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

VFM Policy Team
Financial Conduct Authority
12 Endeavour Square
London, E20 1JN.

17 October 2024

Dear Policy Team,

Value for Money Framework Consultation

We welcome the opportunity to respond to this consultation, and we are encouraged that there is ongoing collaboration with TPR, with a view to delivering a framework that can improve member outcomes across all workplace pension schemes.

Our responses to the consultation questions are set out on the following pages. The ACA is content for our response, or extracts of our response, to be published. The key points we wish to highlight are:

- We strongly support the proposed approach of taking into account measures of performance and service quality, rather than a myopic focus on costs and charges only.
- The governance around the accumulation phase of workplace schemes, and the value these schemes offer members, has come a long way. While there is rightly a desire to build on this through the new VFM framework, it ignores decumulation. Decumulation presents an area of concern to us, as there is potential for significant erosion of value at the point of, and beyond, retirement. The extension of VFM to decumulation products would be valuable.
- Most of the quantitative metrics within the framework are backward-looking. We accept that forward-looking metrics such as expected future investment returns are more challenging to calculate consistently, sight of this should not be lost. A working group to maintain momentum on this should be considered.
- The FCA and TPR should not underestimate the challenges some administrators will face in gathering the data and service metrics, at a time when pension administration resources are thinly stretched. We encourage the FCA to engage with administrators to understand the practical issues they may face, and to not allow lack of initial availability of metrics to slow the introduction of the broader framework.

If you wish to follow up any matters, please contact me at Tessa.page@mercer.com or on +44 (0)7557 031198

Yours sincerely

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

1. Scope and Thresholds Questions – Key Points

1.1 We support the focus on default and quasi—default arrangements within workplace schemes. This will allow the new VFM framework to target a large proportion of pension savers and assets under management.

1.2 A blunt exemption for arrangements with under 1,000 members (within FCA-regulated workplace schemes) would in our view not be appropriate as a general rule, however we consider the three proposed tests for this category that would serve to bring a large number of such schemes into scope to be sensible. Our comments in the trust-based landscape will however be different – here we wish to see the VFM framework apply to smaller schemes with very few exemptions.

1.3 We note that a small proportion of legacy schemes have unique benefits to members (e.g. defined underpins or guaranteed annuity rates). While more common in the trust world, they do exist within FCA-regulated arrangements. The Consultation states that IGCs should "take account of any valuable features or characteristics" such as these benefits. We do have some concern that this remains an opaque area and would therefore support a more consistent approach to how such benefits are assessed for value.

1.4 Finally, while we acknowledge and support the desire in this phase to focus on default arrangements, over time our preference would be to expand the framework to include self-select, non-workplace and decumulation vehicles. The latter arrangements present a particular area of concern to us, as there is potential for significant erosion of value at the point of, and beyond, retirement. The current wide variation in decumulation product charging levels and structures makes comparisons, and transparent identification of poor value products, challenging for most individuals and indeed advisers. As non-workplace consolidators (e.g. PensionBee) become more popular with retail customers – we note increased mainstream advertising – we believe their size will grow significantly and the extension of VFM to these schemes could be an important tool for individuals to compare the value of the products.

2. Investment Performance Questions – Key Points

Metrics

2.1 We agree with the proposed time periods for historic performance assessment, and the "years to retirement" approach for calculating such performance. Other points to note:

- The proposal to show a range and median figures for performance net of all costs (not just investment) is a good compromise. Individual scheme level net performance for every single employer within a workplace scheme would be onerous, but this is an important metric, and we consider that the range and median approach will still support comparisons.
- It is not clear how arrangements with a shorter track record will be treated – for such arrangements, we suggest performance is only disclosed up to the longest timeframe for which a track record is available within the defined timeframes (i.e. 1, 3, 5, 10, 15 years). That is, we do not suggest since inception performance should be disclosed given the lack of comparability on this basis.
- The proposed maximum drawdown metric (peak to trough approach) is useful; however, we would propose defining a timeframe for the maximum drawdown (e.g. maximum 3 month or 12 month drawdown). This would give consistency and comparability across arrangements in understanding the risk of shorter-term losses (longer-term losses will be reflected in investment return figures).
- Regarding the risk metrics – given unusual market movements since 2022, particularly for bonds, consideration will be needed as to appropriate determination of what constitutes "poor" value within the VFM framework (e.g. any threshold being used as a determinant of 'poor' value should take this into account).

- There needs to be more focus on performance relative to objectives. For example, linked to the point above, typically funds that aim to mirror annuity price movements will have delivered negative returns in recent years. However, they have absolutely succeeded in meeting their objective (annuities have also become cheaper to buy). We would have concerns about funds with very different goals in mind being compared and critiqued without this context.

Chain-linking

2.2 Chain-linking means that the disclosures will continue to reflect the performance of earlier arrangement designs. Typically, changes to investment design will have been made with a view to improving member outcomes. For example, the objective of the default may have changed from one that targets annuity purchase, to one that targets flexible withdrawal. Alternatively, the investment managers may have been changed completely.

2.3 By chain linking, there will be performance reported on one or more default strategies that no longer exist. That data will be compared against other schemes whose returns may similarly be a combination of existing and legacy defaults.

2.4 We struggle to see what action this will prompt or how such an approach will help governance bodies to assess whether their current defaults offer good value.

2.5 We would support chain-linking where a change is less strategic and more “like for like” (e.g. changing the manager of a passive equity fund investing in the same market, moving to a new wrapper without changing the allocation). For more strategic changes the past is unlikely to be helpful in assessing future value.

Other comments

2.6 In relation to with-profits funds, the proposed approach will require co-operation from with-profits providers who do not typically disclose or provide monthly underlying investment returns. Metrics and their calculation approach (and the timescales for providing this information) will need to be very clearly defined as part of any requirements, to ensure effective engagement with with-profits providers.

2.7 While we can understand the rationale behind the proposal not to include forward-looking metrics at this stage, we would like to see an acceleration of momentum on developing a framework in this area, perhaps through an industry working group. We would be pleased to engage with the FCA in this regard.

3. Asset allocation disclosures – Key points

3.1 The disclosures are sensible overall, noting the following:

- While the disclosure of UK vs non-UK is useful for Government given its objectives in this area, and also prompts decision-making bodies to consider regional diversification levels, we do not see this as being an indicator of VFM. Reviewing this alongside return data is likely to result in lower VFM results for schemes with higher allocations to the UK, given the underperformance of this market relative to other major regions. We also note that the UK stock market includes a large proportion of companies that generate the majority of their revenue overseas.
- We suggest the statement under 5.17 is made clearer as part of any requirements for listed alternatives – i.e. should funds offering indirect exposure to alternative asset classes (such as listed property and infrastructure companies) be assigned to the listed equity category, or the alternative asset class category? We suggest such funds should be assigned to listed equity, given in reality they invest in listed companies which in the short to medium term are more likely to be equity-like in nature. We suggest assignment to the alternative asset classes should be limited to direct allocations.

3.2 Our preference would be to include all default arrangements rather than limiting the scope to provider-designed defaults. As a minimum, we suggest that IGCs should require the advisers of bespoke defaults to confirm that asset allocation (in the prescribed categories) is reviewed as part of their ongoing advice, and available to members of such arrangements on request, if not via the annual provider disclosures.

4. Costs and Charges – Key Points

4.1 We agree with the requirement to split and disclose service costs, investment charges and total costs and charges. It has been a great frustration for many governance bodies that where an arrangement is found to be relatively expensive, currently it is not always possible to identify which component(s) of fees is the driver (provider administration or investment). In some lobbying commentary we have seen stakeholders argue that unbundling does not benefit governance bodies or inform decisions. We dispute this – only by understanding the components of fees can sensible negotiations on how to address this can take place.

4.2 However, the proposal to require only the reporting of one year back for investment charges and service costs for vertically integrated arrangements seems limited. It is not clear why unbundling fees and charges would be any more complicated in the first year than it will be in future years. We believe that providers should have sufficient internal data to fully unbundle costs and charges. If this is not the case, it is a fundamental transparency problem that the swift implementation of the framework will help to address.

4.3 We also agree with the proposal not to factor transaction costs into the assessment. Transaction costs are inherently influenced by market movements which makes them difficult to compare over longer timeframes. They also tend to constitute a small element of the total costs members bear and are included in net performance.

5. Quality of Services – Key Points

Headlines

5.1 We recognise the challenges around condensing more qualitative elements of value into quantitative metrics and should accept that it will never be perfect.

5.2 One key issue is that there is a difference between the quality of the product and the (shorter term) perception of the services. The perception might relate for example to how quickly the helpdesk answered a single call, or the outcome of a specific complaint on a small aspect of the service. Quality of the product itself has more to do with the "whole of life" offering to the membership as a whole the ability for the product to support good decision-making, the provision of a sustainable and adequate income, and the ability to be flexible enough to look after savers with a diverse range of needs and preferences.

5.3 Whilst SLAs, speed and efficiency of transactions, and the level of customer service are all important, they don't impact significantly the core objective of a pension scheme. The four levers that affect good member outcomes are cost, investment performance, savings levels and good decision-making. Value for Money is ostensibly an objective assessment of the relationship of the first lever with the other three.

Metrics

5.4 The proposals list out 5 indicators, some of which may impact on good outcomes, but others less so.

- **Transactions (secure and prompt)** – this is less about long term outcomes. We see this more as a basic governance duty to monitor regularly rather than a key component of VFM, but it is helpful to have consistent definitions and frameworks for SLA reporting.
- **Satisfaction with the service** – again more about perception at the point of engagement.
- **Supported to make plans and decisions** – this relates clearly to outcomes and, as such, we support the proposals here,
- **Can amend their pension with ease** – indirectly linked to outcomes (and could have unintended consequences of providers with robust checks and requirements are seen to be weaker on "amending with ease" versus providers with fewer such controls).
- **Supported to engage** – this is closely linked with good outcomes, and we support this.

Challenges

5.5 For some of the data quality metrics, providers are often reliant on employers to provide information. Sometimes individuals prefer their employer not to be aware of certain information (e.g. personal email address, target retirement date). People frequently change personal details and do not think to advise their employer, let alone their pension scheme provider.

5.6 The proposed metrics for the promptness of core financial transactions could also penalise providers for delays outside their control. The assessment needs to focus on time that is under their control. For example, transfers can be complex and require appropriately strong anti-scam due diligence to be completed and depend on the individual circumstances of each transfer request. Scammers also tell members that the transferring scheme is just deliberately holding the process up and encourage them to raise complaints. In such cases, it is not uncommon for members to become frustrated with the transferring scheme and this may impact on perceptions.

5.7 To avoid a purely statistical / quantitative approach, in the proposed event-based member satisfaction survey (which we support), it would be helpful to include additional text boxes should a member mark a response as “strongly disagree” to supply the provider with richer information in order to identify any trends and ultimately improve member services.

5.8 In relation to web users, it will be important to distinguish between unique and returning visitors, and to consider “click through rates” on different elements of an online offering to build a picture of member activity and trends as opposed to just basic registrations. To add to “beneficiaries” and “contributions” we suggest changes to retirement age, use of online guidance and education areas of a site, and use of retirement modellers.

6. Assessment and Outcomes – Key Points

Comparators

6.1 The requirement for two providers to have DC workplace assets above £10bn will focus attention onto the largest providers. It is inherently assumed that this is where the strongest VFM lies. However, this may bias the comparisons towards long established options which may have large legacy books of business, rather than taking into account newer entrants that could be very capable of offering value. We support encouraging governance bodies to consider a broader set of comparators.

6.2 While we accept that an FCA-regulated pension provider would not be able to transfer members of an arrangement deemed to offer poor value to a single employer arrangement, and hence using a single employer arrangement as a comparator seems illogical, looking at what good single employer arrangements are doing can serve to shine a light on how to deliver good VFM. In particular, we are seeing own trusts embrace more innovative investment strategies (e.g. private markets), without the burden of commercial pricing pressure that GPPs and master trusts face. Publishing case studies or facilitating information sharing forums could help to avoid herding depending on the legal structure of an arrangement.

RAG ratings and assessment process

6.3 We support the RAG rating approach but have concerns that an amber rating will result in the scheme being closed to new business. This seems very punitive when there is opportunity for improvement. In fact, improvements may have already been made in terms of the design of an arrangement but not yet showing in the Framework data (most of which is backward looking).

6.4 Investments in alternative assets will most likely result in an increase in investment charges which will show relatively quickly in the framework data, whereas the long-term future performance impact will take time. It is not inconceivable that this could contribute towards an amber rating and may thus act as a disincentive, especially given the outcome of an amber rating. Specific guidance instructing IGCs to take this into account as part of contextualisation when assessing value for money could help to alleviate the problem.

6.5 Closing to new employers on an amber rating will likely mean that the amber rating is very rarely used as the impact on the provider's business will be significant. IGCs will be encouraged to do everything possible to justify metrics not to rate as amber as closing business will be damaging and effectively set them down a spiralling path of a red rating and full closure, when there could be mitigating actions that could improve value back to green. If IGCs become reluctant to rate amber because of the commercial consequences, there is no room for a rating of "could do better". It may also drive sub-optimal behaviours with the providers not wishing to take any risks and herding.

6.6 Proposals on assessing bespoke arrangements may disincentivise their future development. This would extend to the ability of an employer to set up a scheme with a bespoke default strategy. A consequence could be that pension providers choose not to facilitate them in the future. While this may be in line with an overarching desire to achieve consolidation in the market and achieve fewer larger pension arrangements, it could limit innovation and result in concentration risk around a small number of very large defaults. It would also constraint employers from being able to implement defaults that meet the specific needs of their employee population (e.g. ESG integration, ability to tolerate risk).

Red Ratings

6.7 Legislative changes to enable schemes rated as red to transfer without individual consent would be beneficial providing appropriate safeguards are put in place to ensure the reasons and outcomes can demonstrate better VFM. We are aware that there are schemes that have changed default investment options in workplace pension schemes but have been unable to switch members' existing assets. Member inertia means most members are still invested in legacy poor performing defaults.

6.8 Whilst in principle ultimately requiring firms to transfer savers out of red-rated arrangements is right, there may be other actions to address the rating (e.g. moving product platform, changing default, reducing fees etc) and therefore it seems sensible to give the provider a reasonable period to take alternative action in agreement with the employers affected prior to triggering a transfer.

6.9 A red-rating and trigger of a transfer to another provider in the market could cause resource constraint issues in the market. It can also create upheaval and costs for employers who will need to manage communications etc.

6.10 While out of the scope of the FCA consultation, the following additional considerations will be needed when looking at extending this principle into occupational trust-based arrangements:

- The cost and upheaval is likely to be significant for employers as they will not only need to undertake a review for selecting a provider for a new arrangements, but they will then need to fund the cost of the scheme to wind-up.
- There may be unintended consequences of effectively forcing hybrid arrangements to close and wind-up. This could include members losing their right to use DC assets to fund tax-free cash from the DB section which is often valuable. Depending on the terms under the Trust Deed and Rules, the wind-up of a DC section could trigger a section 75 debt for the DB section.

Interaction with Employers

6.11 We support information sharing with employers on the results of the VFM – this should be in an easily digestible format that is consistent between providers and schemes (in contrast to the current IGC annual reports, which are each presented differently and are extremely lengthy). Employers should be encouraged to review the assessments regardless of the RAG rating so that the methodology and approach becomes familiar. Without this foundation, issuing notice out of the blue that a scheme has been given an amber or red rating is likely to cause concern.

6.12 Consideration should be given to:

- Employers who use contract-based arrangements for their workplace pension generally have no involvement over arrangements for past employees, not least because they often have no access to management information from the provider for these ex-employees. It would therefore seem odd to write to an employer regarding an old legacy arrangement which has no current members to advise them of an amber or red rating when there is no action, they could take to address any concerns.
- What are the expectations of the employer on receipt of such information? If an employer takes no action, what protection do they have from legal action from an employee that they have taken no action following warning of an amber or red rating and therefore a member possibly suffered poor outcomes?
- Informing all employers at the same time is likely to create an influx of queries from employers creating service pressures which could have an unintended consequence of distracting the provider from taking action to improve value, or simply servicing the current book. This could have a knock-on effect to other schemes the provider offers which have been rated green.
- Any communication must be very clear on what scheme or product has been given an amber or red rating. Providers will have a wide range of products and schemes which are not readily understood by either employers or members and there is the risk of brand contamination.

Gaps

6.13 To not require in-scope arrangements to make any consistent disclosure regarding the integration of ESG into their proposition is a missed opportunity to assist IGCs and facilitate comparisons.

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