ASSOCIATION OF CONSULTING ACTUARIES

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1 December 2023

ASTM1@frc.org.uk

Vanessa Leung
Director of Actuarial Policy
Financial Reporting Council
8th Floor,
125 London Wall
London
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Dear Vanessa

AS TM1: Statutory Money Purchase Illustrations

I am writing on behalf of the Association of Consulting Actuaries in response to the consultation on the proposed version 5.1 of AS TM1.

Our comments on your questions are set out in the Appendix.

We hope that you find the contents of this letter of assistance. We would be happy to discuss them further if that is helpful. In this event, please contact us at David.Everett@lcp.uk.com and / or Tessa.Page@mercer.com.

Yours sincerely

Tessa Page
Chair, DC Schemes Committee
On behalf of the Association of Consulting Actuaries Limited

AS TM1: Statutory Money Purchase Illustrations

Specific consultation questions

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.**

Yes, and we also agree with your increasing the accumulation rates by 1 percentage point for volatility groups 2 and 3.

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.**

Yes, and this is consistent with our experience of reducing equity risk premia as we have uplifted bond returns in our assumption setting for non-AS TM1 purposes.

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

Not on the accumulation rates being proposed, but you should be aware that the volatility model is producing some odd and misleading results for trustees and providers, which we expect to become apparent to scheme members if comparing a version 5.1 SMPI with a version 5.0 SMPI.

Although your technical analysis paper suggests that there will be very little movement of funds from one volatility group to another as we move from the 5 years ending 30 September 2022 to that ending 30 September 2023, for those funds that do move there could be a double-uplift in the accumulation assumption making a post 1 April 2024 SMPI look much better than a 1 October 2023 – 31 March 2024 SMPI.

In addition, from analysis we have seen, there is now a risk that the recent increased volatility in long gilts and index-linked gilts could lead to these assets being placed in volatility group 4 when they more naturally belong in volatility group 2. Indeed, we have seen this happen in many cases and have strong concerns around the potential impact on member decision making and understanding.

In extremis, the provider of a version 4.2 SMPI issued prior to 1 October 2023 might have chosen to project these funds at 3% pa (or even lower in some instances), whilst the same provider of a version 5.1 SMPI issued after 5 April 2024 might have to project the very same funds at 7% pa. This is alongside certain equity funds which, owing to their diversified nature and periods of lower market volatility, have lower return assumptions.

It is not obvious to us that you can use any of your tools within AS TM1 to automatically address these issues. We suggest that your volatility approach needs to enable providers to be able to distinguish between some monthly returns that are representative of the asset class and others that are not. Alternatively, AS TM1 should give the provider the opportunity to override the generated volatility band if it appears extreme, with say a disclose and explain type requirement.

We also mention less liquid assets including private markets, which tend to have a very low calculated volatility owing to slow moving valuations and therefore are given a low accumulation rate in AS TM1 – the opposite to what we understand that the Government believes to be the case. As more DC schemes add private equity and other illiquids to their default funds as part of implementing the Mansion House proposals, it could be that the AS TM1 SMPIs illustrate worsening returns.

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

We agree with the proposed effective date of 6 April 2024, but we suggest that you do not express it as "calculations performed" on or after 6 April 2024.

We understand that you have used this term for consistency with C.2.8, where the 5-year period over which volatility is determined is by reference to the 30 September preceding the financial year "in which the calculation is performed".

We also understand that when you refer to the date that a calculation is performed you are intending this to be the same as the "illustration date" which is a defined term in AS TM1. Given this we think that version 5.1 should apply where the illustration date falls on or after 6 April 2024. You should also take the opportunity to amend C.2.8 so that it references illustration date.

Use of "illustration date" removes any doubt as to which SMPIs version 5.1 applies to. By contrast, introducing the term "calculations performed" is problematic as, for those unaware that you mean "illustration date", it may be far from obvious when a SMPI was actually performed. There will also naturally be a delay between when the calculations are undertaken and when the SMPI is made available – in some cases for many months.

"Calculations performed" is also a departure from the "illustrations issued" formulation that was used for version 5.0 and the various 4.x versions of AS TM1. As you will appreciate "illustrations issued" should be closer to being a matter of fact – such as the date on a paper copy just before it is posted or the date on an e-mail alerting the recipient to the existence of the SMPI available online.

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