Accumulation rates used by providers of statutory money purchase illustrations since 6 April 2017

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 2017. 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 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 2017.

Results of the review

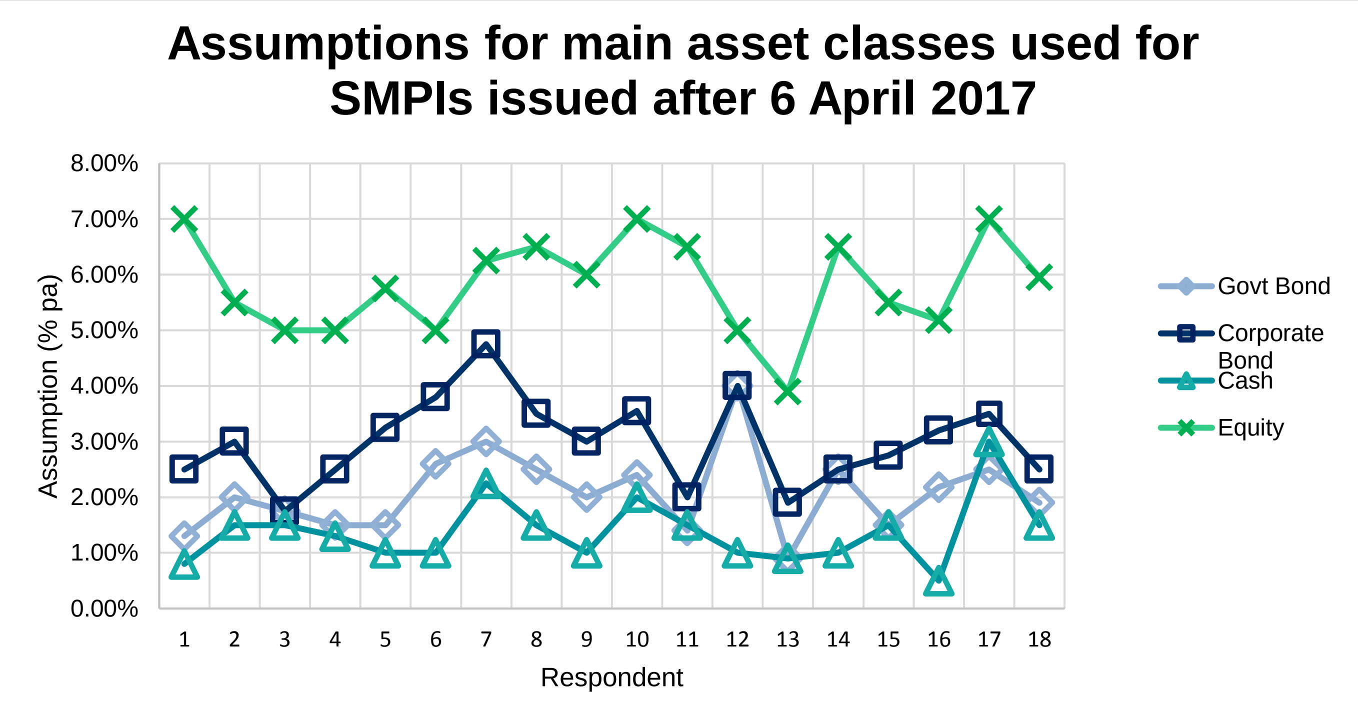
The FRC is grateful to the nineteen providers who responded to the survey. Together they issue over 24 million SMPIs a year, approximately 62% of which are issued to members of contract-based defined contribution arrangements. The reduction in number from the 2016 survey (when 22 responded) was due to a combination of providers merging, withdrawal from the market and declining to respond.

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 2017, and the accumulation rate assumptions used for statements issued may have changed subsequently.
- Respondents 1-10 are insurers; respondents 11-18 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 17 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 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.

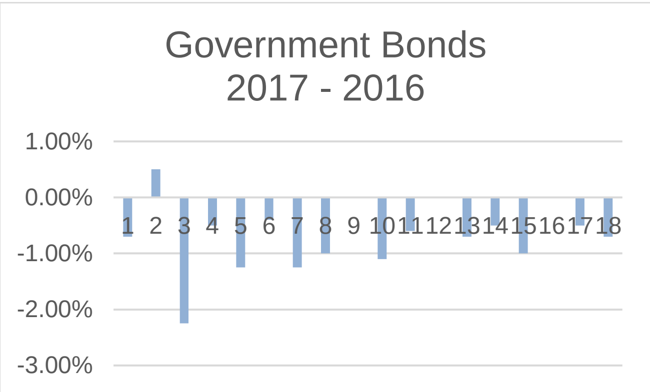
Engagement of Individuals receiving SMPI statements

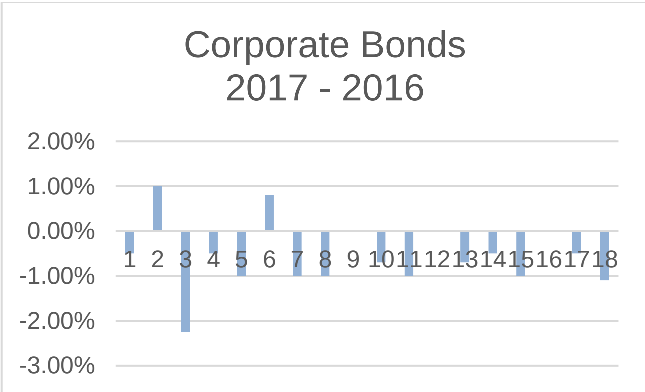
We asked providers to indicate the level of feedback or interest that they receive from recipients when sending out the annual statements. The response was that there is no response or engagement of any real level. We are aware of anecdotal comments that recipients of the statements have been disillusioned by the relatively low levels of projections compared to last year, but the responses to this survey do not suggest that this is widespread. Notwithstanding this we are concerned that the method of projection and presentation currently being required of providers is at risk of being outmoded in this modern digital environment.

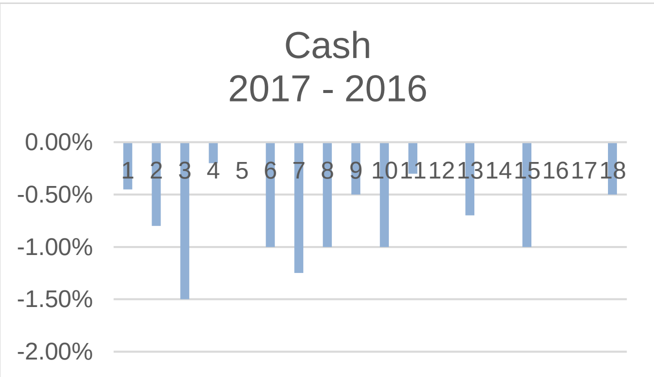
Comparison with 2016 accumulation rates

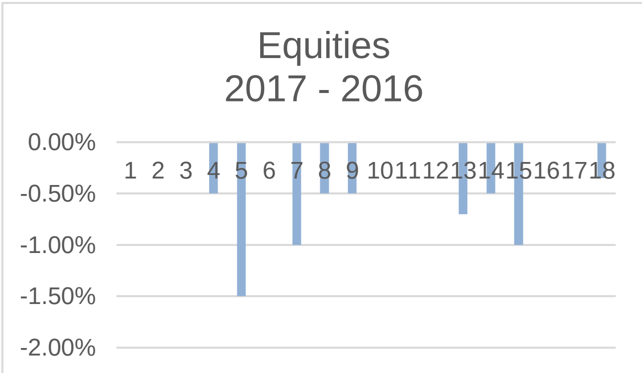
For those participating both last year and this year, the accumulation rates used for government bonds, corporate bonds and cash reduced on average by approximately 50 – 60 bps between the two years. For equities the reduction was approximately 30bps. While the average reduction for equities is similar between insurers and consultancies, there is significant variation at the level of individual responses by both insurers and consultancies.

The following graphs show for each asset type how each respondent has changed the accumulation assumption between 2016 and 2017.









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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

From the above graphs the main area of variation in rate reduction is with equities where some participants reduced the accumulation rate assumption for equities significantly and others left it completely unchanged. This is against a background of volatility in equity prices between April 2015 (when the FTSE 100 stood around 7000 points) to April 2016 (when it had fallen to around 6200) and April 2017 (when it had rebounded to around 7100). It would appear that there were divergent views as to whether equity accumulation rates should be reduced or whether it was reasonable to continue to assume unchanged accumulation rates.

Throughout the period interest rates remained low and virtually all respondents took the view that future assumed accumulation rates should be reduced.

Allowance for lifestyling

All respondents reported allowing for the effect of lifestyling on accumulation rates in the calculation of SMPIs. However, as in previous years, there was little commonality in the way this was done. The approaches split into two types:

- Reducing the accumulation rate in the specific SMPI to reflect fund switches as they are projected to occur, or
- Making adjustments to the assumed accumulation rate of the fund at the outset.

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.

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