Financial Reporting Council

Accumulation rates used by providers of statutory money purchase illustrations since 6 April 2013

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 is the accumulation rate at which a scheme member's investments will build up. That accumulation rate was previously capped and when version 3.0 of AS TM1 was issued, the FRC said it would monitor the accumulation rate assumptions used in SMPIs in order to assess the impact of the removal of the cap. This report summarises the findings of a survey for statements issued after 6 April 2013. The FRC is publishing its 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 and approach to the accumulation rate. At this stage the FRC does not consider there is an immediate need for further changes to AS TM1 but we will keep the matter under review.

Setting the accumulation rate

Early versions of AS TM1 set a maximum accumulation rate of 7% pa in line with the central assumption required by the Financial Services Authority (FSA) for sales illustrations. Insurers and other providers of SMPIs were required to use a lower rate if 7% pa could not be justified by the member's individual circumstances and expectations of investment potential over the period to retirement.

Following a joint consultation with the FSA, we removed the 7% cap in version 3.0 of AS TM1. The purpose of this change was to encourage the use of judgement and reduce the risk that the maximum rate was selected by default. We considered that this approach would lead to information that is better tailored to scheme members' investment profiles. Under version 3.0, providers should document the rationale for the accumulation rate used and make it available to members on request.

Version 3.0 of AS TM1 applied from 6 April 2013 with a transitional arrangement to allow compliance with the previous version (version 2.0) for illustrations issued before 6 April 2014.

Approach to the review

The FRC invited providers to complete a questionnaire on their approach to setting the accumulation rate assumptions for SMPIs issued after 6 April 2013. Meetings were held with several stakeholders to discuss their approaches, including insurers (many of which provided their input through the Association of British Insurers) and actuarial consultancies.

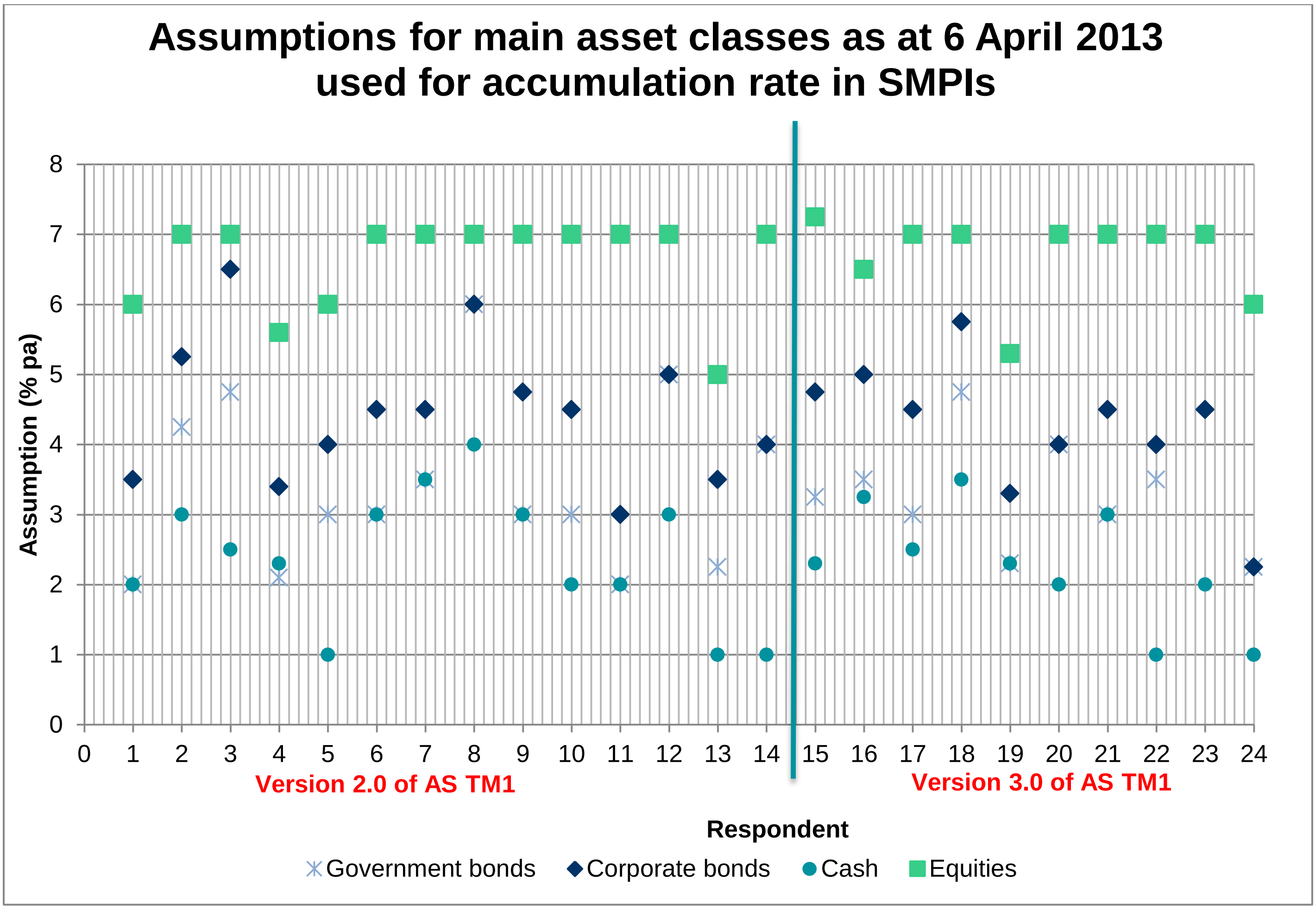
Results of the review

The FRC is grateful to the twenty-six providers who responded to the survey. Together they issue over 17 million SMPIs a year, over three-quarters of which are issued to members of contract-based defined contribution arrangements.

One consultancy respondent noted that some of their clients had moved to version 3.0, whilst others were still using version 2.0. This was borne out by other respondents with 14 using version 2.0 and 11 version 3.0.

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) whilst another respondent was unable to provide this information in the format requested.

The following chart shows the comparable 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 large number of providers still using version 2.0 of AS TM1; and the variety of investments available within each asset class.



- The data were collected over the period July to October 2013 and the accumulation rate assumptions used for statements issued may have changed subsequently.
- Respondents 1-14 are using version 2.0 of AS TM1 (with a cap on the accumulation rate assumption) and respondents 15-24 have adopted version 3.0 (without a cap).
- Respondents 3, 6 and 18 assumed equities will return 8%, 7.4% and 8% pa respectively, but capped the overall rate for each SMPI, reflecting the actual asset allocation, at 7% pa. The rate shown in the graph above reflects the assumption for a 100% equity fund which is capped at 7% pa.
- The assumptions for respondents 5 and 13 show the (reduced) assumptions adopted from August and July 2013 respectively.
- 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.
    - a range of assumptions for corporate bonds depending on grade. The rate shown in the chart is the lowest assumption.

Next steps

In 2014, we plan to carry out a full review of AS TM1 considering all aspects of the actuarial basis, including the accumulation rates. We plan to include a similar survey of the accumulation rates used for statements issued after 6 April 2014 when transitional arrangements will have expired and all statements will be subject to version 3.0 (or the newly issued version 4.0 which does not alter the requirements in respect of the accumulation rate assumption) of AS TM1.

Please contact Faye Dyce at f.dyce@frc.org.uk with any comments.

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