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Email: [redacted]
Ref: TM1/May2022

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Private and Confidential
The Director of Actuarial Policy
Financial Reporting Council
8th Floor
125 London Wall
London
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Dear Sirs

Proposed revision to AS TM1: Statutory Money Purchase Illustrations (SMPIs) – consultation

I am writing on behalf of Buck Consultants Limited ('Buck') in response to the above consultation.

Buck's employees are impacted directly by the consultation as they provide advice to trust-based occupational DC schemes in respect of setting assumptions for SMPI projections and provide third-party administration services to these types of arrangements.

Our responses to your specific questions are set out in the appendix to this letter.

We would be happy to discuss our responses to the questions further if that would be beneficial. Please contact Laura Joyce [redacted] or Alison Lewis [redacted] if you would like to discuss these responses further.

We look forward to your response to this consultation.

Yours sincerely

[redacted]

Laura Joyce FIA
Consulting Actuary
For and on behalf of Buck Consultants Limited

Appendix – responses to consultation

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?

In general we agree that it is beneficial to have consistency in how assumptions are set across different providers. However, the proposed approach means only one view is adopted across the industry, and hence there is a bigger risk if this view is 'wrong'.

In addition, we have provided further comments later in this appendix in respect of the appropriateness of some of the specified assumptions for the form of the annuity.

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

We are comfortable with the proposed effective date of 1 October 2023 in conjunction with the Pensions Dashboard roll out. However, this is on the basis that confirmation of final approach is provided by 1 October 2022 to provide firms with sufficient time to be able to update systems and test these revisions accordingly.

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

Whilst we appreciate the reasons why this approach has been proposed, we believe that there are some material issues with adopting this kind of approach and of the specific methodology set out in the consultation. For example:

- *There will be a tendency to 'penalise' diversified approaches, which aim to sit on (or above) the efficient frontier and assign higher accumulation rates to certain single-strategy funds which have high volatility but are not necessarily on the efficient frontier.*
- *Certain assets such as long-dated gilts can have high volatility in certain market conditions but are not expected to have high returns.*
- *Monthly return figures may not be readily available for all funds – use of quarterly figures to calculate volatility would lead to less additional work being required and be easier to access information.*
- *Where there is insufficient performance history, we would suggest considering the benchmark as an alternative guide to classification rather than mandating use of the performance of a similar existing fund. While this may not be appropriate in all cases, we believe it would give a better approximation in the majority of cases, and allowing the use of either approach would allow advisers to use their judgement to choose the most appropriate method. We appreciate this opens the possibility of different advisers making different decisions, however, this would also be the case under the proposed 'similar other fund' approach as different advisers would be likely to choose different 'similar funds'.*

We note the example regarding property funds which was given to justify the volatility approach over an asset class approach. However, it is unclear that the asset class approach (if correctly defined) would be any 'worse' for this than the volatility approach. Under the volatility approach a fluctuating cash holding in a predominantly property fund would be unlikely to result in a different band classification from a fund which was 100% invested in property, and a larger more sustained cash holding (that might trigger a lower volatility bond) is likely to reflect a fund which is not fundamentally a core property fund and so would be classified differently anyway under an asset class approach. Such funds could instead be dealt with alongside multi-asset funds or other alternatives, and an alternative way to deal with these is set out below.

To address the above points, while considering the aims, objectives and concerns raised in the consultation, we would propose that an alternative approach could be considered with a mix of ‘by asset type’ and ‘by volatility’ approaches.

For example, for relatively simple asset classes, use a ‘by asset type’ approach (equity funds, cash funds, corporate bond funds, gilt funds) but for mixed funds, use a volatility approach (DGFs, Managed funds, etc.). Under this, any asset class which didn’t fall clearly into the categories ‘by asset class’ would be done on a volatility basis, thus futureproofing against new asset classes coming available.

We also believe that this approach will be conceptually difficult to explain to members and trustees. Therefore, where there is a material change in a individuals’ projections as a result of this change in methodology, careful consideration will need to be given as to how this can be simply communicated to members to ensure that individuals remain engaged with their retirement savings.

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?

We agree that the proposed accumulation rates are broadly reasonable based on current market conditions. It could be argued that these accumulation rates are perhaps slightly over prudent for higher volatility levels and less prudent for lower volatility levels. However, this seems a sensible way to approach the accumulation rate if the aim is to avoid people having shortfalls at retirement relative to the projections they have received during their working life.

We would note interaction with question 3 that though a fund may not typically be viewed as high risk it could end up having a high volatility (e.g. long-dated gilts) over a particular period and could end up in the 'wrong' category and, therefore, an unrealistic accumulation rate (based on the asset class) could apply to that fund.

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

We support this proposal, and we already allow for derisking when we complete projections. We believe it is more appropriate to provide projections based on this approach, in particular in order to manage members’ expectations and to ensure that they are not provided with projections that are over generous (as would occur if derisking were not allowed for).

6. What are you *(sic)* views on the proposals that the recalculation of volatility indicator should be annually as at 31 December with a 0.5% corridor?

If this approach is adopted, an annual calculation seems a sensible way to simplify this, and 31 December would be an appropriate date and, therefore, consistent across all schemes.

If the benefit statement season were to be introduced, this would also allow sufficient time ahead of the benefit statement season for this information to be collated and for the accumulation rates to be determined.

The proposed corridor approach works once the ‘correct’ category is determined, however, if a fund is ‘actually’ a category 4 fund but happens to have fallen just into category 3 when first calculated, this could mean it spends a longer time in category 3 than it should do before the ‘true’ data comes through. This will have a greater impact the longer the time frame a member has until retirement and for younger members could result in misleading projections.

We would propose consideration is given to a different approach for the first calculation if the fund falls within the corridor at outset. For example, providers could consider what the previous year's calculation would have been (or previous two years') and determine the initial category based on that. This reduces the risk of abnormal data being used as the benchmark for setting accumulation rates.

This approach could also apply each time a new fund is added into an arrangement.

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

We have little experience of DC benefits with with-profits funds, however, the proposal seems reasonable, but it will depend on the practicalities of obtaining the information required.

In addition, we would note that there is a small proportion of these types of funds remaining in the marketplace compared to unit-linked based funds.

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?

We have little experience in the use of unquoted assets in occupational DC schemes.

We would note that this approach could discourage the use of unquoted assets. We believe that estimated returns, perhaps subject to a prudence margin, would be more realistic and appropriate to use.

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

Assuming the overall proposal is adopted, we are comfortable with this specific proposal. We believe this provides a balance between practicality and accuracy. However, we would comment that the proposed approach is not theoretically consistent with the volatility approach for single 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?

We believe it is practical to show a level pension without an attaching contingent spouse's pension. This is a common option that individuals now select, in particular, if individuals are looking to have a base level of income through purchasing an annuity. However, we believe that it is important for this to be clearly communicated to members if this is a change in approach compared to previous illustrations members have received.

We would highlight that following the introduction of the pension flexibilities from 2015, there has been a shift away from individuals purchasing an annuity at retirement, with more individuals seeking to utilise drawdown or encashment options at retirement depending on their circumstances.

Therefore, the proposed illustration will not necessarily align with the options members ultimately choose at retirement. We feel it could be beneficial to provide members with further details / illustration in respect of this, however, we appreciate the additional assumptions that would need to be made in order to facilitate this.

We would note that the proposed treatment of the individual not taking tax free cash at retirement is out of line with actual member behaviour. In addition, we believe that this could also be misleading to members who have *been provided with details of their pension historically based on a tax-free cash lump sum being taken at retirement, and careful consideration will be needed in explaining this change in statements.*

We also believe that it is important that individuals are aware of the ability to take a tax-free cash lump sum, as this can make a material difference to individuals' retirement planning (i.e. using tax free-cash lump sum prior to State Pension age to supplement their income and phase an individual's retirement).

We understand the rationale behind this proposal, as it is linked to the Pensions Dashboard which will also show details of defined benefit pensions, where it would be extremely complicated to illustrate tax-free cash entitlement and be potentially misleading. However, given the simplicity of completing this for defined contribution pensions and that there are a greater number of defined contribution pensions compared to defined benefit pensions (with this difference expanding over time), we would encourage the FRC to consider this point further.

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?

We believe that this is a reasonable amendment for retirements that are more than two years in the future at the date of the projections.

However, for individuals less than two years from retirement, we would note that not all providers of SMPI projections directly provide annuities, as such we would need to obtain market rates from an alternative source.

In addition, if sample market rates were used, this could result in individuals believing that the illustration is more accurate compared to the conversion being based on general assumptions. In reality, the actual annuity available to an individual could be materially different if the individual was to obtain an open market quotation.

We believe if this approach were to be adopted that there would need to be a standard approach for obtaining these rates and also to ensure that the information is readily available in order to not delay the production of SMPI. Otherwise, this could result in inconsistency in projections that members receive which defies the aim of the consultation.

We would be comfortable for the approach for retirements that are more than two years in the future to be adopted across all projections. This allows a consistent methodology and avoids potential large step changes as an individual is closer to their selected retirement age (which in reality may not be the actual age at which they retire). This is the approach that Buck currently adopts when providing SMPIs to those individuals who are less than two years from their retirement.

Furthermore, given that many individuals do not elect to take an annuity at retirement, we believe that focusing too much on the accuracy of the projections close to retirement for an annuity could be distracting to members compared to alternative retirement options that are now available.

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?

We believe that this update is reasonable to allow for more up-to-date mortality tables. We are comfortable that using generic assumptions also allows for consistency between schemes. Finally, we believe it is fair for standard parameters for practical purposes, but we appreciate that this is not necessarily the most accurate approach; however, this remains appropriate for the purpose of the illustrations.

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

Significant changes are being proposed to the approach for calculations. Therefore, sufficient lead time must be available prior to the effective date of implementation, to allow providers time to update their systems and test these changes, given such a material change hasn't been required in respect of these projections for a significant period of time.

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

Administration

For the proposed approach for projections for individuals more than two years away from their selected retirement date, we do not believe that this would result in a material additional cost for revising the calculation approach as proposed.

However, as it is proposed that projections for individuals within two years of their selected retirement date be based on market annuities, as a third-party administrator who does not provide annuities as a product, Buck would need to obtain details of these rates from an insurer or a central resource. The methodology for how these rates should / will be obtained is not clear from the consultation. If this information is not available publicly, this would require additional resource to source the appropriate annuity rates for different ages from an insurer. It is also not clear how often it would be required for these annuity rates to be updated. The more frequently these market annuities need to be updated, the great the cost implication for Buck (and therefore clients) as a third-party administrator. Therefore, we believe that there could moderate additional costs involved to implement the proposed approach for those individuals within two years of their selected retirement date.

Consulting

For the proposed approach for deriving the accumulation rates, we believe that there will be a material increase in costs in order to source the appropriate volatility information and considerations during the first year of implementation if funds had been allocated to the correct volatility banding. We would expect these costs to be directly passed on to trustees.