include these would fit in the DWP disclosure regulations, and the expected FCA rules for dashboard operators. But there is little time to consumer-test any such warnings, and then change and align the regulations along with the AS TM1 guidance.

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

14. We believe using volatility to determine accumulation rate is a flawed approach, as it implies that past

[1] ABI user research (2021) showed that 6 out of 10 potential users would find interactive income projection useful. https://www.abi.org.uk/globalassets/files/publications/public/lts/2022/britain-things-pensions-dashboard-report-jan-2022.pdf

performance of a fund is a guide to its future performance. This is commonly known to be not always accurate, for example the FCA's handbook requires investment firms to include prominent warning that figures refer to the past and that past performance is not a reliable indicator of future results. A similar requirement does not seem to be mentioned in this document. The volatility-based approach will likely give extreme (either overly optimistic or pessimistic) projections, especially after market shocks. Given the recent events and volatility in the past five years would be considered, when the new methodology is launched in 2023 the projections will likely be unreliable in the short term. It will be important for customers to understand this context.

15. The approach also excludes other indicators of performance, for example a fund which is better managed to reduce volatility will be penalised under the proposal with a lower accumulation rate. The five-year volatility concept, and thus why a particular growth rate was used, is difficult to explain to customers. There is a risk that customers would consolidate their pots to pensions with a higher volatility thus accumulation rate when seeing the projections place side by side on dashboards. This might not always be the suitable outcome for the consumer and can potentially be misleading.
16. The approach is also problematic as illiquid assets will also be projected at nil real growth, making them seem unattractive for long term investment. In the longer term, the impact will be significant because of DC pension investments' ongoing shift towards illiquid assets. The trend is being accelerated through the Government and regulator's work on the long term assets fund (LTAF) and productive finance. From existing data, the decoupling of volatility risk and return has already begun[2], partially brought by this shift. We expect volatility will become less and less reliable as an indicator of future return.
17. From an implementation perspective, the volatility-based approach will bring significant burden onto providers which contradicts the FRC's principles. The approach requires a huge number of calculations which every pension scheme and provider will need to undertake just to come up with one of the four accumulation rates. It will also be challenging to implement for firms who do not keep volatility data in a format which can support the calculation. As proposed by the FRC in the consultation as an alternative, we believe asset-class assumptions would be more suitable to accommodate the changing investment approach and is simpler to implement in general. We appreciate that these assumptions will require more maintenance. A simpler solution will be to assign groupings to common assets and allow a principle-based approach of assumptions for other assets. Both the ABI and Investment Association (IA) publish sector definitions which can be used as a basis for these groups.

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?

18. As discussed above, we do not believe volatility is an appropriate guide for accumulation rate and would suggest using asset-class based assumptions instead. More information will also be needed to understand why the accumulated rate groups are proposed.

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

19. We strongly disagree with the proposal. The consultation document suggests that accumulation rate will be reduced to reflect a derisking approach. We agree that if the investment potential of the assets is reduced then this should be reflected in the accumulation rates used. However, this is not guaranteed as these rates are determined solely by a volatility measure under the proposal. Therefore, whilst the principle is correct, the execution will not necessarily follow.
20. Also, derisking approaches can be very different across providers as suggested in the consultation document. The proposal can only reflect changes in projected income when the customer is closer to retirement and people at working age might receive overly optimistic projections at the outset and under-save. Providers should continue to be allowed to make an approximate adjustment providing they can demonstrate that it provides broadly equivalent results. An actuary should be able to certify that this is the case for the provider's projection basis.

6. 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?

21. We agree with the proposed recalculation date and the approach to include a corridor. However, 0.5%

[2] https://capa-data.com/risk-return-younger-saver-30-years-from-retirement-5-year-annualised/

might be too narrow and lead to changes in the growth assumptions being too frequent. From a customer's perspective point of view, the assumed projection rate for the fund might go up or down by 2% pa, only to be reversed at the next projection date without any change in the investment structure of the fund. The rationale for this is unlikely to be understood, which runs contrary to the drive to increase customer engagement in our view. We believe a 1% corridor, or two successive reviews where 0.5% test is breached, would be a more reasonable alternative.

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

22. More clarity on the arrangement for unit-linked funds with a minimum growth guarantee is needed. Currently the proposal only just mentions an "adjustment" in the with-profits chapter and might cause misalignment in the industry's approach. We believe these funds should use the greater of: a) the growth rate driven by the FRC's proposal and b) the minimum guaranteed growth rate.

8. 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?

23. The proposed approach is overly simplistic and risks significantly understating the value of unquoted assets, especially assets like property which exist in both quoted and unquoted forms. It also risks deterring consumers from investing in unquoted assets if they appear unattractive compared to quoted assets on pension dashboards. As mentioned in our answer to Q3, this will likely be unsustainable and bring negative customer outcomes with the Government and regulator's wider work to promote investment in illiquid assets. Explaining why these assets have zero growth rate will also be challenging and will impact customers' trust in the projection's reliability. This further highlights the limit of the volatility-based approach and merits of using asset-class assumptions instead.
24. If using asset-class assumptions is not possible, some in our membership has proposed that providers should be able to set the volatility group and growth rate for such assets, with reference to the ranges prescribed in AS TM1. While this can provide consumers a more meaningful projection, we understand this is not ideal as it will contradict the original intention to improve consistency in the assumptions.

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

25. The proposed approach for policies invested in more than one fund will be complex to build for those systems that do not already follow the proposed method. In some existing systems different funds cannot be projected independently. The fund value for each fund will have to roll over a month at a time because various charges are taken from the fund value proportionately across funds. This can create delivery risk for the implementation timeline.

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?

26. We do not agree with the proposal to entirely exclude cash lump sums from the calculation. In the industry's experience, most if not all consumers will take cash lump sums from their pots. Some statutory schemes also provide for pension and cash rather than just the right to commute for cash. If projections are calculated without taking cash lump sums into account, consumers will likely receive projections higher than the income they would get. They might be misled to reduce their savings level if they assume the tax-free lump sum can still be supported on top of their retirement income. This adds additional risks when the projection figures are used for retirement planning purposes. The assumption and its impact on income will need to be carefully explained to customers in standardised warnings, for example that the projected income could be reduced to generate a lump sum. We strongly suggest that there should still be an option to include cash lump sums in the projection, especially for products designed to provide both income and lump sum, to ensure the figure's reliability.
27. We understand the reasoning behind using single-life level annuity as the annuitisation basis. However, this approach might not be able to accurately reflect GARs written in a different format. If a GAR is on an escalating basis or includes a spouse pension, then it cannot be taken into account. A

GAR is a valuable benefit that customers should be aware of if they have one, and excluding them can greatly impact the accuracy of the projection. We propose there should be more flexibility to allow different GARs to be included in the projections.

28. There are also several downsides of using a level assumption. For example, it will create inconsistency with other projections in the dashboards environment. Pension provision from defined benefits and state pension still include escalation so their projected income will not be comparable with AS TM1 projections. Using a level assumption might also risk consumers neglecting the effects of inflation in retirement. The DWP disclosure regulations require a statement that "any amounts…are expressed in today's prices". There are different views on what the alternative should look like. Some in our membership proposed include allowing indexed assumptions to reflect some product's structure, or using inflation-linked annuity assumptions, or fixed increases (for example 3% a year) rather than index-linking.
29. Overall, the difficulty to find a one-size-fits-all solution partially reflects the complex nature of pensions but also the many possibilities under pension freedoms. There should be mandated warning next to AS TM1 projections, both on statements and dashboards, to inform customers of their rights to take pensions in a different way. It also demonstrates the benefits of dashboards being responsible for projections. It would be much simpler to illustrate the impact of different annuity options (e.g. level, escalating, joint life annuity) on a dashboard, as well as the impact of taking a cash lump sums or not, based on individual preference.

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?

30. To help achieve more consistent income projections across different regimes, we believe this revision of AS TM1 should take into account of the FCA's assumptions. In 3.1R(7) of COBS 13's Annex 2, the annuity assumption would only change one year before maturity. We believe both regimes should follow the same approach.

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?

31. Similar to our answer to Q11, we believe there should be consistency with COBS rules on mortality basis referenced in 3.1R(2) of COBS 13's Annex 2.

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

32. We would like to understand whether C.3.14 means both the higher figures taken of guaranteed annuity terms and the lower figure will need to be disclosed, and which one should be returned to dashboards.
33. If the new AS TM1 is the intended projection methodology for pensions dashboards, more considerations need to be given to how it will interact with dashboard regulations and design standards. As raised in our answer to Q3, we believe the volatility-based approach could bring customer detriment. When consumers are viewing projections side by side on dashboards, there's a risk that they will choose to consolidate to the highest risk fund, purely because it has the highest accumulation rate. This point needs to be clearly communicated to consumers with mandated warnings.
34. The DWP consultation proposed to include a 'accrued annualised value' which will also be calculated based on the new AS TM1. We note that the precise methodology is not explained either in the FRC or DWP's consultation. More details must be given by either parties to ensure the value is returned with a consistent approach, for example if inflation or charges should be considered in the illustration.
35. There are also differences between how DWP and FRC describe the date when the estimated retirement income is expected to be payable. The DWP refers to 'normal pension age', which according to the definition given could be the nominal pension age of 55 or 57 ('the earliest age at which the member is entitled to receive benefits', as defined in section 180 of the Pension Schemes Act 1993(c)). This definition of 'normal pension age' in the draft regulations does not align with the 'retirement date' defined in AS TM1, which can be set by the pension provider or agreed with the customer for SMPI. We believe the FRC's definition is correct, and all values related to money purchase benefits should reference retirement date as explained in the Disclosure Regulations (SI 2013/2734) instead of normal pension age.

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

36. We believe the cost to implement the proposal would be much higher than the FRC's assumption because of the changes' complexity. There will be significant costs to change systems in some areas because of the way that projections are calculated, for example for multiple-pooled funds. The cost of revising wordings on statements should also be considered, which will incur additional costs to implementation.
37. As raised in our answer to Q1, we believe the review of AS TM1 assumptions should consider wider sectoral needs beyond the launch of dashboards. There should be a holistic plan on how the projection regimes can be unified so the industry would not need to make duplicated efforts and implement major assumption changes again when the unification comes into fruition.