Buck
20 Wood Street
London
EC2V 7AF

Email: werner.marx@buck.com
Ref: TM1/November2023

4 December 2023

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

Sent by email to ASTM1@frc.org.uk

To the Director of Actuarial Policy

Proposed revision to AS TM1: Statutory Money Purchase Illustrations (SMPIs) – consultation

I am writing on behalf of Buck Consultants Limited ('Buck') in response to the above consultation.

Buck's employees are impacted directly by the consultation as they provide advice to trust-based occupational DC schemes in respect of setting assumptions for SMPI projections and provide third-party administration services to these types of arrangements.

Our responses to your specific questions are set out in the appendix to this letter.

We would be happy to discuss our responses to the questions further if that would be beneficial. Please contact Werner Marx (werner.marx @buck.com) or Alison Lewis (alison.lewis@buck.com) if you would like to discuss these responses further.

We look forward to your response to this consultation.

Yours sincerely

Werner Marx
Consulting Actuary
Buck, A Gallagher Company

Appendix – responses to consultation

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

We support the proposal to increase the accumulation rate for volatility group 1 from 1% to 2%, given this group is primarily composed of short-dated cash instruments which are currently yielding higher returns than they have done for over 15 years. We understand that this change will provide less prudent projections for members but believe the proposed figures to be more realistic given the current economic outlook.

We note that with base rates at their current level an even larger increase could be justified. However, we also agree that the accumulation rate should factor in that there have been long periods of time where short-dated instruments have not kept up with inflation, and we believe that the figures should allow for a degree of prudency, as well as a reasonable degree of stability of assumptions over time. As such, on balance, we are in favour of the proposed new accumulation rate for volatility group 1.

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.

As discussed in our response to question 3, below, we continue to believe there are issues with the volatility group classification system and note that these are manifesting particularly within the investment funds being assigned to volatility group 4. This means we believe the proposed accumulation rate for volatility group 4 is not appropriate for all the investment funds currently falling into this group and that are likely to continue falling into this group. For some of these investment funds (e.g. long dated index-linked gilts and long-dated fixed interest gilts) we would favour a lower accumulation rate (say 4%), while for others a (slightly) higher rate (say 7.5%) may be appropriate.

However, within the bounds of the volatility group classification system, where it is a requirement to have a single accumulation rate for all volatility group 4 investment funds, we believe maintaining the current 7% rate is the most reasonable option. This maintains an ascending order of accumulation rate assumptions, while avoiding, due to not increasing the 7%, further aggravating the issue of members seeing inflated pension projections due to holding long duration (but low expected return) asset classes that get classified within this group.

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

As flagged as part of the initial May 2022 consultation exercise, the volatility group classification system can lead to long duration investment funds being assigned higher accumulation rate assumptions, even if these investment funds are, in reality, expected to have fairly low long-term returns in the future.

We have now seen this happening in practice - certain high quality long-dated bond funds are being assigned a higher accumulation rate than that assigned to certain equity funds, or to investment funds containing other return-seeking assets. The new proposed accumulation rate assumptions will be unable to address this fundamental issue.

In particular, the accumulation rate for volatility group 4 is having to cover investment funds with significantly different expected returns – it covers both traditionally high volatility asset classes (equities etc.) and also those that are traditionally low volatility, but that have been heavily impacted by the extreme yield movements of recent years (long dated index-linked gilts and long-dated fixed interest gilts).

We do not believe there is a solution to this unless there is a move away from using actual past investment return volatility as the sole criteria by which investment funds are classified.

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

We believe that these changes should be implemented as soon as practical such that where possible the next set of calculations use these updated assumptions. However, we recognise the practical advantages of delaying implementation until 6 April to align with the financial year and hence believe this to be an appropriate approach.

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

We agree with the FRC's impact assessment of the proposed changes to the accumulation rates. Buck's systems used to calculate volatility groups enable parameters to be adjusted very simply and easily. These updates would be implemented by the team efficiently and we estimate that the costs incurred would be minimal.