Financial Reporting Council

Accumulation rates used by providers of statutory money purchase illustrations since 6 April 2016

Introduction

The FRC's actuarial standard Technical Memorandum 1 (or AS TM1) sets out the methods and assumptions to be used in producing annual statutory money purchase pension illustrations (SMPIs).

A key assumption in the production of the illustration is the accumulation rate at which an individual's investments will build up.

AS TM1 requires that the accumulation rate assumption used for SMPIs takes account of the expected returns from the current and anticipated future investment strategy of the member's funds over the period to the retirement date consistent with an inflation rate of 2.5% pa. Additionally, the method used to determine the accumulation rate should be consistent from year to year, and the rationale used should be documented and made available to members on request.

Prior to 6 April 2013, the accumulation rate was capped at 7% pa. To assess the impact of the removal of the cap the FRC monitors the accumulation rate assumptions used in SMPIs through an annual survey.

This year's survey, which considers statements issued after 6 April 2016, sought information about the impact of changes to the Disclosure Regulations and the introduction of pension freedoms on the information provided on annual statements. We also sought information on the impact of the change to AS TM1 which gave providers discretion to take account of guaranteed annuity terms in illustrations.

This report summarises the findings of this survey which indicates that the majority of providers are following the intent of AS TM1 and exercising judgement in setting the accumulation rate assumption. Additionally, the majority of providers have not made significant changes to the form of benefit illustrated on annual statements in light of the revised Disclosure Regulations and have not made changes to statements in light of the introduction of pension freedoms. We found that the majority of providers with policies which have guaranteed annuity terms had not amended illustrations to take account of those terms.

We are publishing our findings in order to inform providers about the accumulation rates assumed during this period and provide an opportunity for stakeholders to give us further input on our findings, the approach to the accumulation rate and the other matters covered.

Approach to the review

The FRC invited providers to complete a questionnaire on their approach to setting the accumulation rate assumptions and their approach on other matters for SMPIs issued after 6 April 2016.

Results of the review

The FRC is grateful to the twenty-two providers who responded to the survey. Together they issue over 23.5 million SMPIs a year, over 65% of which are issued to members of contract-based defined contribution arrangements.

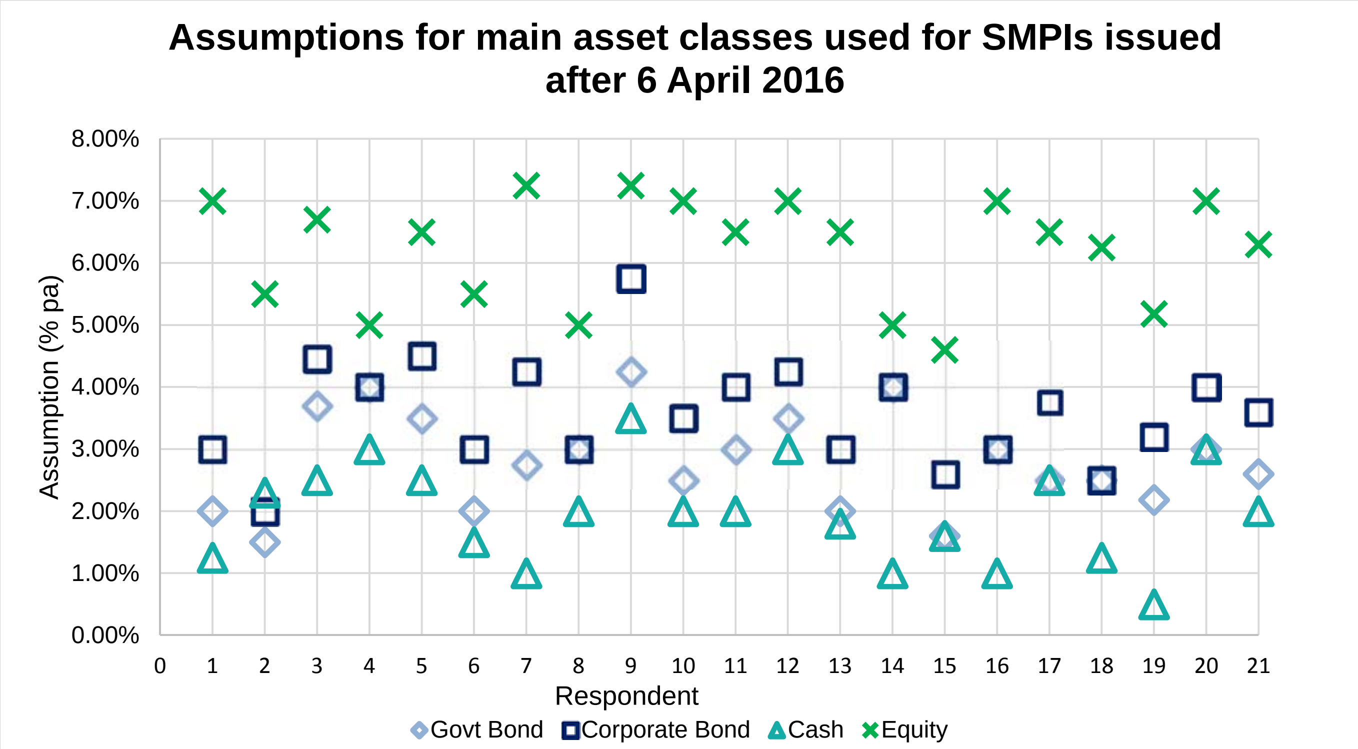
Accumulation rates

As with previous years' reviews, the FRC sought information on the accumulation rates being assumed for the broad asset classes of: equities, government bonds, corporate bonds and cash. One respondent provided the information in an alternative format (and is not included in the following analysis).

The following chart shows the survey results for accumulation rates for each of the main asset classes reported by respondents. The FRC is not seeking to judge the appropriateness of the accumulation rate assumptions reported on the basis of the survey, because of the variety of investments available within each asset class.

One provider reported that they were overriding their judgement concerning the appropriate accumulation rate assumption by capping it at a lower rate in order to be consistent with the central assumption required to be used by the FCA when providing projections.

We would highlight that the intention behind the provisions in AS TM1 is for providers to base the accumulation rate on expected returns from the current and anticipated future investment strategy of the member's funds. Under the current version of AS TM1, there is no requirement to cap the accumulation rate at a specified maximum rate.



Notes

- The data were collected over the period June to August 2016, and the accumulation rate assumptions used for statements issued may have changed subsequently.
- Respondents 1-12 are insurers; respondents 13-21 are consultancies and others.
- Respondent 7 assumed equities will return 7.25% pa, but capped the overall accumulation rate for each SMPI, reflecting the actual asset allocation, at 5% pa.
- Some respondents provided more detailed information. For example, some providers gave:
    - UK and non-UK equity return assumptions. The rates shown in the chart are the UK equity returns, which are lower than the corresponding non-UK returns.
    - Passive and active fund return assumptions. The rate shown in the chart is the passive fund assumption which is lower than the active fund assumption.
- Respondent 20 produces statements for a large number of clients who all approach the assumptions differently. For this respondent, the mid-point of the range of assumptions which this respondent uses as the basis for advice to clients on assumptions is shown for each asset class.

Impact of Disclosure Regulations

We found that few respondents are utilising the changes in the Disclosure Regulations[1] and AS TM1[2] effective from 6 April 2014 which allow providers to personalise the illustration individuals receive - the majority of respondents do not show a lump sum and continue to show a pension that increases in line with inflation.

Guaranteed annuity terms

Version 4.1 of AS TM1 (effective from 6 April 2015) gave providers discretion to take account of guaranteed annuity terms in illustrations. We found that the vast majority of providers have not amended illustrations to take account of guaranteed terms.

Impact of pension freedoms

The majority of respondents have not amended their annual statement in light of the pension freedoms introduced from 6 April 2015. Some providers have amended the wording on annual statements to note the changes and the extra choice introduced from April 2015, and to flag the Pensions Wise guidance service. Over half of respondents show a projected fund value on annual statements, but this is not a change in practice resulting from the introduction of the freedoms.

Comments

Please email ASTM1@frc.org.uk with any comments.

October 2016

[1] SI 2013/2734

[2] Changes introduced by version 4.0 of AS TM1 and retained in version 4.1 of AS TM1