ASSOCIATION OF CONSULTING ACTUARIES

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5 December 2024

ASTM1@frc.org.uk

Vanessa Leung
Director of Actuarial Regulation
Financial Reporting Council
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125 London Wall
London
EC2Y 5AS

Dear Vanessa

AS TM1: Statutory Money Purchase Illustrations

I am writing on behalf of the Association of Consulting Actuaries in response to the consultation that proposes retaining version 5.1 of AS TM1 following its annual review.

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 either me at David.Everett@lcp.uk.com or Tessa Page, Chair of the DC Committee at Tessa.Page@mercer.com.

Yours sincerely

David Everett
On behalf of the Association of Consulting Actuaries Limited

APPENDIX

AS TM1: Statutory Money Purchase Illustrations

Specific consultation questions

1. **Do you agree with the FRC's proposal not to amend the accumulation rates in AS TM1 v5.1 at this annual review? If not, what alternative accumulation rates do you consider to be more appropriate? Please provide supporting evidence for any alternative view.**

Yes, we are happy that the accumulation rates are not revised at this review.

2. **Do you agree with the FRC's proposal not to amend any of the non-accumulation rate assumptions? If you think they should change, what changes do you consider to be appropriate? Please provide supporting evidence for any alternative view**

Yes, we agree.

3. **Do you agree with the conclusions in the impact assessment? If not, please give reasons for your response.**

Yes, and given your recommendations not to make any changes, there is no impact to assess.

Other points

We have two other points as follows.

1. Effective date

Version 5.1 of AS TM1 says that it is effective for statutory illustrations based on <u>calculations performed</u> on or after 6 April 2024.

We previously suggested that you should not use the phrase "calculations performed" and that instead you should require that version 5.1 is effective for statutory illustrations <u>with illustration dates</u> on or after 6 April 2024. We also suggested that you should adjust the wording in C.2.8 so that the 5-year period over which volatility is determined is by reference to the 30 September preceding the financial year in which the <u>illustration date falls</u>, rather than in which the <u>calculation is performed</u>.

Our reasoning is that "illustration date" removes any doubt as to which SMPIs version 5.1 applies to, unlike the term "calculations performed".

In paragraphs 39-41 of your response to last year's consultation you said, in relation to this matter, that you intended to "conduct further stakeholder engagement in due course on this matter to consider if further amendments may be appropriate in any subsequent review".

It is not clear to us whether you have now done this. It is important to be clear when a particular version of AS TM1 should be applied. Not doing so will mean inconsistencies in many cases for members with DC pots in different arrangements with the same illustration date. This will particularly not look good within the pensions dashboard context. We do think you need to address this issue ahead of any version 5.2 of AS TM1 and at the same time modify version 5.1 of

AS TM1 so that it becomes clear that it cannot be used for illustration dates on or after 6 April 202X (where this is the date at which any version 5.2 is operative).

2. Concerns with the volatility model

In our response to last year's consultation, we said that the volatility model, that was introduced by version 5.0 of AS TM1 with effect from 1 October 2023, is producing some odd and misleading results for providers. We suggested 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 would be happy to develop some thoughts in this area if this is something you would like to give consideration to.

We have continued to see odd results from the volatility model as statutory illustrations have started to pick up version 5.1 of AS TM1 from 6 April 2024. For example, members have asked why an index-linked fund has a higher long term return assumption than that for emerging markets equities. You acknowledge, in your technical analysis paper, that there is a disconnect between volatility and expected returns for index-linked funds, and that it has arguably increased over the 12 months to 30 September 2024, so it seems that this issue will continue when it comes to statutory illustrations in 2025.

We note in your technical analysis paper, that since the previous annual review at 30 September 2023, most equity funds have seen a decrease in volatility of between 0% and 1% and most fixed income funds have seen an increase in volatility of between 0% and 1%. As a result, the gap between these two asset classes of the median 5-year volatility has significantly narrowed. This in turn is likely to mean that statutory illustrations from 6 April 2025 onwards are likely to show less of a difference in projection results between those invested predominantly in equities to those invested predominantly in fixed income. We note the statement in your technical analysis paper that a large proportion of fixed income funds now have a volatility of 15% to 17%, implying that they will be allocated a 7% accumulation rate, whilst the majority of equity funds are below the 15% boundary, implying that they will be allocated a 6% accumulation rate. One can see how this is likely to result in further member queries.

As a result of odd results that have so far been observed, some trustees are now issuing a "main illustration" based on more realistic assumptions, alongside the statutory illustration as a secondary version, with wording that essentially warns against reliance on the statutory illustration. Examples some of us have seen recently had a statutory illustration that was more than double the "realistic" one. This can create confusion for members and damages credibility of the illustration process. However, it seems likely that more trustees will opt for this dual calculation given that it seems that the volatility model will increasingly produce odd results.

A separate issue is that we are seeing more year-to-year variation between statutory illustrations than we used to see, meaning the annual benefit statement can be a disconcerting surprise rather than being a reliable estimate for members. One of the main reasons for this variation seems to be the 2022 gilt market volatility which had a bigger impact for some illustrations versus those in other years because of the 30 September cut off. As the year ending 30 September 2022 drops out of the analysis in future, we may see the five-year volatility on gilt funds reduce to such an extent that at some point there is a step change down in the long-term return assumption for such funds. By contrast, a short period of equity market volatility in future could lead to a step change up in the long-term return assumption for equity funds. These step changes in what is a long-term assumption are difficult to explain.

Trustees are having to put a lot of work into additional communications to explain the odd results. Whilst this isn't a problem in itself, there are probably better uses for this communication resource.

Where odd results arise, actuaries advising trustees with these projections may need to consider their duties under the Actuaries' Code, in particular under the Communication principle, where they may need to raise any concerns they have with the outcome of the statutory illustration. Again, this does not look good.

Separate to the Actuaries' Code there is an argument that the production of statutory illustrations by an actuarial firm falls within scope of being "technical actuarial work" by virtue of leg (ii) of the definition (i.e. "which the intended user could reasonably regard as technical actuarial work by virtue of the manner of its communication"). If so, such work would need to be assessed against TAS 100. This could prove to be problematic, particularly as it may not be possible to be satisfied that the reliability objective has been met, nor might the member "user" be able to make informed decisions on the basis of the statutory illustration.

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