PENSIONS AND
LIFETIME SAVINGS
ASSOCIATION

PROPOSED REVISIONS TO ASTM1: PLSA RESPONSE

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ABOUT THE PLSA

Our mission is to help everyone achieve a better income in retirement. We work to get more people and money into retirement savings, to get more value out of those savings and to build the confidence and understanding of savers.

We represent the defined benefit, defined contribution, master trust and local authority pension schemes that together provide a retirement income to 20 million savers in the UK and invest £1 trillion in the UK and abroad. Our members also include asset managers, consultants, law firms, fintechs and others who play an influential role in the governance, investment, administration and management of people's financial futures.

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EXECUTIVE SUMMARY

The PLSA welcomes the FRC objective of creating greater consistency in the new ASTM1 rules. The PLSA was involved with the Joint Forum for Actuarial Regulation that discussed at length these proposals as they were being developed by the FRC.

As with the PLSA's responses to the DWP and FCA consultations on pensions dashboards, it is essential that extensive user testing of the proposals be carried out to make sure users of many different types understand the information presented. It is also essential that suitable disclaimer warnings are used on dashboards to make it clear that the numbers and projections are only indicative.

We are not yet fully convinced that the FRC proposals on volatility-based assumptions are definitely the best solution. A final view will only be possible after seeing the technical paper from the University of Bath on which the work was based and which will not be published until this October. The technical paper will provide critical context that will help ourselves and our members fully consider the FRC's proposals on volatility intervals as a basis for defining growth assumptions.

Alternatively, it may be a more expedient approach for schemes to base growth assumptions on the asset classes and mix of asset classes. This would have the added benefit of reducing calculation costs associated with evaluating volatility and associated growth rate and re-evaluating on an annual basis.

We would like to see a growth assumption higher than zero for illiquid unquoted assets that fairly reflects potential growth.

The PLSA strongly disagrees with proposals to have decumulation assumptions based upon a single life level annuity. The proposals lead to a lack of comparability with DB schemes, that are index linked in various ways and have survivor's benefits. The proposals could also nudge people into buying single life annuities over joint life annuities, which on the whole could lead to a widening of the gender pensions gap.

In respect of AVCs, those that are either used to maximise tax free cash alongside a DB pension or buy additional years in a DB pension should be treated differently to other DC pension schemes. Showing an estimated retirement income for aforementioned types of AVCs could lead to savers taking sub-optimal decisions as a result.

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ANSWERS TO CONSULTATION QUESTIONS

1. How supportive are you of the approach to prescribe the accumulation rate and form of annuitisation more precisely, in order to improve consistency across projections from different providers? In particular, do you have any concerns arising from the loss of independence and judgement allowed to providers to set these terms?

The PLSA is very supportive of improving consistency across projections as this will aid saver understanding when comparing DC projections in a Pensions Dashboards setting, in particular.

Our members have expressed concerns about the latitude providers had in setting terms for projections in the current ASTM1 rules and that this gave the opportunity to "game" projections. Even in the case where providers are setting different terms for totally benign reasons if Pension A has the same underlying funds as Pension B, but the projections are different, savers may be drawn to the wrong conclusions when comparing the two pensions alongside each other on a dashboard.

2. What are your views on the proposed effective date of 1 October 2023?

We are comfortable with the timeline for the new ASTM1 rules to take effect. We understand that the FRC wishes to publish the outcome to this consultation and the new rules by 1 October 2022, which then gives providers and schemes 12 months to modify projection calculations. We have consulted with our members, and they have said that 12 months from certainty should be deliverable, all things being equal.

We would hope that the time between the consultation closing and the outcome of the consultation also involves user testing of the proposals, as previously indicated by FRC and DWP.

PLSA members are interested to understand the planned relationship between all DC schemes returning new-basis AS TM 1 projections, i.e. by 30 September 2024, and the planned launch of dashboards to the public at the Dashboards Available Point (DAP), as well as the rationale for these plans.

3. What are your views on the proposed volatility-based approach for determining the accumulation rate?

As stated above, we are supportive of the approach by the FRC to seek consistency with growth assumptions.

We understand that there has been significant research from the University of Bath that has been commissioned to underpin the proposed volatility approach. The PLSA has been privy to some of the findings but not the full research. We also understand that the technical paper on the research is due to be released in October after it is peer reviewed. It

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is disappointing that the technical paper could not be socialised in a draft non-peer reviewed form to inform consultation responses.

Our members are comfortable with the four growth rates as set out, but some questions have been raised about the use of volatility and whether it would be better for schemes to attribute the growth rates directly to asset classes and mixes of asset classes.

In the findings the PLSA has seen from the research, the volatility-based approach correlates growth rates with asset classes on the whole, so it would be reasonable to take the next step and attribute growth rates to the asset classes, taking out a layer of costly calculations by schemes and providers, and reducing the risk of odd outlier results.

We understand the FRC argues that there is variation within asset classes, but as the objective of the SMPI is to provide an estimate of growth not an accurate prediction of growth, we believe the level of variation is likely to be tolerable.

Some of our members have run the volatility methodology against their own funds and found that the results were surprising, often underestimating growth rates.

It is our understanding that in respect of default funds, some of our members have an investment strategy that is designed to smooth volatility but still seek strong returns. The volatility-based approach to projections could mask these default funds' potential for growth.

Our members might be more comfortable with the volatility approach if they could see the technical paper from the University of Bath on the research that underpins said approach. This might allow PLSA members to see where their funds fit into the macro picture of projections, and whether under-estimates or over-estimates of projections are consistent.

4. Based on an assumed CPI of 2.5% do you find the accumulation rates proposed for the various volatility indicators to be reasonable and suitably prudent?

We may be entering a period of high inflation, but we are comfortable with a CPI assumption of 2.5% over the long term. We also understand that the FRC would issue new assumptions if higher inflation becomes more endemic in the UK economy.

We are comfortable with the accumulation rates as proposed but still would like to see the full research that underpins the assumptions before coming to any firm conclusions.

5. What are your views on the proposed approach to reflect de-risking when calculating the accumulation rate assumptions?

Some of our members have raised questions regarding how life styling would be reflected in projections, concerned that the likely reduced growth figures closer to retirement may not be incorporated in the estimate retirement income. We welcome that FRC has considered life styling in depth and has come up with a good workable proposal.

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The consultation outlines two approaches to life styling:

- Reducing assumed growth rates for all years to price in life styling in years leading up to retirement
- Projecting on full assumed growth rates for pre-life styling years and have different growth rate for years in life-styling funds.

Our members would be comfortable with either approach, but we recognise the need to be consistent and determine one approach, and on this basis we welcome the FRC approach to de-risking, i.e. the latter approach above.

6. What are your views on the proposals that the recalculation of volatility indicator should be annually as at 31 December with a 0.5% corridor?

We have seen some of the University of Bath findings on this and understand that it would only lead to changes in growth assumptions on average every 3.4 years which, if correct, would help schemes and savers as projections would change infrequently.

Some of our members have questioned whether the corridor would need to be larger for a volatility approach, but again we think all would benefit from seeing the technical paper from the University of Bath to fully understand FRC thinking on this matter.

If, on the other hand, a volatility approach was not taken and instead the FRC based the four growth assumption buckets on asset classes and mixes of asset classes, then the corridor would not be needed.

7. What are your views on the proposed approach for with-profits fund projections?

We are comfortable with the unsmoothed returns of the underlying assets being used to calculate the volatility, and hence the assumed growth figures, because using the volatility of annual bonuses would not give a true reflection of likely growth.

In an approach that doesn’t use volatility to underpin the growth assumptions, the underlying assets could be attributed to their asset classes or mix of asset classes and an assumed growth rate assigned on this basis.

8. Do you have experience of unquoted assets held in pension portfolios and what are you views of the proposed approach for unquoted assets? In particular do you regard a zero real rate of growth to be acceptable and if not please provide suggested alternatives with evidence to support your views?

Schemes and Providers are increasingly being encouraged by government to hold illiquid unquoted assets. Illiquid unquoted assets are therefore playing an ever more important role in default fund strategies. With their growing importance and the proportion of assets they represent in pension default funds, rating them at zero growth rate could have artificially reduce the assumed growth rate of many occupational pension schemes.

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The zero rating of illiquid unquoted funds could also act as a disincentive to schemes to invest in the very assets that government is seeking schemes to invest in.

The proposals are also misleading to savers as they imply that illiquid assets are likely to have a lower return than cash.

It should be possible to create an assumed volatility rate or simply assign them to one of the growth rate assumptions.

We would like to see a growth assumption higher than zero for illiquid unquoted assets that fairly reflects potential growth.

9. What are your views on the proposed approach to determine the accumulation rate assumption across multiple pooled funds?

The proposed approach of aggregating pooled funds based on current allocation and allocation of future contributions does on balance appear to make sense to PLSA members.

It would be good, however, to understand, under the proposed volatility approach how often the combined effects of changes in volatility and changes in allocation (based on divergent investment growth) might lead to changes in growth assumptions. Perhaps the University of Bath paper will answer this question.

10. What are your views on the proposed prescribed form of annuitisation and treatment of lump sum at retirement? In particular, does the recommendation to illustrate a level pension without attaching spouse annuity cause you any concerns in relation to gender equality or anticipated behavioural impacts?

We have a number of concerns with the proposals for a single life level annuity as the prescribed decumulation assumption, including gender equality and comparability with DB pension schemes. These concerns lead us to strongly disagree with FRC's proposal.

For example, the CISI's Insuring Women's Future project highlighted single life annuities as one of the causes of the gender pensions gap, as female surviving spouses/civil partners are not left with pensions on death of their partner. Using a single life rather than joint life basis for the annuity assumptions could nudge more people to buy single life over joint life and lead to a widening of the gender pension as a result.

DB pension benefits are inflation linked in various ways and have attaching survivor's benefits so it is also important to have greater comparability and quote the annuity assumptions for DC projections on an inflation linked joint life basis. The FCA's rules on DB transfer advice include the use of a transfer comparator that quotes the benefits that can be bought by a DC scheme on an index linked joint life basis, to have greater comparability.

The PLSA would like to see an approach taken that takes into account the Gender Pensions Gap, and allows for greater comparability with DB benefits, which means quoting on an index linked joint life basis. And, as an alternative, sustainable drawdown percentages should be explored as part of the planned extensive user testing.

See our comments under Q13 below in relation to lump sums in certain circumstances.

11. What are your views on the proposed approach to determine the discount rate assumption when used to determine the annuity rates for illustration dates which are a) more than two years from retirement date and b) less than two years from retirement date?

a) The proposed approach of disapplying the 3.5% discount option is appropriate as RPI is being phased out and this will allow for greater consistency.

b) The proposed approach to switch to using market available annuities two years or less out from retirement seems to be appropriate for savers. We would like to see user testing to make sure savers understand the difference between what they are seeing three years out compared to two years out, they understand the risks and that they understand the actions they need to take to get figures relevant to their circumstances.

12. What are your views on the proposed new mortality basis for determining the annuity rates where the illustration date is more than 2 years from the retirement date?

Updating the Continuous Mortality Investigation Bureau (CMI) tables used from 2008 to 2016 data set, whilst acknowledging that the long-term effects of Covid-19 on pensioner mortality is appropriate. Setting the core parameters as 50/50 Male/Female as the FRC proposals do, allows for greater consistency than allowing schemes and providers to set their own parameters for interrogating the tables.

13. Do you have any other comments on our proposals?

User testing of the proposals for saver understanding is crucial to making sure that these proposals and pensions dashboards are a success.

Disclaimer wording

In the consultation you state, “It is important for individuals to be aware that the future is not yet written and that illustrations are no more than that”. We would agree and furthermore believe this underlines the need for mandatory disclaimer wording on all pensions dashboards.

In simplifying pension dashboard displays, there is a considerable risk that pension scheme members, when they view their pensions on a dashboard, may not:

- understand that the pension income figures are purely indicative estimates, or

- realise that a range of varied options may exist for each of their different pensions.

Therefore, savers may take actions, or fail to take actions, based on a misunderstanding of the full details of each pension.

It is very important that schemes are not liable for these user actions (or users' failure to act). Nor should the View data schemes return to be viewed on dashboards in any way change their liability. For example, schemes must not be liable to pay the figures shown on dashboards, as they were only estimates.

So strong disclaimer, and liability waiving, wording must be shown on all dashboards. Users may not read, or understand, this wording, but it is essential, nevertheless. Ideally the regulations should mandate the disclaimer wording that all QPDSs, and the MoneyHelper dashboard, must display. Alternatively, the PDP Design Standards could mandate that this wording must be displayed by all QPDSs. It needs be crystal clear that this wording extinguishes schemes' liability from users making poor decisions based on View data.

The wording must be understandable and unambiguous. We would be happy to work with DWP, PDP, FCA and others to suggest and refine the final disclaimer wording, and we have already begun working with some of our members to do this.

AVCs

Our members have raised concerns about the treatment of AVCs by ASTM1 on the pensions dashboards. Many AVCs have been set up by scheme members to maximise tax free cash and allowing less or none of very valuable DB pension benefits to be commuted into tax free cash. Other AVCs were set up to buy extra years in DB pension schemes. With both AVCs set up to maximise tax free cash and AVCs set up to buy extra years, showing a projected income could lead savers to take decisions that are sub-optimal.

14. Do you agree with our impact assessment? Please give reasons for your response.

The move to consistent projections, essential for saver understanding / comparability across different DC pensions on dashboards, will inevitably have cost burdens on DC schemes and providers. However, PLSA feels these burdens have been suitably mitigated and are reasonable. Furthermore the 12-month lead in time from the publication of the new ASTM1 to the implementation deadline is appreciated and will help keep costs manageable.

That said, there are considerable delivery risks, for industry and PDP, in changing the DC projection basis whilst Cohort 1 dashboards staging (i.e. April 2023 to March 2025) is still underway. This is far from ideal requiring a significant amount of testing and control to be put in place to ensure the correct figures are returned and dashboard users are not confused / do not misunderstand the new figures they see on dashboards.

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