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AS TM1

Isio response to FRC consultation

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Consultation questions

Question one

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?

Isio response

Consistency across projections would be ideal. Given we are expecting to show the Expected Retirement Income (ERI) pension figure as an outcome on the dashboards, the ERI should have a common underlying method. This, however, should not be the sole motivation. Member understanding of figures shown on dashboard (particularly around adequacy of saving) would also be a measure of success – a simple, best estimate and consistent methodology for the accumulation rate and/or annuitisation form could be a positive in that regard.

The dashboards will show the individual's pot now, the ERI pot plus the annual ERI itself. We believe it should also show the average net annual growth assumption for each DC pot (i.e. the overall accumulation rate net of inflation) to aid comparison. Therefore the methodology of obtaining an accumulation rate for each pooled fund need not be prescribed as strictly as proposed.

Loss of independence and judgement in setting accumulation rates will mean further watering down of the reliance that can be placed on these projections. We acknowledge there will always be a level of inaccuracy – as these are only projections after all – but this approach will not allow for nuances that could materially affect the projected ERI pot.

Providers are likely to have better insight into the assets they hold (and member behaviours)– these may differ from industry standard therefore the inability to tailor to scheme specifics is a downside of the proposals. There are benefits in providing some flexibility to providers and trustees – they should be able to make sensible simplifications in their approach to avoid hard wiring complexity and/or spurious accuracy. Equally, providers should be able to undertake complex stochastic modelling if they wish to do so, reflecting outcomes that are more reflective of the DC pots held by their members.

However, we do support the suggestion that the form of annuitisation should be prescribed and consistent between DC schemes. The ERI is a key output that the members will be comparing alongside the ERI pot – if the ERI is not proportional to ERI pot size, this will cause much confusion, questions, and potentially distrust in figures viewed.

Question two

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

Isio response

Acceptable – there would be a sufficient lead up to issue statements prior to "going live" on dashboards. Ideally would have the first set of SMPIs issued under this revised AS TM1 prior to dashboard release, so members will see the same figures on paper as well as online.

Question three

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

Isio response

Theoretically, we can understand the proposed approach – we appreciate that increased risk is correlated with increased return. We also acknowledge the substantial research behind these proposals, and that historic volatility has the advantage of being objective, rather than dependent on subjective judgement.

However, this approach does cause a dependence on historic market returns, which may produce results that depend on the period being examined, and potentially conflict with the intuitively correct classification. For example, emerging market equity funds - those passively tracking the MSCI Emerging Markets index over the 5 years to 31 December 2021 would likely be classified within volatility group 3 - as the index produced calculated volatilities (based on the specified formula) of 13.1% - whereas emerging markets should logically be treated as "higher volatility equity funds" with a corresponding higher accumulation rate.

Further, the proposal contradicts principles of being easy to describe and explain. This complicated method will mean members will not understand why similar funds result in such different amounts. The 5% volatility banding is quite a crude split, but we do note there are some benefits from simplicity too.

The small number of volatility buckets means that the resulting outputs are very dependent on whether funds happen to fall in certain buckets, e.g. if Fund 1 has historic volatility 9.8% and Fund 2 has historic volatility 10.2%, then their assumed returns are 2% p.a. different which is a very large difference for two funds that are quite similar.

There is a huge difference in 3% pa compounded over 30 years vs. 5% pa i.e. a pot of £10,000 now could equal an ERI pot of £24,200 or £43,200. If we were to proceed with the volatility approach, we would suggest additional volatility groupings with staggered returns to avoid significant jumps over time and / or inconsistencies in ERI figures between similar assets as demonstrated here.

We believe an asset class approach is preferable – it is more easily understood and there is the benefit of closer consistency with the current approach taken. We would suggest AS TM1 sets guidelines for the long-term return of each of the key asset classes (relative to 2.5% CPI). This would allow providers to set a sensible accumulation rate based on the member's fund selection (e.g. if they are currently invested in a 100% equity fund or if they are in a life-styling default).

We would be open to AS TM1 setting out a maximum rate of rate of return for each broad asset class, allowing each provider or trustee to set their own reasonable assumption for each of these. They would be best placed to decide on the level of complexity of modelling required to reach an appropriate assumption; and this should be more realistic as they will have the benefit of understanding their own assets. Providers should also be required to set out a justification for their approach in setting their assumption.

This approach would also make more intuitive sense to members than the volatility method, particularly when showing the net return assumption on the dashboard. Members will understand the link between asset classes and level of return much more easily.

Question four

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?

Isio response

Overall the proposals are reasonable, however we would prefer best-estimate assumptions (which the provider/trustee should be willing to justify) rather than those with prudence attached. Given there continues to be a crisis of people not saving enough in their pensions, is quoting prudent assumptions really the best thing to do? It risks deterring people from saving.

We do accept that achievable and realistic accumulation rates are required, therefore a level of prudence that is proportionate is justified. We would separately suggest that a long-term CPI assumption of 2.0% in line with the Government's target would be preferable to the 2.5% proposed.

Question five

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

Isio response

The proposed approach – of adjusting the accumulation rates in line with planned de-risking is sensible – this approach taken by many schemes currently, and is likely to continue to happen in future.

Question six

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?

Isio response

As stated above, our preference would be to avoid the volatility approach in favour of the asset class approach. The 0.5% corridor would be acceptable for the sake of stability; however it does raise the issue (as detailed under question 3) of similar funds falling in different volatility groups and lead to differing accumulation rates.

Question seven

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

Isio response

Once again, our preference would be to avoid the volatility approach.

We would suggest allowing providers to set their own assumption, having taken a reasonable approach in deriving this. Any modelling, stochastic or otherwise, would be subject to any maximum set of individual asset class returns in line with the standard asset class proposals above. This would of course make allowance for any guarantees, as proposed, with the assumptions justified and disclosed.

Question eight

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?

Isio response

We note that there may be unintended consequences if a zero rate of growth is adopted. It may lead to a lower level of investment in these assets, should comparisons take place between the accumulation rate of different providers. This would be contrary to government efforts to encourage investment in these illiquid assets.

Once again, providers will understand their own assets and should have the flexibility to set reasonable assumptions based on appropriately complex or simplistic modelling for these unquoted assets.

Question nine

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

Isio response

Proposed approach seems reasonable - aggregation to take into change in allocations based on current or known future strategies, however we would prefer this to be done by asset class and not via the volatility approach.

Question ten

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?

Isio response

We note a minimal number of annuities bought at present - de-risking fully and purchasing an annuity is not an optimal course of action for most. However, the decumulation market is not as developed as to suggest a way forward as yet. We'd expect drawdown and default investment strategies in retirement to become more sophisticated in future. therefore would suggest revisiting at next review – indeed if master trust CDC decumulation arrives and/or pooled annuities we may have further options to consider.

We note the arguments to make allowance for the lump sum option given the level of take up - not doing so could lead to ERI figures that that do not reflect the likely annual income in retirement. However we believe the ERI figures should ignore the cash lump sum – in due course individuals will be able to model this as they approach retirement under their provider's own modellers. The dashboard is about individual adequacy of saving, not displaying the option of taking a lump sum and resulting pension. We would also prefer to show DC pot figures consistent with those shown for DB schemes – therefore displaying the real value of the ERI pot and the ERI without lump sum distractions.

There is the lack of understanding of risks in retirement. Whilst change might arise in the form of annuities purchased, perhaps due to greater numbers of members receiving Pensions Wise guidance, there is an argument that the dashboard should be used more as an educational tool to spur action, rather than a modelling tool.

Most now do not purchase annuities and those who do buy single life/non-increasing pensions. We would suggest illustrating a CPI single life pension as the basis for the ERI, to be more consistent with inflation-linked DB pensions and the State Pension. This would then mean the ERI becomes more about the individual's overall income in retirement (and allows for inflation risk during this period). It removes the need to explain the impact of erosion due to inflation after decades in retirement on a higher non-increasing pension, instead challenging the member to consider whether they could live on the inflation-adjusted ERI shown on the dashboard.

Whilst we acknowledge the gender pensions gap, the dashboard is designed to work for individuals therefore we believe a single life annuity is preferable. Individuals will be able to adjust for their own circumstances using other modelling tools – these dashboard figures are merely an initial step in engagement in their pensions.

Question eleven

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?

Isio response

Where less than two years away from retirement, we would prefer to continue with the same approach as taken for individuals more than two years away for the sake of consistency. Very few annuities are purchased nowadays, and a policy or plan's given retirement date may not be aligned to other pensions shown or the individual's actual plans therefore reflecting the current position of the annuity market is not as important as stability in figures shown in those later years.

The potential for some significant cliff edges means we believe it would it be better to keep things simple and use the same rate at all ages/terms to retirement

Question twelve

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?

Isio response

Acceptable for now – agree with updating to latest model and tables. As TPR says, longer term impact of Covid yet to be known, so the use of core CMI projections not unreasonable – expect further refinement in future regular reviews.

Question thirteen

Do you have any other comments on our proposals?

Isio response

There is likely to be confusion for members around the changes from their last SMPI statement to their statement under these propose new rules. This is an area which will need to be tackled – we suggest some consistent wording and explanation is provided to be included across all statements to assist here.

As mentioned above, we believe setting out the net average accumulation rate over the period to retirement for each DC plan would be beneficial to individuals.

Question fourteen

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

Isio response

If proceeding with the volatility approach, note it will be costly for providers to change systems and monitor funds, perhaps onus should be on fund managers to publish 5 year volatilities rather than requiring duplication of work for the rest of industry.

Our proposed asset class approach would be significantly less onerous on those currently using deterministic assumptions for each asset class, significantly less work using broad brush asset classes, whilst justifying and disclosing the assumptions used.

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