Accumulation rates used by providers of statutory money purchase illustrations since 6 April 2019

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 considers statements issued after 6 April 2019. We asked again about how statements had changed in the light of pensions freedoms, whether the SMPIs stated that guidance on the exercise of pensions freedom is available from Pension Wise and on the extent of feedback from recipients.

Additionally, this year we asked about the proportion of SMPI projections that reflected either paid up plans or plans for which future contributions were level in monetary amounts. A major difference between projections produced under AS TM1 and FCA rules occurs where contributions are assumed to increase in line with inflation. Therefore, we wished to understand to what extent plans do allow for contributions or premiums increasing with inflation.

This report summarises the findings of this survey which indicate that the majority of providers are following the intent of AS TM1 and exercising judgement in setting the accumulation rate assumption. Additionally, no respondents reported that they had received any meaningful feedback on the accumulation rates from sending out the SMPIs which may indicate a very low level of engagement of recipients with the SMPI statements. We also discovered that the majority of projections do not reflect contributions (or premiums) increasing with inflation.

We are publishing our findings

- To inform providers about the accumulation rates assumed by others in the market during this period;
- To provide an opportunity for stakeholders to give us further input on our findings, the approach to the accumulation rate and the other matters covered; and
- To encourage providers to be more transparent about their rationale in choosing their accumulation rates for SMPIs.

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 2019.

Results of the review

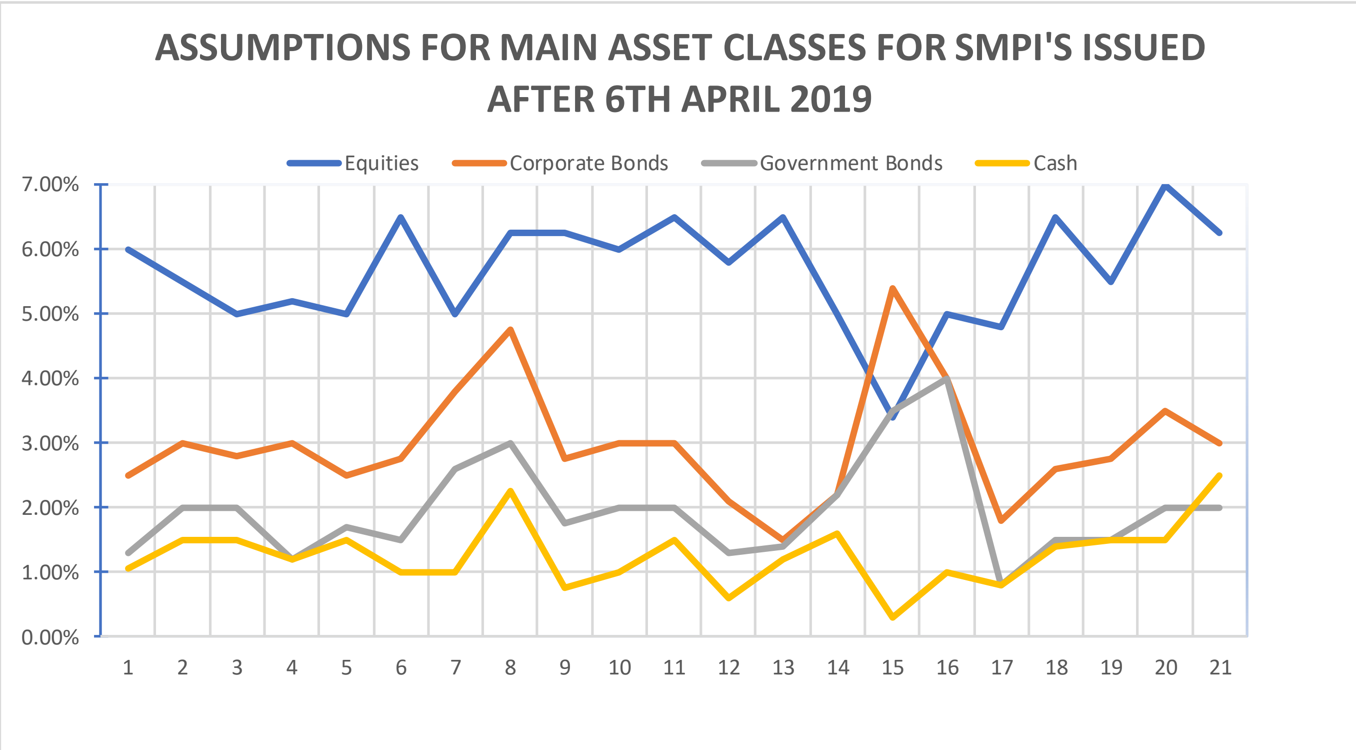
The FRC is grateful to the twenty-two providers who responded to the survey. Together they issue over 33 million SMPIs a year, approximately 59% of which are issued to members of contract-based defined contribution arrangements. We are grateful to the twenty-one respondents from last year who all participated again in this survey. The increase in the number of participants from the 2018 survey was the inclusion of a further wealth manager.

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.

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. These assumed accumulation rates are in the context of anticipated inflation at 2.50% per annum. From the results of the survey, providers are assuming that equities return positive real rates, government bonds and cash are generally assumed to return less than inflation and for corporate bonds the position is less clear, although on balance just exceeding inflation. 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 July to September 2019, and the accumulation rate assumptions used for statements issued may have changed subsequently.
- Respondents 1-12 are insurers; respondents 13-21 are consultancies and wealth managers.

- 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 21 produces statements for a large number of clients who all approach the assumptions differently. For this respondent, we show the mid-point of the range of assumptions which this respondent uses as the basis for advice to clients for each asset class.

Impact of the introduction of disclosure of transaction charges

None of the respondents reported making any changes to their assumed accumulation rates in response to the requirement to disclose transaction charges. Some mentioned no requirement to make any adjustments, some mentioned that the rates were net of all charges and some provided no further explanation.

Engagement of Individuals receiving SMPI statements

We asked providers to indicate the level of feedback or interest that they receive from recipients when sending out the annual statements. All respondents replied either that they receive none or very little contact from recipients of the annual statements.

Two insurers mentioned that they had received positive feedback on new simplified annual statements. The recipients reacted positively to the simpler more understandable presentation rather than to the assumptions used. One insurer did comment that some clients had wanted to know how accurate the statements are and mentioned also the discrepancy with the FCA projections.

Last year one consultancy observed that they published the SMPIs on-line and provide a link by email. Their experience was that only 3% of the SMPIs were accessed by members. This year that same consultancy reported that less than 10% of members who received the online statements accessed them.

All of these observations suggest that, consistent with previous years, there is very low engagement of individuals receiving SMPI statements.

Comparison with 2018 accumulation rates

For those participating both last year and this year, the accumulation rates used for government bonds, corporate bonds and cash differed on average by less than 5 bps between the two years. For equities the average rate reduced by approximately 15 bps. If we measure the absolute movement[1] we find that government bonds, corporate bonds, cash and equities each moved on average by approximately 20 bps.

Therefore, we see stability between the rates used in 2018 and those used in 2019. However, insurers exhibited more stability between the two years with the consultancies and others showing more volatility.

The following graphs show for each asset type how each respondent has changed the accumulation assumption between 2017 and 2018.

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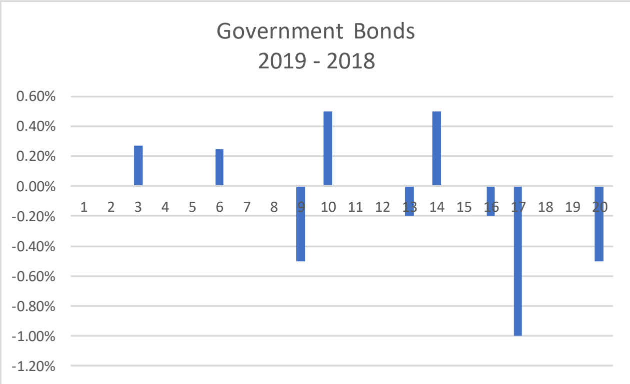
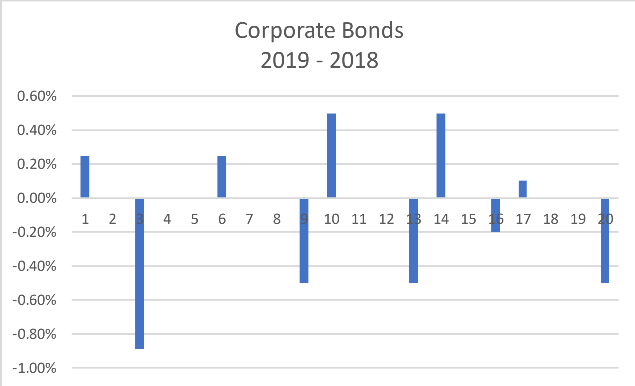
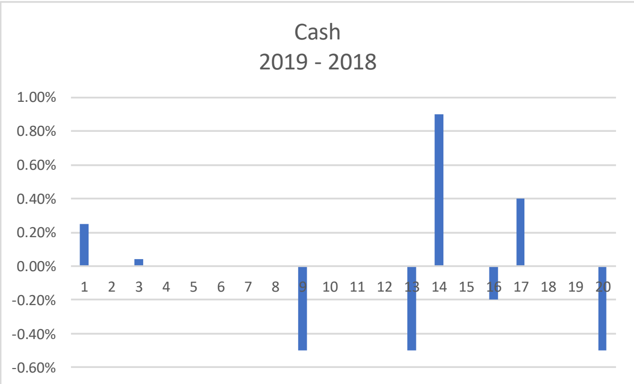
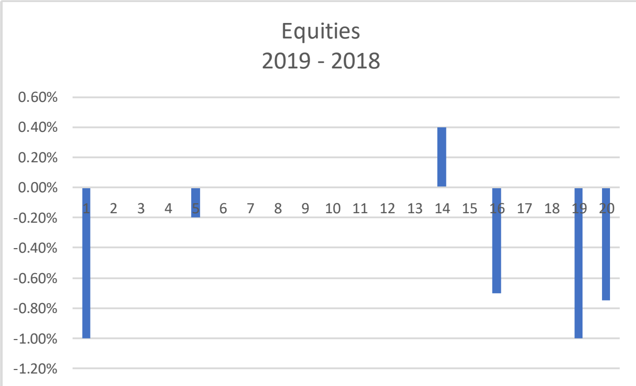
[1] *Considering only the absolute value of movements and not allowing opposite directions of movement to cancel each other.*









From the above graphs we can see that the majority of insurers who participated in both years left the accumulation rates for all classes unchanged. By contrast, consultants and wealth managers were more likely to have changed their accumulation rates in all classes (mostly by around 1% or less).

This is against a background of economic uncertainty where the uncertainties of the nature of Brexit complicate predictions of future economic performance in the UK.

Proportion of projections with no future contributions or future contributions level in monetary amounts

This year we asked two linked questions in the survey. The first was for the approximate proportion of projections for which there are no future contributions/premiums assumed. The second was for the proportion of projections which assumed contributions increasing in line with inflation.

A major difference between projections made under the SMPI rules versus FCA projections arises from the difference in assumptions made on the real growth rate of future contributions where these are projected to increase with wage inflation. Therefore, these questions were included to examine how significant this difference is overall.

To avoid imposing undue work on the providers we asked only for the quintile of projections[2] for which there are no future contributions assumed or for which future contributions are level. This means that the statistics are high level indicative only.

What the responses show is that very approximately 35% - 40% of SMPIs are for plans with no future contributions. This means that we estimate that very approximately 60% to 65% of plans allow for continuing future contributions.

[2] *For example, quintile 1 means that between 0% to 20% of total projections of this provider have no future contributions/premiums.*

However, it should be noted that the sample covers only 21 million of the 33 million issued by the providers in the survey. As such, the estimate is subject to significant doubt.

We asked also similarly for the proportion of plans which project future contributions increasing with wage inflation. Again, caution must be exercised in interpreting the data because responses were received in respect of only just over 20 million out of the 33 million issued by the providers in the survey.

With that caveat, approximately one third of plans project contributions that do not increase with inflation.

Overall, combining these two results, we estimate that one half or more of SMPIs do not project contributions increasing with inflation. But that means that up to 16 million projections may have contributions increasing with wage inflation.

The scale of these results is such that it would be worthwhile to examine this issue in more detail in future surveys.

Allowance for lifestyling

Of the eleven insurers who responded, five allowed accurately for lifestyling, five allowed approximately through blended accumulation rates and one did not allow for lifestyling.

All the actuarial consultants replied that they allow accurately for accumulation rate changes as the individual progresses through the projection period. By contrast, none of the wealth managers allowed for lifestyling.

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 2019