



Financial Reporting Council

AS TM1: Statutory Money Purchase Illustrations

Consultation paper

November 2023

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1. Introduction

Background

- 1.1 The Financial Reporting Council (“FRC”) is the UK’s independent regulator responsible for promoting high quality corporate governance and reporting to foster investment. The FRC is responsible for setting technical actuarial standards in the UK.
- 1.2 Since 6 April 2003 money purchase pension arrangements have been required to provide members with Statutory Money Purchase Illustrations (“SMPIs”). These illustrations are governed by the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013¹ as amended. Legislation requires that statutory illustrations are produced in accordance with guidance prepared by a prescribed body approved by the Secretary of State for Work and Pensions and by the Department for Social Development in Northern Ireland.
- 1.3 The FRC has been the prescribed body since 6 April 2007 and fulfils its obligations through the publication of Actuarial Standard Technical Memorandum 1: Statutory Money Purchase Illustrations (“AS TM1”). AS TM1 specifies the assumptions and methods to be used in the calculation of statutory illustrations of money purchase pensions, also known as defined contribution (“DC”) pensions. The FRC reviews AS TM1 regularly.
- 1.4 A revised AS TM1 v5.0 was published in October 2022, effective for SMPIs issued on or after 1 October 2023. As set out in the feedback statement², the FRC intends to review the appropriateness of accumulation rate assumptions and volatility group boundaries annually based on 30 September data, and conduct a one-month consultation in November on proposed changes if necessary. This will then allow the FRC to aim to publish the revised AS TM1 by 15 February for application in the following financial year.

Aims and audience of this paper

- 1.5 The aim of this paper is to consult on proposed changes to AS TM1 v5.0, focusing on the assumptions in relation to accumulation rates. We are not proposing any other changes to AS TM1 v5.0 at this time.
- 1.6 This paper has been written for anyone with an interest in SMPIs including those responsible for providing SMPIs (trustees, insurers, wealth managers and administrators) and the pension scheme members and policyholders who receive SMPIs or access the pensions dashboards, as well as organisations which represent and advise these groups.

¹ Consolidated Regulations may be accessed [here](#)

² in paragraphs 1.16 and 1.17: <https://www.frc.org.uk/document-library/actuarial-policy/2022/as-tm1-statutory-money-purchases-illustrations-fee>

How to Respond

- 1.7 Comments on the questions set out in this consultation document are requested by 4 December. Responses should be sent by email to ASTM1@frc.org.uk.

Or in writing to:

The Director of Actuarial Policy
Financial Reporting Council
8th Floor,
125 London Wall
London
EC2Y 5AS

- 1.8 It is advisable to send your response electronically.
- 1.9 All responses will be regarded as being on the public record unless confidentiality is expressly requested by the respondent. A standard confidentiality statement in an email message will not be regarded as a request for non-disclosure. We do not edit personal information (such as telephone numbers or email addresses) from submissions; therefore only information that you wish to publish should be submitted. If you are sending a confidential response by email, please include the word "confidential" in the subject line of your email.

2. Accumulation rate

- 2.1 AS TM1 v5.0 paragraphs C.2.3 to C.2.6 specify the method and assumptions to be used to determine the accumulation rate that is used in SMPs as specified in of AS TM1.
- 2.2 At the [previous annual review](#)³, the global market conditions and outlook had changed significantly since the review carried out in Q4 2021, but we recognised at the time that considerable uncertainty remained and considered it appropriate to retain the assumptions in AS TM1 v5.0 in the interest of maintaining stability of these assumptions over time. Since Q4 2022, we consider there is evidence of a more sustained move to a higher interest rate environment.
- 2.3 The FRC considers there to be sufficient evidence to support higher accumulation rate assumptions for volatility groups 1 to 3, in response to higher long term interest rates and gilt yields, resulting in a higher expected return for funds in volatility groups 1 to 3. We set out below the proposed accumulation rates by volatility group and supporting rationale based on analysis carried out by the FRC reflecting market data to 30 September 2023. Further details on this technical analysis can be found in this [technical paper](#).
- 2.4 **Volatility group 1- proposed 2% accumulation rate.** Volatility group 1 is primarily composed of short-dated cash instruments. An accumulation rate assumption of 2% for this group would mean a real accumulation rate assumption (i.e. net of inflation which is assumed to be 2.5% under AS TM v5.0) of -0.5%. This is below the implied future real 'risk-free' interest rate of c. 1% (derived from long-dated gilt yields). This allows for the expectation that money market funds earn a lower return than long-dated gilts due to their shorter term as well as allowing a margin for prudence. We consider a return slightly below inflation is appropriate to avoid giving unrealistic expectations of long-term growth in cash holdings, particularly given there have been significant periods of time (such as 2008 to now, and in the 1970s) where cash did not keep up with inflation.
- 2.5 **Volatility group 2- proposed 4% accumulation rate.** Volatility group 2 is primarily composed of lower volatility multi-asset funds and corporate bond funds. Both of these would be expected to yield a premium above the 'risk free rate', although the level of this premium requires a certain amount of judgment. A 4% accumulation rate gives a real rate of 1.5% over inflation. Based on a real risk-free interest rate of 1%, this implies a risk premium of 0.5%. We consider this to be an appropriate assumption based on allowing a margin for prudence below expected returns on these fund types.
- 2.6 **Volatility group 3 – proposed 6% accumulation rate.** Volatility group 3 is primarily composed of lower volatility equity funds. For these we would expect a higher return over the long term than group 2 assets but lower than group 4 assets. We consider it reasonable to increase the accumulation rate of group 3 by 1% thereby also preserving a 2% margin between groups 2 and 3.

³ <https://www.frc.org.uk/news-and-events/news/2023/01/frc-concludes-no-changes-needed-to-as-tm1/>

- 2.7 **Volatility group 4 – proposed 7% accumulation rate.** Volatility group 4 is composed of higher risk equity funds and some index linked gilt funds. The FRC considers the assumption of 7% continues to be consistent with the experience over the long term of returns on higher volatility investments, after a suitable adjustment for prudence. The FRC considers an increase to the accumulation rate for group 4 above the current 7% could risk providing overly optimistic pension illustrations to individuals, and so we have maintained a rate of 7%. Although this results in a reduction in the gap between accumulation rates for volatility groups 3 and 4, we note that this is consistent with the observed reduction in the risk premium estimates used since 2021 used in third parties' capital models, where these have been made available to us.
- 2.8 The FRC also considered the consistency of the accumulation rate assumptions across all four groups by considering the 'risk/return ratio', being the percentage additional return expected based on the additional volatility in the fund. Economic theory suggests that this ratio reduces for higher levels of volatility (i.e. the average expected return increases more slowly as the level of risk increases). This is consistent with our having a lower gap between the accumulation rates for volatility groups 3 and 4.
- 2.9 In summary, the FRC proposes to revise the accumulation rate assumed for each volatility group as follows:

Volatility Group	Volatility group (as set out in C.2.11 of AS TM 1)	Accumulation rate assumptions in AS TM1v5.0	Proposed accumulation rate assumptions
1	0% - 5%	1%	2%
2	5% – 10%	3%	4%
3	10% - 15%	5%	6%
4	Above 15%	7%	7%

QUESTION 1

Do you agree with the proposed change to accumulation rate for volatility group 1 (from 1% p.a. to 2% p.a.)? If not, what alternative accumulation rate do you think would be appropriate for this group? Please provide supporting evidence for any alternative view.

QUESTION 2

Do you agree with not amending the accumulation rate for volatility group 4? If not, what alternative accumulation rate do you think would be appropriate for this group? Please provide supporting evidence for any alternative view.

QUESTION 3

Do you have any other comments on the proposed accumulation rates as set out above?

2.10 The FRC intends for the proposed changes to the AS TM1 to be effective for calculations performed from 6 April 2024 so that the SMPs where the calculation is performed in the financial year from 6 April 2024 to 5 April 2025 will be based on assumptions based on the market conditions up to 30 September 2023.

QUESTION 4

Do you agree with the proposed effective date of 6 April 2024?

3. Other assumptions

Volatility Group

3.1 AS TM1 paragraphs C2.7 to C2.15 specify how the volatility group is determined for each investment. In particular, C.2.11 specifies that the volatility must be used to assign the investment to a volatility group calculated in the following table (subject to requirements set out in paragraph C.2.12):

Volatility Group	Volatility
1	0% - 5%
2	5% – 10%
3	10% - 15%
4	Above 15%

3.2 Although a general increase in volatility has been observed in the data over the course of the year, this is relatively small for most funds. The analysis of the distribution of the volatilities by fund types shows that volatility group boundaries in AS TM 1 v5.0 paragraph C.2.11 continue to be appropriate. The FRC therefore proposes for these assumptions to remain unchanged.

Inflation assumption

3.3 The inflation assumption is used to discount the accumulated fund from retirement age to today's purchasing power, and therefore needs to be suitable for long-term periods. This is currently specified to be 2.5% per annum.

3.4 As at 30 September 2023, the market implied long-dated breakeven inflation was around 3.6% p.a.⁴, broadly similar to what it was at 31 August 2021 (which was the effective date of our analysis underpinning AS TM1 v5.0). This is expected to contain a margin for the differences between RPI and CPI (which will exist until 2030) and an allowance for an inflation risk premium.

3.5 The FRC observes from research by the Office of Budget Responsibility on CPI and RPI forecasts⁵ that, after a short period of higher, unstable inflation followed by a period of around 0% in the medium term, CPI inflation is expected to substantially return to the Government's target of 2% within 5 years of projection from 2023. The HM Treasury comparison of independent forecasts for the UK economy⁶ published Aug 2023 shows

⁴ 20 year spot rate from the [Bank of England implied inflation spot curve](#)

⁵ <https://obr.uk/forecasts-in-depth/the-economy-forecast/inflation/#CPI>

⁶ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1180276/forecomp_Aug1.pdf
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average forecasts of CPI inflation for 2023 to be 7.4%, falling to 3.1% in 2024, and remain at 2.0%, 1.9% and 2.1% in 2025, 2026, and 2027 respectively. This would indicate that a medium and long-term CPI inflation assumption of 2% (i.e. Government target rate) is reasonable but uncertain, and the FRC does not consider a reduction in the assumed inflation rate to 2% is appropriate at this time.

- 3.6 We also note that the inflation assumption is of second order to the accumulation rate assumption (net of inflation) which is one of the key drivers of the size of the accumulated fund. Given uncertainty and in the interest of simplicity, we consider the current long term inflation assumption of 2.5% to continue to be reasonable and should remain unchanged.

Other assumptions

- 3.7 The FRC has conducted a review of the other assumptions in AS TM1 v5.0 and has determined they continue to remain appropriate.

4. Impact Assessment

4.1 The proposed change is to three parameters within calculation systems of providers of money purchase pensions. As set out in AS TM1 v5.0 and the feedback statement published in October 2022, the FRC expects these parameters will be reviewed annually and may be expected to change periodically.

Benefits

4.2 The proposed change ensures the accumulation rate assumptions in AS TM1 continues to remain up-to-date given latest economic conditions and outlook. This in turn will ensure all SMPIs and ERI illustrations on future pensions dashboards remain appropriate.

Costs

4.3 Amending the accumulation rate assumptions as proposed is expected to result in minimal costs to providers relating to:

- updating parameters within SMPI calculation systems, and testing of these updated parameters
- updating accompanying communications to SMPI users.

4.4 At the time of finalising AS TM1 v5.0 in October 2022, the FRC stated our intention to carry out an annual review of accumulation rates and volatility boundaries, and AS TM1 v5.0 states that the methods and assumptions used may be changed as a result of regular reviews of the standard. We therefore anticipate providers will have developed systems in such a way to enable these parameters to be updated annually.

4.5 As a result, the FRC anticipate the cost of any system changes to be relatively low and outweighed by the above benefits to users.

QUESTION 5

Do you agree with our impact assessment? Please give reasons for your response, and estimates of costs where possible.

Annex 1: Exposure Draft AS TM1 v5.1



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