ASSOCIATION OF CONSULTING ACTUARIES

Association of Consulting Actuaries Limited · First Floor (129) · 40 Gracechurch Street · London · EC3V 0BT
Tel: +44 (0)20 3102 6761 · Email: acahelp@aca.org.uk · Web: www.aca.org.uk

ACA response to consultation on proposals to update the asset information collected from defined benefit schemes

A joint consultation from the Pension Protection Fund (PPF) and The Pensions Regulator (TPR), setting out proposed changes to the asset class information to be provided annually by defined benefit (DB) schemes.

Rationale for change

Question 1
Section 2 sets out our rationale for change. It includes wider regulatory context and changes to how schemes invest their assets.
Subsections 2.2 and 2.3 explore the changes in asset allocation for pensions schemes, and the current and future trends in asset allocation.
Do you agree that bonds will continue to be a focus for pension plans?

Yes

Comments

Likely to continue to play a significant role in matching liabilities and cash flows.

Question 2
Are there other market development we need to consider?

The approach to LDI is still not clear, especially for swap-based LDI. Many managers just report the mark-to-market value of swaps as a cash holding. The PPF could either make it clearer in their guidance how to treat swap-based LDI (e.g. as leveraged gilts and negative cash), or change to an alternative approach which works for both gilt and swap-based LDI (e.g. could ask schemes to report the accounting value of the LDI portfolio along with the PV01 and IE01).

Detailed proposals on asset class information

Question 3
Section 3 sets out our proposals for the asset class information that will be collected. The information required will vary depending on the size of the scheme under a three tier approach.

Subsections 3.2 to 3.5 set out our proposals for fixed interest bonds.

Do you agree with our proposals for new bond categories under Tier 1?

Yes

Comments

…

Question 4
Do you agree with our proposals for more granular detail under Tier 2?

Yes

Comments

There could be a case for separating out emerging market debt, given the different risk characteristics of those assets.

Question 5
Do you agree that private debt should be included for Tier 2 and 3? If so, do you agree that a single sub-asset class is appropriate?

Yes

Comments

…

Question 6
Subsections 3.6 and 3.7 propose changes to inflation-linked bonds.
Do you agree with our proposal for having a dedicated category for UK Government inflation-linked bonds given the implications for US TIPS?

Yes

Comments

'Yes' to removing US TIPS from UK inflation protection. Ideally, they should not be treated as fixed credit (given the inflation link) but this may be a reasonable, pragmatic approach. We would expect actual allocations to US TIPS to be significantly lower than UK index-linked gilts for most schemes.

Question 7
Subsection 3.8. sets out proposals for equities.

Do you agree with our proposals for leaving the equity spilt unchanged for Tier 1?

Yes

Comments

…

Question 8
Do you agree with the proposal for tier 2 to spilt equities into developed and emerging markets?

Yes

Comments

…

Question 9
Subsection 3.9. proposes changes to other asset class categories.

Do you agree with including a category for diversified growth funds for all tiers?

Yes

Comments

A step in the right direction but raises the question of whether all DGFs should be treated equally as there is a broad range of approaches. There is also a case for treating the more complex DGFs as hedge funds rather than a 60/40 equity/bond mix.

Question 10
Do you agree with our proposals to add absolute return strategies for Tier 2 and above?

Yes

Comments

It is important to make clear what is a “DGF” and what is an “absolute return” fund.

Question 11
Given our proposals for diversified growth funds and absolute return strategies, do you agree that the hedge fund category can be removed?

Yes

Comments

…

Question 12
Do you agree with our proposals to remove the commodities and insurance categories?

Yes

Comments

Not likely to be widely used outside of DGFs. This asset class can cause challenges for small schemes who are invested in with-profits funds and the proposal to move either split them out or treat as "Other" makes sense.

Question 13
Subsection 3.10. raises the growing use of multi-asset credit funds and how to identify appropriate rollforward indices & stress factors.

Do you agree with our proposal for multi-asset credit funds to be broken down into the constituent parts for the scheme return?

Yes

Comments

…

Question 14
Are there any other changes we should consider for asset class categories?

Consider separate category for infrastructure - at the moment, infrastructure equity funds would have to be treated as private equity, when in reality they are often much less risky, especially where government contracts are involved.

ASSOCIATION OF CONSULTING ACTUARIES

Proposals on tier boundaries

Question 15

Section 4 sets out the proposals for a tiered approach to collecting asset allocation information and our accompanying rationale.

Subsection 4.2 explores the definition of scheme size.

Do you agree with our proposals to measure scheme size by submitted s179 liabilities?

Yes

Comments

It would be helpful if this could be refined to non-insured s179 liabilities, as there are several smaller schemes with sizeable annuity holdings, which would be moved into Tier 2 if these liabilities were included.

Question 16

Subsections 4.3. to 4.5. set out proposals for the tier 1 to tier 2 boundary.

Do you agree with the proposal to set the tier at £20m?

Yes

Comments

….

Question 17

Do you believe there is a case for a higher initial threshold for Tier 1? If so where should this be set?

No

Comments

….

Question 18
Do you support our proposal to allow schemes to voluntarily provide more asset information?

Yes

Comments

…

Question 19
Could it become more difficult for schemes in Tier 1 to complete the standard asset return, if industry reporting moves to provide more granular information in Tier 2?

Unlikely as still likely to be able to group assets appropriately.

Question 20
Subsection 4.6. sets out proposals for Tier 2/3 boundary.
Do you believe that there is a need for TPR to collect more detailed information on derivatives for a larger proportion of schemes?

Yes

Comments

Schemes that materially use derivatives should reflect the exposures, including credit derivatives which are becoming more prominent. We also suggest including synthetic equity in tier 2 as treating these exposures in different ways can change the outcome materially. As schemes have the option to select Tier 3, an alternative would be for any additional reporting/detail to be added to Tier 3 rather than Tier 2.

Question 21
Do you agree that the boundary for Tier 3 should be £1.5 billion of s179 liabilities?

Yes

Comments

…

ASSOCIATION OF CONSULTING ACTUARIES

PPF proposals for indices

Question 22

Section 5 sets out the PPF proposals on indices used to rollforward assets and ensure broad consistency of this data between schemes when calculating risk-based levies in any year. Subsection 5.2. explains our core proposal.

Do you agree that maintaining a simplified roll forward approach is appropriate given the relative costs and benefits (rather than establishing a more sophisticated approach using a wider range of indices as described below)?

Yes

Comments

…

Question 23
Do you agree that the index proposals set out above are appropriate, in particular the approach to roll forward 'Other' holdings, diversified growth funds and absolute return funds?

No

Comments

We prefer the alternative in table 6. Recent moves in credit spreads highlight the flaws of rolling forward corporate bonds using gilts. However, we are comfortable with the proposed roll-forward approach to Other, Diversified growth funds and Absolute return funds.

Question 24
Subsection 5.3. sets out an alternative approach to rollforward indices.

Do you agree that if a more sophisticated set of indices is applied then those set out above would be appropriate?

Yes

Comments

…

ASSOCIATION OF CONSULTING ACTUARIES

Question 25
If you favour an intermediate approach between the two approaches we have outlined, for which of the proposed asset classes would separate indices be beneficial?

While we agree with splitting out investment grade from being treated in line with UK fixed interest gilts, the added complexity for the full level of granularity in Table 6 may not always be justified (e.g. splitting out gilts by maturity), given the relatively short roll-forward periods.

Response from:
Association of Consulting Actuaries

10 June 2021

About the Association of Consulting Actuaries (ACA)

Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes. Members of the Association are all qualified actuaries and all actuarial advice given is subject to the Actuaries' Code. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the majority of members of private sector defined benefit pension schemes. The ACA is the representative body for UK consulting actuaries, whilst the Institute and Faculty of Actuaries is the professional body.