Accumulation rates used by providers of statutory money purchase illustrations since 6 April 2018

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 2018. 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.

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 are publishing our findings

- To inform providers about the accumulation rates assumed 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 2018.

Results of the review

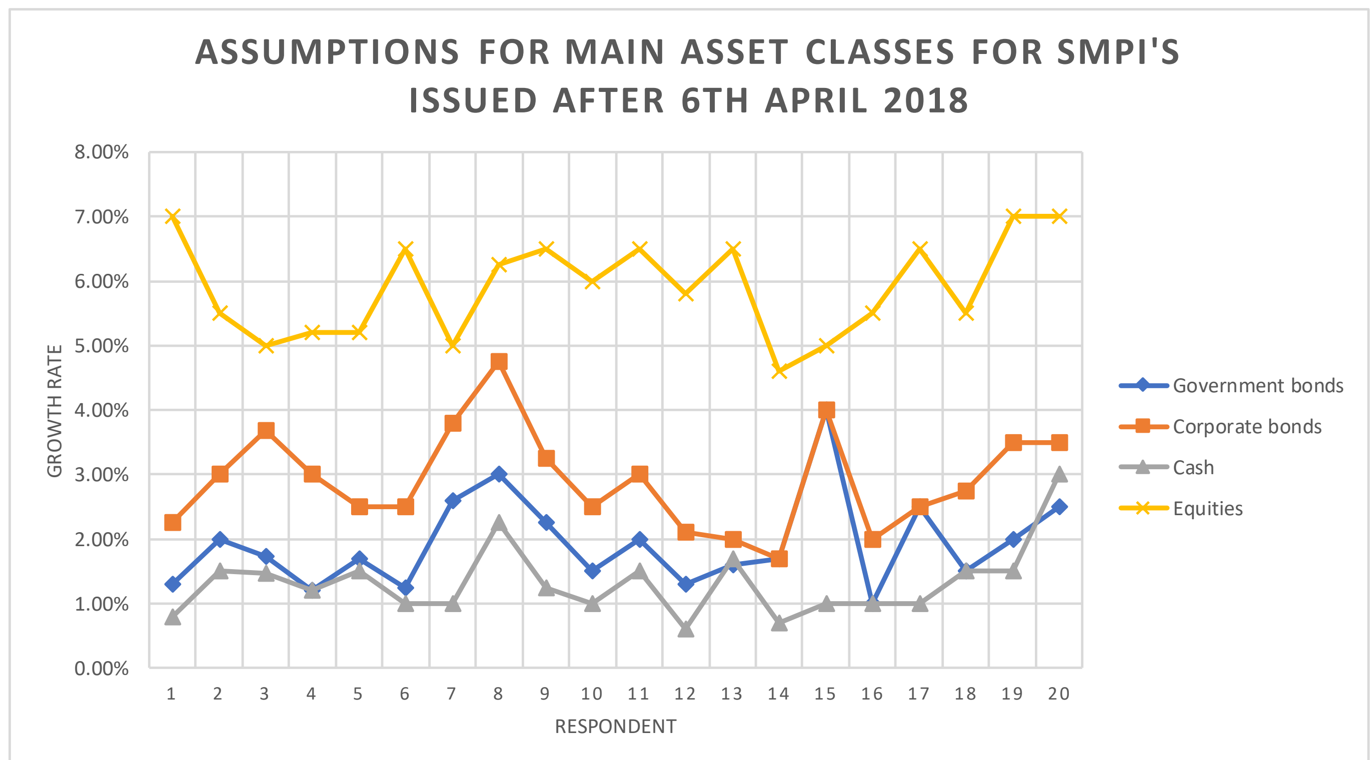
The FRC is grateful to the twenty-one providers who responded to the survey. Together they issue over 30 million SMPIs a year, approximately 57% of which are issued to members of contract-based defined contribution arrangements. The increase in number from the 2017 survey (when 19 responded) was due to the balance between one mid-sized insurer failing to submit data and 2 minor consultancies no longer issuing SMPIs and the inclusion of one major insurer, two other insurers and two consultancies supplying data.

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 assumed to return less than inflation and for corporate bonds the position is less clear. 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 2018, and the accumulation rate assumptions used for statements issued may have changed subsequently.
- Respondents 1-12 are insurers; respondents 13-20 are consultancies and others.
- 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, 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 Disclosure Regulations

We found that it is still the case that relatively 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 that individuals receive – the majority of respondents continue to show a pension that increases in line with inflation.

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. Only one respondent said that anyone had requested information on the rationale for choosing the accumulation rates. The vast majority were clear that none had done so.

On the question of feedback from recipients of SMPIs just over half the participants said that they received no feedback and just under half said that they received very little feedback. Two participants (one insurer and one consultancy) stated that they were planning to survey statement recipients to seek feedback.

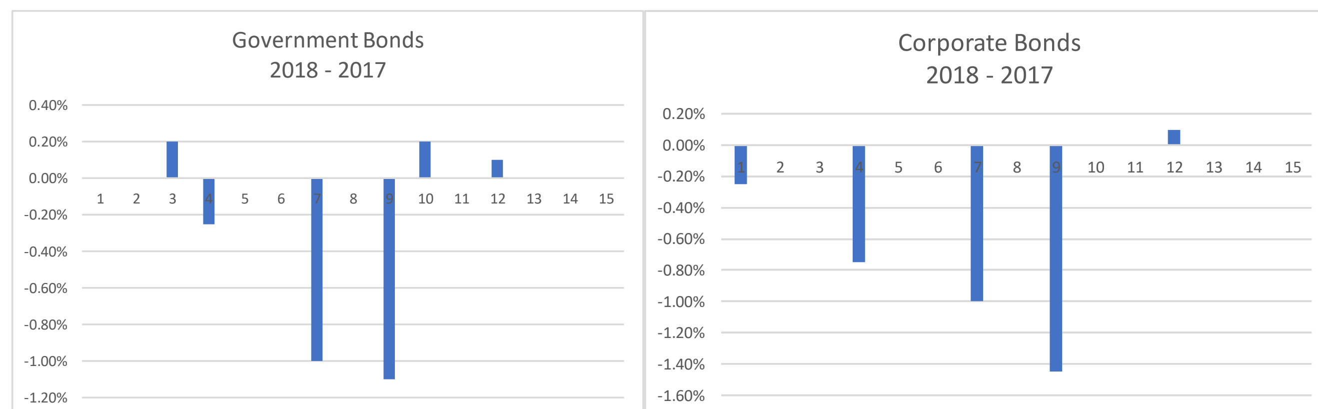
One consultancy observed that they published the SMPIs on-line and provide a link by email. Their experience is that only 3% of the SMPIs were accessed by members.

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

Comparison with 2017 accumulation rates

For those participating both last year and this year, the accumulation rates used for government bonds, cash and equities differed on average by around 10 bps or less between the two years. For corporate bonds the average rate reduced by approximately 20 bps. However, this relative stability in the average rates masks a degree of variability between insurers and others and between different participants. For example, the average accumulation rate for government bonds decreased by 12 bps overall between the two years. However, for insurers this was a decrease of 24 bps and for others it was an increase of 6 bps. Further if we measure the absolute movement[3] we find that government bonds, corporate bonds and cash each moved on average by 20bps and equities moved by 30bps.

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



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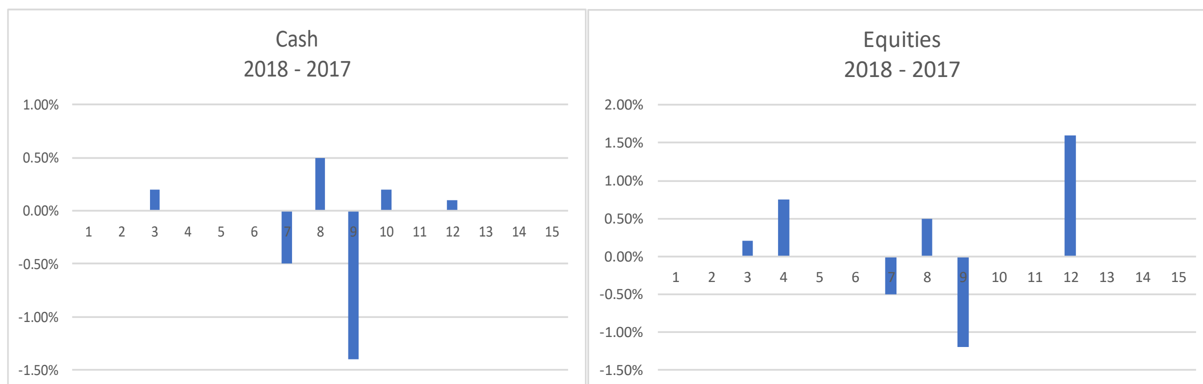
[1] SI 2013/2734

[2] Changes introduced by version 4.0 of AS TM1 and retained in version 4.2 of AS TM1

[3] 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 both insurers and others who participated in both years left the accumulation rates for all classes unchanged.

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.

Allowance for lifestyling

Of the sixteen respondents who made allowance for lifestyling, one third did so approximately (for example by adjusting the average accumulation rate used) whereas the majority stated that they had allowed accurately for the impact of lifestyling by adjusting the accumulation rates within their projection systems for the relevant funds in the appropriate future years of the projections.

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.

Pension Wise

There was an equal split between those who said that they referred to Pension Wise and those who did not do so in the SMPI statement. This was true both for insurers and for others. Three respondents commented that they refer to Pension Wise only for statements provided within a short period before the individual's retirement date.

Comments

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

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