Vanguard

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

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Submitted via email to: APT@frc.org.uk

Proposed revision to AS TM1: Statutory Money Purchase Illustrations

A) Background on Vanguard

The Vanguard Group, Inc. (VGI) began operations in the USA in 1975 and is headquartered in Valley Forge, Pennsylvania, USA. Today VGI (together with its affiliates, as appropriate, Vanguard) operates in the USA, Europe, Asia, Australia, Canada, and Latin America. Vanguard is one of the world's leading asset managers offering a wide selection of low-cost mutual funds, exchange traded funds (ETFs), and related investment services to individuals, financial professionals, and institutional investors.

Vanguard aims to offer investors the highest value investment products and services available and has an unwavering focus on investor value and costs. VGI is owned by the US domiciled funds that VGI manages, and these funds are in turn owned by the investors in the funds. This unique structure aligns our interests with those of our investors – benefiting investors worldwide – and drives the organisation's culture, philosophy, and policies.

As of 31 December 2021, Vanguard's global assets under management (AUM) were approximately £6.2 trillion. Vanguard manages around £223 billion on behalf of our clients in UK our Ireland-domiciled funds range, including over £36 billion invested in our Exchange Traded Funds (ETFs)marketing 95 funds to investors in the UK. Vanguard Asset Management Limited (VAM) manages portfolio assets with a total AUM as of 31 December 2021 of approximately £285.4 billion. Vanguard also provides a variety of investment services and products to retail and institutional investors across Europe through offices located in Dublin, Paris, Amsterdam, Frankfurt, Berlin, Milan, and Zurich.

In May 2017, Vanguard launched a direct investment Personal Investor service – Vanguard Investor – to UK retail investors. The online investment service was designed to help simplify and lower the cost of investing for individual investors from all financial backgrounds and needs. By accessing Vanguard's funds directly (including Vanguard's Ireland-domiciled funds and ETFs), investors benefit from one of the best value for money offerings in the UK and can avoid the additional fees often charged on other platforms. The service helps investors navigate an increasingly complex investment landscape by providing clear information and education with the aim of giving them the best chance for investment success. Just as importantly, it enables UK retail investors to access a diverse range of investment opportunities from within the UK and globally, providing valuable and necessary diversification at scale and at low costs.

In February 2020, our Self Invested Personal Pension (SIPP) was launched and has become one of the fastest growing pensions in the direct to consumer (D2C) market and winning the Which award for three years running.

Our commitment to delivering value, good consumer outcomes and our belief in the value of advice led to the launch in April 2021 of Vanguard Personal Financial Planning service. This is a low-cost, easy access digital advice service delivering a tailored financial plan to support consumers retirement goals.

B) Executive summary

Vanguard welcomes any initiative that helps ensure consumers make informed decisions around their investments.

In principle, the overall objective for regulatory change should be the removal of unnecessary frictions in the consumer investment market to enable consumers to obtain better financial outcomes and to spur much needed competition within the market. We have previously highlighted to the FCA the principal challenge for firms has been the gradual process of "regulatory layering" in respect of rulemaking and policy change: new regulations that are in effect added onto existing obligations without necessarily assessing or reviewing the broader impacts of this approach on firms, nor on their potential ability to service a broader range of prospective retail clients.

We are concerned that the proposals create greater disparity between illustrations produced in line with AS TM1 and those under FCA COBS 13. Such divergence creates confusion for consumers and increases complexity and cost for the pensions industry. We would strongly encourage that the opportunity is taken to align AS TM1 and COBS to ensure consistency for consumers.

We have responded to each of the questions within AS TM1: Statutory Money Purchase Illustrations below but the key points can be summarised as follows: -

Volatility

Whist supportive of the initiative to achieve consistency across differing pension providers, we do not believe that volatility alone is a suitable metric to determine investment returns. Instead, we propose an approach linked to broad sub-asset classes.

As presented, the proposals will create a significant and costly burden across both pension providers and asset managers.

We are also concerned as to how this methodology can be easily explained to consumers so that they make informed decisions around their pension savings. Consumers do want to understand how illustrations are calculated and it is important that this can be done in a straightforward manner. Any solution which requires copious explanatory notes risks adversely impacting consumer confidence and engagement.

Omitting Pension Commencement Lump Sum from projections

Consumers are aware and understand the ability to take a Pension Commencement Lump Sum (PCLS) from their pensions and, in our experience, it is rare for a client not to access at least a portion of it. We are concerned that consumers will continue to assume that PCLS can be taken alongside the projected income shown without necessarily understanding why this is the case.

Projections should reflect the expected behaviour of consumers when they access their pension. Omitting PCLS in projections will create confusion for existing consumers, who will see an increase in their predicted pension income compared with previous statements. This could impact consumer behaviour, reducing savings levels and having a detrimental impact upon retirement outcomes.

C) Consultation responses

Q1: 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 are supportive of the aims of this consultation. Achieving consistency in the methodology used to produce projections across providers will allow consumers to compare products, make informed decisions and lead to better retirement outcomes.

Q2: What are your views on the proposed effective date of 1 October 2023?

We agree with the proposed 12-month period between publication of the new standards and implementation. 12 months is the minimum period to accommodate changes, and this should be adhered to should publication of the new standards be delayed.

Q3: What are your views on the proposed volatility-based approach for determining the accumulation rate?

We believe that volatility alone is a weak proxy for returns. Higher volatility does not always correlate with higher returns, which is why the Sharpe Ratio and other similar risk-adjusted return metrics were created.

Instead, we would propose an approach linked to broad sub-asset classes which is easier for consumers to understand. For example, it could include:

- Developed market equity
- Emerging market equity
- Developed government bonds
- Developed credit bonds
- Emerging government bonds
- Emerging credit bonds
- Cash

Additionally, we believe that there is a gap between cash and high-quality, low-duration bonds that could be bridged through the creation of a 0% volatility category with a return of 1% or less, and another with volatility of >0% - 5% with a return in the 1% - 2% range.

Q4: 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?

We would like to understand if these proposed rates are intended to be nominal returns or real returns. If nominal, we believe that these are low; conversely if these are intended to be real returns, we would consider these to be too high.

By way of comparison, Vanguards median 40-year nominal return for equities is 6.77% with an inflation projection of 1.9%. This yields a real return for broad equities of 4.87%. We consider broad equities to span Volatility Groups 3 and 4, which are projecting nominal returns of 5% and 7%, or real returns of 2.5% and 4.5%.

For bonds, Vanguards 40-year return is projected to be 2.86% with inflation of 1.9%, for a real return of 0.96%. We view bonds spanning Volatility Groups 1 and 2, which have projected nominal returns of 1% and 3%, or real returns of -1.5% and 0.5%.

Q5: What are your views on the proposed approach to reflect derisking when calculating the accumulation rate assumptions?

Vanguard strongly supports the proposed approach.

Q6: What are you views on the proposals that the recalculation of volatility group should be annually as at 31 December with a 0.5% corridor?

We agree with the proposal of the 0.5% corridor, subject to a time limit for how long a fund can stay within a corridor without being reclassified.

Q7: What are your views on the proposed approach for with-profits fund projections?

Not applicable to Vanguard.

Q8: 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?

Not applicable to Vanguard.

Q9: What are your views on the proposed approach to determine the accumulation rate assumption across multiple pooled funds?

Not applicable to Vanguard.

Q10: 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 are very concerned about the proposal to project estimated income on the full pension fund with no allowance for consumers taking a pension commencement lump sum (PCLS). The ability to take PCLS is widely understood by consumers, and it is rare that a member accesses their pension without taking some element of PCLS.

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Illustrating projected incomes without accounting for consumer behaviour around PCLS risks poor client outcomes. Some consumers will believe that they will be able to receive the higher income that will be shown in projections will not understand the impact that taking PCLS will have on that income. This could impact future savings behaviour impacting their retirement outcomes. Vanguard believes that projections should assume that consumers take PCLS.

Q11: 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?

We believe that this will add additional complexity to the process of producing projections with little benefit to consumers.

Q12: 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?

Not applicable to Vanguard.

Thank you for the opportunity to comment. If you would like to discuss these comments further you can contact Brent Beardsley, Principal, Head of Personal Investor, Europe, at [redacted] or Alex Bruce, Government Relations Director, UK Policy, at [redacted].

Yours faithfully,

Alan Cowan

Vanguard Asset Management Limited